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THE INTERNATIONALIZATION OF SECURITIES TRADING MARKETS

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ABSTRACT

The rapid growth of international equities trading appears certain to continue. Such markets provide additional profit opportunities for investors and expanded sources of capital for entrepreneurs. Computer and communications technology, improvements in links between exchanges and other financial institutions, deregulation, and an increasingly interdependent world economy have contributed to this growth. Problems remain, among others, as to the proper degree of regulation of this trading, the extent of protection or favorable consideration that should be accorded domestic as against foreign interests, and such technical difficulties as rapid and accurate clearance mechanisms.

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THE INTERNATIONALIZATION OF SECURITIES TRADING MARKETS

INTRODUCTION AND SUMMARY

One of the striking phenomena of today's world economy has been the spirited growth of trading of equity securities across national boundaries. This is, of course, only part of the growth in international financial transactions of all kinds, including notably that of Eurobonds, other foreign bonds, and foreign currencies. More and more investors are seeking profit, through diversification and hedging opportunities, by trading in equities of foreign companies. Similarly, corporations, when seeking capital funds, are often finding such capital on better terms abroad than in their domestic markets. Rapid advances in communications and computer technology are accelerating the ability of stock exchanges and security dealers to access stock information and negotiate transactions in markets around the world, and, increasingly, on a 24-hour-a-day basis. Links between stock exchanges across national boundaries and among stock information and clearing firms are being developed in many parts of the world. Major stock exchanges are listing stock of more foreign companies on their boards and are permitting foreigners to become members. Mutual funds and instruments such as American Depository Receipts (ADRs) have been created to facilitate purchases of foreign company equities. Large institutional investors, notably pension funds, have greatly increased their investment in foreign stocks. The gradual deregulation of national capital markets around the globe, together with the efforts of key regulatory agencies in major nations to bring their security regulations into closer alignment, have been both cause and effect of greater international equity trading. Legislation, such as the 1984 repeal by the United States of the withholding tax on interest paid to foreign holders of U.S. bonds, has helped businesses tap capital abroad. Hardly a day passes when one cannot note in the financial press some item relating to the acceleration in the growth of international securities trading and in the instrumentalities and technology that makes such growth possible.

Nonetheless, it should not be overlooked that significant risks in foreign investment and stock transactions, when compared to investments in domestic equity securities, remain. There is no international regulatory agency to coordinate market regulation by independent nations. Disclosure regulations and monitoring procedures for market transactons in many countries are much laxer than U.S. requirements and practices. Investors, in general, are far less familiar with foreign companies, their securities, and economic prospects than with domestic firms, and often find essential investment information difficult to obtain and interpret. The fluctuation of foreign exchange rates can significantly increase the risks and uncertainty of engaging in equity transactions across national boundaries. Some of the technology and transaction procedures that have been developed to speed international transactions and make them more accurate may prove to be costlier than the additional business they might create would justify. Clearing of international stock transactions remains time-consuming and frustrating to many investors and dealers. Finally, many national governments still provide more favorable treatment for domestic dealers or investors than they do for foreign companies. It should also be recognized that there will always be private and public institutions that will interpret steps to accelerate internationalization of securities trading as a threat to their own profitability or power and will. therefore, attempt to thwart, or at least slow down, specific measures designed to further such internationalization.

This report deals primarily with only a small segment of international capital flows, namely internationally-traded equities and the markets and investors dealing with these securities. There are several reasons for this focus. First, it is an area of growing importance as more and more U.S. investors are attracted to investing in foreign securities. Second, there is increasing interaction among the world's securities markets, reflected both in more and more ties among them which permit wider and more effective markets for investors, and in heightened competition among the world's stock exchanges. Third, and perhaps most important, is the problem of how much further the U.S. Government should go in protecting individual investors who participate, directly or indirectly, in overseas transactions. Such transactions often require dealing with foreign exchanges or brokerage firms with different rules from those prevailing in the United States. Frequently, they involve the additional risks of fluctuating foreign exchange rates. In addition, they commonly involve securities of companies with whose management and operations the U.S. investor is less familiar than with comparable domestic firms. Such protection might require either or both increased authority of the Securities and Exchange Commission or further international agreements and international machinery to settle disputes.

This report is intended to provide basic information on the following aspects of international equity trading, its expansion and its problems: a review of statistics on the growth of international financial transactions in general and equity trading in particular; the development of Eurobonds as the most significant precursor of international equity trading on a large scale; instrumentalities that have been developed to facilitate trading in equities across national boundaries; steps taken by stock exchanges and other institutions to increase their capacity to trade equities internationally; links established between exchanges and other institutions of different countries; problems related to protecting investors and other market participants in the growing international stock market; and possible approaches to resolving such problems.

I. GROWTH IN INTERNATIONAL CAPITAL MOVEMENTS BETWEEN THE UNITED STATES AND OTHER COUNTRIES

The post-World War II period has been one of an enormous increase in capital flows between the United States and the rest of the world, flows in both directions. On the one hand, there has been a substantial outflow of capital from the United States to foreign countries, including direct investment abroad by American corporations, American purchases of foreign securities, both bonds and stocks, and government loans and government purchases of foreign currencies.

Even greater has been the rise in foreign investment in this country in terms of both private investment and foreign government assets in this country. Both the Federal Government deficit and the trade deficit, as well as the attractions of the U.S. economy to foreign investors and business corporations, have contributed to this rise. Every year, a sizeable proportion of the borrowing by the Federal Government as a result of the fiscal deficit comes from foreign lenders. Today, the biggest market for U.S. Government securities outside New York is Tokyo. 1/ Similarly, the vast trade deficit means that foreigners are obtaining substantial dollar surpluses, much of which is invested in this country. The rise in foreign investment in the United States has, in fact, been so substantial that, combined with a decline in U.S. investment abroad, in 1985 we became a net debtor nation for the first time since 1914, as has been widely noted in the business press.

1/ Calvin, Donald L. Testimony before the Committee on Banking, Housing, and Urban Affairs, United States Senate. Washington, February 26, 1986. p. 3.

TABLE 1. International Investment Position of the United States At Year-End, Selected Years, 1970-1984 ($ millions)

	1970	1973	1976	1979	1982	1983	1984
U.S. Assets Abroad	$165,385	$222,430	$347,160	$510,563	$838,962	$893,826	$914,693
U.S. Private Assets	118,755	169,245	282,418	433,184	730,676	780,833	795,125
Direct Investment Abroad	75,480	101,313	136,809	187,858	221,843	226,962	233,412
Foreign Securities	20,892	27,446	44,157	56,800	75,672	84,270	89,875
Bonds	14,319	17,420	34,704	41,966	56,698	57,719	61,973
Corporate Stocks	6,573	10,026	9,453	14,834	18,974	26,551	27,902
U.S. Claims a/	22,383	40,486	101,452	188,526	433,161	469,601	471,838
U.S. Official Reserve Assets b/	14,487	14,378	18,747	18,956	33,957	33,748	34,933
Other U.S. Govt. Assets c/	32,143	38,807	45,944	58,423	74,329	79,246	84,635
Foreign Assets in the United States	106,912	174,536	263,582	416,106	691,975	787,611	886,448
Foreign Assets, Excluding Official Assets	80,761	105,270	159,137	256,254	502,787	593,106	687,427
Direct Investment in the U.S.	13,270	20,556	30,770	54,462	124,677	137,061	159,571
U.S. Treasury Securities	1,194	958	7,028	14,210	25,802	33,922	56,870
Other U.S. Securities	34,786	46,116	54,913	58,587	93,567	114,710	128,201
Corporate and Other Bonds	7,577	12,600	11,964	10,269	16,805	17,454	32,290
Corporate Stock	27,209	33,516	42,949	48,318	76,762	97,256	95,911
U.S. Liabilities to Unaffiliated Foreigners reported by U.S. Nonbanking Concerns	8,831	11,712	12,961	18,669	27,459	26,790	30,488
Other U.S. Liabilities Reported by U.S. Banks	22,680	25,928	53,465	110,326	231,282	280,623	312,297
Foreign Official Assets in the U.S. d/	26,151	69,266	104,445	159,852	189,188	194,505	199,021
Net International Investment Position of the United States	$58,473	$47,894	$83,578	$94,457	$146,987	106,215	28,245

a/ Consists of U.S. claims on unaffiliated foreigners reported by U.S. nonbanking concerns and U.S. claims reported by U.S. banks not included elsewhere.

b/ Consists of gold, special drawing rights, reserve position in the International Monetary Fund, and foreign currencies.

c/ Consists of U.S. loans and other long-term assets, U.S. foreign currency holdings, and U.S. short-term assets.

d/ Consists U.S. Government securities, other U.S. Government liabilities, largely associated with military sales contracts, U.S. liabilities not included elsewhere, and other foreign official assets.

Source: U.S. Department of Commerce. Bureau of Economic Analysis. Survey of Current Business, June 1985. p. 27.

Some of the basic statistics of international capital movements for the period from year-end 1970 to year-end 1984 are shown in table 1. As that table shows, the total of U.S. assets abroad rose from $165 billion at the end of 1970 to $914 billion on December 31, 1984, while, for the same period, foreign assets in the United States increased from $107 billion to $886 billion. The net international investment position of the United States (U.S. assets abroad minus foreign assets in the United States) reached a high of $147 billion at the end of 1982, but has been dropping sharply since then, down to $28 billion by December 31, 1984, and became a minus quantity in 1985.

Among the major segments of U.S. assets abroad, the growth from the end of 1970 to the end of 1984 is noteworthy in the following areas: direct investment abroad up from $75 billion to $233 billion, foreign securities up from $21 billion to $90 billion; and bank loans to industrial and third-world countries up from $14 billion to $443 billion.

Similarly, the even greater relative growth of foreign assets in the United States for the same period, from the end of 1970 to the end of 1984, includes direct investment of foreign firms in the United States up from $13 billion to $160 billion, investment in corporate securities up from $35 billion to $124 billion, private holdings of U.S. Government securities up from $1 billion to $57 billion, foreign bank loans to U.S. firms up from $23 billion to $312 billion, and foreign government holdings of U.S. government securities up from $18 billion to $143 billion.

