TESTIMONY OF JOHN R. EVANS, COMMISSIONER
SECURITIES AND EXCHANGE COMMISSION
BEFORE THE SUBCOMMITTEE ON COMMERCE, CONSUMER, AND MONETARY AFFAIRS
OF THE HOUSE COMMITTEE ON GOVERNMENT OPERATIONS

April 6, 1982

Mr. Chairman and members of the Subcommittee, I am pleased to have this opportunity to testify on behalf of the Securities and Exchange Commission regarding the role of the Commission in assisting the Department of Defense to determine possible foreign ownership, control or influence of certain defense contractors.

In your letter of March 23, you requested that we respond to five specific questions.

First, you asked us to describe the enforcement problems that the Commission encounters as a result of (a) securities held in street or nominee names and (b) securities held in Swiss numbered accounts.

The practice of registering securities in nominee and street name benefits investors and the securities industry by facilitating the transfer of record ownership and the clearance and settlement of securities transactions. At the same time, it may create difficulties in any inquiry into possible violations of the Federal securities laws. The principal problems are the need to expend additional enforcement resources to ascertain the persons or entities employing nominee or street names, the delays that this creates in situations where prompt action is necessary to protect investors, and the difficulty of determining at an early stage of an inquiry whether a particular matter should be pursued.

At the very least, the use of nominee names requires that Commission investigators perform additional work to ascertain

the identity of the beneficial owners of securities involved in possible violations of the securities laws. Generally, however, as long as investigations can be conducted within the territory of the United States, the Commission is able to obtain necessary underlying account and beneficial ownership information pursuant to its right of access to broker-dealer records and its authority to issue subpoenas that compel testimony and the production of information and documents.

Apart from the additional effort required to ascertain the identity of beneficial owners, the use of nominee or street names creates difficulties when immediate action is essential, such as in takeover contests, and in cases involving insider trading when it may be necessary to act promptly to freeze illicit profits before they can be removed from the United States or from the jurisdiction of a district court.

The problems associated with the use of nominee or street names are most prevalent when banks or other non broker-dealer financial institutions are used as intermediaries to effect securities transactions. Generally, the Commission cannot obtain information concerning customer accounts at such institutions without a subpoena. Although the Commission may authorize the use of subpoena power in connection with a formal investigation, routine surveillance inquiries are generally conducted as preliminary investigations without benefit of subpoena power. As a result, the staff is confronted with a dilemma in that it is precluded from identifying certain purchasers or sellers in connection with its routine surveillance, and, without such information, absent unusual

circumstances, it generally does not have sufficient information to request that the Commission authorize a formal investigation. Moreover, even when the Commission authorizes subpoenas in connection with an investigation, compliance with the Right to Financial Privacy Act can cause substantial delays in obtaining access to certain bank records.

The second part of your first question focuses on Swiss numbered accounts. I am sure you realize, however, that the problem is more widespread than the question might indicate because a significant number of other countries throughout the world also have secrecy laws prohibiting financial institutions from disclosing information with respect to customers who make use of their services.

The Commission encounters difficulties in conducting investigations of American or foreign investors who have used foreign financial institutions in certain countries as intermediaries in effecting securities transactions in the United States. This is illustrated by two well known recent insider trading cases brought by the Commission. The first is SEC v. Banca della Swizzera Italiana, et al., 81 Civ. 1836 (MP) (S.D.N.Y.), which is referred to as the "St. Joe case" because it involves transactions in, and options to purchase, the common stock of St. Joe Minerals Corporation. The other case is SEC v. Certain Unknown Purchasers of the Common Stock of, and Call Options for the Common Stock of, Santa Fe International Corporation, 81 Civ. 6553 (WCC). These cases involve allegations that customers of Swiss banks used material non-public information to purchase securities prior to the public announcement of takeover bids

for St. Joe and Santa Fe. In each case, secrecy laws have impeded the Commission's investigation of, among other things, whether these customers were insiders or had received material inside information.

Another area of concern involves possible violations of the Williams Act which, among other things, requires any person or group of persons who acquire more than five percent of a class of registered securities to disclose their holdings in a filing with the Commission. Similar disclosure requirements are applicable to persons who make tender offers.1/ The Commission cannot carry out its statutory responsibilities to police compliance with these requirements unless it is able to determine the identity of persons who acquire substantial blocks of stock or engage in transactions that may constitute tender offers, together with the relevant facts concerning the transactions involved.

