Session 1 – Keynote speech

Lance Liebman
Director, The American Law Institute
William S. Beinecke Professor of Law, Columbia University

It's my great pleasure to introduce the Chairman of the Securities and Exchange Commission, Christopher Cox. In the 30 seconds that we got to see each other before this started, I established that he did not take a course from me when he was a student at Harvard Law School and I was a young teacher. It makes me feel better, because I can remember some of the stupid things I was saying in those days.

Christopher Cox served 17 years in the House of Representatives. He then became the 28th Chairman of the Securities and Exchange Commission, succeeding my longtime friend, Bill Donaldson. The chairman has three important goals - I'm sure he has more - but among his important goals are continuing the tradition of vigorous enforcement of the securities laws by the SEC; adapting the SEC's work to the global capital markets - and that fits perfectly with today's subject; and also adapting their work and adapting the entire financial information system to new technology, which is a tremendous challenge. He was described by a leading lawyer, when he was named to this position, as one of the smartest guys in Congress. Now, you can decide for yourselves what exactly that meant. I give you Chairman Cox.

Christopher Cox
Chairman, Securities and Exchange Commission
(speech taken from the SEC website)

Thank you, Prof. Liebman, for your kind introduction. And if I may, I'd like to return the compliment by commending you for your exceptional work even beyond Europe, in India, Japan, Vietnam, and elsewhere around the globe — all in addition to your leadership as Director of the American Law Institute. Thank you as well to Antonio Borges, for getting us off to a good start, and for your leadership as Chairman of the European Corporate Governance Institute. I especially want to acknowledge Eddy Wymeersch, my regulatory colleague as Chairman of the Committee of European Securities Regulators. I see too that former SEC Commissioner Harvey Goldschmid is with us this morning, and will be a panellist this afternoon, as well as my old congressional colleague, former Sen. Paul Sarbanes. By all of your being here, you have guaranteed that this will truly be a trans-Atlantic summit not only of regulators, but also distinguished academics and business people. To all of you who have made it a point to be here, thank you for your commitment to the broad and enduring partnership between Europe and America that we're focused on strengthening during this Conference.

You have chosen a significant and auspicious date to celebrate trans-Atlantic corporate governance. It was supposedly on this day in the year 1000 that Leif Ericson discovered what many cartographers and historians believe to be the land we now call New England. Our trans-Atlantic partnership has thus prospered over perhaps more than a millennium, and so we have ample tradition to draw upon — and a great deal of experience in contending with the sometimes stormy but more often calm waters that separate us.

The objectives of better integrating our capital markets and promoting prosperity are of course the great underlying aim of this conference. Beyond the unification of Europe and America, our global markets are leading the way to a global cooperation that is just as important to building bridges and understanding, and ultimately to promoting peace and prosperity, as any diplomacy that our foreign ministries and departments of state routinely conduct. And just as with diplomacy and statecraft among nations, the way forward for our capital markets requires not only hope but also patience, thought, and wise choices. As the world's markets continue to grow and integrate, Europeans, Americans, and the entire world stand ready to reap the benefits.

At the same time, as our markets become increasingly interconnected, the regulatory friction from different national regimes becomes more significant. That friction is often produced by different conceptions and assumptions about corporate governance that are challenging regulators and marketplace actors alike to think about what we can do, individually and together, to help realize the benefits of a global marketplace. It is certainly requiring us at the SEC to think carefully about the consequences of globalization for our fundamental missions of investor protection, capital formation, and the maintenance of orderly markets.

One of Germany's greatest thinkers once said, "I hate all bungling like sin — but most of all bungling in state affairs; that produces nothing but mischief for thousands and millions." There are always serious consequences when government policymakers get it wrong. So while it is true there are remarkable opportunities ahead of us, in embracing those opportunities we've got to keep our principles sharply in focus. I can assure all of you here this morning that the thousands of men and women at the Securities and Exchange Commission are doing just that.

Our deep commitment to investor protection and to an increasingly closer cooperation with our counterpart regulators in Europe is reflected in the several agreements that I have recently signed with CESR and its constituent members. Both Europe and the United States have committed ourselves to a process that will insure far deeper and closer consultation, cooperation, and exchanges of information. We were able to do this because both the SEC and our European counterparts share a commitment to keeping our markets open and fair. We recognize that by sharing information and granting one another access to our own regulatory data, we can all do a better job of supervising global securities firms, regulating public companies, and overseeing what are now truly global markets.

