

BEYOND BORDERS PART II: A NEW APPROACH TO THE REGULATION OF GLOBAL SECURITIES OFFERINGS

BY

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I. INTRODUCTION

Expanding on a concept proposed in a provocative article authored by Ethiopis Tafara and Robert Peterson earlier this year,¹ Erik Sirri, Director of the Division of Market Regulation of the U.S. Securities and Exchange Commission (the “SEC”), recently gave a speech in which he addressed the “increasing pace of cross-border securities transactions.”² In particular, Mr. Sirri noted that “[m]ore companies are raising capital beyond their geographic boundaries. U.S. investors are allocating their capital in foreign securities markets at a higher rate, and our securities markets have attracted an increasing share of foreign investments. It is important that our regulatory system not only continue to keep pace, but also facilitate the benefits of a global market place.”³ While Mr. Sirri’s remarks were focused primarily on the possibility of achieving a cooperative approach with respect to easing cross-border access by broker-dealers and securities exchanges, which was the focus of the Tafara and Peterson article, his words are equally applicable with respect to the cross-border regulation of securities offerings.

Although the United States has indeed been successful in attracting foreign investment, and foreign issuers continue to offer their securities to U.S. investors and list on U.S. exchanges, there are signs that the United States is losing ground to other securities markets.⁴ Moreover,

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¹ Ethiopis Tafara & Robert Peterson, *A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARVARD INT’L L. J. 31 (Winter 2007). This article expands upon a concept I first proposed in *Beyond Borders: Time To Tear Down the Barriers to Global Investing*, 48 HARVARD INT’L L. J. 85 (Winter 2007) (“*Beyond Borders I*”), which was written in response to Tafara and Peterson’s article.

² Erik R. Sirri, Director, SEC Div. of Market Reg., Trading Foreign Shares (Mar. 1, 2007), <http://www.sec.gov/news/speech/2007/spch030107ers.htm>.

³ Sirri, *supra* note 2. See also *Appetite for Foreign Equities Breaks Records*, FIN. TIMES at 1 (Oct. 11, 2006). Even excluding mutual fund holdings, the total holdings of U.S. equity securities by non-U.S. investors has increased from approximately \$550 billion in 1995 to approximately \$2.3 trillion in 2005; in the same period, the total holdings of non-U.S. equity securities (including ADRs) by U.S. investors increased from approximately \$790 billion to approximately \$3.0 trillion. See BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, FLOW OF FUNDS ACCOUNTS OF THE UNITED STATES, ANNUAL FLOWS AND OUTSTANDINGS: 1995–2005, at 82 tbl. L.213 (corporate equities (1)) (Dec. 7, 2006), <http://www.federalreserve.gov/releases/z1/Current/annuals/a1995-2006.pdf>.

⁴ See, e.g., Henry M. Paulson, Treasury Secretary, Remarks on the Competitiveness of the US Capital Markets at the Economic Club of New York (Nov. 20, 2006); THE COMMITTEE ON CAPITAL MARKETS REGULATION, INTERIM REPORT (Nov. 30, 2006), http://www.capmksreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf; SUSTAINING NEW YORK’S AND THE US’ GLOBAL FINANCIAL SERVICES LEADERSHIP (New York City Mayor Michael

access to U.S. markets comes with a heavy price – not only to foreign issuers seeking to raise capital here (which may, either willingly or inadvertently, find themselves subject to costly and potentially redundant U.S. disclosure and reporting requirements), but also to U.S. investors seeking exposure to foreign securities, which ultimately bear the burden of increased transaction costs.⁵ Since investing in non-domestic markets is no longer the exclusive province of mega-institutions or the ultra wealthy and, indeed, is an essential component of prudent portfolio diversification for all investors, this burden falls even more heavily on retail investors, who are not typically able to participate in private placements or offshore offerings by foreign issuers.⁶

U.S. regulators should seek to encourage foreign issuers to publicly offer their securities in the United States so that U.S. investors, including retail investors may achieve adequate portfolio diversification without expenditure by both such issuers and investors of excessive and unnecessary transaction and other costs. As a practical matter, however, this is only likely to be achieved through the adoption of a mutual recognition framework that would permit non-U.S. issuers subject to comparable offering regulations in their home jurisdictions (or the jurisdictions in which their securities are already listed) to publicly offer their securities to U.S. investors without compliance with the securities registration requirements of the Securities Act or the periodic disclosure requirements of the Exchange Act and, similarly, would permit U.S. issuers subject to the registration requirements of the Securities Act to publicly offer their securities to non-U.S. investors without compliance with the securities registration requirements of the local jurisdiction.

II. Global Warming is a Problem—Warming Up to the Reality of a Global Marketplace Should Not Be

The United States primarily follows a national treatment model for securities regulation; that is, in the interests of protecting U.S. investors, the United States generally applies a uniform standard to each of those who participate in the U.S. securities markets, including issuers, broker-dealers and exchanges (collectively, “market participants”), regardless of residency or jurisdiction of incorporation.⁷ A national treatment model subjects (with certain very limited

Bloomberg & Senator Charles Schumer, sponsors) (Jan. 2007), http://www.nyc.gov/html/om/pdf/ny_report_final.pdf [hereinafter BLOOMBERG-SCHUMER REPORT]; COMMISSION ON THE REGULATION OF U.S. CAPITAL MARKETS IN THE 21ST CENTURY, U.S. CHAMBER OF COMMERCE, REPORT AND RECOMMENDATIONS (Mar. 2007), <http://www.uschamber.com/publications/reports/0703capmarketscomm>.

