Perspectives in Company Law and Financial Regulation

EDITED BY MICHEL TISON,
HANS DE WULF,
CHRISTOPH VAN DER ELST AND
REINHARD STEENNOT

CAMBRIDGE

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The SEC embraces mutual recognition

ROBERTA S. KARMEL

I. Introduction

The traditional approach of the United States Securities and Exchange Commission (SEC) toward foreign (non-US) issuers, financial intermediaries and markets has been national treatment rather than mutual recognition. In the view of the SEC, mutual recognition was appropriate only when there was harmonized securities regulation between the US and a foreign jurisdiction. Accordingly, although the SEC made accommodations to foreign issuers, it rarely engaged in mutual recognition, the one important exception being the multi-jurisdictional disclosure (MJDS) regime with Canada. This exception actually proved the rule because the Canadians amended their securities laws to harmonize their securities regulations with US law, and to the extent that this was not the case, with regard to generally accepted accounting principles (GAAP), Canadian issuers were required to reconcile Canadian GAAP to US GAAP.

More recently, however, the SEC has been taking a new look at mutual recognition, and in the case of international financial reporting standards (IFRS) it now allows foreign issuers to use IFRS rather than US GAAP based on a theory of convergence rather than a requirement of harmonization. Furthermore, with regard to the prospect of foreign exchange and broker-dealer access to the US capital markets, the SEC is contemplating mutual recognition based on a theory of regulatory equivalence rather than a requirement of harmonization. On 1 February 2008, SEC Chairman Christopher Cox and European Union Commissioner for the Internal Market and Services Charlie McCreevy met in Washington, DC and agreed to a goal of an EU–US mutual recognition arrangement for securities regulation, declaring that 'mutual recognition offers significant promise as a means of better protecting

investors, fostering capital formation and maintaining fair, orderly, and efficient transatlantic securities markets'.[1]

This chapter will discuss the differences between mutual recognition based on securities law harmonization, securities law convergence and securities law equivalence, and suggest that changes in the international capital markets are forcing the SEC to reconsider its long-standing insistence on harmonization as a predicate for mutual recognition. By accepting IFRS from foreign issuers, the SEC based its rule-making on convergence between US GAAP and IFRS, rather than insisting on full harmonization. In considering allowing foreign trading screens into the US, the SEC may base new rules on regulatory equivalence. In order to remain a leading securities regulator, the SEC is engaging in discussions with foreign regulators to achieve regulatory comparability, whether called harmonization, convergence or equivalence, and the promise of mutual recognition may well act as an incentive to realizing high international standards for investor protection.

II. National treatment

A. Public companies

Generally, the most common approaches to regulating foreign issuers which sell securities to domestic investors are: requiring them to comply with host country laws (national treatment);[2] creating special host country rules for them;[3] developing harmonized international standards;[4] and accepting compliance with home country standards (mutual recognition).[5] The US historically approached this problem through national treatment, with some special rules to ameliorate the problems of compliance for foreign issuers. By contrast, the EU has a

[1] SEC Press Release 2008–9, 'Statement of the European Commission and the US Securities and Exchange Commission on Mutual Recognition in Securities Markets', www.sec.gov/news/press/2008/2008–9.htm, at 2 (last accessed 1 February 2008).

[2] See R.C. Campos, 'Speech by SEC Commissioner: Embracing International Business in the Post-Enron Era', speech at the Centre for European Policy Studies in Brussels (Belgium), www.sec.gov/news/speech/spch061103rcc.htm (last accessed 11 June 2003).

[3] Ibid. This has been the SEC's approach to some extent.

[4] See M.G. Warren III, 'Global Harmonization of Securities Laws: The Achievement of the European Communities', *Harvard International Law Journal*, 31 (1990), 191.

