

SEC SCRUTINIZING FOREIGN REGISTRANTS REGARDING DEALINGS IN COUNTRIES UNDER U.S. SANCTIONS

Introduction

The U.S. Securities and Exchange Commission ("SEC") has instituted a series of changes to the securities registration process directed at foreign companies that seek to offer securities in the United States. The purpose of the new measures is to enable the SEC to ascertain whether foreign registrants conduct business either with or within countries targeted by U.S. sanctions or embargoes and to disclose such business activities to U.S. investors. This memorandum describes the congressional origins of the new measures, summarizes the modifications to the existing registration process for foreign issuers, and suggests that additional, more stringent measures could be proposed in legislation to be considered later this year.

Background

Announced in a May 8, 2001, letter from Acting SEC Chairman Laura Unger to Representative Frank Wolf (R-VA), Chairman of the House Appropriations Committee subcommittee that controls the SEC's funding, the new measures are a direct response to Representative Wolf, other members of Congress, and private organizations that have long urged restricting or banning access to U.S. capital markets by foreign entities seen as cooperating with or profiting from governments associated with terrorism, religious persecution, or other human rights abuses.

Of special interest to these members is financial activity in the U.S. (such as the issuance of securities) of potential benefit to countries and regimes currently subject to statutory sanctions and embargoes enforced by the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC"). These include Iran, Iraq, Libya, Sudan, Cuba, and the Taliban in Afghanistan. U.S. companies are prohibited from engaging in any business activity in these countries. OFAC also enforces other restrictions on certain business activities with North Korea, Sierra Leone, Burma (Myanmar), Syria, the UNITA faction in Angola, and specified parties in the Federal Republic of Yugoslavia.

While a complete ban on access to U.S. markets by foreign companies that do business with the targeted countries is beyond the SEC's current statutory authority, both the SEC and Representative Wolf's allies among human rights and international security activists hope that the new disclosure policy will discourage investment by U.S. citizens in such companies. Over the long term, Wolf or others may propose stronger measures against such companies as Congress considers legislation later this year that would extend the existing sanctions against Iran and Libya for an additional five years.

New SEC Measures

With the exception of an anticipated rulemaking on electronic filing, each of the new measures identified below is being carried out under the SEC's existing authority and is already underway.

1. Closer review of foreign registration statements. SEC staff is scrutinizing all registration statements filed by foreign companies to identify "material business dealings" with countries, governments, and entities on OFAC's sanctions list. Under the old policy, such reviews were selective because of limited staff resources.
2. Enhanced disclosure for foreign registrants doing business in sanctioned countries. The SEC has concluded that such business activity is "substantially likely to be significant to a reasonable investor's decision about whether to invest in that company." It will require disclosure of information pertaining to such activity as material to investors' interests through direct contact by SEC staff with foreign entities that have filed registration statements with the SEC. Supporters of disclosure believe that providing investors with this additional information will underscore the risk of investing -- even indirectly -- in "rogue regimes" and countries that are off-limits to U.S. companies and will shrink the U.S. market for such investments.
3. SEC-OFAC Coordination. The SEC staff has been directed to focus on cooperation and information-sharing with OFAC. The anticipated result is that information obtained by the SEC regarding foreign companies' activities in sanctioned countries will be communicated to OFAC and other government agencies responsible for enforcing those sanctions. In addition, the SEC has expressed support for creating a new interagency working group on Sudan, a particular concern of Representative Wolf and others critical of Chinese and Canadian oil companies' alleged support of human rights abuses through their investments in that country.
4. Rulemaking to require electronic filing of registrations by foreign companies. Acting Chairman Unger has directed SEC staff to prepare a proposed rule for consideration by the Commission, probably this summer, that will eliminate the existing election of paper filings and require foreign companies to submit their registration statements electronically. This proposed change would significantly improve the SEC staff's ability to carry out the new

mandate to review foreign registrations more carefully and also allow broad public access to the filings through the SEC's EDGAR system, which is accessible through the Internet.

Potential for Additional Measures

While the latest SEC developments are significant, they fall short of the measures advocated by key members of Congress, which include a complete ban on access to U.S. markets by foreign companies doing business with targeted countries. Such a ban is not currently possible under U.S. law. Later this year, Congress is expected to consider and pass legislation that would extend for another five years the Iran-Libya Sanctions Act ("ILSA") which expires in August, 2001. Recent congressional hearings on the proposed reauthorization revealed significant, bipartisan interest in preventing any use of U.S. capital markets to enable the targeted countries to profit from the current rise in global energy prices, particularly for oil. We expect that supporters of a ban will actively attempt to include in the ILSA extension one or more provisions that could curtail the participation in U.S. markets of foreign companies with ongoing investments in energy production in the targeted countries.

Whether such attempts succeed will depend on several factors, such as: the strength of the competing view that domestic energy needs require an end to sanctions to allow U.S. access to the massive oil reserves in Iran and Libya; potential political transitions in these two countries (including the Iranian national elections on June 8th) that could encourage closer ties with the U.S.; and the apparent reluctance by senior officials in the Bush Administration to continue the use of sanctions as a foreign policy tool.

Conclusion

Foreign companies contemplating the issuance of securities in the U.S. will need to proceed carefully if they also have dealings with or in countries subject to U.S. trade sanctions. The new SEC policies can raise compliance issues under U.S. securities laws as well as generate possible enforcement actions by OFAC and other agencies. Moreover, the disclosure of any information on activities involving sanctioned countries, even when permissible, will result in attention from political forces and interest groups seeking to discourage U.S. investors from purchasing the securities of these foreign companies.

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