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The EU Challenge to the SEC

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Abstract

This Article argues that the European Union (“EU”) has been instrumental in moving the United States (“U.S.”) Securities and Exchange Commission (“SEC”) from a policy of national treatment of foreign (non-U.S.) issuers to a policy of mutual recognition of financial disclosure accounting standards based on convergence between U.S. accounting standards and international accounting standards. Further, future initiatives based on a national treatment model are under consideration by the SEC. At the same time, progress on the road to mutual recognition has been made possible by SEC influences on the EU, leading to securities regulation reform in the EU, and greater convergence between U.S. and EU securities regulation.

THE EU CHALLENGE TO THE SEC

*Roberta S. Karmel**

INTRODUCTION

This Article argues that the European Union ("EU") has been instrumental in moving the United States ("U.S.") Securities and Exchange Commission ("SEC") from a policy of national treatment of foreign (non-U.S.) issuers to a policy of mutual recognition of financial disclosure accounting standards based on convergence between U.S. accounting standards and international accounting standards. Further, future initiatives based on a national treatment model are under consideration by the SEC. At the same time, progress on the road to mutual recognition has been made possible by SEC influences on the EU, leading to securities regulation reform in the EU, and greater convergence between U.S. and EU securities regulation.

The mutual recognition concept in financial regulation was a construct of the EU. In order to realize the goal of the free flow of capital, the European Commission promulgated directives aimed at harmonizing the regulatory structure for financial institutions and securities offerings and trading, and then established the single passport principle whereby a financial institution authorized in one EU state could do business in any EU state without further regulatory approvals.¹ Therefore, any bank or investment bank authorized to do business in one EU country can conduct business in another EU country or trans-nationally.

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1. See generally Council Directive No. 2000/12, O.J. L 126/1 (2000) (directing, in the context of the European Union ("EU"), that the "home Member State," i.e., the place of permanent establishment, may require authorization for financial services, but that the "host Member State," i.e., where the credit institution has a branch or simply provides services, may not require authorization); Second Council Directive No. 89/646, O.J. L 386/1 (1989) (amending First Council Directive No. 77/780, O.J. L 322/30 (1977) [hereinafter Second Banking Directive]); First Council Directive No. 77/780, O.J. L 322/30 (1977) [hereinafter First Banking Directive]; see also Emiliou Avgouleas, *A Critical Evaluation of the New EC Financial-Market Regulation: Peaks, Troughs, and the Road Ahead*, 18 *TRANSNAT'L LAW* 179, 183 (2005) (briefly including Banking Directives in discussion of European harmonization).

Similarly, the Prospectus Directive and the Transparency Directive harmonize disclosures by companies making offerings and trading in the public securities markets and then provide a basis for requiring all EU Member States to accept the disclosure documents produced pursuant to these directives as meeting host country securities regulation requirements for securities offerings.² In addition, all EU issuers must report their accounts according to International Financial Reporting Standards (“IFRS”), as promulgated by the International Accounting Standards Board (“IASB”).

Arguments that the U.S. SEC should similarly engage in mutual recognition of foreign financial institutions and public company disclosure documents have been made for many years.³ Until recently, however, the SEC has refused to embark upon mutual recognition, with a few notable exceptions,⁴ and rather, has insisted upon national treatment of foreign issuers and financial institutions. Foreign issuers were required to submit to the same regulatory regime as U.S. issuers if they wished to sell securities to U.S. nationals or have their securities traded on U.S. exchanges. Similarly, if a foreign investment bank or exchange wished to engage in business in the U.S., it was required to register with the SEC under the same terms and conditions as a U.S. broker-dealer or exchange. No foreign exchanges so registered,

2. See generally Council Directive No. 2001/34, O.J. L 184/1 (2001), amended by Council Directive No. 2003/71, O.J. L 345/64 (2003); Council Directive No. 2001/34, O.J. L 184/1 (2001), amended by Council Directive No. 2004/109, O.J. L 390/38 (2004).

3. See generally Ethiopis Tafara & Robert J. Peterson, *A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 31 (2007); Edward F. Greene, *Beyond Borders: Time to Tear Down the Barriers to Global Investing*, 48 HARV. INT'L L.J. 85 (2007); Edward F. Greene, *Beyond Borders Part II: A New Approach to the Regulation of Global Securities Offerings* (2007), http://www.sechistorical.org/collection/papers/2000/2007_0501_GreeneBeyondT.pdf; Edward F. Greene & Linda C. Quinn, *Building on the International Convergence of the Global Markets: A Model for Securities Law Reform*, 1372 PLI/CORP 561 (2001); Roberta S. Karmel & Mary S. Head, *Barriers to Foreign Issuer Entry Into U.S. Markets*, 24 LAW & POL'Y INT'L BUS. 1207 (1993).

4. See generally Cross-Border Tender and Exchange Offers, Business Combinations and Rights Offerings, 64 Fed. Reg. 61,382 (Nov. 10, 1999) (codified at 17 C.F.R. §§ 200, 230, 239, 240, 249, 260); Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers, Exchange Act Release No. 29354, 56 Fed. Reg. 30,096 (July 1, 1991) (codified at 17 C.F.R. §§ 200, 201, 210, 229, 230, 239, 240, 249, 260, 269); see *infra* note 16 and accompanying text; see also, Tzung-bor Wei, *The Equivalence Approach to Securities Regulation*, 27 NW. J. INT'L L. & BUS. 255, 279 (2007) (explaining some of the reasons behind, and effects of, Multi-jurisdictional Disclosure System (“MJDS”).

and most foreign investment banks wishing to do business in the United States formed U.S. subsidiaries and registered them as broker-dealers with the SEC.

