MEMORANDUM

From : Jeffrey D. Bauman

Re : Legislative History of the Problem of Requiring Issuers of Foreign Securities Traded Over-the-Counter to Comply with the Disclosure Requirements of the Securities Exchange Act of 1934

Date : December 14, 1964

Introduction

This memorandum discusses legislative proposals and inquiries concerning the problem of requiring issuers of foreign securities to comply with the disclosure provisions of the Securities Exchange Act of 1934. It does not discuss the regulation of foreign issuers under the 1933 Act, nor does it deal with the Commission's regulation of listed foreign companies and the forms on which those companies now register with the Commission under the Securities Acts prior to the 1964 Amendments. Most of the materials discussed here arose in connection with prior Frear-Fulbright legislation, but the problem of regulating foreign securities has also arisen in various hearings not directly related to OTC companies. I am appending a list of all the relevant legislative and Commission material at the end of this memorandum. All discussion of the 1964 Amendment will be reserved for a subsequent memorandum.

Four bills prior to the 1964 Amendment attempted to require disclosure from OTC companies, and all included a provision pertaining to those foreign issuers whose stock was traded OTC. HR 7151 was introduced in 1946, S.2408 in 1949, S. 2054 in 1955, and S.1168 in 1957.

I. 1946 - 1949

Immediately after World War II, the Commission undertook a study of the protection afforded to investors in unlisted securities. In the course of preparing this study, the Commission recognized the problems arising from the attempted regulation of a foreign issuer which was not doing business in the United States, but whose securities were traded in domestic markets. In a proposed report to Congress, the Commission acknowledged that "it is clear that enforcement would be more difficult in the case of such companies than in the case of domestic companies or foreign companies doing business here."1/ The Commission

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1/ Proposed Report to Congress Recommending an Amendment to the Securities Exchange Act of 1934 which would Extend to Investors in Securities not Registered on Exchanges the Protection Now Afforded to Investors in Registered Securities by Reason of Sections 12, 13, 14 and 16 of the Act, p. 74. This report is undated but was probably written early in 1946.

felt that the problem warranted further study, and recommended that Congress give the Commission broad exemptive power where "It is not practicable to enforce the obligation of the statute upon such (foreign) companies."2/

In the report which it submitted to Congress, the Commission made its position regarding exemptions more precise, although the report deletes the discussion of the nature of the problem which had appeared in draft. The Commission suggested that consideration relevant to the granting of exemptions with respect to foreign issuers include "the extent to which it is practicable to enforce the obligations of the statute with respect to them, and the extent to which there may exist a substantial interest in the securities of such issuers in the United States."3/

Although the Commission may have considered the problem of how to regulate foreign issuers at the time of the passage of the 1933 and 1934 Acts, its study in 1946 appears to have been the first time that the Commission made any effort to propose a solution within the context of the entire OTC problem.

The Commission's recommendations concerning all OTC securities, including those of foreign issuers, were embodied in H.R.7151. The bill required all companies meeting certain stockholder and asset tests to comply with Sections 12, 13, 14 and 16 of the 1934 Act. Subsection 12(g)(3) gave the Commission the power, by rules and regulations, to exempt certain securities and provided that

> "(3) The provisions of this subsection shall not apply in respect of any issuer, security, transaction, or person which the Commission may by rules and regulations exempt, either unconditionally or upon such terms and conditions as may appear to be necessary or appropriate in the public interest or for the protection of investors, as not comprehended within the purposes of this subsection. The Commission may so exempt any issuer, whether or not it is engaged in interstate commerce or in business affecting interestate commerce, if substantially all its securities are held within a single State. In respect of foreign issuers, considerations relevant to the granting of such exemption may include the extent to which the provisions of this subsection are susceptible of enforcement with respect to such issuers, and the extent to which there may exist a substantial interest in the securities of such issuers among investors located within the United States or any State."

2/ Ibid.

3/ Proposal to Safeguard Investors in Unregistered Securities, 79th Congress, 2nd Session, House Document No. 672, 1946, p. 24

The problem as the Commission defined it in its draft report, and the initial legislative solution of H.R. 7151 represent the position which both the Commission and Congress maintained until the 1964 Amendment. No factual information was provided to either Congress or the Commission, which might have aided either in gaining more insights into the nature of the problem. Subsequent testimony supported the Commission's earliest view of the problem; virtually none of the witnesses were able to help in formulating a solution.

No hearings were held on H.R. 7151, and no further legislative action was taken until 1949. In the interim, John Haskell, then Vice-President of the New York Stock Exchange, suggested that the Commission consider the possibility of "inducing" registration of foreign issuers on national exchanges (not OTC issuers). The Commission replied by reserving the topic for future consideration.4/

It does not appear that the Commission ever took any action in this direction. While the problem of "inducing" foreign companies to list arose in the context of an effort to encourage American investment abroad, the analogy to the present situation is clear. Because of the possibility that ultimately the Commission will be unable to acquire jurisdiction over a foreign issuer, the avenue of persuasion of inducing voluntary compliance takes on an added significance.

