

American Enterprise Institute

Conference

Current Policy Issues in Securities Regulation

Jonathan R. Macey

**Comment on “Internationalization of
Primary Public Securities Markets” by
Professor Hal S. Scott**

CORNELL LAW SCHOOL



Overview:

Interesting, provocative thoughtful, careful article.

Important contribution to the literature on international securities regulation

Some comments and one fundamental question (but you have to wait till slide 12 for my big question)

- Problem: Securities markets are not sufficiently international:
 - issuers cannot distribute securities worldwide using one “optimal” set of disclosure procedures, documents, liability standards and enforcement remedies



PROFESSOR SCOTT'S SOLUTION:

OFFSHORE FREE-ZONE

- Allow U.S. investors to be free to participate fully in the primary offshore markets for foreign issues **and allow foreign issuers freely to market their securities within the U.S.**
- Secondary market outside the U.S. would develop

On some of Professor Scott's arguments and assumptions:

(1) p. 71: definition of optimality? U.S. rules clearly are optimal for many U.S. issuers under his definition....

(2) pp. 75 – 78: The Economics of Disclosure

Professor Scott argues that disclosure is important and relevant; Nobody thinks that disclosure is unimportant. This is a straw man argument. The real issue is whether the market can generate a disclosure policy that is closer to optimal than SEC regulation.

Prof. Scott seems to think that the answer is yes (see p. 73).

(3) Philosophical Question?

Why doesn't he adopt the International unregulated private placement market as his template?

Professor Scott on harmonization:

harmonization can stifle innovation. Competition among regulators is an important source of regulatory reform and change. Professor Scott clearly is correct about this. What follows:

- (1) Good news: if Professor Scott is right that U.S. rules are not optimal, over time, regulatory competition will correct the problem;
- (2) Bad news: U.S. may lose its dominance position at the center of the world's capital markets along the way.

We begin with the question, why do firms issue securities in the U.S.?

Because the U.S. has the World's Biggest Pool of Liquidity (Scott p. 73)

Problem: U.S. rules regarding distribution procedures, disclosure documents, enforcement are not "optimal."

Professor Scott would make it easier for this liquidity pool to move off-shore.

Professor Scott's goal: to make it easier to move U.S. liquidity pool off-shore to give U.S. investors access to securities issued by foreign issuers.

This is not likely to sell very well, politically, because, under the Scott proposal, it would be cheaper (in terms of transaction costs) for a U.S. investor to buy a foreign security than to buy a U.S. security and cheaper for a foreign issuer to sell its securities abroad to U.S. investors than to sell its securities to U.S. investors here in the U.S.

- Practical Problems:
 - Proposal would favor foreign issuers over U.S. issuers;
 - Proposal would favor foreign secondary markets over U.S. secondary markets (Free trading off-shore right away);
 - US issuers would argue that they should be able to participate on equal footing with foreign investors for U.S. investors;
 - U.S. exchanges will argue that they should be able to trade these securities right away;
 - What if the offering is made off-shore but *limited to U.S. investors*, then there would be no recourse for fraudulent offerings.

Professor Scott (pp. 98-99) acknowledges that his proposal calls for “discrimination against ... U.S. issuers” but says that “this discrimination will not have a serious impact,” because “domestic issuers already must comply with a principal feature of U.S. regulatory regime” (US GAAP)

But if Professor Scott were right that “domestic issuers would not see great advantages from issuing abroad” then logic requires Professor Scott to acknowledge that foreign issuers would not see great disadvantages from issuing domestically.

- Registration under '34 Act, which requires registration by *any* company with > 500 equity holders and > \$10 million in assets
- Relief from '34 Act registration is available to issuers that have not chosen to use the facilities of the American securities markets. But if Prof. Scott's proposal goes into effect, there would be companies with *identical* shareholding populations (i.e. mostly American), but with different registration requirements under the '34 Act depending on whether they chose to use the facilities of the American securities markets.

· What is the point of Professor Scott's proposal? To create a place where U.S. investors can invest in the securities of foreign issuers without requiring that the issuers register.

· **MY FUNDAMENTAL QUESTION.....**

· **Why is this proposal superior to a proposal that would allow foreign issuers to sell in the U.S. under international documentation?** The only difference between Professor Scott's proposal and this proposal relates to the physical location of where the securities are traded. Presumably it is cheaper for U.S. investors to trade securities in the U.S. than it is for them to trade securities abroad. It seems to me that we should try to encourage issuers to issue and trade securities here rather than to encourage them to issue and trade securities in other countries.

The Problem is Political:

The problem with allowing foreign issuers to sell securities here under international standards rather than U.S. standards is that domestic issuers would argue that they should be able to do this, too. This is the same reason that the SEC is reluctant to allow foreign firms listing on US securities exchanges to use home country accounting rather than US GAAP.