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1988. 2/ This would, as noted by Gordon Macklin, President of the National Association of Securities Dealers (NASD), mean an increase in the cross-border share of world equity trading from less than 12 percent to more than 16 percent of the total. 3/ The New York Stock Exchange reports that 200 U.S. companies were listed on the London Stock Exchange (as of September 1985), 45 on the Paris Bourse (as of December 1984), and 10 on the Tokyo Stock Exchange (as of June 1984).

All told, United States brokerage firms now have over 250 branches in 30 countries (exclusive of Canada and Mexico), while nearly 100 foreign brokerage firms have branches in the United States. 4/

Merrill Lynch International has over 600 international account executives in 48 offices in 28 countries other than those in the United States and Canada. It has enlarged its international research department from 8 to 30 analysts in the last two years. Merrill Lynch trades Japanese, Amsterdam, Singapore, and Hong Kong stocks on a 24-hour basis. 5/

InterSec Research Corporation estimates that U.S. pension funds have been increasing their investments in foreign securities at a rapid rate. In 1981 such funds were estimated at $6 billion; they rose to $16 billion in 1984, $26 billion in 1985 and are expected to reach over $33 billion in 1986. 6/ Nonetheless, the

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2/ Arthur Andersen & Co. and Securities Industry Association. Keys to a Changing Securities World. Chicago, 1985. p. 8-9.

3/ Macklin, Gordon. Letter to John Wheeler, Secretary, Securities and Exchange Commission. November 4, 1985. p. 1.

4/ Ibid., p. 3.

5/ Ibid., p. 2, 3.

6/ Feder, Barnaby J. Foreign Equities Gain Favor. New York Times, January 3, 1986. p. D1.

$26 billion invested abroad in 1985 represented only about 1 percent of the total retirement funds in the United States. Nineteen percent of U.S. pension funds made investments in overseas securities during 1983 and another 9 percent were expected to begin making such investments in 1984.

On the other hand, the Securities Industry Association in October 1985 estimated that about 10 percent of the volume on the New York Stock Exchange is now attributable to foreign investors. 7/ The Japanese have been rapidly increasing their purchases of foreign, especially American, equities. A monthly record was established in June 1985 when $533 million in foreign equities was purchased by Japanese investors.

There has been a rapid increase in the number of stock issues which are termed international equities, i.e., stock having an active and liquid market in at least one center outside of the home base of their corporate issuers. According to the monthly Euromoney, there were 236 international equities in December 1983 and 328 at the end of 1984. John Shad, Chairman of the Securities and Exchange Commission, estimates that double the 1984 figure of 328 international securities are likely to be actively traded around the clock and around the world within five years. 8/

As may be seen from table 2, the home base for the largest number of these corporations issuing equities that are traded internationally in 1984 and 1985 was the United States, followed by Japan. Combined, these two countries accounted for 56 percent of all the corporations with international equities in December 1983 and 47 percent in December 1984.

7/ Securities Industry Association. Federal Regulation Committee and Corporate Finance Committee. Letter to John Wheeler, Secretary, Securities and Exchange Commission. October 17, 1985. p. 2.

8/ Shad, John. Major Efforts and Issues at the SEC. Address before the Council of Institutional Investors. Atlanta, Georgia, October 29, 1985. p. 5.

Table 3 gives a further breakdown of the 328 leading international equities at the end of 1984, giving both the number of companies involved and the market value at year end of the equities of these companies both by country and by industry. Data are shown for 13 separate countries and 20 industry groups. As can be seen, the total market value of all the international equities, as defined by Euromoney, at the end of 1984 was over $1 trillion. The leading industries, by market size, were energy ($187 billion), computers, copying equipment and photographic equipment ($156 billion), electronics ($102 billion), consumables (food,

TABLE 2. Number of International Equities a/
by Home Base Country of Issuing Corporation
1984-1985

	1984		1985	
	Number	Percent	Number	Percent
Total	236	100%	328	
United States	84	35.6%	85	25.9%
Japan	49	20.8%	65	19.8%
Australia	16	6.8%	25	7.6%
United Kingdom	13	5.5%	25	7.6%
West Germany	17	7.2%	22	6.7%
Canada	12	5.1%	15	4.6%
Netherlands	7	3.0%	13	4.0%
Hong Kong	5	2.1%	11	3.4%
France	1	0.4%	11	3.4%
Sweden	10	4.2%	10	3.0%
South Africa	7	3.0%	10	3.0%
Italy	2	0.8%	9	2.7%
Switzerland	5	2.1%	9	2.7%
All other b/	8	3.4%	18	5.5%

a/ Stock having an active and liquid market in at least one center outside of home base of its corporate issuer.

b/ Includes Belgium, New Zealand, Denmark, Norway, Singapore, and Malaysia for 1984 and 1985, and Spain and Mexico for 1985 only.

Source: Euromoney. May 1984 and May 1985.

TABLE 3. Leading International Equities a/
by Country and Industry, 1984
(number of companies and market value at year-end 1984, $ billions)

	Total All Countries	United States	Japan	Australia	United Kingdom	West Germany	Canada	Netherlands	Hong Kong	France	South Africa	Sweden	Switzerland	Italy	All Other
Total, All Industries	328 $1,027.0	85 $554.6	65 $201.7	25 $18.1	25 $73.8	22 $45.4	15 $34.8	13 $25.4	11 $10.9	11 $7.9	10 $9.6	10 $6.2	9 $20.2	9 $6.7	18 $11.6
Automobiles	15 $72.9	4 $37.5	3 $21.9	0 —	1 $0.5	5 $11.2	0 —	0 —	0 —	1 $0.3	0 —	0 —	0 —	1 $1.5	0 —
Business and Public Sectors	6 $5.2	0 —	1 $1.6	0 —	2 $1.7	0 —	0 —	1 $0.3	1 $1.0	0 —	0 —	0 —	1 $0.5	0 —	0 —
Chemicals	24 $58.6	6 $26.7	8 $11.2	0 —	2 $6.6	3 $8.8	0 —	1 $1.0	0 —	0 —	1 N.A.	0 —	1 $3.1	1 $0.7	1 $0.5
Consumables (Food, beverages, tobacco)	24 $82.6	12 $60.5	0 —	0 —	4 $9.7	0 —	1 $3.6	2 $3.6	0 —	4 $2.8	0 —	0 —	1 $2.3	0 —	0 —
Computers, Copying Equipment, and Photographic Equipment	32 $156.1	10 $117.6	16 $34.7	0 —	1 $0.7	1 $1.2	0 —	1 $0.2	1 $0.1	0 —	0 —	0 —	0 —	1 $1.2	1 $0.5
Electronics	23 $102.2	3 $33.1	9 $43.8	0 —	4 $11.7	2 $7.0	0 —	1 $3.3	0 —	1 $0.4	0 —	3 $2.9	0 —	0 —	0 —
Energy	27 $186.9	13 $136.7	0 —	5 $5.5	2 $18.7	0 —	3 $8.1	1 $12.9	0 —	1 $2.3	0 —	0 —	0 —	0 —	2 $2.6
Financial Services	30 $93.8	5 $19.7	6 $41.6	3 $3.6	0 —	4 $8.8	0 —	3 $3.1	1 $2.9	0 —	2 $1.2	0 —	3 $9.8	0 —	3 $3.1
Forest Products, Housing, and Construction	8 $4.2	1 $0.9	1 $0.5	2 $1.2	1 $0.2	0 —	1 $0.6	0 —	0 —	0 —	1 $0.1	1 $0.7	0 —	0 —	0 —
Health and Personal Care	25 $56.7	7 $28.0	6 $11.7	0 —	3 $8.7	1 $0.7	0 —	1 $0.3	0 —	1 $1.0	0 —	2 $1.4	2 $3.9	1 $0.4	1 $0.6
Industrial Components	7 $12.2	2 $7.4	2 $3.4	0 —	0 —	1 $0.6	0 —	0 —	0 —	0 —	0 —	1 $0.4	0 —	1 $0.3	0 —
Industrial Equipment	10 $15.1	3 $8.4	3 $4.4	0 —	1 $0.6	1 $1.1	0 —	0 —	0 —	0 —	0 —	2 $0.6	0 —	0 —	0 —
Leisure	3 $2.2	1 $1.4	0 —	0 —	0 —	0 —	0 —	0 —	0 —	1 $0.4	0 —	0 —	0 —	0 —	1 $0.5
Merchandising	10 $24.6	4 $19.7	1 $2.9	1 $0.8	0 —	0 —	0 —	0 —	0 —	2 $0.7	0 —	0 —	0 —	1 $0.3	1 $0.2
Metals	11 $18.4	3 $6.8	3 $6.0	0 —	0 —	1 $0.7	2 $4.5	1 $0.3	0 —	0 —	0 —	0 —	0 —	0 —	1 $0.1
Mining	21 $15.6	2 $1.4	0 —	10 $5.1	1 $1.1	0 —	4 $2.4	0 —	0 —	0 —	4 $5.7	0 —	0 —	0 —	0 —
Multi-Industry (Conglomerates)	23 $37.0	3 $14.0	2 $3.5	3 $1.5	2 $6.4	0 —	2 $5.6	0 —	4 $3.0	0 —	1 $1.0	1 $0.2	0 —	2 $0.6	3 $1.3
Real Estate	4 $2.9	0 —	1 $1.2	0 —	0 —	0 —	0 —	0 —	2 $1.6	0 —	0 —	0 —	0 —	0 —	1 $0.1
Telecommunications	9 $45.0	2 $22.8	1 $1.2	0 —	1 $7.3	0 —	2 $10.0	0 —	0 —	0 —	1 $1.7	0 —	0 —	1 $1.7	1 $0.2
Transportation — Shipping and Airlines	8 $15.6	3 $10.3	1 $2.8	1 $0.4	0 —	1 $1.0	0 —	1 $0.5	0 —	0 —	0 —	0 —	1 $0.5	0 —	0 —
Utilities	8 $19.4	1 $1.7	1 $9.3	0 —	0 —	2 $4.2	0 —	0 —	2 $2.4	0 —	0 —	0 —	0 —	0 —	2 $1.8

a/ Corporate stock having an active and liquid market in at least one market outside the home base of the company issuing the stock.