At the end of 2007, however, the SEC determined to accept IFRS rather than U.S. Generally Accepted Accounting Principles (“GAAP”) in SEC filings by foreign issuers. Further, the SEC has suggested that it may permit foreign stock exchanges and perhaps foreign broker-dealers to engage in business in the United States based on mutual recognition if a foreign jurisdiction has a regulatory regime that is “equivalent” to the regulatory regime of the United States. This significant change in SEC policy was the result of political pressure on the SEC by the EU and a cooperative effort on the part of the SEC and the EU. Part II of this Article will set forth the story of the SEC’s change of policy and the EU’s role in accomplishing that change. Part III will discuss the contours of a possible new regulation utilizing mutual recognition as a basis for permitting non-U.S. stock exchanges and broker-dealers to enter the U.S.

The EU’s effort to persuade the SEC to accept IFRS and to permit EU stock exchanges to place their screens in the U.S. needs to be seen in the context of globalization of the capital markets. Various players in the financial markets were also pressuring the SEC to change its policies. Further, the securities regulations of the EU and the SEC have been converging over the years, and just as the EU has influenced rule-making at the SEC, the SEC has influenced the EU in the development of its securities laws. The development of strong capital markets in Asia and South America has also influenced the SEC and the EU to cooperate in the international securities regulatory sphere.

II. *THE ROADMAP TO RECOGNITION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS*

A. *Requirements of the U.S. Securities Laws for Public Issuers*

The U.S. federal securities laws establish mandatory disclosure of the business and financial affairs of all companies which make a public offering of securities. The Securities Act of 1933 (“Securities Act”) covers initial distributions of securities and requires that securities issuances be registered with the SEC prior to sale unless an appropriate exemption from registration is

available.⁵ The Securities Exchange Act of 1934 (“Exchange Act”) regulates post-distribution trading in securities and requires publicly traded companies to file annual and periodic reports with the SEC, including audited annual financial statements prepared according to U.S. GAAP.⁶ The most important part of an SEC registration statement is the prospectus circulated to investors. Information required in a prospectus is specified in Section 7 of the Securities Act.⁷ For all securities, except foreign government securities, the registration statement must contain the information and documents specified in Schedule A, and if the entity registering is a foreign government, Schedule B.⁸ Under Section 19(a) of the Securities Act, the SEC may adopt rules and regulations and define terms.⁹ Pursuant to this authority, the SEC has adopted Forms for the registration of securities offerings, Regulation S-K, specifying the narrative contents of such forms, and Regulation S-X, specifying the accounting statements required to be included in SEC filings.¹⁰ The SEC’s rule-making power is very broad and gives the SEC authority to specify accounting principles. The SEC has exercised this authority by delegating its authority to the accounting profession, specifically the Financial Accounting Standards Board (“FASB”), by recognizing its standards as “authoritative” for filed documents.¹¹

The SEC generally requires foreign issuers that publicly raise capital in the United States or list their shares on a U.S. securities exchange to comply with the registration requirements of the Securities Act and the Exchange Act, unless appropriate exemptions from registration are available. Nevertheless, the SEC has designed special registration forms for foreign issuers

5. 15 U.S.C. § 77e (2008).

6. *Id.* § 78m.

7. *Id.* § 77g.

8. *Id.* § 77aa.

9. *Id.* § 77s(a).

10. Form S-1 is the general form of registration statement; Form S-3 is a form for seasoned issuers. Regulation S-K is set forth at 17 C.F.R. § 229.101 (2008), Regulation S-X is set forth at 17 C.F.R. § 210.2-01 (2008).

11. Accounting Series Release No. 150, 1973 WL 149263 (Dec. 20, 1973), *updated* in Commission Statement of Policy Reaffirming the Status of FASB as a Designated Private-Sector Standard Setter, Securities Act Release No. 33-8221 (Apr. 25, 2003), <http://www.sec.gov/rules/policy/33-8221.htm>. The SEC has specified the contents of financial statements and other information for Securities Act registration statements and Exchange Act filings in Regulation S-K and Regulation S-X.

which relax some of the rigors of the registration requirements. Form 20-F is the core document authorized by the SEC for use by foreign issuers.¹² In October 1999, the SEC amended the foreign issuer disclosure forms to substantially replace the non-financial disclosure requirements in Form 20-F with disclosure standards endorsed by the International Organization of Securities Commissions ("IOSCO").¹³ The development of these international disclosure standards by IOSCO, with the cooperation of the SEC and European securities regulators, was an important step in the convergence of U.S. and EU disclosure standards.

IOSCO's non-financial disclosure standards took a decade to develop. In adopting IOSCO's disclosure standards for foreign private issuers, the SEC significantly changed the form, although not the content of previous disclosure standards.¹⁴ The SEC did not, however, change its accounting disclosure regulations at that time for foreign private issuers, which were still required to reconcile their financial statements to U.S. GAAP. However, it did issue a Concept Release requesting comments to determine under what conditions it would accept financial statements of foreign private issuers prepared using International Accounting Standards Committee ("IASC") (the predecessor to IASB) standards.¹⁵

Until last year, the SEC accepted the mutual recognition principle in only two instances. First, it negotiated a multijurisdictional disclosure system ("MJDS") with Canada, whereby documents filed by Canadian issuers with their securities regulator could be used as SEC disclosure filings. The predicate for the MJDS was the harmonization of U.S. and Canadian securities laws. Nevertheless, Canadian issuers were required to reconcile their financial statements to U.S. GAAP.¹⁶ The second area in

12. Forms F-1 and F-3 are registration forms for foreign private issuers.

13. *See generally* International Disclosure Standards, Securities Act Release No. 7745, 64 Fed. Reg. 53,900 (Oct. 5, 1999) (codified at 17 C.F.R. §§ 210, 228, 229, 230, 239, 240, 249, 260).

