STATEMENT OF THE HONORABLE RAY GARRETT, JR., CHAIRMAN SECURITIES AND EXCHANGE COMMISSION, BEFORE THE SUBCOMMITTEE ON SECURITIES OF THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS ON S. 425, 94th CONG., 1st SESS.

(March 5, 1975)

Mr. Chairman, members of the Subcommittee:

I am pleased to appear today before this Subcommittee to testify an S. 425, "the Foreign Investment Act of 1975." With me this morning is Alan B. Levenson, Director of the Commission's Division of Corporation Finance.

S. 425 apparently is intended to serve two primary purposes. First, this bill would, if enacted, enable the Commission to elicit more information regarding persons making acquisitions of the equity securities of American companies. It would also make more effective any monitoring of foreign investments in the equity securities of most large, publicly-owned, American companies.

Second, S. 425 would impose a screening process for significant foreign investments in American companies. It would authorize the President, in his discretion, to prohibit any foreign person from acquiring more than five percent of any class of equity securities of any large United

States company, if the President, determines that such an acquisition is not in the national interest.

The need for accurate and current information concerning the record and beneficial ownership of equity securities issued by American companies is well established. This Subcommittee, and particularly its Chairman, have been instrumental in proposing and facilitating the enactment of legislation to require improved disclosures by certain holders of equity securities and by persons contemplating acquiring such securities. And, in response to the growing importance of institutional investors in our capital markets, this Subcommittee has endorsed legislation requiring increased and uniform disclosure of institutional portfolio holdings and significant transactions.

The Commission supports the efforts by the Subcommittee to improve the disclosures required under the Securities Exchange Act. Pending the passage of any new legislation, we have continued to appraise the effectiveness of the disclosures we presently require under our existing authority and the need for further disclosures of the identity and background of shareholders. As part of this appraisal, last fall the Commission ordered a Public Fact-Finding Investigation in the Matter of Beneficial Ownership, Takeovers and Acquisitions by Foreign and Domestic Persons, in order to determine whether we should exercise our rulemaking authority under the Securities Exchange Act, or recommend legislative changes, to require additional disclosures.

Our staff is still reviewing the record compiled during that public investigatory proceeding — consisting, as of this date, of 1,667 pages of transcripts; 25 prepared oral statements; 36 exhibits; and 78 letters of comments from interested persons. We are hopeful that, during May or June of this year, we can publish for comment some new disclosure rule proposals, assuming, of course, that new legislation, making our proposals unnecessary or superfluous, has not already been enacted.

Although we believe we presently have significant rulemaking authority to require the new disclosures proposed in S. 425 for five percent equity shareholders or persons proposing to acquire five percent of the equity shares of a company, we generally support the bill's proposal to improve these disclosures by statute.

Similarly, the Commission is generally in favor of improved disclosure of the identity of the persons with the power to vote the equity securities of large American companies who would not otherwise be required to file reports under Section 13(d) of the Securities Exchange Act, although we are troubled by the specific approach to obtain this information embodied in S. 425. The Commission also concurs in the assumption underlying S. 425 — that improved disclosures demand explicit legislative recognition of new enforcement remedies — although we have not had serious difficulty persuading the federal courts to fashion effective equitable remedies under existing laws. We are, however, troubled by the decision to limit these new

remedies only to violations involving foreign investors, and, even then, only to violations of the new screening provisions that would be added to the Act.

Finally, while we have some comments on the mechanics of the screening provisions of S. 425, the Commission has no comment on the desirability of these provisions of the Act. As made clear by proposed new Section 13(f) (2), at page 7 of S. 425, the need for, and use of, screening powers raises questions of "national security" and "foreign policy"; these are matters beyond the responsibility of this Commission.

I should like briefly to summarize the provisions of S. 425 that are of most importance to us. The Commission's detailed, written, comments on S. 425 have already been furnished to the Subcommittee and its staff, and will, I assume, be made a part of the Subcommittee's record of hearings on this bill.

Improved Disclosures by Five-Percent Shareholders of Equity Securities

S. 425 proposes to amend Section 13(d) of the Securities Exchange Act to require, in addition to existing provisions of law, that persons who have acquired, or who propose to acquire, five percent of the equity shares of large American companies must, subject to our rulemaking powers, disclose the residence, identity and financial statements of the beneficial owner of those securities; the background, identity, residence and nationality of any associated persons who participated or are expected to participate in the

acquisition; and a detailed description of any other persons sharing or having exclusively the authority to exercise the voting of rights of those securities.