Source: Greig, Katherine, Charles Hildeburn, and Quek Peck Lim. The Corporate List: The Surge in International Equities. Euromoney, May 1985. p. 121-151.

beverages, tobacco) ($83 billion), and automobiles ($73 billion). These six industries accounted for 68 percent of the market value of all international equities at the end of 1984. United States and Japanese-based corporations accounted for 75 percent of the market value of all international equities.

Tables 2 and 3, above, provide one indication of the dominance that the United States, followed by Japan, exercises in international equity trading. Another measure, shown in chart 1, shows the percent share of the world equity market by the major stock exchange in each country. The measure of the world equity market in this chart is the total market value of equities traded on each of the exchanges shown. The New York Stock Exchange (NYSE) is, of course, far and away the world's largest financial market, embracing a little over half of the globe's $3.5 trillion in equity capital. 9/ Tokyo comes in second, with 21 percent of the world equity market, followed by London with nearly 8 percent. These three thus account for 80 percent of the equity trading on the major exchanges of the world.

It is, thus, not surprising that New York, London, and Tokyo are increasingly being recognized as the three focal centers for international equity trading, each predominant in its particular segment of the globe. This position is being viewed with some apprehension by officials of other stock exchanges and of governments of countries who find their own stock exchanges' business and influence shrinking.

As Richard Kirkland, Jr., writing in Fortune in 1985, stated:

> The worldwide market will crystallize into three centers, each dominant in its own time zone -- New York, London, and Tokyo. If Europe's other exchanges continue to liberalize and modernize, they can become strong regional markets, bearing the same relationship to

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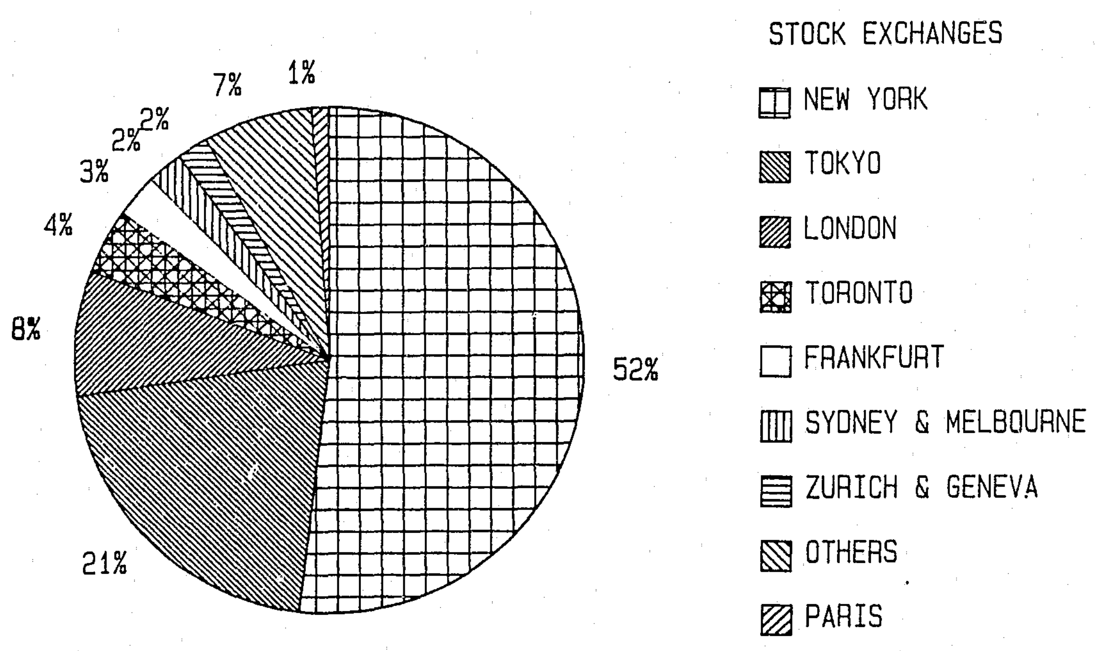
9/ Berss, Marcia. Tomorrow the World. Forbes, July 2, 1984. p. 104.

CHART 1. Percent Share of World Equity Market
(Value of Listed Shares, by Exchange)



Source: Berss, Marcia. Tomorrow the World. Forbes, v. 134, July 2, 1984. p. 106.

London as, say, the New Orleans exchange to New York. If they don't, they could travel swiftly from irrelevance to extinction. 10/

10/ Kirkland, Richard I., Jr. The Stock Market...Upheaval in Europe. Fortune, October 14, 1985. p. 158.

II. THE EUROBONDS AND EUROCURRENCIES SINCE THE EARLY 1960S

The phenomenal increase in Eurobond and Eurocurrency transactions since the early 1960s has been a major development in international finance and has, in many ways, been a model for the rise in international equities trading, the increase of which, in general, came more recently than the bond increase. As was shown in table 1, both U.S. investment in foreign bonds exceeded investment in foreign stocks, and foreign investment in U.S. corporate bonds exceeded foreign investment in U.S. corporate stocks.

A. Eurobonds

There have been various definitions of a Eurobond, definitions which, rather than contradicting each other, simply stress various characteristics it possesses. Perhaps the simplest definition is that a Eurobond is a bond denominated in currencies other than that of the country in which the bond is sold, such as dollar-denominated Eurobonds sold in London. A Eurobond has also been defined as a long-term bond underwritten by an international syndicate of banks and marketed internationally in countries other than the country of the currency in which it is denominated. The issue is, thus, not subject to national restrictions. It is important to note that Eurobonds are not limited to bonds issued in Europe. More properly, the word "external" should be substituted for the prefix "Euro." This holds true not only for the term Eurobond, but for the related terms, Euromarkets and Eurocurrencies.

Since a Eurobond is usually offered for sale simultaneously in a number of countries, its currency denomination is foreign to a large number of buyers. This characteristic of Eurobonds, being offered for sale in a number of countries at the same time, is one that distinguishes them from foreign bonds, which have been in existence far longer than Eurobonds. Eurobonds first made their appearance in 1958. The foreign bond is a long-term security issued by a borrower company of one country in the national market of one other country. Underwritten by a syndicate from that other country alone, and sold only on that country's capital market, the foreign bond is denominated in the currency of the single country in which it is marketed. An example of a foreign bond is the so-called Yankee bond, which is a dollar obligation of a non-U.S. firm underwritten and sold in the United States.

Although the beginnings of Eurobonds can be traced back to 1958, the first main impetus to their growth was the imposition by the United States Congress of the Interest Equalization Tax (IET) in July 1963. As a 1983 CRS Report has noted,

> Prior to 1963, many foreign governments and companies had issued foreign bonds in the United States because of the lower interest rates and the more highly developed capital market in the United States. The IET, however, reduced the after-tax yield on foreign bonds to U.S. investors, and foreign borrowers began issuing bonds in European capital markets. 11/

Even after the IET and controls on U.S. direct investment abroad were terminated in 1974, foreign companies and governments continued to be important issuers of Eurobonds and the by then firmly established Eurobond markets have continued to flourish.

11/ U.S. Library of Congress. Congressional Research Service. Eurodollars, Eurocurrencies and Eurobonds: Description and Growth. Typed Report, by Arlene Wilson. Washington, August 31, 1983. p. 10.

The rapid rise in the issuance of Eurobonds and other international bonds since 1970 is shown in table 4. Total Eurobond issues rose from under $3 billion in 1970 to nearly $80 billion in 1984 and to over $67 billion in the first half of 1985. During most of the years in this period, Eurobonds denominated in United States dollars accounted for over half of all Eurobonds. Over the three-year period, 1982-1984, they accounted for over 80 percent of all Eurobonds.

There are important reasons for this rise in Eurobonds, both on the demand and supply sides. The supply of Eurobonds was originally created primarily as a more efficient way to help finance national payment deficits and, increasingly, as a source of funds by corporations when such funds are obtainable at more advantageous terms than from domestic markets. Demand for Eurobonds by investors reflected the significant growth in world savings, plus the relatively greater attraction of fixed-income securities over other such forms of investment as property and equities. As M.S. Mendelsohn noted in 1980:

> Fixed-interest investment in strong currencies, for which the international bond market provides an opportunity, was actually one of the few investments which proved profitable in real terms in the world climate of the late 1960s to the late 1970s. It was that consideration which attracted a growing proportion of institutional investment into Eurobonds and other international bonds during the decade. And it did so without any special tax advantage for institutional investors, most of which were exempt from tax liability by their official status or offshore domicile. But in the case of individual investors, exemption from withholding for tax on the income from all classes of international bonds is an overriding consideration, far outweighing any other attractions. 12/

The rise in Eurobond markets has certainly been expedited by important technological advances in computerization and communications. For example, two organizations, Euro-clear and Cedel, have developed highly efficient systems for clearing Eurobond transactions. "Euro-clear is now probably the largest

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12/ Mendelsohn, M.S. Money on the Move, the Modern International Capital Market. New York, McGraw-Hill, 1980. p. 182.

TABLE 4. International Bond Issues
1970-1985
($ U.S. millions)

	(1) Eurobonds Total (cols. 2+3)	(2) Eurobonds ($ U.S.)	(3) Eurobonds (Other Currencies)	(4) Foreign Bonds (outside U.S.)	(5) Foreign Bonds (inside U.S.)	(6) Total (cols. 1+4+5)
1970	$2,966	$1,775	$1,191	$378	$1,216	$4,560
1971	3,642	2,221	1,421	1,538	1,104	6,284
1972	6,335	3,908	2,427	2,060	1,353	9,748
1973	4,193	2,447	1,746	2,626	1,019	7,838
1974	2,134	996	1,138	1,432	3,291	6,857
1975	8,567	3,738	4,829	4,884	6,460	19,911
1976	14,328	9,125	5,203	7,586	10,602	32,516
1977	17,735	11,628	6,107	7,185	7,286	32,206
1978	14,125	7,290	6,835	14,359	5,795	34,279
1979	18,726	12,565	6,161	17,749	4,515	40,990
1980	23,970	16,427	7,543	14,521	3,429	41,920
1981	31,616	26,830	4,786	13,817	7,552	52,985
1982	51,645	43,959	7,686	20,451	5,946	78,042
1983	48,501	38,428	10,073	23,283	4,545	76,329
1984	79,458	63,593	15,865	22,466	5,487	107,411
1985	136,746	97,782	38,964	26,318	4,655	167,719

Source: Morgan Guaranty Trust Co. World Financial Markets, various issues.

securities settlement system in the world, clearing more than $1 trillion a year in negotiable securities, almost as much as the New York and Tokyo Stock Exchanges combined." 13/

Although Euro-clear was established as a Eurobond clearing institution, it now is planning to provide the service of clearing equities through its network of 1,600 participating financial institutions around the world. Cedel already handles the clearing of some 400 stocks. For both, bond clearing remains the

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13/ Clearing the Way to Globalization. Euromoney, October 1985. p. 268.

predominant portion of their business. This, of course, reflects in part the fact that bond trading internationally still greatly exceeds stock trading. (See table 1 on page 6, and page 15 above.)

