Speech by SEC Commissioner:
The Euro and the Dollar: Pillars in Global Finance

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Thank you and good afternoon. I am honored to be a participant in this important conference bringing together regulators from both sides of the Atlantic to exchange perspectives on regulatory convergence. Before I continue, let me state that the views I express here today are my own and do not necessarily reflect the views of the U.S. Securities and Exchange Commission or my fellow Commissioners.

As technology and innovation continue to dismantle geographic barriers, and issuers and investors increasingly seek out cross-border investment opportunities, regulators and policymakers have come under increasing pressure to harmonize regulatory frameworks and remove unnecessary regulatory impediments to the free flow of capital. Global market convergence and competitiveness test traditional regulatory approaches and require greater cooperation among regulators. Towards that end, the SEC engages regularly with its international regulatory counterparts on both a bilateral and, through our participation in IOSCO and CESR, a multilateral basis. The Commission is also an active participant in the EU-U.S. Financial Markets Regulatory Dialogue.

In recognition of the need to rationalize and respond to market changes, the Commission has recently taken several actions that should further the openness and competitiveness of transatlantic markets. Last month, the Commission adopted rules making it easier for foreign private issuers to deregister their securities in the United States under a principled approach based on an accurate and easily verifiable quantitative measure of U.S. investor interest.[1] In addition, to facilitate the merger of the New York Stock Exchange and Euronext, the Commission has established a framework of consultation and mutual cooperation with our European colleagues that recognizes the international ownership and operation of the new company, while maintaining necessary regulatory protections for U.S. investors.[2] This framework is consistent with ongoing cooperative efforts with other market regulators that will continue to lay a foundation for greater mutual recognition.

While these developments have clearly come about in response to competitive pressures, they reflect the Commission's interest in strengthening the transatlantic market as well as increased sensitivity to the effect of U.S. securities regulations on other markets. Three other key areas that remain a focus of the Commission and reflect interests of greater convergence and cooperation are: corporate governance, accounting standards and market supervision.

I. Corporate Governance

The past five years have seen tremendous change and renewed focus on issues of corporate governance. In the United States, this shift was propelled by the corporate scandals such as Enron and WorldCom that led to the passage of the Sarbanes-Oxley Act of 2002,[3] but a heightened focus on corporate governance was also likely inevitable with the expansion of global markets and the increase in cross-border investment. While effective corporate governance plays an important role in maintaining investor confidence and market integrity, it is a broad and sometimes politically sensitive area that often tests differing approaches towards corporate law.

U.S. corporate governance has no one code or source, but is a compilation of state corporate law, federal securities laws, and exchange listing criteria. It is a complex system that is built upon historic and traditional views of the proper role and functioning of the corporation and the relationship, responsibilities and duties among company management, the board of directors, and shareholders.

In the first instance, corporate governance is a matter of state law. With over 50% of U.S. public companies incorporated in Delaware, Delaware corporate law and adjudications by Delaware courts effectively establish corporate governance standards at the state level. Over the course of the past 70 years, state corporate law has been supplemented by various federal laws aimed at addressing apparent insufficiencies in existing law brought to light by various corporate scandals — the most recent comprehensive effort to address such failings being the Sarbanes-Oxley Act.

The SEC's role in U.S. corporate governance is largely effected through mandatory disclosure requirements, its proxy rules and the implementation of specific corporate governance requirements such as the internal control provisions of the Sarbanes-Oxley law. The Commission's approach has historically been largely disclosure-based and intended to protect investors by ensuring full, fair, accurate and timely reporting of material information about public companies.

The 2006 amendments to the SEC's rules on executive compensation, for example, reflect the agency's disclosure-based approach.[4] The SEC did not seek to set limits on CEO pay, but sought to mandate clearer, more complete and useful disclosure of compensation. Despite the rule amendments and perhaps as a result of the greater disclosure required, executive compensation continues to be an issue of intense public focus and a lightening rod for corporate governance criticism. The Commission remains committed to ensuring the effectiveness of the rule and continues to monitor the new disclosures' sufficiency in informing investors.

The SEC also plays an important role in the U.S. corporate governance scheme through the administration of its proxy rules authorized under the federal securities laws. The basic purpose of the SEC's proxy rules is to ensure that shareholders who are asked to vote by proxy on corporate proposals receive sufficient information to make an informed decision.

