SYMPOSIUM

Current Issues of International Financial Law, *Part II*

Editor's Note:

International financial law has increased in importance dramatically in recent years and will undoubtedly continue to do so as national economies and financial systems become more interdependent and as international organizations expand their roles or are created to serve new functions. This Symposium, presented in two parts, addresses numerous aspects of international financial law from a variety of perspectives. Part I, as you will recall, featured two articles from Sir Joseph Gold and Ibrahim Shihata examining the role of international organizations in this area. Sir Joseph examined the IMF's ability to borrow from private market sources and Ibrahim described the convention to establish the Multinational Guarantee Agency (MIGA).

Part II is dedicated to two subject categories: (1) "United States Regulations, Judicial Decisions and Institutions," and (2) "New Forms of International Financing and Restructuring." In the first category relating to financing activities in the United States or by U.S. parties, Andre Newburg *discusses Eurobond financings by U.S. companies, with particular attention paid to recent changes in U.S. tax laws.* Richard Breeden *next analyzes various proposals for reforming the regulation of United States financial services. Following that is an article by* David Holland *examining a particular aspect of the United States financial regulatory system, i.e., the regulation by the Federal Reserve Board of foreign banking organizations in the United States.* Robert Rendell *next discusses the recent* **Allied Bank** *case, focusing on the role of the situs of property in Act-of-State analyses. The fifth article, by* John Bohn, Jr., *discusses Eximbank's role in international finance, including how Eximbank has responded to competition from other countries' export financing techniques.*

The final section of the Symposium contains three articles addressing questions relating to new forms of financing, refinancing, and restructuring. Armel Cates *discusses swap transactions, including their history and various legal questions associated with them.* Alfred Mudge *discusses various issues relating to restructuring private and public sector debt.* Keith Clark *then analyzes the complicated questions involved in seeking, with respect to restructuring sovereign debt, parity of treatment between equivalent creditors in relation to comparable debt.*

ANDRE W. G. NEWBURG*

United States Companies and International Financings

The past two years have seen not only significant developments in international financing techniques (such as the remarkable growth of the short-term Euronote market and of swap arrangements) but also new tax legislation in the United States which has had an important bearing on debt financing in international capital markets by U.S. companies. A key development for U.S. borrowers was the repeal by the Tax Reform Act, in July 1984, of U.S. withholding tax on "portfolio interest", the statutory term of art which covers most types of interest paid to foreign investors on portfolio debt instruments.[1] The 30 percent withholding tax on U.S. source interest had been at best a complicating factor and occasionally a barrier for the issuance of Euromarket obligations by U.S. companies, and its repeal represented a major step toward the internationalization of U.S. capital markets.

Indeed, withholding tax repeal was widely thought to presage the advent of the "global" bond issue, offered simultaneously and freely traded in United States and international markets, and the consequent decline of importance of Eurobond financings for U.S. companies. The experience of the past two years has, however, been to the contrary. Bond issues specifically targeted for the Euromarket and foreign bond markets have reached record levels, while the global bond issue has not become a generally accepted or practical financing technique.

This continued segregation of primary markets in the United States from international bond markets is due to various factors, including the

---

*Partner, Cleary, Gottlieb, Steen & Hamilton, New York, N.Y. This article is based on a paper delivered by the author on July 19, 1985, at the London meeting of the Section of International Law and Practice. The author is grateful for valuable assistance provided by his associates Greer Phillips and Samuel Y. Sessions.

1. Pub. L. No. 98-369, title IV, § 428, 98 Stat. 494 (1984).

preference of most Euromarket investors for the anonymity associated with bearer instruments and the complex regulatory scheme that implements the repeal of U.S. withholding tax and the earlier Tax Equity and Fiscal Responsibility Act of 1982, commonly known as TEFRA.[2]

I. TEFRA Registration Requirements

TEFRA, reflecting the Administration's efforts to augment revenues without raising taxes, sought to improve taxpayer compliance by requiring most debt securities in the United States to be issued in registered (that is to say nominative) form.[3] TEFRA also imposed information reporting and "backup" withholding requirements on issuers, paying agents, custodians and brokers. These backup withholding rules were strengthened by the Interest and Dividend Tax Compliance Act of 1983 upon the repeal, prior to its effective date, of the 10 percent domestic withholding tax on interest and dividends that had originally been enacted by TEFRA.[4]

A. Eurobond Exception

When the TEFRA legislation was being considered, the Congress was made aware (due to the efforts of the investment banking community) of the incompatibility of the TEFRA registered form requirement with the Euromarket's clear preference for bearer securities and anonymity. In order not to jeopardize access by U.S. borrowers to international capital markets, the so-called "Eurobond exception" was written into TEFRA.