B. Eurocurrencies

The growth in Eurocurrency markets has, in large measure, paralleled that of Eurobond markets, and, for purposes of this report, is dealt with only briefly. 14/ This growth can be seen from an examination of table 5.

A Eurocurrency can be defined generally as a currency deposited in banks located outside the country issuing the currency. Thus, Eurodollars are dollar deposits in banks located outside the United States. The Eurodollar market is, in fact, the major component of the Eurocurrency market. Financial institutions dealing in Eurocurrencies are called Eurobanks. They simultaneously bid for time deposits and make loans in one or more currencies other than that of the country in which they are located. 15/

As a 1983 CRS report has stated:

> Eurobanking markets locate and grow in particular areas because of favorable regulatory and tax climates (often conscious decisions on the part of governments to attract Eurocurrency business), time zone considerations, political and economic stability of host countries, and the availability of communications facilities and experienced personnel. Eurobanks are located in major financial and industrial centres such as London, as well as in off-shore banking centres such as the Bahamas and the Caymans, Hong Kong and Singapore. . . . The main attractiveness of the Euro[currency] markets is that interest rates on deposits are higher, while rates on loans are lower than in domestic markets. 16/

14/ For a more comprehensive treatment, see Eurodollars, Eurocurrencies, and Eurobonds.

15/ George, Abraham M., and Ian H. Giddy. International Finance Handbook. v. 2. New York, John Wiley, 1983. p. G-7.

16/ Eurodollars, Eurocurrencies, and Eurobonds, p. 2, 3.

TABLE 5. Estimated Size of the Eurocurrency Market, 1964-1984
($ U.S. billions)

Year End	Gross Size a/	Annual Growth Rate	Net Size b/	Annual Growth Rate
1964	$20	--	$14	--
1965	24	20%	17	21%
1966	29	21%	21	24%
1967	36	24%	25	19%
1968	50	39%	34	36%
1969	85	70%	50	47%
1970	115	35%	65	30%
1971	150	30%	85	31%
1972	210	40%	110	29%
1973	315	50%	160	45%
1974	395	25%	220	38%
1975	485	23%	255	16%
1976	595	23%	320	25%
1977	740	24%	390	22%
1978	950	28%	495	27%
1979	1,235	30%	590	19%
1980	1,525	23%	730	24%
1981	1,860	22%	890	22%
1982	2,055	10%	960	8%
1983	2,148	5%	N.A.	N.A.
1984 c/	2,222	3%	N.A.	N.A.

a/ Total foreign currency liabilities of banking offices in major European countries, the Bahamas, Bahrain, Canada, Cayman Islands, Hong Kong, Japan, Netherlands Antilles, Panama, Singapore, and the United States (international banking facilities only). Statistics prior to 1972 exclude the Netherlands Antilles.

b/ Gross size minus interbank deposits within and betweeen market centers listed in the footnote above.

c/ June.

Source: World Financial Markets, various issues; Dufey, Gunter, and Ian H. Giddy. The International Money Market. Engelwood Cliffs, Prentice Hall, 1978. p. 22.

C. An Example of Globalization of Currency Markets

An example of how the globalization of currency markets has been occurring can be seen from the specific way in which foreign currency futures markets reacted at the time of the announcement on Sunday, September 22, 1985, of the plan by five leading industrial nations gradually to lower the value of the dollar. Traders wanting to take advantage of the market, especially those who were long on the dollar (i.e., holding dollars in their accounts), or short on yen (i.e., committed to deliver yen they don't own), would not have been able to offset their position until Monday if they were limited to action on U.S. or European markets. However, it was possible for them to act because of the established foreign currency futures linkage between the Chicago Mercantile Exchange and the Singapore International Monetary Exchange (SIMEX). By the time trading ended in Singapore, traders on the Singapore Exchange in Eurodollar, West German mark and Japanese yen futures had their busiest day since since the exchange opened on September 7, 1984. As William J. Brodsky, President of the Chicago Mercantile Exchange, said:

> The record 5,556 contracts traded on the Simex last Monday may not have been much, compared with our daily volume in these futures, but it did give alert traders who were long the dollar a chance to offset their positions when our market was closed. And that is what exchange linkages are supposed to do. 17/

While this example concerns currency futures rather than corporate equities, the principle involved is similar. It should be noted in addition that the success of such linkages as the one cited depends, in large measure, on uniformity of regulations on the exchanges involved. In the case of the Chicago and

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17/ Maidenberg, H.J. Linked Boards Pass Big Test. New York Times, September 30, 1985. p. D7.

Singapore Exchanges, both have agreed to abide by American exchange regulations. The prospect of similar agreement among some of the other, especially the larger, exchanges, involving different national regulatory laws and procedures, is expected to be more difficult. (For further discussion of the difficulties in such linkages, see p. 32-33, below.)

III. CAUSES OF INCREASES IN INTERNATIONAL EQUITY TRADING

The growth in international trading in equities, especially in the most recent decade, has been substantial, as already noted. This growth has had many causes, the more important of which can be noted at this point. These include (1) such economic factors as the growing profitability of trading in foreign equities, the large investment funds available for such investment, particularly by pension funds, and the availability of funds desired by corporations for investment purposes when available overseas on better terms than at home, (2) technological progress making international equity trading much more practical than it had been, and (3) such institutional changes as the development of American depository receipts and of international mutual funds, and financial deregulation affecting major financial centers of the world.

A. Economic Factors

Often, especially in 1985, gains on many foreign stock markets have outpaced those of U.S. markets. According to the Morgan Stanley Capital International indexes, there was, in 1985, an increase in the value of stocks of 172 percent in Austria, 132 percent in West Germany, 128 percent in Italy, 103 percent in Switzerland, 78 percent in France, and 27 percent in the United States. 18/

18/ In dollar terms, including capital appreciation and dividends. Source: Sebastian, Pamela. Latest Strategy of Mutual Funds: Invest in Securities of One Country. Wall Street Journal, January 6, 1986. p. 23.

Besides the potential for greater return by investing in foreign exchanges, many investors are attracted to foreign security markets by the greater diversification it affords their portfolios, and the opportunity to hedge against potentially adverse developments in home markets. Similarly, industrialists and other venture capitalists often find funds on more favorable terms abroad than at home.

This increase in supply of and demand for investment capital crossing national boundaries has begun to bring about many other changes in marketing practices. Trading hours in many exchanges have been lengthened and international linkages created that make it possible for broker-dealers to trade continuously around the clock. As already noted, more and more U.S. securities are being listed on foreign exchanges and foreign securities on U.S. exchanges.

Finally, it may be noted that the 1984 repeal of the withholding tax on interest paid to foreign holders of U.S. bonds has helped American businesses to tap an extra supply of capital in foreign markets.

B. Technological Advances

Probably even more fundamental than the development of these trading devices is the whole new revolution in communications and computer technology which makes possible fast and accurate transactions of unprecedented volume and covering the entire world in a way inconceivable two or three decades ago. As David C. Batten of First Boston Corporation said in May 1985:

> The physical location of market participants is largely irrelevant given the current capability of computers to manipulate data at formerly incredible speeds and to transmit it worldwide instantaneously. 19/

19/ U.S. Congress. House. Committee on Energy and Commerce. Subcommittee on Telecommunications, Consumer Protection and Finance. (continued)

The increasing use and sophistication of computers and communications technology is a major factor in the growing internationalization of trading not only in securities, bond and equity, but also in such instruments as futures, options, and currencies. As the New York Times reported in October 1985,

> What is dawning, say experts, is a new generation of financial interchange stemming not just from the instant awareness of information but from the ability to act upon data by trading through a computer. 20/

Euromoney reported in May 1985 that it expected that within two to three years eight of the top ten stock markets in the world will be operating with some kind of computerized trading system. 21/

Competition among these communications systems will help lower costs. To what extent or when it would lead to a relative weakening of existing stock exchanges is not yet clear. Some argue that the existing exchanges can use the new automated systems to their advantage. As Euromoney recently reported,

> Most stock exchange managers believe that automated quotation systems will improve trading activity both on and off the trading floor. The removal of the less actively traded stocks into a computer-assisted trading system will leave traders free to concentrate on the bigger volume stocks. That is the way most exchanges see the harmonization of computer and trader in the initial stages. 22/

Gordon S. Macklin, President of NASD, sees technology shaping the world market for equities along the following lines:

(continued) Financial Restructuring. Hearings, May 2, 1985. Washington, U.S. Govt. Print. Off., 1985. p. 295.

20/ Kristof, Nicholas D. Computers Reshape Markets. New York Times, October 7, 1985. p. D1.

21/ The World's Traders Get Off the Floor. Euromoney, May 1985. p. 159.

22/ Ibid.

> Market center-to-market center linkages will share up-to-the-second price and trade information and thus provide the basic data for decentralized trading. Dissemination of this information to the worldwide investor community will be vital to market depth and liquidity. Surveillance and regulation in the market centers will be facilitated by these linkages and information flows. Networks parallel to this structure will link clearing and depository information and inject essential foreign exchange information into the whole system.
>
> Multiple trading locations, multiple clearing and depository locations, multiple currency settlement facilities and multiple cooperating self-regulatory organizations will be the principal building blocks of the world market for equities. 23/

C. Institutional Changes

In addition to the fundamental economic and technological changes just referred to, there have been important institutional changes that have also encouraged international equity trading. Among the most important are the introduction of American Depository Receipts, the growth of international mutual funds, and the growing deregulation of financial markets, both here and abroad.

