U.S. SECURITIES REGULATION: THE NEED FOR MODIFICATION TO KEEP PACE WITH GLOBALIZATION

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1. INTRODUCTION

The United States was once a one-of-a-kind capital market.¹ No other country offered securities markets of comparable size, sophistication, or liquidity. The Securities and Exchange Commission ("SEC"), the agency responsible for regulating the U.S. securities markets,² was free to establish rules and requirements secure in the knowledge that issuers and investors who objected to the regulations "could not find non-SEC-regulated substitute markets at reasonable cost."³ Today, however, although the United States remains the preeminent capital market in the world,⁴ there are other markets companies and investors can turn...
to for their capital and investment needs.\(^5\) For example, the
United Kingdom and Japan both have well-established markets,
and other nations, such as Hong Kong and Singapore, have
securities markets that, while relatively new, are attracting
growing numbers of issuers and investors.\(^6\)

Still, the existence of other markets is not enough to threaten
the dominant position of the U.S. securities markets. As with
other goods and services, international trade can exist only if there
are links between markets that allow buyers and sellers to
interconnect. Certainly, businesses generally have become
increasingly globalized, as demonstrated by NAFTA, the Uruguay
round of GATT, the European Union, and the rapid development
of the Pacific Rim nations.\(^7\) This globalization — also known as
internationalization — has been and continues to be reflected in
the globalization of the world's securities markets.\(^8\) In fact, the
pace of internationalization in the securities world has been even
greater than the rate of growth in international trade generally.\(^9\)
U.S. investors are investing in non-U.S. securities in record
numbers\(^10\) and foreign companies are listing their securities in the

\(^5\) See Grundfest, supra note 1, at 4.

\(^6\) See Singapore Aims for Big League, S. CHINA MORNING POST, Mar. 10,

\(^7\) See generally Richard C. Breeden, The Globalization of Law and Business
in the 1990s, 28 WAKE FOREST L. REV. 509 (1993) (discussing the globalization
of business generally, financial markets specifically, and resultant law-related
policy issues).

\(^8\) See Andreas J. Roquette, New Developments Relating to the International-
ization of the Capital Markets: A Comparison of Legislative Reforms in the United
States, the European Community, and Germany, 14 U. PA. J. INT'L BUS. L. 565,
566 (1994).

\(^9\) See RICHARD HERRING & ROBERT LITAN, FINANCIAL REGULATION IN
THE GLOBAL ECONOMY (1994), reprinted in HAL S. SCOTT & PHILIP A.
WELLONS, INTERNATIONAL FINANCE: TRANSACTIONS, POLICY, AND
REGULATION 10 (2d ed. 1995).

1994, at 109 (reporting that trading volume in American Depositary Receipts
has tripled since 1990); Jack O'Hara, Global Investments Can Provide Value and
Diversity, LEGAL INTELLIGENCER, July 20, 1993, at 6 (stating that during 1992,
Americans bought and sold 33% more stock than in 1991); Cheryl B. Strauss,
United States at a record level. The extent of globalization of capital markets has reached levels some commentators describe as “revolutionary.”

Some commentators question whether the United States can maintain its dominant position in the face of global competition. Regulatory requirements make trading on the U.S. exchanges and on the National Association of Securities Dealers Automated Quotation System (“NASDAQ”) expensive, and some commentators fear that as the foreign exchanges improve, the lower costs associated with listing on those exchanges will attract listings away from the United States. Currently, foreign companies that want to list their securities on any of the U.S. exchanges or on NASDAQ must comply with the U.S. securities laws, which have the world’s most burdensome registration and reporting requirements. It is not, however, the registration and reporting requirements per se that are the most controversial aspects of the securities regulations. The weight of the criticism is leveled at the requirement that issuers either prepare their financial disclosures in accordance with U.S. Generally Accepted Accounting Principles (“U.S. GAAP”) or reconcile them with U.S. GAAP. This


See William Glasgall & Dave Lindorff, The Global Investor, BUS. WK., Sept. 19, 1994, at 96, 97 (noting that the once arcane American Depositary Receipts are multiplying “at a ferocious pace”). The growth in the market for American Depositary Receipts (“ADRs”) presents a sharp contrast to just a few years ago, when investor interest in international equities was “barely apparent” and the only international offerings consisted of issues from South African gold mines, a few European multinationals, and “a smattering of other quirky issues.” Id. at 99.

See Roquette, supra note 8, at 565.

For a discussion of the costs and benefits of listing on U.S. exchanges, see infra section 3.1.

The term “exchanges” refers to the New York Stock Exchange, the American Stock Exchange, and local exchanges.

The NASDAQ is a computerized system that provides updated price quotations (i.e., bids and offers). See LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 618-20 (3d ed. 1995). Dealers use the exchange to find the best prices and then execute the transaction by phone. See id.

See discussion infra section 2.3.

See, e.g., McConnell, supra note 4, at S126-27 (stating that reconciling disclosures with U.S. GAAP is a lengthy process and that acquiring the
is an expensive and time-consuming process that many commentators believe disadvantages U.S. exchanges and NASDAQ relative to the world's other exchanges. As the foreign exchanges improve, the lower costs of foreign exchanges may attract listings away from the U.S. exchanges and NASDAQ.

This Comment analyzes whether the United States should maintain its current regulatory requirements or whether it should seek to reform its laws in an effort to retain its competitive position in the global capital market. Section 2 of this Comment explains why investors and the U.S. exchanges and NASDAQ want foreign stock listings, the means by which U.S. investors invest in foreign stocks, and the current regulations by which foreign securities must abide. After a brief introduction to the basic economics of securities regulations, Section 3 of this Comment compares the arguments of those who support the status quo with the arguments of those who support modifying the regulatory requirements that apply to foreign securities. Section 4 argues that the regulations need to be modified and suggests several alternatives to the current regulatory scheme. This Comment concludes that the SEC must implement regulations that ease the burden on foreign companies that want to list on the U.S. exchanges in order to remain competitive in the global financial market.

2. BACKGROUND

2.1. Why U.S. Listings of Foreign Companies Matter

2.1.1. Securities Regulations and the U.S. Exchanges and NASDAQ

The U.S. capital market is a vital part of the nation's economy, particularly the New York Stock Exchange ("NYSE"), the American Stock Exchange ("Amex"), and NASDAQ. The U.S. exchanges, NASDAQ, and the SEC all want to maintain the United States' position as the preeminent financial market in the necessary data can be difficult).  

18 For a discussion of the difficulties inherent in reconciliation with U.S. GAAP, see infra notes 90-94 and accompanying text. But see McConnell, supra note 4, at S122 (opining that compliance with SEC regulations is not an obstacle to foreign companies wishing to list securities in the United States).
world, but opinions vary over what — if anything — must be done in order to do so. If the United States is unable to maintain its competitive edge in the midst of growing internationalization, it will lose its investment banking activities, which employ "some of the most talented... individuals in the global business community," as well as the substantial international influence wielded by the country with the title of "global financial capital."  

2.1.2. Investor Interest in Foreign Stocks

Two types of investors exist in the market: retail investors and institutional investors. In the past, retail investors were the driving force behind the U.S. securities markets. In recent years, however, there has been a major increase in the role of institutional investors. By 1990, institutional investors held fifty-three percent of the value of publicly-traded U.S. equity and accounted for over seventy percent of the volume of U.S.-traded securities. This trend is important to bear in mind when evaluating U.S. securities regulations because "rules and regulations that might be quite attractive in markets dominated by retail investors can lead to substantial inefficiencies and distortions in markets composed of sophisticated institutional investors."

