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OFFSHORE OFFERINGS BY FOREIGN ENTITIES: HOW FAR WILL THE SEC REACH TO REGULATE?

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¶ 1 Many countries' regulatory regimes, including that of the United States, traditionally require registration of all investment services offers or securities sales to their citizens. Many have claimed that the Internet will make such financial regulation obsolete. With the advent of the new technology, regulatory bodies across the globe have been forced to redefine what constitutes an offer to purchase securities within their borders. They have come up with a variety of models for regulating cross-border capital flows. Even countries with similar legal traditions such as Britain, the US, and Australia have taken different approaches.

¶ 2 In the US, the Securities and Exchange Commission (SEC) is currently attempting to define the American approach to regulating offshore securities offerings on the Internet. There are several potential frameworks available for the SEC to adopt. The main issue, however, is the degree of control the US regulators ultimately demand over Internet-based securities offerings. A greater degree of control may protect US investors, but at the expense of vigorous activity in the international online securities market. A lesser degree of control would have the opposite effect, allowing the market free rein, but leaving US investors vulnerable.

Recent Debate

¶ 3 In the US, the current law governing financial services and security offerings on the Internet arises from No-Action Letters and Interpretative Releases from the SEC. Flooded by numerous requests for interpretations, the SEC in 1990, ceased to issue No-Action Letters on the subject and stepped behind closed doors to draw up a new regulatory framework. This framework addresses many important issues raised by the Internet in the realm of securities, including the extent to which the US will exercise jurisdiction over offshore offerings by foreign entities. The public is anxious to see what form of legislation the SEC will develop.

¶ 4 There are two possible broad forms that this new legislation is likely to take. Some countries have implemented regulations granting broad jurisdiction over foreign securities offerings. Other countries have utilized the framework of law developed by the International Organization of Securities Commissions (IOSCO). The US may adopt provisions similar to the IOSCO recommendations that would recognize the jurisdiction of other nations over securities offers made over the Internet, even though the offers are accessible to US investors. The other option would be for the SEC to adopt a more extensive system of regulation. This system would give little deference to foreign regulations and attempt to exercise significant jurisdiction over foreign entities whose securities offerings were accessible to US investors over the Internet. Given the history of US securities regulation, it is likely that the SEC's new regulations will be closer to this second system.

¶ 5 The degree of control that the SEC decides to take in the international securities arena will have broad implications for foreign entities, such as Australia, that have more liberal national systems. Australia is a useful country to compare in this context, both because it is a common-law country and also because it has already established regulations in this arena. In the Third Restatement of Foreign Relations, §416, it is stated that the United States may generally exercise jurisdiction over securities transactions "carried out, or intended to be carried out, on an organized securities market in the United States" or "conduct, regardless of where it occurs, if it has a substantial effect in the United States." Additionally, the broader the SEC definition of an offer in the US, the greater the chance that US law will conflict with foreign regulations. The SEC must balance its responsibility to protect US investors with its interest in the value and efficiency that the Internet introduces to the world securities markets. The Australian Securities & Investment Commission stated this well in their Policy Statement 141 on Offers of Securities on the Internet. "If every regulator sought to regulate all offers, invitations and advertisements for financial products that were accessible on the Internet in their jurisdiction, the use of the Internet for transactions in financial products would be severely hampered." The SEC currently must weigh the value of the Internet to the development of financial markets against the importance of protecting US investors from foreign issuers of securities who are beyond the reach of US jurisdiction.

Frameworks for Governing Foreign Offerings on the Internet

The Current SEC Approach

¶ 6 Under the traditional rule of securities offerings in the US, any person offering securities within the US must register with the SEC. This requirement, embodied in Regulation S of the 1933 Securities Act, applies whenever an issuer offers or sells securities in the US through the mail or other means of interstate commerce. Some courts have made exceptions where a "conduct and effects test" is used for transactions that fall outside of the Regulation S safe harbor.¹ But in general, in applying the Regulation S standard to the electronic media, the SEC has employed the same regulations used for paper documents to establish what is acceptable for electronic media. For example, just as with paper, electronic media that contain securities offerings are considered to be within the control of the sender. The sender has the responsibility to make sure the materials are not sent to US investors when the sender has not registered the securities within the US.² This rule may be easily applied to some types of electronic media such as e-mail. The issue becomes much less clear, for example, when the securities offering is made on a web board posting or on a web page. In those cases, it may be difficult to determine whether the securities offer was "sent" to US investors.

¶ 7 In an effort to respond to questions regarding what constitutes an offer targeted at the United States, the SEC provided an interpretive release effective March 23, 1998 that gives further guidance in the areas where securities laws and electronic media interact.³ This SEC Interpretation clarifies the SEC's requirements for the electronic delivery of documents under the federal securities laws, issuer liability for web site content, and the requirements for conducting online offerings. This Interpretation rules that web postings will not come under US regulation as long as there are precautionary measures that are "reasonably designed to ensure that offshore Internet offers are not targeted at the US." In practice, however, the Internet makes it difficult to discern what constitutes being "targeted" at the US.