Foreign bank secrecy laws have also been obstacles to the investigation and prosecution of schemes to manipulate the market price of a security 2/ and to sell securities in the United States in violation of the registration requirements of the Securities Act.3/ In addition, financial institutions

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1/ See, e.g., SEC v. General Refractories Co., 400 F. Supp. 1248 (D.D.C., 1975); SEC v. Banque de Paris et des Pays-Bas (Suisse) S.A. (D.D.C., 77 Civ. 798).

2/ See, e.g., SEC v. Everest Management Corp., et al. (S.D.N.Y., 71 Civ. 4932); SEC v. Edward M. Gilbert, et al., 82 F.R.D. 723 (S.D.N.Y., 1979).

3/ See, e.g., SEC v. American Institute Counselors, Inc., et al. (D.D.C., 75 Civ. 1965).

located in jurisdictions with secrecy laws have been used as intermediaries for making questionable or illegal payments,4/ misappropriating corporate assets 5/ and "laundering" funds generated by other illegal activities. 6/

In sum, persons who effect transactions through foreign institutions subject to secrecy laws have been able to conceal their interest in the securities involved, thereby impeding the Commission's efforts to detect violations of securities laws. Moreover, even when investigations reveal misconduct, these secrecy laws cause problems in effecting service of process upon defendants and obtaining discovery in connection with subsequent Commission enforcement actions.

The result is a de facto double standard with respect to the enforcement of the federal securities laws -- a strict standard for those who effect securities transactions through domestic broker-dealers, banks or other financial institutions, and a lesser standard for those persons, whether Americans or citizens of foreign nations, who choose to effect such transactions through certain foreign intermediaries. We believe it is essential that this double standard be eliminated to the extent possible in order to enhance the effectiveness of the statutory scheme enacted by Congress to protect investors and insure the honesty and fairness of our domestic capital markets.

4/ See, e.g., SEC v. Lockheed Aircraft Corp., et al. (D.D.C., 76 Civ. 611); SEC v. The Goodyear Tire & Rubber Co. (D.D.C., 77 Civ. 2167).

5/ See, e.g., Robert L. Vesco, et al. (S.D.N.Y., 72 Civ. 5001).

6/ See, e.g., SEC v. Kasser, 548 F.2d 109 (3rd Cir. 1972).

Your second question refers to the Commission's December 1976 "street name report" in which the Commission stated that the practice of registering securities in nominee and street name, particularly in the names of foreign financial institutions, may impede enforcement of the beneficial ownership disclosure requirements of the federal securities laws. You have asked us to describe our present experience with and position on enforcement problems raised by securities held in street or nominee names; any specific steps that we are taking to deal with the problem; and any legislation that we are recommending.

The Commission has continued to encounter problems associated with the accumulation of substantial ownership or control of United States corporations by foreign persons or entities without complying with the beneficial ownership disclosure requirements of the securities laws. Three examples serve to illustrate this fact.

On March 17, 1978, the Commission filed a complaint in the United States District Court for the District of Columbia against Bank of Credit and Commerce International, S.A., and nine individuals.7/ The defendants consented to the entry of the judgment without admitting or denying the allegations in the Commission's complaint and the court entered judgments of permanent injunction restraining and enjoining the defendants from violations of Section 13(d) of the Exchange Act and Rules 13d-1 and 13d-2 and Schedule 13D promulgated thereunder.

7/ SEC v. Bank of Credit and Commerce International, S.A., et al. (D.D.C., 78 Civ. 0469).

The violative activity alleged in the Commission's complaint concerned acts and transactions in connection with the securities of Financial General Bankshares, Inc. ("FGB"), which are registered with the Commission pursuant to Section 12(b) of the Exchange Exchange Act and traded on the American Stock Exchange. The Commission's complaint alleged that certain of the defendants, acting together, engaged in a series of acquisitions of approximately 20 percent of FGB outstanding common stock through open market purchases and privately negotiated purchases from substantial shareholders of FGB and failed to make required Schedule 13D filings. Adding these purchases to other FGB securities held, these defendants controlled approximately 28 percent of the outstanding stock of FGB. This course of conduct was structured in such a manner to avoid public disclosure of their activities.

At various times, conflicting representations were made to to certain sellers of such securities concerning the purpose of the acquisitions by certain of the defendants; the identity of the purchasers; and their intention to acquire control, to obtain influence over the management of FGB, and to seek representation on FGB's Board of Directors.

On September 28, 1977, the Commission filed an action for a permanent injunction, naming as defendants, Diplomat National Bank ("DNB"); its former chairman Charles C. Kim; Tongsun Park; Bo Hi Pak, an associate of Sun Myung Moon; and Spencer Robbins.8/

8/ SEC v. Diplomat Bank, et al. (D.D.C., 77 Civ. 1695).