The Eurobond exception permits obligations to be issued in bearer form provided that interest is payable only outside the United States and that there are "arrangements reasonably designed" to ensure that the obligations will be sold (or resold in connection with the original issue) only to non-U.S. persons.[5] This phrase, in an unusual application of securities law concepts to tax legislation, was taken directly from the 1964 SEC release[6] that sets forth the broad guidelines pursuant to which U.S. com-

2. Pub. L. No. 97-248, 96 Stat. 324 (1982).
3. TEFRA imposes fiscal sanctions on issuers and holders of "registration-required obligations" that are not in registered form. There are certain exceptions, including the "commercial paper" exception for obligations with a maturity at issue of one year or less. I.R.C. §§ 163(f), 165(j), 312(m), 1287(a) and 4701. The TEFRA requirement that obligations be in registered form must, of course, be distinguished from registration with the Securities and Exchange Commission of securities prior to their public offering in the United States.
4. Pub. L. No. 98-67, title I, § 101(a), 102-110, 97 Stat. 369 (1983).
5. I.R.C. § 163(f)(2)(B). Bearer obligations must also contain a legend to the effect that U.S. persons holding an obligation will be subject to certain limitations under U.S. income tax laws.
6. SEC Sec. Act. Rel. No. 4708, 17 C.F.R. § 231.4708 (July 9, 1964).

panies have for over two decades made Eurobond offerings without registration under the Securities Act of 1933 (the 1933 Act).[7]

At the time TEFRA was enacted in 1982, the principal means by which a U.S. company could raise funds in international capital markets free of U.S. withholding tax was through an offshore finance subsidiary. Most such financings were made by special purpose Netherlands Antilles finance subsidiaries, with parent company guarantees.[8] Interest payments made outside the United States by such a foreign subsidiary were generally not subject to information reporting and possible backup withholding, and the Eurobond exception made it possible for such finance subsidiaries to continue to issue bearer securities in foreign markets in accordance with what had become, over a number of years, standard Euromarket practice.[9]

B. Repeal of United States Withholding Tax

The Tax Reform Act of 1984 built on the TEFRA Eurobond exception by exempting from withholding tax bearer obligations issued after July 18, 1984 in conformity with the Eurobond exception. The exemption applies also to obligations in registered form, but only if a statement is delivered (to the person who would otherwise have been required to withhold the tax) that the beneficial owner of the obligation is not a U.S. person.[10]

While repeal of withholding tax opened the way for U.S. corporations to issue debt obligations in foreign markets without use of an international finance subsidiary, the new law did not change the TEFRA information

---

7. Securities Act of 1933, 15 U.S.C. §§ 77a–77aa (1982).

8. *See, e.g.*, Pugh & Smeets, *Holding and Finance Companies in the Netherlands and the Netherlands Antilles*, 4 Tax Adviser 260 (May 1973); Newburg, *Financing in the Euromarket by U.S. Companies: A Survey of the Legal and Regulatory Framework*, 33 Bus. Law. 2171 (July 1978); Pergam, *Eurocurrency Financing: Legal Positioning of U.S. Corporate Issuers*, International Capital Markets and Securities Regulation (H. Bloomenthal ed. 1982).

9. Regulations under TEFRA include a "safe harbor" rule under which the Eurobond exception is satisfied if an obligation is offered for sale or resale (in connection with its original issuance), and is delivered, only outside of the United States and, in reliance on a written legal opinion, the issuer determines that no SEC registration is required because the obligation is intended for distribution only to persons who are not U.S. persons. Treas. Reg. § 1.163-5(c)T(2)(i)(A). The regulations also apply the Eurobond exception to bearer securities registered with the SEC or exempt from SEC registration under Section 3 or 4 of the 1933 Act, provided that the securities are offered abroad only to foreign investors or qualified U.S. financial institutions, and that certain other procedures designed to prevent distribution to U.S. persons (other than such institutions) are followed. Treas. Reg. § 1.163-5(c)T(2)(i)(B).

