DIFFERING GLOBAL REGULATORY REQUIREMENTS ARE CONFUSING THE AIMS OF A TRULY GLOBAL MARKET, SAYS PRICEWATERHOUSECOOPERS' **PETER WYMAN**.

ASSESSING WORLD AFFAIRS

Financial scandals have arisen with monotonous regularity at each downturn of the economic cycle over at least the past 300 years since the separation of management and ownership of businesses began. In this respect, the recent scandals in the US were no different from the loans and savings debacles in the US or those in the UK in the early 1990s; a relatively small number of companies collapse when the economic tide goes out and exposes their flawed business model. New regulation is introduced to make sure that 'nothing like this can every happen again'. Honest businesses comply, but the next generation of chancers do not, and get found out eventually when the economy goes full circle again.

GLOBAL SCANDALS. In one very material respect, however, Enron and the other US scandals were very different from those which preceded them. In the past, scandals and the associated remedial regulation have been almost entirely national affairs. The collapse of the Maxwell empire received relatively modest coverage in the US press, even though there were large US businesses involved, and the reverse was true with the loans and savings scandal. Certainly, neither scandal produced a regulatory response the other side of the Atlantic. However, a perhaps unexpected consequence of the globalisation of business, investment and the media was that Enron produced a regulatory reaction in almost every country with a developed capital market, even when no scandal had arisen there.

To compound matters, the US Securities and Exchange Commission (SEC), together with the Public Company Accounting Oversight Board, have set themselves up to be, in effect, a global regulator. Their logic is that their duty is to protect American investors in companies listed on an American stock exchange, regardless of the domicile of the company concerned. As a result, British, German and Australian companies, to name but a few, that have a listing in the US are subject to US securities laws and regulatory oversight in an unprecedented way and to an unprecedented extent. So, too, are their auditors, again wherever domiciled. Since markets do not easily accept companies listed on the same exchange having different regulatory and disclosure requirements, it is inevitable that the US regime will in due course become the universal regime across all stock markets where there are one or more companies that are also listed in the US.

However, as has already been said, governments and regulators across the world have also imposed their own new, additional regulatory requirements on companies listed on their stock exchanges. While there has been much discussion between regulators, and many of the principles in the regulation of one country can be seen in the regulation of others, each has gone about matters in a slightly different way and each has imposed, therefore, duplicative regulation on multinational companies and their auditors.

Of course, countries have always sought to protect their investors through what they regard as appropriate regulation. However, they have also recognised that other countries have their own regulation and, where another country is seen to have a broadly acceptable regulatory environment, its regulation is recognised as an acceptable substitute for appropriate parts of the host country's procedures. So, although, for example, the London Listing Rules apply to all companies listed in London, the Listing Authority will not require all aspects of UK corporate governance to apply to, say, a US company. Furthermore, London will recognise, again by way of example, US auditors, provided they have been approved by the appropriate US regulators. It is this concept of mutual recognition which the Americans have now largely destroyed. And regrettably, but inevitably, other countries are now playing tit-for-tat, so that, before long, companies listed on more than one stock exchange, or with large subsidiaries in more than one country, will face multiple regulation.

At this point an example might be helpful. Section 404 of the US Sarbanes-Oxley Act 2002 requires that CEOs and CFOs must now certify that financial reporting controls are both fit for purpose and have been applied. They must document these controls, test them and, in due course, their external auditors will be required to attest to their assessment. By contrast, the UK has had a requirement for companies to review, annually, the effectiveness of their internal controls relating to their financial reporting. This is a different process from the US and, whereas when it was introduced in the UK there was no similar requirement in the US, Section 404 now places a much heavier requirement on US-listed companies than those that are listed only in the UK. Other countries around the world either have, or are introducing, their own requirements relating to the assessment of the effectiveness of internal controls, all aimed at producing broadly a similar result, but all with different detailed requirements.

Either duly listed companies will find themselves having to comply with different regimes, or they will simply adopt the US requirement, despite the fact this does not sit well with the principles-based approach to corporate governance, financial reporting and auditing adopted in the UK and elsewhere. To avoid either the duplication of cost and effort or the global adoption of the US requirements, the world needs to agree the overall principles relating to the assessment by directors of internal controls and the reporting of that assessment by both directors and auditors. Each country which then adopts these principles into its own domestic reporting requirements should then be recognised by all others as having a comparable system, therefore restoring the long-standing approach of mutual recognition.

UNNECCESSARY REGULATION. Therefore, the imposition on multinational companies of unnecessary regulation is not only costly but is potentially counterproductive if all the effort has to go into ensuring compliance with the letter of the regulation of a number of different countries, rather than having time to think properly about the results of their assessment. A proper system of mutual recognition will relieve this danger and, at the same time, introduce a healthy degree of regulatory competition. The cost of capital will be less in those markets which are seen to have effective regulation and so, over time, companies will be attracted to them. This is good for the development of global markets, which in turn is good for the global economy which, at the end of the day, should be the key objective.

‘THE IMPOSITION ON MULTINATIONAL COMPANIES OF UNNECESSARY REGULATION IS NOT ONLY COSTLY BUT IS POTENTIALLY COUNTERPRODUCTIVE’

Global markets ultimately depend on a successful ‘global’ capital market. A global capital market cannot be efficient if there are wildly different requirements imposed on it by each national jurisdiction. At the end of the day, therefore, a return to mutual recognition of national arrangements, under an agreed framework, is needed for the good of the global economy.

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