The complaint alleged that the defendants had violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, by participation in a scheme whereby Park, through three nominees, purchased 10 percent and Pak, through at least 18 nominees, purchased approximately 40 percent of DNB's common stock during its initial offering in 1975. These purchases by Pak and Park were alleged to be in contravention of express representations in DNB's offering circular that no one individual would hold more than five percent of DNB's common stock after the completion of the initial offering. Shortly after filing of the action, without admitting or denying the complaint's allegations, all defendants consented to entry of orders of permanent injunction enjoining them from further violations of the antifraud provisions in connection with DNB stock or any other securities.

On May 1, 1979, the Commission filed an action against Unification Church International ("UCI"), a District of Columbia corporation.9/ The complaint alleged that UCI violated the antifraud provisions of the federal securities laws by participation in a scheme to gain and maintain undisclosed control of DNB by purchase of a controlling percentage of DNB stock through nominees and others, including Pak, during the initial offering. On July 6, 1979, the United States District Court for the District of Columbia entered an order permanently enjoining UCI from violations of the antifraud provisions in

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9/ SEC v. Unification Church International, et al. (D.D.C., 79 Civ. 1197).

connection with DNB stock. UCI consented to entry of this order without admitting or denying the allegations of the complaint.

Recent events have caused us to focus on the use of foreign financial institutions subject to secrecy laws to shield insider trading. The Commission has taken a number of specific steps to deal with this problem. In the St. Joe case, referred to in the previous question, the Commission moved for an order compelling discovery pursuant to Rule 37 of the Federal Rules of Civil Procedure. The Commission's motion was based upon the refusal of a Swiss bank to provide information in response to interrogatories concerning the identities of the principals for whom it purchased St. Joe stock and options.

On November 16, 1981, after eight months of Commission effort to obtain disclosure by cooperative means, the United States District Court for the Southern District of New York issued an opinion which held that, given the circumstances in the case, the Swiss secrecy laws must yield to the vital national interest of the United States in maintaining the integrity of the securities market. The opinion added:

> "It would be a travesty of justice to permit a foreign company to invade American markets, violate American laws if they were indeed violated, withdraw profits and resist accountability for itself and its principals for the illegality by claiming their anonymity under foreign law."10/

In the course of his opinion, the district judge determined that the bank had made deliberate use of Swiss secrecy

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10/ [Current] Fed. Sec. L. Rep. (CCH) ¶98,346 (S.D.N.Y., November 16, 1981) at 92,149.

laws to evade the provisions of the federal securities laws that encompass insider trading. The judge issued an order which froze any assets derived from the purchase or sale of St. Joe Minerals Corporation securities owned, controlled or in the possession of the defendants. In addition, he indicated that he would impose severe contempt sanctions upon the bank if it did not reveal the names of the customers for whom it had executed the purchases in question. Following these actions, the bank obtained waivers of confidentiality from its customers and supplied certain information before the court acted to impose such sanctions.

The most recent Commission legislative proposal to enhance the Commission's ability to conduct investigations involving foreign financial institutions was sent to Congress in the mid-1970's. At that time, we proposed that Section 21 of the Exchange Act be amended to authorize the federal courts to impose sanctions in aid of Commission investigations. These proposed sanctions included the following:

- The impoundment or withholding of any dividends or interest otherwise due any person from whom the Commission has failed to receive information;

- Revocation or suspension of shareholder voting rights with respect to any person from whom the Commission has been unable to obtain information; and

- An order to any issuer or transfer agent to refrain from effecting a registration or transfer with respect to any purchase or sale by any person having an interest in the securities involved until the information sought from such person is furnished to the Commission.

The Commission is not now recommending additional legislation to deal with the problem, but it is our present judgment that the legislative proposal submitted during the mid-1970's deserves further consideration. Accordingly, this topic is currently under review by the Commission's staff.

Another possible approach is rulemaking. In 1977 the Commission proposed a rule amendment that would condition access to the United States securities markets upon customer waivers of foreign secrecy provisions.11/ Under this proposal, brokers holding joint accounts or an account for a person other than a natural person would be obligated to obtain the agreement of the person authorized to effect transactions for the account that such person would, at the request of the Commission, furnish the name and address the of beneficial owners of securities that were traded or held for such accounts. Comments on this proposal were generally negative. Many suggested that the rule would be difficult to enforce and would have an adverse impact upon United States securities markets. Nonetheless, the Commission is currently giving this approach further consideration.

Your third question asks whether the Commission or any other government agency has the power to determine the true or beneficial ownership of stock held in street or nominee names, and if so, under what circumstances that power may be exercised.

