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ARE U.S. REGULATORY REQUIREMENTS FOR FOREIGN FIRMS APPROPRIATE?

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One way to begin approaching the question of whether U.S. regulatory requirements for foreign firms are appropriate is to review some trends in the data. As shown in Figure 1 below, the London Stock Exchange has already made significant strides in becoming a transnational equity market for Europe. What remains back in the home country — in Milan or Madrid — is primarily the retail business. On average, London accounts for 30% of the trading in Continental European equities.

FIGURE 1. FOREIGN COMPANIES ON EIGHT MAJOR STOCK MARKETS

Market	1992 Average Daily Turnover (millions of US $)	1992 Foreign Turnover as a Percentage of Average Daily Turnover	Number of Foreign Companies 1986	1989	1992
NYSE	6,782	6.8%	63	86	120
NASDAQ	3,508	3.6%	244	286	261
London	2,610	43.2%	584	599	522
Tokyo	1,931	0.3%	52	116	117
Germany	1,802	1.5%	266	535	594
Paris	500	2.3%	195	223	222
Zurich	339	8.5%	145	229	240
Hong Kong	315	0.1%	7	14	27

Investors are exhibiting a growing appetite to trade non-North American securities in North American markets. Purchases and sales of foreign equities in the United States, for example, total over U.S.$350 billion.

Investors in the United States are quickly going from low levels of foreign exposure in their equity portfolios to much higher levels as they try to capture higher returns and lower risk through international diversification. We are witnessing a "once and for all" shift in the composition of the average portfolio for equities, and if we do not make the regulatory changes that will allow U.S. exchanges to fully participate in the growth

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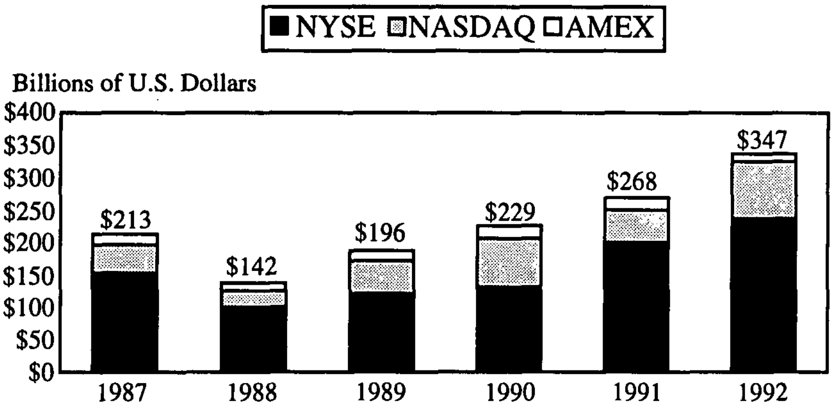
FIGURE 2. PURCHASES AND SALES OF FOREIGN STOCKS IN THE UNITED STATES



of international trading, this "once and for all" shift may undermine the preeminence among world capital markets that the U.S. capital market now enjoys.

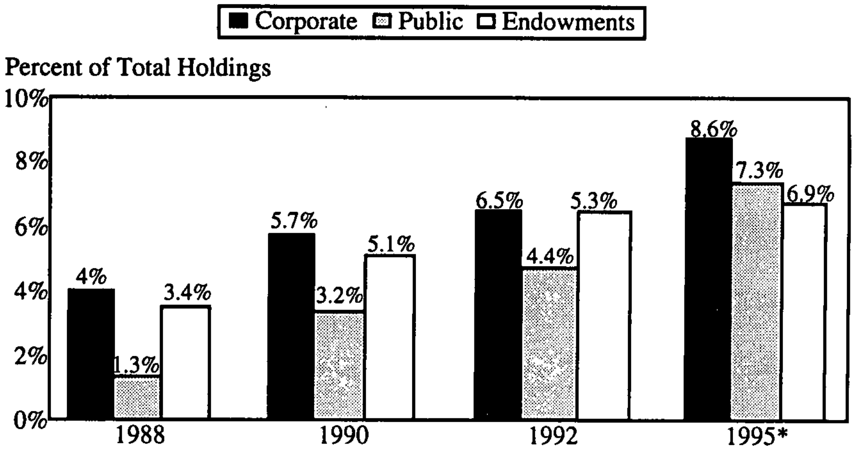
One of the primary factors behind the massive growth of foreign holdings in the United States is the rise of the U.S. institutional investor. As shown in Figure 3, the appetite for pensions funds to increase their exposure to foreign stocks is expanding rapidly, and the absolute amount of money flowing into foreign markets as a consequence is enormous.

