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Panel I Discussion

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PANEL I DISCUSSION

MR. SILKENAT: I have a question for Joe Velli. I have some feeling for what kinds of changes Jim Cochrane and the New York Stock Exchange might want to make. But, from The Bank of New York's perspective in dealing with so many foreign companies on a daily basis, what regulatory changes would you make if you could be the one to make the decision today or tomorrow to move the market along, to give easier access to these companies?

MR. VELLI: We are in basic agreement that the best way to approach it is by taking these world-class issuers and making them exempt or subject to less accounting and disclosure requirements. We think that is probably the best way to go, this world-class issuer concept that Jim Cochrane explained, where you take the top 300 or 500 companies and, if they want to, enable them to list in the U.S. without conforming to U.S. accounting or disclosure.

QUESTION: I have a question for Mr. Jensen on 144A. Would you expand a little on the interaction of Regulation S with Rule 144A? In a recent case, it is pointed out that securities sold under 144A are restricted securities and cannot be sold within the U.S. public market for the two years because they were specifically made 144A restricted securities. That rule was modified a little bit to allow a two-year holding period. But, I think, the philosophy of 144A was to create a marketplace for great, big institutions that do not need the protection of the securities law but for the anti-fraud provisions. How does that mesh with your notes on interfacing with Regulation S?

MR. JENSEN: Regulation S is, in fact, itself a safe harbor for issues outside the United States, but it provides specifically that 144A securities can be issued in the United States simultaneously with an extraterritorial, outside-the-U.S. offering.

MR. VELLI: To QIBs. Outside the U.S. they could be offered to anybody.

QUESTION: Simultaneously in the United States?

MR. JENSEN: QIBs in the United States, anybody outside, as long as you stay within the Regulation S safe harbor. And I think there is probably some concern about flowback of the Regulation S securities into the U.S. market, but there are also procedures to prevent that, specific procedures under Regulation S. So the two should work together, and in fact do work together.

QUESTION: But the concern in the question I had would be on your point that securities purchased in the United States under 144A can be resold outside the United States. Let's pick for a scenario a QIB, California State Teachers Pension Fund, that buys bonds that are over 40 days old. They could certainly sell them to Metropolitan Life in the United States. But the trading desk of the pension fund works this for ten or fifteen minutes, gives up, calls a broker and says, "Blow this overseas." On Day 41, the 144A paper is sold to anybody under Regulation S — let's say, a Zurich money manager or a high-net-worth individual in Hong Kong. That seems to be fine. Day 42, the Hong Kong purchaser, under Regulation S, sells it to a widow in Kansas or an orphan in New York City. That's not two years.

MR. VELLI: As long as the security overseas is seasoned, it can come back into the U.S. That's the way Regulation S works.

MR. JENSEN: But if it's Day 42, there is theoretically indirect distribution in the United States.

QUESTION: Well, 40 days is your bond period. So, if the U.S. institution blows it out overseas on Day 41, then, theoretically, they can come into the public market on Day 42, thus eliminating the whole rationale that 144A securities cannot get into the U.S. marketplace for two years.

MR. VELLI: But as long as that security sold under Regulation S outside is done through a legitimate transaction on an exchange . . . .

QUESTION: It could be 48 hours.

MR. VELLI: Exactly. Even if there was no 144A component, if a company just made a foreign offering, after a seasoning period, U.S. investors could buy those shares or debt directly anyway.

QUESTION: I'm more concerned about it coming back into the public market.

MR. VELLI: But it comes back into the public market. If a U.S. investor buys it directly in Europe, it comes back in.

QUESTION: Could any of you comment on what the typical foreign issuer is that you would advise to go for a direct listing of stock versus American Depositary Receipt?

MR. DECKER: I guess one quick answer to that, if I understand your question correctly, the ADR may be used in all private placement listings or offerings. It's not a question of whether you would use the ADR. The question is at what point you would be well advised as a company to do a listing versus an offering.

I guess the short answer I would give is what I said before. That is, if there is no burning need right now to raise funds in the U.S. markets, but you would view the listing as an initial step toward keeping your options open to do that in the future, I think that yours is the kind of company where it makes sense to consider the listing alternative versus the public offering.

MR. VELLI: There is an awful lot of confusion about this. In fact, I am told almost every day, "We don't want to list our ADRs in the United States; we want to list our shares." The fact of the matter is that, excluding Canada, non-U.S. companies — as Jim Cochrane said, they are looking at the possibility of direct listings — but right now, if a non-U.S. company wants to list in the United States, they have to use ADRs. There really isn't a choice.

There have been a few Chinese companies who have formed shell companies in Bermuda and then listed their shares, not ADRs, directly in the United States. There have been a couple of other cases where European companies have done that. But they're not listing the company; they are forming a separate company and listing that company. Essentially, they are listing a U.S. company in the U.S. marketplace. Everywhere else — France, Spain, Italy — they all use ADRs.

Even in the event the New York Stock Exchange does invent a better mousetrap from a trading standpoint, there are a lot of other obstacles that have to be overcome as well. A lot of U.S. pension funds, a lot of U.S. investment managers, legally must invest in ADRs when they are investing in non-U.S. securities.

