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THE SARBANES-OXLEY ACT AND THE RULES APPLICABLE TO FOREIGN COMPANIES: THE POSSIBLE IMPACTS ON THE CAPITAL MARKETS*

ANDREA FERNANDES ANDREZO

Introduction. I. The Sarbanes-Oxley Act and the implications to foreign issuers. II. Main complaints of the non-US issuers regarding the Sarbanes-Oxley Act. III. The SEC final and proposed rules. IV. The SEC International Enforcement. V. Possible responses of the market to the Sarbanes-Oxley Act. Conclusion.

Introduction

The "Public Company Accounting Reform and Investor Protection Act of 2002", popularly known as Sarbanes-Oxley Act, brings many new rules of disclosure and corporate governance for companies. It is a response of the Congress to the recent corporate scandals that undermined the investors' confidence and interrupted the continuous growth of the American capital markets in the last years.

The American capital market experienced an exponential growth in the 90's. The total market value of US stocks rose from $ 3.3 trillion in 1990 to $ 14 trillion by September 1999.[1] The dollar amount of securities filed for registration with the Securities and Exchange Commission increased more than five-fold between 1990 and 1999 rising from $ 379 billion to $ 2.1 trillion.[2] The number of foreign companies registered with the Commission also increased significantly, and almost tripled between 1990 and 1999 from 434 to over 1,200 from 57 countries.[3] The following chart shows some other numbers about the growth of the American capital market during the 80's and especially during the 90's:

	1980	1985	1990	1995	1997	1998
Stock Market						
Total Market Value of U.S. Stocks ($ billions)[1]	$1,405	$2,132	$2,896	$6,394	$10,276	$10,531
Trading Volume on Exchanges and Nasdaq (shares in billions)	22	58	87	208	324	409
Dollar Volume Traded on Exchanges and Nasdaq ($ billions)	$545	$1,434	$2,069	$5,906	$11,041	$14,066

* Dissertação apresentada em maio de 2003 para obtenção do título de Mestre em Direito pela *Columbia University.*

1. SEC, *US Securities and Exchange Commission GPRA* (2000), at <http://www.sec.gov/about/gpra1999-2000.shtml#grow>.

2. Id.

3. Id.

	1980	1985	1990	1995	1997	1998
Public Offerings						
Dollar Amount of Securities Registration Statements Filed with the SEC ($ billions)[2]	$104	$323	$379	$824	$1,440	$2,550
Dollar Amount of Initial Public Offerins Registered with the SEC ($ bilions)[2]	$13	$90	$50	$122	$166	$257
Value of Public Offerings – excluding private placements ($ billions)[1]	$58	$133	$309	$705	$1,302	$1,819
Foreign Securities/Interests						
Foreign Companies Registered with the SEC	n/a	272	434	744	1,030	1,100
Foreign Companies – Dollar Amount Registered with the SEC ($billions)	$1	$1	$8	$49	$128	$241

1. Due to a change in source, some numbers differ from those cited in previous Industry statistics.
2. Fiscal year data. All other data are calendar year.
Source: SEC (at http://www.sec.gov/about/gpra1999-2000a.htm#ginds)

In the 90's, the American capital market became not only bigger, but also more popular. In 1998, there were 84 million direct and indirect shareholders, representing 43.6 percent of the country's adult population.[4] This shareholder figure is up 21 percent from 1995's 69.3 million and up 61 percent from 1989's 52.3 million.[5] Of those, 33.8 million, or about 40 percent of all stockholders, resided in households that owned stock directly in 1998.[6] Indirect equity holdings (through equity mutual funds, self-directed retirement accounts or pension plans) accounted for 40 percent of all corporate stock owned by households.[7] The shareownership in non-US companies is also noteworthy. In 1998, nearly 45 percent of shareowners had some exposure to shares in companies headquartered outside the United States.[8] While less than four million shareholders directly owned shares in non-US corporations, a much larger group—nearly 35 million shareholders—owned shares in non-US firms through equity mutual funds.[9] The chart below provides more information about it.

Total Number Of Shareowners (millions) 1989-1998				
Definition of shareowner:	1989	1992	1995	1998
Individuals owning stock directly, through mutual funds, retirement saving accounts or defined contribution pension plans	52.3	61.4	69.3	84.0
Individuals owning stock directly, through mutual funds or retirement saving accounts	42.1	51.5	59.6	75.8
Individuals owning stock directly or through mutual funds	31.5	35.3	38.6	48.5
Individuals owning stock directly only	27.0	29.2	27.4	33.8

Notes: Tabulations are based on the 1989, 1992, 1995, and 1998 Surveys of Consumer Finances. All individuals who report holding mutual funds that invest in stocks and bonds are included as shareholders. If a married couple owns stock, both spouses are classified as shareowners. The Survey of Consumer Finances does not provide information on equity ownership by minor children, or by unaffiliated adults who are members of a household but are neither the household head nor the spouse of the household head.

Source: Shareownership 2000, p. 56 (at <http://www.nyse.com/pdfs/2001_factbook_05.pdf>)

4. See NYSE, *Shareownership 2000*, 5 (2000), at<http://www.nyse.com/pdfs/2001_factbook_05.pdf>.
5. Id.
6. Id.
7. Id.
8. Id., p. 56.
9. Id.

The 90's were also characterized by a bull capital market with increasingly stock prices not only of the overvalued emerging technology companies of the New Economy, but also of some traditional large companies of the Old Economy.

