INCREASED ACCESS TO UNITED STATES CAPITAL MARKETS: A BRIEF LOOK AT THE SEC'S NEW INTEGRATED DISCLOSURE RULES FOR FOREIGN ISSUERS

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1. Introduction

1.1. The international securities market and the SEC

The modern financial community has begun to experience a significant increase in access to capital through a phenomenon characterized as the "internationalization of the securities markets", whereby increasing numbers of corporations cross national boundaries to issue and sell their securities. Accordingly, regulatory bodies, such as the Securities and Exchange Commission (hereinafter the Commission), have had to grapple with transnational as well as national problems.

I have assumed a major role at the Commission in overseeing international securities matters and coordinating the Commission's efforts to identify new issues, examine relevant policy concerns, and formulate possible regulatory approaches. I firmly believe that the internationalization of the securities markets is a vital economic development; the free flow of capital between countries will stimulate world commerce, promote the efficient allocation of resources, and ultimately rebound to the benefit of Japan, the United States, and all other nations. To this end, I think the Commission should reduce unnecessary regulatory impediments to foreign issuers seeking access to United States markets, while maintaining its commitment to ensure adequate disclosure of information important to the United States investors.

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Admittedly, striking this balance will be a difficult task. Foreign issuers are currently subject to Commission requirements that are often quite different from their own nation's counterparts, which may be based upon different accounting and auditing principles, disclosure practices, and trading market mechanisms. This divergence causes additional disclosure burdens and resulting expenses that can deter foreign issuers from entering United States markets. However, because the Commission requirements traditionally have been deemed essential for the protection of United States investors, they cannot easily be eliminated or modified.

Despite the difficulties involved, I believe the Commission can reconcile the interests of both foreign issuers and United States investors. Furthermore, it is important for securities regulators in other countries to adopt a flexible approach to the problems of United States issuers so that they can have greater access to capital markets outside of the United States.

1.2. The flow of capital between Japan and the United States

One example of the increasing transnational flow of capital is the growing number of Japanese issuers seeking to raise capital in United States markets. Between 1980 and 1983 more Japanese issuers than ever before have held discussions with the Commission's Division of Corporation Finance with respect to offering their securities directly in United States markets. In July 1981, Nomura Securities International became the first Japanese brokerage firm to secure a membership on the New York Stock Exchange, a development which should facilitate the offering of even more Japanese securities in United States markets.

United States issuers are also demonstrating an increasing interest in the Japanese markets. For example, in January 1982, Dow Chemical made a $100 million offering in yen denominated bonds in the Japanese Samurai debt market. Undoubtedly, many problems had to be solved to make the Dow offering possible. What is important is that the problems were solved and U.S.–Japan relations were strengthened.

2. The new revisions in the disclosure rules

On November 18, 1982, the Commission took an important step toward resolving some of the major problems of foreign issuers seeking access to United States markets by promulgating comprehensive revisions of its foreign securities registration requirements [1]. These revisions should constitute the most significant change in foreign issuer registration requirements since the original passage of the Securities Act in 1933.

Significantly, the new rules for foreign issuers offering securities in the United States are part of a broader effort by the Commission to simplify and
improve the disclosure requirements for all issuers, both foreign and domestic. Even when not targeted specifically to the problems of foreign issuers, the Commission's general deregulatory efforts will reduce their disclosure burdens.

2.1. Integrated disclosure system: Incorporation by reference

The new rules revise the registration requirements for foreign issuers offering their securities in the United States under the Securities Act of 1933 (hereinafter the Securities Act) [2]. Perhaps most significantly, they create an integrated disclosure system whereby certain foreign issuers can satisfy the Securities Act registration requirements by incorporating by reference, or by attachment, information disclosed in a Form 20-F already filed with the Commission pursuant to the Securities Exchange Act of 1934 (hereinafter the Exchange Act) [3]. Previously, most foreign issuers offering securities in the United States were required by the Securities Act to register their securities by filing a Form S-1, a full registration document which contains detailed information about both the issuer and the securities transaction [4]. These same issuers must file a Form 20-F pursuant to regulations promulgated under the Exchange Act if they have previously offered securities in the United States, have securities listed on a United States exchange, or have more than 500 shareholders and more than $300 million in assets [5] unless exempt under Rule 1293-2 (b), the information-supplying exemption.