[5] Ibid.

regime of mutual recognition, at least within the EU.[6] While there is no international securities regulator with the ability to impose a disclosure or other regulatory regime on all issuers worldwide, the International Organization of Securities Commissions (IOSCO) has developed a template for basic disclosure standards and the International Accounting Standards Board (IASB) has developed international accounting standards (formerly known as IAS and now known as international financial reporting standards or IFRS).[7]

When the Securities Act of 1933 ('Securities Act') was passed, Congress contemplated that foreign issuers might make offerings into the United States, and provided a special disclosure regime for sovereign debt.[8] Further, the jurisdictional reach of the law extended to interstate and foreign commerce.[9] The US courts have given the SEC authority to impose its disclosure obligations on any foreign company that sells shares to US nationals.[10] Under the federal securities laws, any foreign issuer which makes a public offering into the US must then become an SEC registered and reporting company. A company wishing to list its securities on a US exchange also must register its listed securities with the SEC under the Securities Exchange Act of 1934 ('Exchange Act') and become subject to the SEC's annual and periodic reporting and disclosure requirements.[11] Although the SEC could require any foreign issuer with more than 500 shareholders worldwide, of which 300 are US investors, and which has $10 million in assets, to register its equity securities pursuant to the Exchange Act,[12] the SEC has not exerted its jurisdiction to this extent. Foreign issuers which would be required to file under the Exchange Act because they have $10 million in assets and 300 out of 500 US shareholders can file for an exemption from such registration.[13]

[6] See M.I. Steinberg and L.E. Michaels, 'Disclosure in Global Securities Offerings: Analysis of Jurisdictional Approaches, Commonality and Reciprocity', *Michigan Journal of International Law*, 20 (1999), 255–61.

[7] See M.I. Steinberg, *International Securities Law: A Contemporary and Comparative Analysis,* (Kluwer Law International, 1999), 27–38.

[8] Securities Act, Schedule B, 15 U.S.C. § 77aa (2008).

[9] Ibid. § 77b (7) (2008).

[10] See *Europe and Oversees Commodity Traders, S.A.* v. *Banque Paribas London*, 147 F.3d 118 (2d Cir. 1998), *cert. denied,* 525 U.S. 1139 (1999) (suggesting that the Securities Act applies when both the offer and sale of a security are made in the United States); *Consol. Gold Fields PLC* v. *Minorco, S.A.*, 871 F.2d 252, *modified,* 890 F.2d 569 (2d Cir.), *cert. dismissed,* 492 U.S. 939 (1989).

[11] 15 U.S.C. § 78a (2008), *et seq*.

[12] See 15 U.S.C. ' 78*l*. The SEC has under consideration rule-making to make this exemption more difficult to claim and maintain. See note 53, *infra*.

[13] Exchange Act Rule 12g3–2 (b), 17 C.F.R. § 240.12g3–2 (b).

The attitude of the SEC staff long was that if a foreign issuer was going to tap the US capital markets then it should play by the SEC's rules. In the mid 1970s the SEC requested public comment on improving the disclosure required by foreign issuers, noting that the registration forms used by them required substantially less information than required of US domestic issuers.[14] The SEC then adopted Form 20-F as a combined registration and annual reporting form,[15] but, since corporate governance regulation generally was left to the states under US law, it was similarly left to the national law of foreign issuers. Among other things, foreign issuers were exempted from SEC proxy solicitation regulations and short-swing insider transaction reporting requirements.[16] Further, in Form 20-F, the SEC bowed to some of the objections of foreign issuers and deleted certain proposed disclosures relating to corporate governance.[17] Additionally, following a policy of international cooperation during the 1980s and 1990s, the SEC fashioned special exemptions for foreign issuers relating to private offerings to institutional investors,[18] and amended its foreign issuer disclosure forms to comply with disclosure standards endorsed by IOSCO.[19]

In 1991 the SEC adopted the MJDS whereby qualified Canadian issuers could issuer securities in the US based on their filings with Canadian securities regulators.[20] This regime was based on harmonization of securities law requirements between the SEC and the Canadian securities regulators and was a mutual recognition system. Canadian issuers could use the same prospectus for offerings in the US as they had

[14] Means of Improving Disclosure by Certain Foreign Private Issuers, Exchange Act Release No.13,056, 41 Fed. Reg. 55,012, at 55,013 (16 December 1976).

[15] 17 C.F.R. § 249.220 (f). This continues to be the primary reporting form for foreign issuers.

[16] 17 C.F.R. § 240.3a12–3.

[17] Specifically, the disclosure of the business experience and background of officers and directors, the identification of the three highest paid officers and directors and the aggregate amount paid to them; and conditioned a material transactions disclosure to the requirements of applicable foreign law. Rules, Registration and Annual Report Form for Foreign Private Issuers, Exchange Act Release No. 16,371, 44 Fed. Reg. 70,132, at 70,133 (6 December 1979). *See also* Adoption of Foreign Issuer Integrated Disclosure System, Securities Act Release No. 6437, 47 Fed. Reg. 54,764 (6 December 1982).