From the Commission's earliest days, proxy issues have been an area of intense controversy and debate. Every few decades, it seems, the issue of shareholder access to the company ballot has resurfaced and called into focus fundamental issues regarding the appropriate balance between state and federal law in the area of corporate governance. Each time the Commission has reviewed the proxy area, in 1942, 1977, 1992, and 2003, the Commission has made improvements to its proxy rules to facilitate greater shareholder voice and communication, but failed to reach consensus on the need, advisability, and appropriateness of what would be viewed as more fundamental changes.

Not to be cheated of this historical challenge, the Commission is again wrestling with the proper interpretation of its policy with regard to shareholder proposals that relate to the election of directors under its proxy rules. A recent decision by the U.S. Court of Appeals for the Second Circuit rejected the SEC's interpretation of its rules in this area and has raised significant uncertainty for issuers and investors as to what the Commission's rules require. Given the long history, sensitivity and controversial nature of this issue, it is my hope that the Commission will soon undertake a process to address this uncertainty and comprehensively consider the effectiveness, efficiency and clarity of its proxy rules in protecting shareholder interests.

As noted above, while the U.S. approach to corporate governance has historically not challenged different international approaches, the passage of the landmark provisions of the Sarbanes-Oxley law triggered such considerations and fostered a greater understanding of the differences between our countries' laws and customs. It further forged a new spirit of cooperation and dialogue that extends far beyond the four corners of any single issue.

To avoid conflicts with the laws and regulations governing capital markets in EU Member and other countries, the Commission made certain accommodations for foreign issuers and their auditors. Despite these efforts, and while Sarbanes-Oxley has been viewed positively overall, compliance with the internal control requirements of Section 404, as implemented through PCAOB Auditing Standard No. 2, has come at the price of unacceptably high burdens and cost.

To address continuing concerns over Section 404, the Commission has repeatedly delayed the compliance date of Section 404 for smaller issuers and certain foreign issuers.[5] The Commission is currently working with the PCAOB to align its revised audit standard with the Commission's management guidance to encourage greater use of a top-down, risk-based, principles approach that would promote greater flexibility and exercise of judgment in both assessing and auditing company internal controls. Such alignment is critical if the 404 process is to become scalable, less prescriptive and more focused on those areas that pose the greatest risk that material misstatements in a company' financial statements would not be detected or prevented on a timely basis.

I would emphasize that fixing 404 is of critical importance to the Commission, and the Commission's recent open meeting on 404 reflects this commitment to making the internal control provisions more efficient and effective for all issuers. Ultimately, our success in achieving such a result will be measured by our ability to alter behavior, and this will depend, just as importantly, on how the SEC and PCAOB examine and enforce the law for compliance and how issuers and auditors view the risk of exercising greater judgment under new guidance and a revised auditing standard. What we put on paper must be borne out in the market, and this will require the Commission to continue to monitor and consider the effectiveness of the changes the Commission and the PCAOB seeks to adopt in the months ahead. I believe that our efforts on 404 further offer the Commission and the PCAOB an opportunity to demonstrate how such requirements can be implemented in a way that avoids a "one size fits all" approach and embraces a more principles-based approach more easily translated to companies of differing size, complexity and governance structure.

As earlier noted, our respective experience in implementing Sarbanes-Oxley has been instructive. Contrasted with EU corporate governance requirements, which generally adopt a voluntary, "comply or explain" approach, U.S. corporate governance standards tend to be more prescriptive and detailed. Further, common law and civil law systems provide differing degrees of protection to shareholders. It may be, as some have suggested, that these differences can be explained in part by the strength and sophistication of the institutional investor base in European jurisdictions, as contrasted with the larger, more diversified retail base in the United States.

However, these differences make comparisons between governance standards difficult without a full appreciation of how each governance system operates as a whole. Indeed, understanding and appreciating our different legal, cultural and historical traditions are critical to achieving greater international harmonization of principles in this area. Further, we must also recognize the natural limitations of regulation in affecting desired market behavior, and be clear that despite effective corporate governance systems, we cannot deter all corporate wrongdoing, expose all fraudulent conduct or prevent the next scandal. Just as importantly, we must recognize and promote the power of market forces in achieving effective corporate governance standards.