It also is important to consider why investors want to invest in foreign securities. First, international stocks can reduce the risk

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19 See discussion infra section 3.
21 Retail investors are individual investors. Institutional investors are entities such as insurance companies, investment companies, pension funds, and trust departments that invest large sums in the securities markets. See DAVID L. SCOTT, WALL STREET WORDS 178-79 (1988).
22 As late as 1975, retail investors dominated share holdings, owning 70% of total equities outstanding. See J. William Hicks, Securities Regulation: Challenges in the Decades Ahead, 68 IND. L.J. 791, 794 (1993).
23 See, e.g., Grundfest, supra note 1, at 6 (noting that this trend alone challenges the current U.S. securities laws, which were designed for a market characterized by the small, individual retail investor).
24 See Hicks, supra note 22, at 794.
25 See Grundfest, supra note 1, at 7.
26 Id.
of an investor's portfolio. Since the 1950s, basic portfolio theory has held that the risk of a portfolio of securities is less than the risk of the individual securities constituting the portfolio. Adding foreign securities to the portfolio can reduce risk even further because the returns of foreign securities have a relatively low correlation with the returns of U.S. securities. The Nikkei average, for example, has shown a very low correlation with the Standard & Poor's 500-stock index ("S&P 500") over the last five years, as have the markets in Malaysia, Portugal, Spain, and Switzerland.

Second, foreign securities can increase investors' returns. In 1995, the U.S. securities markets grew explosively, while foreign stock markets were "nowhere nearly as spectacular as the U.S. market." Prior to 1995, however, many foreign securities markets were outperforming the U.S. markets. The United States has been among the top five performing markets in the world only four times in the last thirteen years. A 1994 study compared a price index of 215 ADRs from twenty-six countries to the S&P 500 and found that the ADRs had outperformed the

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27 Investors commonly hold many different securities, and these combined holdings are referred to as a portfolio. See generally RICHARD A. BREALEY & STEWART C. MYERS, PRINCIPLES OF CORPORATE FINANCE 129-174 (4th ed. 1991).

28 See Harry Markowitz, Portfolio Selection, 7 J. FIN. 77 (1952). Diversification can be explained loosely as not putting all your eggs in one basket. More comprehensively, diversification eliminates the risk peculiar to a company (unique risk) because while most stocks are more variable than the market itself is, holding several stocks reduces the overall variability of the portfolio. See BREALEY & MYERS, supra note 27, at 129-74. This benefit does not improve significantly if a portfolio holds more than 20 to 30 stocks. See id. at 137.

29 See Smith, supra note 20, at 77.

30 See Glasgall & Lindoiff, supra note 11, at 97-98 (examining data from Morningstar, Inc., a Chicago financial research house).


33 See O'Hara, supra note 10, at 6 (stating that the United States was among the top five markets only three times in the last 12 years).

34 ADRs are essentially proxies for foreign stocks. See discussion infra section 2.2.
S&P 500 by twenty-five percent since 1992. A promising foreign stock such as that of Swiss food-maker Nestlé illustrates why foreign stocks are popular. Nestlé was expected to increase earnings more than eight percent in 1994, yet it sells at only fourteen times earnings; this in contrast to the U.S. corporation Procter & Gamble Co., which trades at seventeen times earnings.

2.2. Investing in Foreign Stocks

ADRs have existed since 1927 when Morgan Guaranty Trust Company invented the ADR as a way to permit Americans to invest in Selfridge’s Ltd., a London retailer. It has only been in the last decade, and particularly in the last few years, however, that the ADR has emerged as a widely utilized trading vehicle. ADRs are now the most common means by which U.S. investors trade foreign equity securities.

If an investor wants to purchase a foreign security by way of an ADR, she tells her broker, who then requests the overseas branch of the firm, or any other securities dealer within the issuer’s home country, to purchase the desired number of shares. Then the U.S. branch of the brokerage firm issues receipts representing the shares. Selling the shares simply involves reversing the procedure. Today, however, because of the great number of ADRs already trading in the United States, an investor (or rather, the investor’s broker) rarely has to follow this procedure. Instead, brokers simply match trades from their own supply of ADRs or, if necessary, buy from (or sell to) other firms.

ADRs can be traded on an exchange, on NASDAQ, or in the electronic over-the-counter market, which is commonly referred

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35 See Glasgall & Lindorff, supra note 11, at 97 (reporting a study by Markus E. Barth, a senior analyst at Merrill Lynch & Co.).
36 See id. at 98.
37 See id. at 99.
38 See id. at 97.
39 See id. at 96-97.
40 See id. at 100.
41 See id.
42 See id.
43 See id.
to as the pink sheet market due to the color of the paper on which securities orders were originally presented. ADRs carry the same voting rights as the stocks they represent. They also allow the holder to participate in rights offerings if the offering is registered with the SEC. If the offering is not registered, the bank holding the ADR sells the rights overseas and remits the profits to the investor.

ADRs are popular because they are more liquid, less expensive, and easier to trade than foreign stocks themselves. ADRs also have the advantage of trading in dollars, which makes the trades easier to monitor. In sum, "ADRs look, act, and smell like U.S. stock certificates." Investors can invest directly overseas but the rules for doing so are archaic, complex, and inconvenient. Thus, the "vast majority" of foreign securities trading within the United States do so via ADRs.

4 ADRs traded on the exchanges or NASDAQ are required to conform with both the Securities Act of 1933 and the Securities Exchange Act of 1934. See LOSS & SELIGMAN, supra note 15, at 154; see also discussion infra section 2.3.

45 See Glasgall & Lindorff, supra note 11, at 100.

46 See id.

47 See id.

48 See id. at 97.

49 See id. The fact that ADRs are traded in dollars, however, does not mean that there is no currency risk. Currency risk may be the biggest danger in trading foreign stocks, and ADRs do nothing whatsoever to eliminate that risk. For example, assume: (1) a Japanese company, X, whose stock trades at 10,000 yen; and (2) an exchange rate of 100 yen to the dollar. With these numbers, X's ADRs will sell for $100 per share. Now, assume the value of a share of X rises by 25% in Japan. If the exchange rate remains constant, X's ADR will appreciate by 25% to $125. On the other hand, if the yen depreciates to 125 yen to the dollar, X's ADR will not rise at all. If the yen falls even further, the ADR would actually decrease in value.


51 See Glasgall & Lindorff, supra note 11, at 99. To invest directly overseas, the investor has to open a foreign bank account, pay large brokerage commissions, high foreign exchange charges, and sizeable local taxes. See id. Alternatively, the investor can go through a U.S. broker but this too is expensive because brokers charge high fees in order to recover the costs listed above. See id. Most brokers also require a $25,000 minimum on all orders bought or sold. See id.

52 See Decker, supra note 50, at S13.
Qualified Institutional Buyers ("QIBs") have the additional option of purchasing privately placed foreign stocks. QIBs are defined under Rule 144A of the Securities Act as institutions that own or manage a portfolio of securities valued at more than $100 million (excluding securities already traded on a national exchange or on NASDAQ). Private placement eliminates the need to register under section 5 of the Securities Act, which can reduce costs by up to two-thirds, as well as the continuous reporting requirements of the Exchange Act, which saves additional costs.

2.3. Foreign Securities Offerings and Compliance with U.S. Securities Regulation

A foreign company that wants its shares to trade or wants to conduct an offering in the United States can choose any of three options: (1) conduct a private sale via Rule 144A of the Securities Act; (2) list its ADRs in the pink sheet market; or (3) list on one of the exchanges or on NASDAQ. ADRs listed in the pink sheet market are known as Level-One ADRs; ADRs listed on an exchange or quoted on NASDAQ are referred to as Level-Two ADRs; and ADRs that are used to issue new equity are sometimes referred to as Level-Three ADRs.