14. *See id.* at 53,908.

15. International Accounting Standards ("IAS") Concept Release, Securities Act Release No. 7801, 65 Fed. Reg. 8,896 (Feb. 23, 2000) (codified at 17 C.F.R. §§ 230 & 240) [hereinafter IAS Concept Release].

16. *See generally* Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers, Exchange Act Release No. 29354, 56 Fed. Reg. 30,096 (July 1, 1991) (codified at 17 C.F.R. §§ 200, 201, 210, 229, 230, 239, 240, 249, 260, 269).

which the SEC established a mutual recognition regime was with respect to tender offers and rights offers.¹⁷ Because of complaints from U.S. 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. But the SEC did not then move forward with any mutual recognition initiatives except to the extent it was prodded to do so by the EU and the IASB.

B. *The Prospectus and Transparency Directives*

In Europe, in the meantime, harmonization efforts with regard to the securities markets and their regulation were also moving along at a very slow pace. Toward the end of the 1990s, however, a driving force for reform was the desire to harmonize disclosure policy and to create a European-wide capital raising mechanism before enlargement of the EU made such a task too difficult.¹⁸ This push for reform led to the development of the Financial Services Action Plan (“FSAP”) in 1999: a series of policy objectives and specific measures to improve the single market for financial services in the EU. It is comprised of forty-two separate measures designed to harmonize EU Member States’ regulation of securities, banking, insurance, mortgages, pensions, and all other forms of financial transactions.¹⁹ These measures included the Prospectus and Transparency Directives.²⁰

The Prospectus Directive seeks to impose a comprehensive disclosure regime on all EU jurisdictions of uniform application. Member States may not impose additional requirements. This has therefore been called a “maximum harmonization” initiative.²¹ The aim of the directive is to ensure investor protection and market efficiency, in accordance with high international

17. See generally Cross-Border Tender and Exchange Offers, Business Combinations and Rights Offerings, Securities Act Release No. 7759, 64 Fed. Reg. 61,382 (Nov. 10, 1999) (codified at 17 C.F.R. §§ 200, 230, 239, 240, 249, 260).

18. See generally Roger J. Goebel, *Joining the European Union: The Accession Procedure for the Central European and Mediterranean States*, 1 LOY. INT’L L. REV. 15 (2003-04).

19. See Securities Expert Group, *Financial Services Action Plan: Progress and Prospects, Final Report* 5-6 (2004), http://www.europeansecuritisation.com/pubs/FSAP_stocktaking_Report.pdf.

20. See *supra* note 2 and accompanying text.

21. See generally EILIS FERRAN, *BUILDING AN EU SECURITIES MARKET* (2004).

regulatory standards. The Prospectus Directive overhauls two prior prospectus directives which were largely unsuccessful in facilitating the raising of capital across borders in the EU because of an absence of harmonized procedures and inconsistent interpretations and implementations in Member States. Although the structure of the directive is similar to the structure of the Securities Act, the United States and EU legal regimes have not been harmonized.

The Prospectus Directive relies on the “single passport for issuers” concept, whereby a prospectus approved by one competent authority will be required to be accepted throughout the EU, without additional approval or administrative arrangements by other Member States.²² The Prospectus Directive identifies two circumstances where a prospectus is required to be published: first, before an offer of securities is made to the public; and second, before securities are admitted to trading on a regulated market.

The Prospectus Directive does not specify the detailed form and content of prospectuses, but an EU Implementing Regulation prescribes content and format schedules for equity, debt, and other types of securities.²³ The EU disclosure standards thus put in place are intended to be in accordance with the international disclosure standards approved in 1998 by IOSCO, and already adopted by the SEC in revisions to its foreign issuer disclosure requirements.²⁴

The EU Regulation implementing the Prospectus Directive provides for incorporation by reference of information already disclosed by an issuer in annual or interim financial reports and certain other documents.²⁵ The disclosure requirements for

22. *See generally* The Forum Of European Securities Commissions, A “European Passport” for Issuers (May 10, 2000) <http://www.cnmv.es/delfos/autoridades/fesco/fesco7.pdf>.

23. *See* Commission Regulation No. 809/2004, O.J. L 149/1, at 3 (2004) (Commission Regulation of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements).

24. *See generally* International Disclosure Standards, Securities Act Release No. 7745, 64 Fed. Reg. 53,900 (Oct. 5, 1999) (codified at 17 C.F.R. §§ 210, 228, 229, 230, 239, 240, 249, 260). This Form applies to foreign issuers in the SEC disclosure regime. The SEC believed that its requirements for U.S. issuers exceeded the International Organization of Securities Commission’s (“IOSCO’s”) standards.

