Since the adoption of Regulation S, it has come to the Commission's attention that some market participants are conducting placements of securities purportedly offshore under Regulation S under circumstances that indicate that such securities are in essence being placed offshore temporarily to evade registration requirements with the result that the incidence of ownership of the securities never leaves the U.S. market, or that a substantial portion of the economic risk relating thereto is left in or is returned to the U.S. market during the restricted period, or that the transaction is such that there was no reasonable expectation that the securities could be viewed as actually coming to rest abroad. These transactions are the types of activities that run afoul of Preliminary Note 2, would not be covered by the safe harbors and would be found not to be an offer and sale outside the United States for purposes of the general statement under Rule 901.[12]

The practices described below generally have involved equity securities of U.S. companies whose securities are traded principally, and typically solely, in the United States.

There have been a variety of schemes involving parking securities with offshore affiliates of the issuer or a distributor. In these transactions, Regulation S is claimed as the basis to sell securities to offshore shell entities formed by the issuer or a distributor (or, in some cases, persons closely associated with the issuer or distributor) to purchase the securities. The entities hold the securities for the restricted period; at the end of that period, proceeds from the U.S. sale make their way, directly or indirectly, to the issuer or distributor. These transactions do not qualify for either the Regulation S safe harbor or the Rule 901 general statement since they are nothing more than sham offshore transactions structured to evade the Securities Act registration requirements.

Troubling issues also have arisen under the resale safe harbor provisions of Rule 904. Rule 904 cannot be used for the purpose of ''washing off'' resale restrictions, such as the holding period requirement for restricted securities in Rule 144.[13] Likewise, the restricted status of securities is not affected by a prearranged transaction by or on behalf of the seller conducted offshore. If a person with restricted securities sold the securities in an offshore transaction and replaced them with a repurchase of fungible unrestricted securities, the replacement securities would be subject to the same restrictions as those replaced.

As noted, the Commission has become aware of a number of instances where the total mix of factors raises the concerns described above. These factors, any one of which may serve to indicate that the economic or investment risk never shifted to the offshore purchaser, and that the securities—as a matter of substance as opposed to form—never left the United States or remained offshore for less than the restricted period, have included the use of: (i) non-recourse promissory notes (notes where the purchaser never is at risk in connection with the purchase of the securities) for all or almost all of the purchase price, where the expectation of repayment stems from the resale of the securities into the U.S. market, (ii) recourse notes where the entity providing the notes is unknown to the seller of the securities or the entity has no, or minimal, assets where, again, the expectation of repayment stems from the resale of the securities into the U.S. market, (iii) fees paid to the purchaser of the securities to hold the securities for the restricted period, whether paid directly or as more frequently seems to be done through significant[14] discounts to the U.S. market price for the issuer's stock, where the fees or discounts are such to indicate that the transaction was intended to create a parking scheme or other scheme where the securities were merely being held offshore to evade the registration requirements, and (iv) short selling and other hedging transactions such as option writing, equity swaps or other types of derivative transactions,[15] where purchasers transfer the benefits and burdens of ownership back to the United States market during the restricted period.[16]

In these cases it appears the transaction is nothing more than a delayed sale by the seller in the United States, with the purported offshore purchaser serving as a statutory underwriter.[17]

III. Request for Comments

In addition to taking enforcement action against those who seek to evade the registration requirements of the Securities Act under the color of compliance with Regulation S,[18] the Commission is considering whether it is necessary to amend the regulation to deter these abuses and requests comment as to the need for revision of Regulation S. A number of proposed revisions have been suggested by commentators.[19] These suggestions are

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burden of establishing the availability of the exemption. *Securities & Exchange Commission v. Murphy,* 626 F.2d 633, 645 (9th Cir. 1980). Such exemptions are construed narrowly. *Id.* at 641.

[12] In addition, a purported Regulation S offering that involves a distribution in the United States may raise issues under Rule 10b–6 under the Securities Exchange Act of 1934. *See, e.g., R.A. Holman & Co., Inc. v. Securities & Exchange Commission*, 366 F.2d. 446, at 449, (2d Cir. 1966) (a distribution of securities is not deemed to be completed until the securities come to rest in the hands of the investing public).

[13] *See* Rule 144(d).

[14] Of course, some discounts may well be warranted in order to compensate for the length of the restricted period, historic volatility of the stock, financial condition of the issuer, the dilution represented by the newly issued shares, current market condition, availability of current information as to the issuer, information the issuer may have had that was disclosed to the purchaser but not otherwise disclosed to the market, or other factors. Nevertheless, some discounts have been so unrelated to the economics of the transaction that the only justification that can be ascertained is that they are part of a parking or holding scheme where the offshore purchaser is simply being used as a conduit for what is in reality an onshore financing.

[15] *See* Securities Act Release No. 7187, Part II.A, which addresses equity swaps and other like investment strategies in different contexts.

Securities would not be deemed to have come to rest abroad during the restricted period if the securities were pledged as collateral, either in a margin account or otherwise, where the expectation was that the collateralization would shift the benefits and burdens of ownership to the lender as opposed to the purchaser and the lender was not offshore.

[16] Since the market for the securities is in the United States, the short-selling or other hedging transaction occurs in the United States markets. If the short-selling or other hedging transaction occurred solely by or among parties offshore, and the purchaser engaged in the transaction could reasonably expect that the economic risk of ownership would remain abroad, then the transaction could satisfy the requirements of the rule if the other provisions of Regulation S were satisfied.

[17] Public resales in the United States by persons that would be deemed underwriters under Section 2(11) of the Securities Act [15 U.S.C. 77b(11)] would not be permissible without registration or an exemption from registration. Footnote 110 of the Adopting Release, which addresses the restricted periods, should not be read to provide otherwise.

Section 4(1) of the Securities Act [15 U.S.C. 77d(1)] exempts ''transactions by any person other than an issuer, underwriter, or dealer.'' Section 2(11) defines the term ''underwriter'' as:

Any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking. . . . As used in this paragraph the term ''issuer'' shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

Accordingly, any distributions by a statutory ''underwriter'' must be registered pursuant to Section 5. *United States v. Wolfson,* 405 F.2d 779, 782 (2d Cir. 1968), cert. denied, 394 U.S. 946 (1969).

[18] *See,* for example, *United States v. Sung and Feher,* Litigation Release No. 14500 (May 15, 1995); *Securities and Exchange Commission v. Softpoint, Inc., et al.,* Litigation Release No. 14480 (April 27, 1995).

[19] *See* Ajhar, ''Foreign Stock Sales: Don't Get Blindsided,'' Worth p. 37 (March 1994); The Corporate Counsel, March-April 1995; E. Greene, ''Recent Problems Under Regulation S,'' Insights