¶ 8 Under the current standard, issuers, broker-dealers, exchanges, and investment advisors are not required to register with the SEC when they implement measures that are "reasonably designed" to guard against offering services to US persons. In the Interpretation mentioned above, the SEC noted that the mere accessibility of a web site in the US does not automatically make the offering open to US persons. But this offering may be viewed as "targeted" at US individuals if the proper measures are not in place to prevent sales of foreign securities to a US person. Moreover, if an offeror has access to information about investors that identifies them as US residents such a US social security number or a payment drawn on a US bank, then the offeror may be charged with violating the SEC regulations. What safeguards are adequate in the eyes of the SEC depend upon all the facts and circumstances and must be determined on a case-by-case basis. This standard is significant because if a US person were to circumvent

reasonably designed measures, such as by falsely answering questions about their country of residence, the offeror may not be held responsible for the violation.⁴

¶ 9 The SEC presently considers several factors in determining whether a foreign broker will come under US securities regulations. These include: (1) posting a prominent disclaimer on the website either affirmatively delineating the countries in which the broker-dealer's services are available, or stating that the services are not available to US persons; and (2) refusing to provide brokerage services to a potential customer that the broker-dealer has reason to believe is a US person, based on residence, mailing address, payment method, or other grounds. It must be noted, however, that the broker still has responsibility to supervise whether the proclaimed methods of guarding against sales to US persons are effective. For example, if significant sales are generated from the US regardless of the precautionary measures, then this evidence would be taken to show that the issuers' methods are not sufficient. The SEC mentions that advertising the existence of a foreign offering web page in a US publication or discussing the tax benefits under the US code of a particular investment plan may be enough to constitute targeting at the US.⁵

¶ 10 At first glance, the SEC Interpretation appears to give some concrete insight into the particular actions necessary for a foreign offering to be exempt under US law. The exceptions mentioned also create ambiguity for foreign entities as to what will be considered "targeting" at US persons. Foreign entities choosing to make an offering of offshore securities today must consider the uncertainty of the current law regarding US jurisdiction over offshore offerings. Because the new regulatory framework has not yet been released, such entities may need to look to other domestic and international resources to anticipate what the SEC's new regulations will require.

¶ 11 Current treatment and No-Action Letters regarding offerings within the US are providing a conservative, rigid view of what future offshore regulations will resemble. Recent releases on domestic Internet issues have established that a US company is responsible for any information that is posted to its website, whether or not it is in the context of an offering, and the company has potential liability over all posted information. The SEC also forces companies to be particularly careful about how they post information. Any information appearing on a web site in close proximity to a statutory prospectus would be considered an "offer" within the meaning of the Securities Act. Companies also must be responsible for all hyperlinks embedded in their web sites, even if such links are only third party information. Such information could then become part of the prospectus and must be filed with the SEC. Thus, according to the SEC, it appears that a strict policy of no tolerance is being established to protect investors. But one

also must recall that such a rigid system stretched into the international field would hinder the use of Internet for financial services by subjecting all foreign issuers to US registrations.

Other Sources Of US Law

¶ 12 One possible solution to the current dilemma of how to regulate offshore Internet offerings would be to look towards the approach adopted by several US states. This analysis allows one to compare the interaction between the various states in the US to that of various countries in the world. Just as the SEC has sought to regulate offshore offerings aimed at US investors on the Internet, many states have developed criteria to determine whether an offering over the Internet is subject to a state's securities laws through so called "Blue Sky Laws." Among these states, Pennsylvania is often pointed out as an example. In 1995, the Pennsylvania Securities Commission issued an order that exempted online offerings from registration and advertising requirements under certain conditions.⁶ This order required that offerings over the Internet indicate that the securities are not being offered to Pennsylvania residents and that no sales of the securities will be made in Pennsylvania as a result of the Internet offer.

¶ 13 The North American Securities Administrators Association, Inc. (NASAA), influenced by Pennsylvania, adopted a resolution that called for states to exempt Internet offerings from registration provisions when the offer indicates, directly or indirectly, that the securities are not being offered to the residents of a particular state.⁷ So far at least 32 states have adopted this resolution, and 16 more are in the process. These attempts to deal with online offerings recognize that states have little control over what their residents can access through the Internet and that attempts to impose stringent registration requirements are likely to be unsuccessful. Furthermore, many states recognize the economic potential of the Internet as a medium to provide information to investors and to sell and trade securities.

¶ 14 Some academics are calling for the SEC to issue similar exemptions in the international arena of US securities law. The goal would be to require foreign issuers to comply with the same requirements that the NASAA has persuaded most US states to adopt. The SEC would retain broad jurisdiction to regulate securities issued from within the United States. Foreign offerors who comply with minimal requirements indicating to investors that the offering is not directed at the US would not find themselves subject to US securities laws and registration requirements unless there was evidence of fraud. This approach may make sense in light of the difficulty the SEC has encountered in elaborating clear guidelines for foreign offerors that can readily be enforced outside the borders of the United States.

