

Internationalization of the Securities Markets: An Empirical Analysis

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Introduction

During the last few years, the Securities and Exchange Commission (SEC or Commission) has been revising its rules for foreign companies that issue securities in the United States or that list securities for trading on a United States securities exchange or through the National Association of Securities Dealers Automated Quotations System (NASDAQ). The Commission in 1979 adopted a new set of rules for periodic reporting by certain foreign issuers whose securities are traded regularly in United States markets,¹ and in 1981 proposed new

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Copies of letters, memoranda, speeches, and interviews cited in this article are on file with *The George Washington Law Review*.

1. SEC Exchange Act Release No. 16,371, 44 Fed. Reg. 70,132 (1979) (codified at 17 C.F.R. §§ 240.3a12-3, 240.13a-16, 240.15d-16, 249.220f, 249.306 (1981)) [hereinafter cited as Release No. 16,371]. The Commission's rules generally subject North American issuers to registration and reporting requirements applicable to domestic companies, and subject non-North American issuers to separate "foreign issuer" requirements. SEC Securities Act Release No. 6360, 46 Fed. Reg. 58,511 (1981) (to be codified at 17 C.F.R. pts.

rules for registration of securities issued by foreign companies in the United States.²

In the 1979 rulemaking proceeding, the Commission adopted Form 20-F as a combination registration and reporting document under the Securities Exchange Act of 1934 ("Exchange Act").³ The form, which is used primarily by foreign issuers who have recently offered securities in the United States or whose securities are listed on an American stock exchange,⁴ substantially upgrades the previous disclosure requirements for foreign issuers reporting under the Exchange Act.⁵ The Commission, however, significantly accommodated foreign issuers by modifying several reporting requirements that remain applicable to domestic companies. Most importantly, Form 20-F permits foreign issuers to provide disclosures about remuneration of management as a group rather than individually; to report revenues, but not profits, by industry and geographic segments, with a narrative discussion if revenue and profit contributions from the respective segments materially differ; and to use their foreign financial statements, adding footnote disclosures about material differences between foreign accounting principles and generally accepted accounting principles in the United States.⁶

In the subsequent rulemaking proceeding in November of 1981,⁷ the Commission proposed an integrated disclosure system for foreign issuers offering their securities in the United States, which parallels to a large extent the integrated disclosure scheme recently adopted for domestic issuers.⁸ The proposed rules permit foreign is-

210, 229, 230, 239, 240, 249, 260) (proposed Nov. 20, 1981) [hereinafter cited as Release No. 6360]. This article focuses on the separate treatment accorded non-North American issuers; thus, the term "foreign issuer" in this article refers to a non-North American issuer unless otherwise specified. The term "American" refers to an entity, person, or market in the United States.

2. Release No. 6360, *supra* note 1, at 58,511.

3. See Release No. 16,371, *supra* note 1, at 70,133.

4. Foreign issuers must report under the Exchange Act using Form 20-F if they distribute their securities in the United States, list their securities on an American exchange, or have at least \$1 million in assets and 500 shareholders, 300 of whom are residents of the United States. Foreign issuers in the last category, however, need not report on Form 20-F if they furnish all of the information to the Commission that is made public about them pursuant to foreign law. See rule 12g3-2(b) under the Exchange Act, 17 C.F.R. § 240.12g3-2(b) (1981).

5. Foreign issuers previously registered under the Exchange Act on Form 20, 17 C.F.R. § 249.220, and reported on Form 20-K, 17 C.F.R. § 249.320 (rescinded 1979). See Release No. 16,371, *supra* note 1, at 70,134. Most of the upgraded requirements entail narrative disclosures pertaining to form items such as description of the issuer's business, description of property, beneficial ownership of voting securities, pending legal proceedings, description of the registrant's principal trading market outside the United States, and description of securities and taxes applicable to American securities holders. *Id.* at 70,135.

6. Release No. 16,371, *supra* note 1, at 70,135. The Commission made these accommodations in response to arguments that equivalent disclosure requirements would put foreign issuers at a competitive disadvantage with respect to other foreign corporations and that some proposed requirements were inconsistent with the commercial practices, privacy concepts, and accounting principles of other countries. The Commission also found that these disclosure accommodations were consistent with the rules and guidelines of the Organization for Economic Cooperation and Development, the European Economic Community, and other international organizations. *Id.* at 70,133-34.

7. See Release No. 6360, *supra* note 1.

8. For the new rules applicable to domestic issuers, see SEC Securities Act Re-

suers meeting certain criteria to use abbreviated disclosure documents under the Securities Act of 1933 ("Securities Act") for registration of newly offered securities. Certain "world class issuers"⁹ may incorporate by reference information from the Form 20-F into the Securities Act prospectus, and foreign issuers who file periodic reports with the Commission for three years may attach their Form 20-F to the Securities Act prospectus instead of adding certain information to the prospectus.¹⁰ To effectuate this integrated disclosure system, the proposed rules for foreign issuers generally upgrade the current disclosure requirements of Form 20-F when it is used as part of an integrated registration statement. This upgrading is designed to ensure that the information disclosed in Form 20-F approximates more closely the information required in registration statements under the Securities Act.¹¹ The Commission again has sought to accommodate foreign issuers, however, by proposing to require less disclosure in Form 20-F from certain world class issuers who offer non-convertible debt securities¹² and from foreign issuers who make certain equity offerings to existing security holders.¹³

Release No. 6383, 47 Fed. Reg. 11,380 (1981) (to be codified at 17 C.F.R. pts. 200, 201, 229, 239, 240, 249) [hereinafter cited as Release No. 6383]. For a discussion of the concept of integrated disclosure, see *infra* note 11.

9. A world class issuer is defined as a foreign private issuer that has an equity float of no less than \$500 million, at least \$150 million of which is beneficially held by United States residents, or that is registering "investment grade debt securities." Release No. 6360, *supra* note 1, at 58,515 & n.31, 58,516. Investment grade debt securities are those that at least one nationally recognized statistical rating agency has rated in one of the four highest categories. *Id.* at 58,516 n.37.

10. The proposed rules allow a world class issuer, see *supra* note 9, who has reported with the Commission for three years to use abbreviated Form F-3 and to incorporate by reference information from Form 20-F. If the issuer either is world class or reports for three years with the Commission, it may attach Form 20-F to Form F-2, another abbreviated prospectus. Other issuers must use Form F-1, which requires the inclusion of Form 20-F information and other information in the prospectus. See Release No. 6360, *supra* note 1, at 58,517.

11. The concept of integrated disclosure is based upon the premise that disclosures made in forms under the Exchange Act are substantially equivalent to the disclosures made in forms under the Securities Act. See Release No. 6360, *supra* note 1, at 58,519. To reduce duplicative disclosure, information from Exchange Act forms can be used in the Securities Act offering prospectus. Accordingly, the proposed rules upgrade the disclosure in Form 20-F to ensure that the Exchange Act reporting information incorporated by reference into the Securities Act prospectus is substantially equivalent to the information requirements under the Securities Act. See generally Release No. 6383, *supra* note 8; Release No. 6360, *supra* note 1.

12. See Release No. 6360, *supra* note 1, at 58,515.

13. *Id.* at 58,515. Although the proposed rules do not require foreign issuers to use financial statements prepared in accordance with generally accepted accounting principles in the United States ("GAAP"), the rules require most foreign issuers to reconcile their financial statements with GAAP and SEC Regulation S-X, 17 C.F.R. Part 210 (1981). This entails recomputing the numbers contained in the foreign financial statements as if the statements were prepared under GAAP, and providing additional textual disclosures that are usually contained in the notes to financial statements prepared under GAAP and Regulation S-X. These disclosures include full segment reporting, information pertaining to pensions, and reserve recognition accounting data. *Id.*

The proposed rules accommodate certain world class issuers, however, by not re-

In developing these new rules for foreign issuers with respect to the amount and type of information they must disclose to American investors, the Commission has been forced to grapple with complex policy questions that continue to be the subject of intense debate. For example, some commentators have argued that the Commission, in order to discharge adequately its mandate of investor protection, should require foreign issuers who voluntarily enter United States markets to disclose information absolutely equivalent to that required of domestic issuers. This requirement presumably would ensure that investors are fully informed before making investment decisions. Similarly, some have contended that reduced disclosure requirements for foreign issuers could place American companies at an unfair competitive disadvantage.¹⁴

In response to these arguments, some commentators have asserted that subjecting foreign issuers to domestic disclosure requirements would, in practice, amount to unequal regulation because of the different business practices and customs of foreign countries. This result, it is argued, would be inconsistent with the international free flow of capital,¹⁵ the efficient allocation of world resources, and the traditional United States policy of neutrality and noninterference with respect to foreign companies doing business in the United States.¹⁶ In addition, some financial experts suggest that the Commission should seek to provide American investors with the opportunity to invest in a wide array of securities, including foreign securities. Imposing burdensome disclosure requirements upon foreign issuers might deprive American residents (especially noninstitutional investors) of investment opportunities by deterring many foreign issuers from offering their securities in the United States.¹⁷

Underlying these policy arguments about the disclosure requirements for foreign issuers entering the United States capital markets is the empirical question of whether the benefits of entry to American investors, brokers, and taxpayers outweigh the costs to Americans. In an effort to begin the difficult task of answering this fundamental question, this article analyzes the available empirical data on significant categories of benefits and costs associated with foreign entry into American capital markets. Specifically, Part I of this article describes the extent to which American investors, both individual and institutional, own and trade foreign securities and the apparent reasons for the increasing American interest in such securi-

quiring them to reconcile their financial statements fully through the textual disclosures discussed above. Rather, these issuers need only recompute the numbers in their financial statements as if GAAP were used. The foreign issuers who are accommodated in this manner include world class issuers who report for three years and offer non-convertible debt securities and all foreign issuers making certain offerings to existing security holders. *Id.* at 58,515, 58,538-39. See *supra* notes 9, 12.

14. *E.g.*, address by Lee B. Spencer, *Moving with the Flow: World Capital Formation and the United States Securities Laws*, Fordham Law School 1980 Corporate Law Institute (Nov. 18, 1980) [hereinafter cited as Spencer address].

15. See Release No. 16,371, *supra* note 1, at 70,134.

16. Note, *Neutralizing the Regulatory Burden: The Use of Equity Securities by Foreign Corporate Acquirers*, 89 YALE L.J. 1413, 1422-25 (1980).

17. See Release No. 16,371, *supra* note 1, at 70,134.

ties. Part II discusses the benefits, such as greater disclosure, lower transaction costs, and higher tax revenues, that would accrue to Americans if more foreign companies issued and listed securities in the United States in addition to or instead of in their home countries. Finally, Part III evaluates certain disadvantages to the United States, such as the possible diversion of needed capital from American companies, if foreign companies were to issue and list their securities in the United States.