During the 90's, the United States experienced high rates of economic growth too — the average annual GDP growth was 3.4% between 1991 and 2001,[10] which is directly related to the growth of the capital market.

Since 2000, however, the American capital market has been in trouble. In 2000, the dotcom bubble burst at the end of March. Nasdaq ended the year down 38% and more than 50% down from its year high.[11] The Dow Jones suffered its first reverse since 1994 and the FTSE 100 closed at 6,179 — a loss of 10.8%.[12]

The worst, however, was yet to come. In 2001 and 2002, besides more declines in dotcoms and other emerging technology companies, the American capital market experienced a series of scandals, starting with the collapse of Enron followed by the revelation of problems at WorldCom, Adelphia, Tyco and others. The stock market capitalization in the United States dropped and investors lost a lot of money.

The dotcom bubble burst was expected by many people, since the emerging technology companies were highly speculative ventures commonly overpriced. The problems with Enron and other well-known large companies were more serious, because they involved frauds and failures of the market safeguards, which undermined the investors' confidence.

In response to these scandals and due to the importance of the capital markets in the United States, the Congress quickly enacted in July 2002 the Sarbanes-Oxley Act to calm troubled markets, restore investor confidence, and avoid future scandals. One of its implications is that the new rules apply not only to American corporations, but also and equally to foreign issuers. Traditionally, before the Sarbanes-Oxley Act was adopted, non-US issuers with access to the American capital market were basically required to provide disclosure in the United States. The new rules go beyond that and touch corporate governance issues as well. Furthermore, some of the new rules apply to foreign gatekeepers too, such as accountants, auditors and attorneys.

Before the Sarbanes-Oxley Act, the costs of being traded in the United States seemed to under weigh the benefits. As provided before, the number of foreign issuers increased a lot in the last years — currently approximately 1,300 foreign issuers file annual reports on Form 20-F or 40-F with the SEC.[13] Some argue that this, however, might change, as the Sarbanes-Oxley Act touches not only disclosure, but also some other aspects of Corporate Governance, related, for example, with the Board of Directors and the Audit Committee. Worse still, some of the new requirements directly contradict some of the foreign rules. The SEC could exempt non-US issuers from many of the new rules, but does not want to seem to back away. Some foreign companies that trade on US exchanges have threatened to delist and others have announced to feel discouraged from listing on American stock exchanges. Some people argue that this might also give force to initiatives to improve the trading of securities at domestic markets. The effects that this might bring to the American capital market, as well as the ways that the SEC and the foreign companies are dealing and could deal with this new scenario will be the focus of this essay.

10. OECD, *OECD in Figures*, OECD Observer 2002/Supplement 1, 12 (2002).

11. Toby Fildes & Neil Day, *Volatility hits new levels in 2000*, Euroweek 34 (2001).

12. Id.

13. See final rule at <http://www.sec.gov/rules/final/33-8124.htm>.

This essay is divided in five parts. Part I shows the most relevant rules of the Sarbanes-Oxley Act applicable to foreign issuers. Part II brings the main complaints of the foreign issuers regarding these new rules. Part III provides the SEC response to these complaints, by showing the SEC proposed and final rules as applicable to foreign issuers. Part IV discusses the SEC international enforcement. Finally, Part V analyzes the possible responses of the foreign issuers to the new requirements applicable to them under the Sarbanes-Oxley Act.

I. The Sarbanes-Oxley Act and the implications to foreign issuers

Before providing an analysis of the new rules, it is essential to know to whom the Sarbanes-Oxley Act applies. This turns, in many cases, on the definition of the term *issuer* in § 2(a)(7) of the Act, as follows: "The term 'issuer' means an issuer (as defined in § 3 of the Exchange Act of 1934), the securities of which are registered under § 12 of that Act, or that is required to file reports under § 15(d), or that files or has filed a registration statement that has not yet become effective under the Securities Act, and that it has not withdrawn".

This definition captures the following three hypotheses:

(i) Registration under § 12

Any US or non-US issuer which has a class of equity or debt securities listed on a US securities exchange or a class of equity securities quoted on Nasdaq is required to register that class of securities under § 12 of the Exchange Act of 1934. In addition, any non-US issuer with total assets in excess of $ 10,000,000 and a class of equity securities held of record by 500 or more persons, of which 300 or more reside in the United States, is required to register the securities under § 12. There is an exemption, however, provided by Rule 12g3-2(b), which applies to most foreign private issuers with Depositary Receipts traded in the US over-the-counter markets ("Level I" ADR program) and issuers that have conducted offerings under Rule 144A. The SEC has made it clear that the Sarbanes-Oxley Act does not apply to foreign private issuers which have claimed the Rule 12g3-2(b) exemption.

(ii) Requirement to file reports under § 15(d)

§ 15(d) of the Securities Act provides that, as a result of an offering of debt or equity securities pursuant to an effective registration statement under the Securities Act of 1933, an issuer must file with the SEC the same periodic reports for any year in which there are 300 or more US holders of the class of security as it would have to file if the class were registered under the Exchange Act of 1934. Foreign private issuers that have sold debt securities in a registered offering or conducted a registered exchange offer of debt securities following an exempt institutional offering are required to file reports under § 15(d), but foreign governments and political subdivisions issuers are expressly exempt from the requirement to file reports under § 15(d).

(iii) Registration Statement not yet effective

The purpose of this part of the legal text is to capture domestic and foreign private pre-IPO issuers, which would not yet be subject to either § 12 or § 15(d). In regard to non-US issuers with ADR programs, the new rules apply basically to those with "Levels II and III" ADR programs, but do not apply to those with "Level I" or Rule 144A program, which have claimed the Rule 12g3-2(b) exemption. Some of the new rules are applicable to foreign gatekeepers as well, such as attorneys and accountants.