Since Section 13(d) of the Securities Exchange Act presently requires the disclosure not only of the information there specified, but also "such additional information...as the Commission may by rules and regulations prescribe…," there is no strict need for the additional disclosures S. 425 proposes to add. Nevertheless, we fully support this provision of S. 425.

Since S. 425 proposes to amend Section 13(d) and, therefore, reports required to be filed pursuant to Section 14(d) of the Securities Exchange Act, the Subcommittee may wish to consider proposing comparable amendments for reports required to be filed with the Commission by directors, officers and principal stockholders pursuant to Section 16(a) of that Act.

Disclosure of Beneficial Ownership

S. 425 would also add a new Section 14(g) to the Securities Exchange Act, creating a multi-tiered reporting procedure so that American companies with a registered class of equity securities could compile an accurate list of the names, residences and nationalities of the beneficial owners of such securities, as well as information with respect to the locus of authority to exercise the voting rights of the securities held of record by other persons. The Commission would be granted rulemaking authority with respect to an issuer's obligation to compile such a list of beneficial owners and to file such

a list, or a portion thereof, with the Commission, presumably as a public document.

The Commission has previously supported the desirability of requiring the disclosure of the situs of significant voting power, particularly when that power is partially or completely vested in persons other than the record owner of the shares. We support such disclosures, however, for both foreign and American investors. While we have some authority to, and are still exploring whether we should, propose appropriate disclosure rules in this regard, legislation governing this subject matter appears preferable, since it would resolve any doubts about the existence, extent, scope and effectiveness of our authority to compel such disclosures.

S. 425, however, may not accomplish its goals. As presently drafted, the bill fails to accomplish its avowed purpose of providing a comprehensive list of the names, residences and nationalities of beneficial owners. -For example, an investor owning less than five percent of the equity securities in a large, publicly-owned United States company may easily arrange to have the certificates evidencing such securities registered in his name and have all dividend, annual reports and proxy statements sent to a mailing address in the United States. Since the record holder is the beneficial owner and is not holding on behalf of another person, these provisions of S. 425 would be inoperative. It should be noted that, in such a case, the public company's list of stockholders would only contain the investor's name, his United States

mailing address and the number of shares owned. Thus, the public company would not know the nationality or residence of such a foreign investor.

More importantly, we are concerned about the substantial costs that would be imposed on brokerage firms, banks, trust companies and, especially, transfer agents, as well as the issuing companies, if the precise provisions of S. 425 were enacted, since the bill would apply to all beneficial owners, even the owner of one share of common stock. The burden of receiving so much material would also be severe on the Commission. Computer print-outs of stock records of widely-held companies can easily fill a large file drawer, and there are some 9,000 companies presently registered under the Exchange Act. It is not unusual for a large company to have over 100,000 record holders of its common stock. AT&T has millions. So much data is too expensive to collect and more than anyone can effectively and properly use.

If the intention of this section of the bill is to elicit significant information regarding beneficial owners, the Congress should consider less burdensome, alternative means of accomplishing this goal. At the very least, the disclosure in filings should be limited, perhaps to the 20 or 30 largest holders, or any holder of more than some percentage such as 2 percent or 1 percent.

The problem in obtaining meaningful disclosure of stock ownership has always been record ownership by fiduciaries who feel constrained by law or custom or good business practice, from their point of view, to decline to

disclose the identities of the persons for whom they hold the stock, except in response to legal process. Foreign fiduciaries, in many cases, will not even recognize our legal process for this purpose. Most fiduciaries will disclose the extent to which they have the power to vote shares held in their name or the names of their nominees, but not the identity of any other person who holds the power solely or jointly with the fiduciary.

The idea of requiring fiduciaries to disclose their beneficiaries, or at least those beneficiaries with voting power, on a regular basis for public filings raises other considerations that must be carefully weighed. One is the long-standing tradition and policy in our law of protecting the privacy of private trusts. Compelling the public disclosure of the portfolios of private trusts — even if only to the extent that they hold equity securities of publicly-owned U.S. companies for which the beneficiaries hold the voting power — is a fundamental departure from our settled norms. Of course, we have long since made this departure where the beneficiary is a reporting person under Section 16 of the Securities Exchange Act or is otherwise a control person, or affiliate, of the portfolio company, or one who has acquired five percent and becomes subject to Section 13 (a.). But we are now considering a more drastic and far-reaching departure.