II. International Accounting Standards

I am pleased to report that I believe progress on the roadmap towards the convergence of international accounting standards and elimination of the U.S. GAAP reconciliation requirement is well underway and clearly within our sights. Speaking at the SEC Roundtable on International Financial Reporting Standards in March, Chairman Cox and EU Commissioner McCreevy reiterated their commitment to eliminating the need for reconciliation requirements no later than 2009.[6] The roadmap construct implied that companies listing on U.S. exchanges could prepare their financial statements under either U.S. GAAP or IFRS. It also suggested that the SEC was seriously contemplating a system in which not only foreign issuers, but domestic issuers as well would have a choice.

As a harbinger of progress, the IFRS roundtable demonstrated consensus by all stakeholders in attendance, including EU and U.S. issuers and legal and accounting professionals, that U.S. recognition of IFRS would serve the interests of issuers and investors. Roundtable participants urged the Commission to move expeditiously along the roadmap to realize the goal of eliminating the U.S. GAAP reconciliation requirement. The discussion at the roundtable also reinforced the view that the ultimate goal is the development of a global set of comprehensive, high-quality accounting standards. Such standards would serve investors by making it easier for them to compare investment options and reduce costs for issuers by no longer requiring them to prepare financial statements under more than one standard.

The Commission staff is currently reviewing the 2005 annual reports of foreign private issuers filed under IFRS to assess how closely IFRS filers are adhering to IFRS standards and whether there is consistency in its application. Staff is also participating in IOSCO and CESR work projects to promote consistency in the application and interpretation of IFRS. Parallel with these efforts, the FASB and the IASB continue to work towards reducing differences between IFRS and GAAP.

Equally important as the elimination of the U.S. reconciliation requirement is the need for cooperative efforts regarding U.S. and EU oversight of auditing firms. Recent talks between Commissioner McCreevy and PCAOB Chairman Olson have produced agreement on the need to launch roadmap discussions for collaboration on auditing oversight.[7] With a substantial number of non-U.S. firms located in the EU, at least some of whom may be subject to PCAOB inspections, and non-European firms in Europe subject to EU auditing requirements, the desirability of launching a roadmap for cooperation and mutual recognition of auditor oversight is clear. Indeed, the benefits of accounting convergence and IFRS could only be enhanced with the greater efficiencies that would result from greater convergence of auditing standards.

III. Supervision

As our markets continue to converge, expand and grow more complex, interests of market stability and investor protection demand new regulatory approaches to identify emerging market risks, ensure adequate consolidated supervision, and facilitate greater investment opportunities for investors.

A. Hedge Funds

One such area that is of particular attention and interest to market regulators is the growth and market impact of hedge funds. Earlier this year, the President's Working Group on Financial Markets issued a set of fundamental principles addressing the activities of hedge funds in three main areas: investor protection, operational risk, and potential for systemic risk.[8] The principles acknowledge the significant benefits that private capital pools bring to the financial markets, while recognizing the risks they present, in part due to a lack of transparency. They generally view market discipline by creditors, counterparties and investors as the most effective way to limit systemic risk and maintain appropriate investor protection standards.

The PWG continues to examine the role and risks of hedge funds in our markets and through its members consider appropriate actions to ensure that investor protection, operational risk and systemic risk are adequately addressed and managed in the market. I believe the role of the PWG is of particular value in the EU-U.S. dialogue in that it presents a constructive forum to address comprehensively financial market issues that cross regulatory authorities within the United States.

B. CSE Program

Over the years, the Commission's rules-based enforcement program has been extremely effective in ensuring the stability and integrity of our capital markets. However, the development of global markets and complex investment bank organizations has led the Commission to recognize the necessity and value of refocusing its regulatory approach to meet the changing realities of the market. This initiative has resulted in two key developments.

In 2004, the Commission embarked on a new program of prudential supervision. With the support of the Federal Reserve Board and the U.S. Treasury Department, the Commission created a prudential regime to supervise the financial adequacy of the holding companies of some of our largest, internationally-active broker-dealers. To date, five investment bank holding companies have elected consolidated supervised entity ("CSE") status with the Commission: Bear Stearns, Goldman Sachs, Lehman Brothers, Merrill Lynch and Morgan Stanley. Citigroup, a bank holding company, has been approved to employ the alternative capital treatment permitted under the CSE rule at its primary broker-dealer, and more applications are in the pipeline.

