Application of Margin Rules to Tender Offers by Foreign Investors

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The highly-leveraged acquisition of U.S. publicly-held corporations by foreign investors represents a source of perceived discrimination which contributes to the continuing scrutiny of foreign investment in the United States. Tender offers made by foreign investors who borrow abroad from a foreign lender are not generally subject to the margin rules which govern U.S. citizens borrowing to acquire corporate control.\(^1\) In 1970 Congress attempted to remedy this comparative inequity by making foreign investors who borrow within the United States to purchase domestic securities subject to margin restrictions.\(^2\) However, the legislation generally did not reach borrowings by foreign persons outside the United States for the same purpose. In 1981 Congress considered, but did not enact, legislation aimed at closing this loophole.\(^3\) The possibility of future legislation or regulatory enforcement action directed at foreign lenders raises issues that bear on long-range planning concerns of foreign investors.

This article examines the applicability of the margin rules to cash tender offers by foreign investors who borrow abroad to acquire U.S. publicly-held corporations. The article explains the functioning of the margin rules, describing specifically how such rules apply to the purchase of securities when effecting cash tender offers. In addition, the article identifies the purposes for which the margin regulations were originally enacted and discusses whether such purposes would be validly served in extending regulatory coverage to all borrowings by foreign investors acquiring corporate control. Finally, the article reviews whether adding restrictions on major foreign investments through extending the margin

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\(^3\) See infra discussion accompanying notes 94-109.
rules is contrary to the national policy of encouraging foreign investment.

I. Description of Margin Rules

Margin requirements were adopted primarily in response to the role that highly-leveraged borrowings played in the market crash of 1929. In the late 1920s brokers fueled market speculation by making loans to customers with little equity required, using the purchased securities as collateral. Banks generally financed these margin accounts maintained by brokers with loans that were similarly secured by the purchased securities. The attractiveness of buying large amounts of securities with little cash increased the number of investors and pushed upward the market value of the securities. As market prices rose, the credit capabilities of stockholders, created by a rise in the value of their stockholdings, also increased. Investors used this enlarged capacity to purchase additional securities. As market prices spiraled higher, borrowing capacities of investors increased even further. With these purchases financed almost completely by credit, a decrease in stock price, even if small, caused lenders to issue a call for additional collateral. Frequently, the leveraged investor had limited sources of additional income. As a result, brokers sold some existing collateral to support the margin call. When the market declined in late 1929 the prevalence of credit buying sparked a chain reaction in the depreciation of stock values. Margin customers were unable to cover decreases in the value of their securities, and forced liquidations further intensified the downward pressure on an already declining market.4

The term "margin" refers to an investor's equity; that portion of the price of securities that the investor deposits. The balance of the purchase price is borrowed from the lender. In the typical margin transaction, an investor obtains a loan from a broker, bank, or other lender to finance the purchase of securities. The loan agreement usually requires the borrower to pledge the purchased securities as collateral for the loan and permits the lender to sell such securities at the lender's discretion. The margin rules set the initial limits on the amount of credit that a lender lawfully can extend to a customer to purchase certain securities.

The initial margin percentage—the ratio of the investor's original equity to the purchase price of the securities—is determined by the Board of Governors of the Federal Reserve System, which prescribes a "maximum loan value" or collateral value for the securities pledged to secure the loan.5 The current maximum loan value is fifty percent of the purchase price of the securities, thus securities purchased at $10,000


would have a loan value of $5,000. As a result, the current margin requirement or amount of equity that a borrower must furnish is also fifty percent. Therefore, an investor who wishes to purchase $10,000 of securities, securing that purchase with the to-be-purchased securities and with cash, would be required to supply $5,000 in cash.7 Alternatively, instead of securing his investment with cash, the investor could substitute securities with a market value of $10,000 which would have a loan value of $5,000. This collateral requirement, levied at the time of purchase, is termed the “initial margin requirement.”

In addition to initial margin requirements the investor may be subject to maintenance margins which ensure that an investor’s equity does not decline below a percentage of the market value of the securities. The “minimum maintenance margin” is the ratio of the percentage of the investor’s current equity to the market value of the collateral.9 To illustrate, the investor’s equity fluctuates to reflect changes in the market value of the purchased securities. When that equity falls to a certain level the investor may be subject to a margin call or request for additional collateral from the particular lender. Although the Federal Reserve Board is authorized to specify a minimum maintenance level,10 it has left the setting of maintenance margin levels to the discretion of the exchanges and individual creditors.11 For example, the New York Stock Exchange requires member firms to ensure that their customers maintain a twenty-five percent margin on the stock-secured borrowings.12 If the margin falls below that amount, the broker is required to make a margin call and request that the customer reduce the loan or furnish additional eligible securities to reduce the loan to the twenty-five percent margin.13

Creditors other than broker-dealers, such as banks and insurance companies, generally do not specify quantitative margin requirements, but do review their loan portfolios to ensure that their loans remain adequately secure. Thus, if an investor purchases $10,000 of stock, furnishing $5,000 in equity, and the value of that stock declines to less than two-thirds of its original value or less than $6,667, a broker should make a margin call, while a bank or other lender is likely to demand more collat-

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7 Extension of Margin Requirements to Foreign Investors: Hearing before the Subcomm. on Securities of the Comm. on Banking, Housing, and Urban Affairs, United States Senate, on S. 1429 and S. 1436, 97th Cong., 1st Sess. 91 (1981) (statement of Kenneth Garbade, Professor of Economics and Finance, New York University) (hereinafter cited as Senate Hearings).

8 Id. at 90-91.

9 Id. at 92-93. See generally 2 L. Loss, supra note 6, at 1248-52.


11 Although the Board has not promulgated any maintenance requirements, special rules govern the withdrawal and substitution of collateral from undermargined accounts. See 12 C.F.R. §§ 220.3(b)(2), 221.1(c) (1982).


13 Id. at 431(d)(6).
eral. At that time, the investor's equity will only be $1,667, which is equal to twenty-five percent of $6,667, the value of the stock. If the customer fails to furnish additional collateral or reduce the loan, the lender, acting under the terms of the loan agreement, generally will sell enough pledged securities to raise the customer's equity to the minimum level. The initial margin requirement thus creates an "equity cushion" which tends to inhibit the forced liquidation of securities.

II. Statutory Background

To prevent the excessive use of credit for the purchase or carrying of securities, Congress enacted section 7 of the Securities Exchange Act of 1934. Sections 7(a) and 7(b) of that statute direct the Board of Governors of the Federal Reserve System to prescribe "regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security." Section 7(c) prohibits any member of a national securities exchange or any broker or dealer from directly or indirectly extending or maintaining credit, or arranging for the extension or maintenance of credit to or for any customer on securities or on collateral other than securities, except in accordance with the rules and regulations of the Federal Reserve Board (hereinafter referred to as Federal Reserve or Board). Section 7(d) makes it unlawful for other lenders to extend or maintain credit or arrange for the extension or maintenance of credit in contravention of the rules and regulations of the Federal Reserve Board.