25. *See generally* Council Directive No. 2003/71, O.J. L 345/64 (2003).

prospectuses are located in annexes to the Commission's regulation. One of these requirements is trend information, which encompasses the "most significant recent trends in production, sales and inventory, and costs and selling prices since the end of the last financial year to date," and "[i]nformation on any known trends, uncertainties, demands, commitments or events that are reasonably likely to have a material effect on the issuer's prospects for at least the current financial year."²⁶ Although the thrust of this requirement is similar to the SEC's requirements for management's discussion and analysis ("MD&A") of financial condition and results of operations, the SEC's regulations are considerably more fulsome.²⁷

The Transparency Directive establishes requirements regarding the disclosure of annual, periodic, and ongoing information by issuers whose securities (equity or debt) are admitted to trading on a regulated market. It is therefore in some ways more limited in its scope than the Prospectus Directive, even though various "new markets" in Europe, as well as traditional stock exchanges, are considered regulated markets. In other ways, the Transparency Directive captures more issuers than the Prospectus Directive because it applies to non-EU issuers who have securities listed on an EU market. The Transparency Directive establishes uniform financial reporting standards and publication requirements among the Member States requiring EU issuers to publish financial reports within four months after the end of the financial year. The reports must remain publicly available for at least five years.²⁸

The Transparency Directive also prescribes the contents of the annual financial report to include audited financial statements, a management report, and a statement by responsible persons within the issuer certifying the accuracy of the financial statements and management report.²⁹ A significant change made prior to the promulgation of the Transparency Directive was the adoption of IFRS as the applicable disclosure standard for all listed issuers across the EU. By an automatically effective regulation, rather than a directive, the Commission mandated

26. Commission Regulation No. 809/2004, annex I (12), O.J. L 149/1 (2004).

27. See generally Regulation S-K, Item 303, 17 C.F.R. § 229.303 (2008).

28. See Council Directive No. 2004/109, art. 4(1), O.J. L 390/38, at 44 (2004).

29. See *id.* art. 4(2), O.J. L 390/38, at 45 (2004).

that consolidated financial reports, annual and half-yearly, must be drawn up in accordance with IFRS.³⁰ A bold move made by the EU when it mandated that all EU issuers conform to IFRS by year end 2005 was to raise the threat that U.S. and other non-EU issuers offering or trading securities in Europe might be compelled to reconcile their financial statements to IFRS. This would depend on whether the EU would deem U.S. GAAP equivalent to IFRS.³¹ The body charged with making this determination and evaluating the implementation of IFRS in the EU was the Committee of European Securities Regulators (“CESR”).³² The threat that U.S. companies might have to reconcile to IFRS proved an important prod to SEC acceptance of IFRS for reporting purposes by foreign issuers. Further, CESR’s involvement led to a comprehensive work plan between the SEC and CESR regarding the SEC’s recognition of IFRS for reporting purposes.³³

C. Convergence of Accounting Standards

In 1988, the SEC explicitly supported the establishment of international accounting standards to reduce regulatory impediments resulting from disparate national accounting standards.³⁴ Yet, the SEC continued to reject a mutual recognition approach except for the MJDS with Canada. Even with respect to the MJDS, the SEC had proposed abandoning this regime, expressing a preference for international harmonization, but protests from Canadian issuers led to renegotiation of the agreement.³⁵

30. See generally Commission Regulation No. 1606/2002, O.J. L 243/1 (2002).

31. See Council Directive No. 2004/109, art. 23(4), O.J. L 390/38, at 53 (2004).

32. See generally COMM. OF EUROPEAN SEC. REGULATORS, CONCEPT PAPER ON EQUIVALENCE OF CERTAIN THIRD COUNTRY GAAP AND ON DESCRIPTION OF CERTAIN THIRD COUNTRIES MECHANISMS OF ENFORCEMENT OF FIN. INFORMATION (2004), <http://www.cesr-eu.org/popup2.php?id=2509>.

33. See Press Release, Securities Exchange Commission, SEC and CESR Launch Work Plan Focused on Financial Reporting (Aug. 2, 2006), <http://www.sec.gov/news/press/2006/2006-130.htm>.

34. See Testimony Concerning Globally Accepted Accounting Standards, Before the Subcomm. on Securities, *Insurance and Investment of the U.S. Sen. Comm. on Banking, Housing, and Urban Affairs*, 110th Cong. 2-3 (2007) (statement of Conrad W. Hewitt, Chief Accountant & John W. White, Director, Division of Corporation Finance, SEC), <http://www.sec.gov/news/testimony/2007/ts102407cwh-jww.htm> [hereinafter Hewitt Testimony].

35. See *U.S.-Canada Working to Preserve Agreement on Cross-Border Offerings*, 32 SEC. REG. & L. REP. (BNA) 1367 (Oct. 15, 1999).

At this time, the SEC also determined not to adopt a process-oriented approach to IASB standards, recognizing them as “authoritative” and therefore comparable to U.S. GAAP standards promulgated by the FASB. 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 effects of changes in foreign exchange rates.³⁶ 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.³⁷ This program was completed in March 2000, and the SEC’s 2000 Concept Release was 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. 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 and interpretation where necessary.”³⁸

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.³⁹ 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 Standing Interpretations Committee and Standards Advisory Council.⁴⁰ The Trustees appoint the Board Members, exercise oversight, and raise the funds needed, whereas the Board has sole responsibility for setting accounting standards. The Chairman of the Nominating Committee established for the purpose of selecting the

36. See IAS Concept Release, *supra* note 15, at 8903 n.33.

37. See *id.* at 8899.

38. See Press Release, IOSCO, International Accounting Standards Committee Standards (May 17, 2000), <http://iosco.org/news/pdf/IOSCONEWS26.pdf>.

