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Icarus and His Waxen Wings: Congress Attempts to Address the Challenges of Insider Trading in a Globalized Securities Market

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NOTES

Icarus and His Waxen Wings: Congress Attempts to Address the Challenges of Insider Trading in a Globalized Securities Market

The boy, his heart with risk and rapture high,
Forsook his guide, aspiring to the sky,
And soared aloft: through nearness to the sun
The wax, that bound the wings, began to run . . . .
—Ovid, *Metamorphoses*

ABSTRACT

This Note addresses the globalization of the world financial securities markets and the potential for fraud in these expanded markets. The author considers actual cases of insider trading that have crossed national borders and the enforcement problems such cases raise. The author analyzes the first significant response by the United States Congress to these problems and concludes that the response is inadequate. Congress recognizes the incredible pace of evolution of the world financial markets, but is slow to address this process. The SEC offered serious proposals to Congress—proposals that apparently have bipartisan support—and Congress failed to act on these proposals within a reasonable time. The author recommends that Congress adopt the SEC's current proposals in this regard and that the United States should continue to negotiate multilateral cooperation agreements that regulate the globalized securities markets and stop the abuses of insider trading.

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I. INTRODUCTION

In response[1] to United States insider trading scandals[2] and other stock market abuses on Wall Street, the United States Congress took a positive step to restore public confidence in the integrity of the United States stock market following "Black Monday"[3] by overwhelmingly passing[4]

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1. H.R. REP. NO. 910, 100th Cong., 2d Sess., *reprinted in* 1988 U.S. CODE CONG. & ADMIN. NEWS 6043, 6044 [hereinafter HOUSE REPORT].

2. *Id.* at 6048-51 (discussing the Dennis Levine, Ivan Boesky, and Stephen Wang insider trading scandals); *see infra* notes 61-63 and accompanying text (discussing Dennis Levine); 75 (discussing Ivan Boesky); 76-81 and accompanying text (discussing Stephen Wang). For a detailed discusion of the current state of the law on insider trading, see generally D. LANGEVOORT, INSIDER TRADING REGULATION (1990).

3. Monday, 19 October 1987, marked the worst day in Wall Street history. The Dow Jones Industrial Average, a closely watched United States market barometer, collapsed more than five hundred points—approximately twenty-five percent—which represented nearly $500 billion in lost equity. *See* Wall St. J., Oct. 20, 1987, at A1, col. 6.

4. The bill passed in the United States House of Representatives by a vote of 410 yeas, 0 nays, 21 not voting. H.R. 5133, 100th Cong., 2d Sess., 134 CONG. REC. H7570 (daily ed. Sept. 14, 1988). The Senate passed H.R. 5133 by voice vote on 21 October 1988; President Reagan signed the bill into law on 19 November 1988. [2 1987-1988] Cong. Index (CCH) 35,111.

the Insider Trading and Securities Fraud Enforcement Act of 1988 (Act).[5] Congress, recognizing that the securities markets are becoming increasingly global and that much insider trading is conducted through foreign entities,[6] included in the Act a section (section 6) to enhance the authority of the Securities and Exchange Commission (SEC or Commission) to cooperate with foreign securities authorities.[7]

Several articles[8] and notes[9] written in the past few years address the problems, especially those of the enforcement of securities laws,[10] resulting from the rapid advancements toward globalization of the world financial and equity markets. Most recently, the United States House of Representatives Committee on Government Operations submitted a report entitled *Problems with the SEC's Enforcement of U.S. Securities Laws in Cases Involving Suspicious Trades Originating from Abroad.*[11] This House Committee Report criticizes the SEC's attempts to investigate suspicious trades initiated outside the United States and makes several recommendations.[12] The Act and the House's recent criticisms of the Commission represent the first congressional response to the inevitable internationalization of the world financial community and the enforcement problems inherent in this rapid evolution.

This Note briefly discusses this internationalization.[13] Part II presents

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5. Pub. L. No. 100-704, 102 Stat. 4677 (codified in scattered sections of 15 U.S.C.).

6. HOUSE REPORT, *supra* note 1, at 28; *see infra* part II, section B.

7. Pub. L. No. 100-704, § 6, 102 Stat. 4677, 4681-82 (codified at 15 U.S.C. §§ 78c(a), 78u(a) (1988)); *see also* HOUSE REPORT, *supra* note 1, at 28.

8. *The Internationalization of the Securities Markets*, 4 B.U. INT'L L.J. 1 (1986); Begin, *A Proposed Blueprint for Achieving Cooperation in Policing Transborder Securities Fraud*, 27 VA. J. INT'L L. 65 (1986).

9. Note, *American Adjudication of Transnational Securities Fraud*, 89 HARV. L. REV. 553 (1976); Note, *International Cooperation in Insider Trading Cases*, 40 WASH. & LEE L. REV. 1149 (1983) [hereinafter WASH. & LEE Note]; Comment, *The Future of Global Securities Transactions: Blocking the Success of Market Links*, 11 MD. J. INT'L L. & TRADE 283 (1987).

10. *See generally* Ferrara & Nerkle, *Overview of an SEC Enforcement Action*, 8 CORP. L. REV. 306 (1985).

11. H.R. REP. No. 1065, 100th Cong., 2d Sess. (1988) [hereinafter HOUSE CRITICISM].

12. *House Committee Report Critical of SEC's International Enforcement*, 20 Sec. Reg. & L. Rep. (BNA) No. 40, at 1551 (Oct. 14, 1988); *see infra* part VI, section A (discussing the recommendations of the Report). This Report was based on a fourteen month study by the Commerce, Consumer, and Monetary Affairs Subcommittee of the House Committee on Government Operations. *Id.*

13. Several recent articles exhaustively cover the internationalization of the world financial community. *See, e.g., supra* notes 8-9. This subject, therefore, is discussed only briefly to facilitate an understanding of the magnitude of the problems facing the SEC

examples of how individuals have taken advantage of globalization to effect illegal insider trading. Part III discusses the process of an SEC investigation of suspicious trading, the problems encountered when the trading becomes transnational, and the current methods of overcoming those obstacles. This Note continues with an in-depth analysis of the Act's provisions that are designed to facilitate international cooperation, including a critique of the possible shortcomings of the new law and a comparison with alternative proposals. Finally, the Note offers several recommendations for improving the SEC's position in regulating internationalized markets and suggests that a multinational conventional response is the most desirable solution.

II. THE GLOBALIZATION OF THE SECURITIES MARKETS

A. *Indicia of Globalization*

Securities market internationalization, the process of "closer integration of the major capital markets of the world,"[14] will continue unless there is a major financial or political eruption analogous to that in the 1930s.[15] In 1970, the New York Stock Exchange and the other United States stock markets accounted for over two-thirds of the world's stock value.[16] The United States stock market is still twice as large as the Tokyo stock market; if, however, Wall Street and Tokyo continue their respective growth patterns over the past fifteen years, Tokyo will displace Wall Street as the world's largest stock market by 1993.[17] Today, the United States can claim only eight of the world's thirty largest companies in six major financial sectors.[18]

Individual stock exchanges continue to evolve and to develop "links" with other stock markets, and the SEC encourages the development of intermarket links and transnational trading.[19] These links are primarily

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and the possible remedial effect of the Act's section 6 concerning international cooperation.

14. Debs, *The Development of International Equity Markets*, 4 B.U. INT'L L.J. 5, 6 (1986).

15. *Id.*

16. Shopkorn, *Global Trading: The Current and Future Impact on United States Markets and United States Portfolio Managers*, 4 B.U. INT'L L.J. 25, 25 (1986).

17. *Id.* Market capitalization in the United States is approximately $2 trillion. Tokyo could claim only five percent of the world's capitalization in 1970, but by 1987 that amount had climbed to twenty-one percent. *Id.*

18. *Id.* The six major sectors listed by Shopkorn are automobiles, banking, chemicals, electrical equipment, food processing, and steel. *Id.*

19. Mann & Sullivan, *Current Issues in International Securities Law Enforcement*, in PRACTISING LAW INSTITUTE, SECURITIES ENFORCEMENT INSTITUTE 1987, at 769,

between United States and Canadian markets,[20] but negotiations to develop market links have occurred between Wall Street, London, Amsterdam,[21] and Tokyo.[22]

In April 1988, the United Kingdom authorized the National Association of Securities Dealers Automated Quotation System (NASDAQ) to transact trades in the United Kingdom, making NASDAQ the first foreign stock market allowed to trade in that state.[23] Because of these growing links between the United States and London markets, the National Association of Securities Dealers (NASD) and the Securities Association of London agreed to an information exchange, particularly regarding securities registration and disciplinary information about individuals and firms involved in the securities and investment business.[24]

Japanese links evolved much more slowly, even though former SEC Chairman David Ruder urged greater cooperation between the Japanese and United States securities markets while he was with the SEC.[25] The Japanese Government will soon allow its banks to conduct foreign fu-

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777 (Corporate Law and Practice, Course Handbook Series, No. 561, 1987).

20. *Id.* at 775. The Boston Stock Exchange (BSE) is linked with the Montreal Stock Exchange (MSE). This link allows an MSE specialist to send orders to a BSE specialist for a few Canadian issues listed in the United States and the 1150 United States issues listed in the Intermarket Trading System. *Id.*; *see also* Exchange Act Release No. 21499, 49 Fed. Reg. 44,575 (Nov. 1, 1984); Exchange Act Release No. 21925, 50 Fed. Reg. 14,480 (Apr. 8, 1985). The American Stock Exchange (AMEX) is linked with the Toronto Stock Exchange (TSE). *See* Exchange Act Release No. 22442, 50 Fed. Reg. 39,201 (Sept. 27, 1985). The Midwest Stock Exchange is also linked with the TSE. *See* Exchange Act Release No. 23075, 51 Fed. Reg. 11,854 (Mar. 28, 1986). Further links are proposed between the two markets. Mann & Sullivan, *supra* note 19, at 775.

21. Mann & Sullivan, *supra* note 19, at 776.

22. Gira, *Toward A Global Capital Market: The Emergence of Simultaneous Multinational Securities Offerings*, 11 MD. J. INT'L L. & TRADE 157, 158 (1987).

23. *NASDAQ Is First Foreign Exchange Recognized by British Authorities*, 20 Sec. Reg. & L. Rep. (BNA) No. 16, at 598 (Apr. 22, 1988). As part of the United Kingdom's "Big Bang," which commenced with the passage of the Financial Services Act of 1986, Britain may recognize a foreign exchange that is a "Recognized Investment Exchange" with adequate investor protection. *Id.* United Kingdom Corporate Affairs Minister Francis Maude declared, "We attach great significance to the desire of [NASDAQ] to operate in the United Kingdom, because it emphasizes the importance of the City of London in the International Financial marketplace." *Id.* at 599. The NASDAQ-London connection allows trading to pass freely from Europe to North America. *Id.*

24. *NASD, London SRO Agree to Information Exchange*, 20 Sec. Reg. & L. Rep. (BNA) No. 42, at 1637 (Oct. 28, 1988).