How will companies like Nestle or Siemens, as well as the newly privatizing companies in the industrializing world, come to the American capital markets if we don't resolve the existing regulatory barriers? Are we going to look back five or six years from now and say we missed the bus? The issue of foreign listing standards is a critical and irreversible policy issue. If you don't get it right, it's not something you can later fix; later is going to be too late. One of the reasons for our concern and for making the foreign listings issue our highest business priority, is that many people involved in policy in this area do not seem to believe that it is an urgent problem.

Before getting into some of the issues of foreign listing standards, I'd like to make a couple of comments about American Depositary Receipts ("ADRs").[1] The New York Stock Exchange

1. *See* Joseph Velli, *American Depositary Receipts: An Overview*, 17 FORDHAM INT'L L.J. S38 (1994) (discussing increased use of ADRs as alternative for non-U.S. companies

FIGURE 3. FOREIGN STOCKS IN U.S. PENSION AND ENDOWMENT FUNDS



*Estimate- - Greenwich Associates

("NYSE") is examining the possibility that Daimler-Benz as an ADR in U.S. dollars may soon be traded side-by-side with Daimler-Benz common stock in deutschemarks.[2] At what point in time is the introduction of this particular combination of trading feasible? We spend a lot of time looking into the problems of an environment where a stock is traded in its home country and, through the foreign exchange market, converted to U.S. dollars, while the same stock is traded in the U.S. market in dollars. Side-by-side trading may not be the right market structure.

ADRs are the product institutional and retail customers want because U.S. investors derive a great deal of comfort from buying a security that is denominated in dollars, with a dividend paid in dollars, through their own broker and a clearance and settlement system with which they are familiar.[3] Keep in mind

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entering U.S. capital markets); Mark Saunders, *American Depositary Receipts: An Introduction to U.S. Capital Markets for Foreign Companies*, 17 FORDHAM INT'L L.J. 48 (1993) (discussing use of ADRs by foreign private issuers raising capital in United States).

2. *See* Anita Raghavan, *Big Board Studies Broadening Of Its Foreign-Stock Dealings*, WALL. ST. J., Mar. 23, 1994 at C1 (acknowledging NYSE's interest in trading foreign stocks in different currencies, engaging in side-by-side trading).

3. *See* Velli, *supra* note 1, at S39 (discussing procedure for purchasing ADRs in United States); Kerry Hannon, *Live here, invest abroad*, U.S. NEWS & WORLD REP., Apr. 4, 1994, at 65 (discussing growth of ADR market).

the problem of foreign exchange risk. For example, assume the Pound Sterling/dollar exchange rate is £1.00 for U.S.$2.00, and that Glaxo is trading in London for £5.00. Then 100 shares of Glaxo is worth £500.00 or U.S.$1,000. If the exchange rate goes to 1:1 and if London trading remains the same, the value of U.S. trading in Glaxo goes from U.S.$1,000 to U.S.$500. It's a serious mistake to believe that because you're dealing in a dollar-denominated world there is no foreign exchange risk.

The NYSE has had some difficult discussions with the Securities and Exchange Commission ("SEC") during the past couple of years on the issue of requiring foreign companies to quantitatively reconcile their financial statements to U.S. generally accepted accounting principles ("GAAP").[4] Clearly, we need to find some compromise whereby an issuer like Nestle can move out of an over-the-counter electronic pink sheet market, which has no volume reporting and no real time quotes, to a listed market — NYSE, NASDAQ, or AMEX — which has more effective overall regulation, without requiring U.S. GAAP reconciliation.

The NYSE's number one priority has been to find a solution to this problem. This year we will list approximately forty new foreign companies. Although this represents a record number, it is minuscule relative to the 2,000 foreign companies eligible to go on our list right now were it not for SEC regulations requiring U.S. GAAP disclosure. While we are proud of the forty foreign companies we will list this year, we are talking about a universe of world-class companies that numbers in the thousands. Foreign listings represent an opportunity that the NYSE doesn't want to miss, both as a business and as an institution important to maintaining the international preeminence of the U.S. securities market. The question is, how do we move public policy from where we are now to an effective compromise?

Exempting foreign issuers from quantitative reconciliation to U.S. GAAP will not harm U.S. investors. Retail investors are

4. Regulation S-X, 17 C.F.R. § 210.4-01(a)(2) (1993) (requiring reconciliation with U.S. GAAP); *see* M. Elizabeth Rader, *Accounting Issues in Cross-Border Securities Offerings*, 17 FORDHAM INT'L L.J. S129 (1994) (discussing difficulties involved in reconciliation of non-U.S. financial statements to U.S. GAAP).

certainly not being protected by current SEC policy, which forces the securities of world-class foreign companies that have not reconciled to U.S. GAAP to trade on the over-the-counter electronic bulletin board where no financial information is made available to investors.[5] Is the investor who just bought a hundred shares of Nestle in that market being protected from the alleged evils of Swiss accounting? I don't see how. Furthermore, institutional investors typically buy a foreign company's security in that company's home market or in London and employ management advisors to sort through the accounting and explain what's going on. If the retail customer now goes to the electronic pink sheets and the institutional investor now goes offshore to the "home" market or London, who are we really protecting with current policy?