Law of Internet Offerings Internationally

¶ 15 The contrasting approaches on domestic securities offerings taken by the SEC and individual states are reflected in various national legal regimes. Specifically, two common law countries stand in the forefront for legal development in this area--the United Kingdom and Australia. Each has developed a different legal structure similar to one of the two domestic regimes mentioned previously. These legal frameworks establish an important precedent the SEC may consider when developing US regulations. Both countries, particularly the UK, have active securities markets that compete with US markets. Additionally, there is a likelihood that the US law will overlap and interact regularly with both legal systems given the compatibility of the countries' financial markets.

¶ 16 In the UK, the Financial Services Authority (FSA) recently adopted new, strict provisions for treating material on overseas websites accessible in the UK but not intended for investors in the UK.⁸ Like the US, the UK provides that "no person other than an authorized person shall issue or cause to be issued an investment advertisement in the UK unless its contents have been approved by an authorized person." The new law also states that any web posting will fall within the definition of restricted activities in the UK if it contains any unauthorized invitation to buy securities. Furthermore, any unauthorized information calculated to lead directly or indirectly to persons entering into or offering to enter into investment agreements is also prohibited. Whereas the SEC mentions that certain disclaimers to the jurisdiction of an offering may be sufficient to prevent registration, the FSA clearly provides that "such steps in and of themselves would not be considered" to be sufficient to stop an investment advertisement from being "made available" to persons in the UK.

¶ 17 The factors put forth by the UK permit the FSA to cast a broad jurisdictional net. Factors that could lead to UK registration requirements include: (1) the location of the site on a server within the UK; (2) availability of investment to UK investors through other forms of media; (3) any advertisement related to the investment directed at UK persons; (4) the lack of any protection on the site to prevent access by UK persons; and (5) whether UK search engines or UK parts of search engines have been notified of the investment's site. Clearly, it can be seen from these regulations that the UK's approach to Internet offerings generates many potential areas of overlapping jurisdiction if another country, such as the US, implements similar measures. It must also be noted that the FSA's statement on the new law does not mention the interaction of the UK law with laws of other countries.

¶ 18 The Australian Securities and Investments Commission has also issued an Inter Policy Statement regarding offers of securities on the Internet. Like the UK law, Australian law covers investments that: (1) target people in Australia; or (2) operate within Australia. Unlike the UK, Australia clearly states that it does not intend to regulate offshore offers that do not affect Australians. Much in the way that Pennsylvania did, this statement gives great deference to disclaimer statements providing that offers are not intended for people in Australia. Furthermore, Australia clearly integrates the role of international regulation into its own provisions by recognizing the governing power of the IOSCO and vowing to cooperate with the regulatory bodies of other countries.

¶ 19 The proposals from IOSCO have contemplated closely mirror those of the NASAA in encouraging cooperation between nations and creating a policy of disclaimers stating in which jurisdiction a particular investment is valid. Thus, it appears that Australia's action and interaction with the IOSCO closely resembles that of Pennsylvania and the NASAA. This model may be another option for the SEC to consider in its new scheme of regulations regarding the Internet.

Conclusion

¶ 20 Looking at both domestic and international standards for the regulation of the use of the Internet for offshore investments, it is clear that there are several potential policies that the SEC could adopt. One model would resemble the SEC's current domestic policy and the UK's strict policy that grants regulators jurisdiction over many potential foreign investments. If such a policy were adopted in the US, many foreign companies would have to use supreme care in how they use the Internet to offer, advertise or create financial resources. The risk of potential infringement of US securities laws would likely deter many legitimate entities from using the Internet to its full extent. Likewise, under this scheme the SEC could encounter great difficulty enforcing strict regulations against foreign entities and find itself drawn into disputes with other countries that also claim broad jurisdiction over offerings made over the Internet. The second method of regulating Internet offerings, recommended by the NASAA and the IOSCO, would create much more lenient requirements for foreign entities whose securities offers reach US residents through electronic media. Such a regime would still permit the US to draw general guidelines such as requiring disclaimers but would not require that foreign entities take extensive measures such as trying to block US residents from their websites. This approach involves greater potential risk to US investors, yet it also provides a number of advantages. Specifically, it stresses cooperation between the regulatory schemes of various nations, reduces

the likelihood of disputes over jurisdiction and promotes efficient use of the Internet for financial purposes.

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Footnotes

1. Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London, 147 F.3d 118 (2d Cir. 1998).

2. *Use of Internet Web Sites To Offer Securities, Solicit Securities Transactions, or Advertise Investment Services Offshore*, at <http://www.sec.gov/rules/interp//34-42728.htm> (last visited Jan 27, 2001).

3. *Id.*

4. *Id.*

5. *Id.*

6. Order of the Pennsylvania Securities Commission, In re: Offers Effected Through Internet that do not Result in Sales in Pennsylvania, 1995 Pa. Secs. LEXIS 71, at *1 (Aug. 31, 1995).

7. <http://www.nasaa.org/bluesky/guidelines/resolu.html>.

8. A statement of these new provisions can be found at http://www.fsa.gov.uk/pubs/guidance/gr02_1998.pdf.