The new integrated disclosure system is structured around three new registration documents: Forms F-3, F-2, and F-1 [6]. Each of these forms is different from those used by domestic issuers, ensuring that distinctive foreign problems receive specific Commission attention. Foreign issuers using these different forms will also be immune from the effects of changes in forms used by domestic issuers.

Foreign issuers using Form F-3, which can be used for all types of securities offerings except exchange offers, can incorporate by reference the information contained in Exchange Act Form 20-F [7]. These issuers, however, are required to deliver Form 20-F upon request. To qualify to use Form F-3, an issuer must have filed reports under the Exchange Act throughout the previous 36 months and must have at least $300 million of voting stock held by non-affiliates [8]. Issuers of highly-rated non-convertible debt securities, however, can use Form F-3 if they have reported to the Commission throughout the previous 36 months, regardless of the amount of voting stock held by non-affiliates [9].

Under the proposed rules, foreign issuers using Form F-2 may attach Form 20-F to the F-2 prospectus, instead of repeating all of the information required by both documents [10]. As with Form F-3, Form F-2 may be used for all Securities Act transactions except exchange offers. A foreign issuer is eligible to use Form F-2 if it has either filed under the Exchange Act throughout the previous 36 months or, if it has so filed only once and has at least $300 million of voting stock held by non-affiliates [11].
Foreign issuers that are ineligible to use Forms F-2 or F-3 are required to use Form F-1. These issuers cannot incorporate by reference into Form F-2 the information also required for Form 20-F. Rather, all information required in Form 20-F, as well as certain other information, must be included in the F-1 prospectus, similar to the Form S-1 previously used by foreign issuers offering their securities in the United States. Form F-1 can be used to register any Securities Act transaction. It is thus the only form under the proposed rules available for the registration of exchange offers by foreign issuers.

2.2. Revision of substantive disclosure requirements

In addition to providing for an integrated disclosure system, the new rules modify other Securities Act disclosure requirements which have been particularly burdensome to many foreign issuers. These modifications permit the use of financial statements prepared in accordance with foreign, as opposed to United States, generally accepted accounting principles (foreign GAAP), segment reporting of revenues, aggregate reporting of remuneration paid to officers and directors, and relax the timeliness requirements for financial statements incorporated into Securities Act prospectuses.

2.2.1. Generally accepted foreign accounting principles

The new rules allow foreign issuers to use foreign financial statements prepared in accordance with “a comprehensive body of accounting principles other than those generally accepted in the United States” [12]. Such issuers, however, have to quantify any material differences between the figures reached under the foreign GAAP and those which would have resulted had the issuers followed SEC Regulation S-X and United States generally accepted accounting principles (U.S. GAAP) [13]. In addition, except for offerings of certain highly-rated non-convertible debt securities and for rights offerings to shareholders or employees, foreign issuers basing their financial statements on foreign GAAP must reconcile their financial statements by providing information required under U.S. GAAP and Regulation X. This information includes reserve recognition accounting data, pension information, and full segment reporting.

2.2.2. Modified segment reporting

The exception to the reconciliation requirement for certain highly-rated non-convertible debt securities and rights offerings to shareholders is probably most significant with respect to the requirement of full segment reporting, which many foreign issuers have found troublesome in the past. Full segment reporting, as required by U.S. GAAP, calls for the disclosure of profits, revenues, and assets for each geographic and industry segment. Foreign GAAP may require segment reporting only of profits. Thus, debt and rights offering

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issuers not required to reconcile their financial statements with U.S. GAAP may dispense with segment reporting of profits and assets if they base their financial statements on foreign GAAP which require segment reporting only of revenues. Even these issuers, however, must provide a narrative explanation of the significance of a sector’s revenue contributions to total operating profits if its revenue contributions differ materially from its profit contributions [14].