At the outset, one must note the paucity of hard data quantifying the costs and benefits of foreign issuers offering and listing securities in the United States. Several relevant studies have been made in this area and graphs and statistics extracted from these studies appear in this article. Much of the information contained in the article, however, has been gathered from interviews conducted with various experts in the field of international finance.¹⁸

I. American Ownership of Foreign Securities

A. Extent and Nature

American investment in foreign stocks rose from \$6.4 billion at the end of 1970 to \$18.9 billion by the end of 1980. Even more dramatically, American investment in foreign bonds rose from \$13.2 billion at the end of 1970 to \$43.2 billion by the end of 1980.¹⁹ Moreover, American investors markedly increased their purchases and sales of foreign stocks and bonds throughout the decade.

18. Informal surveys that produced data for this article were conducted by Joel A. Ornstein and F. Scott Reding of Dean Witter Reynolds, Inc., Stan West and Lyn Dominguez of the New York Stock Exchange ("NYSE"), and Robert C. Pozen of the law firm Caplin & Drysdale. The author also conducted four meetings from May to August 1981 at the NYSE with experts in the field of international finance.

19. See Scholl, *The International Investment Position of the United States: Developments in 1980*, 61 SURV. OF CURRENT BUS., Aug. 1981, at 52, 56 (Table 3) (1980 data); Scholl, *The International Investment Position of the United States: Developments in 1972*, 53 SURV. OF CURRENT BUS., Aug. 1973, at 18, 21 (Table 3) (1970 data).

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Table 1
**GROSS TRANSACTIONS IN FOREIGN STOCKS AND
BONDS BY AMERICAN RESIDENTS²⁰**

Year	Value of Stock Transactions (Millions)	Value of Bond Transactions (Millions)
1971	\$2,819	\$4,308
1972	4,655	4,833
1973	3,283	3,941
1974	3,630	4,290
1975	3,272	11,103
1976	4,196	18,638
1977	4,920	21,176
1978	6,805	26,384
1979	10,016	29,199
1980	17,978	34,960

American investors were most attracted by foreign stocks issued by Canadian companies, with stocks from Japan and the United Kingdom in second place. With respect to foreign bonds, American investors were most attracted by bonds from the United Kingdom, with Japan and Canada in second place, and the Netherlands and France in third. The distribution by country during 1980, for example, is displayed in Table 2 below.

Table 2
**1980 DISTRIBUTION BY COUNTRY OF GROSS
TRANSACTIONS IN FOREIGN STOCKS AND
BONDS BY AMERICAN RESIDENTS²¹**

Country	Value of Stock Transactions (Millions)	Value of Bond Transactions (Millions)
Australia	\$ 158	\$ 98
Belgium/Luxembourg	180	929
Canada	6,682	4,001
France	1,136	1,275
West Germany	459	876
Japan	2,696	4,625
Mexico	59	316
Netherlands	521	1,485
Scandinavia	52	721
Switzerland	1,526	1,003
United Kingdom	2,745	12,233
Other	1,764	7,398
Total	\$17,978	\$34,960

Although systematic data are not kept on the composition of Amer-

20. See U.S. DEPT OF TREASURY, TREASURY BULLETIN 103 (July 1981). Figures in Table 1 include transactions in Canadian securities.

21. U.S. DEPT OF TREASURY, TREASURY BULLETIN 111 (July 1981). Tables A and B below separate by nation the gross transactions of American investors in foreign debt and equity securities from 1970 to 1980. Figures less than \$500,000 are rounded to zero. Raw data for these tables were compiled from numerous issues of U.S. DEPT OF TREASURY, TREASURY BULLETIN § VI, Table CM-VI-10 (Capital Movements: Transactions in Long-Term Securities by Foreigners Reported by Banks and Brokers).

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ican investors who buy or sell foreign securities, it is apparent that both individual and institutional investors participate significantly in the market for foreign securities. One financial analyst estimates that substantially more individuals than institutions trade in this market, though institutional investors have larger foreign securities holdings than individual investors.²²

Individual investors have reportedly been interested for a number of years in gold stocks from South Africa and oil stocks from Canada, and more recently in the stocks of Japanese companies.²³ This individual interest in foreign stocks is reflected, for example, in the creation of a new "Foreign Stocks" section in the *Value Line Investment Survey*, which is oriented mainly to individual investors and small

in the United States — Foreign Purchases and Sales of Long-Term Securities by Type and Country, During Calendar Year).

Table A
DISTRIBUTION BY COUNTRY OF GROSS TRANSACTIONS
IN FOREIGN STOCKS BY AMERICAN RESIDENTS
(In Millions of Dollars)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Australia	8	3	5	5	6	4	7	11	14	40	158
Belgium/ Luxembourg	87	86	91	64	65	68	98	75	54	77	180
Canada	615	1,048	1,530	1,156	916	788	1,288	1,224	1,845	4,510	6,682
France	84	90	104	137	190	222	321	257	366	650	1,136
West Germany	57	57	108	37	30	140	218	87	191	173	459
Japan	293	639	1,328	809	874	653	975	1,348	1,942	1,404	2,636
Mexico	11	30	21	12	8	6	16	10	14	64	59
Netherlands	156	152	296	137	75	181	290	350	248	231	521
Scandinavia	0	2	6	5	0	5	25	5	9	53	52
Switzerland	132	199	398	187	232	202	219	215	450	613	1,526
United Kingdom	239	322	480	450	863	587	431	993	1,249	1,443	2,745
Other	170	211	340	284	371	456	340	344	483	758	1,764
Total	2,030	2,919	4,655	3,283	3,630	3,272	4,196	4,920	6,806	10,016	17,978

Table B
DISTRIBUTION BY COUNTRY OF GROSS TRANSACTIONS
IN FOREIGN BONDS BY AMERICAN RESIDENTS
(In Millions of Dollars)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Australia	13	36	30	32	14	196	471	249	220	44	96
Belgium/ Luxembourg	167	136	149	113	91	298	568	620	662	567	929
Canada	1,561	1,875	1,947	1,429	2,228	3,912	5,341	3,463	4,623	3,460	4,001
France	66	83	120	73	137	479	1,146	797	581	544	1,275
West Germany	144	79	144	86	50	151	517	641	697	477	876
Japan	27	45	90	94	80	404	532	1,494	3,766	4,833	4,625
Mexico	28	66	183	102	46	210	193	259	204	166	316
Netherlands	53	57	48	37	59	74	214	214	195	2,040	1,465
Scandinavia	65	51	82	104	34	241	325	1,011	801	935	721
Switzerland	415	267	348	206	141	544	1,133	1,488	947	854	1,003
United Kingdom	318	471	641	529	462	928	2,316	4,437	6,761	8,325	12,333
Other	1,074	1,240	1,371	1,136	948	3,864	4,856	6,503	6,927	6,934	7,398
Total	3,931	4,306	4,833	3,941	4,290	11,103	18,638	21,176	28,394	29,199	34,960

22. Letter from Walter A. Eberstadt, Lazard Freres & Co. and NYSE Advisory Committee on International Markets, to Commissioner Barbara S. Thomas (Aug. 5, 1981) [hereinafter cited as Eberstadt letter].

23. Letter from Anthony M. O'Connor, Anthony M. O'Connor & Co., Inc. (Investment Counsel), to Commissioner Barbara S. Thomas (July 14, 1981) [hereinafter cited as O'Connor letter].

institutions.²⁴ The interest of American individuals in foreign stocks is also revealed in the Public Transaction Study conducted by the New York Stock Exchange ("NYSE") covering the fourth quarter of 1980. During that period, individual investors accounted for 62.5% of the shares and 50.2% of the market value of foreign securities (including American Depository Receipts) traded on stock exchanges or the over-the-counter market in the United States. Individuals made 83.6% of the trades in the quarter.²⁵

The high proportion of American individual investors trading in foreign securities on American markets is explained by the common practice of institutional investors of purchasing and selling foreign securities directly in foreign markets.²⁶ Pension funds, managed by banks and other institutional investors, appear to represent the largest group of investors in foreign securities, with \$3.25 billion invested abroad at the end of 1980. This is an increase of eighty-five percent from the end of 1979, when pension assets invested abroad were \$1.75 billion.²⁷ Pension funds as well as other institutional and fiduciary accounts are the principal beneficiaries of the vast majority of foreign securities traded by commercial banks and trust departments.²⁸ Among the banks, the largest investor in foreign securities is Morgan Guaranty Trust Co. with about \$3 billion in foreign securities, a significant portion of which is held by pension funds.²⁹ Like banks, insurance companies through their separate accounts invest pension and other assets in foreign securities. In addition, insurance companies through their own general accounts purchase foreign securities, mainly through private placements.³⁰ Finally, at least fifteen invest-

24. *Id.* The *Value Line Investment Survey* covers approximately 17 stocks in its special "Foreign Stocks" section, of which 10 are Japanese. Although a number of other major foreign companies, such as Royal Dutch Shell, and some smaller foreign mining and oil companies are included in the investment survey under their respective industry categories, the recent creation of the special "Foreign Stocks" section indicates the growing interest of individuals and small institutions in foreign shares.

25. Letter from Stan West, NYSE, to Robert C. Pozen, Caplin & Drysdale (Aug. 26, 1981) [hereinafter cited as Aug. 1981 West letter]. For a discussion of American Depository Receipts, see *infra* note 53.

26. See *infra* text accompanying notes 42-47.

27. Hertzberg, *Pension Managers Invest More Overseas, Aware of Risks but Hopeful About Profits*, Wall St. J., July 2, 1981, at 42, col. 1. Apparently, pensions invest much more in stocks than in bonds, in part because of the effect currency fluctuations have on fixed income securities. *Id.* InterSec Research Corporation, a firm that monitors pension fund investments, predicted that by 1985 United States pension investments abroad could reach \$25 billion. *Id.* A study by the Federal Reserve Bank of New York indicated that in 1980 approximately \$9-\$10 billion of private pension fund assets were held in foreign securities. According to the study, international investments by private United States pension funds are likely to reach \$120 billion by 1990. Ehrlich, *International Diversification by U.S. Pension Funds*, 6 FED. RES. BANK OF N.Y. Q. REV., Autumn 1981, at 1, 12. The Federal Reserve study noted that certain historical barriers to foreign investing by pensions, such as unfamiliarity with foreign markets and the perception of investment abroad as being "un-American," were reduced by factors such as increased international trade and expanded international capabilities of money managers. In addition, the report stated: "Undoubtedly, there is also the consideration that foreign diversification has by and large proved attractive." *Id.* at 4.

28. Aug. 1981 West letter, *supra* note 25; interview with Martin Shea, Vice President of Morgan Guaranty Trust Co., in New York City (July 22, 1981).

