The rapid pace of technological advances is bringing us closer to the reality of a seamless global capital market. In such a world, investors would have access to increased liquidity, greater diversification, and a wider range of investment options regardless of their location. Capital would be more efficiently allocated throughout the global economy to the benefit of all participants. However, complex political obstacles are hindering such a development.

One underlying problem facing the United States is how to balance improved U.S. investor access to foreign investment opportunities with the need to safeguard the integrity of the U.S. market. The Securities and Exchange Commission (“SEC”) is responsible for regulating this balance and is guided by its mission “to protect investors; maintain fair, orderly and efficient markets; and facilitate capital formation.”

In *A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, Ethiopis Tafara and Robert Peterson put forth a seemingly compelling argument to address this problem through the adoption of a new international framework for the SEC’s handling of foreign investment opportunities. Tafara and Peterson argue that change is necessary as the SEC’s current approach to foreign investment opportunities is out of date and needs to adapt to the increasing interconnectedness of global markets. They point out that while the SEC has made accommodations for some foreign issuers listing on U.S. exchanges, its counterparts in other countries have not given U.S. investors similar support and instead offer limited information and several layers of costly intermediaries. The proposed framework aims to rectify this situation through a system of substituted compliance with SEC regulations whereby

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* Executive Vice President and General Counsel, TIAA-CREF.
** Vice President and Associate General Counsel, TIAA-CREF.
3. Id. at 35–42.
4. Id. at 51.
“instead of being subject to direct SEC supervision and U.S. federal securities regulations and rules, foreign stock exchanges and broker-dealers would apply for an exemption from SEC registration based on their compliance with substantively comparable foreign securities regulations and laws, and supervision by a substantively comparable foreign securities regulator.”

However, while such reform may on the surface seem reasonable, the practicability of implementing these changes today is questionable while the risk for U.S. investors is high.

**I. Maintaining Strong Regulatory Standards**

The SEC performs its task admirably—and sets the standard against which all other regulators around the globe are judged. The U.S. market is desirable and one of the most efficient at raising capital. The SEC, with its track record and high standards for protecting investors, has historically been a leader in setting benchmarks for market regulation. Still, as a result of both historical and cultural influences, other countries may have differing standards for disclosure that are either less stringent or based on different assumptions than those found in the U.S. markets. For example, some foreign markets may have different cultural or legal views towards insider trading. In contrast, disclosure and 10b-5 fraud standards have long been a cornerstone of regulation and are widely understood in the United States. Under the proposed framework the SEC would cede oversight to foreign entities that may operate under similarly varying regulatory standards. This could undermine the exemplary standards the SEC has worked so hard to establish and uphold. In order to maintain the current level of protection afforded to U.S. investors, the SEC needs to remain self-sufficient and set its own standards for the protection of U.S. investors.

To be fair, the proposed substitute compliance approach does include a comprehensive process for both foreign trading screens and foreign broker-dealers aimed at preventing the reduction of U.S. regulatory standards. Specifically, Tafara and Peterson envision a four-step process:

- **Step 1:** A foreign entity petitions the SEC for an exemption from registration.
- **Step 2:** The SEC and foreign securities regulator enter into discussions. These discussions will conclude with the negotiation of an enforcement, inspection, and information-sharing arrangement or memorandum of understanding.
- **Step 3:** The SEC and petitioning entity begin a dialogue, at which time the petitioning entity will have to agree to SEC jurisdiction and service of process with regard to the U.S. securities anti-fraud laws.

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5. Id. at 32.
Step 4: The SEC gives the public notice of the petition and seeks public comment.

While well-intentioned, this process will likely generate problems for both the United States and the foreign petitioning entities. For example, under the regulatory system Tafara and Peterson envision, there would be a high risk that the new framework would become politicized since the SEC would undoubtedly face pressure to approve the regulatory regimes of U.S. allies. In turn, many foreign countries would view this compatibility assessment as another example of the United States trying to force its standards on others. As Tafara and Peterson acknowledge, any U.S. securities regulation needs to remain nationality-neutral. However, given the current political climate, such hopes might appear to be optimistic at best.

There is also the potential for countries to go through the motions of this review process in order to gain access to U.S. investors and secure an exemption from SEC registration, but then fail to apply or enforce the regulatory regime to which they agreed. Subsequently, the new framework would have to include continual monitoring of foreign markets that have gained exemptive status to ensure that they adhere to regulatory standards agreed upon in the compliance review process—another aspect that may prove to be politically sensitive.