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14 15 U.S.C. § 78g (1976). In hearings considering the legislation, Governor Black of the Federal Reserve Board testified as to the Board's willingness to administer the margin regulations as long as it could do so in the public interest and for investor protection:

If it is desired the Board will be glad to undertake the responsibility of the bill regarding the fixation of marginal requirements upon loans based upon exchange equities, whether the loans are made by brokers or banks, provided power is vested in the Board to handle this subject in the public interest and to the protection of the investor. This function would usefully supplement the considerable powers vested in the Board under the Banking Act of 1933 to prevent the undue use of credit for speculative purposes and would in the judgment of the Board furnish effective protection against the economic evils of speculation.


15 Securities Exchange Act § 7(a), 15 U.S.C. § 78g(a) (1976). The Federal Reserve has described the term "to extend credit" as a somewhat broader concept than a loan. For example, the Board has held that a guaranty of a loan may be an extension of credit. 23 Fed. Res. Bull. 717 (1937).

16 Securities Exchange Act § 7(c); 12 C.F.R. § 221.3(c) (1982) (defining "indirectly secured").

17 Securities Exchange Act § 7(c); 12 C.F.R. § 220.7(a) (1982) (defining "arranging for loans by others").


19 Id. § 7(d), 15 U.S.C. § 78g(d) (1976).
III. Regulatory Promulgations

Responding to its statutory mandate, the Board promulgated a regulatory scheme which placed the burden of compliance on lenders. The Board promulgated Regulation T, governing the extension of credit by any broker or dealer, in 1934; Regulation U, governing the extension of credit by "banks," in 1936; and Regulation G, governing the extension of credit by persons other than banks, brokers, or dealers, in 1968.

Regulation T generally prohibits a regulated broker or dealer from extending credit for the purpose of purchasing or carrying securities except where the credit is collateralized by "margin securities," and then the amount of the loan may not exceed the current margin rate. Thus, a broker or dealer may extend only "purpose credit," that is, credit to purchase margin securities, and may collateralize that loan only with registered or exempt securities. Thus, Regulation T prohibits a broker from making an unsecured loan or a loan not secured by margin securities. In addition, with certain limited exceptions, a broker may arrange only for the extension of credit on the same terms and conditions under which he may originally offer such credit. Under Regulation U, a bank must conform with margin requirements when extending credit to purchase or carry any "margin stock" if that borrowing is secured directly or indirectly by any stock. Thus, banks may extend unsecured purpose credit or purpose credit secured by collateral other than stock without restriction, while the extension of such credit by brokers is regulated or wholly prohibited.

21 Regulation U, id. § 221 (1982).
22 Regulation G, id. § 207 (1982). Regulations G, T and U are companions in the regulatory framework; any decision involving one also would have far-reaching implications on the others. The Second Circuit treats cases arising under one "interchangeably" with those arising under the others. See Schy v. Federal Deposit Ins. Corp., 465 F. Supp. 766, 770 n.12 (E.D.N.Y. 1977) (citing Freeman v. Marine Midland Bank-New York, 494 F.2d 1334, 1338 (2d Cir. 1974)).
23 Regulation T, 12 C.F.R. § 220.2(f) (1982) (defining "margin security").
24 The term "purpose credit" refers to credit which is for the purpose, whether immediate, incidental or ultimate, of purchasing or carrying a margin stock, despite any temporary application of funds otherwise. 12 C.F.R. § 207.2(c)(1) (1982). In addition, credit to reduce or retire an indebtedness incurred to purchase stock margin securities is for the purpose of "carrying" such securities. Id. § 207.2(c)(2) (1982).
26 Id. § 220.2(g) (1982) (defining "exempted" securities).
27 A broker, however, may arrange (i) extensions of credit that are secured by margin securities and which comply with Regulation U and (ii) private placements that are not for the purpose of purchasing or carrying publicly-held securities and which do not violate Regulations U and G. 12 C.F.R. § 220.7(a).
28 Regulation U, id. § 221.3 (v) (1982) (defining "margin stock").
29 Id. § 221.3(c) (1982) (defining "indirectly secured").
30 Id. § 221.1(a) (1982).
31 The statutory restrictions on brokers or dealers extend beyond those placed on banks and other lenders. Congress was concerned with the economic incentive for brokers to create highly-leveraged accounts which produced high interest changes on the margin loans. In addition, by generating sales of stock, brokers received a commission on every purchase or sale of
In 1968 the Federal Reserve Board promulgated Regulation G which provides that a registered lender is subject to the margin rules when extending credit for the purpose of purchasing or carrying "margin securities"32 which are collateralized, directly or indirectly,33 by such securities.34 Regulation G requires that any person other than a broker-dealer or bank who extends credit in any calendar quarter of $100,000 or more, or has outstanding during any calendar quarter $500,000 or more credit, must register with the Federal Reserve if such credit is secured directly or indirectly by margin securities.35 The purpose of the regulation was to bring lenders other than banks, brokers, or dealers within the coverage of the Board's rules governing margin requirements on securities transactions.36 The Board promulgated this regulation to stem excessive credit from flowing into the securities markets from such "other" lenders, including foreign lenders.37 Regulation G is similar to Regulation U, except that Regulation G only applies to "purpose credits" secured by margin securities while Regulation U covers "purpose credits" secured by stock.38

The margin regulations clearly apply to acquisition financing. Despite arguments that the regulations focus primarily on retail level transactions, the Federal Reserve Board and the Securities and Exchange Commission (SEC) have consistently taken the position that acquisition financing is subject to the requirements of the margin rules.39 Courts which have considered the issue have uniformly agreed with the position of the Board and the SEC.40

IV. Legislative Purpose

Three purposes of margin regulation are recognized: controlling securities as an instrument of national credit policy, minimizing market fluctuations through price stabilization, and protecting investors.41

stock by their customers. Congress also believed that bankers were more responsible and gave greater scrutiny to their borrowers. See generally 2 L. Loss, supra note 6, at 1259 n.59.

32 Regulation G, 12 C.F.R. §207.2(d) (1982) (defining "margin security").
33 Id. §207.2(i) (1982) (defining "indirectly secured").
34 Id. §207.1(a) (1982).
35 Id. §207.
38 Compare Regulation G, 12 C.F.R. §207.2(c),(d) (1982) with Regulation U, id. §221.3(b),(d) (1982).
41 Louis Loss, in his treatise on securities regulation, states:
The [Securities Exchange] Act and its legislative history indicate that the credit provisions rest on three separate philosophies, which are not altogether consistent:
(1) The statute itself speaks in terms of 'preventing the excessive use of credit for
The primary purpose of margin regulations, as embodied in the statutory language and the legislative history, is directed at selectively controlling securities credit as an instrument of national credit policy. This goal is prominently set forth in the House Report accompanying the Securities Exchange Act as "to give a Government credit agency an effective method of reducing the aggregate amount of the nation's credit resources which can be directed by speculation into the stock market and out of more desirable uses of commerce and industry." Although courts and legal commentators have relied on this language to justify imposing margin requirements, economists have increasingly questioned whether limiting the amount of credit-based speculation causes any channelling of resources into more desirable uses. The amount of credit committed by banks to fund takeover battles has been criticized as an unproductive diversion of funds.