25. *Ruder Urges Greater Cooperation Between U.S., Japanese Stock Markets*, 20 Sec. Reg. & L. Rep. (BNA) No. 17, at 261 (Feb. 19, 1988). Chairman Ruder argued that greater cooperation would lead to both "increased efficiency and capital availability" for both Japan and the United States. *Id.*

tures and options trading for individual investors,[26] and seven Japanese banks have already become members of either the Chicago Board of Trade or the Chicago Mercantile Exchange.[27] Further, the Japanese Ministry of Finance decided to allow forty percent of new ten-year Japanese Government bonds to be sold through a price auction system.[28] This development will improve the "competitive opportunities" of foreign market participants in Japan.[29]

The links between the Canadian, United States, and London markets, as well as the liberalization of the Japanese markets, enhance the evolving twenty-four hour trading day.[30] This expansion of markets has resulted in a substantial increase in the amount of United States equities bought and sold by foreigners.[31] Foreign investors bought and sold $481.9 billion worth in equities, eighteen percent of the value of all transactions in the United States stock markets during 1987.[32] This represents an eighteen-fold increase over 1977, when foreigners bought and sold only $25.6 billion worth in United States stock.[33] The increase in activity almost doubled during the periods 1985-86 and 1986-87.[34] Al-

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26. *Japanese Finance Ministry to Permit Trading in Overseas Futures, Options*, 20 Sec. Reg. & L. Rep. (BNA) No. 34, at 1328 (Aug. 26, 1988). This move is part of the efforts of the Japanese Ministry of Finance to liberalize further both Japanese banking and securities industries.

27. *Id.* at 1329. The Japanese Government will also allow the banks to trade on the Singapore International Financial Monetary Exchange and the London International Financial Futures Exchange. The Chicago Board of Trade began listing Japanese Government bond futures and a Tokyo Stock Exchange Index future in 1989. *Id.* The SEC has agreed not to block the offer of a "future" based on the price-weighted index of 225 stocks traded on the Tokyo Stock Exchange. Mann & Sullivan, *supra* note 19, at 777.

28. *Japan Will Use Price Auction System to Sell 40 Percent of New 10-Year Bonds*, 20 Sec. Reg. & L. Rep. (BNA) No. 36, at 1401 (Sept. 16, 1988).

29. *Id.* at 1402.

30. *See generally* Hunter, *The Status and Evolution of Twenty-Four Hour Trading: A Trader's View of International Transactions, Clearance, and Settlement*, 4 B.U. INT'L L. J. 15 (1986). The "24-hour book"—trading by large securities firms and institutions in their own positions—is possible because, when the London Exchange is open, its hours overlap with the opening of Wall Street and the Tokyo Stock Exchange, and the Pacific Exchange's hours overlap the opening of the Tokyo Exchange. Wall Street, the Tokyo Stock Exchange, and the Pacific Exchange have all expanded their hours of operation, and these markets, as well as the London Exchange, are considering even further expansion of hours to facilitate international trading. *See id.*; *see also* Debs, *supra* note 14, at 9.

31. HOUSE CRITICISM, *supra* note 11, at 3. The statistics were provided to Congress by the United States Treasury Department.

32. *Id.*

33. *Id.*

34. *See id.* 1985 volume was $159 billion, 1986 volume was $277.5 billion, and 1987

though not as large, the United States investment in foreign equities totalled $101.2 billion during 1986.[35]

In this discussion of the empirical indicia of the globalization of securities markets, the reader should note that several factors may combine to be the underlying forces behind globalization.[36] One commentator, Richard Debs, opined that the volatility of exchange rates is possibly the most important factor.[37] Debs also lists high interest rates as a motivating factor.[38] Probably the most frequently cited factor is the rapid progress in computer telecommunications technology, especially in the securities arena.[39] The phenomenon that Debs refers to as the "institutionalization of the markets"[40] is a moving force in this process. Finally, there has been a philosophical and political move toward deregulation,[41] the objective of which is to "remove constraints on competition . . . . [P]hilosophically this applies to foreign competition as well as domestic so that market forces will work."[42] This deregulation has occurred in the

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volume was $481.9 billion. Also of interest, the dollar amount of purchases was more than the dollar amount of sales. 1986 purchases outstripped sales by $18.7 billion, and 1987 purchases exceeded sales by $16 billion. *Id.*

35. Mann & Sullivan, *supra* note 19, at 774.

36. Debs, *supra* note 14, at 6-7; *see* Shopkorn, *supra* note 16, at 26-27.

37. Debs, *supra* note 14, at 6. "[T]he volatility in exchange rates . . . has driven people to consider currency. Moreover, it would be negligent on the part of any major investor or issuer who is able to do so, not to take into account foreign currency considerations and foreign investments or markets that might be available outside the United States." *Id.*

38. *Id.* at 7. These rates are high relative to both historical standards, which reflect the inflationary times of the late 1970s and early 1980s, and the monetary policy of the Federal Reserve Board begun in October 1979, which has increased the sensitivity of interest rates to an all-time high.

39. *See, e.g., id.* at 7; *see* Mann & Sullivan, *supra* note 19, at 774; *see also* HOUSE CRITICISM, *supra* note 11, at 3.

40. Debs, *supra* note 14, at 7. Debs is referring to a trend whereby savings are pooled by intermediation through larger institutions, including, for example, pension funds and insurance companies. "These larger institutional investors have the sophistication, the ability, the interest, and the machinery to have access to all markets of the world through a variety of financial institutions." *Id.*

41. *Id.* at 7; *see also* Shopkorn, *supra* note 16, at 26.

42. Debs, *supra* note 14, at 7. Debs cautions that this deregulation may not be permanent, because governments may change. Consider, for example, what would happen if the Labour Party were to gain control in the United Kingdom. Also, there has been increased talk in Congress pointing to further regulation of commercial banks. *Id.* Debs does not believe government is entirely responsible for the deregulation of the past five to ten years; instead, he claims that market forces are primarily responsible, with "the regulators, the legislators, and the supervisors . . . a couple of steps behind the market participants," and that these groups have only generally accommodated what the market al-

United States, Britain, Japan,[43] Germany, and Australia.[44]

The markets are expanding,[45] and the SEC recently issued a policy statement on the regulation of international markets, which sets forth the principles and goals that it considers central to achieving a "truly global market system."[46] The policy has three main points: (1) efficient structures;[47] (2) sound disclosure systems;[48] and (3) fair and honest markets.[49] The statement focuses on the need for transnational agreements that will prevent insider traders from shielding themselves and their profits from the laws of the state affected.[50] Until laws and regulatory systems are reconciled, the continued growth and viability of markets are threatened.[51]

B. *Actual Cases of Foreign-Originated Insider Trading*

The internationalization of the world financial markets, which has produced a significant increase in foreign transactions in United States stock markets,[52] has also produced a significant increase in United States securities law violations.[53] Professor Hurd[54] testified before Congress that because acts that violate United States securities laws are not illegal in other states,[55] and in some states these acts are not even considered

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ready has established. *Id.*

43. *Id.*

44. Shopkorn, *supra* note 16, at 26.

45. Debs, *supra* note 14, at 10.

46. *SEC Sets Policy on Regulation of International Markets*, Fed. Sec. L. Rep. (CCH) No. 1312, pt. 1, at 3 (Nov. 16, 1988). SEC Chairman David Ruder presented the policy statement at the Annual Conference of the International Organization of Securities Commissions in Melbourne, Australia. *Id.*

47. *Id.* The SEC recommended efficient structures for quotation, price, and volume information dissemination; order routing; execution; clearance; settlement; and payment. The system also needs strong capital adequacy standards. *Id.*

48. *Id.* Sound disclosure systems refers to accounting principles, auditing standards, auditor independence standards, registration and prospectus provisions, and listing standards. *Id.*

49. *Id.* The establishment of fair and honest markets requires a high level of enforcement cooperation. *Id.*

50. *Commission Issues Policy Statement on International Securities Regulation*, 20 Sec. Reg. & L. Rep. (BNA) No. 45, at 1753, 1754 (Nov. 18, 1988).

51. *See* Debs, *supra* note 14, at 10.

52. *See supra* notes 30-35 and accompanying text.

53. *See generally* HOUSE CRITICISM, *supra* note 11.

54. Associate Professor of Law and Public Policy, Syracuse University. *Id.* at 3.

55. Switzerland only recently outlawed insider trading. *Swiss Parliament Agrees on Insider Trading Compromise*, 20 Sec. Reg. & L. Rep. (BNA) No. 1, at 7. This is especially important because the Swiss will generally relax their bank secrecy laws only

undesirable, it "would strain credulity" to believe that illegal activity has not kept pace with the process of internationalization.[56] Harvey Pitt, a former General Counsel of the SEC, testified that "foreign [insider trading] cases challenge the [SEC]'s investigative staff far more than even domestic investigations do."[57] These trades usually originate in states with bank secrecy[58] or blocking statutes,[59] both of which seriously impede SEC investigations because these statutes prevent disclosure of relevant information. These impediments are furthered by "layering."[60]

The Dennis Levine case is a perfect example of the relative ease of avoiding SEC detection.[61] Levine's method was simple. He opened a bank account in a Bahamian bank to effect insider trades in over fifty securities from 1980 to 1985. Bahamian secrecy laws protected Levine's identity. Indeed, no one discovered his activity until a brokerage firm received an anonymous tip and passed it on to the SEC.[62] The House Committee on Government Operations describes the seriousness of the problem:

> If Levine had "layered" his trading by using another bank in a different

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in situations in which the activity in question is considered a crime in Switzerland. Note, *Swiss Bank Secrecy and United States Efforts to Obtain Information from Swiss Banks*, 21 VAND. J. TRANSNAT'L L. 63 (1988); *see infra* notes 96-101 and accompanying text (explaining secrecy laws).

56. HOUSE CRITICISM, *supra* note 11, at 3-4.

57. *Id.* at 4. Pitt observered:

> I think there is consensus that dramatic changes in the world securities markets have provided new and fertile opportunities for the unscrupulous and the dishonest. The globalization of the securities markets and almost continuous introduction of new financial instruments have introduced greater rewards at seemingly less risk for those who . . . conceal their wrongdoing behind . . . nondisclosure laws.

Id.

58. *Id.* ("It is relatively easy for individuals and entities to open accounts with foreign banks or brokerages, which can then place trades on U.S. markets without revealing the identities of their clients.") (testimony of SEC Chairman Ruder); *see infra* notes 106-15 and accompanying text (discussing BSI case); *see also infra* notes 96-101 and accompanying text (discussing bank secrecy laws).

59. HOUSE CRITICISM, *supra* note 11, at 4; *see infra* notes 96-98, 102-05 and accompanying text (describing blocking statutes).

60. HOUSE CRITICISM, *supra* note 11, at 5. The text accompanying note 63 defines layering. For a more complete analysis of the obstacles to SEC investigations, see *infra* part III, section A.

61. HOUSE CRITICISM, *supra* note 11, at 6. On the Dennis Levine case, see Wise, *Levine Sentence Seen in Line with Insider-Trading Penalties*, N.Y.L.J., Feb. 24, 1987, at 1, col. 3; Brill, *Insider Trading Scandal: Death of a Career*, N.J.L.J., Jan. 8, 1987, at 1, col. 1.