The vast bulk of ADRs are traded in the electronic pink sheet market. The pink sheet market is popular because it allows a foreign security to trade in the U.S. market at a lower cost than an exchange or NASDAQ listing. Level-One ADRs are less expensive to register for trading because the pink sheet market is

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53 See 17 C.F.R. § 230.144A(a)(1) (1995) (defining the term "qualified institutional buyer"); see also Roquette, supra note 8, at 582-83 (discussing the statutory definition of "qualified institutional buyer").
54 See 17 C.F.R. § 230.144A(a)(1).
55 See infra note 72.
56 See infra note 73.
57 See Roquette, supra note 8, at 585.
58 See Decker, supra note 50, at S13-20.
59 See Davis, supra note 10, at 110; Strauss, supra note 10, at 18.
60 See Strauss, supra note 10, at 18.
61 One advantage of being inexpensive is that foreign companies can use the pink sheet market to test demand for their securities. See id. If an ADR fizzles on the pink sheet market, it may not be worth the price of listing on an exchange or NASDAQ. See id.
significantly less regulated than the exchanges and NASDAQ. Level-One ADRs can trade in the United States upon the filing of an F-6 registration, which requires only the names of the company and the depositary bank. The reporting requirements for trading unlisted ADRs are equally simple. The company only has to furnish the same information that it provides to authorities and shareholders in its home country. A Level-One ADR can be formed and traded within eight weeks.

There are, however, disadvantages to trading in the pink sheet market. The pink sheet market offers no volume reporting, no last-sale reporting, and no real time quotes. Furthermore, very little easily accessible financial information exists about the companies whose securities are represented by the pink sheet ADRs. Overall, the pink sheet market is a less transparent, less liquid, and less regulated means of trading foreign equities. In the words of one industry researcher, "[a] fund manager's nightmare is holding an unlisted ADR and being unable to get a price when something goes wrong."

Moving from a Level-One ADR program to a Level-Two ADR program is a significant step, for Level-Two ADRs must conform with U.S. securities laws (with a limited number of exceptions discussed below). There are seven related but separate statutes governing federal securities law in the United States.

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62 See id.
63 See 17 C.F.R. § 239.36 (authorizing the use of Form F-6).
64 See id. § 240.12(g)(3)-2(b)(1) (exempting certain foreign issuers from the reporting requirements of § 12(g) of the Securities Act).
65 See Davis, supra note 10, at 110.
66 See James L. Cochrane, Are U.S. Regulatory Requirements for Foreign Firms Appropriate?, 17 FORDHAM INT'L L.J. 58, 61 (1994). Volume reporting refers to the number of shares of the security traded on a daily, monthly, or yearly basis. See SCOTT, supra note 21, at 381.
67 See Franklin R. Edwards, SEC Requirements for Trading of Foreign Securities on U.S. Exchanges, in MODERNIZING U.S. SECURITIES REGULATIONS, supra note 1, at 57, 62. Last-sale is the price at which the security last traded. See SCOTT, supra note 21, at 192.
68 See Cochrane, supra note 66, at 61. Real time quotes list the price at which offerors of the security are currently willing to sell.
69 See Edwards, supra note 67, at 62.
70 Davis, supra note 10, at 111.
71 The seven securities statutes are: the Securities Act of 1933; the Securities Exchange Act of 1934; the Public Utility Holding Company Act of 1935; the Trust Indenture Act of 1939; the Investment Company Act of 1940;
For the purposes of this Comment, however, only two are important: the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act").

The Securities Act requires registration with the SEC. Registration in turn requires certain financial disclosures. The Securities Act also prohibits fraud and deception in the offering of securities. The Securities Act primarily governs the distribution of securities and thus is important to foreign companies only if they wish to participate in a public offering in the United States.

If a foreign company has a registered security trading in the United States, or if a foreign company wants to list an already existing stock, it must comply with the Exchange Act. The Exchange Act requires continuous reporting and disclosures and, like the Securities Act, contains a general prohibition against fraudulent practices.

Both Acts require companies from other countries to provide

\[\text{the Investment Advisers Act of 1940; and the Securities Investor Protection Act of 1975. See generally LOSS & SELIGMAN, supra note 15, at 33-47 (briefly explaining the function of each act).}\]


\[73 \text{See id. §§ 78a-78kk.}\]

\[74 \text{Section 5 of the Securities Act requires users to register their securities prior to any offers to buy, offers to sell, sales, confirmation of sales, or delivery of securities. See id. § 78b. The SEC is the administrative agency responsible for enforcing the federal securities laws and has the additional charge of formulating rules that further the effectiveness of the securities laws. See Kosnik, supra note 2, at 597. The mission of the SEC can be summarized as a "mandate to ensure the integrity of the markets and the protection of investors." Id. The SEC was established by the Securities Exchange Act, 15 U.S.C. § 78d (1988 & Supp. IV 1992).}\]

\[75 \text{See 15 U.S.C. § 77g (listing the information that is required in the registration statement); id. § 77aa (listing the schedule of information that is required in the registration statement).}\]

\[76 \text{See §§ 12(a)(2), 11, & 17(a) of the Securities Act at 15 U.S.C. §§ 77k, 77l(2), & 77q(a).}\]

\[77 \text{See LOSS & SELIGMAN, supra note 15, at 34.}\]

\[78 \text{Section 12 of the Exchange Act establishes registration and reporting requirements. See 15 U.S.C. § 78g. Sections 13 and 15(d) require periodical and other reports. See id. §§ 78m, o(d). Foreign companies that file "home country" reports are exempt from the registration requirements of § 12(g). See 17 C.F.R. § 12(g)(3)-2. The reporting requirements, therefore, are generally limited to companies that trade on one of the exchanges or NASDAQ.}\]

\[79 \text{See 15 U.S.C. § 78i(b).}\]
greater disclosure than they are required to provide in their home countries: the United States has the most highly regulated exchanges in the world.\textsuperscript{80} The U.S. securities laws also provide for greater liability in cases of fraud and insider trading.\textsuperscript{81} Finally, and most importantly, in terms of the current controversy, the SEC requires foreign companies to report their financial data in accordance with U.S. GAAP. It is the combination of securities liability, a high level of disclosure, and the tedious and expensive process of reconciling accounting with U.S. GAAP that deters foreign companies from listing on U.S. exchanges.