Today, when investors look across the Atlantic, it is possible to see bonds between our markets that are stronger than ever before in history. The combined NYSE and Euronext comprise a transatlantic company that operates six different exchanges catering to many different types of issuers. The International Accounting Standards Board and the U.S. Financial Accounting Standards Board have for years been working on a convergence project to eliminate needless regulatory friction between International Financial Reporting Standards and U.S. Generally Accepted Accounting Principles. And that has made possible the SEC's announcement that we are taking the next steps on our Roadmap to eliminate the reconciliation requirement in the United States, and that we are even considering allowing U.S. issuers to use IFRS.

In the brief moments we have together this morning, I'd like to share with you just a few thoughts on how corporate governance questions factor into this calculus. And as I do so, it is important to make one basic point as a foundation for those topics.

As regulators, we have to be aggressive in our role as market referees and protectors of investors' interests. And at the same time we have to be humble in recognizing that regulation is not the fuel that drives our markets — though it undoubtedly is the oil that greases the gears. Too little regulation, and investors demand a premium for their money to compensate them for the greater risks they face in a lawless market. Too much regulation, and the costs outweigh the benefits — robbing investors of return and making markets less efficient. When that happens, not just investors but consumers and entire national economies pay. So it is always important that regulators strike a balance between under-regulation, which carries with it the risk of fraud, abuse, and a loss of investor confidence, and over-regulation, which saps the economic vitality of otherwise vibrant markets.

What isn't so obvious is that this balance can be achieved in different ways. The differences in national systems of regulation aren't necessarily reflective of regulatory competition, or worse yet, intentional regulatory arbitrage by governments. Different markets can legitimately have different concerns. And those concerns arise, in many cases, from unique circumstances.

In America, our system of federal regulation has been built upon a foundation of laws and rules established by 50 state governments as well as U.S. territories and their respective courts of law. Fundamental corporate governance policies, such as the duties of care and loyalty that the board of directors owes to the corporation and its shareholders, are established not by federal but by state law. The SEC's rules complement state law, principally by focusing on the requirement of full, fair, and accurate disclosure of material information about public companies to their shareholders. We do not, generally, tell companies what to do. Rather, the SEC is primarily concerned that companies tell investors what they do. That is a different point of departure for the discussion of corporate governance than exists in Europe. The difference does not mean that we cannot align our systems of regulation, but it means that we have to be sensitive to the underlying reasons that we sometimes do things differently.

One of America's early icons was a rough-and-tumble frontier lawyer who was also Tennessee's first Congressman. He once memorably said, "It is a damn poor mind indeed that cannot think of at least two ways to spell the same word." Old Hickory, as he came to be known, was our nation's seventh President. Andy Jackson's folk wisdom is a good reminder to us today as we tackle the question of when it is better to be the same, and when it is better to be different.

The European Union itself is a vivid demonstration of why differences in markets can sometimes justify differences in regulation. In the United Kingdom and the Netherlands, for example, ownership of most public companies is widely diffused. There are few, if any, shareholders that own a controlling block of a public company's shares. In Germany, many public companies have controlling shareholders. Traditionally, those have been large banks. In Italy, the controlling shareholders are often entrepreneurial families. Even in markets that seem similar, we often see differences that profoundly affect how our markets work. For example, like the United States, the United Kingdom has many companies owned by large numbers of shareholders, none of whom owns enough to constitute control. But unlike the United States, the UK market historically has not had a very large retail component. Over the past few decades, the investors that predominate are not retail investors but large financial institutions, all located within a few blocks of each other in the City of London.

There are historical reasons for all of these differences, of course, and regulators need to take them into account. The important point is this: when it comes to securities regulation, differences in market structure will necessarily give rise to different problems, and it is up to the national regulator to diagnose and treat them.

For example, in markets with large blockholders, or markets where retail investment isn't common, regulators will naturally focus first on protecting minority shareholders from possible abuses by controlling shareholders. In other respects, they're more likely to take a "caveat emptor" approach to oversight. On the other hand, in markets with diffuse share ownership and heavy retail participation, regulators tend to focus on areas such as auditing standards and internal controls, to help these shareholders guard their interests against possible managerial abuses.