A more widely accepted theory for the margin rules is that the rules serve as a regulatory tool in minimizing market fluctuations. Although price stabilization was not originally regarded as the primary purpose of section 7, Congress subsequently has recognized the contemporary relevance of this goal. Under this rationale, the regulations protect against the purchase or carrying on of securities. So does the House report ... . (2) The report of the Senate Banking and Currency Committee's investigation, on the other hand, says that the margin provisions are also intended 'to protect the margin purchaser by making it impossible for him to buy securities on too thin a margin ... .' (3) At the same time, Congress apparently had in mind also that the Board's powers would be used to prevent undue market fluctuations and help stabilize the economy generally ... . In the early and most recent years, at least, the chief emphasis seems to have been placed on this third philosophy.

2 L. Loss, supra note 6, at 1242-43 (1961).

42 William McChesney Martin, former Chairman of the Board of Governors of the Federal Reserve, has characterized the regulatory scheme as "a supplemental instrument of credit policy—one of the means of making a broad credit and monetary policy effective." Joint Committee on the Economic Report, Monetary Policy and the Management of the Public Debt: Their Role in Achieving Price Stability and High-Level Employment, S. Doc. No. 123, 82d Cong., 2d Sess. 409 (1952).


44 See, e.g., Moore, Stock Market Margin Requirements, 74 J. POL. ECON. 158, 160-61 (1968); J. Bogen & H. Krooss, supra note 4, at 38-40; Cohen, Federal Reserve Margin Requirements and the Stock Market, J. FIN. & QUANT. ANAL., Sept. 1966, at 30, 53 ("considerable doubt exists about the effectiveness of margin regulations in controlling the flow of funds into the stock market").


46 See Report of Special Study of Securities Markets of the Securities and Exchange Commission, H.R. Doc. No. 95, 88th Cong., 1st Sess. 9 (1963). Although an individual margin violation is virtually harmless, a forced sale may "put pressures on securities prices ... [and] cause other forced sales and the resultant snowballing effects may in turn have a general adverse effect upon the entire market." Id. at 5 (hereinafter cited as SEC Study).

47 The Bank Records and Foreign Transactions Act of 1970 provides evidence that Congress has been placing greater weight on the goal of market stabilization. Pub. L. No. 91-508, 84 Stat. 1118. In proposing what ultimately became section 7(f) of the Exchange Act, the Senate Committee on Banking and Currency observed that: 
destabilizing price declines by controlling securities-collateralized credit.\textsuperscript{48} Price stabilization is particularly important in light of the potential rapid increase or decrease of stock prices when tender offers are made.

Investor protection has been recognized as an objective of section 7(f) by several leading commentators\textsuperscript{49} and a number of courts.\textsuperscript{50} Courts have generally denied investors a private right of action for margin violations. Several decisions have stated that investor protection is a "by-product" of securities credit enforcement, but not a primary objective of the regulatory scheme.\textsuperscript{51} Nevertheless, other courts have stated that Congress intended investor protection to serve as a primary goal of the margin regulations.\textsuperscript{52}

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See also Moscarelli v. Stamm, 288 F. Supp. 453, 460 (E.D.N.Y. 1968), where the SEC, as amicus curiae, advised the court that "the artificial demand created by purchasing securities which are not to be paid for unless the market value of the stock rises can have an unsettling and potentially manipulative effect on the securities market, contrary to the purposes of the Act;" Daley v. Capitol Bank and Trust Co., 506 F.2d 1375, 1377 (1st Cir. 1974); Comment, Application of Margin Requirements to the Cash Tender Offer, 116 U. PA. L. REV. 103, 126-27 (1967) (effect of margin credit on acquisition financing). But see Largay & West, Margin Changes and Stock Price Behavior, 81 J. POL. ECON. 328, 338 (1973).
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\textsuperscript{48} SEC Study, supra note 46, at 9. Although such credit "does not enter directly into the securities stream, it has important market implications because, as prices recede, securities serving as collateral may be vulnerable to forced sales resulting from margin calls." Id. at 2 .
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\textsuperscript{49} Id. See also Lipton, Some Recent Innovations to Avoid the Margin Regulations, 46 N.Y.U. L. REV. 1, 7 (1971); Karmel, The Investment Banker and the Credit Regulations, 45 N.Y.U. L. REV. 59, 61 (1970).
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\textsuperscript{51} See, e.g., Stern v. Merrill Lynch, Pierce, Fenner & Smith, 603 F.2d 1073, 1088 (4th Cir. 1979).
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\textsuperscript{52} See, e.g., Goldman v. Bank of Commonwealth, 467 F.2d 439, 446 (6th Cir. 1972); Serzysko v. Chase Manhattan Bank, 290 F. Supp. 74, 78 (S.D.N.Y. 1968). Debate on the House floor reveals that the representatives considered investor protection a fundamental purpose of the margin provisions. This goal was the basic tenet of the law from the outset. In introducing the bill, Representative Rayburn, Speaker of the House and Chairman of the House Committee, declared that a purpose of the House bill was to protect investors from speculating on insufficient margin and stated that a "[r]easonably high margin is essential so that a person cannot get in the market on a shoe string one day and be one of the sheared lambs when he wakes up the next morning." 78 CONG. REC. 7,700 (1934). Other Congressmen shared Representative Rayburn’s view that the margin provisions were intended to safeguard investors. Discussing the broader aspects of the bill, Representative Ford remarked: "This bill does three things. It protects investors, controls market manipulations that are destructive to values, and tends to curb destructive speculation." 78 CONG. REC. 7,717 (1934). Representative Sabath likewise stressed investor protection: "I am of the opinion that, in view of the fact that we cannot... prohibit speculation or gambling, that it is our duty to see that the investing public, or rather the 'lambs,' be protected by this Government so that their investments shall not be wiped out even before the receipt of the stock certificates issued to them." 78 CONG. REC. 8,011 (1934).
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Testimony before the Senate committee also refuted the argument that section 7 was passed solely to effectuate broad macro-economic policy. For example, Mr. Thomas Corcoran,
The responsibility for interpreting, amending, and monitoring the effectiveness of the margin provisions rests with the Federal Reserve, while the Securities and Exchange Commission (SEC) is the principal enforcement agency. The statutory scheme of enforcement includes administrative action, injunctive relief, and criminal sanctions. The SEC is empowered to sue in federal district court for injunctions against violations of the Act. Both the SEC and the Federal Reserve Board may transmit evidence of violations to the Attorney General for the institu-