⁵ See, e.g., Tafara & Peterson, *supra* note 1, at 38 (identifying factors constraining U.S. investor access to foreign investment opportunities).

⁶ See, e.g., Catherine L. Mann and Ellen E. Meade, *Home Bias, Transaction Costs, and Prospects for the Euro: A More Detailed Analysis*, (Institute for International Economics Working Paper 02-3, June 2002), <http://www.iie.com/publications/wp/02-3.pdf> (finding that transaction costs have a significant influence on U.S. portfolio holdings).

⁷ For example, the definitions of “issuer” under both § 2(a)(4) of the Securities Act of 1933, as amended (the “Securities Act”) and § 3(a)(8) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) generally include any person who issues or proposes to issue any security and do not refer to the jurisdiction of organization of such person. See Securities Act § 2(a)(4), 15 U.S.C. § 77b(a)(4); Exchange Act § 3(a)(8), 15 U.S.C. § 78c(a)(8). The term “national treatment” originated in the context of trade negotiations, where countries generally seek to have their exports treated the same as the products made in the importing country. For further discussion of the national treatment approach in U.S. securities regulation, see Edward F. Greene *et al.*, *Concepts of Regulation - The US*

exceptions) foreign market participants to the same regulatory requirements as domestic market participants, even if the foreign market participants are subject to a similar or comparable regulatory regime in their home jurisdiction.⁸ Accordingly, foreign market participants that wish to access the domestic market are often subject to duplicative, overlapping and sometimes contradictory obligations. To the extent these additional obligations deter or limit participation by foreign market participants in domestic markets, they also create obstacles to investments in foreign issuers by domestic investors who must either go to the foreign market directly (if possible) or access that market through a domestic intermediary (which itself may need to use a foreign intermediary to access the foreign market). While the SEC clearly has a mandate to protect investors, it also has a responsibility to facilitate capital formation and maintain fair, orderly and efficient markets, and it should do so in a manner that does not create unnecessary barriers to market participation and competition.

A regulator following a national treatment model can, in general, address duplicative, overlapping or contradictory regulations using two basic approaches: through concessions or by harmonization. A regulator following a global model has a third, and I believe more far-sighted and more promising, option: mutual recognition.

A. *Concessions*

Concessions address differences in regulation by exempting the foreign market participant from certain select domestic requirements or by applying different domestic requirements to the foreign market participants. The burdens imposed on foreign private issuers under the U.S. Sarbanes-Oxley Act, a classic example of national treatment, have been reduced by some minor concessions granted after vigorous protest by foreign issuers subject to regulation in the United States.⁹ The SEC has also granted limited concessions to foreign private issuers in certain other situations. For example, foreign companies are, as a general matter, exempt from the U.S. proxy

Model, THE FUTURE FOR THE GLOBAL SECURITIES MARKET: LEGAL AND REGULATORY ASPECTS (Fidelis Oditah, ed., Oxford University Press 1996).

⁸ Throughout this article, “foreign” and “domestic” are used in a neutral manner (*i.e.*, not necessarily from the perspective of the United States). Here, “foreign” and “domestic” are from the perspective of the regulator following a national treatment model. For a regulator in the European Union (or “E.U.”) applying a national treatment model, the United States would be “foreign” and the European Union would be “domestic.”

⁹ Under U.S. securities laws, a “foreign private issuer” is generally a non-U.S. issuer other than a non-U.S. government so long as the majority of its outstanding voting securities are not held directly or indirectly of record by residents of the United States and the issuer does not have certain other substantial U.S. connections. *See* Rule 3b-4 under the Exchange Act. A foreign private issuer can become subject to the periodic reporting requirements of the Exchange Act both by issuing securities directly into the United States and, unless otherwise exempt, by issuing securities in respect of which ADRs are issued. Concessions to foreign private issuers under the Sarbanes-Oxley Act include an exemption, in certain circumstances, from the requirements of Regulation G, 17 C.F.R. §§ 244.100-244.102, regarding disclosure of non-GAAP financial measures. These issuers were also given additional time to meet: (i) the requirements for management certification of periodic reports promulgated under § 302 of the Sarbanes-Oxley Act, 15 U.S.C. § 7242; (ii) the requirements for attestations regarding internal controls over financial reporting under § 404 of the Sarbanes-Oxley Act, 15 U.S.C. § 7262; and (iii) the requirements regarding an independent audit committee set out in Rule 10A-3 under the Exchange Act, 17 C.F.R. § 240.10A-3.

rules,¹⁰ requirements regarding quarterly reporting,¹¹ reporting requirements regarding transactions by statutory insiders pursuant to Section 16 of the Exchange Act,¹² and requirements regarding disclosure of the compensation of individual officers and directors.¹³ In addition, these issuers are permitted to report in the United States using financial statements prepared in accordance with local accounting standards instead of U.S. Generally Accepted Accounting Principles (“GAAP”).¹⁴ This last concession, however, is of limited value to foreign private issuers because the local financial statements must be audited under U.S. auditing standards, by auditors satisfying U.S. independence standards and, most importantly, must be reconciled to U.S. GAAP.¹⁵ Solving regulatory differences through selective concessions represents an *ad hoc* approach to regulation that is certainly less than ideal.