I'm absolutely certain that we can accommodate these differences as we seek to increase regulatory cooperation around the world. But unless we keep in mind the reasons that legitimate differences can exist — and it's easy for us to forget that, in our increasingly globalized world — then the job of mutual cooperation will be made needlessly more difficult. Just because capital now flows across borders more easily, and businesses routinely operate on a worldwide basis, doesn't mean that a one-size-fits-all approach to securities regulation is wise. We've got to respect our differences as we build on common ground.

Having said that, recognizing that there are differences doesn't require us to give up on the idea that convergence can be achieved in many important areas, or on the idea that mutual recognition is possible after a significant degree of convergence has been achieved. But it does mean that we regulators have to look closely at our national systems. We have to ask ourselves exactly why we do what we do. And if the answer is because we've always done it that way, that won't be enough.

The point of overarching importance is that as our markets evolve and globalize, we find that we now have more things in common than we used to. The need to get enforcement cooperation from our neighbours when corporate governance problems lead to financial traumas that quickly leap the Atlantic has nearly driven us into one another's arms. We all understand that we can't go it alone, if ever we could before. And as the SEC works with our counterparts overseas, we're increasingly finding that in many areas our regulatory objectives are very much the same.

In fact, we've now reached the point where we can ask: Given that our regulatory objectives are the same, shouldn't our regulations be the same as well? That we can ask the question at all is a testament to just how closely our markets are linked, and a tribute to the efforts that regulators around the world have made in seeking common ground. But let me anticipate the analysis and go straight to the answer to that question:

No. Our regulations shouldn't all be the same.

There is fool's gold here — the notion that a universal, global, single set of regulations would allow businesses, financial firms, and investors to operate in a completely borderless world. However attractive that utopian vision might sound to some, we must never forget that our rapidly globalizing markets present not only splendid new opportunities, but serious new dangers of fraud and unfair dealing.

And here is the risk in meeting the globalization of markets with a plan to merge all the world's securities regulatory regimes into one: Even where our regulatory objectives are the same, regulators are not omniscient. We don't always have the right answers to the problems that lie before us.

Experiments are as valuable to the regulator as they are to the scientist. While it's easy to imagine that conformity with a single standard has many advantages — and indeed, sometimes it does, since in many cases the comparability and simplicity of having just one approach outweighs the benefits that accrue from regulatory experimentation — that is not always the case. As a result, we regulators have to become comfortable diagnosing the differences. In America, that means using the variety that inheres in our federal system as the wind at our backs. We've seen, for example, how majority voting for director elections has advanced under this diversity model. As companies increasingly adopt majority voting standards, and in other cases, shareholders approve shareholder proposals for majority voting, we cannot help but notice that the states in which most U.S. public companies are incorporated make either of these approaches available, just as they permit either majority or plurality voting. Ultimately, shareholders can determine which of these methods they want the corporation to apply.

Both in Europe and America, our systems of regulation should be comfortable with giving investors choices. The idea that informed investors are in the best position to judge for themselves how to allocate their capital is the bedrock upon which our markets are built. That's why ensuring that both retail and institutional investors are properly informed is so central to the trans-Atlantic regulatory dialogue. Just as disclosure and transparency is a key element of good corporate governance, the cost of obtaining and processing information about the corporation presents a barrier to shareholders that is a systemic problem in corporate governance. The traditional answer to this problem — that the shareholder can rely upon an efficient market to judge the information for him or her — carries with it profoundly unsatisfying implications for the individual investor. That's why at the SEC, we are focusing so much attention on improving the quality of financial reporting through interactive data, which will let ordinary investors obtain information much more quickly, inexpensively, and usefully. Not incidentally, XBRL, the computer language of interactive disclosure, is a truly global phenomenon, deeply rooted in Europe and active in nearly 100 countries around the world.

For the same reason, we are focused on improving the comparability of accounting information in our global capital markets. Protecting the interests of shareholders and other stakeholders in the corporation, and ensuring integrity and ethical behaviour by directors and executives, is accomplished time and again by ensuring that all investors have access to clear, factual information. The financial reporting process forms a crucial link in enabling investors to monitor the directors who serve them.

So our task is to promote healthy corporate governance, both here in America and in Europe, as a means of securing the many potential benefits of global markets for investors and issuers alike — while continuing to provide the strong investor protections that our capital markets ultimately depend upon. We've got to be confident in determining that in some cases, convergence and harmonization are the right approach; that in other cases, an intentionally different national approach is best; and sometimes, simply offering investors a choice after full disclosure is the way to go.

