FRAUDS AND BOARDS

International capital market regulation. Last month securities regulators from 52 countries gathered in Toronto, Canada, for a meeting of the International Association of Securities Commissions and Similar Organisations. The prime issue on their agenda was the emergence of international capital markets and the integration of financial services, but it was a proposal advanced by the US Securities and Exchange Commission (SEC) which caused the most stir.

The remorseless movement towards international capital markets is a response to the financing needs of world conglomerates, the increasingly interdependent world economy through international trade, and the rise of institutional investors who diversify by investing pension funds in foreign securities. The significance of the latter should not be underestimated as pension managers are becoming more adventurous and today many portfolio managers have as much as 10 percent of their funds invested in foreign securities. A few years ago 1 to 2 percent was typical.

The meeting was informed that the movement towards international capital markets was having such significance for the US in particular because of the size of its capital markets. For example, in the US alone pension fund assets amount to $1 trillion. In 1983, $11.5 billion in pension funds money was invested in foreign securities, up by $6.5 billion over 1982. Further, although many foreigners scoff at Reaganomics, foreign corporations and overseas investors are now pouring into the US in search of profits and growth. New York's financial institutions have surged to world supremacy and New York is now truly the capital of "capital". Wall Street has 55 percent of the world’s total equity market making it three times as big as second placed Tokyo and eight times the size of London. Foreign companies raised more than $2.8 billion in equity capital in the US last year. The dollar volume of trading in foreign stocks listed with the electronic network of the National Association of Securities Dealers increased from $5.7 billion in 1982 to $11.4 billion in 1983. As a result, it is not unusual for companies such as British Petroleum Co PlC of Britain to trade more actively in New York than it does in London.

While any investment flow will occur wherever the spouses outweigh the minusse, there are risks. One problem widely discussed at the meeting was the trade-off of investor protection in the name of capital market efficiency. There is the problem, particularly in the international sphere, of not offering the same degree of protection to all investors regardless of nationality. Information technology advances are increasing the significance of the problem. Telecommunications have made it easy to transfer funds from Bahamas to Zurich or from Boston to New York. Alternatively, transactions on a US stock exchange can be easily executed from other places such as Tokyo or Geneva. Naturally enough the SEC, acting as it does as protector of the US investor and security markets, is particularly concerned about the double standard of behaviour that presently exists in the US — the behaviour of US investors as opposed to that of foreigners.

John Fedders of the SEC spoke at length about the "second-guessing" hiding behind "a shield of secrecy and lack of information" of other countries. The SEC is often blocked in its inquiries by the financial structure executing the trade. These foreign institutions claim they are acting within the bounds of secrecy laws of their own countries. These laws frequently embody national interest and prohibit documents in the state being disclosed in compliance with orders of foreign authorities. Unfortunately, this has resulted in investors who execute trades in the US being subjected to stricter accountability than those who use foreign agencies.

Because of this problem the SEC has considered proposing a "waiver by conduct" law in the US so that countries with secrecy laws would apply principles that would contruct such laws as inapplicable to the extent that they relate to investors using foreign financial institutions to engage in US securities transactions. That is, the SEC hopes that foreign jurisdictions will accept the premise that investors automatically waive their rights to national secrecy laws as a precondition of dealing in the US capital markets. This would remove the double-standard that presently exists. The SEC is particularly concerned because it involves fraudulent dealings on US stock markets as threatening its free market system.

Other countries may not be so enthusiastic and view such rights being sought by the SEC as an infringement of their sovereign rights. However, the figures are that from 1978 to 1983 purchases of stocks and bonds in the US by foreign investors increased from $23.6 billion to $79.8 billion. The SEC proposal also envisages making the US broker the agent for the foreign investor which would allow subpoenas to be served with the broker.

The SEC considered this proposal on May 31 deeming it merited consideration by the US Congress after further analysis. It is open to comment on this proposal or alternatives until November 1. The SEC believes that negotiating bilateral and multinational agreements would be time-consuming and unlikely to succeed. Unilateral action by the US government appears to the SEC to be the best way to move.

If the SEC wanted a case to cite as an example (its usual practice is to neither confirm or deny any investigation) it could make use of its current investigation into insider trading and takeover bids which has resulted in over $40 million of trading profits being reaped by more than 20 Wall Street individuals, law firms, and securities firms. The SEC apparently suspects that details of pending corporate takeovers were leaked to certain people prior to the public announcements. The SEC is seeking the names behind several accounts at Zurich-based Ellis AG in the belief that many of the suspect trades, extending from the late 1970s to the present, were done through Ellis. So far, the SEC hasn’t pursued Ellis to identify the holders of the suspect accounts.

New Board Formed. Earlier this year the trustees of the Financial Accounting Foundation approved the formation and funding of a Government Accounting Standards Board (GASB). It replaces the National Council on Governmental Accounting (NCGA) which was a part-time voluntary group associated with the Municipal Finance Offices Association. The GASB was formed with the understanding that it would establish financial reporting standards for activities and transactions of state and local government entities. The Financial Accounting Standards Board (FASB) will continue to establish standards for the activities and transactions of all other entities.

The new board has five members, appointed for five year terms by the Foundation trustees, with James Antonio as the full-time chairman.

During August the GASB produced its first official Statement — "Authoritative Status of NCGA Pronouncements and the AICPA Industry Audit Guide". The Statement upheld certain rulings by the NCGA and the American Institute of Certified Public Accountants (AICPA). All NCGA pronouncements previously issued and currently in effect, and the currently effective accounting and financial reporting guidance contained in the industry audit guide, "Audits of State and Local Governmental Units", of the AICPA, are to continue in force unless amended or superseded by a subsequent GASB pronouncement.

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