62. HOUSE CRITICISM, *supra* note 11, at 6 n.10.

> bank secrecy country, such as Panama or Liechtenstein, and then had instructed that bank to place orders through the Bahamian bank involved, his massive fraud—the disclosure of which led to his cooperation with the SEC that resulted in the insider trading conviction of Ivan Boesky—may have gone uninvestigated by the SEC.[63]

Dennis Levine's method of avoiding detection is not new. Congress recognized this problem as early as 1970, when it acknowledged the "proliferation of 'white collar' crime" resulting from the use by United States citizens and others of secret foreign bank accounts.[64]

The Commission brought two actions in 1981, *SEC v. Banca della Svizzera Italiana (St. Joe)*[65] and *SEC v. Certain Unknown Purchasers (Santa Fe)*,[66] which were the first major cases combating the use of secret foreign bank accounts to conduct insider securities trading in the United States. *St. Joe* involved a transaction producing an overnight profit of $2 million in which all the insider trades were conducted through Swiss accounts.[67] Certain procedural steps, possible because of unique circumstances, eventually revealed the defendants' identities.[68] *Santa Fe* was a $7.8 million[69] insider trading case in which, like the transaction in the *St. Joe* case, all of the trades were conducted through secret Swiss bank accounts.[70] This case represented the first successful

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63. *Id.* at 6.

64. SEC v. Banca della Svizzera Italiana (St. Joe), 92 F.R.D. 111, 117 (S.D.N.Y. 1981) (quoting H.R. REP. No. 975, 91st Cong., 2d Sess. 12, *reprinted in* 1970 U.S. CODE CONG. & ADMIN. NEWS 4394, 4397).

65. *Id.* at 111.

66. [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,484 (S.D.N.Y. Feb. 26, 1986).

67. *St. Joe*, 92 F.R.D. at 113. Options and stock of St. Joe Minerals Corp. were purchased one day before Joseph E. Seagram & Sons announced a $45 per share tender offer. *Id.* at 112. Before Seagram's tender offer, St. Joe shares were trading at approximately $30 per share. *Id.*

68. SEC, Request For Comments Concerning a Concept to Improve the Commission's Ability to Investigate and Prosecute Persons Who Purchase or Sell Securities in the U.S. Markets from Other Countries (Release No. 21186, File No. S7-27-84, July 30, 1984) [hereinafter SEC Request], *reprinted in* 16 Sec. Reg. & L. Rep. (BNA) No. 31, at 1305, 1308 (Aug. 3, 1984); *see infra* notes 106-15 and accompanying text.

69. [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,484 (S.D.N.Y. Feb. 26, 1986). At that time, this case was the largest insider trading case ever brought by the SEC. *Id.* The case against Ivan Boesky is currently the largest insider trading case ever brought by the SEC. *See infra* note 75.

70. Defendant's transactions were similar to the trades in the *St. Joe* case. *Id.* The "certain unknown purchasers" bought 17,000 shares of common stock and 3500 call options carrying the rights to buy 350,000 shares of common stock of Santa Fe International just before Kuwait Petroleum announced a $51 per share takeover bid. Prior to

attempt by the SEC to obtain assistance from the Swiss Government in the discovery of the identity of Swiss bank customers.[71]

The 1986 case of *SEC v. Katz*[72] was the next significant case involving the use of Swiss bank accounts. The SEC discovered the identity of the Swiss bank customers by invoking the 1982 Memorandum of Understanding (MOU)[73] between the United States and Switzerland, making *Katz* the first action in which the SEC could take advantage of that agreement.[74]

In 1988, the SEC cracked the second largest[75] insider trading case to date. *SEC v. Wang*[76] focused on the tips of Stephen Sui-Kuan Wang, a Morgan Stanley & Co. analyst, to Taiwanese national Fred Lee,[77]

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the takeover bid, the stock sold for $24.75. The unknown purchasers parlayed $750,000 into $6.2 million virtually overnight. The unknown purchasers were determined to be Darius N. Keaton, a director of Santa Fe, and his tippees. *Id.*

71. *Id.* The assistance of the Swiss Government was not wholly voluntary. The SEC was forced to have the United States Justice Department file a request pursuant to a treaty with Switzerland for the production of evidence. Treaty on Mutual Assistance in Criminal Matters, *done* May 25, 1973, United States-Switzerland, 27 U.S.T. 2019, T.I.A.S. No. 8302 (entered into force Jan. 23, 1977) [hereinafter Mutual Assistance Treaty]. Switzerland's highest court twice considered and denied the United States request, but on appeal to the Federal Council, Switzerland's highest political body, the United States successfully secured the necessary authorization to obtain the secret customer identities. *Santa Fe*, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,484.

72. [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,867 (S.D.N.Y. Aug. 27, 1986). Marcel Katz, an analyst with the investment banking firm Lazard, Freres & Co., obtained material, nonpublic information about the upcoming merger between RCA and General Electric. He tipped his father, Harvey, who then tipped Elie Mordo, a foreigner, who took advantage of the information by effectuating a stock transaction through his Swiss bank account. *Id.*

73. Memorandum of Understanding to Establish Mutually Acceptable Means for Improving International Law Enforcement Cooperation in the Field of Insider Trading, *done* Aug. 31, 1982, Switzerland-United States [hereinafter Swiss MOU], *reprinted in* 22 I.L.M. 1 (1982), *and in* 14 Sec. Reg. & L. Rep. (BNA) No. 39, at 1737 (Oct. 8, 1982); *see infra* note 121 and accompanying text.

74. *Katz*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,867.

75. The case against Ivan Boesky is the largest insider trading case to date. As a result of the disposition of that action, Boesky paid a $100 million fine, was banned permanently from the securities industry, and was sentenced to three years in jail. *SEC Charges Taiwanese Businessman in Second Largest Insider Trading Case*, 20 Sec. Reg. & L. Rep. (BNA) No. 26, at 1015 (July 1, 1988) [hereinafter *SEC Charges*]; *see also* Wise, *Prosecutors, Defense Lawyers View Boesky Sentence as Fair: 3-Year Term Stiffest for Insider Trading*, N.Y.L.J. Dec. 21, 1987, at 1, col. 3.

76. SEC v. Wang, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,802 (S.D.N.Y. June 27, 1988); *see SEC Charges*, *supra* note 75, at 1015.

77. Lee paid Wang $200,000 for nonpublic, material information concerning twenty-

which resulted in alleged profits to Lee of more than $19 million.[78] SEC Chairman David Ruder testified before Congress that negotiations were underway pursuant to the United States-Swiss MOU[79] to obtain evidence about Lee and to freeze any assets that he might have in Switzerland.[80] Lee may also be liable under Switzerland's new laws against insider trading.[81]

The Levine case, *Santa Fe*, *St. Joe*, *Katz*, and *Wang* demonstrate the techniques available for exploiting the internationalized securities markets. The globalization of markets is continuing, but that process is also producing an environment conducive to international crime.[82] Although critics recently condemned the Commission for its enforcement role, or lack thereof, in the global markets,[83] questions still remain concerning the rules of the globalized market and the SEC's role in that market.

III. INTERNATIONAL ENFORCEMENT OF UNITED STATES SECURITIES LAWS

A. *Barriers to Global Investigation*

There are three basic steps to an SEC investigation: (1) identification of a violation; (2) compilation of relevant evidence of that violation; and (3) prosecution of the violators.[84] Self-regulatory organizations usually

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five issuers involved with mergers, acquisitions, or leveraged buyouts. *Former Securities Analyst Sentenced over Role in Insider Trading Scheme*, 20 Sec. Reg. & L. Rep. (BNA) No. 42, at 1634 (Oct. 28, 1988) [hereinafter *Former Securities Analyst*]. Wang subsequently settled the civil charges and pleaded guilty to a criminal charge, receiving a three year jail sentence. *Id.*

78. *SEC Charges*, *supra* note 75, at 1015. The court froze $3 million held in Lee's account at Charles Schwab & Co. *Former Securities Analyst*, *supra* note 77, at 1634. The court also froze $12.5 million in Lee's accounts with Standard Chartered Bank, which has branches in both Hong Kong and New York. *Id.*

79. Swiss MOU, *supra* note 73; *see also infra* note 120.

80. Domm, *Wang Case Signals More Insider Trading*, Reuter News Reports, July 3, 1988 (LEXIS, NEXIS Library, REUTER File).

81. *U.S. Insider Trading Figure Could Be Liable Under Swiss Law*, Reuter Business Report, June 30, 1988 (LEXIS, NEXIS Library, BUSRPT File). SEC Enforcement Division Director Gary Lynch told Reuters that Swiss laws would apply against Lee. These laws make it illegal to pass corporate secrets to another party who would trade on the information. *Id.*

82. *See* Domm, *supra* note 80. As of 3 July 1988, the SEC was investigating over forty cases of suspect foreign securities trading. *Id.*

83. HOUSE CRITICISM, *supra* note 11, at 7-11.

84. Cox, *Internationalization of the Capital Markets: The Experience of the Securities and Exchange Commission*, 11 MD. J. INT'L L. & TRADE 201, 215 (1987).

identify potential violations,[85] and then refer these violations to the Commission.[86] Once a possible violation is referred to it, the SEC begins an investigation if it determines that such action is warranted. When the transaction is transnational, the search for evidence may be fruitless. A restriction in the Securities Exchange Act of 1934[87] limits the service of process and subpoena power of the SEC to "any place in the United States,"[88] and this limitation is a serious impediment to effective regulation of securities markets.[89] If a witness or potential defendant is outside the United States, in personam jurisdiction may not exist and, therefore, no further discovery would be possible.[90] This was the result in one recent situation in which the SEC identified substantial violations of the securities laws and the identities of the foreign traders involved;[91] the SEC could not pursue any action to redress the wrong for two reasons: the investors refused to cooperate, and service was impossible because neither defendant was within the reach of a United States court.[92] The SEC's primary investigative tool is the subpoena, and Professor Hurd[93] testified to Congress that this tool is ineffective in international trading cases for two reasons:

> First, U.S. courts are reluctant to order U.S. individuals or business organizations residing or doing business abroad to comply with subpoenas issued in the United States when compliance with a subpoena would violate

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85. Self-regulatory organizations (SRO) are groups, such as the New York Stock Exchange and the National Association of Securities Dealers, that conduct market surveillance. SROs are the first line of detection of illegal activity.

86. HOUSE CRITICISM, *supra* note 11, at 7.

87. Ch. 404, 48 Stat. 881 (codified as amended in scattered sections of 15 U.S.C.).

88. 15 U.S.C. § 78u(b) (1988).

89. Mann & Sullivan, *supra* note 19, at 779-80. "[T]he case law demonstrates that, where a witness is beyond the personal jurisdiction of U.S. courts, discovery can be avoided despite the fact that U.S. subject matter jurisdiction exists." *Id.* at 780; *cf.* CFTC v. Nahas, 738 F.2d 487 (D.C. Cir. 1984) (addressing similar problems under the Commodity Exchange Act).

90. Mann & Sullivan, *supra* note 19, at 780.

91. HOUSE CRITICISM, *supra* note 11, at 30. The Commission identified two Middle Eastern individuals who traveled to Europe, opened up a bank account, and apparently traded on inside information a couple of days before Chicago Pacific announced its takeover of Textron. The two investors bought 124,750 shares of Textron common stock, which was three times the average trading volume of the stock. The two investors, who did not have a prior history of investing in the United States market, realized $629,264 in profits when they sold their stock a couple of days after the public announcement of the takeover. *Id.* at 30-31.