1. American Depository Receipts

An American Depository Receipt is

> a negotiable receipt, registered in the name of the owner, for shares of a foreign corporation held in the vault of a foreign branch of an American bank. The receipt may or may not be on a share-for-share basis with the underlying security. . . . Because of ease of transfer and resale, ADRs are a popular form of domestic equity ownership of foreign corporations. 24/

23/ Macklin, Gordon S. Testimony of Gordon S. Macklin before the Committee on Banking, Housing and Urban Affairs, United States Senate, February 26, 1986. p. 16.

24/ Pessin, Allan H., and Joseph A. Ross. Words of Wall Street. Homewood, Ill., Dow Jones-Irwin, 1983. p. 10.

ADRs are traded over the counter in the United States and can be bought in the same way as domestic corporate equity shares. Transactions are all in dollars, the banking firms undertaking the conversion into dollars from foreign currencies.

ADRs were first devised in 1927 and have become the most widely used form of trading foreign securities in the United States. In 1961, there were about 150 foreign companies whose securities were traded in the United States by means of ADRs. By 1978, this number had grown to 400 companies, and by early 1984, to over 500. 25/ Today, ADR trading is so active that turnover in some foreign stocks is, at times, larger in New York than it is for the same stocks in major foreign markets.

Since January 1983, 16 foreign companies have raised over $1 billion in new equity financing by issuing ADRs in the United States. 26/

ADRs are seen to be advantageous both to American investors and to foreign companies sponsoring them. For the investor they provide a quick, convenient way of transferring ownership, receiving dividends and taking care of other routine transactions which would prove complicated and time consuming if carried out using the actual shares. The impact of foreign taxes or exchange control laws are minimized since transactons are undertaken domestically. ADRs also provide U.S. investors with the opportunity to buy stocks in foreign companies having issued ADRs, which may have achieved a favorable competitive position compared with competitive U.S. companies.

25/ Royston, Jonathan W. The Regulation of American Depository Receipts: Americanization of the International Capital Markets. North Carolina Journal of International Law and Commercial Regulation, v. 10, winter 1985. p. 87-88.

26/ Chew, Lillian, and Liz Hecht. Bulls Find New Pastures. Euromoney Corporate Finance, no. 13, December 1985. p. 20.

For foreign companies, the advantages include access to American capital markets, facilitating U.S. acquisitions, providing a means of compensating U.S. management with stock option programs, serving as a prestigious form of advertisement for a company's products and services, and, at times, providing a company with a higher stock price than is available domestically. 27/

2. International Mutual Funds

Mutual funds specializing in foreign securities have also grown apace and are currently thriving, on the average, more than most other mutual funds. According to Lipper Analytical Services, in 1982 there were 20 mutual funds specializing in investing abroad, 38 in 1984, and 41 by September 30, 1985. By that date, total assets of these 41 mutual funds reached over $7 billion, 28/ up from $4.6 billion at the end of 1984. By now, many of the major mutual fund groups include one fund consisting entirely or largely of equities of foreign corporations. Among the most prominent of these are (1) Dean Witter World Wide Investments; (2) Fidelity Overseas Investments; (3) IDS International Fund; (4) Merrill Lynch International Holdings; (5) Prudential Bache Global Fund; (6) Kemper International Fund; (7) Keystone International Fund; (8) Merrill Lynch Pacific Fund; (9) Putnam International Fund; (10) T. Rowe Price International Fund; (11) Scudder International Fund; and (12) United International Growth Fund. The first five of these have been established since January 1983. There are also a growing number of mutual funds investing in the securities of a single foreign country, such as Australia, Canada, Japan and Korea.

27/ Hecht, Liz. American Depository Receipts. Euromoney Corporate Finance, no. 12, November 1985. p. 16.

28/ New York Times, January 3, 1986. p. Dl.

These mutual funds have, in recent years, often outpaced comparable domestic funds and provide a means for individual investors with little personal experience in international business or finance to take advantage of the experience of managers with expertise in international equity markets. A. Michael Lipper, President of Lipper Analytical Services, reported in February 1986 that, of all the groups of mutual funds, international funds, which invest only outside the United States, increased in value 39 percent in 1985, more than any other mutual fund group except mutual health funds which rose in value by 43 percent. Just behind international funds were global funds (those investing anywhere, but with at least 25 percent outside the United States), which increased in value by 37 percent in 1985. 29/

3. Deregulation

The general movement in many industrialized nations to deregulate national capital markets and the parallel effort of key regulatory agencies of major nations, including the United States, Great Britain, Japan, and Canada, to bring their security regulations into closer alignment has also stimulated international financial trading. This lessening of regulation is reflected in the increasing willingness of many of the developed countries to permit foreign investors to participate directly in domestic markets. For example, more and more European countries are reducing restrictions on the involvement of foreign brokers in their markets. In addition, in several countries foreign exchange controls have been relaxed. Many American bankers and others involved in

29/ Lipper Says Mutual Fund Industry Is Growing Rapidly. Washington Post, February 9, 1986. p. F3.

international equity trading are urging further deregulation that would facilitate American participation in international equity markets. (See p. 48-49 below.)

IV. FACTORS LIMITING GROWTH OF INTERNATIONAL FINANCIAL MARKETS

The previous chapter surveyed some of the factors that help explain the vast increase in international trading of corporate securities. There are, of course, other factors that still act as a deterrent to, or at least cause a slowing down of, this rise. Many of them reflect the relatively greater risk that is involved in international as compared to domestic trading in equity securities. The more important would include the following.

Investors have, in general, a much more difficult time obtaining and, above all, interpreting information on foreign companies, their stocks, and their economic prospects, as compared to getting such information on domestic corporations. Different accounting methods, foreign regulations, and government policies, some of which may act as a subsidy and others as a hindrance to the operations of a particular firm, are among the factors that make it difficult for investors to accurately assess the earnings' prospects of a foreign company.

Fluctuating exchange rates are an additional element that increases the risks of many foreign investments. A rise in the value of a foreign currency as compared to the dollar can largely or entirely offset the gains of a company measured in its domestic currency. The reverse is, of course, also true. A rise in the value of a foreign currency can lower the value of a foreign investment in dollar terms. But, in any case, the uncertainties of currency movements are an added element of risk in foreign investment.

There is no uniformity among nations as to disclosure regulations for market transactions. Probably no major nation has as rigorous disclosure regulations as the United States.

Government monitoring of international equity trading is far less comprehensive than oversight of domestic equity trading. Some argue that more monitoring is not needed since most international traders are relatively knowledgeable and sophisticated and that the self-regulation by international markets is adequate. Others believe that, especially with the growth in international trading and its growing attractiveness to many individuals, the risks of fraud, misrepresentation, and deception will grow and the risk resulting from lack of governmental regulation are likely to rise.

Closely related is the fact that there is no international regulatory agency to coordinate the market regulations by various nations, or adjudicatory agency to resolve international disputes. Many believe that such an agency or agencies should be considered, although opinions differ as to the extent or nature of authority such agency or agencies should have. Others feel that, at the present time, with changes rapidly occurring in trading methods and technology, establishment of any such agency would be premature.

In some areas, particularly in transaction clearing procedures, there remain difficulties and delays that have been negative factors for many traders. Differing regulations of stock trading in major trading nations account for a considerable part of this difficulty. As Euromoney claimed, in October 1985:

> The absence of a speedy settlement system is perhaps the principal constraint on the emergence of an international secondary market for equities on the scale of that for Eurobonds. . . . Brokers dealing in international equity investments lament the time wasted. Institutional investors go on waiting for their scrip or cash, as capital markets around the world grope their way towards a common clearing system for the growing business in international share dealings. 30/

Although computer and communications technology clearly has accelerated the growth in international financial transactions, it is still in a stage where the

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30/ Clearing the Way to Globalization, p. 268.

profitability of its utilization is uncertain in many instances. For example, where there is a relatively low volume of international transactions on a particular exchange, the costs of speeding up such transactions may prove to be prohibitive.

Policies of some national governments provide more favorable treatment for domestic over foreign investors or dealers. As Thomas A. Russo of the law firm, Cadwalader, Wickersham and Taft, stated recently:

> The two biggest hurdles [to globalization of securities trading] concern national sovereignty and protection against fraud. No nation will readily agree to have its citizens subjected to foreign laws. This applies to criminal acts such as fraud. While the Chicago Merc [Mercantile Exchange] and Simex [Singapore International Monetary Exchange] have agreed to a uniform set of rules, this may not be the case with the much older, much larger and more powerful London markets. 31/

The risks involved in international equity trading are well illustrated in the following cautionary note included by T. Rowe Price and Company in its May 1, 1985, prospectus to its new International Fund which lists the following risks involved in foreign versus domestic stock transactions:

> . . . the fluctuation in exchange rates of foreign currencies; the possible imposition of exchange control regulation or a currency blockage which would prevent cash from being brought back to the United States; less public information with respect to issuers of securities; less governmental supervision of stock exchanges, security brokers and issuers of securities; lack of uniform accounting, auditing and financial reporting standards; less liquidity as a rule in foreign markets as compared to U.S. markets; the possible imposition of foreign taxes; and the possible utilization of securities of companies in developing as well as developed countries.

31/ Maidenburg, Linked Boards Pass Big Test, p. D7.

V. INSTITUTIONS DIRECTLY INVOLVED IN GROWTH OF INTERNATIONAL EQUITY SECURITY TRADING

The development of the internationalization of securities trading may be seen as involving three discrete, although interrelated, types of activities. First, there is evidence of substantial growth in international business by existing brokerage firms and mutual funds and stock exchanges. Second, linkages between stock exchanges and other securities marketing organizations, such as over-the-counter markets, are being developed at an increasingly rapid pace. Third, servicing or vendor organizations are developing facilities to expand and improve such services as providing securities information worldwide and providing network linkage services between clearing organizations and depositories. Several examples of each of these three kinds of developments can be shown. More are being announced almost daily in the financial media throughout the world.