II 1949 - 1954

In 1949, Senator Frear introduced S. 2408. 12(g)(3) remained unchanged insofar as it dealt with foreign issuers. At the hearings, Louis Loss spelled out the dilemma facing the Commission. The chief difficulty with any legislation would be enforcement. The Commission cannot compel a foreign company to disclose if it did not want to, and the cessation of trading in the stock of a non-complying company would hurt the American investor rather than the foreign issuer. He suggested that the problem was one which Congress should solve and asked the Senate to suggest standards for the Commission's guidance.5/

4/ Commission Committee Minutes, July 16, 1947, p. 4

5/ Hearings Before a Subcommittee of the Committee on Banking and Currency, United States Senate, 81st Congress, 2nd Session on S. 2408, p. 32-3.

Before further legislation was introduced Congress held hearings on the workings of the stock market and on the state of the economy. In one of the latter held in 1952, Keith Funston, President of the New York Stock Exchange, suggested that in order to facilitate the Point 4 Program, the United States could enter into "securities treaties" with friendly countries. Such treaties would exempt foreign equity securities from our Securities Acts provided these securities were validly registered under foreign securities laws and that these laws reasonably conformed to those of the United States. The Commission staff rejected this approach because the Staff believed that most foreign laws did not reasonably conform to the Securities Acts, and that no foreign law would provide delivery of prospectuses in connection with sales in the United States.6/

In 1954, Chairman Daumler added another dimension to the problem facing the Commission. Testifying before the House, he said that if the United States wished to encourage portfolio investment abroad by private investors, either the Commission's standards of disclosure had to be let down, or standards of foreign issuers had to be raised. If the Commission compelled foreign issuers to raise their standards, the process of investment abroad might be impeded. If the Commission lowered its standards to accomodate foreign issuers, the result might be a lowering of American standards because American issuers would demand equal treatment.7/

In the context of our balance of payments problem, this dilemma may seem easier to resolve now than in 1954, but looking past the Interest Equalization Tax, the dilemma is still one which the Commission must try to resolve. Rule 3(a)12-3 which exempts listed foreign companies from certain requirements of the 1934 Act is one answer but the question still remains as to whether it is the best resolution.

During Senate hearings in 1954, Keith Funston was asked about the possibility of securing information from European issuers. He replied that both European exchanges and companies are accustomed to less rigorous disclosure than that of the Securities Acts and are discouraged by our requirements. Significantly, he believed that, given enough time, West European companies could provide the information we require, but that they could not do so immediately.8/

6/ Memo to Commission from Arden L. Andersen Re: Position That Might be Taken by Commission with Respect to Proposals Made by Funston and McCormick to Heller Committee, April 14, 1952. p. 6.

7/ Hearing Before the Committee on Interstate and Foreign Commerce, House of Representatives, 83rd Congress, 2nd Session on H.R. 7550 and S.2846, p. 73.

8/ Ibid.p. 84-5

III. 1955 - 1957

S. 2054 contained language identical to past bills in that section pertaining to foreign issuers. In preparing testimony on this bill, the Commission changed its view of the proper solution of the problem of foreign issuers. Chairman Armstrong believed that although the Commission should have broad rule-making power enabling it to deal flexibly with problems of securities regulation, the proposed statute "should not place upon the Commission the necessity of making decisions which are essentially legislative in character without appropriate legislative guides."9/

Accordingly, the Commission proposed changing 12(g)(3) to eliminate all mention of foreign issuers. The revised section provided that

> "Upon application of the issuer or upon its own motion, the Commission may enter an order terminating registration of a security pursuant to this subsection, subject to such terms and conditions as it may deem necessary to impose for the protection of investors, if it finds, after appropriate notice and opportunity for hearing, that by reason of the small number of public investors, lack of trading interest, inactivity of the issuer or the small amount of the public investment as measured by the market value of the security, or otherwise, continued registration of the security is not necessary in the public interest or for the protection of investors."10/

This amendment omits the difficulty of enforcement as a specific criterion for exemption, and subsumes it in the word "otherwise." The Commission's decision to eliminate any reference to foreign issuers is difficult to understand. No evidence appears to have been available to the Commission in 1955 which had not been previously available. The Commission's files for this period indicate that the principal reason was Armstrong's belief that the decision to exempt foreign issuers was essentially a legislative one, and that unless Congress could lay down specific guidelines for the Commission to follow, there should be no indication that the Commission might have different considerations in treating foreign issuers than it would have for domestic issuers.