92. *Id.* at 31.

93. *See supra* note 54.

> a secrecy or blocking law[94] of the host nation. Second, U.S. courts do not have the power to enforce an order requiring foreign nationals in their own countries to comply with a subpoena issued in the United States.[95]

The most serious constraints preventing the Commission's effective enforcement of the securities laws are the blocking and secrecy laws enacted in other states.[96] Congress recognized the potential effects of these laws two decades ago,[97] and their effect was the central issue in *Santa Fe*.[98] Secrecy laws provide for confidentiality of specific information.[99] The basis for secrecy laws reflects national public policy regarding banking relationships, which is analogous to the national public policy behind the attorney-client privilege in the United States.[100] Secrecy laws protect parties in privity, while blocking statutes protect states' interests.[101] Blocking statutes restrict the flow of certain types of information out of the jurisdiction. One commentator presents two rationales for blocking statutes: first, to prevent disclosure of information by the state's nationals involved in United States litigation; and second, "to prevent the United States government from conducting investigations and imposing its regulations within [the state's] borders."[102] Canada recently enacted a block-

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94. *See infra* notes 96-102 and accompanying text (describing bank secrecy and blocking statutes).

95. HOUSE CRITICISM, *supra* note 11, at 31; *cf.* CFTC v. Nahas, 738 F.2d 487. *But cf.* 7 U.S.C. § 15 (1988). Congress enacted 7 U.S.C. § 15 as a response to *Nahas*, which foreclosed the Commission from serving subpoenas on persons outside the United States. *See* H.R. REP. NO. 624, 99th Cong., 2d Sess., *reprinted in* 1986 U.S. CODE CONG. & ADMIN. NEWS 6005, 6010; *see also* Futures Trading Act of 1986, Pub. L. No. 99-641, § 103, 100 Stat. 3556, 3557 (amending 7 U.S.C. § 15 (1988)). "Many countries have objected to the enactment of this provision as an 'extraterritorial' power for the CFTC. This power has yet to be exercised." Mann & Sullivan, *supra* note 19, at 783; *see also* 17 C.F.R. § 21.03(c), (e)(1) (1989).

96. *See supra* notes 65-66 and accompanying text (discussing cases in which these laws were at issue).

97. *See* H.R. REP. NO. 975, 91st Cong., 2d Sess. 12, *reprinted in* 1970 U.S. CODE CONG. & ADMIN. NEWS 4394, 4397; *see supra* note 64 and accompanying text.

98. *See supra* notes 66, 69-71 and accompanying text.

99. Such information would include banking, manufacturing, or business secrets. *See* Mann & Sullivan, *supra* note 19, at 809, 812. The Swiss Penal Code penalizes bank associates who breach client confidentiality. The criminal act "characterize[s] the interest in secrecy as being personal to the parties." *Id.* at 812. If the principal is Swiss, a breach of confidentiality is "an offense against the state." *Id.* at 813.

100. Comment, *supra* note 9, at 294.

101. *Id.* at 294-95.

102. *Id.* at 295. Foreign governments design blocking statutes to prevent the extraterritorial application of United States substantive law. *See* M. SHAW, INTERNATIONAL LAW 369 (2d ed. 1986).

ing statute that theoretically could hinder an otherwise excellent relationship between Canada's provincial securities agencies and the SEC.[103] The SEC, however, received assurances from the Ontario Securities Commission that the blocking statute probably will not be used to prevent the passage of evidence to a United States court because insider trading and market manipulation are also illegal in Canada.[104] National sovereignty is therefore not at issue.[105]

B. *Present Methods of Enforcement*

The United States District Court for the Southern District of New York in *SEC v. Banca della Svizzera Italiana (St. Joe)*[106] circumvented the Swiss secrecy laws by applying Rule 37 of the United States Federal Rules of Civil Procedure[107] and the balancing approach of the *Restatement (Second) of Foreign Relations (Restatement)*.[108] Banca della Svizzera Italiana (BSI) effected trades for common stock and options of St. Joe Minerals (St. Joe) prior to a tender offer by Joseph E. Seagram & Sons. The transactions resulted in overnight profits for BSI of $2 million. The SEC, recognizing that such short-swing profits indicate a strong probability of inside trading, froze BSI's New York bank accounts and served formal interrogatories on BSI requesting the identity of the

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103. Mann & Sullivan, *supra* note 19, at 777-78; *see* Foreign Extraterritorial Measures Act, CAN. REV. STAT. ch. F-29 (1985).

104. Mann & Sullivan, *supra* note 19, at 778-79.

105. *See id.*

106. 92 F.R.D. 111 (S.D.N.Y. 1981). Banca della Svizzera Italiana (BSI) was subject to the jurisdiction of the United States District Court for the Southern District of New York because BSI does business in New York City. *Id.* at 112.

107. FED. R. CIV. P. 37.

108. RESTATEMENT (SECOND) OF FOREIGN RELATIONS § 40 (1965). Section 40 provides:

> Where two states have jurisdiction to prescribe and enforce rules of law and the rules they may prescribe require inconsistent conduct upon the part of a person, each state is required by international law to consider, in good faith, moderating the exercise of its enforcement jurisdiction, in the light of such factors as
>
> (a) vital national interest of each of the states,
>
> (b) the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person,
>
> (c) the extent to which the required conduct is to take place in the territory of the other state,
>
> (d) the nationality of the person, and
>
> (e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state.

Id.

principals for whom the bank bought and sold the St. Joe stock.[109] BSI refused to comply with the discovery request and claimed that it would be subject to criminal sanctions under Swiss law if the information were released.[110] The SEC filed an action for an order pursuant to Rule 37 to force BSI to provide the requested information.[111] The district court applied the *Restatement*'s balancing approach and ruled in favor of the Commission.[112] Judge Pollack wrote:

> BSI acted in bad faith. It made deliberate use of Swiss nondisclosure law to evade in a commercial transaction for profit to it, the strictures of American securities law against insider trading. Whether acting solely as an agent or also as a principal (something which can only be clarified through disclosure of the requested information), BSI invaded American securities markets and profited in some measure thereby. It cannot rely on Swiss nondisclosure law to shield this activity.[113]

"BSI, fearful of . . . significant fines, received a waiver of the secrecy laws from its principles [*sic*]," which allowed it to disclose the requested information.[114] The SEC succeeded in *St. Joe*, but it understood that the use of Rule 37 "is viewed as hostile by foreign governments" and that case by case adjudication to compel production of evidence is not "an effective deterrent to securities laws violators."[115]

The Commission also takes advantage of bilateral[116] and multilateral[117] agreements for the production of evidence, but these agreements are not altogether effective. One principle limitation is that the agreements are criminal in nature,[118] whereas the SEC normally files civil actions.[119] These agreements also limit cooperation; if the state involved has blocking statutes or secrecy laws, cooperation may not be available.

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109. *St. Joe*, 92 F.R.D. at 113.
110. *Id.* at 117.
111. *Id.* at 112.
112. *Id.* at 119.
113. *Id.* at 117 (footnote omitted).
114. Comment, *supra* note 9, at 311.
115. SEC Request, *supra* note 68, at 1308.
116. *See, e.g.*, Mutual Assistance Treaty, *supra* note 71; Treaty on Mutual Assistance in Criminal Matters, *done* June 12, 1981, United States-Netherlands, — U.S.T. —, T.I.A.S. No. 10734 (entered into force Sept. 15, 1983); Treaty on Extradition and Mutual Assistance in Criminal Matters, *done* June 7, 1979, United States-Turkey, 32 U.S.T. 3111, T.I.A.S. No. 9891 (entered into force Jan. 1, 1981).
117. The Hague Convention for the Taking of Evidence Abroad, *opened for signature* Mar. 18, 1970, 23 U.S.T. 2555, T.I.A.S. No. 7444, 847 U.N.T.S. 231 (entered into force Oct. 7, 1972).
118. Mann & Sullivan, *supra* note 19, at 814.
119. *Id.*

Furthermore, insider trading is not illegal in many states; this fact formerly prevented the Commission's use of the Swiss Mutual Assistance Treaty.[120]

The use of Memorandums of Understanding (MOU) provides the most effective technique of international securities enforcement. Following *St. Joe* and the inapplicability of the United States-Swiss Mutual Assistance Treaty due to the dual criminality requirement, the United States negotiated and signed an MOU with the Swiss.[121] The Commission has entered into MOUs with Switzerland,[122] Canada, Japan, the Cayman Islands, the United Kingdom, and Brazil.[123] The Commission is currently negotiating MOUs with France, Italy, New Zealand, and Australia, while also pursuing agreements with both West Germany and Hong Kong.[124] The MOU is very important to the SEC's continued oversight of the markets. The Commission rarely pursues potential insider trading violations when the trading in question originates from states that have not entered into an MOU with the United States.[125] Trades originating in Panama, Luxembourg, Liechtenstein, and Monaco are appropriate examples because these states have blocking or secrecy

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120. *See* Switzerland: Swiss Supreme Court Opinion Concerning Judicial Assistance in the *Santa Fe* Case, 22 I.L.M. 785, 796-98 (1983) (reproducing an English summary of the opinion of the Swiss Supreme Court); *see also* Mutual Assistance Treaty, *supra* note 71, art. 4(2)(a). Dual criminality was a requirement for assistance under this pact, but the Swiss have since banned insider trading. The new Swiss law will enhance the Commission's ability to utilize the 1977 Mutual Assistance Treaty. *See Swiss Parliament Agrees on Insider Trading Compromise*, 20 Sec. Reg. & L. Rep. (BNA) No. 1, at 7, 7-8 (Jan. 8, 1988) (quoting Michael Mann, SEC, Associate Director for International Affairs, Enforcement Division).

121. The first use of the United States-Swiss MOU was in SEC v. Katz, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,867; *see supra* notes 72-74 and accompanying text; *infra* note 160 (describing the requirement of dual criminality).

122. The Swiss MOU expired upon the enactment of the Swiss insider trading law. The parties to the MOU agreed that once insider trading was made illegal in Switzerland, assistance would be established pursuant to the 1977 Mutual Assistance Treaty, *supra* note 67; HOUSE CRITICISM, *supra* note 11, at 22 n.41 and accompanying text.

123. HOUSE CRITICISM, *supra* note 11, at 22; *see also* Szekely, *U.S.-U.K. Sign Securities Law Enforcement Agreement*, Reuters North European Service, Sept. 23, 1986 (LEXIS, NEXIS Library, REUTER File). For an in-depth analysis of these MOUs, see Comment, *A Comparative Analysis of Recent Accords which Facilitate Transnational SEC Investigations of Insider Trading*, 11 MD. J. INT'L L. & TRADE 243 (1987).

124. *See* Cooney, *SEC Holding Enforcement Talks with Four More Countries*, Reuters Library Report, May 19, 1988 (LEXIS, NEXIS Library, SECURITIES File).