A. Stock Exchange Moves

It seems clear that the major stock markets of the world are, virtually without exception, taking action that, in one way or another, will facilitate world trading of equity securities. In many cases, exchanges are limiting their focus to regional growth of trading, primarily to adjacent or nearby countries, and often priority treatment is accorded native dealers. Nonetheless, the trend towards broader international trading efforts by the world's exchanges is unmistakable. Several examples can be cited.

1. London Stock Exchange

The London Stock Exchange is in the process of preparing to eliminate fixed minimum commission rates in 1986, and, effective January 1987, will permit financial institutions, including foreign and domestic banks, to become members and engage in the full range of securities transactions. Richard Kirkland believes that the London Stock Exchange's announced abandonment of fixed commission rates, after long holding out against such a move, will have such an impact that "three years from now, there won't be a major market in the world that doesn't allow negotiated commissions for institutional buyers." 32/

2. Tokyo Stock Exchange

The Tokyo Stock Exchange announced on November 29, 1985, that it was, for the first time, permitting foreign brokerage firms to become members. Although it had revised its rules several years ago to permit foreign firms to become members of the exchange, no seats were available until the exchange agreed last summer to increase its membership from 83 to 93. Of the ten new seats that became available, three went to American, three to British, and four to Japanese firms. The three American companies that obtained seats on the Tokyo Exchange were Goldman, Sachs International, Merrill Lynch Securities Co., and Morgan Stanley International. These firms will no longer need to patronize Japanese brokers and pay them commissions to trade on the Tokyo Exchange. Major Japanese financial companies hope that this presence of foreign members on the Tokyo Stock Exchange will persuade more foreign companies to list their stocks on the Tokyo Exchange and to bring in more foreign capital. At present, there are 18 foreign companies

32/ Kirkland, The Stock Market ... Upheaval in Europe, p. 160.

whose stock is listed on the Tokyo Exchange, most of them being American. It may be noted also that three of the four largest Japanese brokerage houses (Nomura, Nikko, Daiwa) have seats on the New York Stock Exchange.

Japan provides a sizable and growing market for foreign stocks, and also attracts foreign buyers of Japanese stock. According to the Tokyo Stock Exchange, Japanese investors bought $1.6 billion of foreign stocks and $56.3 billion of foreign bonds and debentures in 1984 -- 1.5 times and 2.8 times as much as in 1979, respectively. Foreign investment in Japanese securities has grown even more. During 1984, foreign investors purchased $35.9 billion in Japanese stocks and $63 billion in Japanese bonds and debentures, 6.5 times and 6.1 times as much respectively as in 1979. 33/ These movements of equity and bond trading have been facilitated by a lowering of barriers to the movement of money into and out of Japan. This has encouraged Japanese and other brokerage firms to become more aggressive in international stock transactions.

3. New York Stock Exchange

While the New York Stock Exchange has been less communicative in its moves to encourage international stock trading, it has taken several steps that are clearly indicative of its desire to participate in this growing enterprise. Its lengthening of its stock trading hours, by opening at 9:30 a.m. instead of 10 a.m., effective on September 30, 1985, was designed, in considerable measure, to increase participation in its trading by London investors and institutions. As the Washington Post noted on September 29, 1985, this change in hours "is part of an effort by the New York exchange to expand its role in the growing, and

33/ Tokyo Stock Exchange. Letter to U.S. Securities and Exchange Commission, June 29, 1985.

increasingly competitive, billion-dollar international equities market." 34/ Many of the technological innovations it introduced in the past two decades have, even if not introduced primarily for that purpose, had a major impact in increasing its potential in international trading. 35/ Finally, it has begun negotiations with the London Stock Exchange to form working linkages between the two institutions, but operating results are not expected to be forthcoming before many of the changes planned by the London Exchange, discussed above, reach fruition.

4. Other Exchanges

At about the same time that the New York Stock Exchange increased its trading hours, by half an hour, the Amsterdam Stock Exchange increased its trading hours by two hours, from 4-1/2 to 6-1/2 hours a day. It also introduced a new electronic trading system that allows continuous trading of the leading Dutch securities. Both moves are expected to stimulate trading in the 294 foreign stocks listed on the Amsterdam Exchange.

The French stock exchange, the Paris Bourse, is expected to permit French brokers to buy stock for their own accounts, a power thus far denied them. In addition, French banks may be granted permission to trade securities directly, a power thus far not permitted them.

34/ Hinden, Stan. Stock Market to Get Off to Earlier Start. Washington Post, September 29, 1985. p. K1.

35/ For details, see: U.S. Library of Congress. Congressional Research Service. A National Market System for Stock Trading: A Review of Developments and Issues. Report No. 85-28 E, by Julius W. Allen. Washington, 1985. p. 19-28.

B. International Linkages of Stock Exchanges

Probably even more significant than the steps taken by stock exchanges independently are the growing number of linkages between stock exchanges and securities firms of various nations, which are being formed at a rapid rate.

One of the most recent, and perhaps most significant of these links, is that between the London Stock Exchange and the National Association of Securities Dealers (NASD), announced in the last week of November 1985. The two organizations have agreed to swap price-quotation information on as many as 580 stocks. These include 300 London-traded stocks on NASDAQ, NASD's automated quotation system, and 280 NASDAQ issues on the London Stock Exchange's computerized quote system, SEAQ. This information sharing will expand the hours during which investors can receive stock price quotations on actively traded American, British and other international issues. American investors will have access to prices at which London market makers will buy and sell the most heavily traded U.S. stocks during London trading hours, which begin at 4:30 a.m. Eastern Standard Time. Approval by the London Exchange's governing council and by the SEC is expected in time for the venture to start as early as March 1986. It is a step in the direction of links between exchanges that will eventually allow investors around the world to trade any major stock at any hour. Thus far, this is seen as an information exchange link rather than as a trading link, but could lead to the latter some time in the future, after legal and regulatory hurdles have been overcome.

A week earlier, on November 18, the Institutional Networks Corporation (Instinet), established to assist institutional investors, put into operation an electronic stock trading system in London through the terminals of subscribers to Reuters PLC. This new setup allows European brokers to buy and sell as well as make markets in more than 8,000 stocks that are traded in the United States.

The London and New York Stock Exchanges have also begun discussions about developing links betweeen each other. A first step would be the introduction of some of the reforms on the London Stock Exchange already mentioned above (p. 36). Of particular concern is the development of an efficient and effective settlement process for international stock trades.

In December 1984, the Toronto Stock Exchange and the American Stock Exchange launched an electronic link that gave traders on both exchanges access to the 36 Canadian stocks listed on both exchanges. A similar link is being established between the Toronto and the Midwest Stock Exchange. This will allow members on both of these exchanges to trade in 19 Canadian and 42 U.S. stocks listed on both exchanges. These particular linkages have proved relatively easy to negotiate since there is already close correspondence between the marketing and regulatory systems of Canada and the United States.

The Boston Stock Exchange and the Montreal Stock Exchange currently operate a link between their markets. Montreal Exchange specialists can send orders in a small number of Canadian national issues also listed in the United States for execution by Boston Stock Exchange specialists. In subsequent phases, the two markets will connect Boston Stock Exchange specialists to the Montreal Exchange's automated small order execution system (MORRE) and may provide access for U.S. broker-dealers and investors to the MORRE system.

The Sydney Stock Exchange is linked on a 24-hour basis with the Amsterdam, Montreal and Vancouver Exchanges. Initially, the four exchanges trade in listed options in gold, silver, and selected foreign currencies.

As has been noted, most of the links between stock exchanges are within the same geographic area, and usually between exchanges subject to similar rules and governmental regulations. It is likely that this pattern of close linkages will be the more common pattern in the near future. Some exchanges resist more extended linkages. Thus, the Tokyo Stock Exchange stated last year:

> The Exchange thinks that at this moment, internationally simultaneous trading is possible only between countries having geographical proximity. For this reason, the Exchange does not deem that there is a possibility of simultaneous trading in listed securities between, for example, Japan and the United States or Great Britain at least for the time being. . . . For this reason, the Exchange does not find it necessary, at least for the time being, to develop linkages between the Japanese securities market and the markets of other countries. 36/

C. Linkages of Clearance and Communications Firms

The effectiveness of linkages between stock exchanges in various countries depends, in large measure, on increasing the ability to process international securities transactions efficiently and to have rapid, accurate communication of transaction prices and volume throughout the world. The linkages between clearing agencies are beginning substantially to improve the processing of stock transactions across national boundaries and various businesses have started or expanded their ability to provide fast and accurate information on such transactions.

Several examples of U.S. clearing firms developing links with foreign clearing firms have been cited by the Securities and Exchange Commission in its April 25, 1985, request for comments on internationalization of securities markets:

> Typically, the links involve a foreign clearing agency becoming a member of a United States clearing agency and participating on behalf of the foreign clearing agency's members. The foreign clearing agency is liable as principal for the transactions of its members and is subject to the United States clearing agency's rules. For

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36/ Tokyo Stock Exchange. Letter to the Securities and Exchange Commission. June 19, 1985.

> example, the Canadian Depository for Securities Limited, a Canadian clearing agency operating in Montreal and Toronto, has become a member of the National Securities Clearing Corporation in New York City. That link processes over-the-counter transactions between United States and Canadian broker-dealers and transactions that occur on the BSE/ME trading floor link. 37/

Similarly, the Midwest Clearing Corporation and the Midwest Securities Trust Company, closely connected affiliates of the Midwest Stock Exchange, and the Vancouver Stock Exchange Service Corporation have developed a clearance and settlement link for Canadian and United States securities named ACCESS (American and Canadian Connection for Efficient Securities Settlements). Through ACCESS, transactions between American and Canadian brokers may be automatically compared and settled. ACCESS processes securities listed on Canadian and United States stock exchanges and in the NASDAQ system. 38/

The Securities and Exchange Commission states, in addition:

> Other processing links not involving foreign clearing agency membership in a United States clearing agency have been developed between the Amsterdam Stock Exchange and the Depository Trust Company in New York City, between Trans Canada Options, Inc. and the Options Clearing Corporation in Chicago, and between Trans Canada Options, Inc. and the National Securities Clearing Corporation. Only those links in which a foreign clearing agency has become a member of a United States clearing agency, however, have enjoyed significant use to date. 39/

How these clearing links will develop in the future is difficult to predict. The likelihood is that they will grow incrementally, as in the past. However, if

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37/ U.S. Securities and Exchange Commission. Request for Comments on Issues Concerning Internationalization of the World Securities Markets. (Release No. 34-21958) Federal Register, v. 50, no. 80, April 25, 1985. p. 16304. (Hereafter cited as SEC, Request for Comments)

38/ Midwest Clearing Corporation/Midwest Securities Trust Company. Letter to Securities and Exchange Commission. October 14, 1985.