29. Interview with Martin Shea, *supra* note 28.

30. Interview with Ronald Gould, Director of International Investments for Connecticut General, in New York City (July 13, 1981); letter from Robert V. Roosa, Brown

ment companies focus primarily on foreign securities on a worldwide basis or in specific parts of the world. The largest is Templeton Growth Fund, a mutual fund with \$627 million in assets, which has been in business for twenty years.³¹ More recently, closed-end funds have been marketed for Japanese and Mexican securities.³²

B. Risk and Return

American investors have been attracted to foreign securities for two main reasons: higher expected returns on investments and lower risk levels through portfolio diversification. As detailed below, returns on foreign stocks were higher than returns on American stocks during the last decade. Although it is uncertain whether such higher returns will be obtained during the next decade, Americans apparently believe that their investments in foreign securities are an appropriate hedge for their United States investments. By obtaining foreign securities, Americans hope to lower the aggregate risk of their securities portfolios.

To compare the returns from stocks in different countries, analysts have developed the concept of "holding period yield."³³ This yield is computed as if an investor bought at the beginning of a specified time

Bros. Harriman & Co., to Commissioner Barbara S. Thomas (Aug. 6, 1981) [hereinafter cited as Roosa letter].

31. Memorandum of Michael Abrams, NYSE Survey on Foreign Stock Purchases (Sept. 21, 1981), at 7 [hereinafter cited as Abrams memo]. The Abrams memo presents the following table illustrating United States mutual fund investments in foreign stocks:

Table C
UNITED STATES MUTUAL FUNDS SPECIALIZING
IN FOREIGN STOCKS

Open-End Funds	Assets 6/30/81 (Millions)	Percentage of Assets in Stocks
Templeton Growth Fund	\$646.8	86%
International Investors	266.6	67
United Services Fund	78.8	91
T. Rowe Price International Fund	63.0	N.A.
Scudder International Fund	56.3	83
Research Capital Fund	52.1	78
Putnam International Equities Fund	42.2	91
Canadian Fund	28.4	85
Strategic Investments Fund	22.2	95
Merrill Lynch Pacific Fund	20.1	49
G.T. Pacific Fund	14.7	88
Golconda Investors	7.7	61
Closed-End Investment Companies		
ASA, Ltd.	487.1	94
Japan Fund	246.1	73
U.S. & Foreign Securities Fund	167.4	91

32. Greenbaum, *Sharing in the Growth of Companies Abroad*, FORTUNE, July 13, 1981, at 145-56.

33. Abrams & Kimball, *U.S. Investment in Foreign Equity Markets*, ECON. REV., Apr. 1981, at 24.

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period and sold at the end of such period. The analysts measure the capital gain (or loss) on stock prices, add dividends, and subtract taxes due at the time of sale. The holding period yield may also be adjusted to reflect changes in exchange rates, because the American investor is interested in dollar returns and most foreign securities are denominated in the currency of the issuer's home country.

During the 1970-1980 period American stocks yielded on the average less than stocks in the six foreign countries with the most active securities markets — Australia, Canada, Japan, Switzerland, United Kingdom, and West Germany. In the 1970's, the average annual yield on American stocks was 5.8%. In comparison, only Switzerland and West Germany had lower average annual yields before adjusting for exchange rates. More significantly, after adjusting for exchange rates during this period, the average annual yield on American stocks was lower than the average annual yield on stocks in any of the six countries.

Table 3
**STOCK PRICE AND EXCHANGE RATE EFFECTS ON
NATIONAL MARKET RETURNS 1970-1980³⁴**
(Annual Percentage Rate)

Country	Unadjusted Yield	Exchange Rate Adjustment	Yield
Australia	6.7	0.3	7.0
Canada	12.3	- 0.7	11.6
Japan	11.9	4.8	16.7
Switzerland	2.0	9.3	11.3
United Kingdom	10.1	- 0.3	9.8
West Germany	3.4	7.1	10.5
United States	5.8	0.0	5.8

Although it is impossible to predict whether returns on foreign stocks will be higher than returns on American stocks during the next decade, economists have generally concluded that purchases of foreign stocks will yield substantial benefits to American investors in terms of diversification of risk.³⁵ This conclusion is based on two facts — the heavy influence exerted by the domestic economy on the performance of domestic stocks, and the considerable variation in economic performance among the major industrialized countries. Thus, if an American investor diversifies a portfolio by purchasing stocks of issuers from several different countries, he or she will reduce the total risk associated with that portfolio because gains from stocks in some countries are likely to offset losses from stocks in other countries.

34. *Id.* at 25.

35. See Agmon & Lessard, *Investor Recognition of Corporate International Diversification*, 32 J. FIN. 1049 (1977); Bergstrom, *A New Route to Higher Return and Lower Risk*, J. OF PORTFOLIO MGMT., Fall 1975, at 30; Lessard, *International Portfolio Diversification: A Multivariate Analysis for a Group of Latin American Countries*, 28 J. FIN. 620 (1973); Lessard, *World, Country, and Industry Relationships in Equity Returns*, FIN. ANALYST J., Jan.-Feb. 1976, at 33; Solnik, *Why Not Diversify Internationally Rather Than Domestically?*, FIN. ANALYST J., July-Aug. 1977, at 48.

Specifically, economists have found that from twenty to fifty percent of the variation in returns from an individual stock can be explained by changes in the stock index of the national market.³⁶ At the same time, as illustrated by Table 4 below, several economists have independently found low correlations between the stock index of the United States and the stock indexes of many foreign countries (with the notable exception of Canada). As a result of these national differences, a portfolio composed of stocks from the United States and these sixteen countries would show less price fluctuation than a stock portfolio composed only of American stocks.³⁷

Table 4
DEGREE OF CORRELATION BETWEEN STOCK INDEX
OF FOREIGN COUNTRY AND UNITED
STATES STOCK INDEX³⁸

Stock Market	Grubel Data (1959-1966)	Solnik Data (3/66-4/71)	Lessard Data (1/59-10/73)
Australia	.06	—	.23
Austria	—	—	.12
Belgium	.11	.47	.46
Canada	.70	—	.80
Denmark	—	—	.04
France	.19	.06	.25
West Germany	.30	.22	.38
Italy	.15	.07	.21
Japan	.11	.19	.13
Netherlands	.21	.51	.61
Norway	—	—	.17
South African Gold Mines	.16	—	—
Spain	—	—	.04
Sweden	—	.29	.33
Switzerland	—	.44	.49
United Kingdom	.24	.20	.29

Moreover, economists recently have concluded that the benefits available from an internationally diversified portfolio cannot be obtained by investing in the securities of American corporations with multinational operations.³⁹ Americans who invest in such a company

36. Lessard, *World, Country, and Industry Relationships in Equity Returns*, *supra* note 35, at 33.

37. One economist, Bruno Solnik, found that an internationally well-diversified portfolio would be one-tenth as risky as a typical [American] security and one-half as risky as a well-diversified portfolio of United States stocks in terms of variability of return. Solnik, *supra* note 35, at 51.

38. Bergstrom, *supra* note 35, at 31.

39. Senchack & Beedles, *Is Indirect International Diversification Desirable?*, *J. PORTFOLIO MGMT.*, Winter 1980, at 49; Jacquillat & Solnik, *Multinationals Are Poor Tools for Diversification*, *J. PORTFOLIO MGMT.*, Winter 1978, at 8.

Jacquillat and Solnik examined 300 European and 100 American firms whose stock

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apparently hypothesize that its stock price reflects to a significant degree the economic conditions in the various countries in which it operates.⁴⁰ This hypothesis, however, is not supported by empirical evidence. As one article stated:

The multinational stock prices do not seem to be extensively affected by foreign factors and behave much like the stock price of a purely domestic firm. Several explanations could be proposed, ranging from the importance of national control, government constraints, the influence of the major stock market where the stock is traded, or investors' poor judgment.⁴¹

II. Benefits from Foreign Companies Entering American Securities Markets

As demonstrated in Part I, American investors are for sound economic reasons increasingly interested in owning foreign securities. Thus, the question is not *whether* Americans will purchase foreign securities; the question is *where* they will purchase foreign securities — in the securities markets of the United States, or in the securities markets of Europe, Asia, Africa, and Latin America.

At present, relatively few foreign securities are actively traded in the United States and registered with the Commission.⁴² Only 113 foreign corporate issuers are listed on any stock exchange in the United States. About half of the listed issuers are Canadian companies, which do not provide American investors with significant diversification of risk because stock prices in Canada are closely correlated with stock prices in the United States.⁴³ Of the other half of the listed foreign issuers, very few are companies from major industrialized countries such as Australia, France, and West Germany.⁴⁴ In addition, fifty-seven foreign issuers (forty-one North American) file periodic reports with the Commission because at one time they engaged in a securities offering registered with the Commission. Their securities, however, are not currently listed on a stock exchange in the United States. Finally, fifty-two foreign issuers (thirty-one North American) that have never made a public offering

prices were available from April 1968 to June 1974. From this group, the economists analyzed 40 European firms and 23 American firms as a subgroup of companies with the greatest multinational activities. Jacquillat and Solnik compared the total variability of returns of a portfolio (1) invested in American companies with little foreign activity, (2) invested in multinational firms, and (3) equally invested on the major national stock exchanges. This comparison revealed that the multinational portfolio had 90% of the risk of the purely domestic portfolio of the same size. The risk for an international portfolio of the same size, however, was only 30%-50% of that of the domestic portfolio. Thus, the authors concluded: "Although multinational firms do perform some international diversification for the investor, [the data] would suggest that [multinational firm] portfolios are poor substitutes for international portfolio diversification." *Id.* at 9.

40. See Jacquillat & Solnik, *supra* note 39, at 8, 10.

41. *Id.* at 12.

42. See Spencer address, *supra* note 14.

43. See *supra* Table 4.

44. These statistics regarding foreign issuers were provided by Carl Bodolus, Chief, Office of International Corporate Finance, Securities and Exchange Commission.

in the United States file periodic reports with the Commission because they have more than \$1 million in assets and 500 shareholders of record (including at least 300 Americans), and do not come within one of the several exemptions from periodic reporting provided for foreign issuers by Exchange Act rule 12g3-2.⁴⁵

Because so few foreign securities are listed on stock exchanges in the United States, American investors purchase most foreign securities on foreign securities markets in one of three ways: (1) directly through a member of a foreign exchange (including banks in certain countries), (2) indirectly through an American broker who for a commission purchases foreign securities through a member of a foreign exchange, or (3) indirectly through an American dealer who purchases foreign securities through a member of a foreign stock exchange and resells at a mark up.⁴⁶ As a general rule, institutional investors purchase foreign securities directly in the foreign markets, whereas individual investors tend to make such purchases indirectly through American broker-dealers.⁴⁷ To trade directly in foreign securities markets, institutional investors establish relationships with members of foreign exchanges, communication networks with foreign markets, and permanent custodians in foreign countries. These tasks are beyond the resources of most individuals.

A. Benefits to American Investors

If more foreign securities were issued and listed in the United States, American investors would benefit through better disclosure, greater investment opportunities, lower transaction costs, more research services by brokers, and reduced risks in foreign investment. These benefits would be conferred to a large degree on individual investors, although institutional investors also would receive some benefits. Both individuals and institutions would no longer have to purchase foreign securities on foreign markets.