It is also relevant to mention the definition of "foreign private issuer", since this

term appears in many SEC rules. Under the Exchange Act Rule 3b-4(c), a foreign private issuer is a non-government foreign issuer, except for a company that (1) has more than 50% of its outstanding voting securities owned by US investors, and (2) has either a majority of its officers and directors residing in or being citizens of the US, a majority of its assets located in the US, or its business principally administered in the US.

An explanation of the main rules of the Sarbanes-Oxley applicable to non-US issuers and gatekeepers follows.

a) The Public Company Accounting Oversight Board (the "Board")

The Act creates a non-profit corporation, subject to the SEC oversight in a manner paralleling the relationship between the SEC and NASD, "to oversee the audit of public companies that are subject to securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports (...)".[14]

The Board is given rulemaking authority with respect to auditing, attestation, quality control, and ethics standards for auditors.[15] Moreover, it has to conduct compliance inspections investigation, which must be conducted annually for firms auditing more than 100 clients and not less than three years for other firms.[16] The Board is also authorized to discipline accounting firms that violate professional standards, Board rules, or the federal securities laws,[17] and may impose sanctions ranging from requiring additional professional training to revocation of a firm's or associated person's accounting license, and may levy fines up to $ 15,000,000 in the case of intentional misconduct by a firm.[18]

All accounting firms that prepare audit reports for public companies must become "registered public accounting firms" by registering with the Board.[19] Registered firms must submit annual reports to the Board, along with such other reports as the SEC or the Board determines.[20]

Foreign public accounting firms that prepare or furnish an audit report with respect to a reporting US or foreign issuer are expressly made subject to the Act and the rules of the SEC and the Board.[21] The Board is authorized to find that even a foreign accounting firm that does not issue audit reports "nonetheless plays such a substantial role in the preparation or furnishing of such reports for particular issuers" should be subjected to the Board's oversight.[22]

Thus, the Board has extraterritorial jurisdiction, which might bring difficulties to foreign public accounting firms and regulators. The SEC and the Board, however, were granted authority to exempt foreign public accounting firms from any provision of the Act or the rules thereunder.[23]

b) Auditor Independence

Under the Sarbanes-Oxley Act, the audit committee must pre-approve all audit and permitted non-audit services provided to a reporting company by the external auditor, with some "de minimus" exceptions[24] that permit, for example, that

14. See Section 101(a) of the Sarbanes-Oxley Act.

15. See Section 103(a) of the Sarbanes-Oxley Act.

16. See Section 104(a) and (b) of the Sarbanes-Oxley Act.

17. See Section 105 of the Sarbanes-Oxley Act.

18. See Section 105 of the Sarbanes-Oxley Act.

19. See Section 102 of the Sarbanes-Oxley Act.

20. See Section 102(d) of the Sarbanes-Oxley Act.

21. See Section 106(a)(1) of the Sarbanes-Oxley Act.

22. See Section 106(a)(2) of the Sarbanes-Oxley Act.

23. See Section 106(c) of the Sarbanes-Oxley Act.

24. See Section 202 of the Sarbanes-Oxley Act.

non-audit services constituting less than 5% of the annual revenues to the firm from the issuer may be provided without prior audit committee approval. The audit committee may delegate the authority to grant pre-approvals to one or more independent directors, but this delegation must be reviewed by the full audit committee at a regularly scheduled meeting. The approval by an audit committee of a non-audit service to be performed by the auditor shall be disclosed to investors in periodic reports.[25]

The Act also provides that accounting firms are prohibited from providing a variety of non-audit services contemporaneously with auditing of any public company, such as bookkeeping, appraisal or valuation services, internal audit outsourcing services, and legal services and expert services unrelated to the audit.[26] Tax services, however, are not forbidden. The Board is authorized to prohibit other non-audit activities and to grant exemptions from this rule on a case by case basis.[27]

Each accounting firm registered with the Board that audits an issuer shall timely report to the audit committee of the issuer:

• all critical accounting policies and practices to be used;

• all alternative accounting treatments that have been discussed with management officials of the issuer, the ramifications of their use and the auditors' preferred treatment; and

• other material written communications between the management of the issuer and the auditors, such as management letters or schedules of unadjusted differences.[28]

Accounting firms registered with the Board are also prohibited from auditing any public company whose chief executive officer, controller, chief financial officer, chief accounting officer or "any person serving in an equivalent position" was an employee of the accounting firm at any time during the one-year period preceding the date of the initiation of the audit.[29] This is the so-called "cooling-off period".

A mandatory rotation of accounting firms is not required, but there must be a rotation of the lead audit partner (*i.e.*, the partner with primary responsibility for conducting the audit) and of the reviewing partners after they provide audit services for the same issuer for five years.[30] The General Accounting Office, however, is required to assess the likely effects of requiring mandatory rotation of accounting firms.[31] This is to be assessed in the context of little competition between the biggest audit firms, since there are only few of them.