Let's consider a concrete example: the move that's afoot throughout Europe and around the world for a truly global set of high quality accounting standards. The vision behind International Financial Reporting Standards is that a single worldwide set of standards will permit investors around the world to benefit from a high level of comparability and a consistently high level of quality in financial reporting. It would eliminate the need for investors and analysts to try to understand financial statements that are prepared using the different accounting standards of many jurisdictions. It would eliminate one of the significant barriers to raising capital outside one's borders. And it would provide a globally enforceable check on corporate governance practices, including executive compensation — where lately the SEC has done so much work.

IFRS promises to integrate our markets. But that promise is jeopardized if IFRS isn't applied faithfully and consistently across jurisdictions. Regulators must beware the impulse to develop nationally-tailored versions of IFRS, and we must cooperate with one another in implementing a set of standards that is faithfully and consistently applied.

Since 2005, the SEC has been following a publicly announced "Roadmap" that charts a path to when issuers would no longer be required to reconcile their IFRS financials statements to U.S. GAAP. We're well down the path charted in the "Roadmap," and we're still very much on track to eliminating the reconciliation requirement by 2009.

The SEC has also been mindful of the other ways in which U.S. laws and regulations intended to deal with corporate governance problems affect foreign issuers in our markets. In particular, we have noted the concerns raised by foreign private issuers about the application of Section 404 of the Sarbanes-Oxley Act. We have repeatedly extended the compliance deadline for certain foreign private issuers. We've been sensitive to the particular needs of foreign private issuers, and we have worked to minimize the burdens that 404 may impose on them.

I also want to point out that our new deregistration rule took effect this summer, allowing foreign private issuers that have a relatively small U.S. trading volume to withdraw their registration and end their U.S. reporting obligations. In short, foreign private issuers can withdraw rather than comply with 404, if they so desire.

But because the concerns raised by foreign private issuers about Section 404 weren't unique to them, the Commission has formally issued new guidance to assist management in evaluating their internal controls over financial reporting. At the same time, we and the Public Company Accounting Oversight Board completely replaced the existing auditing standard under 404 with a much shorter, risk-based and principles-based approach that will make compliance more rational and efficient, while at the same time better focusing the internal control assessment and auditing effort on what is truly material to the integrity of the financial statements.

The challenges we face are daunting, but I am absolutely certain that by working together, we can build a regulatory framework for corporate governance that supports global markets. After all, working together, our countries have confronted and surmounted challenges far greater than these in the past.

Many of us, as securities regulators, are similarly like-minded and we share common regulatory objectives. Even where our particular tactics differ, we must see ourselves as allies in a united effort to improve our markets together, for the benefit of our investors. We all share a conviction that protecting the property rights of investors is one of society's most effective means of advancing prosperity, and that directors and managers who uphold their traditional duty to operate their businesses in the best interests of shareholders contribute to the economic security of every nation.

Here, and wherever the world's securities regulators share the same objectives, we should relentlessly seek to make common ground. Where possible, we should work closely together to eliminate unnecessary and redundant regulations, to recognize how different regulatory approaches may achieve our shared objectives, and to learn from each other about what works and what doesn't.

And we should learn together to trust the choices investors make as we help ensure that those choices are fully informed.

I know everyone in this room is committed to these objectives. Thank you for inviting me to participate in this important discussion, and for permitting the SEC to host it. Most of all, thank you for what each of you does every day to bring our nations and our world closer together.

Questions & Answers

Andrew Clearfield, President, Investment Initiatives
Given that the SEC's mission has been, as you stated, primarily to involve itself in questions of disclosure, why is it that the Commission has chosen to sit on the New York Stock Exchange recommendation to abolish the Burger vote for directors?

Christopher Cox
Well, far from sitting on it, it is intensely being evaluated and discussed, as you might imagine and we are, as we enjoined to do at the front end of this proceeding, looking very, very carefully at empirical data, at studies and at market information. The context in which these choices are being made is just as important as the specific choices themselves. We want to make sure that, as we push in one Chinese door, another one doesn't pop out somewhere else that we hadn't contemplated in a way that we didn't intend. So it is because of the intense consideration, not for lack of it, that there is not a final result on that. The Exchange itself, I think, is going to be giving us different proposals.