One approach might be to require such disclosure only when the shares constitute more than a specified percentage of the outstanding shares, but making the percentage much lower than 10 percent or even 5 percent. One and two percent have been suggested. The theory, then, would be that an

investor can preserve privacy through a personal trust and yet retain voting power so long as he keeps his positions in publicly-owned companies insignificant in terms of voting strength. Above that, public policy favoring disclosure will prevail over that favoring the privacy of personal investments.

Another consideration is one of competitive fairness among fiduciaries — broker-dealers and trust companies and U.S. and foreign banks. The foreign part of the problem is not just one of even application of the law as written, but also as enforced. This Subcommittee is familiar with our long, and so far futile, efforts to compel disclosure of bank customers in some countries, even for purposes of criminal investigation. Here, S. 425 offers a device that might do the job, namely, the disenfranchisement of the stock. S. 425, as presently drafted, would employ this device only for violations of the screening provisions, but it might also be used to obtain disclosure, both foreign and domestic.

As I have stated, these proposals, although well-motivated, appear to be too all-encompassing for any reasonable use, and therefore should be revised. We are not yet prepared to recommend specific legislation to do this, although we hope to be soon, after we have reviewed our voluminous hearing record.

Screening of Foreign Investors

S. 425 also would add a new Section 13(f) to the Securities Exchange Act to require any foreign person, company or government to file with the

Commission a confidential statement, containing certain specified information, 30 days in advance of any acquisition by which that foreign investor would own more than five percent of any class of equity securities of any United States company with more than $1 million in assets. The Commission would be required to transmit the pre-acquisition statement to the President, who would be authorized to prohibit the acquisition if he finds it necessary to protect the national security, foreign policy or the domestic economy of the United States.

These proposed screening provisions involve significant national policy matters which can only be decided by the Congress. The Subcommittee no doubt recognizes that any deterrent to foreign investments in the United States could have an adverse impact on the future ability of public companies to raise capital in the United States and could impair the future depth and liquidity of trading markets in the securities of United States companies. Mr. Bennett, Undersecretary of the Treasury, gave some statistics in his testimony yesterday which would indicate that at least in the recent past the impact of the deterrent, while adverse, would have been small. The future possible impact, while difficult to estimate, is what must be considered.

Similarly, legislation of this nature could lead to the enactment of still more protectionist legislation by other countries which may impair the ability of United States companies to raise or invest capital abroad.

In the past, the Commission has supported the enactment of the Foreign Investment Study Act of 1974. Presently the Departments of Treasury and Commerce are conducting an extensive study of foreign investments in the United States pursuant to that Act. An interim report from the Departments of Treasury and Commerce to the Congress is due on or about November 1, 1975, and a final report is due sometime around May 1, 1976. If Congress determines that time permits, it may be appropriate to review the findings of the Commerce-Treasury report prior to the enactment of any screening legislation in this area.

Nevertheless, if the Congress should deem it appropriate to adopt some type of screening legislation at this time, we are troubled by the provisions prescribing our involvement in the filing and consideration of pre-acquisition statements.

First, proposed Section 13(f) (l) (C), on page 7 of S. 425, would require that, "in exercising its authority... the Commission shall consult and cooperate with the President to assure that its actions are in accordance with the President's powers and responsibilities with respect to the activities of foreign investors in the United States." While we acknowledge that we are one logical repository for pre-acquisition reports, if required, we are troubled by the requirement that we "consult" with the President in carrying out our functions. This requirement would thrust us into an area — the establishment of national foreign policy — in which we have no expertise. If reports are to

be required, and if we are to receive them, we prefer not to have any nonsecurities policy-making functions vested in us.

Second, the Commission might become enmeshed in significant conflicts of interest if we are the repository for these pre-acquisition reports and the present provisions of the bill, relating to the confidentiality of these reports, are maintained. For example, under this bill, the Commission could receive secret, but material, information regarding a proposed acquisition of equity securities of an issuer by a foreign investor while the Commission's staff is simultaneously reviewing the adequacy of disclosures in a filing relating to a public offering of that issuer's securities or relating to corporate actions to be adopted by a vote of that issuer's security holders.

Accordingly, the Commission requests that, if the screening provisions of the bill are enacted, and the Commission is designated as the repository for the pre-acquisition filings, the Commission be authorized to require the publication of those reports if we find it necessary in the interests of investors.

Enforcement Powers

S. 425 proposes to amend Section 21 of the Securities Exchange Act by adding explicit sanctions — loss of voting powers or forcing the sale of any securities acquired —against foreigners who fail to file a pre-acquisition report with the Commission. These sanctions would be enforceable not only by the Commission, but by the Attorney General and any record holder of the

equity securities of the company whose shares are involved. The bill also proposes to make the aiding and abetting of any violation of the Securities Exchange Act a specific statutory violation, as the federal courts repeatedly have held over the last ten or more years.