The Federal securities laws do not now require disclosure to the Commission or the public of the beneficial owners of

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11/ See Securities Exchange Act Release No. 13149 (January 10, 1977).

all securities. However, the Commission does have authority to require such disclosure under some circumstances. This authority is derived from several statutory provisions and Commission rules. Sections 13(d) and 13(g) of the Exchange Act, for example, require any person who is directly or indirectly the beneficial owner of more than five percent of certain types of equity securities to send to the issuer and file with the Commission a statement disclosing that person's name, address, citizenship, occupational background, source of funds, and purpose in effecting the acquisition, as well as the number of shares of the subject security which are beneficially owned by such person and each associated person. Thereafter, any material change in ownership must likewise be reported.

Section 16(a) of the Exchange Act requires any person who becomes the beneficial owner of more than ten percent of any class of non-exempt equity securities registered pursuant to Section 12, or who is a director or officer of the issuer of such securities, to file with the Commission a statement listing the amount of that issuer's equity securities so owned. Thereafter, any change in ownership must be reported within ten days after the close of the calendar month in which the change occurs.

Section 13(f) of the Exchange Act and Rule 13f-1 thereunder require institutional investment managers which exercise investment discretion with respect to certain equity securities having an aggregate fair market value of at least $100 million

to file reports with the Commission.12/ The information in these reports includes the name of each issuer whose securities are held in accounts over which the institutional investment manager exercises investment discretion and the title, class, CUSIP number, number of shares or principal amount, and aggregate fair market value of the shares so held.13/

Broker-dealers and registered clearing agencies also are required to provide beneficial ownership information with respect to the securities for which they are shareholders of record.14/ Rule 17Ad-8 under the Exchange Act requires registered clearing agencies to maintain a securities position

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12/ The term "institutional investment manager" is defined in Section 13(f)(5)(A) of the Exchange Act.

Investment discretion is defined in Section 3(a)(35) of the Exchange Act.

Section 13(d)(1) of the Exchange Act specifies the securities subject to Section 13(f).

13/ Section 13(f)(3) of the Exchange Act requires the Commission to tabulate the information obtained from the reports in a manner which enhances its usefulness to other federal and state authorities and the public, and to make the information contained therein conveniently available to the public for a reasonable fee.

The legislative history states that the Commission is required by the statute to accord confidential treatment to institutional disclosure reports made pursuant to Section 13(f) of the Act which identify the security holdings of any natural person or estate or trust (other than a business trust). See S. Rep. No. 75, 94th Cong., 2d Sess. 87 (1975).

14/ Section 17(a) provides in part that registered broker-dealers, registered clearing agencies and certain other entities "shall make and keep for prescribed periods such records, furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title."

listing and, upon request, to furnish such listing to each issuer whose securities are held in the name of the clearing agency or its nominee. A securities position listing is a compilation of the holdings of the participants in a clearing agency, or, in other words, those on whose behalf the clearing agency holds securities. It lists their positions in each security held as of a specified date. As the clearing agency is required to identify only the holdings of its own participants, the listing will not identify the owners on whose behalf the depository's participants or those participant's institutional customers are holding securities (the true owners).

Rule 17a-3(a)(9) under the Exchange Act requires brokers and dealers to make and keep "a record in respect of each cash and margin account . . . containing the name and address of the beneficial owner of such account . . . ." The Commission has proposed a new paragraph to Rule 17a-4 which would clarify the Commission's authority to compel disclosure of records that are required by Commission rule to be kept by broker-dealers.15/ The new provision would require brokers and dealers, upon request, promptly to provide Commission examiners with beneficial ownership records required to be made by broker-dealers under Rule 17a-3(a)(9).

Because many entities are not subject to the reporting and recordkeeping requirements of Sections 13(d), (f), (g), Section 16(a) or Section 17(a) of the Exchange Act, and the rules thereunder, the Commission's power to compel disclosure of beneficial

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15/ See Securities Exchange Act Release No. 16644 (March 11, 1980).

ownership information through use of subpoena power set forth in Section 21 of the Exchange Act is particularly relevant. In appropriate circumstances, this subpoena power allows the Commission to reach, among others, the institutional investment manager exercising investment discretion over accounts that have an aggregate fair market value of less than $100 million, and who is therefore not subject to Section 13(f) of the Act, and the beneficial owner who does not meet the threshold requirements of Sections 13(d) and (g) or Section 16(a).

Similarly, in connection with non broker-dealer financial institutions, the Commission has the power to compel disclosure of beneficial ownership information through the use of its subpoena power, subject to the requirements of the Right to Financial Privacy Act. However, the records kept by such a financial institutions will generally contain only the information required by appropriate financial institution regulatory authorities.