These provisions aim to strengthen auditor independence, and may cause the relationship between issuers and their external auditors to become more strictly regulated and formal.

c) Audit Committe

The Act requires national securities exchanges and national securities associations to adopt listing standards under which an audit committee of a public company must be composed entirely of independent board members.[32] An issuer either may have a separately designated audit committee composed of members of its board, or if it chooses to do so or if it fails to form a separate committee, the entire board of directors will constitute the audit committee. In this case, the board of directors as a whole will be required to comply with the requirements applicable to the audit committee.[33]

25. Id.
26. See Section 201 of the Sarbanes-Oxley Act.
27. Id.
28. See Section 204 of the Sarbanes-Oxley Act.
29. See Section 206 of the Sarbanes-Oxley Act.
30. See Section 203 of the Sarbanes-Oxley Act.
31. See Section 207 of the Sarbanes-Oxley Act.
32. See Section 301 of the Sarbanes-Oxley Act.
33. See Section 205 of the Sarbanes-Oxley Act.

In order to be considered "independent", an audit committee member may not be an "affiliated person" of the company or any subsidiary, and may not "accept any consulting, advisory, or other compensatory fee from the issuer".[34] In short, the director may receive only a director's fee and no other income.

The Act also expands the role of the audit committee, by making them "directly responsible for the appointment, compensation, and oversight of the work" of the independent auditor (including resolution of disagreements between management and the auditor regarding financial reporting), and by providing that the audit firm "shall report directly to the audit committee".[35]

The audit committee is also required to establish procedures for (i) the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and (ii) the confidential, anonymous submission by employees of the listed issuer of concerns regarding questionable accounting or auditing matters.[36]

Each audit committee has the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties.[37]

Finally, the Act authorizes the SEC to require each issuer to "disclose whether or not, and if not, the reasons therefore, the audit committee of the issuer is comprised of at least one member who is a financial expert". The SEC is also given authority to define the term "financial expert", but in defining it, the Commission must consider whether a person has, through the education and experience as a public accountant or auditor or a principal financial officer, controller, or principal accounting officer of an issuer, or from a position involving the performance of similar functions:

34. See Section 301 of the Sarbanes-Oxley Act.
35. Id.
36. Id.
37. Id.

a) an understanding of generally accepted accounting principles and financial statements;

b) experience in the preparation or auditing of financial statements of generally comparable issuers, and the application of such principles in connection with the accounting for estimates, accruals, and reserves;

c) experience with internal accounting controls; and

d) an understanding of audit committee functions.[38]

d) Executive certifications

The SEC shall require for public companies that the issuer's principal executive officer(s) and financial officer(s) certify in each quarterly and annual report that:

1. the signing officer has reviewed the report and, based on the officer's knowledge, the report does not contain any material misstatement or omission and "the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer as of, and for, the periods presented in the report";

2. the signing officers are responsible for establishing and maintaining internal controls and have designed such internal controls as necessary to ensure that material information relating to the issuer is made known to such officers during the reporting period;

3. they have evaluated the effectiveness of the issuer's internal controls within the 90 days prior to the report and have presented in the report their conclusions about the effectiveness of their internal controls as of that date;

4. they have disclosed to the company's auditors and to the audit committee

38. See Section 407 of the Sarbanes-Oxley Act.

all significant deficiencies in the design or operation of internal controls as well as any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and

5. they have indicated in the report whether there were significant changes in internal controls that could significantly affect such controls subsequent to the date of their evaluation.[39]

An officer providing a false certification potentially can be subject to Commission action for violating Section 13(a) or 15(d) of the Exchange Act and to both Commission and private actions for violating Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5.

Another executive certification is also required, which is subject to criminal penalties. Under Section 906 of the Sarbanes-Oxley Act, CEOs and CFOs must also certify that the information contained in periodic financial reports fairly presents, in all material respects, the financial condition and results of operations of the issuer. If they certify, knowing that this statement is not true, they can be fined up to $ 1,000,000 or imprisoned up to 10 years, or both. If they willfully do that, the maximum criminal penalties are $ 5,000,000 of fine, or 20 years of imprisonment, or both.[40]

Coffee calls the attention to the fact that "there is no reference to generally accepted accounting principles (GAAP). Apparently, an officer could be held liable if material liabilities in off-balance sheet transactions are hidden, even though they comply with the GAAP".[41] Thus, compliance with GAAP would not provide a safe harbor.

39. See Section 302 of the Sarbanes-Oxley Act.

40. See Section 906 of the Sarbanes-Oxley Act.

41. Coffee, Jr., John, "An Introduction to the Sarbanes-Oxley Act", in *Sarbanes-Oxley Act Special Supplement* 8 (2002).

e) Restatements of Financial Results

In the event that an issuer is required to prepare an accounting restatement because of material non-compliance resulting from misconduct, the chief executive officer and the chief financial officer must reimburse the company for any bonus or other incentive-based or equity-based compensation that they received during the 12 months following the issuance or filing of the financial report and for any profits they made on their sale of company stock during that period. The Commission is granted authority to exempt any person from this provision.[42]

f) Executive loans

An issuer is prohibited from directly or indirectly extending or maintaining credit, or renewing or arranging for an extension of credit, in the form of a "personal loan" to any director or executive officer. Personal loans outstanding on the date of the enactment of the Act are exempted, provided that "there is no material modification to any term (...) or any renewal of any such extension of credit on or after the date of enactment". The Act provides some very limited exemptions to this rule, including home loans, consumer credit, charge card, and margin loans, only if the loans or extension of credit are made or provided (i) in the ordinary course of the consumer credit business of the company, (ii) are "of a type that is generally made available by the issuer to the public", and (iii) are made on "market terms (...) no more favorable that those offered by the issuer to the general public".[43]

g) Enhanced Disclosure

g.1) *Periodic Reports*: Periodic reports that contain financial statements must dis-