As I noted earlier, we have been successful in obtaining a variety of equitable sanctions for violations of the provisions of the laws we administer. The specific remedies-proposed for violations of the screening provisions would, however, be effective deterrents to such violations. But, if the Congress intends to provide explicitly for such remedies, we urge, that the Subcommittee extend these remedies to all other provisions of the Act to which they may be relevant, to avoid any confusion about the broad equity powers of the courts under the federal securities laws. Naturally, if such a change were made, it would be inappropriate, we believe, to extend civil enforcement powers to any entity or person other than the Commission and, in appropriate instances, such as cases involving violations of the proposed beneficial ownership reporting requirements, the issuing company might be given explicit standing to sue.

Finally, we strongly endorse the provisions of S. 425 making the aiding and abetting of a violation of the Securities Exchange Act an explicit violation of that Act, although, as I have noted, under the cases construing the Act, aiding and abetting has always been deemed to be a violation of the Securities Exchange Act.

MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION PREPARED FOR THE SUBCOMMITTEE ON SECURITIES OF THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS ON S. 425, 94th CONGRESS.

(MARCH 5, 1975)

INTRODUCTION

As stated in the purposes clause of the bill, S. 425 would amend the Securities Exchange Act of 1934 ("Exchange Act") [FOOTNOTE: 15 U.S.C. 78a, et seq.] to require notification by foreign investors of proposed acquisitions of equity securities of United States companies; to provide notice to the President so that he may take action to prohibit any such acquisition, as appropriate, in the national interest; and to provide a system by which issuers of securities registered under the Exchange Act can maintain a list, to be filed with the Securities and Exchange Commission (the "Commission"), stating the names and nationalities of the beneficial owners of their equity securities.

ANALYSIS OF THE BILL

The bill would amend and expand existing Section 13(d) of the Exchange Act to require, explicitly, that statements of beneficial ownership of equity securities (Section 13(d) statements) must include information with

respect to the beneficial owner's residence, nationality and financial status. Also, the Section 13(d) statement would be expanded to require information as to the background, identity, residence, and nationality of any person, other than the beneficial owner who files the report, who possesses sole or shared authority to exercise the voting rights evidenced by the securities being acquired.

As a means of obtaining information with respect to acquisitions of equity securities of "United States companies" by "foreign investors," as those terms are defined in Section 2 of the bill, S. 425 also would require that a Section 13(d)-type statement be filed confidentially with the Commission 30 days in advance of any proposed transaction pursuant to which a foreign investor would acquire beneficial ownership of more than 5 percent of a class of any equity security of a United States company with more than $1 million of assets. This provision would apply regardless of whether the United States company has securities registered under the Exchange Act. Once a foreign investor has filed a statement with the Commission, the bill states that the Commission shall transmit the statement to the President for appropriate action. S. 425 also would vest authority in the President to prohibit acquisitions by foreign investors as he deems appropriate to protect the national security, foreign policy or domestic economy of the United States.

The bill also creates a reporting structure pursuant to which certain issuers of securities can compile lists of their beneficial owners. Thus, the bill imposes an obligation on every holder of record, for another person, of any

security described in Section 13(d) to file certain reports with the issuer. The content of these reports would be subject to the Commission's rulemaking authority and would contain information such as the identity, residence and nationality of the beneficial owner of such securities and any person, other than the beneficial owner, possessing sole or shared authority to exercise the voting rights of the securities. To provide necessary information by which the record holder may compile the above statement, S. 425 would also impose a series of obligations on each other person who stands as an intermediary holder between a record holder and the beneficial owner. Each intermediary holder would be required to furnish information to the person who holds for his account, and the information, subject to the Commission's rulemaking authority, would describe the identity, residence, and nationality of the beneficial owner and any other person possessing sole or shared voting authority with respect to such securities. Subject to the Commission's rulemaking authority, the issuer would be required periodically to file with the Commission a list of the beneficial owners of its equity securities.

With respect to the advance notice requirement for acquisitions by foreign investors of equity securities of a United States company, S. 425 specifies sanctions and remedies for violations; the Commission, the Attorney General, a United States company in which a foreign investor has acquired or proposes to acquire an equity security or a holder of record of any equity security of such a United States company may bring actions in Federal district court to enjoin violations or enforce compliance by the foreign investor. The bill also states that the court may order appropriate relief, including the

revocation or suspension of voting rights of securities acquired by foreign investors in violation of new Section 13 (f) and the sale of any securities so acquired.