In conclusion, it should be noted that the Commission has authority to require large institutional investment managers, all registered broker-dealers, all registered clearing agencies and certain individual shareholders to maintain and disclose information concerning the beneficial ownership of certain securities to the Commission. The available information, however, does not include all beneficial owners of securities because the Commission has not required that such information be maintained. Insofar as it deems it necessary or appropriate in the public interest, the Commission may require more

extensive records concerning beneficial ownership pursuant to Section 17(a) of the Act. However, considering the costs that would result from imposing more extensive record keeping requirements, for most purposes it may be preferable for the Commission to use its subpoena power to obtain beneficial ownership information which can not be gleaned from the records currently required by Commission rule.

Your fourth question asked whether the Commission routinely coordinates with the Department of Defense ("DOD") regarding foreign acquisitions of United States securities that are required to be reported under the securities laws, and whether there are any legal or other impediments to such coordination.

The Commission does not have the responsibility, resources or expertise to identify and forward information filed with us that may be of interest to other government agencies. Thus, we do not routinely coordinate with DOD regarding foreign acquisitions of shares required to be reported under the federal securities laws. The Commission does, however, cooperate with all federal agencies, and Congress, by providing information upon request.

In this regard, recently the Commission has received several requests for information from the Committee on Foreign Investment in the United States ("CFIUS"). As you are aware, CFIUS is an inter-agency committee established in 1975 pursuant to Executive Order to review the strategic, economic and national security implications of foreign investment in the United States. Members of CFIUS include officials from the State, Treasury,

Defense and Commerce Departments, the Council of Economic Advisers and the Office of the Special Trade Representative.

Pursuant to request, information has been furnished to CFIUS concerning: the tender offer by Joseph E. Seagram & Sons, Inc. to purchase the securities of Conoco, Inc,; the tender offer for the securities of Texasgulf, Inc. by Elf-Acquitaine Co.; the merger between Santa Fe International Corp. and Kuwait Petroleum Co.; and the tender offer by Whittaker Corporation for Brunswick Corporation.

There are no legal impediments to providing to DOD or any other federal agency information regarding foreign acquisition of shares. Most such information is public upon filing and is made available through the Commission's public reference section. Additionally, although share acquisition information provided to the staff in preliminary proxy material is not available for public inspection before definitive material has been filed, Rule 14(a)(6)(e) specifically permits the Commission's staff to furnish the preliminary material to any department or agency of the United States government. Similarly, whenever a request for confidential treatment of certain information relating to an acquisition is presented to the Commission, it must be accompanied by the written consent of the requestor permitting the Commission to provide the confidential portion of the disclosure document to other federal departments or agencies.16/

16/ See Rule 485 under the Securities Act and Rule 24b-2 under the Exchange Act.

The cost and difficulty of routinely coordinating with DOD regarding foreign acquisitions of shares depends upon the volume and nature of information to be supplied. If DOD is able to identify the entities in which it is interested and the nature of the disclosure information desired, the Commission's costs would, of course, be lower than if the Commission were asked to search its files for information which the Commission believes would be of interest to DOD. Moreover, it may not be possible for the Commission to identify all companies that are defense contractors because reporting requirements under the securities laws are based on a standard of materiality. If a company has defense contracts that are not material to its operations, the Commission might not have any reason to be aware of DOD's interest in that company's filings. It is, therefore, advisable that routine coordination consist of specific requests from DOD for the information that it deems to be material to its mission.

Finally, you have asked for a description of the results of recent meetings between United States and Swiss government officials in improving access to information on beneficial owners of Swiss numbered accounts. The consultations held between United States and Swiss representatives on March 1 and 2 are an important and constructive step in the process of achieving an understanding with the Swiss on the subject of SEC access to information in the possession of Swiss banks with respect to securities transactions that may have violated the federal securities laws. Although the consultations included

the subject of access to information concerning beneficial ownership, they were primarily concerned with insider trading problems, as evidenced recently in the Sante Fe and St. Joe takeover situations. Among other things, the participants addressed the applicability of the Mutual Assistance Treaty in Criminal Matters between the Swiss Confederation and the United States, which became effective in January 1977. The delegations also considered a number of potential new procedures, including a convention among Swiss banks, leaving open the role that the governments would play in the exchange of information.

In light of the spirit of cooperation exhibited during the consultations, we are hopeful that it will be possible to develop new, mutually acceptable procedures to assist in the investigation and prosecution of insider trading activities in the United States capital markets. Any procedures would, of course, have to be consistent with the sovereign interests of both nations. Due to the delicate and tentative nature of the discussions, as well as the complexity of the problems involved, the delegations have elected to continue the consultations at a later date.