42. See Section 304 of the Sarbanes-Oxley Act

43. See Section 402 of the Sarbanes-Oxley Act.

close "all material correcting adjustments that have been identified" by a company's auditors.[44] Moreover, the SEC must issue rules to require the disclosure of "all material off-balance sheet transactions, arrangements, obligations (including contingent obligations) and other relationships" that might have a "material current or future effect" on the financial health of the company.[45] The purpose of the new rules is to improve the transparency of reporting companies' off-balance sheet arrangements and to provide an overview of aggregate contractual obligations.

g.2) *Pro Forma Financial Information*: The SEC must issue rules providing that pro forma financial information does not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the pro forma financial information not misleading, and reconciles it with the financial condition and results of operations of the issuer under generally accepted accounting principles (GAAP).[46]

g.3) *Real Time Disclosures*: Reporting companies must disclose material changes in the financial condition or operations, in plain English, on a rapid and current basis, as the SEC determines by rule.[47]

g.4) *Internal Control Report*: The SEC must develop this new disclosure document, which shall "state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting" and must be reported annually by any reporting company. It must also contain a management assessment of "the effectiveness of the internal control structure and procedures of the issuer for financial reporting", which the audit firm must "attest to and report on".[48]

g.5) *Insider Trades*: The principal stockholders, officers, and directors must report to the SEC all changes in ownership of registered equity securities within two business days of the transaction (instead of ten days after the closing of the month as the former rule required). Such reports must be filed electronically and will be made public within one business day of filing through the SEC's and the company's website.[49]

g.6) *Codes of Ethics*: The SEC must issue rules to require each public company to disclose if it "has adopted a code of ethics for senior financial officers, applicable to its principal financial officer and comptroller or principal accounting officer, or persons performing similar functions" or justify why it has failed to do so. Moreover, changes in or waivers of the code must be promptly disclosed on a Form 8-K, the Internet, or other electronic methods.[50]

h) Attorneys appearing and practicing before the SEC

The Sarbanes-Oxley Act requires the SEC to prescribe "minimum standards of professional conduct for attorneys" who appear and practice before the SEC. These rules must require attorneys who represent public companies "to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof" to the company's chief legal counsel or CEO. If these officers do not take appropriate action in response to the evidence, the SEC's rules must require the attorney to report the evidence to the company's audit committee, to another committee of the board of directors comprised solely of directors not employed by the issuer, or to the board of directors as a whole.[51]

44. See Section 401(a) of the Sarbanes-Oxley Act.

45. See Section 401(a) of the Sarbanes-Oxley Act.

46. See Section 401(b) of the Sarbanes-Oxley Act.

47. See Section 409 of the Sarbanes-Oxley Act.

48. See Section 404 of the Sarbanes-Oxley Act.

49. See Section 403 of the Sarbanes-Oxley Act.

50. See Section 406 of the Sarbanes-Oxley Act.

51. See Section 307 of the Sarbanes-Oxley Act.

The Act also empowers the SEC to censure, suspend, or deny any person the privilege of appearing or practicing before the SEC (temporarily or permanently) if that person is found by the Commission, after notice and opportunity for hearing, not to possess the "requisite qualifications to represent others", to be "lacking in character or integrity, or to have engaged in unethical or improper professional conduct", or to have willfully violated or aided and abetted a violation of the securities laws or the rules and regulations thereunder".[52]

II. Main complaints of the non-US issuers regarding the Sarbanes-Oxley Act

Companies across the world are complaining for being exposed to extra costs and regulation in order to comply with the Sarbanes-Oxley Act. Some of them do not agree that their management structure and in-house controls have to match US standards. Some foreign regulators also complain of the extraterritoriality application of the Sarbanes-Oxley Act.

Some foreign issuers, gatekeepers, regulators and industry associations feel bothered by the fact that the Sarbanes-Oxley Act applies to foreign issuers with certain level of access to the American capital market. US regulators, however, justifies the new rules as a condition of participation in the American market and as necessary to provide more protection to investors. The problem is that some of the new rules conflict with some other countries' rules and customs.

One of the provisions most likely to have immediate effect on non-US companies is the requirement that CEOs and CFOs of reporting companies provide on a continuing basis a prescribed certification of their company's financial statements. Many foreign private issuers asked the SEC not to impose the executive certification requirement on them, either because this would be inconsistent with home country rules concerning the allocation of responsibility for financial reports or because home country rules were viewed as providing substantially equivalent protection against fraud. In fact, foreign issuers, as well as the US issuers, fear the severe criminal provisions on the failure of corporate officers to certify financial reports.

The audit committee provisions of the Act also bring problems to foreign issuers, particularly for those incorporated in civil law jurisdictions that require two tier boards, such as Germany. Typically, the lower tier (or "managing board") is composed exclusively of inside corporate executives who cannot satisfy the independence requirements of Section 301 of the Act. Problems also arise with the co-determination statutes, under which there must be representatives of employees in the Board, since this structure leaves little room for an audit committee of independent directors. These provisions also leaves some doubts to countries, such as Brazil, Italy and Japan, which require or provide for auditor and managers oversight through a board of auditors or similar body. In Brazil, for example, every publicly traded company must have a Board of Auditors (*Conselho Fiscal*), whose members are nominated directly by the shareholders. Directors and officers of the issuer are prohibited from being appointed for the Board of Auditors. The Board of Auditors in Brazil basically supervises the actions of the Board of Directors and audits the financial statements, besides the audit done by the independent auditor. Therefore, there is some overlap between the functions of this board and the Audit Committee. A similar thing happens in Italy with the *Collegio Sindicale*.