There is a growing consensus among experts that requiring foreign companies to file additional U.S. GAAP reconciliation after their home country documents are made public is of little value to investors. These filings have no material impact on the price of the stock, which is set by economic fundamentals in the home country. Even when foreign companies go through the work to reconcile with U.S. GAAP, U.S. investment analysts following the company typically rely more on financial statements based on home country accounting. If the stock is being priced in its home country using its own financials and it's being priced here in the United States using home country financials, what have we accomplished by forcing the company through this particular kabuki?

I'm often asked on this particular issue about parity for the U.S. issuer. If the NYSE achieves a compromise whereby foreign issuers have fewer hoops to jump through, wouldn't this be unfair to domestic listed companies? What we have found, after two years of going to focus groups of CEOs, to The Business Roundtable, and to our own Listed Company Advisory Committee, is that a large percentage of CEOs are reasonably objective and, although some view it as a little unfair, they are nonetheless

5. *But see* Richard C. Breeden, *Foreign Companies and U.S. Securities Markets in a Time of Economic Transformation*, 17 FORDHAM INT'L L.J. S77 (1994) (discussing superiority of U.S. disclosure requirements and accounting practices); Richard Kosnik, *The Role of the SEC in Evaluating Foreign Issuers Coming to U.S. Markets*, 17 FORDHAM INT'L L.J. S97 (1994) (discussing superiority of U.S. disclosure requirements and accounting practices).

prepared to live with it if doing so helps to keep U.S. capital markets strong. They are ready to accept a little bit of inequity for the sake of that larger, more important goal. Although you will hear from lots of people that domestic issuers will be "outraged" if any type of compromise is made, we have not found that to be true.

Unfortunately, it is a fact of life that a certain amount of protectionism resonates well among certain segments of the business community. With respect to the issue of fairness for domestic issuers, keep in mind that U.S. companies can currently issue shares and list them for trading in most major foreign markets without having to conform to foreign financial, disclosure, and accounting rules. This fact should be sufficient to silence any protectionist protests.

How is this issue of foreign listing standards going to get resolved? Our discussions with Arthur Levitt, the new Chairman of the SEC, have so far been very open and productive. I would like to outline three potential avenues of compromise and give you some of the pros and cons of each.

First, the NYSE has been working for two years on a compromise that involves establishing specific quantitative criteria in order to distinguish "world class" foreign companies. Relevant criteria could include, for example, revenues of U.S.$5 billion and market capitalization of U.S.$2 billion, or average weekly trading volume outside the United States of at least U.S.$1 million or 200,000 shares. Such world class non-U.S. issuers would be required to register securities in accordance with current disclosure requirements. However, instead of quantitative reconciliation to U.S. GAAP, independently-audited home-country financial statements would be accepted, as long as they included a written explanation of any material differences between home-country accounting practices and U.S. GAAP. Although the idea is not dead, and many still think it could be the avenue to go down, there are problems with this approach, particularly the legal problem of discriminating between companies on the basis of some measurement of class and size.

While the first approach focuses on characterizing the solution in terms of the issuer, the second approach defines the solution by the characteristics of the investors and the market structure itself. It involves placing foreign issuers in a separate list with regard to the physical location of trading, entry to the consolidated tape, and overall dissemination of trades and quotes. Access to this market would be limited to qualified investors, similar to the approach taken in the Rule 144A[6] market, or, less rigidly, the approach taken in the U.S. derivatives markets, where customers must be screened by a broker-dealer and deemed appropriate. One problem here is the contradiction inherent in "separate but equal": can a market that is separate from public markets in fact be equal in quality to public markets? Additionally, foreign issuers have indicated that they are not interested in a separate U.S. listing with non-U.S. financial disclosure and limited access to investors. Their primary motivation for entering U.S. capital markets is precisely the large and growing retail demand for foreign equity.

The third approach, generically, is attempting to compromise through accounting changes. There are four ways the global accounting community, with the global regulatory community, can resolve the issue of foreign listings by focusing on accounting.