[18] See Regulation S, 17 C.F.R. §230.901–905; Rule 144A, 17 C.F.R. §230.144A; Rule 12g3-2 (b), 17 C.F.R. §240.12g3-2(b).

[19] International Disclosure Standards, Securities Act Release No. 7745, 64 Fed. Reg. 53900 (5 October 1999).

[20] Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers Securities Act Rule 29354, 56 Fed Reg 30096 (1 July 1991).

used in Canada, except that they were required to reconcile their financial statements to US GAAP.[21] After the MJDS was put into effect, the SEC considered establishing a mutual recognition regime with other jurisdictions, in particular, the United Kingdom, but this effort was abandoned. Among other reasons, the British authorities were advised that the SEC could not establish a mutual recognition regime with only one and not other EU countries.

Another area in which the SEC established a mutual recognition regime was with respect to tender offers and rights offers.[22] Because of complaints from US investors holding foreign securities who were deprived of the opportunity to participate in foreign issuer takeover and rights offerings by reason of SEC protections they did not desire, the SEC established a principle of mutual recognition for these types of cross-border offerings. These rules were adopted at about the same time that the SEC revised its disclosure standards for foreign private issuers based upon the international disclosure standards endorsed by IOSCO. The SEC was also going forward at this time on a program to harmonize US and international accounting standards through the IASB. Unfortunately, this spirit of international cooperation between the SEC and foreign regulators was undermined by the enactment of the Sarbanes–Oxley Act of 2002 ('Sarbanes–Oxley').[23]

Although foreign issuers had become used to a regime under which US corporate governance standards did not apply to them, Sarbanes–Oxley did not exempt foreign issuers from its new corporate governance requirements. Foreign issuers viewed the context for Sarbanes–Oxley to be US financial scandals and failures, and argued that the SEC should not be imposing corporate governance regulations on corporations that functioned in very different corporate finance systems and with very different structures than US firms.[24] Congress and the SEC retreated to the view that if foreign issuers wish to tap the US capital markets, they needed to play by US rules. Financial scandals in Europe, including the Royal Ahold, Parmalat and Vivendi cases,[25]

[21] Ibid. at 30101.

[22] Cross-Border Tender and Exchange Offers, Business Combinations and Rights Offerings, Securities Act Release No. 7759, 64 Fed Reg. 61382 (10 November 1999).

[23] Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, 116 Stat. 745 (2002) (codified in scattered sections of 11, 15, 18, 28 and 29 U.S.C.).

[24] See K.S. Lehman, 'Recent Development: Executive Compensation Following the Sarbanes–Oxley Act of 2002', *North Carolina Law Review*, 81 (2003), 2132–33.

[25] See L. Enriques, 'Bad Apples, Bad Oranges: A Comment From Old Europe on Post-Enron Corporate Governance Reforms', *Wake Forest Law Review,* 38 (2003), 911; E. Mossos,

strengthened this view and made the SEC unwilling to craft exemptions for foreign issuers. Although the SEC did exempt foreign issuers from the requirement that their audit committees have independent directors if their governance structures achieved the same goals as the Sarbanes–Oxley audit committee provisions,[26] the SEC required foreign issuers to comply with other provisions such as the CEO-CFO certification requirements[27] and the internal control provisions of Section 404 of Sarbanes–Oxley.[28] After some difficult negotiations, the SEC and foreign regulators came to an accommodation regarding regulation of audit firms.[29]

B. Foreign exchanges and broker-dealers

Pressure from the EU on US policy makers to allow foreign trading screens in the US has been ongoing for some time.[30] A response to this pressure was expressed by SEC Commissioner Roel C. Campos, who explained that the SEC 'imposes significant regulatory requirements on exchanges, as well as on issuers who list on those exchanges, whether foreign or domestic. The exemptions being requested by some foreign

'Sarbanes-Oxley Goes to Europe: A Comparative Analysis of United States and European Union Corporate Reforms After Enron', *Currents: International Trade Law Journal,* 13 (2004), 9; C. Storelli, 'Corporate Governance Failures – Is Parmalat Europe's Enron?', *Columbia Business Law Review,* 3 (2005), 765.

