

*Client Alert*

March 2005

**SEC Favors Coordinating Global Securities Markets Regulation  
But Will Not Compromise Investor Protections**

Since the Sarbanes-Oxley Act (“Sarbanes-Oxley”) was enacted in 2002, non-U.S. issuers, their representatives and regulators have raised concerns over the accounting, corporate governance and certification standards it requires, claiming the requirements create duplicative or even contradictory obligations for non-U.S. issuers with a presence in the U.S. securities markets.<sup>1</sup> Members of the U.S. Securities and Exchange Commission (“Commission” or “SEC”) and its staff (“Staff”) have been addressing these concerns for some time.<sup>2</sup> Recently, however, Alan L. Beller,<sup>3</sup> Director of the Commission’s Division of Corporation Finance and William H. Donaldson,<sup>4</sup> Chairman of the Commission, have responded publicly. This alert provides highlights of their public statements.

In separate conferences in London, Mr. Beller and Mr. Donaldson each assured non-U.S. issuers that the Commission remains sensitive to their concerns, particularly where regulatory duplication or contradiction exists or may arise, but these speeches also illustrate the strong Commission position, held both at the Commissioner and Staff level, that the Commission is “unwilling to compromise where investor protections are concerned.”<sup>5</sup>

Highlights from Mr. Beller’s and Mr. Donaldson’s public statements are provided below.

**Remarks of Alan Beller**

Mr. Beller discussed the challenges of global securities market regulation and the Commission’s response to date. He noted that he had never seen more active discussion of global coordination of securities market regulation than during the last two years and attributed the activity to:

- increasingly global securities markets,
- implementation of the requirements of Sarbanes-Oxley,
- obvious advantages in coordinating accounting, disclosure and corporate governance standards for issuers, investors and market regulators, and

- progress made by European Union (“EU”) regulators integrating markets and adopting common standards for accounting and disclosure.

In his remarks, Mr. Beller noted the following:

***The Commission’s Approach to Global Coordination of Securities Markets Regulation***

The Commission is committed to coordinating securities regulation on a global basis and to participating in the multilateral dialogue, but will stay true to its mission to:

- administer and enforce the federal securities laws in order to protect investors,
- maintain fair and efficient markets, and
- facilitate capital formation.

The Commission’s long-standing system of disclosure regulation applies similar requirements to U.S. and non-U.S. issuers, ensuring that investors have comparable information about all companies trading in the U.S. markets and maintaining a level playing field for all U.S. market participants. Further, the Commission has already made accommodations for non-U.S. issuers since the U.S. securities laws were enacted in the 1930s, including, for example:

- extending compliance periods for periodic disclosure requirements,
- establishing exemptions from proxy rules, short-swing profit regulations and transaction reporting obligations for the issuer’s insiders, and
- accepting certain disclosures filed by non-U.S. issuers according to their local requirements.

The Commission is currently considering cost-benefit and other concerns raised by non-U.S. issuers interested in participating, or already participating, in U.S. capital markets and agrees with its critics that common global and even cross-border systems of regulation can promote market efficiencies, where the systems are workable.

Multilateral relaxation of certain national restrictions may also be advisable as in, for example, the Commission’s proposal to relax restrictions on communications, especially written communications, for issuers engaged in the registration process and to substantially streamline the registration process for all issuers.

The Commission has in place a number of initiatives designed to encourage securities offerings and exchange listings in the U.S. by non-U.S. issuers.

### ***Sarbanes-Oxley Requirements***

The Commission has been attentive, flexible and sensitive to concerns of non-U.S. issuers in implementing Sarbanes-Oxley's internal control reporting requirements and has:

- accepted statutory auditors, boards of auditors and shareholder ratification of external auditor selection in lieu of the audit committees Sarbanes-Oxley proscribes,
- provided exemptions from requirements of financial reporting in accordance with U.S. Generally Accepted Accounting Principals ("U.S. GAAP") for communications made outside the U.S., even where those communications reach the U.S.,
- provided exemptions from the prohibition on loans to issuer insiders for non-U.S. banks, and
- provided extended periods for compliance.

As with other provisions of Sarbanes-Oxley, Mr. Beller emphasized that the benefits to investors and markets (e.g., by requiring CEO and CFO certifications) outweigh the costs of issuer compliance.