The first is that U.S. GAAP grows in usage as more emerging markets find it easier to penetrate the North American market by simply conforming to U.S. GAAP. For example, the Chinese companies that we have listed this year have no problem with U.S. GAAP because, frankly, they are going from a rather rudimentary accounting system to a very sophisticated one. Because they need some sophisticated accounting system, why not utilize U.S. GAAP? Although U.S. GAAP is spreading around the world as issuers in newly industrializing countries use it to tap our markets, it is presumptuous to assume that U.S. GAAP will eventually become the "language" of international accounting as English is the language of international business. Many sophisticated, mature, industrial companies in Germany or Switzerland — among others — do not appear willing to voluntarily conform to U.S. GAAP, even when the reconciliation would not be particularly difficult.

The second approach is to continue or accelerate the SEC's ad hoc accommodation of foreign issuers on a case-by-case basis and relax the standards for what can pass as "equivalent to" U.S.

6. 17 C.F.R. § 230.144A (1993).

GAAP. Requiring full quantitative reconciliation is unnecessary because European accounting is not as bad as Americans perceive, while U.S. GAAP is not as inflexible as Europeans perceive. The differences are mostly a matter of degree rather than principle and are not insurmountable. This process is already underway — accelerate it, and maybe more foreign companies will find it less onerous to jump through the hoops to register securities in the United States.

The third path is through mutual recognition of national accounting and disclosure statements, perhaps with some agreed upon minimum standard. This is the avenue that the regulators would prefer to go down. However, trying to negotiate mutual recognition on a bilateral basis will be a long-term process. The U.S.-Canada multi-jurisdictional disclosure system negotiations of 1992-93 are indicative of how tortuous and relatively fruitless this approach can be.[7]

The fourth and, perhaps, most promising route would be recognition by the SEC of the principles produced by the International Accounting Standards Committee ("IASC").[8] IASC has demonstrated a tremendous amount of leadership and is beginning to make real progress. The IASC process now has momentum behind it under new SEC Chairman, Arthur Levitt. The SEC's recent acceptance of International Accounting Standard No. 7 on cash flow was a symbolic gesture on the part of the SEC that there is a serious effort underway to move towards International Accounting Standards. We take that as a very strong sign of encouragement. As IASC principles are adopted by more major non-U.S. issuers — and as these principles get closer to U.S. GAAP — financials done by a foreign issuer using them will be sufficient for U.S. investors to make completely informed judgments about the issuer's state of health. European companies have indicated that all they need is U.S. acceptance of IASC principles and they'll be knocking down the door of the NYSE and U.S. capital markets.

One observation about accounting to keep in mind, U.S.

7. Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers, Securities Act Release No. 6902, Exchange Act Release No. 29,354, 56 Fed. Reg. 30,036-01 (July 1, 1991).

8. *See* Pat McConnell, *Practical Company Experience in Entering U.S. Markets: Significant Issues and Hurdles from the Advisor's Perspective*, 17 FORDHAM INT'L L.J. S120 (1994) (discussing function and goals of International Accounting Standards Committee).

GAAP is not pristine or pure. There is a lot of flexibility and room for maneuver within U.S. GAAP, even for two domestic companies. For example, Exxon and IBM both use U.S. GAAP, but if you look at Exxon financials and IBM financials in a line-by-line comparison, you're not comparing "apples to apples." The notion that U.S. GAAP presents a wonderfully clear snapshot is misleading almost to the point of being dangerous. Companies — both domestically and internationally — use accounting differently in large part because of the different legal and regulatory environments in which they operate. Consequently, international accountants generally warn that quantitatively reconciling foreign accounting data to U.S. GAAP will often convey an illusion of comparability that does not exist. To understand a foreign company's financial position, one must ultimately come to terms with the home country's legal and regulatory environment as well as it's accounting standards. In the days following Daimler-Benz's recent NYSE listing, a major U.S. bank sent out a cautionary tale detailing some of the problems caused by superimposing U.S. GAAP on Daimler-Benz's accounting. The report concluded that such forced reconciliation had in fact produced more darkness than light.

In this public policy debate on foreign issuers, we in the United States are hung up on measurement issues about specific accounting items. Timely and useful, investor-oriented information should be the primary goal of disclosure, not whether one number is measured definitively.

For example, in a world in which Exxon is traded in New York, Toronto, Tokyo, Frankfurt, London and Paris, if you're the Chief Financial Officer of Exxon in Dallas and something material happens to your company in Singapore at 3:00 a.m. Dallas time, when should you announce that news? It is increasingly difficult, particularly for the European companies, to figure out when announcements should be made. We have had conversations with CEOs who say that one of the reasons for their nervousness about entering U.S. markets is their concern about the content and timing of material moves.

From a public policy point of view, the issue of foreign listing standards really does matter. Not thinking through the implications of what we are doing — or not doing — could cause some difficulty as we go further down the road. If we lose some of the international stature of our financial markets because of static regulations, we may never get it back. We need to ensure that international trading flourishes in the United States so that the U.S. capital market maintains its position as a major international financial center.