Another problem related to the Audit Committee arises from the fact that, in many countries, the power to hire and fire auditors rests with shareholders. This is the case in Germany, for example. Since Sarbanes-

52. See Section 602 of the Sarbanes-Oxley Act.

Oxley requires audit committees to have the power to appoint the auditor, these two rules have a direct conflict even though the spirit of both of them is the same — to keep that power away from management. In other countries, the power to hire and fire auditors rests with the Board of Directors, and this power cannot be delegated to any committee.

Problems might also arise from the rule that if earnings are restated bonuses awarded to executives for that year must be forfeited. However, if a bonus payment is part of a legal contract of employment, a CEO or CFO may have a superior claim under his or her home law. Thus, it is not clear how this provision will work in the context of the employment laws of different jurisdictions.

The prohibition on personal loans to executives might also cause troubles to issuers from places where, as a matter of practice, companies make personal loans to directors, since it is very wide-ranging and may include legitimate types of compensation. However, this does not seem to be relevant to many foreign issuers, since personal loans are not a common practice in many countries, especially in Europe. In fact, the practice of giving personal loans to executives is one of the criticisms that European experts make on the American system.

All these problems were brought to the SEC appreciation and some of them were addressed by the SEC on final and proposed rules as follows.

III. The SEC final and proposed rules

The SEC has the authority to exempt foreign companies from many of the provisions of the Sarbanes-Oxley Act,[53] but exercising such authority would put the SEC in a bad political position with the Congress, since, according to the SEC's interpretation, the purpose of the Act is to restore investor confidence in the US financial markets, regardless of the origin of the market participants.[54]

The SEC does not want to seem to back away, but at the same time, when adopting rules, it has to consider the impact that any new rule would have on competition. The Section 23(a)(2) of the Exchange Act prohibits the SEC from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. Moreover, Section 2(b) of the Securities Act and Section 3(f) of the Exchange Act require the SEC, when engaging in rulemaking, to consider or determine whether an action is necessary or appropriate in the public interest, and to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

The new rules intend to enhance the proper functioning of the capital markets basically by increasing the quality and accountability of financial reporting and restoring investor confidence. This is believed to increase the efficiency and competitiveness of the US capital markets. Increased market efficiency and investor confidence also may encourage more efficient capital formation. However, to the extent foreign exchanges or other markets do not impose these standards, competitors could, all things being equal, migrate to those markets to avoid compliance. This could cause US exchanges and securities associations to lose trading volume, and investors to lose liquidity or the benefits of trading in a US market.

In this sense, the SEC has attempted to accommodate the inconsistencies between home-country laws and the provisions of the Sarbanes-Oxley Act. In the past

53. See Section 36 of the Securities Exchange Act of 1934, and Section 106(c) of the Sarbanes-Oxley Act.

54. See Securities Act Release 34-47235.

months, the SEC has adopted final rules to implement many of the provisions of the Sarbanes-Oxley Act and has issued proposed rules in important areas. The new SEC rules applicable to non-US issuers and gatekeepers, under the Sarbanes-Oxley Act, will be analyzed below.

a) Public Company Accounting Oversight Board ("Board")

The SEC has not issued any rule regarding the Board by now. The Board has proposed a registration system for public accounting firms, but has not yet proposed rules related to auditing, attestation, quality control, and ethics standards for auditors.

The proposed registration system consists of nine rules[55] (PCAOB Rules 1000, 1001, 2100 through 2105, and 2300) and a form (PCAOB Form 1). The Board's registration rules and form will not take effect unless and until approved by the Commission.

Under the proposed rules, any public accounting firm that wishes to prepare or issue any audit report with respect to any public company that is required to file reports with the Commission or that has filed a registration statement for a public offering of securities must register with the Board. In addition, any public accounting firm that "plays a substantial role in the preparation or furnishing of an audit report" with respect to any issuer must register.

A public accounting firm that is organized or that operates outside the United States must register, if it wishes to prepare or issue an audit report on any public company that is required to file reports with the Commission or that has filed a registration statement for a public offering of securities. Although the SEC and the Board were granted authority to exempt foreign public accounting firms from any provision of the Act or the rules thereunder,[56] the proposed registration rules do not contain an exemption for non-US public accounting firms. Even those that do not issue audit reports on US public companies, but that play a substantial role in the preparation or furnishing of such reports, are required to register under the proposed rule. The Board believes that this decision is appropriate in light of the requirements of the Sarbanes-Oxley Act and of the pre-existing requirements and conditions to which foreign auditors that participate in the audit of US public companies have been subject. Some examples are given to illustrate that. All financial statements filed as part of reports with the Commission must be audited in accordance with US generally accepted auditing standards ("GAAS"), which applies whether the report is filed by a domestic issuer or by a foreign private issuer. All financial statements filed as part of reports with the Commission must also be audited by an auditor satisfying US independence requirements. Again, this applies whether the report is filed by a domestic issuer or by a foreign private issuer. Foreign public accounting firms that participate in audits of domestic or foreign private issuers are also subject to Commission enforcement action for any violation of the federal securities laws.

The Board, however, recognizes that the registration of non-US firms will raise special issues, and sought comments on whether the registration requirements should be modified for non-US firms and on how the Board should discharge its oversight responsibilities with respect to registered foreign public accounting firms.

Individual accountants that are associated with public accounting firms are not required to register, but firms must list all individual accountants that are associated with the firm on the firm's registration ap-

55. See proposed rules at <http://www.pcaob.com/displaypcaob.php?level=2&pub_id= PCAOB-Rules&chap_id=RS1&message_id=242>.