39/ SEC, Request for Comments, p. 16304-16305.

trading accelerates appreciably and involves more and more trading areas around the globe, the need for a centralized, internationally-governed clearing agency becomes critical. As the Securities and Exchange Commission stated in April 1985:

> As the trend toward international trading increases, it will become increasingly important for foreign trading markets to establish efficient, safe, and accurate comparison, clearance, and settlement systems especially if they seek to link with United States securities markets and their respective clearing agencies. 40/

One of the prime requirements for effective international stock trading is a system of rapid and accurate international price quotations. A considerable number of firms, individually and jointly, are increasing their capacity in this endeavor. One leader is the British firm, Reuters Holdings, PLC. Its MONITOR system serves thousands of terminals in securities firms worldwide. It plans to be able to provide global inside quotations -- the highest bids and lowest offers anywhere on hundreds and eventually thousands of internationally traded securities. Joint ventures serving the same end have been set up by AP, Dow Jones & Co., and Quotron Systems, the largest domestic vendors of stock price information in Europe; by AP, Dow Jones & Co., and Telerate, a large British vendor; and by Citibank and McGraw-Hill. The latter joint venture is focusing originally on commodities, but is a potential vendor in equities as well.

One of the leading information companies, Quotron Systems, headquartered in Los Angeles, had fewer than 150 terminals abroad in 1984, but now has over 1,000. Telerate, of New York, is finding its revenues from outside North America growing 70 percent annually, and expects such revenues to account for nearly a third of its total revenues in 1985.

40/ Ibid., p. 16307.

VI. REGULATORY AND OTHER ISSUES INVOLVED IN THE GROWTH OF INTERNATIONAL EQUITY TRADING

A number of the difficulties and problems involved in the surge in international equity trading have been referred to earlier in this report. (See p. 2, 31-33.) Some of the major ones and approaches for dealing with them are considered in this chapter. Foremost is the question to what extent additional regulation of international equity markets in the interest of protecting investors and assuring safety of operations is warranted, desirable or feasible. Other issues considered more briefly in this chapter are the problems associated with exchange rates, differing accounting practices in various trading countries, continuing difficulties in clearing international transactions, and the problems associated with assuring stockholders the ability to exercise their voting and other rights as owners of foreign securities.

A. Regulation of International Equity Transactions

Probably the key regulatory problem, or in a sense the overriding problem that covers a multitude of specific issues, is how the fairness and safety of international equity markets can be assured and the interests of investors, especially, of course, of U.S. investors, be protected. Fear that fraud and deception will increase with the growth of international trading is widespread.

The growing concentration of trading in the stock exchanges of New York, London and Tokyo is giving rise to concern among other financial markets throughout the world. Similarly, the potential domination of most international equity trading by a few large brokerage firms is raising questions of monopoly or excessive power that threatens many smaller brokerage firms and those away from major stock market centers. As Richard I. Kirkland, Jr. stated in October 1985,

> The biggest shock wave [will] come . . . from the emergence of a handful of giant firms that will dominate the underwriting and trading of multinational securities. They'll also be capable of making their own markets to trade foreign stocks outside existing exchanges. 41/

At present, the securities laws of the United States and the surveillance mechanisms of the Securities and Exchange Commission are more comprehensive and more stringent than virtually any others in the world. But the growth of international securities trading has made the tasks of domestic regulatory agencies more difficult. The Securities and Exchange Commission in April 1985 summarized this problem as follows:

> The Commission notes that the growing internationalization of the United States capital markets has made market surveillance and enforcement more difficult. Because the Commission's investigative subpoena authority is limited to United States citizens and persons within the United States, it cannot compel testimony from non-United States citizens located abroad. Further, because foreign law often does not allow for any investigative or pretrial discovery, Commission efforts to develop facts to file a case where suspicious circumstances exist are often frustrated. Finally, the Commission has been required to engage in lengthy proceedings and negotiations to obtain information regarding transactions effected through banks or securities firms located in countries with secrecy or blocking laws.
>
> There are few surveillance or enforcement mechanisms in place to safeguard the integrity of securities trading conducted simultaneously in multiple international markets. This is a matter of concern to the Commission; as the global market becomes more developed, fraud or manipulation in multiply-listed securities may affect adversely the markets for those securities in the United States as well as other nations. Moreover the efficacy of trading halts imposed by the Commission or a securities market could be impaired as more trading in United States stocks occurs abroad. 42/

John Fedders, former Director of the Enforcement Division of the Securities and Exchange Commission, has warned that without greater international coopera-

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41/ Kirkland, The Stock Market ... Upheaval in Europe, p. 161.

42/ SEC, Request for Comments, p. 16309.

tion on law enforcement, investors in foreign markets "will face insider-trading problems and stock manipulation scams they haven't dreamed about." 43/

Opinion on this subject appears to be concentrated on two partially opposing propositions. One is a caution against expanding regulation, basically using the argument that additional regulation may be more harmful than beneficial, particularly in an era in which many new techniques and practices are being developed, and, further, that there are few investors who need protection by a governmental source, since almost all traders on international markets are sophisticated investors who are able to act intelligently in their own self-interest in international markets without any governmental interference. The second position is that an international agency to provide guidance and/or to serve in an adjudicatory role in case of international transaction disputes is highly desirable at this point. A middle ground between these two positions also, of course, exists.

Industry representatives in large measure have shared the view that protection of the ordinary individual investor in international stock trading was relatively unimportant, since most trading across national boundaries is done by sophisticated, experienced professional specialists. For example, the Amsterdam Stock Market, in a June 27, 1985, communication to the U.S. Securities and Exchange Commission, wrote that information requirements for internationally traded stock might not need to be as rigorous as for domestic stock since

> . . . the international markets are mostly used by the more sophisticated investors, needing less protection with respect to the quality of the investment instruments offered. 44/

43/ As Global 24-Hour Trading Nears, Regulators Warn of Market Abuses. Wall Street Journal, February 11, 1985. p. 25.

44/ Amsterdam Stock Exchange. Letter to the Securities and Exchange Commission, June 27, 1985. p. 7.

Similarly, Samuel E. Hunter, Senior Vice President of Merrill Lynch Capital Markets, wrote to the SEC on September 30, 1985:

> It [the international securities market] is largely a professional market and appears likely to remain so for the foreseeable future. Since there is little need or demand for individual U.S. investor participation, the need for customer protection rules is not as acute as it would be for an exchange or other market with a significant retail participation. 45/

Also representative of the position recommending restraint in imposition of further regulation is the following statement by Gordon S. Macklin, President of the National Association of Securities Dealers, in a letter dated November 4, 1985, to the Securities and Exchange Commission:

> . . . the NASD believes that the [Securities and Exchange] Commission should exercise restraint in consideration of any proposals for application of formalized market structure elements to the international marketplace, such as suggestions for a uniform system of consolidated quotations and transaction reporting or formalized market linkages of the nature currently in use in domestic markets. These concepts are unique to the American marketplace and may be counter-productive in terms of their appearance as an attempt at regimented integration of foreign and domestic markets. The NASD believes that during this evolutionary period of the international marketplace, concentration upon the control of foreign markets and the practices unique unique to each may tend to restrain rather than enhance international cooperation and development of competitively motivated market interaction. A more appropriate emphasis would be upon generalized facilitation of trading among international markets and linkages between clearing and settlement systems to provide the experience and economic incentive necessary to foster the expansion of trading opportunities. Additionally, this approach would provide a climate for advocation of cooperative regulatory initiatives which can be accepted by foreign governments or their regulatory bodies.
>
> It would appear appropriate during the near term to recognize to the extent possible the law applicable in foreign jurisdictions until changed through cooperative endeavor, thus avoiding the impression that American law and securities market structures are solely appropriate for universal application. Such would undoubtedly have a negative impact on global market evolution. 46/

45/ Hunter, Samuel E. Letter to John Wheeler, Secretary, Securities and Exchange Commission, September 30, 1985. p. 5.

46/ Macklin, Letter to John Wheeler, p. 8-9.

Some, particularly representatives of banking and other financial institutions, would go further by advocating even more deregulation of American businesses engaged in international financial markets. They point to the success of the largely unregulated Eurobond markets (see p. 15-19, above) as demonstrating the advisability of such lesser regulation. Such legislation as the International Banking Act of 1978 and the Glass Steagall Act is seen as limiting the ability of U.S. banks and other financial institutions from competing effectively with major foreign financial businesses. As Dennis Weatherstone, Chairman of the Executive Committee of J.P. Morgan & Co., recently stated before the Senate Committee on Banking, Housing and Urban Affairs:

> As demonstrated by experience in the Eurobond market, if freed from unnecessary regulatory restraints, American commercial bank affiliates could play a significant role in increasing competition and spurring innovation in our securities markets. In the U.S. municipal securities and commercial paper markets, the competition provided by commercial banks has already helped to narrow spreads and reduce the interest rates paid by borrowers. Moreover, the successful participation by commercial banking organizations in the Eurobond market demonstrates that they can engage in corporate securities activities without jeopardizing their safety and soundness and without creating conflict of interest problems. . . .
>
> In order to assure the continued leadership of our capital markets and of American financial institutions, our laws must be updated to take full advantage of the benefits of free competition in capital markets. Other countries -- including Britain, Japan, Germany, France and Switzerland -- are already in the process of making swift and dramatic changes so as to participate more successfully in world financial markets. A revision of our statutory framework would not only enhance the position of the United States in world financial markets, but would also strengthen our banking system and permit borrowers to benefit from increased competition in the U.S. securities markets. 47/

Representative of the point of view of the desirability of establishing an international agency to regulate, supervise and/or adjudicate issues in international securities trading are the following remarks by Charles L. Marinaccio,