Most foreign companies register with the SEC on Form F-1 for offerings and Form 20-F for listings.\textsuperscript{82} These forms are essentially the same.\textsuperscript{83} The "heart and soul" of the forms is a prospectus.\textsuperscript{84} From the standpoint of both investors and issuers, the most important portion of the prospectus is a discussion of the company's financial statements, related financial information, and risk factors.\textsuperscript{85}

Both forms require audited balance sheets for two fiscal years, statements of income, cash flow reports, and reports of changes in shareholders' equity.\textsuperscript{86} The two main obstacles to satisfying the requirements of these forms are the availability and the sensitivity of the information.\textsuperscript{87} Most foreign companies use the accounting standards of their home countries in their ordinary business affairs, and must therefore generate an audited reconciliation to U.S. GAAP.\textsuperscript{88} Reconciliation includes a discussion of the differences between the two standards as they affect net income and shareholders' equity.\textsuperscript{89}

\textsuperscript{80} See James D. Cox, Rethinking U.S. Securities Laws in the Shadow of International Regulatory Competition, 55 LAW & CONTEMP. PROBS. 157, 159-65 (1992).
\textsuperscript{81} See Daniel A. Braverman, U.S. Legal Considerations Affecting Global Offerings Shares in Foreign Companies, at 609 (PLI Corp. Law and Practice Course Handbook Series No. 907, 1995).
\textsuperscript{82} See Decker, supra note 50, at S16.
\textsuperscript{83} See id.
\textsuperscript{84} Id. at S17.
\textsuperscript{85} See id.
\textsuperscript{86} See id. at S17-18.
\textsuperscript{87} See id. at S18.
\textsuperscript{88} See id.
\textsuperscript{89} See id. Rule 4.01(a)(2) of Regulation S-X, which applies to both the Securities Act and the Exchange Act, requires foreign private issuers to either
Both conformance to and reconciliation with U.S. GAAP can be very difficult. Conceptually, this problem is the result of accounting standards that are designed to achieve different goals and to serve in different business environments. Accounting standards also are often developed in keeping with home-country tax law. Even in the United States, where accounting standards are designed by a private organization, the Financial Accounting Standards Board, the standards are tailored to fit U.S. tax laws. In other countries, such as Japan, the government promulgates accounting standards which likewise reflect home-country tax regulations.

Gathering the information necessary to produce the forms in accordance with U.S. GAAP is a "truly formidable task" that has the potential to be both time consuming and very expensive. Some of the information might not even be available. It is this task that many commentators believe deters foreign companies from listing in the United States and forces non-U.S. companies to other, less regulated, non-U.S. exchanges.

Once the initial registration and reporting requirements are completed, the Exchange Act still requires companies to report on a semi-annual basis. All of these disclosures must be made in

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90 See Hicks, supra note 22, at 798.
91 See Baumol & Malkiel, supra note 4, at 41.
92 See Hicks, supra note 22, at 799.
93 McConnell, supra note 4, at 126-27.
94 See id. at 127. The information that is most likely to be missing is certain footnote disclosures. See id. Footnote disclosures include items such as market value of investments on a historical basis, historical property, and plant and equipment data. See id.
95 Domestic companies are required to report quarterly, but an exception is made for foreign companies. See infra note 103 and accompanying text.
accordance with U.S. GAAP.96 The burden of these subsequent disclosures, however, is not as great as with the original filing because the foreign company can maintain its financial information using U.S. GAAP on a current basis without having to reconcile or refigure old information.

2.4. Recent Improvements for Foreign Issuers

Although the SEC has been unwilling to exempt foreign issuers from the requirements of the Securities and Exchange Acts and the concomitant reconciliation with U.S. GAAP, it has taken some steps to facilitate U.S. securities listings by non-U.S. companies. Indeed, some commentators have stated that in terms of the SEC’s willingness to accommodate and help foreign issuers, there has never been a better time to list in the United States.97

In 1993, the SEC made it easier for foreign companies to conduct offerings by reducing the public float requirement for the F-3 short form (an alternative to the lengthier F-1 form) from $300 million to $75 million.98 The SEC estimates that this change will increase the number of issuers eligible to use the short form by one-third.99 In addition, the SEC has lightened the disclosure burden by changing forms F-1, F-2, F-3, and 20-F.100 Foreign issuers are now able to disclose less information than U.S.

Foreign companies also are exempt from the proxy requirements of § 14 and the short-swing profit regulations of § 16 of the Exchange Act. See 17 C.F.R. § 240.3a12-3.

96 See id. § 210.4-01(a).

97 See Davis, supra note 10, at 112 (noting that the “SEC has become much more issuer-friendly”); Kosnik, supra note 2, at S98 (noting that it is the author’s experience at the SEC as Associate Director of the Office of International Corporate Finance that the last several years have produced “a dramatically different attitude toward regulating foreign issuers”); McConnell, supra note 4, at S127 (noting that in the author’s experience, the SEC is very flexible with regard to historical data missing from footnote disclosures); Roquette, supra note 8, at 570 (stating that “the SEC has acknowledged the need for flexibility”).

98 See Davis, supra note 10, at 112. Public float is the volume of publicly traded shares of a security. See SCOTT, supra note 21, at 140.

99 See Davis, supra note 10, at 112; Kosnik, supra note 2, at S103. Note that this change only makes the initial registration form shorter and does not ease the burden of reconciliation with U.S. GAAP or the subsequent requirements under the Exchange Act. See 17 C.F.R. § 239.33 (1995).

100 See Roquette, supra note 8, at 573.
issuers would have to disclose.\textsuperscript{101} For example, foreign issuers may be able to withhold information regarding management compensation.\textsuperscript{102} These changes, however, do not reduce the burden of reconciliation with U.S. GAAP.

Foreign companies have more leeway in reporting frequency. Although domestic companies are required to submit quarterly financial reports under the Exchange Act, foreign companies need only submit semiannual reports and provide information that they release in their home country.\textsuperscript{103} Rule 3-19 of Regulation S-X sets requirements for the age of financial statements of foreign issuers.\textsuperscript{104} Rule 3-19 previously required that the statements be not more than six months old,\textsuperscript{105} which took away some of the benefits conferred by not having to file Form 10-Q. Recently, however, the SEC has extended the age to ten months, thus easing the burden on foreign companies.\textsuperscript{106}

In addition to the minor technical changes, the SEC has made two more substantive changes in an effort to attract foreign issuers. These changes are implemented by Rule 144A\textsuperscript{107} and by a multi-jurisdictional disclosure system with Canada ("MJDS").\textsuperscript{108} The MJDS allows Canadian companies to meet most U.S. disclosure requirements by following Canadian law.\textsuperscript{109} This system is obviously very appealing: if the SEC expanded the scope of the MJDS to include European and Japanese companies, for example, the current debate would not exist because companies would not have to comply with U.S. securities laws. The Canadian disclosure system and the Canadian accounting principles, however, are very similar to those found in the United

\textsuperscript{101} See id. at 574.
\textsuperscript{102} See id.
\textsuperscript{103} See 17 C.F.R. §§ 240.13a-16, 249.306.
\textsuperscript{104} See id. § 210.3-19; Kosnik, supra note 2, at S102. Regulation S-X applies to both the Securities Act and the Exchange Act. See 17 C.F.R. § 210.
\textsuperscript{105} See Kosnik, supra note 2, at S102.
\textsuperscript{106} See id.; 17 C.F.R. §§ 210.3-19(b), (c).
\textsuperscript{109} This rule is limited to "substantial issuers," which are those companies meeting certain requirements in terms of total capitalization and public market float. See Roquette, supra note 8, at 576 n.46.
States.\textsuperscript{110} Other countries are less like the United States, and it is unlikely that the MJDS will be extended to other countries any time soon.\textsuperscript{111} Rule 144A was designed to allow trade in privately placed, and hence unregistered, securities.\textsuperscript{112} Although Rule 144A may attract foreign issuers to the United States,\textsuperscript{113} it only impacts the private market, and thus will not increase the number of publicly listed companies.

3. CONFLICT

3.1. Costs and Benefits

Before introducing the positions for and against relaxing listing standards for foreign companies, it is important to appreciate the factors that foreign companies consider when deciding where to conduct offerings or where to trade their securities. This section presents a brief overview of the economic framework of securities markets. First, companies are attracted to markets where capital is available and where there is a liquid secondary market. This reflects the elementary economic principles of supply and demand. The United States has traditionally been a very attractive market because of its great supply of capital and large trading volume.\textsuperscript{114} In fact, the recent trend towards privatization often involves companies that are so large, and which require so much capital, that the United States is the only market to which the country can turn.\textsuperscript{115}

On a more comprehensive level, it is a well-established economic principle that in order for capital markets to function

\textsuperscript{110} See id. at 576-77.