B. *Harmonization*

Harmonization, on the other hand, addresses duplicative or overlapping regulations by making them identical or, at the very least, consistent. As a result, although the market participant may still be subject to multiple regulatory schemes, the duplicative regulation should not be unduly burdensome because the requirements, if not identical, are at least not inconsistent with each other (of course, there may still be additional monetary cost in terms of duplicative filing fees, as well as other costs that arise from differences in interpretation and application of the agreed requirements). As will be discussed in more detail, the United States and the European Union have made considerable progress towards harmonization with respect to several aspects of their disclosure requirements, but continue to diverge in other ways, such as the regulatory structure of securities offerings, insider trading provisions and regulatory enforcement.

Complete harmonization, though a laudatory goal, has been elusive. In part, the difficulty in achieving harmonization is a result of the sheer number of elements in any regulatory scheme, each of which must be the subject of discussion, compromise and consensus between those

¹⁰ See Rule 3a12-3(b) under the Exchange Act, 17 C.F.R. § 240.3a12-3(b). However, foreign private issuers with securities listed on a national securities exchange thereby become subject to certain proxy requirements. For example, pursuant to Rule 402.04 of the NYSE LISTED COMPANY MANUAL, “actively operating companies” are required to solicit proxies for all meetings of shareholders, although an exception may be made where applicable law precludes or makes virtually impossible the solicitation of proxies in the United States.

¹¹ See Rule 13a-10(g) under the Exchange Act, 17 C.F.R. § 240.13a-10(g).

¹² See Rule 3a12-3(b) under the Exchange Act, 17 C.F.R. § 240.3a12-3(b). Foreign insiders of U.S. issuers, however, are not exempt, so that shareholders, including foreign corporations, are subject to § 16, 15 U.S.C. § 78p, with respect to the applicable equity securities of U.S. issuers that they own.

¹³ See Form 20-F Item 6.B.1 under the Exchange Act, 17 C.F.R. § 249.220f, <http://www.sec.gov/about/forms/form20-f.pdf>.

¹⁴ See *id.* Item 17.C.

¹⁵ In addition to these concessions, Exchange Act Rule 12g3-2(b), 17 C.F.R. § 240.12g3-2(b), provides an exemption from the normal U.S. periodic disclosure requirements for eligible foreign issuers not listed in the United States that furnish to the SEC their home country disclosures and meet certain other requirements. See EDWARD F. GREENE ET AL., U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES MARKETS, § 3.02 (Eighth Edition, 2006).

responsible for the two regulatory schemes. In perhaps greater part, the difficulty in achieving harmonization may arise from the fact that there are often multiple reasonable approaches that regulators could take to address the same basic objectives, or multiple reasonable balances that regulators could strike among the same basic objectives, and it may not be obvious which course is superior. Where two regulatory schemes implement different and incompatible, but nonetheless equally reasonable, solutions to the same problem, harmonization would require a concession or compromise by one or both of the regulators with no obvious way to determine what concession or compromise should be chosen.

Moreover, the existence of different reasonable ways to address the same issue makes harmonization between national regulations a naturally unstable state of affairs. For instance, even if complete harmonization between U.S. and E.U. disclosure regulations had been achieved before the collapses of Enron and WorldCom, the divergent views of the United States and the European Union regarding the best way to address the issues raised by their collapses may have resulted in divergent responses—as they in fact did with the passage of the Sarbanes-Oxley Act in the United States. The hypothetical complete harmonization would disappear at that point unless the two jurisdictions had a commitment to harmonization sufficient to keep them together – and any such strong commitment would raise its own problems by impairing the ability of each jurisdiction to react to crises and preventing each of the jurisdictions from acting on its own best judgment of how to achieve the basic goals of its regulatory scheme.

C. *Mutual Recognition*

Mutual recognition (or “substituted compliance”), a third approach to addressing differences in regulation, begins by recognizing the existence of different reasonable approaches to achieving the same basic goals underlying a regulatory scheme.¹⁶ Although some degree of regulatory harmonization may be an element of a mutual recognition framework, complete harmonization is neither anticipated nor strived for. Where a domestic regulator determines that a foreign jurisdiction provides comparable regulation of certain market participants, reasonably sufficient to protect domestic investors, there is no need for the domestic regulator to impose additional requirements or insist that such foreign market participants comply with the domestic regulatory scheme in order to access domestic markets. Instead, the domestic regulator permits the foreign market participant to comply with the comparable foreign regulatory scheme rather than the domestic regulatory scheme. Although the unilateral recognition of a foreign regulatory scheme is possible,¹⁷ regulators should nonetheless strive for mutual recognition in order to eliminate

¹⁶ For additional discussions of the mutual recognition approach, see Tafara & Peterson, *supra* note 1, at 5; Greene, *Beyond Borders I*, *supra* note 1; Edward F. Greene, *Resolving Regulatory Conflicts between the Capital Markets of the United States and Europe*, 2 CAPITAL MARKETS L. J. 5 (Winter 2007); Roel C. Campos, Comm’r, SEC, SEC Regulation Outside the United States (Mar. 8, 2007), <http://www.sec.gov/news/speech/2007/spch030807rcc.htm>.

¹⁷ “Unilateral recognition” refers to a situation in which, e.g., a U.S. regulator permits a market participant located in a non-U.S. jurisdiction to access the U.S. market based on compliance with a comparable regulatory scheme established by the non-U.S. market participant’s home country regulator (and without the additional need to comply with U.S. regulatory requirements), without conditioning such access on reciprocal recognition by the home country regulator of the adequacy of the U.S. regulatory scheme and obtaining acknowledgment from the home country regulator that a U.S. market participant may access the non-U.S. market without the additional need to comply with the non-U.S. jurisdiction’s regulatory scheme. This is the approach taken by the U.S. Commodity

unnecessarily duplicative regulation of domestic market participants and to create a level playing field for all market participants.¹⁸ In addition to a compatibility determination, mutual recognition will likely also require a comprehensive memorandum of understanding (or “MOU”) between the regulators regarding information sharing and the allocation of enforcement responsibilities.