A leading spokesman for the drafters, emphasized the dual purposes of the provisions: "One is to protect the lamb; another, and probably the more important of the two, although it does not appeal to human instincts as completely, is the protection of the national business system from the fluctuations in the market." Stock Exchange Practices: Hearing before the Comm. on Banking and Currency, United States Senate, on S. Res. 84 and S. Res. 56 and S. Res. 97, 73d Cong., 1st Sess. 6494 (1934). The Senate committee report accompanying the Act further demonstrated concern for individual investors: "By the development of the margin account, a great many people have been induced to embark upon speculative ventures in which they were doomed to certain loss." S. Rep. No. 792, 73d Cong., 2d Sess. 3 (1934). Since the House and Senate bills differed, they were sent to a Senate-House conference committee. The resulting compromise bill did not contain any inference as to the purposes of the credit regulation provisions. Although the conference report accompanying the bill spells out point-by-point the differences between the Senate and House bills, it does not mention the margin regulation purposes. Had any disagreements emerged between the Senate and House conferences as to those purposes, such differences would logically have surfaced in the conference report. Furthermore, the Senate Committee Report, released ten days after the passage of the Act, stands as the most reliable source of Senate intent toward the purposes of the margin regulations. In articulating the purposes of the credit regulations, this report confirmed that investor protection was not a mere by-product of the margin regulations, but was a coordinate purpose of the regulatory scheme: "These provisions are intended to protect the margin purchaser by making it impossible for him to buy securities on too thin a margin, and to vest the Government credit agency with power to reduce the aggregate amount of the Nation's credit resources which can be directed by speculation into the stock market." S. Rep. No. 1455, 73d Cong., 2d Sess. 11 (1934).

In addition to section 7, additional statutory provisions impact on the Board's authority to regulate securities credit. Section 17(g) of the Act obliges lenders subject to the margin regulations to "make such reports to the Board as it may require as necessary or appropriate to enable it to perform the functions conferred upon it . . ." and "to permit such inspections to be made by the Board . . . as the Board may deem necessary to enable it to obtain the required information." 15 U.S.C. § 78q(g) (1976). Under section 23(a) of the Act, the Federal Reserve is empowered "to make such rules and regulations as may be necessary or appropriate to implement the provisions of this chapter for which they are responsible or for the execution of the functions vested in them by this chapter . . . ." 15 U.S.C. § 78w(a). Section 23(b) requires the Federal Reserve to "make an annual report to Congress on its work for the preceding year" and to include in the report "whatever information, data and recommendations for further legislation it considers advisable with regard to matters within its respective jurisdiction under this chapter." 15 U.S.C. § 78w(b). Section 8(b)(1) of the Federal Deposit Insurance Act authorizes the Federal Reserve and other federal banking agencies to issue cease and desist orders to insured banks "when the agency has reasonable cause to believe that the bank is about to engage in an unsafe or unsound practice in conducting the business of such banks, or is violating or has violated . . . or is about to violate a law, rule, or regulation . . . ." 12 U.S.C. § 1818(b)(1) (1976). The procedure for such action by the Federal Reserve against banks under its supervision is outlined in 12 C.F.R. § 263 (1982).

The Federal Reserve's regulatory structure also has relied in the past upon the existence of private causes of action in implementing its statutory obligations. The threat of a private suit has been regarded by the Federal Reserve as a necessary inducement to strict compliance by lenders subject to the margin rules. See Brief of the Board of Governors of the Federal Reserve System, Stern v. Merrill, Lynch, Pierce, Fenner & Smith, 603 F.2d 1073 (4th Cir. 1979).

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tion of criminal proceedings. In addition, the SEC may initiate administrative proceedings to revoke a broker-dealer's registration or suspend or expel him from an exchange or from the National Association of Securities Dealers (NASD). Further, the 1934 Act provides that securities exchanges must enact rules for disciplining members before registering with the SEC. The NASD has also promulgated rules, such as those demanding minimal initial and maintenance margin requirements of its members. For violations of these rules, members of the NASD may be penalized by censure, fine, suspension, or expulsion.

Historically, the SEC has construed broadly its jurisdiction over foreign lenders in the area of margin regulations. The SEC has argued that it has jurisdiction over a securities transaction if such transaction has an effect on the national interest. Under the existing scheme regulating securities credit, the SEC has adopted the view that borrowing abroad which has a significant impact on the United States securities market should be subject to the margin rules.

V. Section 7(f)

The applicability of margin regulations to foreign lenders surfaced as an issue in 1968 in Metro-Goldwyn-Mayer v. Transamerica Corp. That case involved a highly publicized takeover attempt by Kirk Kerkorian, a well-known speculative investor. Credit for the takeover was financed almost exclusively abroad by Eurodollar borrowings from international banks. MGM, the target company, argued that the proposed acquisition financing from such foreign lenders violated Regulations G and T and that, as a result, the tender offer was illegal. The court rejected the argument that such foreign lenders were subject to existing margin restrictions, stating that "[n]othing contained in the 1934 Act—nor in any of the Regulations promulgated thereunder, including Regulation G—in any way indicates an attempt or intent to regulate the acts of foreign

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55 Id. § 78u(d).
57 Id. §§ 78o-3(a)(7), 78s(a)(3) (1976). The National Association of Securities Dealers (NASD) is a self-regulatory organization created by a 1938 amendment to the Securities Exchange Act of 1934. Many, but not all, broker-dealer firms are members of the NASD, which is registered with the SEC pursuant to law.
58 Id. § 78f(b)(6), (7); § 78o-3(b)(7) (1976).
59 National Association of Securities Dealers Manual (CCH) ¶ 2180A.
60 Id. ¶ 2301. See also L. LOLL & J. BUCKLEY, THE OVER-THE-COUNTER SECURITIES MARKETS 221 (1967).
63 See Senate Hearings, supra note 7, at 39-53 (statement of Philip Loomis).
65 Id. at 1346.
66 Id. at 1354.
67 Id. at 1356.
lending institutions.\footnote{68}{Id. at 1357.}

In 1970 Congress enacted Title III of the Bank Records and Foreign Transactions Act of 1970, amending section 7 of the Exchange Act to provide, for the first time, regulation of borrowers in margin transactions.\footnote{69}{Pub. L. No. 91-508, § 301(a), 84 Stat. 1114 (1970) (codified at 15 U.S.C. § 78g(f) (1976)). A salient result of the enactment of section 7(f) has been the reversal of judicial precedent granting investors a private right of action for margin regulations. The congressional intent in section 7(f) of applying the margin rules to borrowers has been reviewed by several courts. Significantly, courts which previously granted borrowers a private right of action have virtually eliminated the availability of such an implied remedy. Prior to section 7(f), courts had implied a private cause of action in favor of investors. See, e.g., Pearlstein v. Scudder & Cerman, 429 F.2d 1136 (2d Cir. 1970), cert. denied, 401 U.S. 1013 (1971). Although designed primarily to curb evasion by lenders not subject to domestic controls, the effect of section 7(f) in promoting the regulatory scheme has been to apply the margin rules to borrowers. See Panayotopulas v. Chemical Bank, 464 F. Supp. 199, 202-03 (S.D.N.Y. 1979). Certain courts, focusing on the express language of the amendment, reconsidered prior decisions and rejected the rationale of imposing absolute liability on the broker. See, e.g., Pearlstein, 527 F.2d 1411, 1145 n.3 (2d Cir. 1975) (on appeal from remand, past holding “questioned” in light of passage of § 7(f); Palmer v. Thomson & McKinnon Auchincloss, 427 F. Supp. 915 (D. Conn. 1977). Recognizing that section 7(f) places compliance responsibility on investors, these courts restored the in pari delicto defense, thus restricting the class of beneficiaries to innocent investors. See Palmer, 474 F. Supp. 286, 289 (D. Conn. 1979). Other courts, however, have rejected the entire theory that investors are entitled to an implied right of action. See, e.g., Utah State Univ. of Agriculture and Applied Science v. Bear, Stearns, & Co., 549 F.2d 164 (10th Cir. 1977), cert. denied, 434 U.S. 890 (1978).