[26] Final Rule: Standards Relating to Listed Company Audit Committees, Securities Act Release No. 8220, 68 Fed. Reg. 18788 (16 April 2003).

[27] Sarbanes-Oxley, §§ 302, 906.

[28] 15 U.S.C. § 7262 (2008).

[29] Sarbanes–Oxley, which created the Public Company Accounting Oversight Board (PCAOB), directed public accounting firms that participate in audits of SEC reporting companies to register with the PCAOB and become subject to PCAOB audit rules and inspection (§§ 102–104, 15 U.S.C. § 7212 (2004)). These provisions applied on their face to foreign auditors, a situation which created conflict between the SEC and foreign regulators. In order to ameliorate these problems, the PCAOB stated its intention to cooperate with non-US regulators in accomplishing the goals of the statute without subjecting non-US public accounting forms to unnecessary burdens or conflicting requirements. *See* Final Rules Relating to the Oversight of Non-US Public Accounting Firms, PCAOB Release No. 2004–005, www.pcaobus.org/Rules/Docket_013/2004–06–09_Release_2004–005.pdf, at 2–3 (last accessed 9 June 2004).

[30] See F. Bolkestein, 'Towards an Integrated European Capital Market', Keynote Address at Federation of European Securities Exchange Convention, London', (13 June 2003); F. Bolkestein, 'Press Conference with EU Internal Market and Taxation Commissioner Frits Bolkestein, Washington, D.C.', http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/03/297&format= HTML&aged=1&language=EN&guiLanguage=en (last accessed 29 May 2002).

exchanges would create access to US investors on different terms than those available to US Exchanges. This, in turn, puts considerable stress on our system of regulation, disrupting the level playing field we have created for all market participants.'[31]

There are two problems with regard to giving foreign securities exchanges access to the United States. One is how to fit such exchanges into national market system (NMS) regulation. Domestic electronic communications networks (ECNs) or alternative trading systems (ATSs) have been brought into the NMS regulatory framework through the adoption of Regulation ATS and a revised definition of the term 'exchange' under the Exchange Act.[32] In its Concept Release proposing that ATSs should either register as exchanges or undertake new responsibilities as broker-dealers, the SEC addressed the problem of foreign exchanges wishing to access the US capital markets.[33] Since then, the SEC and the EU have put in place comprehensive and probably incompatible regulations governing trading on regulated markets.[34] The second major problem preventing foreign stock exchange access is that thousands of foreign securities that are not registered with the SEC and whose issuers do not meet SEC disclosure and accounting standards, would become tradeable in the US.[35] The SEC has suggested several possible solutions to this problem. First, the SEC could subject foreign exchanges to registration as 'exchanges' under the Exchange Act and prevent them from trading any securities not registered with the SEC under the Exchange Act.[36] Second, the SEC could limit cross-border trading by ECNs, ATSs or foreign exchanges seeking US investors to operate through an access provider which would be a US broker-dealer or ECN.[37] Third, the SEC could limit trading in foreign securities by foreign exchanges to transactions with sophisticated US investors so that some exemption from Securities Act registration

[31] R.C. Campos, 'Speech by SEC Commissioner: Embracing International Business in the Post-Enron Era', speech at the Centre for European Policy Studies, Brussels, www.sec.gov/news/speech/spch061103rcc.htm (last accessed 11 June 2003).

[32] See Exchange Act Rule 3b-16, 17 C.F.R. § 240.3b-16 (2000).

[33] Concept Release, Regulation of Exchanges, Exchange Act Release No. 38672, 62 Fed. Reg. 30485 (4 June 1997) [hereinafter 'ATS Concept Release'].

[34] See R.S. Karmel, 'The Once and Future New York Stock Exchange, The Regulation of Global Exchanges', *Brooklyn Journal of Corporate, Financial and Commercial Law,* 1 (2007), 370–79.

[35] See ATS Concept Release, *supra* note 33, at 30529.

[36] Ibid. at 30488.