39. See IAS Concept Release, *supra* note 15, at 8901-02.

40. See Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards (“IFRS”) Without Reconciliation to U.S. GAAP, Securities Act Release No. 8818, 72 Fed. Reg. 37,962, 37,964 (July 11, 2007) (codified at 17 C.F.R. §§ 210, 230, 239, 249) [hereinafter Acceptance of IFRS Proposing Release].

initial Trustees for the restructured IASB was then SEC Chairman Arthur Levitt, Jr. The Chairman of the new body of Trustees was Paul A. Volker, Former Chairman of the U.S. Federal Reserve Board.⁴¹

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.⁴² But the spirit of cooperation that had been established between the SEC, the EU, and the IASB was unfortunately dampened by the stock market collapse of 2000-01 and the enactment of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley").⁴³ This is because the provisions of Sarbanes-Oxley dealing with the structure of audit committees and the registration and regulation of auditors by the newly created Public Company Accounting Oversight Board ("PCAOB") was made applicable to foreign issuers and their auditors, and met with strenuous objection abroad. Relations between U.S. and foreign regulators soured to some extent and the SEC became too preoccupied with implementing various mandates in Sarbanes-Oxley and structuring necessary accommodations for foreign auditors and audit committees to focus on mutual recognition in financial disclosure.

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 U.S. GAAP rather than their home country GAAP, to IFRS, by mandating that all listed companies report in IFRS and threatening to make U.S. EU-listed companies also report in IFRS. Moreover, Asian and other issuers also began looking at IFRS, rather than U.S. GAAP, as an alternative to reporting in their national GAAPs for offerings in the international capital markets.⁴⁴ As the markets

41. *IASC Trustees Announce New Standard-Setting Board to Reach Goal of Global Accounting Standards*, BUSINESS WIRE, Jan. 25, 2001.

42. *See generally* Donald T. Nicolaisen, Chief Accountant, Statement by SEC Staff: A Securities Regulator Looks at Convergence, 25 NW. J. INT'L L. & BUS. 661 (Apr. 2005), available at <http://www.sec.gov/news/speech/spch040605dtn.htm> [hereinafter Nicolaisen Speech].

43. *See* Maria Camilla Cardilli, *Regulation Without Borders: The Impact of Sarbanes-Oxley on European Companies*, 27 *FORDHAM INT'L L.J.* 785, 791, 820 (2004); *see generally* Roberta S. Karmel, *The Securities and Exchange Commission Goes Abroad to Regulate Corporate Governance*, 33 *STETSON L. REV.* 849 (2004).

44. *See* Sir David Tweedie & Thomas R. Seidenstein, *Setting a Global Standard: The Case for Accounting Convergence*, 25 NW. J. INT'L L. & BUS. 589, 593 (2005).

in Europe and Asia strengthened, relative to the U.S. markets, New York was no longer the only place where multi-national corporations could raise capital and the SEC was no longer a regulator that 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-U.S. companies to reconcile to U.S. GAAP financial statements prepared according to IFRS.⁴⁵ This roadmap was explicitly affirmed by SEC Chairman William Donaldson in a meeting with EU Internal Market Commissioner Charlie McCreevy on April 21, 2005,⁴⁶ and then reaffirmed by SEC Chairman Christopher Cox in February 2006 on the occasion of another visit of EU Internal Markets Commissioner Charlie McCreevy to Washington, D.C.⁴⁷ On March 6, 2007, the SEC held a Roundtable on IFRS as a prelude to issuing a proposed rule on July 2, 2007 to accept from foreign private issuers financial statements prepared in accordance with IFRS.⁴⁸

In that release, the SEC pointed out that almost 100 countries, including the twenty-seven EU Member States, were using IFRS, with more countries considering adopting IFRS.⁴⁹ The SEC made two arguments in favor of allowing foreign issuers to report in IFRS, which were a somewhat remarkable turnabout from its prior resistance to a foreign GAAP. First, the SEC asserted that it had long advocated reducing disparity between U.S. 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 U.S. standard.⁵⁰ Therefore, based on increasing convergence between U.S. GAAP and IFRS, and cooperation between the SEC, IOSCO, and CESR, the SEC proposed amendments to its rules that would allow a foreign private issuer to file financial

45. See generally Nicolaisen Speech, *supra* note 42.

46. See generally Press Release, SEC, Press Release No. 2005-62, Chairman Donaldson Meets with EU Internal Market Commissioner McCreevy (Apr. 21, 2005), <http://www.sec.gov/news/press/2005-62.htm>.

47. See generally Press Release, 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 (Feb. 8, 2006), <http://www.sec.gov/news/press/2006-17.htm>.

48. See Acceptance of IFRS Proposing Release, *supra* note 40, at 37,968.

49. See *id.* at 37,965.

50. See *id.* at 37,965-66.

statements without reconciliation to U.S. GAAP, if those financial statements are in full compliance with the English language version of IFRS as published by the IASB.⁵¹ Perhaps more remarkably, the SEC issued a Concept Release proposing possible reporting in IFRS by U.S. corporations.⁵² 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.⁵³ Yet, significant differences between IFRS and U.S. GAAP continue to exist, 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 U.S. and EU regulations.⁵⁴ Nevertheless, by persuading the SEC to recognize IFRS for foreign

51. *See id.* at 37,970.

52. Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards, Securities Act Release No. 8831, 72 Fed. Reg. 45,600 (Aug. 14, 2007) (codified at 17 C.F.R. §§ 210, 228, 229, 230, 239, 240, 249), *corrected* 72 Fed. Reg. 53,509 (Sept. 19, 2007). This development is related to the EU's program for accepting U.S. Generally Accepted Accounting Principles ("GAAP") financial statements by U.S. companies listed on European exchanges. Such companies can continue to report in U.S. GAAP because the U.S. has permitted EU companies to use International Financial Reporting Standards ("IFRS") in Securities and Exchange Commission ("SEC") filings and also has made a public commitment to converge U.S. GAAP with IFRS. *See* Establishing a Mechanism for the Determination of Equivalence of Accounting Standards Applied by Third Country Issuers of Securities Pursuant to Directives 2003/71/EC and 2004/109/EC of the European Parliament and of the Council, Commission Regulation No. 1569/2007, O.J. L 340/66 (2007).

53. *See generally* Final Rule, Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP, Securities Act Release No. 8879, 73 Fed. Reg. 986 (Jan. 4, 2008) (codified at 17 C.F.R. §§ 210, 230, 239, 249).

54. The Sarbanes-Oxley Act of 2002 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. 15 U.S.C. §§ 7212-14 (2008). 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-U.S. regulators in accomplishing the goals of the statute without subjecting non-U.S. public accounting firms to unnecessary burdens or conflicting requirements. *See* PCAOB, Final Rules Relating to the Oversight of Non-U.S. Public Accounting Firms, Release No. 2004-005 (June 9, 2004), at 2-3, http://www.pcaobus.org/Rules/Docket_013/2004-06-09_Release_2004-005.pdf. Nevertheless, convergence of auditing standards between the U.S. and the EU is long way off. *See* Roberta S. Karmel, *The Once and Future New York Stock Exchange: The Regulation of Global Exchanges*, 1 *BROOK. J. CORP. FIN. & COM. L.* 355, 364-65 (2007).

issuers, and consider recognizing IFRS in the future for U.S. issuers, the EU achieved an important political breakthrough in SEC-EU cooperation on the convergence, if not the harmonization, of securities regulatory standards.

SEC Chairman Cox has now become an advocate of IFRS, preparing the way for use of IFRS by U.S. corporations. He has stressed the growth of cross-border investment and the decisions by over 100 countries to adopt IFRS.⁵⁵ In his view, it is:

[D]ifficult to overstate the potential upside for investors of the growing consensus behind IFRS. Whereas just a few years ago the planet truly was a Babel of different of [sic] accounting languages, today we're on the threshold of an authoritative *lingua franca* that could be used throughout the world's developed and developing markets.⁵⁶

III. FOREIGN EXCHANGE ACCESS

A. *The European Union Campaign*

An even more difficult mutual recognition challenge to the SEC teed up by the EU is that of allowing foreign stock exchange and broker-dealers to do business with U.S. investors in the United States, without meeting SEC registration and regulation requirements for such financial institutions. In particular, foreign exchanges which now engage in screen trading have been desirous of placing their screens in the United States and signing up U.S. members, without registering as exchanges with the SEC and without requiring all of their listed companies to become registered and reporting companies in the United States pursuant to the Exchange Act.⁵⁷ Former EU Commissioner Frits Bolkestein strongly advocated a transatlantic financial community which would permit foreign market access in the United States by European exchanges based on the principle of mutual recognition.⁵⁸ Some critics of the SEC have suggested that the

55. See generally Christopher Cox, SEC Chairman, Address to the American Institute of Certified Public Accountants' International Issues Conference: International Business—An SEC Perspective, (Jan. 10, 2008), <http://www.sec.gov/news/speech/2008/spch011008cc.htm>.

56. *Id.*

57. Foreign issuers with USD \$10 million and 300 (out of 500) U.S. shareholders become subject to SEC registration unless they file for an exemption. See 17 C.F.R. § 240.12g-3-2(b).

58. See Frits Bolkestein, Member of the European Commission in charge of the

SEC's refusal to allow free access to foreign exchanges is protectionist and anti-competitive.⁵⁹ The response to this criticism was expressed by SEC Commissioner Roel C. Campos, who explained that the SEC:

[I]mposes 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 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.⁶⁰

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 ("ATs") 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.⁶¹ In its concept release proposing that ATs should either register as exchanges or undertake new responsibilities as broker-dealers, the SEC addressed the problem of foreign exchanges wishing to access the U.S. capital markets.⁶²

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 dis-

Internal Market and Taxation, Keynote Address at Federation of European Securities Exchange Convention, London: Towards an Integrated European Capital Market, Some of the Major Issues Reconsidered (June 13, 2003), <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/03/297&format=HTML&aged=0&language=EN&guiLanguage=en>.

59. See generally Chris Huhne, *Atlantic Trade Wars Loom Again*, FIN. NEWS, June 22, 2003.

60. Roel C. Campos, SEC Commissioner, Speech at the Centre for European Policy Studies: Embracing International Business in the Post-Enron Era (June 11, 2003), <http://sec.gov/news/speech/spch061103rcc.htm>.