Significantly, the amendment specifically authorized the Federal Reserve to exempt any class of regulated borrowers from application of the statute. Securities Exchange Act § 7(f)(3), 15 U.S.C. § 78g(f)(3) (1976). The House committee report reflected this congressional intent to give administrative flexibility to the Federal Reserve “to fashion requirements and conditions with which compliance can reasonably be expected as well as practicably can be enforced.” In this regard the stated purpose of Regulation X is:

[To] prevent the infusion of unregulated credit obtained both outside and within the United States into U.S. securities markets in circumvention of the provisions of the Board's margin regulations or by borrowers falsely certifying the purposes of a loan or otherwise wilfully and intentionally evading the provisions of those regulations:

12 C.F.R. § 224.1 (1980). Regulation X, in general, makes it unlawful to obtain credit that contravenes Regulation G, T, or U, except where the borrower makes an “innocent mistake” and takes corrective action promptly. Id. §§ 224.2, .6.

Responsibility placed on the lender by the enactment of section 7(f) should not have been eroded by the promulgation of Regulation X. A Board letter dated November 1, 1971, the effective date of the Regulation, stated:

[Since persons who deal with financial institutions such as banks, brokers, or dealers, can be expected to rely upon the institution for guidance in matters affecting the transactions it appears that the most efficient way of making the public aware of Regulation X will be by asking lenders to inform borrowers prior to or concurrently with a transaction in which securities credit is extended.

Letter from the Federal Reserve Board to District Federal Reserve Banks (Nov. 1, 1971). This language indicates that borrowers generally rely on the lenders to learn about the margin requirements and that lenders continue to act as the primary source of compliance. A Federal Reserve pamphlet distributed to banks and broker-dealers as an education effort aimed at margin investors states: “Banks, broker-dealers and many other lenders also have copies of the Regulation X or are familiar with its provisions. Ask your banker or brokers about them.” Federal Reserve Board, If You Borrow to Buy Stock — (19—). Other courts and commentators have suggested that since the legislative history of section 7(f) does not reveal any intention to overrule existing case law, Congress did not intend to remove from the investor any protection previously available to him. Soloman & Hart, Recent Developments in the Regulation of Securities
cision in \textit{MGM} and influenced by additional indications of securities-related borrowing abroad, acted to prevent the infusion into the United States securities market of unregulated credit. Both the Senate and House reports connected with the Act refer to the \textit{MGM} decision. The Senate Report stated:

Under a recent decision of a United States District Court, it has been determined that the margin requirements authorized under the Securities Exchange Act of 1934 apply only to United States lenders and not to United States borrowers . . . . If this interpretation is correct, a United States borrower can easily circumvent the margin requirements by borrowing from a foreign lender.\footnote{70}

In addition, the House Committee on Banking and Currency noted:

Americans and others, using the facade of secret foreign banks, can purchase securities in our markets ignoring the Federal Reserve Board's regulations on margin requirements and for the purpose of evading the income taxes. American companies are subject to takeovers or the acquisition of substantial interests by those about whom little or nothing is known. Criminal elements infiltrate and control substantial segments of American businesses through securities purchases and financing by secret foreign sources. Several of the recent corporate takeovers and acquisitions have involved security considerations in that defense contractors or other sensitive American industries became the target.\footnote{71}

These reports reflect that, at the least, Congress intended to regulate acquisition financing obtained from outside the United States by subjecting U.S. borrowers to domestic controls. As originally drafted, the legislation contained no reference to margin regulations.\footnote{72} The Act itself was the product of congressional concern that white-collar criminals were utilizing financial institutions for a variety of illegal purposes and was intended primarily to correct the "serious abuses associated with the

\textit{Credit}, 20 J. PUB. L. 167, 209 (1971); \textit{Palmer}, 427 F. Supp. 915 (D. Conn. 1977). In \textit{Palmer}, the court, finding that Regulation X implies that only borrowers who "falsely," "willfully," or "intentionally" evade the provisions of the Act are subject to its sanctions, the court concluded that no reason existed to deprive a good faith borrower of a cause of action particularly since such suits aid in enforcement of statutory prohibitions. 427 F. Supp. at 921. In Neill v. David A. Noyes & Co., 416 F. Supp. 78 (N.D. Ill. 1976), another federal district court concluded that enforcement-based arguments for allowing civil recoveries retain their persuasiveness:

Despite some recent changes in section 7, . . . the \textit{Pearlstein} doctrine remains viable. . . . Innocent investors . . . continue to possess a valid cause of action for violations of margin requirements. The overall purposes of the Securities Exchange Act of 1934 are best met by allowing this type of cause of action to continue.

416 F. Supp. at 80. Other courts have failed to distinguish between innocent and culpable investors. \textit{E.g.}, \textit{Utah}, 549 F.2d 164 (10th Cir. 1977) (no private right of action allowed), \textit{cert. denied}, 434 U.S. 890 (1978). It should be noted that in certain decisions, by reaching the merits of the borrowers' claims, courts have implicitly acknowledged the continuing availability of a private action in the proper circumstances.


\footnote{72} \textit{Id.}
uses of foreign bank accounts.\textsuperscript{73} When testimony indicated that unregulated foreign credit contributed to market instability and aided corporate takeovers, market manipulation, and insider abuse, the House Committee on Banking and Currency responded by adding Title III as an amendment to the original bill.\textsuperscript{74} Summarizing the legislative intent, Representative Patman, Chairman of the House Committee on Banking and Currency, stated:

This amendment was found necessary if we were to wholly and completely deal with the problems created by the use of recent foreign financial institutions for illegal purposes. Through a simple device of making the margin requirements applicable to the borrower, as well as the lender, we will be equipping the Securities and Exchange Commission . . . with sufficient legal and investigative weapons to require adequate disclosure of foreign financing.\textsuperscript{75}

The Senate Committee Report considering this proposal likewise stressed the legislative concern with the increasing use of foreign accounts by U.S. citizens for illegal activities.\textsuperscript{76} The report warned that the objective of preventing destabilizing credit flows could be weakened if U.S. borrowers could circumvent U.S. laws by obtaining credit abroad in excess of the Federal Reserve's margin regulations.\textsuperscript{77} Due to practical difficulties in asserting personal jurisdiction and enforcing judgments over foreign lenders, Congress focused on the borrower by prohibiting the receipt of loans by U.S. investors in violation of the margin regulations.