Mutual recognition has a number of important advantages over the alternative approaches:

- Mutual recognition is readily achievable. As discussed above, complete harmonization, while academically appealing, is simply neither realistic, nor—given inevitable differences in application, enforcement and response to crises—is it likely achievable.¹⁹ Mutual recognition is inherently a more flexible approach and (as further discussed below) encourages market innovation and competition, and is thus a more realizable goal.
- Mutual recognition preserves each jurisdiction’s ability to respond independently and rapidly to perceived crises. If, for example, the United States and the European Union had been operating under a mutual recognition approach at the time of the Enron and WorldCom collapses, the United States could still have unilaterally imposed the Sarbanes-Oxley requirements on domestic issuers without impeding the continued mutual recognition of the E.U. disclosure regime or imposing additional burdens on foreign issuers subject to such regime.
- Mutual recognition enables a regulatory race to optimality. By preserving the ability of the different jurisdictions to adopt divergent regulatory schemes to address common basic principles and goals, mutual recognition enables healthy regulatory competition. Issuers will gravitate toward markets that have the lowest cost of capital (after taking into account the costs of compliance with the regulatory scheme). Investors will gravitate

Futures Trading Commission (the “CFTC”) in its “Part 30 Rules.” Under those rules, the CFTC may grant a non-U.S. firm an exemption from compliance with certain of the CFTC’s requirements, including registration, when a comparable regulatory system exists in that firm’s home country and certain safeguards are in place to protect U.S. investors. *See* 17 C.F.R. Part 30. This permits certain non-U.S. firms acting in the capacity of futures commission merchants or introducing brokers to accept and to execute non-U.S. futures and options orders directly from certain U.S. customers without having to register with the CFTC. Although “in considering an exemption request, the Commission will take into account the extent to which United States persons or contracts regulated by the Commission are permitted to engage in futures-related activities or be offered in the country from which an exemption is sought,” (17 C.F.R. Part 30 App. A), such permission by the foreign regulator is not a requirement for recognition by the CFTC of the foreign regulatory scheme.

¹⁸ Moreover, a failure by the foreign regulator to reciprocate by recognizing the comparability of the domestic regulatory scheme may call into question the initial determination that the foreign regulatory scheme was comparable to the domestic regulatory scheme by indicating a difference of views regarding the basic objectives of the relevant regulatory scheme or what constitutes a reasonable approach to achieving them.

¹⁹ *See* Ethiopis Tafara, Director, SEC Office of Int’l Affairs, The SEC’s Experience in the Development of an Integrated Securities Market in the United States, presented at the 2nd Annual European Financial Services Conference (Jan. 27, 2004), <http://www.sec.gov/news/speech/spch012704et.htm> (It “may not always be feasible to harmonize or converge [regulatory] differences away, or pretend that vastly different policy choices somehow produce equivalent regulation. Nonetheless, we should, where possible, work to minimize conflicts between them.”).

toward intermediaries that provide the best balance of investor protection and efficiency and toward markets that provide the best balance between returns on investment (after the costs of regulatory compliance) and investor protection. The result should be a competition based on efficiently providing an optimum level of investor protection.²⁰ In any event, a fear that such regulatory competition will instead lead to a “race to the bottom” appears unfounded since, as a condition for mutual recognition, each jurisdiction must provide regulation of its market participants comparable to that provided in the other jurisdictions and reasonably sufficient to protect investors in the other jurisdictions.²¹

In a recent article, I discussed the process by which a regulator would determine the comparability of a foreign regulatory scheme for purposes of mutual recognition.²² In summary, the regulator should begin by identifying the fundamental principles and objectives underlying its own rules that must be embraced by the foreign regulator before compliance with the foreign regulatory scheme would provide a basis for an exemption from the domestic regulatory scheme. Once those fundamental principles and objectives are identified, the regulator should determine whether the foreign regulatory scheme embodies the identified principles and whether the foreign regulatory scheme has robust supervision and enforcement mechanisms.²³ If the foreign regulatory scheme has robust supervision and enforcement mechanisms and implements the identified fundamental principles and objectives, the foreign regulatory scheme is comparable and a candidate for mutual recognition—even if it differs in the specific details of the implementation of the principles or their enforcement.²⁴

III. APPLICATION OF THE MUTUAL RECOGNITION APPROACH TO SECURITIES OFFERINGS

Before examining any other jurisdiction’s securities offering regime, the SEC must first look inward, towards its own regulatory scheme and identify the fundamental principles and objectives underlying its own requirements that must be embraced by the non-U.S. regulator before determining whether substituted compliance with the non-U.S. regulatory regime will be acceptable. Fortunately, these are fairly easy to identify. The securities registration and prospectus access provisions of the Securities Act and the periodic reporting provisions of the Exchange Act are fundamentally intended to ensure that investors have the information they

²⁰ See Tafara & Peterson, *supra* note 1, at 67 (describing a “regulatory ‘race towards optimality,’ where investor protection, market transparency and efficiency, and efficient capital formation are strengthened around the world”).

²¹ See Tafara & Peterson, *supra* note 1, at 52 (“healthy regulatory competition exists when different regulators share the same overarching regulatory objectives, but, in implementing comparable regimes, compete with each other to develop the most effective and least costly ways to achieve these goals.”); see also Sirri, *supra* note 2.