56. See Section 106(c) of the Sarbanes-Oxley Act.

plication. In general, individual accountants are not required to register; however, an individual accountant who wishes to prepare or issue, in his or her own name, an audit report on an issuer would be viewed as a sole proprietor and required to register.

The proposed deadline to register is 180 days following the determination of the Commission that the Board has the capacity to carry out the requirements of the Sarbanes-Oxley Act.

Public accounting firms that wish to apply for registration must do so by completing and submitting to the Board Form 1. Form 1 consists of ten parts, subdivided into various items requiring the disclosure of particular information concerning the applicant and its associated accountants and the applicant's issuer clients. The information provided in registration applications will be available to the public, subject to "applicable laws relating to the confidentiality of proprietary, personal, or other information".

Applicants for registration must pay a fee. The Board will set this fee at a level sufficient to recover the costs of processing and reviewing applications. The amount of an applicant's fee will vary with the size of the applicant.

After reviewing the application for registration, and any additional information obtained by the Board, the Board will determine whether to approve the application or not. The Board will approve an application for registration if it determines that registration is consistent with the Board's responsibilities under the Act to protect the interests of investors and to further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors. If the Board is unable to make this determination, or if the Board concludes that the application is inaccurate or incomplete, it will either request additional information from the applicant or disapprove the application. After the registration, the registered firms have additional disclosure obligations, as they are required to file annual reports with the Board, and the Board may require periodic updating of the information contained in a registered firm's registration application.

The Board's registration system is expected to be ready to receive registration applications in late June or early July, 2003.

b) Auditor Independence[57]

As mentioned before, the Sarbanes-Oxley Act basically applies to US issuers and non-US issuers with Levels II and III ADR Programs. The final rule on auditors covers the auditors of all these issuers. This includes foreign accounting firms that conduct audits of both foreign private issuers subject to the Act and foreign subsidiaries and affiliates of US issuers.

The only different treatment granted to foreign accounting firms is regarded to the time afforded with respect to compliance with the rotation requirements. Accordingly, for all partners with foreign accounting firms who are subject to rotation requirements, the rules are effective as of the beginning of the first fiscal year after the effective date of these rules. Likewise, in determining the time served, that first fiscal year will constitute the first year of service for such partners. Thus, for a partner from a foreign firm who is serving as the lead partner for an issuer with a calendar year, 2004 would constitute the first year of the five year rotation period for that partner, without regard to the number of years he or she had previously served in that capacity. Therefore, additional time is afforded for foreign accounting firms with respect to compliance with the rotation requirements.

57. See final rule at <www.sec.gov/rules/final/33-8183.htm> and the Securities Act Releases 34-47265; 35-27642; IC-25915; IA-2103, FR-68.

In regard to the prohibited non-audit services, the SEC makes clear that, like domestic accounting firms, foreign accounting firms can provide tax services, as appropriate, despite their local definition and local licensing requirements. Thus, tax services are allowed under the American law even in certain jurisdictions where they are defined as legal services and can only be rendered by persons licensed to practice law. Tax services such as tax compliance, tax planning and tax advice are allowed. Some tax services, however, might be regarded as prohibited legal or expert services, such as representing an audit client before a tax court and formulating tax shelters, which may require the accountant to audit his or her own work, assume a management function or become an advocate for a client in seeking to minimize tax obligations or defend novel tax issues.

The SEC also makes clear that it intends to continue to address conflicts between the US and foreign requirements regarding non-audit services on an *ad hoc* basis. The Commission staff has previously afforded relief from proscriptions against appraisal and valuation services where, among other things, the auditor and issuer were able to demonstrate that the auditor was not providing an opinion on the fairness of a given transaction. The Commission will continue to consider requests for exemptive relief from foreign auditors.

The SEC final rule also requires more disclosure of the fees for audit and non-audit services. Non-US issuers are now required to include in their annual reports on Forms 20-F or 40-F four categories of fees:

1. audit fees: for services that generally only the independent auditor can provide,

2. all other fees paid for the auditor,

3. audit-related fees: for employee benefit plan audits, M&A due diligence, accounting assistance and audits in connection with proposed or consummated acquisitions, internal control reviews, and consultations concerning financial accounting and reporting standards, and

4. tax fees.

Other than for the audit fees category, the rules also require a description of the types of services provided under the remaining three categories. Disclosure is required for the two most recent fiscal years. Additionally, to the extent that an audit committee has applied the *de minimis* exception discussed previously, companies must disclose the percentage of the total fees, by category, paid to the independent accountant where the *de minimis* exception was used. These new disclosure requirements are to enable investors to better evaluate the reliability of financial statements and the independence of the auditors.

Finally, if an issuer fails to have an Audit Committee, the entire board of directors will constitute the audit committee[58] and may perform the pre-approval function for the issuer. In the case the issuer has a Board of Auditors or similar body, rather than an Audit Committee, this board or body may perform the audit committee pre-approval function. The same body responsible for pre-approval of audit and non-audit services is also the body to whom the communications required under the Section 204 of the Sarbanes-Oxley Act are made by the issuer's auditor.[59]

c) Audit Committee[60]

Two final rules were issued regarding this topic.