So we would be all for it if the New York Stock Exchange could invent a better mousetrap, because there is still going to be some role in there for The Bank of New York as transfer agent, etc. But right now, and I would say for the foreseeable future, the only workable solution is for a company to use ADRs.

MR. COCHRANE: Just so I'm not misunderstood on that particular item, we went out and did a fair amount of surveying. There is anecdotal evidence in the securities industry that there is an enormous appetite to trade foreign securities in ordinary form in their own local currencies. We surveyed that to death, and it is not true. It is going to be true someday, but someday is pretty far out there.

MR. VELLI: So, for the foreseeable future, ADRs are the way to list. In fact, from a practical standpoint, it's the only way to list in the U.S.

QUESTION: There is a high transactional cost for this question for coming to the front. The question is to all of the panelists. Does a foreign company really have to come to the United States to raise U.S. capital, or can a foreign company raise U.S. capital through, for example, B shares? It seems that none of the panelists has mentioned that. As I am aware, there might be an issuing of specific U.S. shares in a local stock exchange, like the London Stock Exchange.

MR. VELLI: Real easy — if the company doesn't register here for a public deal, they're not going to be able to raise capital here. Yes, these B share companies in China, even though they trade in U.S. dollars or in Hong Kong dollars in China, when they do their offerings they cannot come and attract U.S. capital without registering here in the United States.

Now, there are some pension funds, like Fidelity, who have overseas operations, and in some ways could be treated as a non-U.S. investor because they're incorporated outside the United States; they would be able to buy it. But a true U.S. investor would not be able to take up that offering.

QUESTION: You discussed some of the high-end companies. Not to turn it into a ghetto, but can you give me some sense of what the requirements are and what would be the minimum size of a foreign company that would be able to gain entrance to the U.S. markets?

MR. VELLI: It all depends on what type of transaction we're talking about.

QUESTION: Primarily 144A.

MR. VELLI: 144A is not typically going to be worth the effort, from the cost standpoint, if they're looking at raising less than U.S.$20 to U.S.$25 million. There have been some smaller deals. On the up-side, there have been deals for U.S.$500 million and more. But typically, 144A deals are somewhere between, I would say, U.S.$25 million and U.S.$75 million. Once you start getting bigger than that, it's more advantageous probably to go the public route.

QUESTION: I am working on a paper right now looking at ADRs. There seems to be a considerable under-pricing of ADRs. For example, take the case of Royal Dutch Petroleum versus Exxon. Royal Dutch seems to be selling at a much higher ratio to book value; it seems to have a higher return on equity investment; and yet, it has been priced much lower to book value than Exxon. And you find the same thing is true for Glaxo versus, say, Merck.

We are finding actually that the accounting method selected seems to have some role in this under-pricing. Are there any other reasons that you can think of? One possibility could be foreign exchange risk, as was pointed out by Mr. Cochrane. However, that doesn't seem to play that great a role simply because, to go back to his example, if the pound basically was devalued, what would happen? What are the other factors that lead to this consistent under-pricing of ADRs?

MR. VELLI: I think one of the key elements is that it's still a non-U.S. company, and in most cases, even though there are exceptions, the home market is still going to be the primary factor in dictating how the company is valued. Again, you take the drug companies or the telecommunications companies, where the typical telecom company in the U.S. would have a higher P/E than a typical telecom company in Europe. What we have seen is, for argument's sake, if the P/E ratio is ten in France and fifteen in the U.S., when the company is moved to the U.S., it will get a higher valuation overall, but it will not go all the way up to the U.S. standard. That's because the home market is really still where 70% or 80% of the liquidity in trading takes place.

QUESTION: I have a question about the confidentiality of filings. I guess the issue plan is confidential. What is the policy of the SEC? Does it evaluate whether eventually everything will be disclosed, or is there sort of negotiation going on between the SEC and the issuer as to what information has to be disclosed?

MR. DECKER: Let me say a few words about that. The idea of a confidential filing is an accommodation that the SEC does provide to non-U.S. issuers fairly routinely. It's almost unheard of for U.S. registrants, but very routine for foreign registrants. It's part of this process that we have talked about, of the SEC trying to work with companies that are having difficulty with the process.

What they will basically do is put that document through a fairly thorough review, even though it's not an official filing and may have some of the required information missing. From the financial statement perspective, which I can speak of, these documents are thoroughly reviewed so that the company can make a determination of how much more they are going to need to do to complete that filing and to get it to the point where it is acceptable to the SEC.

There are lots of different reasons why companies do confidential filings, but that's one of them, to get most of the substantive issues out in the open before they officially file the registration statement, where it would be a matter of public record.

MR. SILKENAT: Let me just follow up. For me, the experience has been a very good one. The SEC has responded in terms of raising good questions and it has been a very useful dialogue. But I think you ought to follow up on that question with Richard Kosnik to get his feel for how the SEC is going to be looking at these issues in the future.

QUESTION: In your opinion, has Regulation S really been serving its purpose? Has it increased the attractiveness of the U.S. securities markets, or is it only in conjunction with 144A that it has?

MR. VELLI: In my experience, it has been in conjunction with 144A. These companies would not be doing these 144As if they couldn't rely on Regulation S.