²² Greene, *Beyond Borders I*, *supra* note 1.

²³ See *id.* at 90-91. It may also be necessary to periodically review this assessment to ensure continued comparability.

²⁴ Requiring correspondence between the details of the implementation of the regulatory schemes is the path of harmonization, with all the problems that entails.

need to make informed investment decisions in primary offerings and in secondary market transactions.²⁵

The next step in the mutual recognition analysis requires the SEC to look outwards, toward the securities offering regime of the relevant non-U.S. jurisdiction to determine whether that regulatory scheme shares the fundamental principles and objectives underlying the U.S. regime. Consider for example the European Union's securities offering regime. The fundamental goals of the E.U. Prospectus Directive and the E.U. Transparency Directive include providing to investors all accurate, comprehensive and timely information necessary to enable them to make an informed assessment of the rights attaching to a security and the business performance and assets of its issuer.²⁶ It seems clear that the E.U. regulatory regime shares the same basic fundamental principles and objectives of the U.S. regime.

Finally, the SEC must look at the relevant non-U.S. jurisdiction's regulatory scheme to determine whether it is a reasonable embodiment of the fundamental principles and objectives and whether it provides for robust supervision and enforcement. A close look at the U.S. and E.U. securities offering regimes will reveal that they are both reasonable implementations of the basic principles and objectives. Indeed, they are a long way down the road to equivalence:²⁷

- Both regulatory regimes require the disclosure of audited financial statements. Pursuant to a "roadmap" laid out in 2005, U.S. and E.U. regulators have been working towards achieving before the beginning of 2009 a harmonization of U.S. GAAP and the European Union's International Financial Reporting Standards ("IFRS") that would result in the U.S. regulators permitting the use of E.U. IFRS without reconciliation to U.S. GAAP and the E.U. regulators' continued acceptance of U.S. GAAP without reconciliation to E.U. IFRS, with an ultimate goal of a single global accounting standard.²⁸ Roadmap discussions have also been initiated between the U.S. Public

²⁵ See Securities Offering Reform, SEC Release No. 33-8591, 70 Fed. Reg. 44722, 44788 (July 19, 2005); SEC, HOW THE SEC PROTECTS INVESTORS, MAINTAINS MARKET INTEGRITY, AND FACILITATES CAPITAL FORMATION (Nov. 9, 2006), <http://www.sec.gov/about/whatwedo.shtml>:

The laws and rules that govern the securities industry in the United States derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it. To achieve this, the SEC requires public companies to disclose meaningful financial and other information to the public. This provides a common pool of knowledge for all investors to use to judge for themselves whether to buy, sell, or hold a particular security. Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions.

²⁶ See Council Directive 2004/109/EC, 2004 O.J. recitals 1-2 (L 390) 38 (Dec. 17, 2004) (E.U.) (amending Transparency Directive, Directive 2001/34/EC, 2001 O.J. (L184) 1, 15 (EC)); Prospectus Directive, Directive 2003/71/EC, 2003 O.J. (L345) 64 (EC).

²⁷ For an in-depth discussion of the correspondence between the two disclosure regulatory schemes, see Greene, *Resolving Regulatory Conflicts*, *supra* note 16.

²⁸ See Donald T. Nicolaisen, *A Securities Regulator Looks at Convergence*, NW U. J. INT'L L. AND BUS. (Apr. 2005); Christopher Cox, Chairman, SEC, Address to the SEC Roundtable on International Financial Reporting Standards (Mar. 6, 2007), <http://www.sec.gov/news/speech/spch040605dtm.htm>.

Company Accounting Oversight Board (“PCAOB”) and the Committee of European Securities Regulators (“CESR”) regarding the equivalence of U.S. and E.U. auditor oversight.²⁹

- Both the United States and the European Union have adopted the ten core areas of non-financial disclosure from the standards for equity securities disclosure published by the International Organization of Securities Commissions (“IOSCO”).³⁰

The United States and European Union also provide for supervision and enforcement of the disclosure requirements for public offerings, although they have adopted somewhat different approaches in this regard.³¹ The SEC has been moving towards a system of continuous, integrated disclosure in which issuers can meet their disclosure obligations in respect of an offering of securities under the Securities Act with the same filings they use to satisfy their periodic disclosure requirements under the Exchange Act as public companies, so that there are fewer hurdles to market access for established issuers. Certain large issuers, so-called “well-known seasoned issuers” (or “WKSIs”), are even permitted to have instant market access, without prior review or approval of their offering documents by the SEC.³² For these issuers the SEC will instead focus its attention on their continuous periodic disclosure to the marketplace.

In the European Union, however, the Prospectus Directive contemplates that the disclosures for all public offerings will be subject to review, with only a limited version of shelf registration. Except in the case of certain debt issuance programs, for which a “base prospectus” can be used together with the final terms of the securities being offered, a prospectus must comprise three sections: the summary, the registration document, which is the general description of an issuer and its business, and the securities note, which is the description of the terms of the offered securities.³³ Once approved by a regulator, a registration document can be used more than once during the period of 12 months for which it is valid.³⁴ Still, the summary and securities note must be separately approved for all public offerings (although certain debt offerings qualify for a

²⁹ See Charlie McCreedy, European Comm’r for Internal Market and Services, Building the Transatlantic Marketplace, Remarks at the Heyman Center on Corporate Governance (Mar. 7, 2007), <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/131>.

³⁰ See Greene, *Resolving Regulatory Conflicts*, *supra* note 16, at 15-16.