10. I.R.C. §§ 871(h), 881(c). The statement must be made by the beneficial owner or by a securities clearing organization, a bank or other financial institution that holds customers' securities in the ordinary course of business.

reporting and backup withholding rules under which backup withholding would apply to interest payments made by a U.S. issuer unless foreign investors provided certification of their identity and exempt status. Such certification was, not surprisingly, viewed as incompatible with the anonymity associated with Euromarket bearer instruments and would have created a practical barrier to the direct issuance by U.S. companies of bearer obligations in the Euromarket.

II. Effect of the Temporary Regulations

The Internal Revenue Service, however, promptly issued temporary regulations that sought to put direct issues by U.S. corporations and by their foreign finance subsidiaries on the same footing as regards information reporting and backup withholding.[11] The temporary regulations, as subsequently modified and supplemented,[12] also contain elaborate rules implementing the withholding tax exemption and modifying the Eurobond exception in certain important respects. Because of the complexity of these regulations, it would seem useful to summarize their effect on certain types of debt financings.

A. Domestic United States Obligations

The temporary regulations exempt a foreign investor from withholding tax and from backup withholding in respect of post-July 18, 1984 obligations of U.S. corporations (and of the U.S. government and government-related entities) issued in the U.S. domestic market in registered form (as required by TEFRA), but only if the foreign investor complies with the full panoply of U.S. information reporting rules. The foreign owner of a registered bond must deliver to the paying agent, or to the financial institution holding the bond for the owner's account, a Certificate of Foreign Status on IRS Form W-8, signed under penalties of perjury and setting out the investor's name and address, and a copy of this form must ultimately be transmitted to the Internal Revenue Service.

Since these conditions not only impose substantial administrative burdens on foreign bondholders and financial intermediaries, but also are incompatible with the desire of many foreign investors for anonymity,

11. T.D. 7965, 1984-2 C.B. 38 (promulgating Treas. Reg. §§ 1.163-5(c)T, 1.165-12T and 1.1287-1T); T.D. 7966, 1984-2 C.B. 324 (amending Treas. Reg. § 35a.9999-3 and promulgating Treas. Reg. § 35a.9999-4); T.D. 7967, 1984-2 C.B. 329 (promulgating Treas. Reg. § 35a.9999-5); T.D. 7972, 1984-2 C.B. 327 (amending Treas. Reg. § 35a.9999-4).

12. T.D. 8046, 1985-40 I.R.B. 9 (amending Treas. Reg. § 1.163-5(c)T, promulgating Treas. Reg. § 1.163-5(d)T and amending Treas. Reg. § 35a.9999-5).

traditional Eurobond investors have continued to prefer bearer obligations of U.S. borrowers specifically designed for foreign capital markets.

B. Foreign Offerings of United States Corporate Bearer Obligations

Payments outside the United States by a U.S. corporate issuer or its paying agent on bearer obligations offered, sold and delivered outside the United States in accordance with the Eurobond exception (as interpreted by the temporary regulations) are exempt from withholding tax and, in the absence of actual knowledge by the issuer or paying agent that the payee is a U.S. person, are not subject to U.S. information reporting and backup withholding.[13]

In addition to a traditional Eurobond offering not registered under the 1933 Act, bearer bonds registered with the SEC (or exempt under Sections 3 or 4 of the 1933 Act) fall within the Eurobond exception if they are sold outside the United States to foreign investors or to qualified U.S. financial institutions in accordance with specified procedures intended to preclude redistribution in the United States or to U.S. persons.[14] A corporate bond issue registered with the SEC thus can be offered simultaneously in the United States in a registered form tranche, and in international markets in a bearer form tranche. However, because the temporary regulations departed from the prior TEFRA regulations in one critical respect, these two tranches will not be fungible.