1. Increased Disclosure

Foreign securities issued in the United States are subject to the registration requirements of the Securities Act. Likewise, foreign securities listed on stock exchanges in the United States are subject to the periodic reporting requirements of the Exchange Act as well as the rules of the relevant exchange. In addition, foreign debt securities offered in the United States are often evaluated by American rating

45. *Id.* For a discussion of rule 12g3-2, see *infra* note 52 and accompanying text.

46. Letter from Maurits Edersheim, Drexel Burnham Lambert, Inc., to Commissioner Barbara S. Thomas (Aug. 3, 1981) [hereinafter cited as Edersheim letter].

47. O'Connor letter, *supra* note 23; Aug. 1981 West letter, *supra* note 25; interview with Walter Stern, Capital Research and Management, in New York City (June 22, 1981).

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organizations to help investors assess the likelihood that the issuers will be able to comply with their debt obligations. Thus, regardless of the modifications made by the Commission in its requirements with respect to foreign issuers, the disclosure system in the United States is still more extensive than that found in the home countries of most foreign issuers. As a result, American investors would receive more substantial and timely disclosure about foreign securities if these securities were issued and listed in the United States.

Admittedly, certain foreign countries have increased some disclosure requirements to levels that are roughly comparable to the level in the United States. For example, the Sixth Directive of the European Economic Community ("EEC") is quite similar to Form 20-F of the Commission.⁴⁸ Comparable disclosure rules are still relatively rare, however. Moreover, even foreign nations that require substantial disclosure do not provide investors with remedies equivalent to those granted by American securities law. Legal action for damages and rescission is not available as a practical matter in most foreign countries.⁴⁹ For instance, although France bans insider trading, the only mechanism for enforcement is a criminal proceeding brought by the French government. Other countries, such as Switzerland, do not even prohibit this form of trading abuse.⁵⁰

In theory, the Commission's reporting rules could apply to a foreign issuer who has never offered or listed securities in the United States. The Securities Act Amendments of 1964 require, subject to Commission exemption, disclosure by foreign issuers whose securities are traded in the American over-the-counter market and who have more than \$1 million in assets and 500 shareholders.⁵¹ In practice, however, the Commission has provided these foreign issuers

48. See memorandum from Douglas W. Hawes, LeBoeuf, Lamb, Leiby & MacRae, to Members of the Subcommittee on International Securities Matters, *Comparison of SEC Form 20-F and Annexes A & B of the EEC's Draft Sixth Directive*, at 2 (Jan. 2, 1980).

49. Cf. letter of Merrill Lynch, Pierce, Fenner & Smith, Inc., to George A. Fitzsimmons, Secretary, Securities Exchange Commission (Jan. 15, 1981) (contained in the SEC's Public File No. S7-849) (encouraging foreign issuers to use United States markets would give investors "added protections of the federal securities laws and corresponding benefit of being able to sue under U.S. law in the U.S. courts rather than overseas").

50. Interview with Marie Claude Robert, Commission des Operations de Bourse, in London (Oct. 27, 1981); Louis, *The Unwinnable War on Insider Trading*, *FORTUNE*, July 13, 1981, at 72, 82.

Recently a United States delegation, represented by officials from the SEC and the U.S. Department of State, met with Swiss government officials to discuss problems the SEC has encountered, as a result of Swiss bank secrecy laws, in investigating suspected insider trading violations by persons trading in American markets through Swiss banks. A joint statement issued in Bern at the conclusion of the first round of the talks stated, *inter alia*, that it was hoped that the discussions would lead to "mutually acceptable procedures to assist in the investigation and prosecution of insider trading activities" in American markets. *Wall St. J.*, Mar. 4, 1982, at 33, col. 2. It was also stated that further talks would be necessary because of the complexity of the issue. *Id.*

51. Prior to 1964, only companies that offered their securities in the United States or listed them on an American exchange had to file reports with the Commission under the Exchange Act. In 1964, however, Congress enacted § 12(g)(1), which requires companies with over \$1 million in assets and over 500 shareholders to report to the Commission. 15 U.S.C. § 78l(g)(1) (1981). Congress also authorized the Commission to exempt a foreign issuer from § 12(g) if such action is in the public interest and consis-

with several exemptions from its reporting requirements, the most important of which is rule 12g3-2(b). It provides that a foreign issuer, regardless of the number of its American shareholders, is exempt from all Commission reporting requirements if it furnishes to the Commission for public inspection copies of all material information it makes public in its home country or sends to shareholders pursuant to foreign law or exchange rule.⁵² In short, if foreign securities are not issued or listed in the United States, American investors will receive only the information about such securities mandated by foreign requirements, which are generally lower than Commission requirements.

2. Greater Investment Opportunities

The increased offering and listing of foreign securities in the United States would provide American investors with greater opportunities to purchase foreign securities not traded by American brokers.⁵³

tent with investor protection. *Id.* § 781(g)(3). The Commission has exercised this exempting authority in rule 12g3-2, 17 C.F.R. § 240.12g3-2 (1981).

52. Rule 12g3-2 also exempts foreign issuers from § 12(g) reporting requirements if the issuer has fewer than 300 shareholders residing in the United States. 17 C.F.R. § 240.12g3-2(a)(1) (1981). Although holders of American Depository Receipts ("ADR's"), see *infra* note 53, are included in determining the number of shareholders residing in the United States, ADR's themselves are exempt from the reporting requirements under § 12(g). 17 C.F.R. § 240.12g3-2(c) (1981).

53. Some foreign securities are traded in the United States through American Depository Receipts ("ADR's"). Typically, an American bank will establish a foreign depository that accepts foreign securities. The bank will then sell ADR's, representing a beneficial interest in the foreign securities deposited abroad, to American investors and will perform certain services for the ADR holder, such as converting dividends into dollars and transmitting information concerning rights offerings. An ADR trading mechanism established by parties other than the issuer of the foreign security underlying the ADR, such as an American bank or broker, is referred to as an "unsponsored" ADR. See generally McGuinness, *Impact of United States Securities Laws on Distribution and Trading of Foreign Securities*, 12 INT'L LAW. 133 (1978); Moxley, *The ADR: An Instrument of International Finance and a Tool of Arbitrage*, 8 VILL. L. REV. 19 (1962); Tomlinson, *Federal Regulation of Secondary Trading in Foreign Securities*, 32 BUS. LAW. 463 (1977); Note, *SEC Regulation of American Depository Receipts: Disclosure*, 65 YALE L.J. 862 (1956).

The unsponsored ADR may resolve some of the problems with trading in foreign securities. For example, an ADR will provide American investors with the opportunity to trade in foreign securities in the domestic market and will obviate many of the inconveniences attendant to executing securities transactions in a foreign country. These inconveniences include physical transfer of bearer certificates, collection of dividends in foreign funds, delays in transit and in obtaining proceeds from sales, and ascertaining information concerning rights offerings.

On the other hand, less disclosure will occur if the securities of foreign issuers are traded through unsponsored ADR's than if the underlying foreign securities are issued or listed in the United States. The Commission has exempted ADR's from the reporting requirements of the Exchange Act, 17 C.F.R. § 240.12g3-2 (1981), reasoning in part that investors are interested in information about the issuers of the underlying foreign security, not the issuers of the ADR. See SEC Release No. 8066, 32 Fed. Reg. 7845, 7845-48 (1967). Issuers of the underlying foreign securities, however, are also exempt from the reporting requirements of the Exchange Act if they do not issue or list their securities in the United States and if they furnish to the Commission information made public in their home country pursuant to foreign law. See 17 C.F.R. § 240.12g3-2 (1981). Therefore, if a foreign security is traded in the United States through an unsponsored

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Many small individual investors, unlike institutional investors, cannot afford to establish a trading network with a foreign market. Similarly, small individual investors cannot easily obtain information about the merits of foreign stock offerings or corporate developments affecting trading prices. Thus, investment in foreign securities would be more feasible for many individuals if these securities were offered or listed in the United States.

In particular, the voluntary entry of foreign issuers into United States markets would allow American investors to enjoy the benefits of rights offerings by such issuers. For example, many foreign companies, especially those in the United Kingdom and Australia, make significant distributions through rights offerings to existing shareholders. If the foreign company has issued and listed its securities in the United States, it may use a short and relatively inexpensive registration form to offer rights to its existing American shareholders.⁵⁴ If the foreign company has never issued or listed its securities in the United States, however, the offering of rights to its American shareholders entails a costly and time-consuming registration process. Faced with this registration process, many foreign companies routinely have decided not to make their rights offerings in the United States to American shareholders.⁵⁵ This decision has been to the detriment of American shareholders (especially noninstitutional) holding foreign securities.

3. Reduced Transaction Costs

In general, the transaction costs for purchasing foreign securities in foreign markets are higher than the costs for purchasing foreign securities listed on a stock exchange in the United States. An American

ADR and the foreign issuer of the underlying security has not issued or listed the security in the United States, American investors probably will receive only the information disclosed pursuant to foreign securities laws. These statutes generally are much less demanding than United States disclosure requirements. See *supra* notes 48-50 and accompanying text.

Another problem in trading ADR's is that rights offerings of the foreign issuer of the underlying securities cannot be forwarded to American ADR holders unless the foreign issuer registers the offered securities under the Securities Act. Because of this registration requirement, ADR holders usually do not have an opportunity to accept rights offerings by foreign issuers. Letter from Dean Egly, Vice President, Morgan Guaranty Trust Co., to Commissioner Barbara S. Thomas (Aug. 10, 1981).

54. See Release No. 6383, *supra* note 8. This Release promulgates a new general integrated disclosure system for domestic issuers. Eligible foreign private issuers who meet certain requirements will be able to register rights offerings using new Form S-3 until the Commission approves an integrated disclosure system for foreign private issuers. *Id.* at 11384-85. To use Form S-3, foreign issuers must furnish all security holders residing in the United States with a copy of the issuer's latest annual report to shareholders, if in English, and must send a copy of its latest Form 20-F filed with the Commission upon the written request of any United States security holder. As an alternative, the issuer may furnish a copy of Form 20-F to shareholders with the S-3 prospectus. Form S-3, Instruction D, *id.* at 11,455 (to be codified at 17 C.F.R. § 239.12). Form S-3 replaces Form S-16, 17 C.F.R. § 239.27 (rescinded by Release No. 6383, *supra* note 8, at 11,385, 11,401), which had similar advantages and requirements for foreign issuers.