³¹ See *id.* at 28-29.

³² Securities Offering Reform, SEC Release No. 33-8591, 70 Fed. Reg. 44722 (July 19, 2005). A “WKSI” is defined, generally, as an issuer that: (i) is required to file reports under the Exchange Act, (ii) is current, and has for the preceding 12 months been timely, in filing those reports, (iii) is eligible to use Form S-3 or F-3, (iv) either (1) has a worldwide market value of its outstanding voting and non-voting common equity held by non-affiliates of \$700 million or (2) has issued at least \$1 billion aggregate principal amount of registered non-convertible securities (other than common equity) in primary offerings for cash in the last three years, and (v) is not otherwise ineligible under specified tests. The SEC estimates that in 2004, WKSIs represented only 30% of all listed issuers, but accounted for about 95% of the total U.S. market capitalization and 96% of the total debt raised by issuers on major exchanges or equity markets over the last eight years. *Id.* at 70 Fed. Reg. 44727.

³³ See E.U. Prospectus Directive, *supra* note 26, Art. 9.3.

³⁴ See *id.* Art. 9.1.

reduced level of disclosure), which means that even large, well-followed companies may face some level of review by a regulator before being able to offer securities to the public.³⁵

These differences in the supervisory process should not, however, impede mutual recognition—they both represent reasonable approaches to the review of comparable disclosure documents that are intended to provide investors with the information they need to make an informed assessment of the issuer and its securities. Each may have its advantages and disadvantages and, once mutual recognition eliminates the barriers that impede competition between the different approaches, the market itself may be able to judge whether one is more efficient than the other in achieving its goal.

Given their comparable approaches to securities offering regulation (albeit different approaches with respect to, among other things, review of required disclosure) the SEC and E.U. regulators should move with all due speed toward mutual recognition of each other's respective regimes.

One potential speed-bump on the road to mutual recognition is that, unlike the United States which has a single securities regulator at the federal level, the European Union does not have a unified securities regulator. Instead, enforcement and supervisory authority under the E.U. securities offering regime is divided among the individual members. For example, under the E.U. Prospectus Directive, each E.U. member designates a single supervisory authority to review and approve offering documents for securities of issuers whose registered office is located in that member's jurisdiction.³⁶ The various securities regulators charged with these responsibilities differ widely in powers, methodologies and degrees of sophistication,³⁷ which may render it difficult for the SEC to adequately assess whether the European Union, as a whole, provides for robust supervision and enforcement of the E.U. securities offering regime. Accordingly, it may not be possible to apply a mutual recognition approach to the European Union across the board at the present time. Instead, the SEC may need to examine each E.U. member on an individual basis to determine whether it provides for robust regulatory supervision and enforcement, which could raise sensitive political issues that could be an impediment to full mutual recognition.³⁸ Nonetheless, although a unified E.U. securities regulator would likely speed the process and reduce thorny political issues, the SEC and E.U. securities regulators should have the political courage to proceed down the path toward mutual recognition with regard to securities offering regulation, even if limited at the outset to certain selected E.U. members.³⁹

³⁵ See *id.* Art. 9.4.

³⁶ See *id.* Recital 37 & Art. 13.

³⁷ See Pierre-Marie Boury, *Does the European Union Need a Securities and Exchange Commission?*, 1 CAPITAL MARKETS L. J. 184, 186 (Nov. 2006).

³⁸ See Greene, *Resolving Regulatory Conflicts*, *supra* note 16, at 8 (identifying the sensitive political issues raised by the subjective evaluation of alternative regulatory regimes as one reason that the SEC did not pursue unilateral recognition of broker-dealer regulation in the 1990s).

³⁹ In this regard, the SEC could begin, for example, with those E.U. members with which it has already executed comprehensive information sharing and cooperation agreements (commonly referred to as "Memoranda of Understanding"). As of February 6, 2006, such jurisdictions include France, Germany, Italy, The Netherlands, Portugal, Spain, Sweden, and the United Kingdom. See http://www.sec.gov/about/offices/oia/oia_bilateral.htm.

As a first step, I would advocate the development of a pilot program under which issuers meeting certain minimum size and other requirements are able to effect public offerings in either the United States or the selected European Union jurisdictions using the registration, disclosure and accounting standards mandated by their home country. Under this pilot program, such issuers would not become subject to the registration and ongoing disclosure, governance and related requirements of other countries into which they offer their securities (“host countries”) – *e.g.*, an E.U. issuer would not, by virtue of offering its securities publicly in the United States, become subject to the Sarbanes-Oxley Act requirement for management certification of periodic disclosure and internal controls,⁴⁰ and could comply with IFRS rather than U.S. GAAP accounting requirements. Participation in the pilot program could initially be limited to issuers meeting certain criteria agreed between the U.S. and E.U. regulators regarding size and reporting history designed to assure that they have a wide following in the marketplace and are subject to scrutiny by investors, the financial press, analysts, and others who evaluate disclosure when it is made.⁴¹

A pilot program would bring significant benefits to U.S. and E.U. investors, in the form of enhanced access to securities issued by the largest foreign issuers, and corresponding benefits to the largest U.S. and E.U. issuers, in the form of enhanced access to capital from foreign investors. Mutual recognition by the U.S. and E.U. of each other’s securities offering process would substantially reduce unnecessary expenditures resulting from the preparation of accounting reconciliations, multiple prospectuses and duplicative periodic disclosure documents, thus reducing the overall cost of raising capital. It would also provide the SEC and the E.U. securities regulators with practical experience in working out the details necessary to enable the mutual recognition program, such as information sharing, cooperation regarding enforcement and allocation of enforcement responsibilities, consents to jurisdiction, the delivery of the foreign disclosure documents and the specification of the additional disclosures that would enable investors to clearly identify the disclosure regime to which each issuer is subject and the differences between the disclosure regimes.⁴² Assuming the pilot is successful, the approach