\textsuperscript{111} See id.


\textsuperscript{113} There is much debate over the efficacy of these programs, specifically Rule 144A. See Strauss, supra note 10, at 18 (noting that Rule 144A has fizzled); Vickie Kokkalenios, Increasing U.S. Investment in Foreign Securities: An Evaluation of SEC Rule 144A, 17 FORDHAM INT’L L.J. S179 (1994) (concluding that amendments to Rule 144A are necessary).


\textsuperscript{115} See generally id. at S4 (explaining the attractiveness of U.S. markets to foreign companies and addressing questions that foreign companies face concerning U.S. markets).
efficiently investors must have company-specific information. Investors need to have sufficient information to allow them to make calculations regarding the relative risk and return of the companies available for investment. At any given level of risk, a certain return must be offered relative to the market. Capital is distributed efficiently when the expected return, discounted by the risk factor, is maximized. An investor can select return-maximizing securities only when she has access to information regarding these factors.

An exchange with no regulation and no disclosure requirements is very favorable to issuers, who are not required to make potentially sensitive disclosures, file costly financial reports, or face potential liability for fraudulent or misleading statements or insider trading. An exchange with extremely strict regulations is very favorable to investors, who are provided with all of the disclosure they desire and are fully protected from insider trading and fraud. Investors will not trade on the ideal issuer exchange, however, because investors will not have access to information about the companies and their securities. Similarly, issuers will not — all else being equal — list on the ideal investor exchange if they have an alternative market.

The most economically efficient market lies between the two extremes. Depending upon how a given regulatory framework balances the interests of investors and issuers, the gains to investors from more detailed disclosure requirements may exceed the cost to issuers of producing that information; alternatively, the gains to issuers from not having to disclose may exceed the loss to investors.

From the investor’s standpoint, information is a good. If an investor can choose between two exchanges with companies offering equal risks and returns, the investor will not choose the market prone to higher levels of fraud, manipulation, or unfairness. The investor will discount the price of the security in

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116 See generally Cox, supra note 80, at 158-64 (explaining the economics of efficient capital markets).
117 See id. at 161-62.
118 “Ideal” is a relative term. Obviously a market with no investors is not ideal; this hypothetical exchange is ideal in terms of expense only.
119 See Cox, supra note 80, at 161-62.
120 See id. at 159.
each market by the likelihood of misconduct. Therefore, stocks will trade at somewhat higher prices on the more regulated market. This does not mean, however, that investors will always choose to invest in the more regulated market. If stocks that trade only on the less regulated market offer higher risk-adjusted returns than those available in the more regulated market, then the investor will choose the stocks on the less regulated exchanges. This is one of the reasons why U.S. investors are turning to the markets in foreign countries in spite of the fact that the U.S. securities market offers them more protection than any other market in the world.

A basic tenet of financial market economics is that if the marginal cost of additional disclosure requirements equals the marginal benefit from the disclosures, issuers and investors alike will be indifferent as to where they conduct their business. Applying this economic truism to the U.S. regulatory system, if the extra disclosures required in the United States do not exceed the additional benefits of the disclosure, then — all else being equal — investors and issuers will be indifferent between securities traded in New York or London. Until recently, the U.S. securities markets did not face any substantial competition. Consequently, the SEC could require high levels of disclosure without jeopardizing U.S. competitiveness. Internationalization, however, has changed the face of securities regulation dramatically. As the above economic analysis reveals, the United States can expect to lose foreign stock listings to other countries if the costs of listing in the United States exceed the benefits. Thus, while in the past the SEC did not have to concern itself with economics, it now has no choice but to consider the market implications of its actions.

121 See id.
122 See id. at 159-60.
123 See discussion supra section 2.1.2.
124 See Cox, supra note 80, at 160. This principle also can be applied to trade within the United States — a marginal cost/benefit analysis determines whether a company chooses to have its securities trade on the pink sheet market, on an exchange, or on NASDAQ.
125 See id.
126 See supra notes 1-5 and accompanying text.
127 See Grundfest, supra note 1, at 7.
3.2. The Status Quo

Richard Breeden, Chairman of the SEC between 1989-1993, has said that the listing requirement issue is not "about the profitability of the New York Stock Exchange, the NASDAQ, or the other American exchanges . . . , [or] about how many deals the brokers have to offer . . . [r]ather, this . . . is an issue of values and fundamental principles." According to Breeden, the very reason the United States has been able to establish such a successful exchange is the high level of confidence that the public has in the honesty and integrity of the market.

Public confidence in the market is important because "people do not participate in markets where they think they are likely to get cheated." In response to the argument that regulation is not necessary because the market will adjust prices to reflect the likelihood of cheating, supporters of the high level of disclosure required by U.S. securities regulations point out that even assuming this theory holds true, the problem is that the prices of both honest companies and dishonest companies will reflect the discount. Consequently, the cost of capital to all market participants rises, even though only a few companies are dishonest. As an illustration, consider a company trading in Germany, a market that has historically been subject to very little regulation.

129 See id. at S81.
130 Id. at S82.
131 This theory is put forth by some economists, although this extreme is accepted by a rather small circle centered in the University of Chicago. Most economists believe that there is at least some minimum level of disclosure that should be mandatory. See generally George A. Akerlof, The Market for "Lemons": Quality Uncertainty and the Market Mechanism, 84 Q.J. ECON. 488 (1970). This view is a reflection of three concepts. First, there is the "lemons problem," meaning that a few lemons (less than scrupulous companies) will make investors wary and raise capital costs for all companies, not just the dishonest ones. See id. (introducing the concept of the "lemons problem"). Second, given that disclosures are necessary — investors need information in order to invest — mandatory disclosures place the burden on the issuer, who can provide the information at the least cost. See Cox, supra note 80, at 161-62. Third, mandatory disclosures prevent investors from over-investing in research (this concept is closely related to the second concept). See id.
132 See, e.g., Foreign Companies, supra note 128, at S82.
One trait of the German accounting system is that companies are allowed to maintain reserve funds that allow companies to engage in "profit smoothing." Therefore, an individual investing in Germany will discount the price of German-listed companies to reflect the chance that a company may not be reporting its earnings accurately. The stock of all German companies is discounted to reflect the uncertainty caused by the hidden reserves even though many companies do not engage in profit smoothing. The discount means that everyone is forced to pay higher costs of capital than they would in a more efficiently priced market. Thus, mandatory disclosures often result in efficiency gains, making the United States' highly regulated market appealing to issuers.

Proponents of the current system also present an empirical argument that the United States continues to attract a great volume of capital in spite of its high level of disclosure. The U.S. capital market is the largest in the world, and proponents of the disclosure system submit that the United States has more investors, greater liquidity, and more foreign offerings than any other country because of its firm commitment to providing investors with the highest level of disclosures possible and to maintaining openness and integrity in the market. According to Richard Breeden, the relevant question is "[i]f you’re scoring a touchdown every time your team gets its hands on the ball, is that the time to radically change the rules of the game?"

Although investor protection was, and still is, the primary goal of the U.S. securities laws, the question of permitting different standards for foreign companies implicates additional objectives. One such objective is to maintain equal treatment for domestic companies. If U.S. companies have to disclose certain facts using U.S. GAAP rules, then so should foreign companies. Foreign companies building factories in the United States have to follow

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133 Profit smoothing occurs when companies under-report earnings in good years, reserving that money to bolster earnings in bad years. See Roberta S. Karmel, Living with U.S. Regulations: Complying with the Rules and Avoiding Litigation, 17 FORDHAM INT'L L.J. S152, S155 (1994).