55. Interview with Dean Egly, Vice President, Morgan Guaranty Trust Co., in New York City (July 13, 1981); interview with Juris Padegs, Scudder, Stevens & Clark, in New York City (June 22, 1981) [hereinafter cited as Padegs interview]. For a discussion of similar problems of American ADR holders, see *supra* note 53.

investor who purchases directly on a foreign exchange without an American broker must pay a foreign brokerage commission, currency conversion charges, cable and shipping charges, and any taxes and exchange charges imposed in the foreign market.⁵⁶ If an American investor purchases foreign securities through an American broker, the investor may pay slightly more in commission fees, but conversion, cable, and shipping charges are usually absorbed by the broker.⁵⁷ When an American investor purchases foreign securities from an American dealer, the investor pays a mark up that includes a profit margin in addition to the commissions and other charges incurred by the dealer in purchasing foreign securities on foreign markets.⁵⁸

Obviously, there are no charges for currency conversion, cable, or shipping in domestic trades. Furthermore, commission rates on most, if not all, foreign exchanges are fixed, whereas commission rates in the United States are negotiated.⁵⁹ A 1978 survey⁶⁰ quantified the difference in transaction costs between domestic and foreign trades as well as the differences in transaction costs among foreign securities markets. The weighted average of total transaction costs for foreign trades was 1.3% of the purchase price. This average cost broke down as follows: .94% commissions and fees and .36% price disturbance.⁶¹ By contrast, the survey found that the weighted average of total transaction costs in comparable domestic trades was .79%, of which commissions and fees constituted .38%, while price disturbance comprised .41%.

56. Letter from Stan West, NYSE, to Robert C. Pozen, Caplin & Drysdale (June 17, 1981) [hereinafter cited as June 1981 West letter].

57. *Id.*

58. *Id.*

59. Padegs interview, *supra* note 55.

60. Address by C. Richard Bartels, Keystone Custodian Funds, Inc., *Transaction Costs and the Trading Experience*, Financial Analysts Federation International Investment Seminar (Feb. 5, 1979) [hereinafter cited as Bartels address].

61. Price disturbance represents the difference in the price of stock from the time an order is entered by the customer to the time the order is executed in full. The price disturbance in the Bartels study is expressed as a percentage of the total dollar amount of the trade. The price disturbance period in many of the transactions included in the Bartels study was one week. This relatively long execution period was caused by factors such as large institutional orders and less liquid international markets.

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Table 5
TRANSACTION COSTS FOR SAMPLE OF TRADES IN
FOREIGN MARKETS DURING 1980⁶²

Country	Number of Trades	Value (Thousands)	Commissions and Fees	Price Disturbance	Total Transaction Costs
Japan	52	\$4,835	0.71%	0.92%	1.63%
United Kingdom	17	3,058	1.46	0.08	1.54
West Germany	16	2,434	0.47	-0.52	-0.05
Netherlands	6	386	0.21	0.0	0.21
Switzerland	9	1,720	0.43	4.53	4.96
Hong Kong	10	947	1.30	-1.35	-0.05
South Africa	5	873	0.0	-5.23	-5.23
France	3	256	1.24	-0.49	0.75
Australia	5	975	0.25	4.67	4.92

Securities professionals generally agree that the listing of more foreign securities on stock exchanges in the United States would substantially reduce transaction costs for individual investors.⁶³ The expense of purchasing directly in foreign securities markets is simply too great for most individual investors.⁶⁴ Because the typical purchaser of foreign securities buys indirectly, he or she often must pay commissions to both an American broker-dealer and to a foreign broker-dealer acting in the principal market.⁶⁵ If the foreign securities were listed on American stock exchanges, the American investor would pay only one negotiated commission to an American broker-dealer. As mentioned above, the transaction costs would not include currency conversion, cable or shipping charges.

Although all investors would benefit if more foreign securities were offered in the United States or listed on American exchanges, institutional investors would benefit less than individuals. Foreign broker-dealers court institutional investors by providing research and other services that in effect reduce the fixed commission rate for purchasing foreign securities.⁶⁶ Institutional investors also have established communication networks and custodial relationships that substantially reduce the marginal cost of any foreign trade.⁶⁷ Nevertheless, even institutional investors would welcome more listings of foreign securities on stock exchanges in the United States. These listings would provide a competitive alternative to executing trades in foreign markets and thereby would keep down the transaction costs of trading foreign securities.⁶⁸ More listings would also lead to increased liquidity and depth in the markets for the sale of foreign se-

62. Bartels address, *supra* note 60.

63. Interview with Nicholas Rey, Merrill Lynch, Pierce, Fenner & Smith, Inc. (International), in New York City (July 13, 1981) [hereinafter cited as Rey interview]; interview with Yves-Andre Istel, Lehman Bros. Kuhn & Loeb, Inc., in New York City (July 13, 1981).

64. See *supra* text accompanying note 56.

65. O'Connor letter, *supra* note 23.

66. *Id.*

67. *Id.*

68. Interview with Howard Moss, U.S. Trust Co., in New York City (June 22, 1981); interview with Howard Frantzen, Teachers Insurance and Annuity Association College Retirement Equities Fund, in New York City (June 22, 1981); interview with Frederick B. Whittemore, Morgan Stanley, in New York City (June 22, 1981).

curities.⁶⁹ Although professional money managers can easily buy foreign securities in foreign markets, they feel more secure about the ability to sell such securities if these are listed on an American exchange or the NASDAQ.⁷⁰

4. Research Services

Retail investors have little American-based research available on foreign issuers.⁷¹ A limited number of American securities firms offer research coverage of these issuers. International brokerage houses that have overseas branches occasionally follow actively traded foreign stocks. Three or four American brokers have established research staffs overseas, primarily in London and Tokyo. Nonetheless, major American brokerage firms follow fewer than fifty foreign companies as compared to their coverage of over one thousand United States concerns.⁷²

Domestic research on foreign stocks is particularly important to American retail investors in properly assessing the risks inherent in trading foreign securities. In addition to putting historical and anticipated earning levels on a basis comparable to United States firms, the research reports provide comparisons of industry data, insights into foreign currency factors, and corporate information commonly obtained by securities analysts in interviews with management. Moreover, foreign-based research does not address the differences between foreign and American accounting principles, procedures, and standards.⁷³

If more foreign securities were issued and listed in the United States, retail investors certainly would receive the benefit of more research on these securities. Research departments of American brokerage firms generally cover a foreign stock only when the stock is expected to generate sufficient commission revenues to justify the coverage. Research coverage is usually initiated when a market is established in the United States as a result of a public offering, a listing on an American exchange, or active trading on the NASDAQ. Typi-

69. Memorandum from Joel A. Ornstein and F. Scott Reding, Dean Witter Reynolds, Inc., to Commissioner Barbara S. Thomas (Nov. 21, 1981), at 16 [hereinafter cited as Ornstein memo].

70. Interview with Frederick B. Whittemore, *supra* note 68. A recent study indicated that greater liquidity in securities and shorter periods between entry of a purchase or sell order and execution generally lower transaction costs. See Condon, *Measuring Equity Transaction Costs*, FIN. ANALYST J., Sept.-Oct. 1981, at 60. Therefore, greater listings of foreign securities on American exchanges, by increasing liquidity in these securities and by reducing the period between order entry and execution, could lower transaction costs for institutional and individual investors. See *supra* note 61.

71. Generally, only institutional investors can gain access to research coverage provided by foreign brokers and banks on foreign stocks. Ornstein memo, *supra* note 69, at 15.

72. *Id.*

73. *Id.*

Total Transaction Costs
1.63%
1.54
-0.05
0.21
4.96
-0.05
-5.23
0.75
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of more foreign securities would substantially reduce the costs of foreign securities. The typical investor must pay foreign brokerage fees for securities that an investor can broker-include

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cally, the research departments of the investment banking firms that manage a foreign stock offering in the United States provide research coverage of the foreign issuers after completion of the offering.⁷⁴ The research is subsequently available for brokers and traders.

5. *Reduction of Other Risks*

When American investors purchase foreign securities in foreign markets, they assume three risks in addition to the normal risk of poor price performance: variation in exchange rates, imposition of capital controls, and illiquidity upon resale. Each of these risks may be mitigated, though not eliminated, by the listing of foreign securities on a stock exchange in the United States.

If a foreign stock is bought in a foreign market, its return is always denominated in local currency and therefore its return to the American investor always depends on the rate of exchange between the dollar and the local currency. The listing of a foreign stock on an American exchange does not necessarily lessen the risk. The price of the stock may still derive from its price in the foreign market. If, however, a foreign stock develops a larger market in the United States than in its home country, there may be some reduction in exchange risk to the extent that the price is no longer purely a derivative of the price denominated in a foreign currency.⁷⁵ Further, if the return on a foreign bond issued and listed in the United States is denominated in dollars, trading in the bond entails no exchange risk.⁷⁶

One risk in buying a foreign security in a foreign market is that the issuer's government may impose capital controls. These may take the form of prohibitions on extraterritorial remittance of proceeds from security sales or of outright confiscation of the securities.⁷⁷ If the foreign security is listed on a stock exchange in the United States, the foreign government may experience more difficulty in prohibiting the remittance or in confiscating the security. Nevertheless, if these controls are imposed they will depress the price even of a security held outside the foreign country.⁷⁸

Finally, whenever American investors purchase foreign securities in foreign markets, there is always the risk that the securities cannot be readily resold in that market.⁷⁹ In some foreign securities markets, large blocks cannot be sold without disrupting trading; in others, the

74. *Id.*

75. Edersheim letter, *supra* note 46. International arbitrage, however, may neutralize the effect of the larger American market. *Id.*

76. O'Connor letter, *supra* note 23.

77. Capital controls are not synonymous with confiscation; the American owner of foreign securities located in the foreign country does not generally lose proprietary rights when controls are imposed. Rather, the investor usually has the right to sell the securities and reinvest the proceeds in the foreign market. Edersheim letter, *supra* note 46.

78. When a foreign government imposes capital controls, the currency of that country also typically comes under pressure. The market price of the foreign stock may decrease and the value of the stock may depreciate on the books of the American investor as a result of currency translations. *Id.*

79. Interview with Howard Levine, Morgan Stanley, in New York City (June 22, 1981).

resale side of the market may dry up from time to time.⁸⁰ By contrast, if a foreign security is listed on a stock exchange in the United States, a specialist is often available to purchase the security from investors who want to sell. Exchange rules in the United States are also designed to minimize trading disruptions and to prevent manipulative practices.

B. Benefits to Other American Groups

Besides investors, other American groups would benefit if foreign securities were more easily issued and listed in the United States. These groups include American employees, taxpayers, and regulators.

1. Employment and Income

The most obvious beneficiaries would be the employees of the securities industry and related service industries. The securities industry employs investment bankers, research analysts, brokers, supervisory staff, secretaries, and clerks. The related service industries include lawyers, accountants, printers, advertising firms, and banks. In addition, employment and income would be created in financial centers like New York, Boston, Los Angeles, Chicago, and San Francisco through increased foreign use of hotels, restaurants, and entertainment.⁸¹

As an international financial center, London has historically generated employment and income for the United Kingdom.⁸² In recent years, London has replaced New York as the center of the international bond market. New York is still the favored place for international stock offerings, however, because of the depth and liquidity of the United States equity markets. If New York is to retain its predominant position in international stock markets — and the employment and income associated with that position — the United States must maintain an environment receptive to the flow of offerings and trading of foreign stocks.