VI. Regulation X

To implement section 7(f) the Board, in 1970, promulgated Regulation X which, for the first time, placed responsibility on the borrower to observe the margin rules by making it unlawful to obtain "purpose credit" in violation of Regulations G, T, U or X.\textsuperscript{78} Regulation X established requirements for those borrowers who are subject to the margin rules and are obtaining purpose credit from within or outside the United States. The regulation applies to any borrower who obtains purpose credit from within the United States\textsuperscript{79} and to the following borrowers who obtain purpose credit from outside the United States:

(i) "United States persons"

(ii) foreign persons who are controlled by United States persons, or

(iii) foreign persons "acting on behalf of or in conjunction with" United States persons.\textsuperscript{80}

When structuring a transaction to avoid being subject to the margin rules, a foreign borrower (1) must obtain credit from outside the United

\textsuperscript{74} 1970 House report, supra note 71, at 14, 24-25.
\textsuperscript{76} 1970 Senate report, supra note 70, at 9-10.
\textsuperscript{77} Id.
\textsuperscript{78} 12 C.F.R. § 224 (1982).
\textsuperscript{79} 12 C.F.R. § 224.2(a) (1982).
\textsuperscript{80} 12 C.F.R. § 224.2(b) (1982).
States, and (2) must not be controlled by or "acting in conjunction with" a U.S. person. However, section 7 and Regulation X provide uncertain guidance in determining whether credit is obtained from within or without the United States. The Federal Reserve has issued comparatively few regulatory rulings or opinion letters in interpreting issues under Regulation X. The absence of clear authority is critical to a foreign investor when arranging financing for a tender offer which, if subject to margin restrictions, would require substantial collateral, and the absence of authority may affect that investor's decision to proceed with the offer.

Whether credit is or is not obtained in the United States depends on the situs of the credit. The following factors are generally considered relevant in determining the situs of the credit:

(i) where the loan agreement is signed,
(ii) where the terms of the agreement are negotiated,
(iii) where the loan is booked,
(iv) where the collateral is physically maintained,
(v) whether the parent or subsidiary is the actual source of funds,
(vi) whether any previous credit relationship exists between the borrower and a parent or subsidiary,
(vii) whether the subsidiary makes loans in the ordinary course of business,
(viii) where activities in arranging and negotiations leading up to the borrowing occur,
(ix) whether such activities involve discussions with officials of the foreign subsidiary who have the authority to bind the subsidiary.

There is no authority to indicate which of these factors, if any, would be controlling, or to judge the comparative relevance from any one of the factors. To ensure that the loan is considered to be from outside the United States, counsel should be careful that all activity leading up to the loan, especially the negotiation of its terms, occurs abroad. Under traditional banking practice in the United States, a loan generally is governed by the laws of the state where the bank is located. While this rule would appear equally applicable to loans involving foreign banks, domestic policy considerations underlying the margin rules may compete with this practice and the situs of a margin loan from a foreign bank may be deemed to be in the United States.

If credit is obtained from outside the United States, a foreign investor may still be subject to the margin requirements if the borrower is deemed to be a "U.S. person" or, a foreign person acting on behalf of or in conjunction with a "United States person." A definitional analysis of these terms is necessary in determining whether the regulatory scheme encompasses a foreign investor.

Section 7(f) sets forth statutory definitions relevant in determining

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83 12 C.F.R. § 224.2(b) (1982).
what parties are subject to the regulation. The term “United States person” is defined to include “a person which is organized or exists under the laws of any State or, in the case of a natural person, a citizen or resident of the United States.” Clearly the definition includes a domestic subsidiary of a foreign corporation. It is less than clear, however, whether a resident alien is subject to the regulatory scheme and whether a person’s status as a permanent resident alien is determinative. It would appear that an individual’s citizenship or place of actual residence at the time the loan agreement was reached would be determinative. Under such circumstances, an individual who is not a U.S. citizen could avoid being deemed a “United States person” and thereby evade the margin requirements simply by avoiding contact with this country during loan negotiations.

The term “foreign person controlled by a United States person” is defined by section 7(f) to include:

[A]ny noncorporate entity in which United States persons directly or indirectly have more than a 50 per centum beneficial interest, and any corporation in which one or more United States persons, directly or indirectly, own stock possessing more than 50 per centum of the total combined voting power of all classes of stock entitled to vote, or more than 50 per centum of the total value of shares of all classes of stock.

This provision is designed to prevent U.S. persons from circumventing the margin rules by simply establishing a foreign corporation to act as the borrowing vehicle. In a letter interpreting the definition, the staff of the Federal Reserve Board stated that a foreign corporation in which U.S. persons own stock having less than fifty percent of the voting power and less than fifty percent of the value of the shares is not a “foreign person controlled by a United States person.”

It should be noted in connection with this interpretive letter that section 7(f), in defining “United States person,” uses the term “includes” while in defining “United States security” the term “means” is used. Section 7(f) may thus be interpreted to provide that a foreign entity located abroad may be subject to the margin rules under certain circumstances. This interpretation would have significant application to offshore companies, such as investment funds, whose investors are non-U.S. persons but whose management decisions are made by U.S. persons.

The term “acting on behalf of or in conjunction with a U.S. person” in reference to a foreign person is defined by Regulation X to mean, in pertinent part: “obtaining credit for the purpose of purchasing or carrying a security in which, or in the income or gains or losses from which, a United States person or a foreign person controlled by a United States person has a substantial direct or beneficial interest.” This definition

85 Id. § 78g(f)(2)(C) (1976).
86 Federal Reserve Board staff letter to Joan Dacey (Feb. 17, 1978).
87 12 C.F.R. § 224.5(a) (1982).
was added as part of Regulation X, and above all others, has created difficulty in forecasting what parties are subject to the margin rules. Neither Regulation X nor written interpretations of Regulation X provide clear guidance to the definition of the term "direct or indirect" in this provision or to what constitutes a beneficial interest in a security or the income or profits thereof or to how substantial that interest should be. In a letter dated December 8, 1977 the Board's staff provides certain guidance as to what constitutes a substantial beneficial interest. In that letter, the Board ruled that a foreign subsidiary of a domestic corporation (a "United States person"), which proposed to acquire forty percent of a foreign company in conjunction with the purchase of the remaining stock by a foreign individual, would have a substantial beneficial interest in the stock. As a result, the Board concluded that the borrowing by the foreign individual from a foreign lender would be subject to the margin rules since a United States person would receive a substantial beneficial interest. The Board apparently does not regard forty percent as the minimum amount which shall constitute a substantial interest; rather, it appears that the minimum depends on the facts of each particular case. The letter is significant in that "substantial interest" is measured, at least in this interpretation of control, in terms of stock ownership. Whether the ability to elect the board of directors would constitute a substantial beneficial interest is still unclear. While a tender offer is generally directed at obtaining fifty-one percent of the voting stock, control may be acquired with a far smaller percentage of stock. In addition, this interpretive letter signals that any joint venture relationship involving a U.S. person and foreign investors must be reviewed to determine whether any foreign person is "acting on behalf of or in connection with a 'U.S. person.'"