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47/ Weatherstone, Dennis. Statement before the Committee on Banking, Housing and Urban Affairs. United States Senate. February 26, 1986. p. 10-11.

then a Commissioner of the Securities and Exchange Commission, in January 1985:

> I believe that we should establish an international structure for the developing world equities market that parallels the structures which now exist for international commerce and international finance. Those structures are the General Agreements on Tariffs and Trade, the Coordinating Committee of Western Nations for Strategic Trade, the coordinating role played through the Bank for International Settlements on monetary policy and on the regulatory policy for commercial banks and the coordinating role being developed by the International Monetary Fund concerning financial information regarding borrowing countries.
>
> The unifying principle of these international bodies which have played such a key role in the development of the world economy is that they operate by consensus not by fiat; and they are comprized in membership by officials in their respective countries with the authority to influence and to put into effect policies in home countries which advance the goals of free and open international markets.
>
> In my view, such a body, established for the international equity market, should be limited in its first years of operation to representatives of the United States, Canada, England, Switzerland, and Japan. It appears to me that the developing integrated international equities market will be centered in those nations. In addition maximum coordination by consensus requiring unanimous action will be achieved by focusing on the central core of the world market.
>
> The representatives to such an international body should be on behalf of the United States the Securities and Exchange Commission and the S.E.C. counterparts overseas. This limitation would ensure that the new structure would concentrate on the specific technical matters requiring attention and would also assure that whenever agreement is reached, implementing regulations would be adopted. I would envision the establishment of a working body having the authority to implement agreements reached by unanimous consensus. 48/

In a somewhat similar vein, representatives of a subcommittee of the American Bar Association stated:

> We believe that, ultimately, no one country will be able to regulate effectively an international securities market. What is needed, we believe, is a formal body to promote and facilitate cooperation among regulators of the financial markets.

48/ Marinaccio, Charles L. Public Policy Issues Concerning the Subjects of Tender Offers and the Development of an International Equities Market. Remarks to the Chicago Regional Group of the American Society of Corporate Secretaries, Chicago, Illinois, January 9, 1985. p. 16-17.

We recommend that consideration be given to the United States' recommending the formation of a committee by the Bank for International Settlements in Basle modeled on the Basle Committee of the same organization (better known as the Cooke Committee). The Bank for International Settlements is controlled by the central banks of the most important industrial nations of the world. 49/ The Cooke Committee is comprised of the representatives of the central banks (*e.g.*, in the United States, the Federal Reserve Board) and of the bank regulators where they are different (*e.g.*, in the United States, the Controller of the Currency and the FDIC). This group meets four times a year to discuss matters of common interest. It has no legislative or enforcement power but its influence is substantial and a number of parallel changes in banking regulation have been generated among the nations represented on the Committee as the result of its deliberations.

We recommend that, for securities regulation purposes, a committee similar to the Cooke Committee be established. Such committee would be composed of representatives of the same banking authorities but with the addition of representatives of securities regulators. Our recommendation to establish such a committee through an international banking institution and to include bank regulators is based on the following considerations:

1. In most jurisdictions outside the United States, the legal distinction between commercial banks and investment banks does not exist, and commercial banks take an active role in the securities markets. Therefore, such a committee composed of bank regulators as well as securities regulators would facilitate functional regulation which is the path recommended by Vice President Bush's Task Force on Regulation of Financial Services

2. In a number of countries, the sponsorship of the central bank would overcome any reluctance to join such a committee.
3. The Bank for International Settlements is an existing institution with a secretariat and budget to facilitate the work of such a committee.

4. The record of achievement of the Cooke Committee would encourage those participating to believe that a similar effort in the securities field would produce results.

5. Most countries with significant securities markets are presently represented on the Cooke Committee. 50/

49/ The United States is not a member of the Bank for International Settlements, but regularly attends its meetings as an observer.

50/ American Bar Association. Federal Regulation of Securities Commission. Section of Corporation, Banking and Business Law. Committee on Federal Regulation of Securities. Subcommittee on International Securities Matters and Subcommittee on Securities Markets and Market Structure. Letter to Securities and Exchange Commission, August 30, 1985. p. 2-4.

The middle ground is represented in a proposal by the Toronto Exchange to the Securities and Exchange Commission. It suggested, in July 1985, that the two organizations, the Federation of International Stock Exchanges, established in 1971, and the International Association of Securities Commissions and Similar Organizations, founded in 1975, be utilized as an institutional forum in which to carry out multilateral discussions to achieve harmonization of the standards to be applied. Such discussion, which will, of necessity, take considerable time, "should not be allowed to dampen the market-driven vitality of developments in international trading, discourage ongoing bilaterial initiatives nor stifle innovation and competitive play by, and between, trading systems." 51/

The Toronto Exchange also recommended that an international securities settlement convention be adopted to avoid confusion resulting from different holidays in Canada and the United States that result in variable settlement dates and to realize the full benefits of international trading. 52/

B. Foreign Exchange Rates

Foreign exchange rates are the cause of several problems in trading international equity securities. Most obviously, the fluctuations in exchange rates, which are difficult to predict with any degree of assurance, make decisions on investments across national boundaries risky for both securities buyers and sellers. There are also technical problems of conversion of stock prices from one currency to another. For example, the customary quotation intervals, such as an

51/ Toronto Stock Exchange. Request for Comments on Issues Concerning Internationalization of the World Securities Markets: Response of the Toronto Stock Exchange. Toronto, July 5, 1985. p. 6.

52/ Ibid., p. 17-18.

eighth of a point, in one currency cannot, as a rule, be converted to a similar quotation interval in another. Some of these difficulties have been well expressed by the Toronto Stock Exchange as follows:

> Absent an automated currency conversion facility built into the trading system, currency conversion poses considerable problems. An investor purchasing stock in a foreign country incurs an exchange rate risk until settlement date. While this risk may be hedged, the hedge represents an additional transaction cost. More importantly, currency fluctuations make it difficult to determine which of two interlisted markets is actually providing the best quotation on an interlisted security. . . .
>
> In all events, conversion results in prices which differ from a standard quotation interval such as one-eighth of a point. The computer software used by North American stock exchanges to input trades into their quotation reporting systems are not adapted to non-standard price intervals. Even if the systems could display non-standard price intervals, such intervals may be confusing to investors, where the information appears together with price information expressed in standard price intervals. Here, then, lies an inhibition to adoption of a consolidated tape and composite quotation system even as between two linked North American markets. 53/

The general questions of alternative ways of determining exchange rates and their impacts are beyond the scope of this report.

C. Accounting Differences

Differences in accounting principles and practices in various countries also are a factor in the risks in investment in foreign equities. As Euromoney Corporate Finance reported in a recent issue:

> The most glaring obstacle to a comparison [of stocks across borders] is the difference in accounting principles from country to country. German accounts, which are drawn up more for tax purposes than for shareholders, tend to understate earnings in comparison with, for example, British accounts. With earnings understated, the p/e ratio is correspondingly overstated. . . . European and Japanese

53/ Ibid., p. 14-15, 15-16.

> accounting principles are steadily moving towards American and British standards. "But the Germans will be the last to change, because of the power of the big German banks which own much of the German corporate sector," comments David Damant of Quilter Goodison [member of the London Stock Exchange]. 54/

D. Clearing Difficulties

While undeniably great strides have been made technologically in expediting international security transactions, there is still unease and dissatisfaction with the speed, accuracy and cost of various procedures, especially clearing procedures.

These difficulties were referred to above on p. 32, and some of the steps being undertaken to resolve them on p. 41-43. One may be reasonably confident that technological advances will eventually ease the settlement problems, but, for now, they remain real.

E. Shareholders' Rights in Corporate Governance

Another issue frequently overlooked is assurance of the ability of shareholders of stock of foreign corporations to exercise the rights of ownership to which they as stock owners are entitled. This includes the right to attend annual meetings of stockholders, vote on issues presented at such meetings or at other times to stockholders, as well as the right to buy and sell stock in the securities market without hindrance. In the United States, for example, owners of foreign equities are often precluded from exercising their subscription "rights" to new stock issues. They should be treated as well as holders of domestic equities. Thus far, this is an issue that has received relatively little

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54/ Chew and Hecht, Bulls Find New Pastures, p. 20-21.

attention, as far as we have been able to ascertain. It may well require the establishment of an international juridical or regulatory agency or agencies, possibly along the lines of some that have been mentioned above in other contexts.

VII. CONCLUSION

The rapid growth in international financial trading, including that of corporate equity securities, that has been occurring during the past decade gives every sign of continuing for the foreseeable future. In part, this is due simply to the growing interdependence of the nations of the world, the rise in international trade and investment, and the strength of leading currencies, notably the U.S. dollar and the Japanese yen. It is also a result of the advances in technology and financial institutions and processes that have made possible much more rapid and accurate international financial transactions than have been available heretofore. The experience gained in large scale international currency and bond transactions is being adapted rapidly to equity trading as well. Equity investment across national boundaries has been stimulated both by vast sums of money, notably pension funds, seeking profit opportunities beyond those available domestically, and by corporations seeking funds on more favorable terms than may exist within their home country. The growth of global equity trading is also being accelerated by deregulation affecting major financial markets, notably in New York, London, and Tokyo.

Nonetheless, there remain important issues to be resolved. Technology, in many cases, remains to be proven cost-effective. Clearing mechanisms in international transactions are still too complex, unreliable, or slow for many traders. Risks of fraud, misrepresentation, and monopolistic or quasi-monopolistic practices by dominating stock exchanges and brokerage firms are believed by many to become more serious with the growth of international equity trading. National opposition to international regulation or enforceable international adjudication of controversies remains strong in many quarters. Risks in international equity trading continue to remain greater than in domestic trading, both on political and economic grounds. At present, the bulk of trading internationally is done by professionals who are reasonably adept at coping with such risks, but this may become less and less true as such trading attracts less knowledgeable and/or less scrupulous traders.

These are issues that are already receiving much attention by the various private firms and institutions as well as by the governmental regulatory agencies involved, such as the Securities and Exchange Commission. How they are resolved will, of course, shape the character, direction and extent of international equity trading in the years ahead.

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