61. See 17 C.F.R. § 240.3b-16 (2000).

62. See generally Regulation of Exchanges, Exchange Act Release No. 38672, 62 Fed. Reg. 30,485 (June 4, 1997) (codified at 17 C.F.R. § 240) [hereinafter *ATS Concept Release*]. The problems of dealing with ATS facilities has troubled regulators worldwide. See generally Alexis L. Collins, *Regulation of Alternative Trading Systems: Evolving Regulatory Models and Prospects for Increased Regulatory Coordination and Convergence*, 33 LAW & POL'Y INT'L BUS. 481 (2002).

closure and accounting standards, would become tradeable.⁶³ 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. Second, the SEC could limit cross-border trading by ECNs, ATSS, or foreign exchanges seeking U.S. investors to operate through an access provider which would be a U.S. broker-dealer or ECN. Third, the SEC could limit trading in foreign securities by foreign exchanges to transactions with sophisticated U.S. investors so that some exemption from Securities Act registration might be available.⁶⁴ Another possibility, now that the SEC has recognized IFRS, is to encourage more foreign private issuers to register with the SEC.⁶⁵

B. *The Security Exchange Commission’s Roundtable and Concept Release*

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 for permitting foreign broker-dealers to solicit U.S. customers without being registered with the SEC.⁶⁶ 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

63. See ATS Concept Release, *supra* note 62, at 30,488-89.

64. See *id.* In 2003 the staff of the Ontario Securities Commission recommended a new approach to the recognition of foreign based stock exchanges based on mutual recognition of companies in national stock indexes. See OSC Staff Notice 21-702, Regulatory Approach for Foreign-Based Stock Exchanges, 26 OSCB 7096 (Oct. 31, 2003), http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part2/sn_20031031_21-702_foreignbased.pdf.

65. Another barrier to this solution, the problems of de-registration by foreign issuers who find that being an Exchange Act registered and reporting company is not in their best economic interests, was addressed by the SEC in its rule-making on de-registration. See generally Final Rule, Termination of a Foreign Private Issuer’s Registration of a Class of Securities under Section 12(g) and Duty to File Reports Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934, Exchange Act Release No. 55540, 72 Fed. Reg. 16,934 (Apr. 5, 2007) (codified at 17 C.F.R. §§ 200, 232, 240, 249).

66. See generally Ethiopis Tafara & Robert J. Peterson, *A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT’L L.J. 31 (2007).

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.⁶⁷ 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.⁶⁸ In this connection, it should be noted, that the SEC has MOUs with the EU, CESR, and a number of individual European securities regulators.⁶⁹

Following the publication of the Tafara article and favorable comments upon it,⁷⁰ the SEC held a Roundtable on Mutual Recognition.⁷¹ 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 U.S. investors under an abbreviated registration system, provided those entities are supervised in a foreign jurisdiction

67. *See id.* at 58-59.

68. *See id.*

69. *See generally* U.S. Securities and Exchange Commission, International Enforcement Assistance, http://www.sec.gov/about/offices/oia/oia_crossborder.htm; U.S. Securities and Exchange Commission, Cooperative Arrangements with Foreign Regulators, http://www.sec.gov/about/offices/oia/oia_cooparrangements.htm.

70. *See generally* Edward F. Greene, *Beyond Borders: Time to Tear Down the Barriers to Global Investing*, 48 HARV. INT'L L.J. 85 (2007); Edward F. Greene, *Beyond Borders Part II: A New Approach to the Regulation of Global Securities Offerings* (2007), http://www.sechistorical.org/collection/papers/2000/2007_0501_GreeneBeyondT.pdf; Howell E. Jackson, *A System of Selective Substitute Compliance*, 48 HARV. INT'L L.J. 105 (2007). *But see* George W. Madison & Stewart P. Greene, *TIAA-Cref Response to a Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 99 (2007).

71. *See generally* Press Release, SEC, Press Release No. 2007-105, SEC Announces Roundtable Discussion Regarding Mutual Recognition (May 24, 2007), <http://sec.gov/news/press/2007/2007-105.htm>.

under a securities regulatory regime substantially comparable (but not necessarily identical) to that in the United States.”⁷² Mutual recognition of foreign markets and broker-dealers was also promoted in speeches by the Director of the Division of Market Regulation.⁷³

One of the drivers of this new attitude toward mutual recognition probably was the merger of the New York Stock Exchange, Inc. (“NYSE”) with Euronext, NV (“Euronext”) in 2007.⁷⁴ 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.⁷⁵ In addition, it was necessary for 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.⁷⁶

On December 18, 2007, Commissioner McCreevy testified before the European Parliament Committee for Economics and Monetary Affairs concerning a window of opportunity in 2008 regarding an agreement for mutual recognition between the SEC and the EU. According to McCreevy, the principles for such an agreement would be: a gradual approach based on a political understanding by the SEC and EU regulators; a multi-lateral process; equality of criteria in determining access to markets and firms established overseas; no extraterritoriality.⁷⁷ Al-

72. *Id.*

73. *See generally* Erik R. Sirri, Director, Division of Market Regulation, Speech by SEC Staff: A Global View: Examining Cross-Border Financial Services (Aug. 18, 2007), <http://sec.gov/news/speech/2007/spch081807ers.htm>; Erik Sirri, Director, Division of Market Regulation, Speech by SEC Staff: Trading Foreign Shares (Mar. 1, 2007), <http://sec.gov/news/speech/2007/spch030107ers.htm>.

74. *See generally* NYSE/Euronext At-a-Glance, http://www.nyse.com/pdfs/NYSE_Euronext_pk.pdf.

75. *See* Christopher Cox, Speech by SEC Chairman: Remarks on Acceptance of the Atlantic Leadership Award from the European-American Business Council (Feb. 1, 2008), <http://www.sec.gov/news/speech/2008/spch020108cc.htm>.

76. *See generally* Press Release, SEC, SEC, Euronext Regulators Sign Regulatory Cooperation Arrangement (Jan. 25, 2007), <http://www.sec.gov/news/press/2007/2007-8.htm>.