From the date Sarbanes-Oxley was enacted, non-U.S. issuers have re-thought plans to list, or have considered delisting, their securities in the U.S. markets in order to avoid costs associated with compliance with U.S. securities laws. As described below, while the Commission has proposed changes to its delisting and deregistration requirements, investor protection remains the Commission's primary concern.

### ***Amendments to U.S. Delisting and Deregistration Requirements***

Amendments to U.S. delisting and deregistration rules are currently published for public comment.<sup>6</sup>

Delisting and deregistration standards based on market access, without consideration of thresholds of ownership, raise significant investor protection concerns among members of the Commission and its Staff.

The Commission is considering how to respond to comments received to its proposed rules and is balancing its commitment to free and efficient markets, including mechanisms for issuers to move their securities into and out of markets, with its fundamental investor protection mission.

### ***Mutual Recognition***

The Commission has received comments from European issuers and corporate associations that the U.S. securities laws generally, and Sarbanes-Oxley especially, create unfair burdens for non-U.S. issuers who must incur additional costs of complying with U.S. financial disclosure, corporate governance and internal control reporting requirements, when they are otherwise regulated in their home markets.

Some comment letters proposed that the SEC adopt the principal of mutual recognition, as implemented by the EU, whereby a company that complies with one set of regulations, i.e., the regulations of its home jurisdiction, would be deemed in compliance with the regulations of another.

Mutual recognition is only feasible, in Mr. Beller's view, where equivalence or convergence of regulatory frameworks, legal systems, market structures, economic systems and regulatory philosophies exists.

Following the disclosure standards established by the International Organization of Securities Commissions ("IOSCO") in the 1990s, the SEC revised its disclosure requirements for non-U.S. issuers by amending its annual reporting forms to IOSCO standards.

A form of mutual recognition in respect of non-U.S. issuers has long been followed by the Commission. Historically, the SEC has required non-U.S. issuers to "comply or explain" to allow non-U.S. issuers to follow their local market standards but disclose material differences between local and U.S. market standards to investors in U.S. markets.

The Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board ("IASB") are developing International Financial Reporting Standards ("IFRS") based on convergence of accounting principles which should greatly benefit global markets and may lead the Commission to eliminate its current requirement to reconcile IFRS to U.S. GAAP.

The Commission expects the number of non-U.S. companies with securities registered in the U.S. who reconcile their financials according to IFRS to increase ten-fold this year as a result of IFRS implementation in the EU.

Ultimately, if current trends continue, non-U.S. issuers will not be required to reconcile their financial statements to U.S. GAAP, nor will U.S. issuers be required to reconcile their financial statements to IFRS.

Establishing high quality international accounting principles and auditing standards and requiring sound interpretive and enforcement mechanisms will be required to reach a point of reconciliation.

Overall, in Mr. Beller's view, issuers enter the U.S. – or any other – market when it makes commercial sense for them to do so and the regulatory issues involved should be viewed as hurdles, rather than as insurmountable obstacles.

### **Remarks of William Donaldson**

Mr. Donaldson also recognized the importance of regulatory coordination and cooperation among the world's securities regulators, but emphasized the positive impact of national regulation, and U.S. regulation, in particular, on the world's securities markets.

### ***On the Subject of Sarbanes-Oxley***

In the Chairman's view, in the aftermath of managerial fraud, accounting irregularities, and gross corporate malfeasance among prominent U.S. and non-U.S. issuers<sup>7</sup> resulting in widespread erosion of investor faith in securities markets, Sarbanes-Oxley and the Commission's implementing rules help to restore and reinforce investor confidence in the U.S. securities markets and lower the cost of capital to issuers participating in them.

The Chairman noted:

- Investors – regardless of nationality – demand honesty and integrity of the companies with whom they invest their capital.
- Nearly half of the world's equity securities, by market capitalization, trade in the United States.
- Maintaining deep and liquid securities markets reduces the costs of capital formation for all issuers in the U.S. securities markets; increases in compliance costs to individual issuers in the short term are marginal.
- Certification of internal managerial controls<sup>8</sup> can be viewed as a managerial opportunity, rather than a costly compliance exercise.
- Sarbanes-Oxley compliance requirements involve facts that investors should know about a company when making an investment decision. Management and directors of these companies should know – and be able to certify the accuracy of – those same facts.