The CSE program was developed in response to the firms' need for group-wide supervision of holding companies in light of the EU's 2005 Financial Conglomerates Directive. The aim of the program is to monitor the holding company and unregulated entities within the group for financial and operational weaknesses that could place the regulated entities, including broker-dealers and banks, or the broader financial system, at risk. Components of the CSE program include examination of the holding company and unregulated affiliates to ensure the adequacy of internal controls as well as near continuous interaction with the critical control functions within the firms, including financial controllers, treasurers and internal risk managers.

The EU has recognized the equivalence of the SEC's prudential supervision under the CSE program as equivalent to that required of EU firms, obviating the need for U.S. firms to restructure their EU operations under an EU supervisor.

Through the CSE program, the Commission has gained experience not only supervising on a prudential basis, but with the day-to-day realities of supervising within an international framework. The Commission may be the only U.S. supervisor that views the world from both the "home" and "host" perspective, to use the Basel lexicon. By that, I mean that we simultaneously play the role of group-wide supervisor *and* the role of overseeing large and complex legal entities within groups supervised by other regulators. When dealing with Goldman Sachs or Lehman Brothers, for example, wearing our holding company supervisor hat, we are the "home" supervisor. We recognize that there are important legal entities within the group that are functionally regulated, including U.K.-regulated broker-dealers, OTS-regulated thrifts and FDIC-regulated banks, and we accommodate the needs of those supervisors for information and assurance regarding the financial and operational condition of the holding company. On the other hand, at Citigroup, where we supervise a large broker-dealer using its own internally-developed models to compute capital requirements, we are the "host" supervisor, and we look to the New York Fed as the holding company supervisor for information and assurance.

More recently, the global market realities that led to the creation of the CSE program are also leading the Commission to consider new approaches to access to U.S. markets by foreign exchanges and broker-dealers. Two staff papers on the issue that offer different approaches to enhancing foreign access to U.S. markets have sparked debate within the Commission. Both approaches are reflective of the Commission's awareness of the need to consider new approaches to meet our mission in a changing world. I am confident that the arrangements for regulatory cooperation and information-sharing that have been established in connection with the NYSE-Euronext merger and other similar arrangements will facilitate developments in this area.

IV. Conclusion

The SEC remains committed to its mission of ensuring investor protection, ensuring efficient, fair and orderly markets and promoting capital formation, and we value our bilateral and multilateral relationships with the EU and EU Members.

Ultimately, we can only be effective in meeting our mission and our shared goal of a strong, vibrant, transparent global market by working together to recognize our differences, seek harmonization and convergence where possible and, in every instance, seek ways of reducing or eliminating barriers to cross-border investment and unnecessary regulatory costs and burdens without diminishing investor protections.

I am heartened by the progress we have made to date and look forward to continuing to work together to achieve new milestones in cooperation and convergence in the years ahead. Thank you again for the opportunity to join you today.

Endnotes

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[1] 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, SEC Release No. 34-55540 (Mar. 27, 2007).

[2] SEC Chairman, Euronext Regulators Meet to Discuss Cooperation in the Event of the NYSE Euronext Combination, SEC Press Release No. 2006-164 (Sept. 27, 2006).

[3] Pub. L. 107-204, 116 Stat. 745 (2002).

[4] Executive Compensation Disclosure, Securities Act Release No. 33-8765 (Dec. 22, 2006).

[5] See SEC Offers Further Relief from Section 404 Compliance for Smaller Public Companies and Many Foreign Private Issuers, SEC Release No. 2006-136 (Aug. 9, 2006); Further Relief from the Section 404 Requirements for Smaller Companies and Newly Public Companies, SEC Release No. 2006-210 (Dec. 15, 2006).

[6] Chairman Christopher Cox' Address to the SEC Roundtable on International Financial Reporting Standards (Mar. 6, 2007); "On the Road Towards Convergence and Equivalence - State of Play in International Accounting," Remarks of Charlie McCreevy, European Commissioner for Internal Market and Services, at SEC Roundtable on International Financial Reporting Standards (Mar. 6, 2007).

[7] PCAOB Chairman Mark Olson and EU Commissioner Charlie McCreevy Meet to Discuss Furthering Cooperation in the Oversight of Audit Firms, PCAOB News Release (Mar. 6, 2007).

[8] Agreement Among PWG and U.S. Agency Principals on Principles and Guidelines Regarding Private Pools of Capital, U. S. Treasury Department Press Release HP-272 (Feb. 22, 2007).

http://www.sec.gov/news/speech/2007/spch041707klc.htm