Under the prior regulations, bonds issued in accordance with the Eurobond exception could freely be converted back and forth into bearer or registered form. The temporary regulations, however, permit conversion only from bearer into registered form (whereupon payments on the obligation become subject to the information reporting rules for domestic U.S. obligations), and not vice versa.[15] Once in registered form, obligations may not be converted into bearer form, and obligations originally issued in registered form may never be converted into bearer form. This

13. Treas. Reg. § 35a.9999-5, Q & A 1, 2. Information reporting continues to apply to payments by a foreign office of a custodian, nominee or other agent of the payee that is (i) a U.S. person (ii) a controlled foreign corporation or (iii) a foreign person deriving 50% or more of its income for a specified period from the conduct of a trade or business in the United States. Treas. Reg. § 35a.9999-4, Q & A 1, 2, 5. Such entities (*e.g.*, foreign branches or subsidiaries of U.S. banks or brokers) are permitted to treat a customer as a foreign person not subject to information reporting if they have documentary evidence in their files, such as a statement on an account application, that the customer is a foreign person. *Id.*

14. *See supra* note 9.

15. Treas. Reg. § 1.163-5(c)T(1). The temporary regulations also do not permit a bearer obligation to be converted into a "targeted" registered form obligation (described below). Treas. Reg. § 35a.9999-5, Q & A 18.

restriction substantially limits trading markets for the entire issue since, as a practical matter, it bars holders of registered bonds issued as part of a U.S. tranche from access to the secondary market for bearer bonds of the same issue.

On the other hand, bearer bonds originally offered abroad under the Eurobond exception may be traded in the secondary market in the United States after the distribution has been completed and the securities have come to rest abroad. Although the SEC has never stated when and under what circumstances Eurobonds distributed abroad without 1933 Act registration may be reoffered and resold in the United States, the SEC staff in a number of no-action letters has blessed certain procedures designed to ensure that the distribution has been completed abroad, including the release of definitive securities only upon certification of non-U.S. ownership after a ninety-day "lock-up" period.[16] Typically, secondary market trading in the United States begins shortly after the expiration of that period. Under the temporary regulations, U.S. persons may purchase and hold such "seasoned" bearer bonds through qualified financial institutions, including banks, broker-dealers, insurance companies, regulated investment companies and investment advisers, which file information reports and observe certain delivery restrictions.[17]

In the absence of more specific SEC guidance, it may be difficult in some instances to determine when distribution abroad of a non-SEC registered issue will have been completed and when the bonds will have been "seasoned" so as to permit their trading in the United States. Under such circumstances, even though the bonds will initially be offered and sold only outside the United States in bearer form, it would be possible to register the issue under the 1933 Act. A Eurobond offering registered with the SEC in compliance with the 1933 Act (and issued under a trust indenture meeting the requirements of the Trust Indenture Act of 1939[18]) would, insofar as the securities laws are concerned, have immediate and unrestricted access to United States markets and protect U.S. broker-dealers from the risk that secondary market activities in the United States might constitute an illegal distribution.

However, TEFRA and the temporary regulations would still require that any such bearer bonds be distributed abroad in accordance with the Eurobond exception. Under the temporary regulations, this means that

16. *Pacific Lighting Company,* May 2, 1974 (available June 13, 1974); *The Singer Company,* July 25, 1974 (available September 3, 1974). Once the securities have "come to rest abroad" within the meaning of SEC Release No. 33-4708 (*supra,* note 3), transactions other than by a dealer involving an unsold allotment should be exempt under Sections 4(1) or 4(3) of the 1933 Act.

17. Treas. Reg. §§ 1.165-12T(c)(3), 1.1287-1T(c).

18. 15 U.S.C. §§ 77aaa *et. seq.* (1982).

offers, sales and deliveries in connection with the primary distribution must take place outside the United States and that underwriters and dealers participating in the distribution must observe certain restrictions on offers and sales. As in the case of a Eurobond issue not registered under the 1933 Act, definitive securities could be released only upon certification of non-U.S. ownership, but the temporary regulations do not require any particular "lock-up" period.