Peter Ehrenhaft, Senior Counsel, Harkins Cunningham, LLP
Among the events of the day that was not mentioned was today's argument before the Supreme Court on the issue of the right of shareholders to bring actions against peripheral parties to disclosure and corporate governance. And I understand that the President personally overruled your desires to support the investors in that particular litigation, and that the Solicitor-General is going in in opposition to the claims of the shareholders. I wondered whether you had a view about the propriety of working to amend the statutes to

begin with, to assure this kind of additional check on corporate governance, or whether you are going to rely on whatever the court does on that matter?

Christopher Cox
Well, first, I think it is not correct that we didn't allude, at least, to the Supreme Court, given Professor Liebman's acknowledgement of the Chief Justice at the outset. He had him in mind, and I think everyone here certainly is interested in what the Court will do in this case.

The process that was followed, by which the SEC contributed its views to what ultimately became the view of the US government is the normal process. It's an inter-agency process. There are many different points of view and regulatory concerns and policy concerns involved in a decision such as this. I think that we squarely presented the view of the SEC, playing the position of the Securities and Exchange Commission and the investors' advocate. The banking agencies had other concerns that arise from their responsibility for looking after the safety and soundness of banks. All of these things, I think, were contributed and considered in the normal way, and so I think there is no question that ultimately the Court will have before it ample expression of the different points of view. Whatever decision the Court makes, it won't be for lack of information and input.

With respect to whether Congress should change the law in this respect, I think we might be getting a little ahead of ourselves, not even knowing what the Court's going to do.

Antonio Borges Vice Chairman, Goldman Sachs International
I very much appreciate your decision to make it easier for foreign companies to de-list. And, in fact, many people argue that it was so difficult to exit the US markets that this became actually a barrier to entry. Many people decided: we should not go to the US, because it's a decision for life. Now this is not the case any more. And so, my question is: are you observing a return of interested companies that indeed de-listed? Are others rethinking about coming to the US because of this decision of yours? Is the US becoming, in your view, more attractive for foreign companies as you move in this direction?

Christopher Cox
The last part of that question is the easiest to answer; I think the answer should be yes, in part, because of our high level of embrace of the challenge of global integration. We are very much committed to this. We are certainly committed to working with our regulatory counterparts to benefit our home markets and investors in the United States who are now increasingly global in their outlook and their investments.

With respect to the empirical data, I would say it's too early. We're only talking weeks and months here. If the principle operates as we expect it will, it will operate over the long haul. That is to say you should, by removing the barrier to leaving, first see some companies leave because they couldn't and there's little apparent demand there perhaps, and in particular there were companies that were in a circumstance where they really didn't have active US investor interest, and but for a rule that was operating they would have left long ago. So if we get that out of the way, then you can observe over a longer term what is the impact here. And certainly the way that the Commission intends this to work is that the rest of the world will see that our market operates fairly and it's a regulatory system that is susceptible of relatively straightforward compliance, where the costs are outweighed by significant benefits.

Graham Mather, President, European Policy Forum
I wonder if I could ask Chairman Cox to comment on the upcoming important G7 discussions on greater transparency, perhaps affecting hedge funds, perhaps affecting the different roles of rating agencies, and whether he sees a clear picture emerging on both sides of the Atlantic there?

Christopher Cox
I was just cataloguing some of the things that I know the G7 nations are focused on. You mentioned hedge funds and rating agencies. I think we're also focused on something that

the SEC is taking a lead on, and that is the possibility of an inter-regulatory approach of mutual recognition. We spent a lot of time in this room with round tables focused on that, and I think that's also an interest at that level.

Taking ratings agencies as another example, the SEC has not in the past been a lead regulator in this area. Now we will be. Indeed, our regulatory function will extend not to traditional areas of inspecting books and records and compliance and conflicts of interest and so on, but into a new area that the SEC hasn't had before for, and that is promoting competition within the industry. That is our statutory responsibility, and we are sending market regulatory people to New York to be permanently located there for that purpose.

The promotion of competition in that space, I would say that that's the cognate of another, similar issue, and that is competition, or lack of it, in the auditing services market, where I think there's also a tension at that level.

So, in each of these areas, I think our menu - what we're working on - dovetails nicely with what is the broader, international agenda.

Hedge Fund regulation, we're also trying to be as collaborative as we possibly can. Here, sharing information is the predicate for any regulatory choices. Between the UK and the United States, we have by far the lion's share of the world's prime brokerage within this space, and so we are focused in part on evaluating what we know from that experience. We're sharing our regulatory judgements as well, and whether or not there is some specific G7 new approach to these topics remains to be seen, but I think what we're doing here at the SEC is putting us in the forefront of what those choices might be.