⁴⁰ Sarbanes-Oxley Act §§ 302 & 404, 15 U.S.C. § 7266 (2002). It is worth noting that recently both the SEC and the PCAOB have proposed measures designed to reduce the burden of compliance with § 404 of the Sarbanes-Oxley Act. *See* Management’s Report On Internal Control Over Financial Reporting, SEC Release 33-8762 (Dec. 20, 2006) and the PCAOB’s Proposed Auditing Standard—An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements, Proposed Auditing Standard—Considering and Using the Work of Others and Proposed Rule 3525—Audit Committee Pre-approval of Services Related to Internal Control (Dec. 19, 2006).

⁴¹ *Cf.* Securities Offering Reform, SEC Release No. 33-8591, 70 Fed. Reg. 44722, 44726-30 (July 19, 2005) (discussing the definition of “well-known seasoned issuer”).

⁴² The SEC may require some assurance that this disclosure is available to U.S. investors as a practical matter; however, the European Union continues to work toward a system such as the SEC’s EDGAR to provide uniform, easily available disclosure. In its June 2006 Technical Advice, CESR recommended a networked approach in which each jurisdiction would be responsible for establishing its own electronic mechanism, subject to minimum standards on a variety of matters, including interoperability, 24-hour accessibility and the use of a language commonly used in international finance, along with the local language. Whether the mechanisms will be public or private remains a political issue. CESR, CESR’s Final Technical Advice On Possible Implementing Measures Concerning The Transparency Directive: Storage Of Regulated Information And Filing Of Regulated Information, CESR/06-292 (June 2006), http://www.cesr-eu.org/data/document/06_292.pdf. As a practical matter, the SEC will also likely need to limit the pilot program to issuers that provide disclosure in English.

could then be expanded to other jurisdictions (both within and outside the E.U.) and to other categories of issuers.

Several significant issues will need to be worked out between the SEC and the E.U. securities regulators in order to put a pilot program into place. In addition to determining the parameters of the pilot program (*e.g.*, the criteria for issuers to qualify for participation), the regulators will also need to agree upon which liability and market misconduct regimes should apply to transatlantic offerings under the program. For instance, the SEC and the E.U. securities regulators will need to determine whether, and if so to what extent, an E.U. issuer that makes a public offering in the United States using a prospectus that complies with applicable E.U. requirements and is approved by its home country regulator will be subject to the U.S. civil and criminal liability regime.

One possibility would be to utilize the approach taken by the SEC and the Canadian provincial securities regulators in the U.S.-Canada multijurisdictional disclosure system (“MJDS”).⁴³ Under the MJDS-type approach, each issuer participating in the pilot program would be subject to the liability regime of each host country into which it offers its securities. However, certain aspects of the U.S. liability regime, such as strict liability for issuers arising out of material misstatements or omissions in offering materials,⁴⁴ may cause E.U. issuers to shy away from using the pilot program to make U.S. offerings.⁴⁵ On the other hand, requiring U.S. investors who purchase securities of E.U. issuers under the pilot program to rely solely on the protections of the issuer’s home country enforcement and liability regimes may not appear consistent with the SEC’s investor protection mandate. A possible alternative approach would be to subject participating issuers to the full home country liability regime, as well as to a more limited liability regime in the host country. For example, rather than subjecting E.U. issuers that conduct public offerings in the United States to strict liability under Securities Act Section 11, such issuers could be subject instead to the liability regime applicable to U.S. private offerings. Under this intermediate approach, participating E.U. issuers could still be held liable for material misstatements or omissions in their offering materials if the misstatements or omissions were made with the relevant fraudulent intent (or “*scienter*”) necessary to establish liability under

⁴³ Under the MJDS, certain Canadian issuers may make cross-border offerings principally in reliance on their Canadian disclosures, but those issuers are subject to U.S. liability rules. *See* Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers, SEC Release 33-6902 (June 21, 1991) (“Issuers using the MJDS continue to be subject to provisions imposing civil or criminal liability for fraud in each jurisdiction where the securities are offered.”). *See also* GREENE ET AL., *supra* note 15, at § 9.08[1].

⁴⁴ Securities Act Section 11, 15 U.S.C. § 77k, in general, imposes liability with respect to certain types of deficient disclosure in the registration statement for a securities offering on issuers, persons signing the registration statement, directors or partners of the issuer at the time of filing, underwriters of the securities being offered and experts consenting to be named in the registration statement. Defendants other than the issuer may be able to escape liability with respect to claims that the registration statement contained an untrue statement of a material fact or omitted to state a material fact necessary to make the included statements not misleading by establishing that they acted within a prescribed standard of care (this defense is often referred to as the “due diligence defense”). *See* GREENE ET AL., *supra* note 15, at § 15.03[1].

⁴⁵ *Cf.* COMMITTEE ON CAPITAL MARKETS REGULATION, *supra* note 4, at 5 (identifying the litigation burden as a deterrent to participation in the U.S. public securities market).

Exchange Act Rule 10b-5.⁴⁶ This intermediate approach may be more palatable to E.U. issuers contemplating issuing securities in U.S. markets.⁴⁷

These are understandably difficult issues, but they should not paralyze the U.S. and the E.U. securities regulators into inaction. Rather, the U.S. and the E.U. securities regulators should show their commitment to improving the efficiency of the global capital markets by moving promptly to resolve these and the other issues that are prerequisites for a successful mutual recognition pilot program.