9/ Draft statement of J. Sinclair Armstrong, June 20, 1955, p. 19. The draft statement was presented to the Senate in its original form, Hearings Before a Subcommittee of the Committee on Banking and Currency, United States Senate, 84th Congress, 1st Session, on S. 2054, p. 1055

10/ Drafts of Proposed Amendments to S. 2054, July 14, 1955 and July 18, 1955.

The thought processes underlying the change in approach are incompletely reflected in the official files. When Myer Feldman, on loan to the Senate from the Commission, said that the Senate was thinking of retaining the original language, Arden Andersen of the Commission's staff indicated that considerations bearing on inclusion or exclusion of the provisions were complex, and that the Commission would recommend excluding the original provision from the bill. 11/ Apart from the problems already discussed, it is hard to see what new complexities had persuaded the Commission to change its mind.

The Presidents of both major stock exchanges rejected the Commission's approach. Keith Funston stated that "enforcement of a requirement that foreign issuers register would in most instances be impossible ... the provisions of the present bill placing the matter in the hands of the SEC under their powers of exemption referred to above present the most satisfactory way of meeting the problem."12/

Edward McCormick, President of the American Stock Exchange agreed that there should be a specific exemption for foreign issuers but rejected both the Senate and Commission version. He believed that an exemption was desirable "in view of the fact that issuers cannot be expected voluntarily to comply with the bill and enforcement of its provisions against them may be impossible because they are outside this country's jurisdiction. The exemption would assure that present and future holders of foreign securities in the United States would not be deprived of an American market."13/

In addition to the problem of enforcement, McCormick raised for the first time, the problem of identifying the number of shareholders in a company because the shares of many foreign securities were bearer shares. He pointed out that neither the Company nor the Commission could definitely determine the number of shareholders, and that it might be impossible for any company, even with the best of intentions to know whether it came under the provisions of the bill. Mr. McCormick proposed an amendment exempting

> "any foreign issuer, any security, or receipt for any security of which has been regularly traded or quoted on any securities market within the United States or in any State for a period of at least five years prior to the effective date of this Act." 14/

11/ Conference Memoranda between Myer Feldman and Arden Andersen, July 22, 1955 and July 25, 1955.

12/ Hearing Before a Subcommittee of the Committee on Banking and Currency, United States Senate, 84th Congress, 1st Session, on S. 2054, p. 1099.

13/ Ibid, p. 1150.

14/ Ibid, p. 1156.

Mr. McCormick's proposed amendment has several weaknesses. The nature of the foreign securities market is such that a security may be very active for a short period, inactive for another period, and alternate in a similar fashion for five years, so that it would be difficult to tell if it had been "regularly traded." Further, the amendment does not meet the essential problem of whether the American investor should be furnished with certain information before any trading is permitted in a given security. If disclosure is desirable, the fact that a security has been regularly traded for five years does not insure that an investor is receiving adequate protection. Finally, the amendment does not provide a viable solution for those companies which have been traded for less than five years in the United States and which may be either blue-chip or highly speculative issues.

IV 1957 - 1963

The final bill prior to the 1964 Amendment was S. 1168, introduced in 1957. The bill changed the language of the section dealing with foreign issuers to read:

> 12(g)(6) The Commission may, if it appears to be necessary or appropriate in the public interest or for the protection of investors, exempt foreign issues and issuers against whom the provisions of this subsection may not be susceptible of enforcement."15/

The hearings on S. 1168 produced little new information. The Commission did not testify as to this clause, and both Funston and McCormick reiterated their earlier positions. Two interesting questions of policy which are still unresolved were raised during the hearings. Keith Funston suggested the first when he said that there should be an exemption "because European tradition, custom, and law is a lot different than ours. We cannot remake all of the world to conform to the American pattern."16/ The other important policy question, that of the conditions under which foreign companies should have access to United States markets, will be discussed in detail in the memorandum on the 1964 Amendment. It was raised in the hearings in the following dialogue between Mr. McCormick and Mr. McKenna, counsel for the Committee.

15/ Cf. Senate Report No. 700, 85th Congress, 1st Session, on S. 1168 p. 14, 21.

16/ Hearings before a Subcommittee of the Committee on Banking and Currency, United States Senate, 85th Congress, 1st Session on S. 594, 1168, 1601, p. 236.

McKenna: I have difficulty in seeing why a foreign issuer who wants to take advantage of the facilities of our markets should not abide by the same restrictions domestic issuers abide by.

McCormick: [We agreed if there were power to compel compliance] "Let us say tomorrow you pass this bill, and a lot of that stock is held in this country - - - They [the American holders] are going to have to dump it in Italy or England, and you are going to say that nobody can buy Fiat."

McKenna: Unless they conform to the requirements of the bill - - - unless they conform to the requirements of the bill, they will not have the privilege of trading in this country.