The bill defines the terms "United States company" and "foreign investor" and makes certain other revisions in the Exchange Act definitions of the terms "person" and "company."

DESCRIPTION OF THE PRESENT LAWS CONCERNING ACQUISITIONS

Under Section 13(d) as it presently exists, any person, directly or indirectly, becoming the beneficial owner of more than five percent of any class of equity securities registered with the Commission pursuant to Section 12 of the Exchange Act, or any equity security issued by a closed-end investment company, or of certain equity securities of insurance companies, must file with the Commission and send to the issuer and each exchange where the security is traded, a statement containing information specified in the subsection, as well as any additional information the Commission by rule may prescribe. The Commission has adopted a form for this purpose — Schedule 13D [FOOTNOTE: 17 CFR 240.13d-101; the Schedule 13D report is also required to be filed in connection with cash tender offers subject to Section 14(d) and Rule 14d-l.] — to specify the information required to be filed. Schedule 13D must be filed within ten days from the date of the acquisition. [FOOTNOTE: The Commission's staff is considering rulemaking to clarify

the Schedule 13D filing requirements applicable to groups. Compare Bath Industries Inc. v. Blot, 426 F. 2d 97 (C.A. 7,1970) with GAF Corp. v. Milstein, 453 F. 2d 709 (C.A. 2,1971).] The Schedule 13D is required to be amended promptly if any material change occurs in the facts set forth in earlier filings.

Under Section 12(i) of the Exchange Act, certain banks and savings and loan associations satisfy certain filing requirements under the Exchange Act, including the requirements arising pursuant to Section 13(d), by filing specified forms with and pursuant to regulations of the Federal Reserve Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board. And, pursuant to Public Law 93-495, those agencies are generally required to issue regulations substantially similar to those promulgated by the Commission pursuant to Section 13 (d) and other sections of the Securities Exchange Act.

New Terms Defined in S. 425 "United States company"

Section 2 of S. 425 defines the term "United States company" to mean any corporation, limited partnership or business trust organized in one of the United States, its territories or possessions, as well as any other "company" with its principal place of business in the United States. Thus, the provisions of the bill applicable to United States companies would apply to any corporation, limited partnership or business trust organized under the laws of a state, territory or possession of the United States, even though the entity's

principal place of business is elsewhere. Any other "company" will be subject to the provisions of the bill if its principal place of business is in the United States.

The definition of "United States company" might be revised, however, to clarify that a business organized or chartered under the laws of the United States (as distinguished from "one of the United States") is within the definition.

"Foreign investor"

The bill also adds a new provision to the Exchange Act to define the term "foreign investor" as meaning any of the following;

— a natural person resident outside the United States;

— a company other than a United States company;

— a foreign government, as described in the bill;

- a United States company that is controlled by any person described above; or

— two or more persons acting in concert for the purpose of acquiring, holding, voting, or disposing of securities, at least one of whom is a "foreign" person as described above.

To clarify that a "foreign investor" includes a United States company which, through several tiers, is controlled by a foreign company, it is suggested that proposed Section 3(a)(23) (4) be revised as follows:

"(4) a United States company controlled directly or indirectly by a person described in paragraph (1), (2), or (3) of this subsection; or".

Amendment to Section 13(d)

Section 3 of S. 425 adds several new disclosure requirements for statements regarding equity securities acquisitions subject to Section 13(d). [FOOTNOTE: The information requirements proposed to be added to Section 13(d) would apply both to acquisitions subject to Section 13(d) and cash tender offers subject to Section 14(d).] One of the new provisions would require the Schedule 13D to disclose the "residence and nationality" of the person acquiring the beneficial ownership. The purpose of this new disclosure is to elicit publicly-filed information to identify whether foreign interests are involved in the Section 13(d) acquisition, or the Section 14(d) tender offer. S. 425 would also amend Section 13(d) to require that the Section 13(d) or 14(d) statement include "financial statements (which must be so certified if required by the Commission) of such person."

Although the Commission believes it already has the authority to require such disclosure under present law, we support the inclusion of these provisions in the statute, recognizing that the Act vests discretion in the Commission to exclude the reporting of such information in appropriate cases.

S. 425 also would add a new disclosure item to Section 13(d) (1) to require the Section 13(d) and 14(d) statements to disclose information as to the voting authority for the securities acquired. New Section 13(d) (1) (F) would require information as to:

"(F) the number of shares of such security with respect to which any person (other than the beneficial owner) possesses sole or shared authority to exercise the voting rights evidenced by such securities and the background, identity, residence, and nationality of any such person."