134 See Foreign Companies, supra note 128, at S84-85.

135 See id. at S83-85.

136 Id. at S85.

137 See id. at S83.

138 See id. at S87-90.
U.S. environmental laws, not those of their home country,\textsuperscript{139} so why should securities laws be any different?

A final concern results from a long-standing U.S. policy that investors should be able to compare companies across industries and without regard for geography.\textsuperscript{140} Requiring reconciliation with U.S. GAAP allows investors to make meaningful comparisons across national boundaries. If the SEC permitted foreign companies to use home country accounting standards, some argue that investors would not be able to compare companies properly when deciding where to invest.\textsuperscript{141}

3.3. Arguments for Modification

Some critics of the present system support modifying the application of the securities laws to foreign companies:\textsuperscript{142}

\begin{quote}
[R]egulations that require reformulation of foreign earnings data to meet U.S. accounting standards may offer little, if any, protection to U.S. investors . . . . Such regulations can also harm the international competitiveness of the U.S. securities industry if they prevent U.S. exchanges from making markets in many of the largest corporations in the world.\textsuperscript{143}
\end{quote}

Many commentators see a need to "find some compromise whereby an issuer like Nestlé can move out of an over-the-counter electronic pink sheet market, which has no volume reporting and no real time quotes, to a listed market — NYSE, NASDAQ, or AMEX — which has more effective overall regulation, without requiring U.S. GAAP reconciliation."\textsuperscript{144}

\begin{footnotes}
\item[139] See id. at S88.
\item[140] See id.
\item[141] See id. at S88-89.
\item[142] Some commentators see the complete overhaul of the U.S. securities laws as necessary to the continued success of the U.S. financial market. See, e.g., Cox, supra note 80 (discussing the need for a wholesale revolution in domestic securities laws). This is an argument, however, that goes beyond the scope of this Comment, which suggests a more moderate, possibly temporary, solution. See discussion infra section 4.
\item[143] Baumol & Malkiel, supra note 4, at 39.
\item[144] Cochrane, supra note 66, at S61.
\end{footnotes}
Supporters of the status quo believe that the United States already has a regulatory system that will permit it to maintain its current position as the world's preeminent financial market.\textsuperscript{145} Those who support change, however, believe that the current rules incur costs greater than the benefits they provide to investors, and that as globalization of the world's financial markets continues, the forces of competition will keep issuers away from the U.S. market.\textsuperscript{146}

The international competitiveness argument flows directly from the economic basics introduced in the previous subsection. As other financial markets improve, in terms of both regulation and capital availability, any extra costs that exceed the benefits produced by those expenditures will force issuers to foreign exchanges or into the U.S. pink sheet market.\textsuperscript{147} Reconciliation with U.S. GAAP, the argument goes, is such a cost.\textsuperscript{148} Modification of the existing system is necessary in order to compete with foreign countries for listings.\textsuperscript{149}

In addition to the international competitiveness argument, some argue that investors cannot invest easily in foreign stocks. According to William Donaldson, a former chairman of the NYSE, U.S. investors are "missing out on some 2,500 foreign companies that would qualify to list on the NYSE."	extsuperscript{150} Many of these stocks offer investors the opportunity to seek greater rates of return than are available in the United States.\textsuperscript{151} Even if the average foreign security is more risky than the average U.S. security, the foreign securities still offer investors the ability to diversify their portfolios.\textsuperscript{152} These benefits are not as readily

\textsuperscript{145} See supra notes 128-41 and accompanying text.

\textsuperscript{146} See, e.g., Baumol & Malkiel, supra note 4; Cochrane, supra note 66; Edwards, supra note 67.

\textsuperscript{147} See supra notes 119-25 and accompanying text.

\textsuperscript{148} See Baumol & Malkiel, supra note 4; Cochrane, supra note 66; Edwards, supra note 67.

\textsuperscript{149} See id.

\textsuperscript{150} Strauss, supra note 10, at 17; see also Cochrane, supra note 66, at S61 (suggesting that the addition of 40 companies to the NYSE is negligible in view of an estimated 2,000 foreign companies that would be eligible to list were it not for the SEC regulations requiring U.S. GAAP disclosure).

\textsuperscript{151} See discussion supra section 2.1.2.

\textsuperscript{152} For a discussion of the benefits of trading in markets that are only loosely correlated with one another, see supra notes 27-30 and accompanying text.
available under the current regulatory regime.

One of the common arguments for allowing foreign issuers to list on the U.S. exchanges without U.S. GAAP reconciliation is that investors purchase foreign stocks anyway, either directly in the foreign market or, more often, through the use of ADRs traded in the pink sheet market. Thus, proponents of change argue that the current SEC rules do not protect investors, but rather force investors into less regulated, more expensive markets. Because investors want to add foreign stocks to their portfolios, institutional investors generally have to turn to overseas exchanges, while retail investors must resort to the pink sheet market.

Being forced to use foreign exchanges and the pink sheet market makes trading much more expensive than trading in listed stocks on the U.S. exchanges or on NASDAQ. In foreign countries, investors face considerably higher brokerage fees and are forced to pay higher bid-ask spreads. There also are higher clearance, settlement, and custody costs. These costs raise another concern, namely that these greater expenses are paid to foreign brokers rather than to U.S. brokers. Investing in the pink sheet markets is likewise more expensive. William Donaldson estimates that U.S. investors are forced to pay from eight to ten percent more than they would pay for listed stocks. Thus, investors are forced to trade in a relatively illiquid and costly market, as opposed to the heavily analyzed and liquid market for U.S.-listed securities.

Another contention of those who favor changing the current regulations is that the SEC relies on the incorrect assumption that foreign securities markets are less price efficient than the U.S. market. In other words, the SEC believes that the prices of

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153 See Edwards, supra note 67, at 64.
154 Although institutional investors are the primary purchasers of foreign securities, retail investors are indirectly hurt by the higher costs. See id. Many of the institutional purchases are made by pension funds and mutual funds, and the costs are passed on to individuals. See id.
155 See Cochrane, supra note 66, at S61.
156 See Baumol & Malkiel, supra note 4, at 43.
157 See id. at 42.
158 See id.
159 See Strauss, supra note 10, at 18.
160 See Edwards, supra note 67, at 64.
foreign securities are less likely to reflect the future earnings potential of foreign firms due to the different disclosure rules.\textsuperscript{161} This, however, is not necessarily so. First, it may be that some of the disclosures required by the SEC are not beneficial to investors. That is, it may be that not all of the disclosures required in the United States are necessary to effect efficient prices. Just because one country does not require certain disclosures does not mean that the prices of securities in that country will be less likely to reflect the earning potential of the companies the securities represent. Second, in response to the argument that inaccurate pricing will prevent investors from making informed choices, proponents of change insist that while U.S. investors may not be able to allocate funds between a U.S. company and a European company, they at least will be able to allocate funds efficiently between two European companies.\textsuperscript{162} Thus, if U.S. investors want to invest a certain percentage of their portfolios in foreign securities in order to increase their portfolios' diversity, they can choose efficiently between the companies that are to comprise that percentage.