IV. CONCLUSION

There have been an increasing number of speeches and articles lately by SEC Commissioners and SEC staff, as well as by representatives of various other U.S. and non-U.S. regulatory agencies and governmental bodies, regarding the need to remove unnecessary barriers to cross-border market access.⁴⁸ Much talk, but unfortunately very little action. The United States and other jurisdictions must acknowledge that the time has come to give up nationalistic models and embrace a new global model of securities regulation that recognizes that there is more than one “right” way to address a particular issue.

Securities regulators admittedly have a duty to protect investors and further market integrity. In this global marketplace, however, these goals can be better achieved through mutual cooperation rather than nationalistic chauvinism. Such cooperation will inevitably lead to greater market efficiency, lower costs and more optimal regulation for all market participants. In a recent speech, Charlie McCreevy, the European Commissioner for International Market and Services, stated that “[w]hat we need is open access, compatibility, a sensible balance between investor

⁴⁶ Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5, among other things, makes it unlawful in connection with the purchase or sale of any security using U.S. jurisdictional means to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made not misleading. Because of its breadth, Rule 10b-5 is often thought of as a “catch-all” antifraud provision and has been widely used by both the SEC and private plaintiffs as a remedy to address material misstatements and omissions made in connection with purchases and sales of securities in both the primary and secondary markets. See GREENE ET AL., *supra* note 15, at § 15.05[1][b]. An essential element of liability under Exchange Act Rule 10b-5 is that the defendant act with fraudulent intent—mere negligence will not support a claim under Rule 10b-5, although courts generally have agreed that recklessness suffices. See, e.g., *Novak v. Kasaks*, 216 F.3d 300, 312 (2d Cir.), cert. denied, 531 U.S. 102 (2000) (“the *scienter* requirement can be satisfied by pleading either ‘conscious recklessness’—*i.e.*, a state of mind ‘approximating actual intent, and not merely a heightened form of negligence’—or ‘actual intent.’”); In re *Silicon Graphics, Inc. Sec. Lit.*, 183 F.3d 970, 977 (9th Cir. 1999)(“recklessness only satisfies *scienter* under § 10(b) to the extent that it reflects some degree of intentional or conscious misconduct”).

⁴⁷ According to the Interim Report of the Committee on Capital Markets Regulation, 94% (by value) of the global initial public offerings from 1999 through the first half of 2006 that do not list in the United States (57% by number) still chose to market their issues privately in the United States under Securities Act Rule 144A even though subject to Rule 10b-5. COMMITTEE ON CAPITAL MARKETS REGULATION, *supra* note 4, at 46.

⁴⁸ See, e.g., Paulson, *supra* note 4; COMMITTEE ON CAPITAL MARKETS REGULATION, *supra* note 4; BLOOMBERG-SCHUMER REPORT, *supra* note 4; COMMISSION ON THE REGULATION OF U.S. CAPITAL MARKETS IN THE 21ST CENTURY, *supra* note 4; McCreevy, *supra* note 29; Sirri, *supra* note 2, Tafara & Peterson, *supra* note 1; Christopher Cox, Chairman, SEC, Re-Thinking Regulation in the Era of Global Securities Markets, Speech before the 34th Annual Securities Regulation Institute (Jan. 24, 2007), <http://sec.gov/news/speech/2007/spch012407cc.htm>.

protection and economic freedom. Investors want choice. We cannot attempt to extinguish all risk: we have to manage it within reasonable limits. Legal systems that attempt to regulate it away fail.”⁴⁹ These words should be viewed as a call to action by all securities regulators.

This article has outlined a methodology for enhancing access to capital markets across jurisdictional boundaries while eliminating unnecessary barriers that serve only to increase costs and impede a regulatory race to optimality. The key to this approach is the recognition that there are many different ways to implement the same underlying fundamental principles and goals and that jurisdictions with comparable regulatory regimes should be respected and allowed to engage in healthy regulatory competition with each other.⁵⁰

Although the SEC and other securities regulators should tread cautiously in order to ensure that fundamental investor protections are not lost in the name of global progress, they must nonetheless continue to move forward and demonstrate a willingness to accept new ideas and be open to different regulatory approaches. One way to do this is to establish, as quickly as possible, a mutual recognition pilot program allowing domestic investors and large domestic issuers access to comparably regulated foreign markets and foreign investors and comparably regulated large foreign issuers access to comparably regulated domestic markets.⁵¹ The European Union appears to be a perfect first partner for this endeavor. After review of the experience with the pilot program, the approach could be expanded to other issuers and jurisdictions (with appropriate refinements if and as necessary), and thereby achieve even greater efficiencies and cost savings for the benefit of all market participants.

The time has come for securities regulators around the globe to walk the walk—not just talk the talk.

⁴⁹ McCreevy, *supra* note 29.

⁵⁰ See Cox, *supra* note 48 (“As each of us looks to cooperate with one another, the world’s governments are quickly coming to see that there is no ‘one true path’ to securities regulation at any one point in time. What we are seeking instead is an understanding that if a jurisdiction adopts an approach that adequately protects investors, that approach is worthy of respect.”).

⁵¹ This pilot program could be implemented independent of other mutual recognition efforts, but would complement the pilot program I urged with respect to broker-dealers, securities exchanges and other market participants in Greene, *Beyond Borders I*, *supra* note 1.