Table 6 below is derived from a hypothetical case study of a typical equity or debt offering made by a foreign corporate issuer in the United States. The table quantifies the benefits in gross revenues flowing to various American industries. The equity and debt offerings are assumed to be of average size, \$30 million and \$75 million, respectively.⁸³ As demonstrated in Table 6, the primary beneficiaries of these public offerings are the brokerage and brokerage-related indus-

80. See Hertzberg, *supra* note 27, at 42, col. 2.

81. Roosa letter, *supra* note 30.

82. Eberstadt letter, *supra* note 22.

83. The equity and debt offering case study assumes, *inter alia*, the following: the equity offering amount is \$30 million, with 1.5 million shares priced at \$20; there is a gross spread of 6.5%, broken down into 1.5% for the management fee, 1.5% for the underwriting fee, and a 3.5% selling concession. The debt offering amount is \$75 mil-

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tries, which receive approximately seventy percent of the gross revenues generated by the equity offering and fifty-five percent of the revenues from the debt offering. The printing and publishing industry is the next major beneficiary, followed closely by the legal and accounting professions. These four industries receive approximately ninety-five percent of the gross revenues attributable to the public offering of the equity issue and ninety percent of the revenues of the debt issue. One must also note one possible benefit to the United States that is not reflected in Table 6: the gross revenues to the United States generated by secondary trading once a security is issued or listed in the United States might equal or exceed the revenues from an initial offering.⁸⁴

Table 6
**FLOW-THROUGH OF BENEFITS ATTRIBUTABLE TO
PUBLIC OFFERINGS BY FOREIGN
CORPORATIONS ANALYZED BY
INDUSTRY⁸⁵**

Industry	Equity Offering		Debt Offering	
	Percentage of \$30 million	Amount (Thousands)	Percentage of \$75 million	Amount (Thousands)
Brokerage and Brokerage-Related	70.3%	\$1,527	54.4%	\$ 659
Printing and Publishing	8.9	192	14.7	179
Legal Profession	7.6	165	10.1	122
Accounting Profession	7.0	150	7.9	95
Hotel and Restaurant	1.3	29	2.4	29
Government Fees	1.2	27	3.9	47
Communications	0.6	14	1.1	13
Transportation	0.6	12	1.0	12
Commercial Banking	0.2	4	2.5	30
Miscellaneous	2.3	50	2.0	24
Total	100.0%	\$2,170	100.0%	\$1,210

2. Taxes

Increased foreign offerings and listings in the United States would generate not only employment and income for those in the securities industries and related fields, but also tax revenues for the United States and the individual states where offerings are consummated or activities related to the offerings take place. The increased income

lion, with a maturity of 10 years, and a gross spread of 1.0%, 0.2% of which is the management fee, 0.2% the underwriting fee, and 0.6% the selling concession.

With respect to both the equity and debt offering, the foreign issuing entity is non-Canadian. Three representatives of the company take two one-week trips to New York City to interview investment bankers, consult with attorneys and accountants, and begin organizing the details related to the contemplated offering. In addition, three representatives from the issuer and two underwriter representatives visit eight American cities in approximately one week for informational meetings with American analysts and institutional investors. The meetings consist of a series of luncheons, cocktail receptions and dinners at which the representatives introduce the company and discuss its history, strategies and prospects. The company also conducts private meetings with selected institutional investors. Also assumed is an underwriter's pricing meeting in New York over a two-day and two-night period. See Ornstein memo, *supra* note 69, App. I, A-1 to A-4.

⁸⁴ *Id.* at 13-14.

⁸⁵ *Id.* at 13.

earned by brokers, bankers, and restaurant owners would lead to greater income taxes; the increased volume of securities transactions and related activity would lead to greater sales taxes. For example, the federal corporate and personal income taxes attributable to an average public debt offering of \$75 million by a foreign corporation have been estimated to range from \$150,000 to \$400,000; similarly, the taxes from an average public equity offering of \$30 million have been estimated to range from \$300,000 to \$600,000.⁸⁶ This tax revenue would benefit all American taxpayers.

3. Regulators

Finally, the Commission as a regulator would benefit from increased offerings and listings of foreign securities in the United States. The Commission has little regulatory jurisdiction over trading by American investors in foreign securities on foreign markets. It often does not have the right to demand a registration statement for the securities, nor does it have the authority to bring enforcement actions in response to fraudulent or manipulative practices.

Moreover, United States courts are becoming more sensitive to the international repercussions engendered by overzealous assertion of extraterritorial jurisdiction. The federal courts are exhibiting concern over alienating other countries that have substantial interests in regulating transactions abroad.⁸⁷ At the same time, at least one foreign country recently enacted a statute that authorizes certain government officials to prohibit the country's citizens and corporations from cooperating with American investigations.⁸⁸

If foreign securities are issued and listed in the United States, however, more transactions in the securities of foreign issuers will occur in the United States. The propriety and legality of applying the American securities laws to these transactions will be beyond question. Accordingly, the Commission could ensure that American investors receive adequate disclosure with respect to these securities, and

86. These estimates are based upon an assumed average pretax profit range of 20%-40% on gross revenues and a marginal corporate and personal income tax rate ranging from 30%-50%. See memo from Joel A. Ornstein and F. Scott Reding, Dean Witter Reynolds, Inc., to Commissioner Barbara S. Thomas (Dec. 11, 1981) for the income estimates upon which these calculations are based.

87. *Cf. ITT v. Cornfeld*, 619 F.2d 909, 921 (2d Cir. 1980) (carefully examining Luxembourg's interests before applying antifraud provisions of the United States securities laws even though foreign entity was plaintiff rather than defendant). Thus, American investors who trade securities abroad may receive less protection in the future from American courts. See address by Commissioner Barbara S. Thomas, *Extraterritorial Application of the United States Securities Laws: The Need for a Balanced Policy*, Sixth Multi-Choice International Corporate Finance Conference, London (Oct. 29, 1981) reprinted in 7 J. CORP. L. (Winter 1982); 2 INT'L CONT. L. & FIN. REV. 545-50 (1981).

88. Protection of Trading Interests Act, 1980, enacted by the United Kingdom. For further discussion of this Act, see generally Note, *Enjoining the Application of the British Protection of Trading Interests Act in Private American Antitrust Litigation*, 79 Mich. L. Rev. 1574 (1981).

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could supervise the trading of the securities in conjunction with the self-regulatory organizations subject to the Commission's oversight.

Notwithstanding this increased regulatory control, however, the Commission still may encounter problems in gaining jurisdiction and asserting subpoena authority over parties located outside the United States who are affiliated with foreign issuers offering and listing their securities here. Thus, some observers have suggested that the Commission should at least consider requiring foreign issuers and related parties, as a condition to offering securities in the United States, to consent to service of process in American judicial proceedings concerning the federal securities laws and in Commission investigations and administrative actions.⁸⁹ The desirability of mandatory consent to service of process, however, remains an unsettled question. Such consent may not provide American investors with any greater protection than is otherwise available to them. Further, foreign issuers may be deterred from offering and listing their securities in the United States because of a fear of increased American jurisdiction over them. The Commission is presently considering this issue with respect to the proposed integrated disclosure rules for foreign issuers.⁹⁰

III. Alleged Capital Drain from American Companies

Although increased foreign participation in American securities markets would bestow significant benefits on American investors, employees, and taxpayers, it arguably could injure one group of Americans — United States companies proposing to raise capital. The specific assertion is that if more foreign companies issue and list their securities in the United States, American investors would allot their limited capital to foreign companies, which would export this capital to their respective foreign countries. As a result, American companies would be able to raise less capital from American investors for use in American operations or would pay higher prices for this capital.

As explained below, however, this fear appears to be based on an unrealistic and parochial view of the capital-raising process. An assessment of the effects of foreign capital-raising on American capital-raising must take into account the international character of today's securities markets. The capital raised through foreign offerings in the United States is partly supplied by foreign investors and partly used in American operations. In addition, the capital raised by foreign issuers in the United States markets is miniscule compared to the capital raised by American issuers in United States markets. Moreover, the net flow of capital on an international basis historically has been toward American issuers, rather than toward foreign issuers.

89. See Release No. 6360, *supra* note 1, at 58,520-21.

90. *Id.* at 58,513, 58,520-21.

A. Anatomy of Foreign Offerings

In calculating the impact of foreign offerings on American capital needs, the threshold questions are (1) what types of investors purchase foreign securities in United States markets; and (2) where are the proceeds from the sales utilized? Unfortunately, the available data do not definitively answer either of these questions, although some preliminary conclusions can be drawn on the basis of extensive interviews with securities professionals.

Foreign investors purchase a significant proportion of foreign securities offered in the United States. Estimates of this proportion vary from twenty to sixty percent for foreign offerings as a whole.⁹¹ In regard to a specific offering, this proportion will vary according to several factors, such as the composition of the syndicate underwriting the foreign offering. If the syndicate includes numerous foreign broker-dealers, the proportion of foreign buyers will be higher than in syndicates composed solely or mostly of American broker-dealers. Another key factor affecting the distribution of an issue is its maturity. Foreign investors are typically interested in intermediate-term obligations (five to seven years), but not in long-term obligations (fifteen years or more).⁹² Special features of a foreign offering are also important. For example, several Japanese convertible debentures were recently sold in the United States mainly to American investors. The bonds featured very attractive conversion prices and were quickly converted; upon conversion, Japanese investors purchased most of the stock.⁹³ A final factor is the relative popularity of the foreign company in its home country and in the United States. If a company is popular with investors in the home country, but unknown to most American investors, its securities offerings will be purchased more often by foreign investors.⁹⁴

This final point suggests that a foreign company will not attempt to enter the American securities markets unless it has or intends to have a significant presence in the United States. In fact, the overwhelming majority of foreign companies that issue securities in the United States have substantial operations here or are seeking to establish such operations.⁹⁵ For example, of the eight offerings between 1975 and 1980 by Japanese companies for which Merrill Lynch served as the managing underwriter, six were for Japanese compa-

91. June 1981 West letter, *supra* note 56; Rey interview, *supra* note 63.

92. See June 1981 West letter, *supra* note 56.

93. *Id.*

94. Domestic and foreign offerings are often made simultaneously. Popularity in the home country may facilitate and create some foreign demand for the American distribution. At the same time, an issue unpopular in a foreign country is less likely to succeed in the United States. Although American investors will comprise a large percentage of the purchasers, a large part of the offering, being unattractive to foreign investors, will probably not be sold. *Id.*

95. Ornstein memo, *supra* note 69, at 18.

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nies with substantial operations here.⁹⁶ According to Dean Witter, securities offerings in the United States provide foreign issuers with a source of United States dollars that can be used to finance American-based operations, international transactions denominated in American dollars, or maturing dollar-denominated debt.⁹⁷

Investment bankers in Europe emphasize that the nexus to American operations is particularly close in the case of debt offerings by foreign issuers in the United States.⁹⁸ These offerings currently comprise the overwhelming bulk of foreign offerings in the United States. The bankers point out that the Euromarket for debt offerings is as good if not better than the American debt market and that the Euromarket is much less regulated than the United States market. Thus, given roughly equivalent interest rates in the Euromarket and the United States market, the foreign issuer will choose to enter the United States market only if it has a present or near-term interest in establishing an American base. This can take the form of a physical plant, commercial distribution, or acquisition through exchange of securities.