- Listing and registration requirements in the U.S. signal that the issuer is committed to the highest standards and is willing to make the investment in managerial and accounting controls to meet those standards.

The Chairman nonetheless remained open to further evaluation of the rules and regulations implementing Sarbanes-Oxley and posed open questions to his audience at the LSE, including:

- Are the rules and regulations the Commission has written to implement Sarbanes-Oxley effective and appropriate?
- Have the rules been implemented in the right way?
- What are the relative costs and benefits of these rules?
- Are there certain situations in which the rules should not apply?
- Are there old rules that have been outmoded and are in need of revision?

***On the Subject of Global Coordination of Securities Markets Regulations***

The Chairman noted the Commission remains an active member of IOSCO and is anxious to listen to and learn from ideas advanced by other regulators. Though the Commission is unwilling to compromise investor protections, Mr. Donaldson confirmed the Commission's commitment to avoid duplicative or contradictory regulations that can compromise investor protections and noted:

- The Commission's cooperation with German regulators to implement final audit committee rules that provide an exemption for jurisdictions that allow employees who are not officers of the issuer to sit on audit committees;
- The Commission's exemption for non-U.S. GAAP communications outside the U.S., even when those communications reach the U.S., in order to avoid interference with the communications of non-U.S. issuers to non-U.S. markets;
- The Commission's work with the Public Company Accounting Oversight Board ("PCAOB") to resolve potential conflicts with non-U.S. privacy laws and blocking statutes arising in the process of registration of non-U.S. accounting firms who provide audit services for issuers listed in the U.S.; and
- His request of the Staff to consider delaying the effective date for internal control on financial reporting requirements for non-U.S. issuers.

Overall, Mr. Donaldson warned that capital will flee markets that are unstable or unpredictable whether as a result of lax corporate governance standards, ineffective accounting standards, lack of transparency or weak enforcement regimes. The Commission will continue to monitor its progress in effective securities market regulation and is prepared to engage in dialogue to address regulatory concerns.

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Should you have any questions or wish us to comment on your behalf concerning any of the proposed amendments mentioned here, please contact Herman Raspé at (212) 336-2301 (hhraspe@pbwt.com), Karen McCarthy at (212) 336-2529 (kmmccarthy@pbwt.com), or Karen Hartman at (212) 336-2787 (kmhartman@pbwt.com).

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### Endnotes:

- <sup>1</sup> See, for example, remarks of Charlie McGreevey, Commissioner for the Internal Market for the European Commission (“EC”), at a recent seminar in Frankfurt, Germany, calling for (i) greater cooperation between regulators of financial markets to avoid regulatory conflicts and inefficiencies, (ii) abolition of costly requirements to publish financial reports according to two sets of accounting standards (i.e., IFRS and U.S. GAAP, each as defined below), and (iii) mutually acceptable procedures for delisting from U.S. exchanges and deregistration with the Commission on behalf of issuers active in or considering entering both the U.S. and European securities markets. Mr. McGreevey also noted that Sarbanes-Oxley was drafted without any external international consultation.
- <sup>2</sup> See, for example, the Commission’s proposed changes to the delisting and deregistration rules, as applied to foreign private issuers, described in our *Client Alert* of July 2004.
- <sup>3</sup> Alan L. Beller, Director of the Commission’s Division of Corporation Finance, speaking at the Practising Law Institute’s Fourth Annual Institute on Securities Regulation in Europe, in London, England on December 6, 2004.
- <sup>4</sup> William H. Donaldson, Chairman of the Commission, speaking at the London School of Economics (the “LSE”) in London, England, on January 25, 2005.
- <sup>5</sup> From Mr. Donaldson’s remarks to the LSE.
- <sup>6</sup> Please refer to our *Client Alert* of July 2004 for further discussion.
- <sup>7</sup> Among the corporations Mr. Donaldson named were Enron, WorldCom, Adelphia, HealthSouth, Tyco, Global Crossing and Cedant in the U.S. and Parmalat, Vivendi, Hollinger, Ahold, Adecco, TV Azteca, Royal Dutch Shell, Seibu and China Aviation outside the U.S.
- <sup>8</sup> Under Section 404 of Sarbanes-Oxley.