77. *See generally* Charlie McCreevy, European Commissioner for Internal Market and Services, Speech at the European Parliament’s Economic and Monetary Committee (Dec. 18, 2007), <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/836&format=HTML&aged=1&language=EN&guiLanguage=en>; *see generally* Joe Kir-

though the SEC had a self-imposed deadline for developing a rule proposal on the recognition of foreign markets and financial intermediaries of the end of 2007, it missed that deadline. However, the Director of the Division of Trading and Markets has expressed his intention to put out such a proposal as soon as possible.⁷⁸

The 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 U.S. markets based on equivalent regulatory standards.⁷⁹ 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 U.S. shareholder following, the SEC might alter its long-standing exemption for foreign issuers from the reporting requirements of the Exchange Act.⁸⁰

CONCLUSION

The EU influence on the SEC has been matched by SEC influence on the EU. The EU has embarked on ambitious programs to reform its securities regulations as a mechanism for achieving integration of its capital markets and better competing with the U.S. capital markets. In so doing, it has proceeded by directives, which take the form of legislation. Many of these directives have similarities to the U.S. federal securities laws and SEC regulations. Although differing in substantive provisions at the margins, the Market Abuse Directive, the Prospectus Directive, and the Transparency Directive echo U.S. law and regula-

win, *McCreery Sees "Window of Opportunity" For U.S.-EU Mutual Recognition Agreement*, 39 SEC. REG. & L. REPT. (BNA) 1993 (Dec. 24, 2007).

78. See generally Stephen Joyce, *SEC Misses Deadline but Continues to Work on Mutual Recognition Proposal*, 40 SEC. REG. & L. REPT. (BNA) 8 (Jan. 7, 2008).

79. See generally John W. White, Director, Division of Corporation Finance, Speech by SEC Staff: "Corporation Finance in 2008—International Initiatives" Remarks Before PLI's Seventh Annual Institute on Securities Regulation in Europe (Jan. 14, 2008), <http://www.sec.gov/news/speech/2008/spch011408jww.htm>.

80. See generally *id.* The SEC now has embarked upon rule-making that would change the parameters of this exemption and base it on the percentage of average daily trading volume in the United States rather than the number of U.S. shareholders. See generally Exemption From Registration Under Section 12(g) of the Securities Exchange Act of 1934 for Foreign Private Issuers, Exchange Act Release No. 57350, 73 Fed. Reg. 10,102 (Feb. 25, 2008) (codified at 17 C.F.R. §§ 239, 240, 249) (2008).

tion.⁸¹ In part this probably is due to the imperatives of the capital markets and investor demands for transparency in the markets.

Although academics often debate regulatory competition,⁸² it is investors and financial intermediaries, not regulators, who drive changes in the markets and their regulation. Since the SEC has served as the gold standard of securities regulation, it is not surprising that as the EU has striven to improve and integrate European capital markets, it has looked to U.S. securities regulation as a model. Yet, changing economics, and in particular the migration of many international issuers to the London markets, has given the EU more power in influencing the SEC. The SEC can no longer take a unilateralist approach to securities regulation and assume that the U.S. markets will remain the premier capital markets. U.S. investors are buying foreign securities in record numbers and foreign issuers no longer believe they need to make offerings in the U.S. to raise capital.⁸³

The merger of the NYSE and Euronext probably was a wakeup call to both the SEC and the EU signaling the need for convergence of their regulatory systems, increased cooperation among regulators, and a new approach to mutual recognition. Current market turmoil caused by the sub-prime mortgage crisis and other events is also a dynamic which leads to regulatory reform. Open questions include what kind of reform will result from this collapse of confidence in the markets and whether the SEC or the EU will drive any reform agenda.

The EU is not the only challenge to the SEC, however. The new strong capital markets in Asia and South America, and in

81. Council Directive No. 2003/6, O.J. L 96/16 (2003); Council Directive No. 2001/34, O.J. L 184/1 (2001) *amended by* Council Directive No. 2003/71, O.J. L 345/64 (2003); Council Directive No. 2001/34, O.J. L 184/1 (2001), *amended by* Council Directive No. 2004/109, O.J. L 390/38 (2004).

82. *See generally* Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice is Not Investor Empowerment*, 85 VA. L. REV. 1355 (1999); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998).

83. *See generally* COMM. ON CAPITAL MKTS. REGULATION, INTERIM REPORT OF THE COMM. ON CAPITAL MKTS. REGULATION (2006), http://www.capmktreg.org/pdfs/11.30 Committee_Interim_ReportREV2.pdf. Many foreign issuers raise money from U.S. investors in the Rule 144A market, which has grown three-fold since 2002 and in 2006 exceeded \$1 trillion. In the first half of 2007, global equity and debt capital raised in 144A transactions was almost \$1 trillion. *See generally* NASDAQ's *Electronic Trading Platform for the 144A Private Placement Market Begins Operation*, PRIME NEWS WIRE, Aug. 15, 2007.

particular in the so-called BRIC countries (Brazil, Russia, India, and China), challenge both the EU and the SEC to shape their regulatory approaches to foreign issuers and foreign financial institutions so as not to lose their competitive places as market regulators. Many of the reforms in emerging markets which have improved them have been influenced not only by the SEC and the EU but also by international organizations such as IOSCO, the World Bank, and the IMF, all funded in large part and influenced by the United States and European countries. The threat from these newer capital markets should challenge both the SEC and the EU to combine forces to strengthen international securities regulation. With respect to IFRS this has occurred to a large extent. Hopefully, this effort at convergence will spread to other important regulatory constructs.