125. HOUSE CRITICISM, *supra* note 11, at 18-19.

laws.[126] Nineteen of the twenty-five states that represent the highest dollar amounts of trading in United States stocks are not party to an information-sharing agreement with the United States.[127]

MOUs are vitally important to the development of fair and honest markets.[128] The pact signed recently with Canada's provincial securities regulators, the model for future MOUs,[129] provides for the most extensive cooperation to date.[130] Under that agreement, either state may compel the other to conduct investigations, including the procurement of testimony and documents, in their respective jurisdictions.[131] Although the Swiss MOU is no longer in force, that agreement provided for the discovery of bank account customer identities.[132]

The MOU is currently the centerpiece of the SEC's international enforcement methods.[133] The SEC needs more statutory authority to facilitate these agreements. The United States-Canadian MOU formalizes an existing ad hoc relationship,[134] but the agreement is ineffectual until Congress grants additional authority to the Commission.[135] The signatories therefore agreed to take "reasonable steps to obtain the necessary authorization."[136]

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126. *Id.*

127. *Id.* at 9.

128. The United States-Swiss MOU was recognized as an important development for international securities regulation which "could provide a basis for further international cooperation in insider trading cases." WASH. & LEE Note, *supra* note 9, at 1171.

129. *See* Cooney, *supra* note 124.

130. Szekely, *U.S., Canada in Far-Reaching Securities Law Enforcement Pact*, Reuters Business Report, Jan. 7, 1988 (LEXIS, NEXIS Library, SECURITIES File).

131. *Id.* The MOU has been the target of criticism in Canada, including a constitutional attack on its validity. The principle argument against the MOU's validity focuses on provincial powers, and the validity of the Ontario Securities Act. *See infra* note 180 and accompanying text.

132. *See* Swiss MOU, *supra* note 73, arts. 3-6.

133. HOUSE CRITICISM, *supra* note 11, at 11. Congress criticizes the focus on the MOU and has proposed additional measures for implementation. *Id.*; *see infra* part V, section A. Furthermore, the United States-Swiss MOU is limited in that only the SEC or the Justice Department has access to the information provided under the agreement; therefore, private litigants potentially injured by illegal trading may not utilize the information. WASH. & LEE Note, *supra* note 9, at 1171.

134. *SEC, Canadian Provinces Sign Securities Enforcement Accord*, 20 Sec. Reg. & L. Rep. (BNA) No. 1, at 17 (Jan. 8, 1988).

135. *See* Cooney, *supra* note 124.

136. *SEC to Seek Authority to Conduct Probes at Request of Foreign Gov'ts*, 20 Sec. Reg. & L. Rep. (BNA) No. 18, at 676, 677 (May 6, 1988) [hereinafter *SEC to Seek Authority*].

IV. THE INSIDER TRADING AND SECURITIES FRAUD ENFORCEMENT ACT OF 1988

A. *The Initial Proposal*

The Commission formally introduced a proposal to Congress in June 1988, seeking expanded powers to tackle insider trading problems.[137] The proposal constituted the first comprehensive legislative effort to address the globalization of securities markets.[138] The proposed bill would authorize the SEC: (1) to conduct, at its own discretion, investigations in the United States at the request of a foreign state; (2) to withhold information provided by a foreign state from disclosure pursuant to the Freedom of Information Act (FOIA);[139] (3) to provide information and evidence to a foreign government; and (4) to restrict or to impose sanctions on a security professional who acts improperly in a foreign state and who tries to conduct business in the United States.[140] The SEC believes that foreign governments will grant similar authority to their respective securities regulatory bodies; the SEC and its counterparts, however, currently yield this power only when their own laws are violated.[141] The power sought enhances the negotiation and formation of more MOUs.[142] The United States Departments of State and Justice both supported the legislative proposal.[143] The Justice Department further commented that the bill is "exceptionally important to law enforcement efforts in general."[144]

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137. *SEC Proposes International Securities Enforcement Cooperation Act*, Fed. Sec. L. Rep. (CCH) No. 1290, pt. 1 (June 15, 1988).

138. *Id.* at 1.

139. 5 U.S.C. § 552 (1988).

140. *SEC to Seek Authority*, *supra* note 136, at 676-77.

141. *SEC Asks for Power to Help Foreign Investigators*, Reuter Financial Report, June 7, 1988 (LEXIS, NEXIS Library, FINRPT File).

142. *Id.* "When we want information from a foreign country we're not in a position to offer reciprocal treatment and that provides a real stumbling block." *Id.* (statement of Michael Mann, SEC, Office of International Legal Assistance). SEC Chairman David Ruder claimed, "[P]assage of this legislation would . . . enhance international cooperation and coordination among securities regulators around the world." *Increased Cooperation Needed in International Markets, Ruder Says*, 20 Sec. Reg. & L. Rep. (BNA) No. 38, at 1480, 1481 (Sept. 30, 1988) (quoting Chairman Ruder).

143. *U.S. Departments Back SEC Call for More Authority*, Reuter Financial Report, Aug. 3, 1988 (LEXIS, NEXIS Library, SECURITIES File) [hereinafter *U.S. Departments*].

144. *Id.* (statement of Mark Richard, Deputy Assistant Attorney General, Justice Department, Criminal Division).

On 21 June 1988, Senator Donald Riegle[145] introduced the International Securities Enforcement Cooperation Act of 1988 (Senate Bill).[146] The Senate Bill emanated from the Commission's proposal, with the exception that the Senate Bill required reciprocal treatment by the foreign state requesting assistance.[147] On 29 June 1988, Representative John Dingell introduced[148] the SEC's proposal in its entirety to the House of Representatives (House Bill).[149] The House Bill did not require reciprocal assistance by a foreign state requesting investigatory assistance from the SEC. SEC Chairman David Ruder addressed the reciprocity issue in his testimony before a House subcommittee,[150] stating that the Commission needs the discretion to assist a foreign securities agency "regardless of whether there is assured reciprocity."[151] Chairman Ruder envisioned two situations in which the SEC might desire to aid the foreign agency even if similar assistance were unavailable in the requesting agency's state: first, a situation in which the SEC needs to protect directly

145. Senator Riegle (D-Mich.) chairs the Senate Banking and Securities Subcommittee.

146. S. 2544, 100th Cong., 2d Sess. (1988). A full copy of the Senate Bill, and a report submitted to the Senate by the Senate Committee on Banking, Housing and Urban Affairs may be found in S. REP. No. 461, 100th Cong., 2d Sess., *reprinted in* Fed. Sec. L. Rep. (CCH) No. 1300, pt. 2 (Aug. 24, 1988) [hereinafter SENATE REPORT].

147. S. 2544, 100th Cong., 2d Sess. § 101(b)(2)(B), *reprinted in* SENATE REPORT, *supra* note 146, at 35-36. The Senate Banking Committee approved the bill on 27 July 1988. *Senate Panel Approves Bill to Let SEC Assist Foreign Securities Agencies*, 20 Sec. Reg. & L. Rep. (BNA) No. 30, at 1209. Senator Riegle commented that "[a]s a result [of current law], the [Commission] has been unable to use its authority in the U.S. to assist its foreign counterparts with their investigations. . . . We also lack a requirement that the foreign authority return the favor. The SEC accordingly has little leverage when requesting aid for its own investigations." *Riegle Introduces Bill to Allow SEC to Assist Foreign Investigators*, 20 Sec. Reg. & L. Rep. (BNA) No. 25, at 982 (June 24, 1988).

148. *See Dingell Introduces Bill to Encourage International Enforcement Cooperation*, 20 Sec. Reg. & L. Rep. (BNA) No. 27, at 1065 (July 8, 1988). Representative Dingell (D-Mich.) cosponsored the House Bill with Representatives Edward Markey (D-Mass.), Norman Lent (R-N.Y.), and Matthew Rinaldo (R-N.J.). *Id.* at 1066.

149. H.R. 4945, 100th Cong., 2d Sess. (1988).

150. Chairman Ruder appeared before the House Energy and Commerce Telecommunications and Finance Subcommittee. *Ruder Says SEC Should Have Flexibility in Assisting Foreign Securities Agencies*, 20 Sec. Reg. & L. Rep. (BNA) No. 31, at 1236 (Aug. 5, 1988) [hereinafter *Ruder Says*].

151. *Id. But see U.S. Departments*, *supra* note 143. Mary Mochary, Deputy Legal Adviser at the State Department, testified before the Subcommittee that the State Department agreed with the SEC's approach, but that "the department believe[d] that cooperation in this area should be reciprocal, and that our law enforcement authorities should always be able to obtain as much assistance from their foreign counterparts as they are willing to provide to those counterparts." *Id.*

threatened United States interests; and second, a situation in which the SEC wants to grant assistance to encourage future cooperation.[152] The Senate rejected the bill's reciprocity requirement, leaving the adopted Act without such a provision.[153]

B. *The Law as Adopted*

"[F]ling away ambition, by that sin fell the angels," Representative John Dingell warned inside traders,[154] invoking Shakespeare to support passage of the Insider Trading and Securities Fraud Enforcement Act of 1988 (Act).[155] The Act amends the Securities Exchange Act of 1934,[156] and includes only part of the SEC's proposal seeking authority to assist foreign securities agencies.

Section 6 of the Act, entitled "Investigatory Assistance to Foreign Securities Authority," first defines the term "foreign securities authority" as an organization, public or private, empowered to enforce that state's securities laws.[157] The major substantive provision of section 6 authorizes the Commission to assist a foreign securities agency at that agency's request.[158] The request must state that the foreign agency "is conducting an investigation which it deems necessary to determine whether any person has violated, is violating, or is about to violate any" securities law or rule administered by the requesting agency.[159] Assistance, while not required, is available at the discretion of the SEC; dual criminality is not required.[160] Congress promulgated two factors for the SEC to consider

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152. *Ruder Says, supra* note 150, at 1236.

153. Pub. L. No. 100-704, § 6(b)(2), 102 Stat. 4677, 4681 (1988) (codified at 15 U.S.C. § 78u(a)(2) (1988)).

154. 134 CONG. REC. H7465, H7469 (daily ed. Sept. 13, 1988) (statement of Rep. Dingell) (quoting Shakespeare's *Henry VIII*). Representative Dingell also likened inside traders to Icarus, because of their fatal ambition. *Id.*

155. Pub. L. No. 100-704, 102 Stat. 4677 (codified in scattered sections of 15 U.S.C.).

156. Ch. 404, 48 Stat. 881 (codified as amended in scattered sections of 15 U.S.C.).

157. Pub. L. No. 100-704, § 6(a), 102 Stat. 4681-82 (codified at 15 U.S.C. § 78c(a)(50) (1988)).

158. *Id.* § 6(b), 102 Stat. 4681-82 (codified at 15 U.S.C. § 78u(a)(2) (1988)).

159. *Id.*; *cf.* 15 U.S.C. § 78u(a) (1982) (setting forth standards for investigation).