[37] Ibid. at 30488.

might be available.[38] Fourth, the SEC could limit trading to world-class foreign issuers.[39]

C. *Marketplace changes*

Marketplace developments in recent years have made a US listing less attractive for foreign issuers. The European markets have matured to a point where capital can be raised there to meet the needs of most companies.[40] Foreign, and even some US companies, engaging in IPOs or stock exchange listings have done so in Europe, rather than in the US. In 1999 and 2000, foreign IPOs on US exchanges exceeded $80 billion, ten times the amount raised in London, but in 2005 London exchanges raised over $10.3 billion in foreign IPOs compared to $6 billion on US exchanges.[41] In 2004, only three out of the twenty-five largest IPOs were listed on US exchanges, in 2005 none of the twenty-five largest IPOs were listed on US exchanges, and during the first half of 2006, only two of the largest twenty-five international IPOs were listed on US exchanges. By contrast, in 2000, eleven of the twenty-five largest IPOs were listed on US exchanges.[42]

Another possible factor in the SECs new attitude toward mutual recognition probably was the merger of the New York Stock Exchange, Inc. with Euronext, NV in 2007.[43] In order for this merger to be accomplished, it was necessary for the SEC to assure European regulators that the SEC would not attempt to impose provisions of Sarbanes-Oxley upon companies listed on Euronext.[44] In addition, it was necessary for

[38] Ibid. In 2003 the staff of the Ontario Securities Commission recommended a new approach to the recognition of securities in foreign based stock exchange indexes based on mutual recognition. *See* Regulatory Approach for Foreign-Based Stock Exchanges, www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part2/sn_21–702_for.

[39] J.W. White, 'Speech by SEC Staff: "Corporation Finance in 2008 – International Initiatives", Remarks Before PLI's Seventh Annual Institute on Securities Regulation in Europe', www.sec.gov/news/speech/2008/spch011408jww.htm, at 15–16 (last accessed 14 January 2008).

[40] See K. Betz, 'Former SEC Official Sees New Realities For Foreign Issuers Seeking to Raise Capital', 38 *Sec. Reg. & L. Rep. (BNA),* (15 May 2006), at 852.

[41] See S. Fidler, 'How the Square Mile Defeated Prophets of Doom', *Financial Times (London), (*10 December 2005), at 11.

[42] See A. Lucchetti, 'NYSE, Via Euronext, Aims to Regain Its Appeal for International Listings', *Wall Street Journal,* 30 June 2006, at C1.

[43] See NYSE Euronext At-a-Glance, www.nyse.com/pdfs/NY7_3_p44_45InSide.pdf.

[44] C. Cox, 'Speech by SEC Chairman: Remarks on Acceptance of the Atlantic Leadership Award from the European-American Business Council', www.sec.gov/news/speech/2008/spch020108cc.htm, at 3 (last accessed 1 February 2008).

the SEC to be assured of regulatory cooperation by European regulators. In order to facilitate this merger, the SEC and the College of Euronext Regulators therefore negotiated a comprehensive arrangement to facilitate cooperation in market oversight.[45]

III. The converge concept and the IFRS roadmap

At the end of last year, the SEC determined to allow foreign issuers to report their financial statements in IFRS, rather than US GAAP, without a US GAAP reconciliation.[46] This step was a significant breakthrough in a step toward mutual recognition by the SEC in circumstances where regulatory standards are sufficiently converged (although not completely harmonized) to protect investors. Of equal importance to the decision by the SEC to accept IFRS in filings by foreign issuers, the SEC proposed to allow US issuers to report their financial statements in IFRS.[47]

The recognition of IFRS has been a long time in coming. In 1988, the SEC explicitly supported the establishment of international accounting standards to reduce regulatory impediments resulting from disparate national accounting standards.[48] Nevertheless, the SEC determined not to adopt a process-oriented approach to IASB standards, recognizing them as 'authoritative' and therefore comparable to US GAAP standards promulgated by the Financial Accounting Standards Board. Rather, it intended to assess each IASB standard after its completion, and then recognize acceptable standards. In 1991 and 1993, it did so with respect to IASB standards on cash flow statements, business combinations and the

[45] SEC Press Release 2007–8, SEC, Euronext Regulators Sign Regulatory Cooperation Arrangement, www.sec.gov/news/press/2007/2007–8.htm (last accessed 25 January 2007).

[46] Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to US GAAP, Securities Act Release No. 8879, 73 Fed. Reg. 986 (4 January 2008) [hereinafter 'Acceptance of IFRS Final Release'].

[47] Concept Release on Allowing US Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards, Securities Act Release No. 8831, 72 Fed. Reg. 45599 (14 August 2007), corrected 72 Fed. Reg. 53509 (19 September 2007).

