John Grout, Policy and Technical Director
The Association of Corporate Treasurers

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Impact of extraterritorial regulation on the cross-border financial markets

Session 2: Panel: The consequences of US Regulation of Non-US Companies

Good morning.

I am here to tell you how it feels as an issuer.

My fellow panellists are going to focus on the *facts* of US regulation and its extraterritorial impact. I am going to operate on a much less elevated level.

I want to talk rather about behavioural aspects… About how foreign businessmen think about US regulation.

Don't confuse us with facts: the perceptions are what counts.

And it is as much perception of culture, as of black-letter law or regulation.

Foreigners pick up countries' culture from simple things.

We are talking about *extra-territoriality*.

Just as the UK did a century before, the US often confuses itself with the world or – "carelessly" as Chris Bates put it earlier, includes the rest of the world in its own arrangements.

Consider: the World Series baseball championship. It consists of various US teams plus one from Canada.

Several years ago, I was a member of a panel discussing the future of securities market regulation for an afternoon at Harvard Law School. The panel included an SEC Commissioner, the head of the PCAOB, heads of various US securities markets etc. I was the only issuer present and, more importantly, the only non-US person. But it was straight-facedly billed as an "International Panel".

By the way, my comments were not welcomed.

I suggested that the *perception* of over-regulation would be liable to weaken the attraction of the US capital markets to non-US issuers. Hmmmm.

Lets get back to basics.

Right to property, rule of law, legal certainty and enforcement without arbitrariness are often held as important contributors to making a place a good place in which to do business. Criticism of China or Russia on these grounds is daily fare in the business sections of newspapers.

The climates of opinion, however, are mostly conditioned by impressions, not analysis. People who don't live a country or visit it regularly get their impressions from the press.

Everyone is afraid of other countries' unfamiliar, no doubt quaint, but threatening, legal systems.

In England, physical restraint in course of an arrest is supposed to be used only where it is reasonably believed that a prisoner may be violent or seek to abscond. Prisoners under restraint brought into court buildings are anonymous in closed vehicles.

In the US, we see the "perp. walk", where a grey-haired man, wrists restrained behind him, is made to walk some distance through photographers and the public throng, escorted towards a trial where he is merely the accused. Our press marvels at this.

Of course we recognise that different countries make different activities criminal. On this island, but not in the UK as a whole, we lack a crime or misdemeanour of a pedestrian failing to use a "designated" crossing place to cross the road – jaywalking.

Earlier this year, a small professor in his late 50s at a history conference in Atlanta was thrown to the ground, handcuffed, arrested, held overnight in cells, charged and brought before the court in the morning.

The professor had tried to cross a deserted road between hotels otherwise than at a designated crossing.

The arresting policeman, by the way was off-duty, said to be wearing a bomber jacket over his uniform and working as a security guard for Hilton Hotels. He summoned a further five or seven policemen to help in the restraint.

His reason to throw the professor to the ground and restrain him? When he stopped the professor and asked to see his ID, the professor asked to see the man's warrant card.

The UK media had a field day. All of them.

The press reports are what matters – not the truth or justice of the authorities' position – in conditioning foreigners' sub-conscious evaluation of the US as a potential place to do business or a capital market in which to raise money.

The US reaction when P&O sold US ports to Dubai Ports – it blocked the deal – did not help.

In London, here, we are regularly reminded that we owe the Euromarket's – originally the Euro-dollar-market's – base in London to foreigners' fear that the US would seek to block access to their investments if maintained in the US. We owe the market's size to the application of interest rate ceilings to foreign deposits in the US.

Reports of trials of US company executives – even where there has clearly been false accounting, defalcation, or simple fraud – often imply that whether a person is chief witness for the prosecution or the principal accused is a matter of chance or of the electoral cycle affecting the prosecuting attorney's office.

That a foreigner's resisting extradition to the US disqualifies them for bail if they are extradited to the US is reported in alarming terms.

The US practice of plea-bargaining is portrayed frighteningly. Sharply reduced sentences for one defendant who pleads guilty in a corporate fraud case may be dependent on their helping secure convictions of former colleagues, guilty or not.

Sentencing for what seem to be minor false-accounting offences, which result in a twenty years in gaol without the possibility for parole, add to the alarm.

Apart from criminal or administrative penalties, there is also the matter of potential civil liabilities.

The stories are like water on a stone.

So if you are a non-executive director of a foreign company which has no connection with the US, you will need a very good reason not to disturb that comforting position. Of course, the CEO and FD are much better paid to face up to legal risks, and can accept doing business with the US more easily.

But the wives of all of them will ask after reading the newspaper over breakfast – "you're not exposed to these US laws are you dear?"

So, if a company's underlying business has no connection with the US, a very good reason is needed to volunteer falling under US jurisdiction just by entering US capital markets.

A very good reason would be if the US had a uniquely large, liquid and accessible capital market.

At the end of WWII, Asia and Europe including the UK lacked capital almost totally. They were pretty well dependent on the US – both for aid such as the Marshall plan, and for direct investment capital.

By the end of the last century, the US capital market was still uniquely deep. But now, with the world awash with capital and with China and resource based countries accumulating capital, US uniqueness is more questionable.