The Commission recommends two changes to clarify the above provision. First, it is recognized that Schedule 13D presently requires information as to all securities beneficially owned by the person filing the report — not just as to the securities acquired in the specific transaction which caused the five percent threshold to be exceeded. This requirement is reflected in Item 5 of Schedule 13D. [FOOTNOTE: Item 5 requires a statement of the number of shares of the security which are beneficially owned, and the number of shares concerning which there is a right to acquire,

directly or indirectly, by (i) such persons, and (ii) each associate of such person. Also, information is required as to all transactions in the subject class of security during the past 60 days by the person filing the statement and by its subsidiaries and their officers, directors and affiliated persons.]

Second, a revision of the parenthetical phrase, "other than the beneficial owner," might be included to clarify that the subject of the parenthetical is intended to be the person filing the statement.

To implement these two recommendations, we suggest the provision be revised as follows;

"(F) as to the class of security acquired, the total number of shares of that class beneficially owned by the person filing the statement; if any other persons possess sole or shared voting rights evidenced by such securities, the background, identity, residence and nationality of such other persons. [FOOTNOTE: Since beneficial ownership would encompass voting rights, including shared voting rights, this provision might require reports by more than one person with respect to the same securities.]

New Section 13(f)

The bill would add a new Section 13(f) to the Exchange Act to require a statement to be filed with the Commission 30 days prior to an acquisition by a foreign investor of beneficial ownership of more than five percent of any

equity security of a United States company which had total assets exceeding $1 million on the last day of its most recent whole, fiscal year. The proposed new Section 13(f) (1) (A) would apply to proposed acquisitions of equity securities of any United States company meeting the $1 million assets test and is not limited to issuers with securities registered under Section 12 of the Exchange Act.

The required statement would have to contain the name of the United States company, the address of its principal executive officers, and such of the information specified in Section 13(d) and such additional information as the Commission by rule may specify as necessary or appropriate in the public interest or for the protection of investors. In calculating the percentage of beneficial ownership, proposed new Section 13(f) states that securities held by or for the account of the United States company, or a subsidiary that may not vote the securities, shall be disregarded. Section 13(f) (1) (B) would require the Commission to transmit a copy of the Section 13(f) statement to the President promptly after filing and specifies that the statement shall not be disclosed to the public. Proposed Section 13(f) (1)(C) would instruct the Commission to consult and cooperate with the President to assure that its actions are in accordance with the President's powers and responsibilities with respect to the activities of foreign investors in the United States.

Section 13(f) (2)would authorize the President, by order, within the 30-day period, to prohibit the proposed acquisition if he deems it appropriate for the national security, to further the foreign policy, or to protect the domestic

economy of the United States. The section would require that the President's actions be taken pursuant to rules and regulations prescribed by him, to include a prompt notice of any exercise of such authority accompanied by a written statement of the reasons for his actions.

New Section 13(f) is intended to give the President notice of situations in which foreign investors propose to acquire more than 5 percent of any equity securities of certain United States companies. These notice provisions would not apply if a foreign investor were acquiring all or a portion of the assets of the specified United States company, nor if a foreign investor were acquiring a debt interest in such company. In both of these situations, the foreign investor may be acquiring control of the business of a United States company, yet the transaction would be outside the reporting requirements of proposed Section 13(f) (1) (A) and the Presidential authority of proposed Section 13(f) (2).

Proposed Section 13(f) also would apply to situations in which a United States company undertakes directly to sell more than 5 percent of its equity securities to a foreign investor. Viewed in this light, the provision may serve as a depressant on the ability of United States companies to raise needed capital through sales of securities.

While the Commission recognizes that the above issues on Section 13(f) involve policy questions to be resolved by Congress, we are concerned that our responsibilities under Section 13(f) may interfere with, and in some

instances be contrary to our obligations under other provisions of the Federal securities laws. For example, having a Section 13(f) statement filed with the Commission but not disclosed to the public could create difficulties in situations in which, for example, the Commission is considering a request for acceleration of a registration statement under the Securities Act of 1933 for the issuer involved. [FOOTNOTE: Under Section 8 of the Securities Act, the Commission may accelerate the effective date of a registration statement:

having due regard to the adequacy of information respecting the issuer theretofore available to the public, to the facility with which the nature, of the securities to be registered, their relationship to the capital structure of the issuer and the rights of holders thereof can be understood, and tothe public interest and the protection of investors.]