[48] C.W. Hewitt and J.W. White, Testimony Concerning Globally Accepted Accounting Standards, Before the Subcomm. On Securities, Insurance, and Investment of the Sen. Comm. On Banking Housing and Urban Affairs, www.sec.gov/news/testimony/2007/ts102407cwh-jww.htm, at 2–3 [hereinafter 'Hewitt Testimony'] (last accessed 24 October 2007).

effects of changes in foreign exchange rates.[49] But the SEC then suspended this approach of recognizing one standard at a time and decided instead to consider all IASB standards after the IASB completed its core standards work program.[50] This program was completed in March 2000, and the SEC then issued a Concept Release as part of the assessment process possibly leading to the SEC's acceptance of IFRS. IOSCO, as well as the SEC and others, were working on financial disclosure harmonization, and by May 2000, IOSCO had assessed all thirty core standards in the IASB work program and recommended to its members that multi-national issuers use the core standards, supplemented by reconciliation, disclosure interpretation where necessary.[51] But in its 2000 Concept Release on accounting disclosure for foreign companies, the SEC continued to reject a mutual recognition approach except for the MJDS with Canada.

At this time, the SEC was not concerned about particular IFRS standards, with a few exceptions, but it questioned whether these standards could be rigorously interpreted and applied.[52] In particular, the SEC had criticized the structure and financing of the IASB and took a heavy hand in restructuring this organization. A new constitution was adopted in May 2000, which established this body as an independent organization with two main bodies, the Trustees and the Board, as well as the Standing Interpretations Committee and Standards Advisory Council.[53] The Trustees appoint the Board Members, exercise oversight and raise the funds needed, whereas the Board has sole responsibility for setting accounting standards. The founding Chairman of the Board of Trustees for the restructured IASB was Paul A. Volker, Former Chairman of the US Federal Reserve Board.[54] It appeared that, despite SEC staff reservations about IFRS, a momentum for mutual recognition of accounting standards, based on convergence, if not harmonization, was moving along. But the spirit of cooperation that had been established between

[49] International Accounting Standards Concept Release, Securities Act Release No. 7801, 65 Fed. Reg. 8896 (23 February 2000), at 8903, n.33 [hereinafter 'IAS Release'].

[50] Ibid. at 8899.

[51] See Press Release, IOSCO, IASC Standards, http://iosco.org/news/pdf/IOSCONEWS26.pdf (last accessed 17 May 2000).

[52] See IAS Release, (*supra* note 49), at 8901–02.

[53] See Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to US GAAP, Securities Act Release No. 8818, 72 Fed. Reg. 37962, (11 July 2007) [hereinafter 'Acceptance of IFRS Proposing Release'], at 37964.

[54] Hewitt Testimony, (*supra* note 48), at 5.

the SEC, the EU and the IASB was unfortunately overtaken by the stock market collapse of 2000–1 and the enactment of Sarbanes–Oxley.

The EU was then able to seize the initiative with respect to international accounting standards by turning those European issuers which had been considering reporting in US GAAP rather than their home country GAAP, to IFRS, by mandating that all listed companies report in IFRS as of the year end 2005 and threatening to make US EU-listed companies also report in IFRS. Moreover, Asian and other issuers also began looking at IFRS, rather than US GAAP, as an alternative to reporting in their national GAAPs for offerings in the international capital markets.[55] As the markets in Europe and Asia strengthened, relative to the US markets, New York was no longer the only place where multinational corporations could raise capital and the SEC was no longer a regulator which could force its regulations on foreign issuers.

In April 2005, the Chief Accountant of the SEC set forth a roadmap for eliminating the need for non-US companies to reconcile to US GAAP financial statements prepared according to IFRS.[56] This roadmap was explicitly affirmed by SEC Chairman William Donaldson in a meeting with EU Internal Market Commissioner Charlie McCreevy in April 2005,[57] and then reaffirmed by SEC Chairman Christopher Cox in February 2006.[58] On 6 March 2007, the SEC held a Roundtable on IFRS as a prelude to issuing a proposed rule on 2 July 2007 to accept from foreign private issuers financial statements prepared in accordance with IFRS.[59]

In that release, the SEC pointed out that almost a hundred countries, including the twenty-seven EU Member States, were using IFRS, with more countries considering adopting IFRS.[60] The SEC made two arguments in favour of allowing foreign issuers to report in IFRS, a somewhat

[55] D. Tweedie and T.R. Seidenstein, 'Setting a Global Standard: The Case for Accounting Convergence', *Northwestern Journal of International Law and Business,* 25 (2005), 593.