160. Pub. L. No. 100-704, § 6(b), 102 Stat. 4681-82 (codified at 15 U.S.C. § 78u(a)(2) (1988)). Dual criminality is the requirement that the alleged violation be a crime under both the foreign law and United States law. The Commission was granted authority to provide assistance "without regard to whether the facts stated in the request would also constitute a violation of the laws of the United States." *Id.* Dual criminality was favored by Commissioner Charles Cox of the SEC, but that standard was not adopted by the Commission. *SEC to Seek Authority, supra* note 136, at 677.

when deciding whether to assist the foreign authority: "whether (A) the requesting authority has agreed to provide reciprocal assistance in securities matters to the Commission; and (B) compliance with the request would prejudice the public interest of the United States."[161]

Congress intends that international assistance proceed in the following manner. The Act requires the foreign security authority to file a detailed request, describing the facts that indicate a possible violation of the foreign state's law. The committee that submitted the bill included this requirement to prevent the Commission from assisting in "an unfocused or unbounded foreign investigation."[162] If the SEC provides assistance, it appoints officers to gather evidence following normal procedures.[163] The mandate to follow normal procedures assures that witnesses will have the same rights and protections as any witness involved in an SEC investigation.[164] These rights and protections include the rights as a subpoened witness to view an order detailing the grounds and subject of the Commission's formal order indicating the purpose of the investigation and to have full access to the usual challenges to a subpoena.[165] Constitutional due process and fourth amendment rights of a witness during testimony are protected in the following manner:

> [A] witness would be entitled to assert all relevant rights and privileges of the United States. In addition, a witness would be entitled to assert privileges available in the country seeking the evidence even as to those matters which are not privileged under U.S. law. Issues of privilege would be preserved on the record of the investigative proceedings for later consideration by a court of the requesting authority. The Committee expects that foreign countries providing reciprocal assistance to the Commission will follow a familar [*sic*] procedure.[166]

The House Energy and Commerce Committee addressed reciprocity and expressed its intent that the Commission should not assist a foreign agency that refuses to offer similar assistance when in fact that agency is authorized to provide some degree of investigative assistance.[167] The Commission is not required to condition its assistance on reciprocity,

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161. Pub. L. No. 100-704, § 6(b), 102 Stat. 4681-82 (codified at 15 U.S.C. § 78u(a)(2) (1988)).

162. HOUSE REPORT, *supra* note 1, at 6066.

163. *Id.*

164. *Id.*

165. *Id.*; *see* SEC v. Dresser Indus., 628 F.2d 1368, 1381 & n.34 (D.C. Cir.) (quoting 17 C.F.R. 203.6-203.7 (1979)), *cert. denied*, 449 U.S. 993 (1980).

166. HOUSE REPORT, *supra* note 1, at 6067 n.24.

167. *Id.* at 6067.

however, because the Committee believed that such assistance may form a foundation for future mutual cooperation.[168] A two-fold purpose exists for not requiring dual criminality: first, the requirement limits the Commission's ability to assist foreign agencies; and second, if other states require dual criminality, the relative broadness of the United States securities laws severely limits the SEC's possibility of assistance from a foreign counterpart.[169]

C. *Critique of Section 6*

1. Legal Community Concerns: Come Back, King George

The SEC's capacity to assist foreign securities agencies traditionally received support from the legal community; some concerns arise, however, with this capability. When the concept was first suggested in 1985, one practitioner expressed his disgust for the idea, proclaiming, "Why don't we just say we made a mistake and want King George to come back and govern our country?"[170] The practitioner further indicated that he would advise his clients not to cooperate and envisioned the English "sicking" the SEC on his client and then charging the client with obstruction of justice or perjury, even though "there is no legitimate interest here."[171] Other securities lawyers express their concerns about foreign investigators controlling the SEC, pointing out the variances in standards of proof and rights of witnesses.[172] Pragmatically, the additional responsibility and cost to the SEC of assisting foreign governments concern many who are quick to mention that existing United States budgetary ailments, such as deficits and fiscal restraint, may make the implementation of these provisions unfeasible.[173] Finally, the defense bar recognizes the problems of representing a client under investigation by a foreign agency;[174] effective assistance of counsel is restricted because of the difficulty of defining the parameters of the investigation and control-

168. *Id.*

169. *Id.* at 6067-68.

170. Franklin, *Wider Net: SEC Authority to Aid Foreign Prosecutions Sought*, N.Y.L.J., Sept. 17, 1987, at 5, col. 5. (statement of Marvin Pickholz, partner in the Washington, D.C. office of New York's Parker, Chapin, Flattau & Klimpl, and member of the ABA Subcommittee on Insider Trading).

171. *Id.* at 6, col. 6.

172. *SEC Asks Congress for New Powers*, Nat'l L.J. News Service, Aug. 25, 1988 (LEXIS, NEXIS Library, PRNEWS File). *But see infra* text accompanying note 190.

173. Franklin, *supra* note 170, at 5, col. 5.

174. *Id.* at 6, col. 6.

ling discovery.[175] The only effective means of representing a client under investigation is to associate with foreign counsel.[176]

Michael Mann, Associate Enforcement Director at the SEC's Office of International Affairs, addresses some of these concerns. He argues that the United States has a vital interest in protecting both domestic and foreign markets from fraud, and that in the long run the United States will actually save money.[177] Indeed, present methods of international securities enforcement require a case by case approach, and bilateral agreements, facilitated by the additional capabilities of the SEC that allow it to cooperate more fully with foreign agencies, improve efficiency.[178]

2. Is Section 6 Constitutional?

The recently signed United States-Canadian MOU[179] brought forth a constitutional challenge in Canada, contesting the authority of Canadian securities agencies to conduct investigations on behalf of the SEC in Canada.[180] Similar concerns persist as to United States congressional authority to give the SEC reciprocal powers.[181] Professor George Berman, Professor of Law at Columbia University, while believing Congress has the power to grant the substantive provisions of section 6 of the Act, nevertheless believes the authority is best suited for an executive branch agency.[182]

Congress is constitutionally vested with the responsibility to "regulate

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175. *Id.*

176. *Id.* Foreign counsel would be required for an understanding of the foreign state's laws eventually applied to the client and the breadth of rights available to the witness. *Id.*

177. *Id.*

178. *Id.*

179. *See supra* notes 129-31 and accompanying text.

180. *SEC Asks Congress for Power to Conduct Investigations to Aid Foreign Gov'ts*, 20 Sec. Reg. & L. Rep. (BNA) No. 23, at 875, 876 (June 10, 1988); *Constitutional Attack Mounted on Recent SEC Memorandum, Ontario Act*, 20 Sec. Reg. & L. Rep. (BNA) No. 34, at 1337 (Aug. 26, 1988).

181. Franklin, *supra* note 170, at 6, col. 6.

182. *Id.* Conflicts, however, within the federal government over foreign policy would be no greater than those already in existence. Former SEC General Counsel David Goelzer suggested that, although not required, the SEC could "back off" if a conflict were to arise. *Id.*; *see also SEC to Seek Authority, supra* note 136, at 677. SEC Commissioner Joseph Grundfest wanted to require, in the legislative proposal to Congress, that the SEC consult with the Executive Branch before assisting foreign government investigations, but this was not adopted. *Id.*

Commerce with foreign Nations."[183] Congress passed the Securities Exchange Act as a valid exercise of its power under the commerce clause.[184] To effect legislative intent, Congress gave the SEC broad investigatory power,[185] subpoena power,[186] and power to petition the judiciary to enforce discovery demands.[187] The Commission's primary enforcement mechanism is the subpoena.[188] The power to issue a subpoena is not limited to situations in which there is "probable cause" nor even suspicion of illegal activity.[189] In 1946, the United States Supreme Court announced a three-part test for determining the validity of an administrative agency's enforcement procedures:

> The requirement of "probable cause, supported by oath or affirmation," literally applicable in the case of a warrant, is satisfied in that of an order for production by the court's determination that the investigation is authorized by Congress, is for a purpose Congress can order, and the documents sought are relevant to the inquiry.[190]

Congress explicitly authorized investigations by the SEC in section 6 of the Act. Whether Congress possesses this power is another question. Congress established the SEC to administer the Securities Exchange Act and the amendments contained in the 1988 Act. The subpoena power

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183. U.S. CONST. art. I, § 8, cl. 3; *see* United States v. Guy W. Capps, Inc., 204 F.2d 655 (4th Cir. 1953), *aff'd on other grounds*, 348 U.S. 296 (1955). The power to regulate foreign commerce is in Congress, not in the executive or the judiciary. *Id.* at 658.

184. SEC v. Torr, 15 F. Supp. 315, 320 (S.D.N.Y. 1936), *rev'd on other grounds*, 87 F.2d 446 (2d Cir. 1937).

185. 15 U.S.C. § 78u(a) (1988).

186. *Id.* § 78u(b).

187. *Id.* § 78u(c).

188. HOUSE CRITICISM, *supra* note 11, at 31 (statement of Professor Hurd).

189. United States v. Morton Salt, 338 U.S. 632 (1950). The Court wrote that administrative agencies have the

> power of inquisition, if one chooses to call it that, which is not derived from the judicial function. It is more analogous to the Grand Jury, which does not depend on a case or controversy for power to get evidence but can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not. When investigative and accusatory duties are delegated by statute to an administrative body, it, too, may take steps to inform itself as to whether there is probable violation of the law.

Id. at 642; *see also supra* note 185 and accompanying text.

190. Oklahoma Press Pub. v. Walling, 327 U.S. 186, 209 (1946). "It is not necessary, as in the case of a warrant, that a specific charge or complaint of violation of law be pending or that the order be made pursuant to one. It is enough that the investigation be for a lawfully authorized purpose, within the power of Congress to command." *Id.* at 208-09.

delegated by statute to the SEC is within the limits of congressional power.[191] The power of Congress to regulate commerce, including foreign commerce, is expressed in the Constitution. The authority of a federal administrative agency to investigate a person in the United States on behalf of a foreign government is a "necessary and proper"[192] means to the effective and legitimate end of protecting not only United States financial markets from fraud, but also of ensuring that the United States is not used as a haven for persons actively defrauding participants in markets around the world.

Another question arises as to whether targets of investigation have constitutional rights. The third requirement in the Supreme Court's test for enforcing an administrative subpoena is a "relevancy" standard. This standard requires that the materials sought be plainly competent and relevant to a lawful purpose.[193] Potential defendants are also protected by the reasonableness requirement applicable to all administrative agency investigations.[194] Congress intended to afford subjects of joint SEC-foreign inquisitions their applicable fourth and fifth amendment rights.[195] A person under investigation, however, is protected even without this expression of intent because investigations by federal officials are conducted under the guise of constitutional standards.[196] Further, although as a general rule a court can compel an immunized witness to testify, the fifth amendment notwithstanding,[197] dicta in one Supreme Court decision imply the opposite when such testimony could incriminate the witness under foreign law.[198]

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191. Endicott Johnson Corp. v. Perkins, 317 U.S. 501, 510 (1943).

192. U.S. CONST. art. I, § 8, cl. 18.

193. SEC v. OKC Corp., 474 F. Supp. 1031, 1036 (N.D. Tex. 1979) (quoting *Endicott*, 317 U.S. at 509).

194. *Oklahoma Press*, 327 U.S. at 208. "The gist of the protections [in the validity of subpoenas] is in the requirement, expressed in terms, that the disclosure sought shall not be unreasonable." *Id.*

195. *See* HOUSE REPORT, *supra* note 1, at 6067 n.24.