Against that background, we saw the US tighten regulation applied to overseas issuers into US capital markets (alongside regulation for domestic issuers) in the Sarbanes-Oxley Act. Only recently has implementation brought the implications fully home to affected foreign companies.

Foreign equity issuers into the main US markets were used to produce accounts reconciled to US GAAP, the long-form Management Discussion and Analysis and other filings.

Now, with strong penalties applied for breach, companies and their principal executives are required to super-certify reports. Some wider requirements were introduced for internal control and risk management generally. The PCAOB was introduced. Audit requirements and supervision of auditors were tightened too.

The language of Sarbanes Oxley itself is reasonably high-level and could be seen as setting principles for companies to follow. The first guidance note issued by the SEC was similar – very short and talking about the need for companies' "maintenance of sufficient procedures to provide reasonable assurance that the company is able to collect, process and disclose" the required information.

However, the PCAOB produced detailed rules for auditors' testing of compliance. The SEC was bombarded with questions and published responses to "frequently asked questions" which quickly became another corpus of rules.

Now detailed audit rules and testing methodology were prescribed for disclosures if the company were listed in the US. And the standard was absolute. No matter how trivial an issue, it had to be tested in the same way. The UK had always adopted a more risk based approach.

At the same time, the auditors – any auditors – whose work would go towards the audit report of a US listed company would now have to meet the PCAOB's requirement and be subject to its inspection.

Remember that the big audit firms are each not one firm, but groupings of firms in different jurisdictions. So the number of firms subject to inspection by the PCAOB is large.

And they are mostly subject to inspection by their national audit regulator.

No doubt in some countries PCAOB audit oversight was an important and necessary improvement. Even in the UK, *independent* auditor regulation is relatively new.

But the US imposed additional costs and potentially large additional penalties for infractions. It takes a long time for companies to react to such changes. Where a company is listed is normally just part of the furniture – it is not a decision a company reviews regularly.

At the end of last month ICI and United Utilities joined the companies de-listing from the US. These relatively small companies announced expected savings of “at least” £4m and £2m a year from withdrawing from US registration. I do not think such savings are material or significant.

But, and much more significantly, they said they expected to see major savings in management time. They did not mention the personal risks.

As an aside, for companies taking a secondary US listing when their primary listing is itself in a developed market, I have to ask how valuable a US listing really is. I doubt if it helps with capital raising.

Of course not all US secondary-listed companies are considering withdrawing. Companies with a major US business who consider their US presence is of strategic significance, are not planning to de-list.

Some companies have been quietly pleased to use the big-stick of Sarbanes-Oxley to tighten up oversight of information flows from, as well as risk management practices and control in, some of the more independent minded parts of their group. “Money well spent, at least for now,” according to one FD who must remain anonymous.

And some regulated sector firms have also found it relatively easy to fall in with application of SarbOx rules.

But for companies without those advantages or commercial need to be seen in the US, the US has indeed become – temporarily, I hope – less attractive as a capital market. London (as a proxy for the European single market, so called) – and increasingly Hong Kong, perhaps soon mainland Chinese centres – beckon.

This is a commonplace in the media.

According to data compiled by Bloomberg, earlier this month “The total amount of money raised in Europe so far this year is 78 percent greater than the value of U.S. offerings, as stricter financial-reporting requirements in New York deter some companies from listing.”

We begin too to see other regulators getting in on the act.

The EU has mandated use of IFRS for firms using EU capital markets unless their accounting system is accepted as “equivalent” by its own regulators.

The EU's 8th accounting directive says that for companies using EU capital markets, the audit certificate must be from a firm recognised by a Member State regulator. Shades of SarbOx. Do we really want the PCAOB and its EU Member State equivalents inspecting auditors all over the world? Mutual recognition and cooperative working are surely the answer.

Indeed, we heard earlier about the moves to improve co-operation between regulators. Ethiopis Tafara reminded us of his advocacy of a new Blueprint for Cross-Border Access to U.S. Investors and other work by SEC people and we have heard about equivalent work going on elsewhere.

And SEC Chairman Cox's tour de force Keynote Address to the IOSCO Technical Committee Conference here in London in November last year was very important. It talks of the impossibility, indeed the undesirability of full regulatory convergence internationally but the need for "appropriate" regulation and cooperation among regulators.

My view is that it is indeed impossible quickly to adopt precisely the same rules internationally. Our cultures are too diverse. But we can surely agree on principles so that mutual recognition must be faster.

Of course the UK claims a principles based regulatory system. But the FSA has 8,000 pages of rules. You can find principles in the US too, among the rules.

Its tough though, to construct a new order, with several countries hosting major capital markets and wanting a seat at the table and perhaps 20 more wanting to be consulted along the way. Difficult.

But we must make the most of current willingness to work on the issues – in the interest of capital markets users everywhere.

Maybe even something can be done about the negative spin we read in our newspapers.

I am an optimist – but perhaps not so much about the spin.

John Grout | Policy and Technical Director
DL: +44 (0)20 7847 2575
W www.treasurers.org
E jgrout@treasurers.org

The ACT's approach to policy issues is set out in our manifesto

ACT
51 Moorgate
London EC2R 6BH, UK
T +44 (0) 20 7847 2540
F +44 (0) 20 7374 8744
www.treasurers.org

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