The Board's staff also interprets Regulation X to mean that a loan by a foreign lender to a foreign corporation for the purpose of acquiring control of a United States corporation is subject to the margin rules if the acquired corporation is merged into an existing subsidiary of the foreign acquiror. By deriving benefits from its affiliation with a company located in the United States, the foreign entity is deemed to be "acting in conjunction with a United States person." However, the Board apparently recognizes a narrow exception to this rule and will permit a foreign corporation to borrow overseas to finance the acquisition of a domestic corporation and then create a new subsidiary corporation for tax purposes into which the acquired corporation can be merged. This advantage appears useful only in the context of negotiated acquisitions rather

89 Id.
than in hostile tender offers where the loan must be negotiated prior to contemplation of post-acquisition corporate reorganization.

A foreign lender will be subject to the margin rules for credit obtained outside the United States only if Regulation X applies to the borrower. In that event the borrower would be responsible for seeing that the credit obtained from the lender complies with the applicable margin regulation.92

VII. Proposed Legislation

Under Regulation X as currently interpreted, the margin rules do not apply where the acquiror is simply a foreign person borrowing acquisition funds outside the United States from a foreign lender.93 In corporate takeovers, this provides an unfair advantage over United States investors because of the foreign person's ability to maintain a highly leveraged position.

In 1981 Congress considered extending the coverage of the margin rules to govern foreign borrowers who obtain unregulated credit from foreign lenders to purchase controlling interests in U.S. corporations to finance corporate takeovers.94 The proposed legislation generally would govern those persons borrowing to purchase five percent or more of the outstanding stock of a U.S. company.95

94 See Senate Hearings, supra note 7.
95 An unclear issue is whether the proposed statute should also govern transactions involving foreign corporations which are listed on U.S. stock exchanges. One of the questions involved is the proper interpretation of § 30(b) of the 1934 Act, which provides:

The provisions of this chapter or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter.

15 U.S.C.A. § 78dd(b) (1981). In Schoebaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), cert. denied, 395 U.S. 906 (1969), the Second Circuit refused to equate the word "jurisdiction" with territorial boundaries and applied the 1934 Act to extraterritorial conduct, stating:

We believe Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities. In our view, neither the usual presumption against extraterritorial application of legislation nor the specific language of Section 30(b) show Congressional intent to preclude application of the Exchange Act to transactions regarding stocks traded in the United States which are effected outside the United States when extraterritorial application of the Act is necessary to protect American investors.

405 F.2d at 206. The SEC maintains that the Act is "generally applicable extraterritorially whenever such application is necessary and appropriate for the protection of American investors and markets." Brief for SEC as Amicus Curiae, at 16, Schoenbaum v. Firstbrook, 405 F.2d 208 (2d Cir. 1968). See generally Note, The International Character of Securities Credit: A Regulatory Problem, 2 LAW & POL. INT'L BUS. 147, 158-64 (1970). The Federal Reserve Board's staff has interpreted Regulation X as applying to securities of U.S. corporations listed on a foreign exchange. Staff letter of October 24, 1982.
In Senate hearings held to consider extending the margin regulations, testimony focused specifically on the underlying tension resulting from several attempts by Canadian companies to acquire U.S. corporations, especially those with oil and natural gas assets. Canada, in turn, established policies to review acquisitions of Canadian companies by foreign investors as well as any transfer of ownership by a foreign company of its Canadian subsidiary. In addition, Canadian government investment policies in the oil and gas field, under which the Government provided financial assistance to Canadian-owned firms and imposed limitations on areas of development by foreign-owned firms, further discriminated against U.S. companies. In certain of the takeover attempts by Canadian firms, the Canadian investment assistance actually provided an economic basis for the tender offer while the restrictions on transfer of corporate control had the effect of hampering management efforts to defend against takeover attempts. In response, Congress sought to restrict the ability of such companies to acquire U.S. corporations, in part by requiring uniform compliance with the margin requirements.

The Securities and Exchange Commission strongly supported the legislation, testifying to the problems arising from the use of foreign sources of credit in the acquisition of securities of domestic corporations. The SEC argued that when a foreign person desires to purchase U.S. securities or acquire control of U.S. corporations, such person should not be excused from laws which would apply if the acquiror was a U.S. person. The SEC emphasized that “the financing of acquisitions and tender offers, even if concluded wholly outside the United States, is an activity over which we unquestionably have jurisdiction.” However, in a letter dated March 20, 1981, the SEC also alluded to the problems of applying the margin requirements to the foreign buyer of U.S. securities rather than to the foreign lender who may be fully in compliance with applicable foreign law. By imposing the require-

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Cited as examples were (1) Seagram's attempt to acquire St. Joe Minerals which in defending itself sold its Canadian energy subsidiary, Can-Del Oil Ltd., Senate Hearings, supra note 7, at 3-4 (statement of Sen. Don Nickles); (2) Dome Petroleum's foray against Conoco which culminated in Conoco's sale of its Canadian subsidiary, Hudson Bay Oil Gas, to Dome, id. at 101; (3) Nu-West's effort to force Cities Services Company to sell its Canadian energy assets, id.; (4) Seagram's tender offer against Conoco resulting in the merger of Conoco and DuPont and the acquisition by Texas-Gulf Co. by Elf-Aquitaine, made possible, in part, by Elf-Aquitaine's agreement with a Canadian corporation, the Canadian Development Company, id. at 3-4.

Id. at 28-29 (statement of Harvey Bale, Jr., Assistant U.S. Trade representative for Investment Policy).

Id.

Id. at 29.

Id.

Id. at 39-53 (statement of Philip A. Loomis, Jr., Member, Securities and Exchange Commission).

Id. at 44.