Also, Section 13(f) specifies that the -Commission shall require that the Section 13(f) statement'contain information "necessary or appropriate in the public interest or for the protection of investors" but the Commission is also responsible to the President to consult and cooperate to assure that Commission actions are "in accordance with the president's powers and responsibilities with respect to the "activities of foreign investors in the United States" (emphasis added). These standards are not parallel and in certain situations may contradict one another.

As to more technical comments on Section 13(f), we note the following points:

(1) Since the section applies to all United States companies meeting the assets test, consideration might be given to the inclusion of a provision relating the scope of Section 13(f) to the interstate commerce clause and other jurisdictional means specified in Section 12 of the Exchange Act;

(2) It is not clear whether the term "acquire" is intended to apply to passive or involuntary acquisitions such as exchanges of securities in mergers, inheritances, stock dividends, conversions of securities, and rights offerings.

(3) It is unclear why a foreign investor should file a statement containing the "name of the United States company and the address of its principal executive officers", unless the term "offices" is intended in lieu of "officers."

(4) The imposition of the requirement of this subsection and the remainder of this section on non-resident citizens who are defined as "foreign investors" would appear to make this provision vulnerable to attack under the due process clause of the Fifth Amendment, especially in the absence of a clearly indicated and defined purpose for the discrimination premised on the national interest.

(5) This subsection implies that if the President does not act within the 30-day period, the proposed acquisition would be deemed approved. If such is the case, perhaps a sentence to that effect should be included in the statute.

The Commission requests that, if the screening provisions of the bill are enacted, and the Commission is designated as the repository for the pre-acquisition filings, theCommission be authorized to require the publication of those reports if we find it necessary in the interests of investors.

New Section 14(g)

The bill adds a new Section 14(g) to the Exchange Act to establish a system by which beneficial ownership of an issuer's securities may be determined. Under Section 14(g) (l) (A), every record holder of any security of a class described in Section 13(d) (1) is required to file reports with the issuer reflecting information as to the identity, residence and nationality of the beneficial owner of such securities, and any person (other than the beneficial owner) possessing sole or shared authority to exercise the voting rights evidenced by the securities. When beneficial ownership is several steps or more removed from the record holder, Section 14(g) (1) (B) requires every person for whom a second- person is holding any such security who, in turn, is holding such securities for the account of a third person, to file reports with such second person containing essentially the same information described above. The bill gives the Commission rulemaking authority to specify the precise information to be furnished to the issuer and to intermediate holders. The bill requires the issuer to file a list of its beneficial owners with the Commission in such form and at such times as the Commission by rule may prescribe, but in no event shall the list be filed less frequently than annually or

more frequently than quarterly. Section 14(g) applies to any security of a class described in Section 13(d) (1), which includes:

"any equity security of a class which is registered pursuant to Section 12 of this title, or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in Section 12(g) (2) (G) of this title, or any equity security issued by a closed-end investment company..."

As presently drafted, proposed Section 14(g) on its face may result in a disclosure hiatus as to persons who are both record and beneficial owners. All substantive provisions of Section 14(g) which impose disclosure obligations on record holders apply only when the record holder is holding the security "for the account of another person" or when he is an intermediary holding the securities "for the account of a third person." If a person holding less than five percent of the securities in issue is both a record holder and beneficial owner of those securities, Section 14(g) imposes no disclosure obligation on him to so advise the issuer. In this respect, the provision is workable as drafted only if the issuer may assume in the preparation of its report to be filed with the Commission, that each record holder is the beneficial owner, unless the issuer receives a report from the record holder to the contrary. However, even on that assumption, there would be no provision for disclosure of the nationality or residence of the record/ beneficial owner.

More importantly, we are concerned about the substantial costs that would be imposed on brokerage firms, banks, trust companies and, especially, transfer agents, as well as the issuing companies, if the precise provisions of S. 425 were enacted, since the bill would apply to all beneficial owners, even the owner of one share of common stock. The burden of receiving so much material would also be severe on the Commission. Computer print-outs of stock records of widely-held, companies can easily fill a large file drawer. It is not unusual for a large company to have over 100,000 record holders of its common stock. AT&T has millions. So much data is too expensive to collect and is more information than anyone can effectively and properly use.

If the intention of this section of the bill is to elicit significant information regarding beneficial owners, the Congress should consider less burdensome, alternative means of accomplishing this goal. At the very least, the disclosure in filings should be limited, perhaps to the 20 or 30 largest holders, or any holder of more than some percentage such as 2 percent or 1 percent.