B. Crowding out

Although foreigners may purchase a significant proportion of the securities offered by foreign issuers in the United States and foreign companies may channel much of the proceeds from these sales into American operations, the argument still remains that foreign issuers are crowding some American issuers out of the United States capital markets.⁹⁹ As explained below, however, the level of foreign securities offerings in the United States has been so low relative to the level of domestic securities offerings that the potential threat to American issuers is quite modest. In 1980, for example, the total foreign securities offerings in the United States were about \$1.4 billion, whereas the total domestic securities offerings in the United States were about \$202 billion.¹⁰⁰ Further, most foreign securities offerings in the United States are for bonds; these offerings do not affect the ability of American companies to issue stock here.¹⁰¹ Moreover, because the United States government heavily dominates the American bond markets

96. See Rey interview, *supra* note 63.

97. See Ornstein memo, *supra* note 69, at 18. A foreign corporation may also seek access to the United States markets for numerous other reasons. First, the breadth and depth of the American capital market is attractive. Second, foreign corporations seek to diversify their funding sources; once a company is known in the United States, regular access to American markets becomes more feasible. Third, and most obviously, American markets may provide more favorable interest rates than the Eurodollar bond markets.

98. Interview with Rodney Ward, S.G. Warburg & Co., Ltd., in London (Oct. 2, 1981); interview with Ted Botts, Goldman Sachs, in London (Oct. 27, 1981); interview with Jacob Rothschild, J. Rothschild & Co., Ltd., in London (Nov. 2, 1981); interview with Jason Bacon, Kidder Peabody & Co., Ltd., in London (Oct. 29, 1981); interview with Milan Kerno, Dean Witter Reynolds Overseas, Ltd., in London (Oct. 30, 1981).

99. Interview with Lawrence Dickey, PepsiCo Corp., in New York City (July 1, 1981).

100. See Ornstein memo, *supra* note 69, at 2 (citing INVESTMENT DEALERS' DIRECTORY, CORP. FIN. DIRECTORY (March 1976-1980; Oct. 1981)).

101. Between 1976 and 1980, foreign stock offerings in the United States ranged from less than \$100 million per year to \$400 million per year. During this same period, for

foreign bond offerings of such relatively modest amounts probably do not significantly limit the ability of American companies to issue debt securities.¹⁰²

Table 7 demonstrates that from 1976 to 1980 the capital raised by foreign issuers, including governmental entities, ranged from 0.7% to 3.4% of the total capital raised in the United States markets. Tables 8 and 9 separate these figures further into debt and equity offerings. Table 8 indicates that foreign issuers never attracted more than 3.2% of the debt capital raised in the United States from 1976 to 1980. During this period, the figure dropped as low as 0.6%. Table 9 reveals that equity capital raised by foreign issuers between 1976 and 1980 generally comprised between 1% and 3% of the total United States equity market, except in 1977 when the figure was 6.1%.¹⁰³

Table 7
**PUBLIC DEBT AND EQUITY RAISED BY FOREIGN
ISSUERS IN THE UNITED STATES CAPITAL
MARKETS (1976-1980)**¹⁰⁴

Year	Amount Raised (Billions)	Percentage of Total Equity and Debt Capital Raised in American Market
1976	\$4.7	3.0%
1977	4.6	3.4
1978	2.0	1.3
1979	2.1	1.5
1980	1.4	0.7

foreign debt offerings in the United States ranged from \$1 billion to \$4.5 billion per year.
Id.

102. See, e.g., *Treasury Debt Issues Dominant This Week on Securities Calendar*, *Wall St. J.*, Aug. 31, 1981, at 19, col. 3; Ornstein memo, *supra* note 69, at 7-10. See also *infra* note 107.

103. As discussed previously, the category "foreign issuers" does not include North American companies. See *supra* note 1.

104. See Ornstein memo, *supra* note 69, at 3 (citing INVESTMENT DEALERS' DIG., CORP. FIN. DIRECTORY (Mar. 1976-1980; Oct. 1981)).

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Table 8
**PUBLIC DEBT RAISED BY FOREIGN ISSUERS IN THE
 UNITED STATES CAPITAL MARKETS**
 (1976-1980)¹⁰⁵

Year	Amount Raised (Billions)	Percentage of Total Debt Capital Raised in the American Market
1976	\$4.5	3.1%
1977	4.2	3.2
1978	1.9	1.3
1979	2.0	1.5
1980	1.1	0.6

Table 9
**PUBLIC EQUITY RAISED BY FOREIGN ISSUERS IN
 THE UNITED STATES CAPITAL MARKETS**
 (1976 to 6/30/81)¹⁰⁶

Year	Amount Raised (Billions)	Percentage of Total Equity Capital Raised in the U.S. Market
1976	\$0.2	2.4%
1977	0.4	6.1
1978	0.1	1.6
1979	0.1	1.7
1980	0.3	2.2
1981 (to 6/30)	0.3	2.9

Some may suspect that for debt offerings these aggregate market figures are misleading because the massive levels of borrowing by American federal, state, and local governments¹⁰⁷ may disguise crowding-out effects in narrower sectors of the market. Table 10, however, compares public debt offerings among nongovernmental corporations of both foreign countries and the United States, and demonstrates that the foreign issuers' share of the American corporate debt market is minute. From 1976 to 1981, nongovernmental corporate foreign issuers attracted less than one percent of the United States debt capital raised during this period by private

105. *Id.*

106. *Id.* at 4.

107. The following table breaks down American entities raising debt into three categories, and indicates that United States governmental issuers raised over 75% of the debt capital in the American markets from 1976 to 1980.

corporations.¹⁰⁸

Table D
TOTAL PUBLIC DEBT OFFERINGS IN THE
UNITED STATES CAPITAL MARKETS

	Cumulative Amount (Billions)	1976-1980 Percentage
Non-Canadian Corporations	\$ 0.4	—%
Canadian Corporations	2.1	0.3
Total Foreign Corporate Borrowings*	2.5	0.3
International Organizations	6.8	0.9
Non-Canadian Governments and Government Guarantees	7.8	1.0
Canadian Governments and Government Guarantees	11.2	1.5
Total Foreign Noncorporate Borrowings	25.8	3.4
Total Foreign Borrowings	28.3	3.7
American Corporations	150.6	19.5
Federal Government	478.0	62.1
State and Local Governments	113.0	14.7
Total United States Borrowings	741.6	96.3
Total Public Debt Securities	\$ 789.9	100.0%

*Includes all corporate issues that bear no governmental guarantee.

See Ornstein memo, *supra* note 69, at 5.

108. Nongovernmental corporations are defined as those offering securities that bear no governmental guarantee.

Because debt securities with long maturities are not typically available in the Euromarkets and foreign national markets, one might hypothesize that any increase in foreign corporate borrowings would be primarily in the long-maturity ranges. Table E below analyzes by maturity all public foreign borrowings in the United States debt market from 1976 through June 30, 1981.

Although roughly one-half of foreign borrowings have occurred in the 15-years-and-over maturity band, over 85% of these borrowings were attributable to foreign entities that are noncorporate or that have governmental guarantees. The non-Canadian corporate issues in the 15-plus year maturity range account for less than one percent of all foreign borrowings in this maturity range.

Table E
MATURITIES OF PUBLIC DEBT OFFERINGS BY FOREIGN
ENTITIES IN THE UNITED STATES CAPITAL MARKETS

	Cumulative 1976-1981					
	Amount (Billions)			Percentage		
	0-7 Years	8-15 Years	15+ Years	0-7 Years	8-15 Years	15+ Years
Canadian Corporations*	\$ —	\$0.2	\$ 2.0	—%	7.7%	7.0%
Non-Canadian Corporations*	—	0.3	0.2	—	1.1	0.7
Total Foreign Corporations	—	0.5	2.2	—	8.8	7.7
Other Canadian Entities	2.4	1.7	7.1	8.4	6.0	24.9
Other Non-Canadian Entities	6.5	3.3	4.8	22.8	11.6	16.8
Total Foreign Noncorporate Entities	8.9	5.0	11.9	31.2	17.6	41.7
Total Foreign Entities	\$8.9	\$5.5	\$14.1	31.2%	26.4%	49.4%

*Includes all corporate issues that bear no governmental guarantees.

Ornstein memo, *supra* note 69, at 8.

Table F below compares the cumulative totals of public debt offerings with maturities of 15 years or longer by American and foreign corporate issuers in the United States markets from 1976 to 1981. Table F does not support the theory that American

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Table 10
PUBLIC DEBT OFFERINGS BY FOREIGN CORPORATE
ISSUERS IN THE UNITED STATES CAPITAL
MARKETS (1976 to 6/30/81)¹⁰⁹

Year	Amount Raised (Billions)	Percentage of Total Public Corporate Debt Raised in the American Market
1976	\$0.2	0.8%
1977	—	—
1978	0.1	0.5
1979	—	—
1980	—	—
1981 (to 6/30)	0.2	0.9

Table 11 similarly indicates the negligible percentage of capital raised by foreign corporate issuers from 1976 to 1981 in the corporate equity market in the United States. During this period, foreign issuers attracted less than 1.4% of the corporate equity capital raised in the United States each year, except in 1977, when these issuers attracted 5.9% of the total.

companies are being crowded out in the long-maturity market. The levels of foreign corporate borrowings are 0.2% of the total United States and foreign borrowings with maturities exceeding 15 years.

Table F
UNITED STATES PUBLIC DEBT OFFERINGS WITH
MATURITIES OF 15 YEARS OR LONGER BY
FOREIGN AND AMERICAN CORPORATIONS

	Cumulative 1976-1981	
	Amount (Billions)	Percentage
Foreign Corporate Issuers*		
Canadian	\$ 2.0	1.8%
Non-Canadian	0.2	0.2
Subtotal	2.2	2.0
U.S. Corporate Issuers		
Industrials	43.9	39.8
Bank & Finance	19.1	17.3
Utilities	45.1	40.9
Subtotal	108.1	98.0
Total U.S. Public Debt Offerings	\$110.3	100.0%

*Includes all corporate issues that bear no governmental guarantees.

Ornstein memo, *supra* note 69, at 9.