C. Foreign "Targeted" Offerings

Under the temporary regulations, U.S. government-related entities such as the Federal National Mortgage Association, the Federal Home Loan Banks, the Federal Home Loan Mortgage Corporation, the Farm Credit Administration and the Student Loan Marketing Association, may not issue or guarantee bearer obligations.[19] Further, the Treasury has announced that it will publish regulations prohibiting the issuance in bearer form of obligations backed by obligations issued or guaranteed by the U.S. government or a U.S. government-related entity.[20] However, largely in order to give the U.S. Treasury and U.S. government-related entities improved access to foreign capital markets, the regulations devised the "targeted" registered form, a hybrid that has characteristics of both bearer Eurobonds and ordinary registered bonds.[21]

Targeted registered obligations are issued directly to foreign investors under procedures similar to those satisfying the Eurobond exception, but are subject to less stringent rules concerning certification of a foreign investor's status than ordinary registered form obligations. Interest paid on a targeted registered obligation is exempt from withholding, and from information reporting and backup withholding, without any need for the foreign beneficial owner to identify itself by providing a Form W-8, if (i) the registered owner is a financial institution, (ii) the interest is paid to an address of the financial institution outside the United States, (iii) the payor does not have actual knowledge that the beneficial owner of the obligation is a U.S. person, and (iv) certain certification requirements are satisfied.[22]

---

19. Treas. Reg. § 1.163-5(c)T(1).

20. Letter from Donald T. Regan, Secretary of the Treasury, to Robert Dole, Chairman, Committee on Finance, United States Senate (September 7, 1984).

21. *See generally* Treas. Reg. § 35a.9999-5, Q & A 12, 13, 14, 15, 16, 17.

22. The certification procedures for a targeted registered obligation are elaborate. In general, the certification procedures apply to the payment of interest on a targeted registered obligation by the last U.S. person in the chain of payment (the withholding agent) to a foreign person. If the foreign person is a financial institution, then that foreign financial institution must file an annual certificate with the withholding agent. Very broadly speaking, that certificate must state that (i) on any interest payment date during the prior year on

Because the certification procedures for a targeted registered obligation are elaborate, such issues generally are less attractive to foreign investors than bearer obligations. Although there have been a number of targeted registered issues by the U.S. Treasury and U.S. government-related entities, this format has not been used by U.S. corporations except under special circumstances where, because of (i) the presence of a direct or indirect government guarantee or insurance of the obligations to be issued or (ii) the use of securities issued or guaranteed by the U.S. government or a U.S. government-related entity to back those obligations, issuance in bearer form is barred.

D. Obligations Not Qualifying for Withholding Tax Exemption

The temporary regulations add limitations (not contained in the statute) on the type of obligation that qualifies for the withholding tax exemption. Obligations exempt from the TEFRA registration requirements for any reason other than the Eurobond exception do not qualify for the withholding tax exemption, even if issued under procedures complying with the Eurobond exception. In particular, obligations issued by natural persons,[23] obligations with a maturity (at issue) of not more than one year and obligations "not of a type offered to the public" do not qualify for the withholding tax exemption for portfolio interest.[24] This regulatory

which the financial institution held a targeted registered obligation, the beneficial owner of that obligation was not a U.S. person and (ii) on any interest payment date during the following year on which the financial institution holds a targeted registered obligation, the beneficial owner of that obligation will not be a U.S. person. The certificate must also state that if a U.S. person was or is the beneficial owner of a targeted registered obligation held by the financial institution on any such interest date, then the financial institution has so notified or will so notify the withholding agent. The notification of U.S. beneficial ownership provided by the financial institution to the withholding agent must state that (i) the financial institution has obtained from the beneficial owner a Form W-9 or substantially similar form, signed under penalties of perjury and including the name, address and U.S. taxpayer identification number of the beneficial owner, and (ii) the financial institution has complied and will continue to comply with U.S. information reporting requirements, if applicable. If the foreign person receiving interest payments from the withholding agent on a targeted registered obligation is not a financial institution, then more stringent certification procedures ordinarily will apply.

23. Under the second set of temporary regulations (*see supra* note 12), mortgage pass-through securities and similar interests in pools of debt obligations are treated for purposes of the withholding tax exemption as independent direct obligations issued by the trust holding the underlying pool of debt obligations, rather than as evidences of beneficial ownership in those obligations. As a result, so long as such a pass-through security is "of a type offered to the public" and has a maturity (at issue) of more than one year, that it will, in general, qualify for the withholding tax exemption, even though the underlying pool of debt obligations fails to so qualify (because, for example, that pool comprises residential mortgage loans issued by natural persons).