196. *See* Stonehill v. United States, 405 F.2d 738 (9th Cir. 1968). The fourth amendment applies to raids by foreign officials only if federal agents so substantially participate in the raids as to convert them into joint ventures between United States and foreign officials. *Id.* at 743.

197. Kastigar v. United States, 406 U.S. 441, 462 (1972).

198. Zicarelli v. New Jersey Investigation Comm'n, 406 U.S. 472, 481 (1972). Mr. Zicarelli was given immunity in exchange for testimony concerning mob activities in New Jersey, but he refused to answer certain questions because the answers would expose him to danger of foreign prosecution. He argued that neither immunity nor the fifth amendment can prevent the use of the testimony by a foreign sovereign. The Supreme Court refused to rule on the issue because "[i]t is well established that the privilege

Section 6 passes constitutional muster. The Act is a legitimate exercise of broad congressional powers under the commerce clause. A person targeted by a foreign agency for investigation still has substantial constitutional protections. Additionally, the SEC can prevent unwarranted inquiries through its discretionary powers in determining whether to commence an investigation on behalf of a foreign government. The Commission rarely wastes its limited resources on fishing expeditions.[199]

3. Has Congress Fallen Short?

Representative Edward Markey,[200] speaking in support of the Act, declared that the measure "will, in fact, begin to convince the investing public that the Congress is taking action that can give them some reason to believe that insider trading is something that will not be tolerated by the Congress or by the courts."[201] Congress did make some rather dramatic changes in the law. The Act increases criminal penalties,[202] imposes liability on control persons,[203] authorizes bounties to informants,[204] and codifies an already implied private right of action.[205] These substantial tools in the enforcement of United States securities laws provide deterrence; nevertheless, a smart professional can still trade on inside information by the use of foreign bank accounts if the trader selects the right sovereign (such as Panama or Luxembourg) and utilizes enough protective layering.[206] The SEC proposed additional measures designed further to enable it to police—and to aid other sovereigns in their efforts to police—international securities markets.

The SEC requested amendments to the Freedom of Information Act

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protects against real dangers, not remote and speculative possibilities." *Id.* at 478. The Court did not consider that questions about New Jersey crimes could present a problem of foreign incrimination. "Should [Mr. Zicarelli] have found it necessary to qualify his answer by confining it to domestic responsibilities in order to avoid incrimination under foreign law, he could have done so." *Id.* at 481.

199. *See* HOUSE CRITICISM, *supra* note 11, at 8 (explaining the SEC's reluctance to conduct investigations involving foreign trades).

200. Representative Markey (D-Mass.) cosponsored H.R. 4945. *See supra* note 148.

201. 134 CONG. REC. H7465, H7468 (daily ed. Sept. 13, 1988) (statement of Rep. Markey). "The average investor must be assured that the securities marketplace is above all else a fair and level playing field and not a steep, rigid incline." *Id.*

202. Pub. L. No. 100-704, § 4, 102 Stat. 4677, 4680 (codified at 15 U.S.C. § 78ff(a) (1988)).

203. *Id.* § 3, 102 Stat. 4677-80 (codified at 15 U.S.C. § 78u-1 (1988)).

204. *Id.*

205. *Id.* § 5, 102 Stat. 4680-81 (codified at 15 U.S.C. § 78t-1 (1988)).

206. *See supra* note 63 and accompanying text.

(FOIA)[207] to ensure confidentiality of evidence obtained by the Commission from a foreign agency.[208] The Senate Bill would have created a narrow exception to keep the same information confidential in the United States that is kept confidential by foreign law.[209] In favor of this bill, the Senate Report indicated that the "adoption of such an amendment will almost certainly allow the SEC to obtain otherwise unobtainable confidential documents from foreign countries for law enforcement purposes. These considerations warrant enactment of the FOIA exemption."[210] FOIA disclosure is one of the most serious causes of foreign government reluctance to provide assistance and information to the SEC.[211] The failure of Congress to provide this exemption therefore will probably bar further negotiation of bilateral agreements near completion.[212]

This deficiency is an obvious flaw in the present law. The SEC needed the "we'll scratch your back, if you'll scratch ours" bait promulgated in section 6 of the Act. Once, however, a foreign government realizes that information provided under any agreement is subject to disclosure under the FOIA, the foreign government becomes reluctant to cooperate. The significance of this flaw is multiplied by the fact that the most crucial information in an international insider trading investigation is the identity of secret bank account customers—information the potentially cooperating sovereign may protect under its strong public policy and secrecy laws. Congress lowers the bait, but it fails to attract any takers. No rationale for this oversight exists; immediate correction is vital.

V. THE INTERNATIONAL SECURITIES ENFORCEMENT COOPERATION ACT OF 1989: CONGRESS CONTINUES TO FALL SHORT

On 1 March 1989, the SEC submitted to Congress the proposed International Securities Enforcement Cooperation Act of 1989.[213] The SEC requested the enactment of an exemption to the FOIA to prevent

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207. 5 U.S.C. § 552 (1988).

208. SENATE REPORT, *supra* note 146, at 10-11.

209. S. 2544, 100th Cong., 2d Sess. § 102(d) (1988), *reprinted in* SENATE REPORT, *supra* note 146, at 37.

210. *Id.* at 10.

211. *SEC Has Sought Enforcement Help under Swiss Treaty, Attorney Says*, 20 Sec. Reg. & L. Rep. (BNA) No. 33, at 1294, 1295 (Aug. 19, 1988).

212. *Id.*

213. *SEC Asks Congress to Increase International Enforcement Powers*, 21 Sec. Reg. & L. Rep. (BNA) No. 9, at 341 (Mar. 3, 1989).

the disclosure of documents provided by foreign securities agencies to the SEC.[214] This exemption is crucial because foreign securities agencies often refuse to enter into MOUs with the SEC until assurances are provided that the documents and any testimony submitted to the SEC by the foreign securities agency will remain confidential.[215] The Commission argued that the legislation would not undermine the policy behind the FOIA:[216]

> If the Commission never obtains documents because there is no MOU in a given case, the documents will never be subject to a FOIA disclosure obligation in the first instance. . . . [A]doption of such an amendment will almost certainly allow the Commission to obtain for law enforcement purposes otherwise unobtainable confidential documents from foreign countries.[217]

Further, the SEC argued that "principles of comity make it appropriate to exempt from disclosure confidential documents obtained from a foreign government if those documents could not be disclosed under the laws of the foreign country."[218]

On 25 September 1989, the United States House of Representatives passed H.R. 1396 in response to the SEC's proposed measure.[219] H.R. 1396 contains the FOIA exemption requested by the SEC. The bill provides in part:

> Except as provided in subsection (e), the Commission shall not be compelled to disclose records obtained from a foreign securities authority if (1) the foreign securities authority here has in good faith determined and represented to the Commission that public disclosure of such records would violate the laws applicable to that foreign securities authority, and (2) the Commission obtains such records pursuant to (A) such procedure as the Commission may authorize for use in connection with the administration or enforcement of the securities laws, or (B) a memorandum of understanding.[220]

Subsection (e) excepts from the FOIA exemption information provided

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214. *Id.*

215. *Id.*; *see also* H.R. REP. No. 240, 101st Cong., 1st Sess. (1989) [hereinafter HOUSE REPORT].

216. *Id.* at 23.

217. *Id.*

218. *Id.*

219. *House Approves SEC-Drafted Bill to Limit Access to Foreign Documents*, 21 Sec. Reg. & L. Rep. (BNA) No. 38, at 1463 (Sept. 29, 1989).

220. H.R. 1396, 101st Cong., 1st Sess. § 2(a)(2), 135 CONG. REC. H5870, H5870 (daily ed. Sept. 25, 1989) (intended to amend 15 U.S.C. § 78x)).

to the SEC in three instances:[221] (1) when the Right to Finance Privacy Act applies;[222] (2) when Congress requests the information; or (3) when the information is requested pursuant to "an order of a court of the United States in an action commenced by the United States or the Commission."[223]

The FOIA exemption that the SEC originally requested was altered to its final form, quoted above, to preserve the integrity of the FOIA.[224] The exemption passed by the House of Representatives was supported by the American Newspaper Publishers Association and the American Society of Newspaper Editors.[225]

H.R. 1396 also contains several other provisions regarding the international securities market. These provisions include:

(1) Authority for the SEC to allow access to its files by foreign law enforcement officials;[226]
(2) Authority for the SEC to sanction securities professionals for violating foreign securities laws;[227]
(3) Authority for SROs to prevent persons convicted under foreign law from membership in an SRO;[228]
(4) Authority for the SEC to accept reimbursement for expenses incurred

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221. *Id.* at H5870-71.

222. *Id.*

223. *Id.* at H5871.

224. 135 CONG. REC. at H5873 (statement of Rep. Markey).

225. Letter of Craig Klugman and Terry Maguire to Reps. Edward Markey and Matthew J. Rinaldo (Aug. 15, 1989), *reprinted in id.* (The legislation is "an acceptable solution which protects the interest of the SEC while prescribing a strong FOIA."). These associations objected to the original language of the bill; they believed that the original proposal would have authorized the SEC to withhold documents beyond the scope of the Commission's concerns, and the language could be interpreted to "deny adequate judicial review of whether the standards permitting the withholding of relevant documents had been met." *Id.*

The standard for confidentiality in the original corresponding Senate bill was whether the "foreign securities authority has in good faith represented to the Commission that public disclosure of such records would be contrary to the laws applicable to that foreign securities authority." S. 646, 101st Cong., 2d Sess. § 2(a), 135 CONG. REC. S3041, S3041 (daily ed. Mar. 17, 1989) (intended to amend 15 U.S.C. § 78x).

226. H.R. 1396, § 2(a)(2), at H5870. For a form letter to be used by foreign securities agencies, see *infra* appendix.

227. *See* H.R. 1396, § 3(a), at H5871 (intended to amend 15 U.S.C. § 78(b)). Section 3 of H.R. 1396 has raised concerns over the due process rights of those sanctioned. *See Enforcement Bills Foreign Provisions Raise Due Process Concerns, Lawyers Say*, 21 Sec. Reg. & L. Rep. (BNA) No. 39, at 1497, 1497-98 (Oct. 6, 1989).

228. H.R. 1396, § 3(b), at H5871 (intended to amend 15 U.S.C. § 79c(a)(39)); *see also supra* note 85 (defining SRO).

on behalf of foreign governmental authorities.[229]

Representative Markey suggested at the time that this legislation would be an important step toward global securities enforcement cooperation:[230] "Both the business communities and governments in these nations have come to recognize the importance of this approach in attracting investors and raising capital in the market place."[231]

H.R. 1396 has not become law. After passage in the House, the Senate delayed action until 16 November 1989, when the Senate considered H.R. 1396.[232] The Senate, however, struck everything after the enacting clause and inserted the text of S. 1712.[233] S. 1712 contains other material concering the SEC as well as the original SEC proposal,[234] but these additions require further consideration by the House before the FOIA exemption is ready for President Bush's approval. Hence, despite the "swift pace of globalization,"[235] leaving international regulation in its trail, the Senate's amendments to H.R. 1396—amendments not even concerning the FOIA exemption—delay any further agreements between the SEC and foreign securities agencies for investigative assistance.[236]

VI. RECOMMENDATIONS

A. *House Committee Suggestions*

The House Committee on Government Operations, which recently criticized the SEC's enforcement efforts in cases involving international trading,[237] made several recommendations to the Commission and Congress.[238] The most prominent of these suggests that the SEC should not emphasize the use of MOUs; the House Committee prefers, instead, that the SEC obtain congressional authority to prohibit securities trading from states that will not enter into an MOU.[239] The Committee also

229. H.R. 1396, § 7, at H5872 (intended to amend 15 U.S.C. 78d(c)).

230. 135 CONG. REC. at H5873.