Not only would the suggested framework be a significant departure from the SEC’s existing regulatory policies, it could also be costly to implement, especially when one considers that there are a multitude of securities exchanges operating around the world and many more foreign financial service providers. In addition, in the current economic climate of potential merger and stock exchange consolidation, the time may not yet be right to implement a system of comparable regulation. The market should evolve naturally and comparable regulation standards should not stand in the way, nor complicate, the natural consolidation of markets. The better approach might be to allow consolidation and then let the combined exchange attempt to meet new standards.

II. Ensuring Investor Protection

The proposed changes are designed to “directly benefit U.S. investors by providing them with greater investment opportunities at lower costs, while offering them greater protections against cross-border fraud than they currently have.” A key assumption of this new framework is the need for retail investors to have greater access to foreign investment opportunities. In order to deliver this greater market access, Tafara and Peterson propose measures that would lower the barriers to entry for these investors.

8. Id. at 51.
9. Id. at 67–68.
Yet it can be argued that the lowering of these barriers may not be entirely in the interest of retail investors since these barriers can serve to protect them. Retail investors currently face high barriers, such as having to use foreign broker affiliates and facing multiple layers of fees, that make direct investment abroad difficult, although not impossible. In dealing with these barriers, the retail investor is well aware that they are going into foreign markets and leaving behind the protection of the SEC regulatory framework.

Indeed, it is in part for this reason that the SEC has a long history of differentiating between large institutional buyers and smaller retail investors. In the 1980s, CREF received two no-action letters from the SEC regarding activity in foreign markets. These letters essentially acknowledged that in many cases large institutional investors such as CREF should be able to invest and be regulated as locals in foreign markets. The SEC considered large institutional investors to have sufficient resources and sophistication to appropriately judge foreign market risk and fend for themselves. The SEC, through the adoption of Regulation S, further extended the idea that certain investors could knowingly give up U.S. regulatory protection and transact on foreign markets, or raise capital abroad, provided that they comply with certain strict criteria.

In contrast, retail investors lack the resources and sophistication of large institutional investors. A risk of the proposed new framework is that falling investment barriers may lead to a lack of protection for small investors. Many individual investors may find it difficult to objectively assess what the “comparable standards” may be in other markets with varying accounting practices, diverse disclosure standards and different laws. In short, when retail investors would leave U.S. regulated markets to make purchases abroad, they would assume all these risks and become vulnerable to unscrupulous brokers, or even well intentioned ones. With respect to foreign stock exchanges, it is also possible that standards will slip—legends on the front screen will soon become footnotes on the back, with retail investors not appreciating the difference sufficiently.

III. Next Steps

In the “Blueprint” Tafara and Peterson present a thoughtful outline for a new direction that seeks to facilitate cross-border access and deliver benefits to U.S. investors. An objective assessment of such a framework shows that while the idea may be an excellent one, given current market and political

12. See, e.g., Rule 904, Regulation S, 17 C.F.R. § 230.904 (2006) (providing that Section 5 of the Securities Act of 1933 does not apply to resales of securities conducted according to certain restrictions regarding sales in the U.S. market or to U.S. persons).
conditions, the time has not yet come where such progressive plans can be implemented without risking the high standards of investor protection that have become synonymous with SEC regulation. Technology has advanced faster than political systems and countries have not yet developed the necessary safeguards to protect investors who cannot protect themselves should the barriers to market access be removed.

A new framework like the one Tafara and Peterson propose is simply not feasible absent further progress in harmonizing the regulatory frameworks of global securities markets. In particular, we would look for greater harmony in disclosure and offering practices, regulations regarding treatment of small investors on exchanges, and even greater agreement in accounting and internal corporate standards. Such a harmonization in regulatory systems would be free of the political and implementation issues—and erosion—that a system of substituted compliance would encounter.

Attaining such a harmonized system may also not be as unlikely as Tafara and Peterson suggest. For example, the difficulties experienced by a number of German banks attempting to list on the New York Stock Exchange—and to comply with GAAP standards—led to the impetus to harmonize international accounting standards. The SEC is currently working toward this goal with the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). 13 The harmonization of international accounting standards would be a significant step toward a uniform regulatory regime.

Until such a time, and given the issues associated with a system of substituted compliance, it is best to continue on the present course and allow a seamless global capital market to evolve naturally. Until sufficient changes are made that ensure markets are in sufficient harmony, large institutional investors can continue to invest under “buyer beware” conditions since they have the ability to understand and bear greater risks while market barriers remain in place to protect individual U.S. investors.

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