[56] D.T. Nicolaisen, 'Statement by SEC Staff: A Securities Regulator Looks at Convergence', www.sec.gov/news/speech/spch040605dtn.htm (last accessed April 2005).

[57] SEC Press Release 2005–62, Chairman Donaldson Meets with EU Internal Market Commissioner McCreevy, www.sec.gov/news/press/2005–62.htm (last accessed 21 April 2005).

[58] SEC Press Release No. 2006–17, Accounting Standards: SEC Chairman Cox and EU Commissioner McCreevy Affirm Commitment to Elimination of the need for Reconciliation Requirements, www.sec.gov/news/press/2006–17.htm (last accessed 8 February 2006).

[59] Acceptance of IFRS Proposing Release, (*supra* note 53).

[60] Ibid. at 37965.

remarkable turnabout from its prior resistance to the use of any foreign GAAP in SEC filings. First, the SEC asserted that it had long advocated reducing disparity between US accounting and disclosure regulations and other countries as a means to facilitate cross-border capital formation; second, the SEC asserted that an international accounting standard may be adequate for investor protection even if it is not the same as the US standard.[61] Therefore, based on increasing convergence between US GAAP and IFRS, and cooperation between the SEC, IOSCO and the Committee of European Securities Regulators (CESR), the SEC proposed amendments to its rules that would allow a foreign private issuer to file financial statements without reconciliation to US GAAP, if those financial statements are in full compliance with the English language version of IFRS as published by the IASB.[62] The SEC adopted final rules on permitting foreign issuers to report in IFRS, substantially as proposed, based primarily on the progress of the IASB and the FASB toward convergence, their expressed intention to work toward further convergence in the future and a finding that IFRS are high-quality standards.[63] Yet, significant differences between IFRS and US GAAP continue to exist, and questions remain about the funding and independence of the IASB, as well as how IFRS will be interpreted and the lack of convergence on auditing standards between US and EU regulation.

Nevertheless, the SEC's decision to end the requirement that foreign issuers reconcile financial statements to US GAAP was extraordinarily important from a philosophical and political standpoint, and showed the rest of the world the US was serious about global accounting standards.[64]

IV. Equivalence as a predicate for mutual recognition

A serious change in the tone and content of the SEC–EU dialogue on foreign exchange access was marked by the publication in 2007 of an article by Ethiopis Tafara, Director of the SEC's Office of International Affairs suggesting 'substituted compliance' as a basis for permitting foreign stock exchanges to place their screens in the United States and also

[61] Ibid. at 37965–66.
[62] Ibid. at 37970.
[63] Acceptance of IFRS Final Release, (*supra* note 46).
[64] S. Marcy, 'End of Reconciliation Requirement Big Step to Common Accounting, IASB Member Says', *39 Sec. Reg. & L. Rep.* (BNA), (10 December 2007), at 1915.

for permitting foreign broker-dealers to solicit US customers without being registered with the SEC.[65] Although the SEC as a matter of policy disclaims responsibility for statements by an SEC staffer, this article nevertheless was a trial balloon of a new approach to a policy of mutual recognition. Tafara's proposal was a system of bilateral substituted compliance for foreign screens and foreign financial service providers based upon four steps: (1) a petition from a foreign entity to the SEC seeking an exemption from registration; (2) a discussion between the SEC and the entity's home regulator to determine the degree to which the trading rules, prudential requirements, examinations, review processes for corporate filings and other securities regulatory requirements are comparable; (3) a dialogue between the entity and the SEC which would include an agreement to submit to SEC jurisdiction and service of process with regard to the anti-fraud laws; and (4) public notice and an opportunity for comment on the petition.[66] An important part of this proposal was collaboration between the SEC and an entity's home jurisdiction, including a memorandum of understanding (MOU) between the two regulators and their ability to share inspections reports, conduct joint inspections and therefore enable them to share enforcement-related information.[67] In this connection, it should be noted that the SEC has MOUs with the EU, CESR and a number of individual European securities regulators.[68]

Following the publication of the Tafara article and favourable comments upon it,[69] the SEC held a Roundtable on Mutual Recognition.[70]

[65] E. Tafara and R.J. Peterson, 'A Blueprint for Cross-Border Access to US Investors: A New International Framework', *Harvard International Law Journal,* 48 (2007), 31.