For debt issues and rights offerings the new rules also allow modified segment reporting by corporations that restate their financial statements according to U.S. GAAP. This would be accomplished through a waiver of the certification requirement for that part of a restated financial statement containing the modified segment disclosure [15]. Foreign issuers offering securities in the United States must have their financial statements certified by an accountant. The accountant must give an opinion that the foreign financial statements have, in fact, been prepared in accordance with the generally accepted accounting principles used by the issuer. As noted above, U.S. GAAP require full segment reporting. Thus, an accountant could not certify as conforming to U.S. GAAP a restated financial statement containing only modified segment reporting. Waiver of the certification requirement as to the segment reporting section of the restated financial statement solves this problem and places equally relaxed segment reporting burdens on foreign debt and rights offering issuers regardless of the accounting principles they utilize.

2.2.3. Disclosure of remuneration

Rather than requiring disclosure, on an individual basis, of remuneration paid to officers and directors, the new rules permit foreign issuers to continue to disclose in their Securities Act registration statements only aggregate amounts unless the remuneration paid to an individual officer or director has been previously disclosed to shareholders or to the public [16]. Similarly, the interest of management in certain transactions must be documented only insofar as the issuer has previously disclosed this information to shareholders or to the public [17].

2.2.4. Timeliness requirements

Under the new rules, foreign issuers are permitted to use financial statements older than those which can be used by domestic issuers. Whereas United States issuers must use financial statements no older than 135 days at the time of the filing and effective dates of the registration statement, foreign issuers can now use financial statements up to 6 months old at the effective date of the registration statement [18]. Foreign issuers’ financial statements, however, have to include more current financial statements issued pursuant to foreign law [19]. In addition, foreign issuers are now permitted to use financial statements up to 12 months old at the effective date of the registration statement for certain offerings to shareholders, such as rights offerings [20]. The standard
135-day requirement for comparable domestic offerings remains unchanged by the new rules.

2.2.5. Additions to Form 20-F

In addition to the changes in the disclosure requirements noted above, the new rules modify the Exchange Act’s Form 20-F in two ways. The item “Management’s Discussion and Analysis” is revised [21], and another item, “Selected Financial Data”, has been added. These items require management to present its views on the issues of liquidity, capital resources, and results of operations.

3. Conclusion

The new rules for foreign issuers may not, at first blush, appear to make entry into the U.S. markets significantly easier for foreign companies. These requirements, however, do simplify greatly the process of offering securities in the United States, while still meeting the basic disclosure needs of U.S. investors. Thus, they manifest a significant easing of the present requirements and represent a major step in the direction of internationalization.

Although the new rules constitute an important step toward making the U.S. capital markets more accessible to foreign issuers, a more unified effort by all countries will be necessary to respond fully to the business realities of the modern multinational corporation, and to create a truly effective internationalized market. In this regard, the SEC and other securities regulators around the world will have to work together to develop a common framework of international accounting principles, disclosure standards, and trading market mechanisms which will harmonize the divergent conventions and practices of all countries. With uniform standards, issuers will be able to enter quickly all markets in the world without the need to tailor their offerings to idiosyncratic national requirements. While a uniform system for foreign issuers may sound like an impossibility, international groups such as the United Nations, the International Accounting Standards Committee, the Organization for Economic Cooperation and Development, and the European Economic Community are already demonstrating the feasibility of such a system through their own significant strides.
Notes

[7] Id. at 54, 779.
[8] Id. at 54, 776.
[9] Id. at 54, 777.
[10] Id. at 54, 775.
[12] Id. at 54, 787.
[13] Id. at 54, 788.
[14] Id. at 54, 783.
[15] Id. at 54, 788.
[16] Id. at 54, 786.
[17] Id.
[18] Id. at 54, 767.
[19] Id.
[20] Id.
[21] Id. at 54, 784.