It also is worth noting that different countries have different industrial and corporate structures, which may influence the efficiency of stock prices even without government regulatory intervention. In many countries, large owners play a more significant role than they do in the United States and consequently, stocks in these countries may be even more efficiently priced than those in the United States.\textsuperscript{163} Unlike in the United States, where banks are rarely major sources of capital,\textsuperscript{164} German companies have a history of obtaining much of their funding from large lenders.\textsuperscript{165} Consequently, lenders have had significant influence and access to information that allows them to value the company and determine the security of their lending transactions, which may therefore enable the market to arrive at efficient prices.

A related contention is that even if information is translated into U.S. GAAP, investors still will not be able to compare

\textsuperscript{161} See id. at 60.
\textsuperscript{162} See id. at 65.
\textsuperscript{163} See id.
\textsuperscript{164} See Karmel, supra note 133, at S155.
\textsuperscript{165} See id.
companies across national boundaries because different countries have different business practices. Assuming that accounting standards are a reflection of these differences, translating home country accounting figures into U.S. GAAP figures will provide only the illusion of comparability. Some even doubt that it is possible to compare U.S. companies accurately. Even with the same accounting standards there is considerable flexibility within the system, and hence a comparison of information provided by IBM and Exxon is not a comparison of apples to apples but apples to oranges. This concern is magnified when financial data is from a foreign company. Investors may find themselves misled due to their misinterpretation of the data.

Then again, investors might prove to be more sophisticated. In fact, some commentators doubt that potentially misleading foreign accounting procedures, such as reserve accounting, actually mislead investors. In the United States, companies sometimes "devote enormous ingenuity to the task of manipulating earnings reported to stockholders . . . by 'creative accounting' — that is, by choosing accounting methods which stabilize and increase reported earnings." A number of studies have concluded, however, that cosmetic changes undertaken to make a company appear to have had a more profitable quarter than it actually had are largely futile. In fact, the changes sometimes backfire in the long-run and result in stock price depreciation because investors are prone to conclude that such changes are a sign of financial weakness. One might therefore conclude that companies that use techniques such as income smoothing will be appropriately valued by investors. Furthermore, analysts who track foreign securities tend to rely more on financial statements based on the company's home country accounting standards than on U.S. GAAP-reconciled reports.

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166 See Baumol & Malkiel, supra note 4, at 42.
167 See id.
168 See Cochrane, supra note 66, at 566.
169 See Baumol & Malkiel, supra note 4, at 50.
170 See id. at 46-48.
171 BREALEY & MYERS, supra note 27, at 305.
172 See id. at 305-07.
173 See id. at 306.
174 See Cochrane, supra note 66, at 562.
In response to the SEC's contention that allowing foreign firms to list on the exchanges and NASDAQ with less than full compliance is unfair to domestic companies, proponents of change argue that in addition to being necessary, such listing is not unfair, and it will not be perceived as so unfair that U.S. companies would protest change.\textsuperscript{175} One high-level NYSE official claims that a large percentage of CEOs are reasonably objective and are prepared to accept changes that help maintain the strength of the U.S. securities markets, even though they do think such exceptions would be slightly unfair.\textsuperscript{176} Other commentators point out that U.S. issuers often can list their securities on foreign exchanges on an equal footing with domestic issuers.\textsuperscript{177} Moreover, the biggest hurdle is changing to U.S. GAAP, not maintaining an accounting system that operates under U.S. GAAP principles. China, for example, is implementing sophisticated accounting procedures for the first time, and many Chinese companies are choosing to utilize U.S. GAAP.\textsuperscript{178} U.S. companies have similarly "grown up" with U.S. accounting principles. In contrast, foreign companies from countries with established accounting systems — the United Kingdom, for example — have to reconcile financial data with an accounting system different from their own.\textsuperscript{179} This means foreign issuers have an additional burden: it does not seem inherently unfair that such burden is lessened or even eliminated.

Another argument is that the fairness concern implicitly assumes that the U.S. GAAP disclosures are not optimal — that they are not worth their expense. If U.S. GAAP is valuable to U.S. investors, then given a choice between two otherwise equivalent companies, they will be willing to pay more for securities of issuers whose financial data was produced using U.S. accounting standards. Domestic companies will thus enjoy a lower cost of capital relative to the foreign issuers that only provide disclosures using home country accounting standards.\textsuperscript{180}

\textsuperscript{175} See id. at S62-63.
\textsuperscript{176} See id.
\textsuperscript{177} See id. at S63.
\textsuperscript{178} See id. at S64.
\textsuperscript{179} See supra notes 88-89 and accompanying text.
\textsuperscript{180} See Edwards, supra note 67, at 69.
Both sides of the debate have the same goal: maintenance of the highly successful, highly profitable, U.S. securities market. The differences between the two sides result from their respective beliefs over how to achieve this goal. The United States must remain competitive, but it must also avoid a shortsighted "race to the bottom."182

A quick look at the U.S. pink sheet market supports the notion that disclosures are valuable to investors and issuers alike. Nestlé, a Swiss food-maker,183 trades in the U.S. pink sheet market, and therefore is not required to make any significant disclosures. Nonetheless, over the course of the past few years Nestlé has voluntarily provided investors with an increasing amount of information.184 Although Nestlé does not provide sufficient U.S. GAAP-based information to meet the demands of the Exchange Act, its increased level of disclosures has helped increase its trading volume in the United States.185 U.S. investors now own fifteen percent of Nestlé’s equity.186 Many other foreign companies likewise have begun to provide more information to investors.187 As investors are able to learn more and more about a company, the company’s cost of capital goes down because the discount resulting from investors’ lack of information is reduced, increasing the price the company is able to command for its stock.188

A similar trend is seen on many foreign exchanges, which are increasing disclosure requirements for listed companies. In Europe, the European Economic Community is working to

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181 Cochrane, supra note 66, at 559.

182 See Cox, supra note 80, at 163-64. The so-called “race to the bottom” theory is that competition between exchanges could lead to fewer and fewer disclosure requirements, eventually leaving all of the exchanges with suboptimal levels of regulations. See id.

183 See supra note 36 and accompanying text.

184 See Glasgall & Lindorff, supra note 11, at 102.

185 See id.

186 See Davis, supra note 10, at 112.

187 See id.

188 See discussion supra section 3.1.
harmonize exchange rules among member nations. Germany in particular has been adding disclosure and other requirements to what historically has been a largely unregulated exchange. Switzerland, whose markets traditionally have been nearly as unregulated as those in Germany, also is seeking to improve its competitive position by improving disclosure requirements.

The actions of foreign issuers and foreign exchanges imply that the level of disclosures in some—perhaps many—foreign countries is below the competitive equilibrium. Companies are releasing more information in order to compete with other companies for capital. Exchanges are pressed to increase mandatory disclosures in order to compete with other exchanges for listings. Increasing levels of disclosure in foreign countries and in the U.S. pink sheet market do not necessarily indicate, however, that the U.S. securities laws require an optimal level of disclosure. All that can be drawn from the activities in the market over the last few years is that some ideal level of mandatory disclosure exists. The United States has not found the perfect mix. Indeed, given that viable alternatives to the U.S. securities exchanges have only recently developed and that the historical lack of competition allowed the SEC to pursue a goal of nearly complete investor protection even if that came at the risk that the disclosures would cost the issuers more than they would benefit investors, it seems unlikely that the United States would have arrived at the equilibrium point. Other countries are probably underregulated from a competitive standpoint, but this does not mean that the United States is not overregulated.