231. *Id.*

232. [1 1989-1990] Cong. Index (CCH) 21,827.

233. *See* 135 CONG. REC. S15,909-17 (daily ed. Nov. 16, 1989).

234. *Id.*

235. 135 CONG. REC. at H5873 (statement of Rep. Markey).

236. The Senate has indefinitely postponed consideration of S. 1712. [1 1989-1990] Cong. Index (CCH) 21,827.

237. HOUSE CRITICISM, *supra* note 11.

238. *Id.* at 11-12.

239. *Id.* This suggested prohibition is similar to the CFTC's Rule 21.03. *See* 17 C.F.R. § 21.03 (1989). The Report recognized the importance of MOUs, but stated that inherent limitations in these agreements suggest the need for a more comprehensive and

suggests that the SEC establish an interagency group, with representatives from the United States Justice Department, State Department, and Internal Revenue Service, to coordinate international law enforcement.[240] A further suggestion urges Congress to grant expanded long arm jurisdiction to the Commission. This would authorize the Commission's service of subpoenas outside the United States while respecting the sovereignty of foreign states.[241] The Commodities Future Trading Commission (CFTC) possesses this authority and utilizes the power as an effective deterrent to illegal trading originated abroad.[242] The Committee also urges the SEC to mandate that foreign banks trading in United States markets identify the beneficial owners of accounts involved in suspicious trading.[243] Finally, Congress could possibly consider a unilateral approach to global securities enforcement.[244] The "waiver-by-conduct" method of enforcement, first presented in 1984, proposes that a transaction in United States securities markets constitutes consent to disclosure of information relating to the trade—even information entitled to protection under foreign law.[245] Congress shelved the waiver-by-conduct proposal after considerable criticism.[246] Critics argue that the concept leads to retaliatory measures by foreign states and the potential for the extraterritorial application of United States laws, which would eventually hinder international cooperation.[247] Additionally, the implied consent to disclosure probably would cause foreign investors to withdraw their capital and invest in other markets,[248] a result that potentially could lead to financial disaster. Over $400 billion in trades were conducted by foreigners in the United States securities markets during 1987.

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reliable international enforcement approach. HOUSE CRITICISM, *supra* note 11, at 11.

240. HOUSE CRITICISM, *supra* note 11, at 12.

241. *Id.* at 14.

242. *Id.*; 7 U.S.C. § 15 (1988).

243. HOUSE CRITICISM, *supra* note 11, at 17.

244. *Id.* at 15.

245. SEC Request, *supra* note 68; *see also* Fedders, Wade, Mann & Beizer, *Waiver By Conduct—A Possible Response to the Internationalization of the Securities Markets*, 6 J. COMP. BUS. & CAP. MARKET L. 1 (1984).

246. HOUSE CRITICISM, *supra* note 11, at 15 n.25; *see also* Bschorr, *"Waiver By Conduct": Another View*, 6 J. COMP. BUS. & CAP. MARKET L. 307 (1984); Lépine, *A Response to Fedders' "Waiver by Conduct"*, 6 J. COMP. BUS. & CAP. MARKET L. 319 (1984); Singer, *The Internationalized Securities Market and International Law—A Reply to John M. Fedders*, 6 J. COMP. BUS. & CAP. MARKET L. 345 (1984).

247. Comment, *supra* note 9, at 317-18.

248. HOUSE CRITICISM, *supra* note 11, at 16.

B. *Additional Recommendations*

As previously mentioned, Congress must seriously consider the amendments to the FOIA as proposed by the SEC. Information that foreign law requires to be kept confidential is not available for sharing with the SEC if such information is subject to public observation. Indeed, as stated earlier, foreign securities agencies refuse to enter into MOUs with the SEC because of the possible disclosure under the FOIA of information that they might be required to provide to the SEC.[249] Congress should also expand the long arm jurisdiction of the Commission, similar to the expansion it already has afforded the CFTC. Once cooperation is established, the SEC can efficiently perform service extraterritorially, subject to the protection of the sovereign interests of both states.

The SEC should also modify its policy regarding MOUs. Although MOUs will continue to be a valid mechanism for international securities enforcement, their role as the primary means of cooperation requires modification. Until every sovereign in the world agrees to enter into a bilateral agreement with the SEC, a haven will always exist for the origination of illegal trading on United States markets.[250] The desire of a state to have capital flowing into its banks will always deter some states from either repealing bank secrecy laws or subjecting account identification to potential discovery under an MOU. In light of this persistent problem, notably the United States is not the only state interested in protecting financial markets. The United States, therefore, should establish multilateral cooperation either through a treaty or through a multinational securities regulatory committee.[251] Either of these regimes are difficult to establish because of the variances in regulatory standards and policies in the different states.[252] A rough set of guidelines could further the basis of international standards. Multinational cooperation in securities regulation is feasible. Recently, representatives of ten states and Interpol met in Washington, D.C. to coordinate investigations regarding one of the largest international securities fraud cases to date.[253] This co-

249. *See* text accompanying note 215.

250. *See* Comment, *supra* note 9, at 318.

251. WASH. & LEE Note, *supra* note 9, at 1172; *see* Williams & Spencer, *Regulation of International Securities Markets: Towards a Greater Cooperation*, 4 J. COMP. CORP. L. & SEC. REG. 279 (Mar. 1982). Williams and Spencer propose the establishment by multilateral treaty of an international committee of security regulators. *Id.* at 284-85.

252. *Id.* at 285.

253. *Enforcement Officials Meet to Coordinate Fraud Inquiry*, 20 Sec. Reg. & L. Rep. (BNA) No. 40, at 1554 (Oct. 14, 1988). The European Economic Community is formulating a uniform insider trading law, which will aid enforcement officials through-

operation could lay the foundation for further multinational coordination.

Congress should not establish unilateral, protectionist means of securities enforcement. Enough barriers exist to the exchange of evidence, information, and cooperation today without Congress creating another. The economies of the world have transcended national boundaries and are rapidly evolving into one truly global economy. The efficient, free flow of capital from market to market furthers this process. Securities regulatory bodies should accept these facts and work for greater interdependence. The attraction of secret bank accounts will continue to draw capital; if alternative means of discovery are not effective in protecting the markets from abuses furthered by these accounts, prohibition of trading with these accounts should be required only in extreme cases. Further, all the major financial centers must ban the use of secret accounts to frustrate effectively their use. It is, however, unlikely such concerted activity will happen.

VII. CONCLUSION

The world securities and financial markets are rapidly evolving into globalized, twenty-four hour markets. Regulatory bodies must quickly prepare a legal and financial framework for international, multilateral cooperation.[254] Ad hoc bilateral cooperation, although a foundation for multilateral cooperation, is not a viable long-term solution.[255] The SEC must focus on establishing a multinational regime. Congress at least has acknowledged the problem, but the enactment of section 6 is just that—an acknowledgment. Section 6 provides little more than a rocky base for further legislation. Congress should amend the FOIA as proposed by the Commission, and formulate further measures that enhance multinational cooperation.

Any legislation should include roles for both the SEC and executive branch agencies[256] in recognition of the inherent foreign policy issues

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out the community. Lee, Robert, Hirsch & Pollack, *Secrecy Laws and Other Obstacles to International Cooperation*, 4 J. COMP. CORP. L. & SEC. REG. 287, 294-95 (Mar. 1982). For an analysis of the recent EEC Directive on Insider Trading, see Note, *A New Look at the European Economic Community Directive on Insider Trading*, 23 VAND. J. TRANSNAT'L L. 135 (1990).

254. Mann & Sullivan, *supra* note 19, at 774.

255. WASH. & LEE Note, *supra* note 9, at 1166.

256. The SEC and Department of Justice (DOJ) already have established a framework for reviewing requests by foreign securities agencies for investigative assistance. The cooperative efforts will include the following:

1. The SEC will give the foreign securities agency request to the DOJ and allow

involved. The creation of an international environment that is conducive to free market forces yet free from abuses is difficult to establish. International coordination of securities regulation remains the best hope to melt the waxen wings of inside traders.[257]

*John Thornell Thomas**

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the DOJ a reasonable time to provide comments to the SEC before the SEC will begin an investigation on behalf of the foreign government;

2. The SEC will notify the DOJ prior to the enforcement of any subpoena issued at the request of the foreign securities agency;

3. "The SEC staff will consult with the DOJ Office of International Affairs regarding the selection of countries for negotriation of" MOUs.

SEC, DOJ Set up Framework for Reviewing Foreign Requests for Investigative Help, 21 Sec. Reg. & L. Rep. (BNA) No. 8, at 295 (Feb. 24, 1989).

257. 134 CONG. REC. H7469 (daily ed. Sept. 13, 1988) (statement of Rep. Dingell); *see Global Recognition of Legal Judgments Next Big Enforcement Issue, Mann Advises*, 21 Sec. Reg. & L. Rep. (BNA) No. 44, at 1665 (Nov. 10, 1989) (interview with Michael Mann, SEC Office of International Affairs, Associate Enforcement Director).

* To my mother, Elizabeth Oglesby Johnson, and to Edward Johnson, as I try to heed the wisdom of Proverbs 1:8-9, and in memory of my father, John Larry Thomas, who introduced me to the stock market when I was seven years old. Their wisdom and memory continue to discipline and guide me.

APPENDIX

Access Request by Foreign Government

Dear _____:

We request access to the investigative and other non-public files of the U.S. Securities and Exchange Commission (the "Commission") related to captioned matter. This request is made in connection with an ongoing lawful investigation or official proceedings inquiring into a violation of, or failure to comply with, a criminal or civil statute or regulation, rule or order issued pursuant thereto, being conducted by [name of requesting agency].

We will establish and maintain such safeguards as are necessary and appropriate to protect the confidentiality of files to which access is granted and information derived therefrom. The files and information may, however, be used for the purposes of our investigation and/or proceedings, and any resulting proceedings. They also may be transferred to our government's criminal law enforcement authorities and self-regulatory organizations subject to our oversight. We shall notify you of any such transfer and use our best efforts to obtain appropriate assurances of confidentiality.

Other than as set forth in the procceding [*sic*] paragraph, we will:

Make no public use of these files or information without prior approval of your staff;

Notify you of any legally enforceable demand for the files or information prior to complying with the demand, and assert such legal exemptions or privileges on your behalf as you may request; and

Not grant any other demand or request for the files or information without prior notice to the lack of objection by your staff.

We recognize that until this matter has been closed, the Commission continues to have an interest and will take further investigatory or other steps as it considers necessary in the discharge of its duties and responsibilities.

Should you have any questions, please contact _____.

Source: H.R. REP. NO. 240, 101st Cong., 1st Sess. 40-41 (1989).