24. Treas. Reg. § 35a.9999-5, Q & A 1.

limitation, which applies whether the obligations are in registered or bearer form, is particularly significant because it excludes from the definition of "portfolio interest" interest on short-term paper with maturities not exceeding one year. Consequently, obligations with a maturity of between 183 days and one year fall within a gap and continue to be subject to withholding tax because the maturity of such obligations is too long to qualify for the exemption applicable to discount obligations with a maturity of 183 days or less and is too short to qualify for the exemption for portfolio interest.[25]

III. Continuing Separation of Markets

Although the repeal of U.S. withholding tax on "portfolio interest" has made it possible for a U.S. corporation to offer an SEC registered issue simultaneously within and outside the United States, issuing bearer bonds to foreign investors and bonds in registered form in the U.S. market, the prohibition on the conversion from registered into bearer form has the practical effect of permanently segregating the U.S. tranche of such an issue from the Euromarket and has been a major obstacle to a truly integrated global debt offering.

There are other reasons as well for the continuing separation of U.S. and international bond markets. Some of these derive from differences in market practices, distribution methods and commission structures. Yield expectations frequently are different, due in part to the fact that while annual coupons are customary in the Euromarket, the U.S. domestic market is geared to semi-annual interest payments. Moreover, even if the regulations were to be changed so as to permit free convertibility between bearer and registered bonds, there would remain other regulatory problems in structuring a genuine global offering.

For example, any underwriter participating in the distribution of an SEC registered security is liable, jointly and severally with all other underwriters, in a civil action under Section 11 of the 1933 Act brought by any purchaser for damages or rescission based on a material misstatement or omission in the registration statement, unless the underwriter can establish its "due diligence" defense or show that the purchaser knew of

25. Discount obligations with a maturity of not more than 183 days and certain deposit obligations are exempt from withholding tax under provisions wholly unrelated to the new exemption for "portfolio interest." I.R.C. §§ 861(a)(1)(A), 861(c), 871(a)(1)(A), 871(a)(1)(C), 871(g)(1)(B)(i), 881(a)(1), 881(a)(3). The temporary regulations exempt payments on such obligations from information reporting and backup withholding, but (except in the case of certain deposit obligations issued in accordance with the Eurobond exception) only if certain relatively stringent conditions (including a minimum denomination of $500,000) are met. Treas. Reg. § 35a.9999-5, Q & A 4, 5, 6.

the misstatement or omission.[26] Such Section 11 liability may be an unanticipated risk for foreign banks and dealers acting as underwriters of an SEC registered offering. While the antifraud provisions of the U.S. securities laws may be applied in certain circumstances by U.S. courts to unregistered Eurobond offerings, the plaintiff's burden of proof in an action under those provisions is substantially greater than under Section 11.[27]

Differences in syndication practices may also raise regulatory issues under SEC rules. Rule 10b-7 under the Securities and Exchange Act of 1934 permits stabilization by underwriters in fixed price offerings under certain conditions, but not in "at the market" offerings. In the Euromarket, underwriters and dealers typically are free to sell their allotments at any price, while the lead manager may make stabilization bids or purchases for the account of the syndicate. Such activities in connection with an SEC registered offering might be viewed as contrary to Rule 10b-7 unless the SEC were to interpret that rule as not applying to that part of the distribution that is made outside the United States.

It seems likely, therefore, that despite the significant changes made by the Tax Reform Act of 1984 and the accelerating movement toward integration of capital markets, U.S. corporations will continue to target issues specifically for foreign markets and that the Euromarket will for some time to come continue to grow and maintain a life of its own.

---

26. 15 U.S.C. § 77k(b)(3) (1982).

27. *See* Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 984-93 (2d Cir.), *cert. denied,* 423 U.S. 1018 (1975); IIT v. Cornfeld, 619 F.2d 909 (1980); Note, *American Adjudication of Transnational Securities Fraud,* 89 HARV. L. REV. 553 (1976).