McCormick: If you want to throw their billions of dollars of business in foreign securities in the United States out the window - and it is a very fine investment in quality securities - of course that is the privilege of the Senate of the United States, but I think they should certainly give it a very careful going over before they do."17/

The conclusion which emerges from a consideration of the legislative history of past bills is that neither the Commission, any representatives of the securities industry, nor any member of Congress, has had sufficient information to justify either registration or exemption. The problem of enforcement is very real and very large, but it seems to have been an excuse for including a clause which would enable the Commission to solve the problem at a later date. The consequence of the scarcity of information upon which either Congress or the Commission could make an informed judgment is that there is very little in past legislative history which helps lead to answers to the problems which must be solved today.

17/ Ibid, p. 197.

CC: Mr. Worthy
Mr. Bagley
Mr. Shreve
Mr. Zwerling
Mr. Kaufman
Mr. Barr
Mr. Millard
Mr. Eyster

APPENDIX

I. Legislative Materials

1) Proposal to Safeguard Investors in Unregistered Securities, 79th Congress, 2nd Session, House Document No. 672.

2) Hearings Before a Subcommittee of the Committee on Banking and Currency, United States Senate, 81st Congress, 2nd Session on S. 2408.

3) Study of Securities and Exchange Commission, Hearings Before a Subcommittee of the Committee on Interstate and Foreign Commerce, House of Representatives, 82nd Congress, 2nd Session on Powers, Duties and Functions of Securities and Exchange Commission.

4) Study of the Securities and Exchange Commission, Report of the Committee on Interstate and Foreign Commerce, 82nd Congress, 2nd Session, House Report No. 2508.

5) Report to the President and the Congress, Commission on Foreign Economic Policy, January 23, 1954, Minority Report, January 30, 1954.

6) Staff Papers Presented to the Commission on Foreign Economic Policy, February 1954.

7) Hearing Before the Committee on Interstate and Foreign Commerce, House of Representatives, 83rd Congress, 2nd Session on H.R. 7550 and S. 2846.

8) Stock Market Study, Hearings Before the Committee on Banking and Currency, United States Senate 84th Congress, 1st Session on Factors Affecting the Buying and Selling of Equity Securities.

9) Stock Market Study (Regulation of Unlisted Securities), Hearings Before A Subcommittee of the Committee on Banking and Currency, United States Senate, 84th Congress, 1st Session on S. 2054.

10) Stock Market Study (Corporate Proxy Contests), Hearings Before a Subcommittee of the Committee on Banking and Currency, United States Senate, 84th Congress, 1st Session on S. 879.

11) Report of the Securities and Exchange Commission on S. 2054 to the Committee on Banking and Currency, United States Senate, 84th Congress, 2nd Session.

12) Supplementary Report of the Securities and Exchange Commission on S. 2054.

13) Factors Affecting the Stock Market, Report of the Committee on Banking and Currency, United States Senate, ;84th Congress, 1st Session, Senate Report No. 1280.

14) Stock Market Study, Report Together with Individual Views and Minority Views of the Committee on Banking and Currency, United States Senate, 84th Congress, 1st Session, Senate Report No. 376.

15) SEC Enforcement Problems, Hearings Before a Subcommittee of the Committee on Banking and Currency, United States Senate, 85th Congress, 1st Session.

16) Hearings Before a Subcommittee of the Committee on Banking and Currency, United States Senate, 85th Congress, 1st Session, on S. 594, S. 1166 and S. 1601.

17) Unlisted Securities, Report from Committee on Banking and Currency, United States Senate, 85th Congress, 1st Session to accompany S. 1168, Report No. 700.

18) Securities Acts Amendments, 1959, Hearings Before a Subcommittee of the Committee on Interstate and Foreign Commerce, House of Representatives, 86th Congress, 1st Session on H.R. 2480.

19) Hearings Before a Subcommittee of the Committee on Banking and Currency, United States Senate, 86th Congress, 1st Session on S. 1178, S.1179, S.1180, S.1181 and S.1182.

II. Commission Materials

1) Proposed Report to Congress Recommending an Amendment to the Securities Exchange Act of 1934 Which Would Extend to Investors in Securities not Registered on Exchange the Protection Now Afforded to Investors in Registered Securities by Reason of Sections 12, 13, 14 and 16 of the Act. Undated - early 1946.

2) Commission Committee Minutes, 7/16/47.

3) Memorandum to Commission from Arden L. Andreson on the Position that Might Be Taken by the Commission with Respect to the Proposals Made by Funston and McCormick to Holler Subcommitee, 4/14/52.

4) Draft Statement of J. Sinclair Amstrong on S. 2054, 6/20/55.

5) Drafts, Proposed Amendments to S. 2054, 7/14/55, 7/18/55.

6) Conference Memorandum between Myer Feldman and Ard[illegible] 7/20/55 and 7/25/55.