109. See Ornstein memo, *supra* note 69, at 7 (citing INVESTMENT DEALERS' DIR. CORP. FIN. DIRECTORY (Mar. 1976-1980, Oct. 1981)).

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Table 11

**TOTAL PUBLIC EQUITY OFFERINGS BY FOREIGN
CORPORATIONS IN THE UNITED STATES
CAPITAL MARKETS (1976-1981)¹¹⁰**

Year	Amount Raised (Millions)*	Percentage of Total Corporate Public Capital Raised in the United States Capital Markets
1976	\$105	1.3%
1977	392	5.9
1978	10	0.2
1979	—	0
1980	144	1.1
1981	87	0.9

*Includes initial public offerings of equity by foreign corporate issuers and excludes convertible debt offerings.

The statistics set out in Tables 7 through 12 indicate that the amount of capital raised in the United States through debt and equity offerings by foreign corporations during the past five years generally ranged from one to three percent of the total debt and equity capital raised in the American market. Accordingly, even a doubling in the volume of foreign securities offered in the American market would divert only a modest amount of capital from American issuers.

C. Net Capital Flows

Even if foreign securities offerings entail some modest capital outflow from the United States, one must recognize that the ability of American issuers to raise capital from foreign investors depends ultimately on the viability of the international securities markets. This in turn depends partly on the ability of foreign issuers to raise capital within the United States. During the past decade, the net international flow of capital clearly has been toward American companies, rather than away from them. Although American investors have been increasing their holdings of foreign securities, foreign investors have been increasing their holdings of American securities at an even greater rate. Accordingly, American companies have a strong stake in the elimination of barriers to the free flow of international capital; any movement toward protectionism in the international securities markets would injure American companies more than foreign companies.

Table 12 below summarizes the figures of the United States Treasury on the net flow of capital toward American companies in terms of

110. *Id.*

stock transactions over the last decade. During this period, net purchases of foreign stocks by foreigners were almost ten times the net purchases of United States stocks by American residents. Moreover, a recent economic analysis showed that the figures in Table 12 on foreign purchases of American stocks were too low.¹¹¹ As a result, the net flow of capital toward American companies in terms of stock transactions was probably greater during the 1970's than that shown in Table 12.

Table 12
**CAPITAL FLOWS FROM INTERNATIONAL
TRANSACTIONS IN STOCKS¹¹²**
(In Millions of Dollars)

Year	Net Purchases of Foreign Stocks by United States Residents	Net Purchases of United States Stock by Foreigners	Net United States Capital Inflow in Stocks
1971	+\$ 49	+\$ 731	+\$ 682
1972	- 409	+ 2,188	+ 2,597
1973	- 176	+ 2,790	+ 2,966
1974	- 184	+ 540	+ 724
1975	+ 188	+ 4,678	+ 4,490
1976	+ 323	+ 2,753	+ 2,430
1977	+ 410	+ 2,675	+ 2,265
1978	- 527	+ 2,423	+ 2,950
1979	+ 786	+ 1,658	+ 872
1980	+ 2,084	+ 5,358	+ 3,274
Total	+\$2,544	+\$25,794	+\$23,250

Similarly, in terms of bond transactions, the net flow of capital during the last decade was markedly in favor of American companies. As shown by Table 13 below, net purchases of United States bonds by foreigners were twice as high as net purchases of foreign bonds by American residents.

111. Willingham, *Estimating Foreign Holdings of U.S. Equities*, 7 SEC. INDUS. TRENDS, June 18, 1981, at 1.

112. See U.S. DEPT OF TREASURY, TREASURY BULLETIN 103 (July 1981). The figures include primary offerings and secondary trading in stocks (including North American stock), though the primary offerings in American and foreign stocks were very small during this period.

Table 13

**CAPITAL FLOWS FROM INTERNATIONAL
TRANSACTIONS IN BONDS¹¹³**
(In Millions of Dollars)

Year	Net Purchases of Foreign Bonds by United States Residents	Net Purchases of United States Bonds by Foreigners	Net United States Capital Inflow in Bonds
1971	+\$ 935	+\$ 2,375	+\$ 1,440
1972	+ 1,031	+ 5,197	+ 4,166
1973	+ 993	+ 2,266	+ 1,273
1974	+ 2,218	+ 567	- 1,651
1975	+ 6,338	+ 2,761	- 3,577
1976	+ 8,774	+ 9,298	+ 524
1977	+ 5,096	+ 27,022	+ 21,926
1978	+ 4,182	+ 7,007	+ 2,825
1979	+ 3,855	+ 3,956	+ 101
1980	+ 846	+ 10,355	+ 9,509
Total	+\$34,268	+\$70,804	+\$36,536

Conclusion

Both individual and institutional American investors are increasing their holdings in securities of foreign issuers. This trend is largely attributable to the higher returns and greater diversification of risk that foreign securities have provided over the past decade in comparison to American securities.

At present, only a small number of foreign securities are listed on a United States national stock exchange or on the NASDAQ. As a re-

113. See *id.* These figures include primary offerings and secondary trading in bonds. Table G below indicates the amount of Eurobonds and foreign bonds (including North American bonds), issued from 1976 to 1980 by American corporations in private and public offerings. Table H indicates the amount of bonds issued in the United States from 1976 to 1980 by foreign corporations in private and public offerings.

Table G
BONDS ISSUED OVERSEAS BY AMERICAN CORPORATIONS
(In Millions of Dollars)

	1976	1977	1978	1979	1980
Eurobonds	\$435	\$1,130	\$1,122	\$2,872	\$4,107
Foreign Bonds	28	40	245	217	307
Total	\$463	\$1,170	\$1,367	\$3,089	\$4,414

See MORGAN GUARANTY TRUST CO., *WORLD FINANCIAL MARKETS* 15 (Dec. 1981).

Table H
**BONDS ISSUED IN THE UNITED STATES
BY FOREIGN CORPORATIONS**
(In Millions of Dollars)

	1976	1977	1978	1979	1980
	\$3,072	\$1,874	\$1,841	\$1,868	\$1,212

See letter from Lyn Dominguez, NYSE, to Robert C. Pozen, Caplin & Drysdale (Nov. 6, 1981).

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sult, American investors generally purchase foreign securities in foreign markets. Accordingly, assuming that American investors will continue to trade in foreign securities, the question is where the trading should occur.

On the basis of the available data, this article concludes that Americans will receive greater benefits from increased participation by foreign companies in the United States markets than from continued American purchases of foreign securities in the foreign markets. These benefits include more and better disclosure, lower transaction costs, and greater brokerage services for United States investors; higher employment and income for securities professionals and related service industries; and increased tax revenues for the United States government and the American public in general. Although these benefits are relatively modest compared with the United States gross national product, the significant point is that the costs to the United States of expanding foreign participation in American markets are probably even more modest.

The major argument against encouraging foreign issuers to offer their securities in the United States is that American capital will be diverted from American companies to foreign issuers. The available evidence strongly suggests, however, that foreign investors purchase a substantial portion of the securities offered by foreign issuers in the United States. The evidence also indicates that some foreign companies utilize a considerable portion of the proceeds from these offerings in their American operations. Moreover, securities offerings by foreign issuers do not appear to crowd American issuers out of the United States capital market. The securities offerings of foreign companies comprise such a small part of the total capital raised in the United States market that even a marked increase in these offerings would probably have a negligible effect on American participants in that market. At the same time, American companies have been able to raise substantial capital in the overseas markets. American firms have become so attractive to foreign investors that the net international flow of capital consistently has been *toward* these companies rather than away from them.

In evaluating the policy arguments for and against increased participation of foreign issuers in the United States markets, one must bear in mind that the SEC rules are only one of many considerations influencing a foreign issuer's decision as to whether to offer and trade securities in the United States. Numerous other factors, such as the United States tax laws¹¹⁴ and fluctuating interest rates,¹¹⁵ have as sig-

114. For example, an important reason for the growth of American investment in foreign equity securities over the past decade was the expiration of the Interest Equalization Tax in 1974. See Interest Equalization Act § 2(a), 78 Stat. 809, amended by Interest Equalization Tax Extension Act of 1973, § 2, 87 Stat. 12, repealed by Tax Reform Act of 1976, § 1904(a)(21)(A), 90 Stat. 1814. This was a tax on the differential in yield between foreign and American investments, making foreign securities less attractive and consequently deterring foreign issuers from entering the United States markets. See Abrams memo, *supra* note 31, at 12-13.

115. The most important factor determining the type of financing a foreign firm uses is the cost of capital. See U.S. DEPT. OF COMMERCE, BUREAU OF ECONOMIC ANALYSIS,

nificant an impact on a foreign issuer's decision. In addition, the foreign issuer's perception of the Commission's attitude toward foreign concerns will heavily influence its decision, regardless of the content of the Commission's rules.¹¹⁶ Thus, the foreign corporate community will probably perceive the Commission's deliberations during the next few months regarding its integrated disclosure rules as presaging the Commission's regulatory direction for the next few years.

There is no question, however, that the content of the Commission's proposed rules and the burdens they impose upon foreign issuers will figure prominently when foreign issuers determine whether to enter the United States market. The empirical analysis set forth in this article suggests that the benefits to American investors and to the United States economy associated with the entry of foreign issuers into the United States market outweigh the costs of such entry. Accordingly, it is incumbent upon the Commission to examine whether it can reduce the legal barriers to entry by foreign issuers into United States markets, while ensuring that American investors still receive material disclosures.

In this effort, the Commission should not be content to assure that the legal rules for capital-raising by foreign issuers in the United States are similar in form to the legal rules for capital-raising by American issuers in the United States. As others have demonstrated persuasively, facially equal rules create significant barriers to foreign entry into the United States capital markets because of numerous practical differences between foreign issuers and American issuers.¹¹⁷ Nor should the Commission assume that every line item in its prospectus requirements for American issuers is necessarily material with respect to foreign issuers.¹¹⁸

Rather, the Commission needs to take an empirical approach in reaching conclusions about its proposed rules for foreign companies issuing securities in the United States. The Commission should closely examine the economic data on American investment in foreign securities and international flows of capital, as set forth in this article and other sources. The Commission should also carefully study the comments on its rule proposals from participants in the international securities markets — investors, issuers, and broker-dealers. With the benefit of these data and these comments, the Com-

UNITED STATES DIRECT INVESTMENT ABROAD 117 (1981). Thus, as interest rates increase in the United States, the desirability of raising money in the United States through debt securities diminishes.

116. See O'Connor letter, *supra* note 23; Edersheim letter, *supra* note 46.

117. See Note, *supra* note 16, at 1419-20.

118. Indeed, modifications in disclosure requirements for foreign issuers, *see supra* text accompanying notes 1-6, may stimulate the Commission to reexamine the efficacy of these requirements for American issuers.

mission should be able to reach an appropriate balance between the need to accommodate foreign issuers and the need to provide American investors with material information about these issuers.