[66] Ibid. at 58–9.

[67] Ibid.

[68] See US Securities and Exchange Commission, International Enforcement Assistance, www.sec.gov/about/offices/oia/oia_crossborder.htm#bilateral; US Securities and Exchange Commission, Cooperative Arrangements with Foreign Regulators, www.sec.gov/about/officies/oia/oia_cooparrangments.htm#enforce.

[69] See E.F. Greene, 'Beyond Borders: Time to Tear Down the Barriers to Global Investing', *Harvard International Law Journal,* 48 (2007), 85; E.F. Greene, 'Beyond Borders Part II: A New Approach to the Regulation of Global Securities Offerings', www.corporateaccountability2007.com/02.pdf (last accessed 2007); H. E. Jackson, 'A System of Selective Substitute Compliance', *Harvard International Law Journal,* 48 (2007), 105. *But see* G.W. Madison and S. P. Greene, 'TIAA-Cref Response to A Blueprint for Cross-Border Access to US Investors: A New International Framework', *Harvard International Law Journal,* 48 (2007), 99.

[70] See SEC Press Release No. 2007–105, SEC Announces Roundtable Discussion Regarding Mutual Recognition, www.sec.gov/news/press/2007/2007-105.htm (last accessed 24 May 2007).

The purpose of the Roundtable was to discuss selective mutual recognition, described as 'the SEC permitting certain types of foreign financial intermediaries to provide services to US investors under an abbreviated registration system, provided those entities are supervised in a foreign jurisdiction with a securities regulatory regime substantially comparable (but not necessarily identical) to that of the United States'.[71] Mutual recognition of foreign markets and broker-dealers was also promoted in speeches by the SEC Director of the Division of Market Regulation.[72]

The SEC Director of the Division of Corporation Finance also has embraced mutual recognition based on mutual recognition of foreign securities regulatory regimes as a means to permit foreign financial intermediaries and broker-dealers to access US markets based on equivalent regulatory standards.[73] He made clear, however, that in his view, such a regime should apply to trading of world-class securities, not to capital raising by foreign companies. Furthermore, he suggested that with regard to foreign issuers with a significant US shareholder following, the SEC might alter its long-standing exemption for foreign issuers from the reporting requirements of the Exchange Act.[74]

V. The way forward

On 1 February 2008, SEC Chairman Cox and EU Commissioner McCreevy met in Washington and agreed to implement a mutual recognition regime in order to better protect investors, foster capital formation and maintain fair, orderly and efficient transatlantic securities markets. They jointly declared that since the US and EU comprise 70% of the world's capital markets, they had a common interest in developing a cooperative approach to securities regulation.[75]

[71] Ibid.

[72] See E.R. Sirri, 'Speech by SEC Staff: A Global View: Examining Cross-Border Financial Services', http://sec.gov/news/speech/2007/spch081807ers.htm (last accessed 18 August 2007); E.R. Sirri, 'Speech by SEC Staff: Trading Foreign Shares', www.sec.gov/news/speech/2007/spch030107ers.htm (last accessed 1 March 2007).

[73] J.W. White, 'Speech by SEC Staff: "Corporation Finance in 2008 – International Initiatives" Remarks Before PLI's Seventh Annual Institute on Securities Regulation in Europe', www.sec.gov/news/speech/2008/spch011408jww.htm, at 16 (last accessed 14 January 2008).

[74] Ibid.

[75] SEC Press Release 2008–9, Statement of the European Commission and the US Securities and Exchange Commission on Mutual Recognition in Securities Markets, www.sec.gov/news/press/2008/2008–9.htm (last accessed 1 February 2008).

Hopefully, future cooperation between the SEC, the EU and CESR will lead to improved investor protection regimes that can form the basis for mutual recognition initiatives based either on convergence or substantial equivalence, thus reducing compliance costs for issuers and financial intermediaries, and making capital formation more efficient. Both the SEC and the EU are facing regulatory competition from other securities regulatory regimes around the world. Working together they can continue to act as leaders in the field of financial regulation and attract both investors and issuers into their markets.