Letter from Acting SEC Chairman Philip A. Loomis to Cong. Timothy E. Wirth
ments on the lender, "possible adverse reaction by foreign governments arising from their perception that Congress is attempting to extend our laws to extraterritorial transactions" is minimized.104

The Federal Reserve Board supported the legislation but with less enthusiasm, questioning the need for the expanded regulation and the benefits that would result. In a letter to Senator Harrison Williams dated July 29, 1981, Federal Reserve Governor Charles Partee supported the legislation proposed in the House and Senate which place legal responsibility for compliance upon foreign borrowers rather than lenders. Speaking on behalf of the Board, Partee stated: "It is our sense that to subject foreign lending institutions to the margin requirement would unnecessarily strain relations between U.S. and foreign financial institutions, would be unworkable, and would risk the threat of unwelcome retaliatory measures."105 In a letter to Senator D'Amato dated July 8, 1981, Federal Reserve Governor Volcker downplayed the importance of margin regulations in corporate takeovers,106 noting that the proposed amendments would not reach all foreign persons buying U.S. stock with foreign credit.107 In particular, a foreign investor would be subject to the Board's margin regulations under the proposed amendment only when the stock purchase otherwise required filing under section 13(d) or section 14(d) of the Securities Exchange Act.108 By doing so, the amendments are directed at investors who are purchasing five percent or more of the outstanding stock of the issuer or who are making a tender offer. The proposed amendment would not reach ordinary retail investors nor would it reach most institutional investors making ordinary financial in-

104 Id. at 54-60.
107 The letter from Governor Volcker stated, in pertinent part:

Both bills are designed to remedy a perceived inequity between domestic and foreign borrowers who purchase U.S. securities. To the extent that foreign purchasers are borrowing funds from foreign banks or other foreign lenders to finance corporate takeovers, or purchase substantial amounts of U.S. securities, both bills would apply to foreign purchasers the margin requirements that presently apply to U.S. borrowers. We believe it is important to point out, however, that even if applicable, the Board's margin requirements would probably not have reached many of the corporate takeovers which have given rise to these bills and similar bills in the House. Most importantly, the proposed legislation would not reach corporate takeovers in which credit is not used. Acquisitions financed with corporate earnings or through an exchange of shares are not subject to the margin requirements and would, therefore, remain unaffected. Also, if a foreign firm is large enough, it could probably provide sufficient other collateral or borrow on an unsecured basis to avoid application of the margin requirements, at least for the time it would take to file and process the required 13(d) or 14(d) statement and for the acquisition to be consummated. The Board does not believe margin requirements, in general, present a significant obstacle to corporate takeovers.

108 Id.
Generally, the Federal Reserve Board has been cautious when considering actions that would impact on foreign banks and their traditional activities occurring abroad.

The possible drawbacks in extending the margin rules to certain borrowings by foreign persons from foreign lenders are considerable. The proposed rule would extend the extraterritorial reach of the securities laws to govern transactions which occur wholly outside the United States. The SEC has justified this expansion since the ultimate transaction, that of acquisition of control of a domestic corporation, will have a substantial impact on the U.S. securities market. However, if market impact is the test, then the SEC should seek legislation to regulate acquisitions of securities which produce a market impact. Certain acquisitions of control may not be financed, and others, as the Board has pointed out, are often financed on an unsecured basis. In the United States, banks are subject to strict regulatory jurisdiction and are subject to a review of their loans, including those which finance tender offers on an unsecured basis. Outside the United States, however, it would be virtually impossible to supervise the character of an unsecured loan or to consider the decision of the lending bank in extending such credit.

Enforcing the margin rules between foreign borrowers and lenders would be exceedingly difficult. The SEC would have little means of utilizing its investigatory powers in challenging the accuracy of purported loan documents. Further, testimony at the Senate hearing questioned the practicable enforceability of the proposed legislation “given limits to the staff resources available at the SEC.” The complexity of the regulatory scheme and the need to devise workable rules in instructing foreign lenders as to the necessary compliance increases the difficulty of enforcement. Further, in many cases, the lender would not be subject to enforcement of the sanctions available to the SEC.

The need to extend the extraterritorial reach of the U.S. securities law is less clear in connection with foreign borrowings than in other extraterritorial activities which have a far less direct impact. For instance, the SEC has focused significant attention to prohibit insider trading by

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109 Since ordinary retail investors and institutional investors making ordinary financial investments are not required to file under § 13(d) or § 14(d) of the 1934 Act, they would not be subject to the proposed legislation. See 15 U.S.C. §§ 78m-n (1976).
110 Loomis Letter, supra note 103, reprinted in id. at 41-42. In the Senate hearings the SEC did not raise the relevancy of section 30(b) of the Exchange Act which states:

The provision of this title or any rule or regulation promulgated thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent evasion of this title.

15 U.S.C. § 78dd(b). To date, the SEC has not promulgated any rules under this section. It would seem, however, that any attempt to regulate lending transactions occurring wholly abroad must address why section 30(b) does not apply.
111 Senate Hearings, supra note 7, at 29 (statement of Dr. Harvey Bale, Assistant U.S. Trade Representative for Investment Policy).
individuals making use of foreign intermediaries. Only recently has the Commission examined the ability of foreign investors borrowing abroad to operate outside the margin regulations.

The congressional purpose of protecting unsophisticated individual investors seems absent with regard to regulating tender offer financing. Generally, to the extent that this interpretation of legislative purpose is still valid, the protection accorded should be extended to individuals, rather than to sophisticated corporate investors. Unlike individual investors who may be tempted to speculate when credit is made available, it would not seem that corporations should be protected from their own folly. Further, it is unlikely that the small individual investor, whom Congress arguably intended to protect, would be borrowing abroad.

The degree to which regulation of tender offer financing prevents market fluctuation is also unclear. The security pledged by an unsuccessful corporate bidder as collateral for the loan usually includes the stock of the target company and of the would-be acquiror. It is unlikely that this security would be sold. Typically, with large holdings as collateral, the pledgee will find either that there is no market for his stock or that the securities held can be sold only at low prices. Since corporations aim to maximize investment the only feasible course of action is, in most cases, to hold the collateral or negotiate with the acquiror for its sale. Nevertheless, it cannot be doubted that tender offer activity to a far greater degree than individual investment may result in a dramatic increase of stock prices. Whether this rise in prices causes a destabilizing effect, absent the sale of collateral is unclear. In October 1982 the Federal Reserve Board announced that its staff is conducting a study on the effectiveness, scope, and structure of federal regulations of margin requirements. The Board stated that the margin rules must be re-examined in light of the changes in the structure of financial markets since the inception of regulation in 1934.

The extension of margin regulations to govern borrowings by foreign investors from foreign lenders also might inhibit investment in the United States. Certain foreign investors might be unable to borrow under the existing compliance standards. Of course, the SEC could argue that this is in accordance with the intended purpose of restricting the availability of loans to any investor unable to adequately support its borrowing. However, other foreign investors might react to such regulations as a direct limitation on major investment in the United States, as well as an overreaching expansion of extraterritorial jurisdiction.


114 Id. at 2.
VIII. Conclusion

The regulation of margin rules has a history of closing loopholes. For a foreign investor interested in making a tender offer for a U.S. corporation, loopholes still exist and such investors may attempt to acquire a controlling interest without being subject to the complex scheme of margin requirements. However, legislation has been considered which would require any borrower attempting to finance a cash tender offer to comply with the margin rules, even if such compliance involves regulation of activities which only involve foreign persons and which occur wholly abroad. Congressional reaction to attempts by foreign investors to acquire U.S. companies may result in renewed attempts to pass this legislation. Yet, it is necessary to balance the competing policy concerns in viewing the perceived inequities in margin compliance. The relative intrusion of regulating certain foreign lending and the possibility of deterring foreign investment seem to outweigh the importance of extending the margin rules at a time when the original purpose of such regulations is being scrutinized.