Perhaps the most powerful argument for the status quo is that the United States is still home to the world’s most successful securities markets, and although issuers do turn to foreign exchanges and the pink sheet market, they also are listing on the exchanges and NASDAQ in record numbers. Supporters of the status quo, although acknowledging that the pink sheet market is home to more issuers than the exchanges or NASDAQ, point out that a study of the ratio of the growth of nonreporting ADRs to

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189 See Roquette, supra note 8, at 587-90.
190 See id. at 611-12.
191 See id. at 572.
192 See Cox, supra note 80, at 158 n.2.
reporting ADRs shows that in relative terms there is parity. These numbers, however, do not support the proposition that the SEC’s current regulations and insistence on GAAP draws issuers to the United States. In fact, the numbers suggest that it is not the regulatory system that has such a powerful draw, but rather a wealth of U.S. investors who have money and a desire to invest it. If the regulations were the primary attraction, the United States would have witnessed a preference for the exchanges, but it has not.

There are several ways to address the conflict over U.S. regulation of U.S.-traded foreign securities. One option would be to do nothing—preserve the status quo and hope that the U.S. financial industry does not go the way of the automobile or the consumer electronics industry. Another option would be to allow all foreign companies to list on the U.S. exchanges and NASDAQ, provided that they comply with their home country securities laws—but this is a radical suggestion urged by almost no one. An ideal option would be to establish international accounting standards and possibly even international disclosure standards. Indeed, the International Accounting Standards Committee is currently working to formulate international accounting standards. Unfortunately, given the number of years that it took to establish the MJDS with Canada, a country with disclosure and accounting standards similar to the United States, international accounting and disclosure standards are unlikely to be realized any time soon.

The NYSE has proposed that companies that qualify as “world-class” companies be allowed to trade on the U.S. exchanges and NASDAQ under relaxed standards. Issuers would still be required to register securities in accordance with

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193 See Edwards, supra note 67, at 62 (observing that “[o]nly a short time ago many [Americans] believed that the United State’s [sic] dominant positions in automobiles, electronics, computers, and other industries were impregnable”).

194 See Cochrane, supra note 66, at S65.

195 See Roquette, supra note 8, at 575.

196 “World-class” companies are those companies with five billion dollars in revenues, market capital of two billion dollars, an average weekly trading volume of one million dollars or 200,000 shares, substantial foreign share ownership, and which are listed on at least one major world exchange in addition to their home country’s exchanges. See Cochrane, supra note 66, at S63; Edwards, supra note 67, at 59.

197 See Edwards, supra note 67, at 59.
U.S. disclosure requirements, but they would not be required to reconcile with U.S. GAAP if the disclosures include a written explanation of any material differences between home-country accounting standards and U.S. GAAP. A similar approach would be to create a bifurcated exchange that recognizes the sophistication of institutional investors and allows them to trade in exchange-listed foreign companies without full regulatory compliance. Another approach would be to allow foreign issuers to list without full compliance if the listing indicates that the company does not follow U.S. GAAP.

None of these solutions address the concern that different requirements for domestic and foreign issuers disadvantages U.S. companies. Although it is clear that the United States faces international competition for stock listings, it is not so clear that allowing foreign issuers to list on U.S. exchanges without reconciliation with U.S. GAAP would in fact disadvantage domestic issuers. U.S. issuers can list their securities on foreign exchanges without changing their accounting standards. Furthermore, U.S. companies have always utilized U.S. GAAP, while foreign companies must undergo expensive and time-consuming procedures to comply with the U.S. standards. If the United States declines to force the foreign issuers to play catch-up with domestic issuers, this should not be perceived as dramatically unfair to domestic companies. Finally, any slight unfairness is justified in order to preserve the United States’ competitive position and to permit U.S. investors greater access to foreign securities.

There is a strong case to be made for completely overhauling the U.S. securities regulations, but that is an argument beyond the scope of this Comment. It is likely that the SEC needs to undertake an intensive economic analysis supported by empirical studies to determine the efficiency of the U.S. securities laws. Until that time, this Comment suggests that change is necessary. The United States should not wait to see if it loses yet another industry to international competition. By the time the United

198 See Cochrane, supra note 66, at 61-62.
199 See id. at 62; Strauss, supra note 10, at 17-18.
200 See generally Cox, supra note 80, at 157 (arguing for a “wholesale revolution in domestic securities laws”); MODERNIZING U.S. SECURITIES REGULATIONS, supra note 1 (containing a collection of articles on U.S. securities regulations from economic and legal perspectives).
States realizes that it has set its regulations at non-competitive levels, it may be too late.\textsuperscript{201}

This Comment argues that in the interest of international competition, the United States should experiment with different regulations.\textsuperscript{202} First, a bifurcated listing system should be created whereby, at a minimum, institutional investors are allowed to trade in "world class" stocks. The United States should begin by allowing world-class companies to trade on the U.S. exchanges and NASDAQ but should permit only institutional investors to invest in them.

If this is insufficient to attract issuers — that is, if issuers cannot be enticed solely by access to institutional investors — the SEC should allow retail investors access to the exchange but should maintain a distinct boundary between the foreign and domestic market.\textsuperscript{203} The SEC is worried that a scandal in which investors were misled by foreign accounting methods could severely harm investor confidence in the U.S. market, but by maintaining a distinction between the two types of listings, any loss in investor confidence could likely be contained to the market for foreign listings.\textsuperscript{204} This is not a radical solution, but rather a moderate accommodation that will give the SEC time to evaluate its regulations. This solution provides a means of preventing any irrecoverable loss in the global capital market

\textsuperscript{201} See Cochrane, supra note 66, at S58 (stating that "if we do not make the regulatory changes that will allow U.S. exchanges to fully participate in the growth of international trading, this . . . may undermine the preeminence among world capital markets that the U.S. capital market now enjoys"); Edwards, supra note 67, at 59 (stating that "in the next few years foreign exchanges could gain an irrevocable advantage").

\textsuperscript{202} See Grundfest, supra note 1, at 8-9. Grundfest suggests making changes on a limited basis and observing their effects in an effort to improve the functioning of the securities market. See id. His suggestions apply to deciding whether to disclose and how to disclose, as well as other regulatory concerns. See id. Grundfest draws an analogy to the decision by the Department of Treasury to engage in a year-long experiment using a new technique for auctioning U.S. Treasury Securities. See id.

\textsuperscript{203} Of course, any foreign issuers who fully comply with the U.S. securities regulations will be able to move to the domestic listings.

\textsuperscript{204} Note that the exchanges have proved resilient in the past. Although the stock market had its last big crash in 1987, investor confidence has been quite high since then. See, e.g., Baker, supra note 31 (discussing the U.S. securities markets' recent spectacular growth).
without jeopardizing the fruits of the current regulatory require-
ments.

5. CONCLUSION

The United States has developed highly successful securities markets, and the value of the U.S. securities regulations — as well as the efforts of the SEC — in creating this system is undeniable. The U.S. system, however, has developed with a bias towards investor protection, and while the lack of international competition once meant that this bias could be maintained without prejudicing the U.S. markets relative to foreign securities markets, the world is now a different place. The significance of institutional investors has supplanted that of retail investors, and the world has witnessed a major trend towards the internationalization of securities markets. The SEC must be alert to these changes and should take steps to lessen the burden on foreign issuers that want to list on the U.S. exchanges and NASDAQ. The SEC should begin by allowing institutional investors to trade in companies that are required to comply with the pertinent securities regulations but are not required to undertake reconciliation with U.S. GAAP — information prepared under home-country accounting standards should suffice. If this change is not sufficient, the SEC should consider allowing access to the same market by retail investors. Finally, the SEC should be mindful of economics and evaluate the current regulations with the knowledge that if the U.S. markets are not competitive, they will not survive.