The problem in obtaining meaningful disclosure of stock ownership has always been record ownership by fiduciaries who feel constrained by law or custom or good business practice, from their point of view, to decline to disclose the identities of the persons for whom they hold the stock, except in response to legal process. Foreign fiduciaries, in many cases, will not even recognize our legal process for this purpose. Most fiduciaries will disclose the extent to which they have the power to vote shares held in their name or

the names of their nominees, but not the identity of any other person who holds the power solely or jointly with the fiduciary.

The idea of requiring fiduciaries to disclose their beneficiaries, or at least those beneficiaries with voting power, on a regular basis for public filings raises other considerations that must be carefully weighed. One is the long-standing tradition and policy in our law of protecting the privacy of private trusts. Compelling the public disclosure of the portfolios of private trusts — even if only to the extent that they hold equity securities of publicly-owned U.S. companies for which the beneficiaries hold the voting power — is a fundamental departure from our settled norms. Of course, we have long since made this departure where the beneficiary is a reporting person under Section 16 of the Securities Exchange Act or is otherwise a control person, or affiliate, of the portfolio company, but we are now considering a more drastic and far-reaching departure.

One approach might be to require such disclosure only when the shares constitute more than a specified percentage of the outstanding shares, but making the percentage much lower than 10 percent or even 5 percent. One and two percent have been suggested. The theory, then, would be that an investor can preserve privacy through a personal trust and yet retain voting power so long as he keeps his positions in publicly-owned companies insignificant in terms of voting strength. Above that, public policy favoring disclosure will prevail over that favoring the privacy of personal investments.

Another consideration is one of competitive fairness among fiduciaries — broker-dealers and trust companies and U.S. and foreign banks. The foreign part of the problem is not just one of even application of the law as written, but also as enforced. This Subcommittee is familiar with our long, and so far futile, efforts to compel disclosure of bank customers in some-countries, even for purposes of criminal investigation. Here, S. 425 offers a device that might do the job, namely, the disenfranchisement of the stock. S. 425, as presently drafted, would employ this device only for violations of the screening provisions, but it might also be used to obtain disclosure, both foreign and domestic.

These proposals, although well-motivated, appear to be too all-encompassing for any reasonable use, and therefore should be revised. We are not yet prepared to recommend specific legislation to do this, although we hope to be soon, after we have reviewed our voluminous, hearing record.

Remedies and Enforcement Provisions

Section 5 of S. 425 amends Section 21 of the Exchange Act to state that the Commission, the Attorney General, a United States company in which a foreign investor has acquired or proposes to acquire an equity security, or a holder of record of any equity security of such a United States company, may bring an action in a district court of the United States to enjoin a foreign investor from violating or to enforce compliance by such foreign investor with the provisions of Section 13(f). In lieu of United States district courts,

action may also be brought in a court of .general jurisdiction, however, designated, in any place, otherthan a State, under the jurisdiction of the United States. On proper showings, the court shall grant appropriate relief in the form of restraining orders and injunctions and orders to enforce compliance. Also, the bill states that the court may order the revocation or suspension for any specified period of the voting rights evidenced by the securities acquired by the foreign investor in violation of Section 13(f), and the sale of any securities so acquired. The bill would also add a new Section 21(h) to state that it is unlawful, for purposes of Sections 21(e), (f) and (g) , for any person to cause, command, induce, procure or give substantial assistance to the commission of an act or practice constituting a violation of the Exchange Act.

Section 6 of S. 425 adds a provision to Section 32 of the Exchange Act to specify a penalty of $1,000 per day against any foreign investor who fails to file a statement required under Section 13 (f).

We have been successful in obtaining a variety of equitable sanctions for violations of the provisions of the laws we administer. The specific remedies proposed for violations of the screening provisions would, however, be effective deterrents to such violations. But, if the Congress intends to provide explicitly for such remedies, we urge that the Subcommittee extend these remedies to all other provisions of the Act to which they may be relevant, to avoid any confusion about the broad equity powers of the courts under the federal securities laws. Naturally, if such, a change were made, it

would be inappropriate, we believe, to extend civil enforcement powers to any entity or person other than the Commission, and, in appropriate instances, such as cases involving violations of the proposed beneficial ownership reporting requirements, the issuing company might be given, explicit standing to sue.

Finally, we strongly endorse the-provisions of S. 425 making the aiding and abetting of a violation of the Exchange Act an explicit violation of that Act, although under the cases construing the Act, aiding and abetting has always been deemed to be a violation.