The SEC considered the propriety of excluding all foreign issuers from the Audit Committee new rules, but determined that such an exclusion would not be appro-

58. See Section 205 of the Sarbanes-Oxley Act.

59. See <www.sec.gov/rules/final/33-8220.htm>.

60. See SEC Rule 10A-3 at <www.sec.gov/rules/final/33-8220.htm>, <www.sec.gov/rules/final/33-8177.htm> and the Securities Act Releases 33-8220 and 34-47235.

priate or consistent with the policies underlying the Sarbanes-Oxley Act. It believes that improvements in the financial reporting process for all listed issuers are important for promoting investor confidence in the American markets. The final rules, however, bring significant flexibility to non-US issuers, reflecting some of their complaints.

In the case of foreign private issuers with two-tier board systems, for example, the final rule clarifies that the term "board of directors" means the supervisory or non-management board. As such, the supervisory or non-management board can either form a separate audit committee or the entire board can be designated as the audit committee, if it is independent within the provisions and exceptions of this rule.

Under the final rule, in order to be considered independent, a member of an audit committee of a listed issuer must meet two criteria.[61]

The first one is that audit committee members are barred from accepting any consulting, advisory or other compensatory fee from the issuer or any subsidiary thereof, other than in the member's capacity as a member of the board of directors and any board committee. This prohibition precludes payments to a member as an officer or employee, as well as other compensatory payments. To prevent evasion of the requirement, disallowed payments to an audit committee member includes payments made either directly or indirectly. Indirect acceptance of compensatory payments includes payments to spouses, minor children or stepchildren or children or stepchildren sharing a home with the member. In addition, indirect acceptance includes payments accepted by an entity in which such member is a partner, member, officer such as a managing director occupying a comparable position or executive officer, or occupies a similar position (except limited partners, non-managing members and those occupying similar positions who, in each case, have no active role in providing services to the entity) and which provides accounting, consulting, legal, investment banking or financial advisory services to the issuer or any subsidiary.

The second criterion is that the audit committee member must not be an affiliated person of the issuer or any subsidiary thereof. The SEC adopted a safe harbor that a person will not be deemed to control the issuer (and will, therefore, not be an affiliate) if the person is not an executive officer or beneficial owner of more than 10% of any class of voting equity securities of the issuer. The SEC also clarified that there is no presumption that a greater than 10% shareholder would be deemed an affiliate. The independence of a shareholder owning more than 10% of the securities of the issuer will depend on a facts and circumstances analysis of control.

Some exemptions of this independence requirement are provided for non-US issuers. The following individuals are permitted to serve on the audit committee of a non-US issuer provided that they are not executive officers of the issuer:

a) an employee elected or named to the board of directors or audit committee pursuant to the issuer's governing law or documents, an employee collective bargaining or similar agreement or other home country legal or listing requirements;

b) a representative or designee of a foreign government or foreign governmental entity that is an affiliate of the issuer;

c) an affiliate of the issuer or a representative of such an affiliate, as long as the member has only observer status on, and is not a voting member or the chair of, the audit committee, and neither the member nor the affiliate is an executive officer of the issuer.

In the two latter cases, the individual is exempted from the second prong ("non-affiliation"), but must satisfy the first prong

61. Different requirements are imposed on investment company issuers.

("no compensation") of the independence requirement.

In addition to these exemptions, the Commission may also exempt a particular relationship with respect to the independence of the audit committee members, as the SEC determines appropriate in light of the circumstances.

The SEC recognizes that several foreign jurisdictions require or provide for auditor oversight through a board of auditors or similar body, or groups of statutory auditors, that are in whole or in part separate from the board of directors. For example, under former Japanese law, large Japanese corporations must maintain a board of corporate statutory auditors, a legally separate and independent body from the corporation's board of directors that is elected by shareholders. Since April 1st, 2003, Japanese corporations have the option to elect either a governance system with a separate board of directors and board of corporate auditors or a system based on nominating, audit and compensation committees under the board of directors. The Italian corporate governance regime provides for an independent board of statutory auditors ("Collegio Sindicale") and the Brazilian corporate law requires a Fiscal Council ("Conselho Fiscal").[62] Both in Brazil and in Italy, this board of auditors is mandatory in all public companies, its members are nominated by the shareholders, but it has no authority to appoint the independent auditors, which lays on the Board of Directors.

Although the members of these Boards of Auditors may not in all cases meet all of the independence requirements and may not have all of the responsibilities set forth for audit committee members, the SEC recognizes that the establishment of an audit committee in addition to these bodies, with duplicative functions, might not only be costly and inefficient, but it also could generate possible conflicts of powers and duties.[63] Therefore, an exemption from certain of the requirements for audit committees was provided for boards of auditors or statutory auditors of foreign private issuers if that board or body is:

• established and selected pursuant to home country legal or listing provisions expressly requiring or permitting such a board or similar body;

• required under home country legal or listing requirements to be either separate from the board of directors, or composed of one or more members of the board of directors and one or more members that are not also members of the board of directors;

• is not elected by the management of the issuer;

• does not include an executive officer of the issuer as a member;

• is subject to independence standards from the issuer or the management of such issuer established by home-country legal or listing provisions;

• is responsible, to the extent permitted by law, for the appointment, retention and oversight of the work of independent auditors.

This last requirement is not intended to override any requirement under an issuer's governing law or documents or other home country requirements for shareholders to elect, approve or ratify the selection of the auditor. Therefore, the issuer's shareholders may elect, approve or ratify the selection of the issuer's external auditors.

If it meets the conditions above, this Board of Auditors or similar body may per-

62. See footnote 160 of the Securities Act Release 33-8220. The SEC gives these examples, but clarifies that they are for illustrative purposes only. The exemption provided in the final rule for boards of auditors or similar bodies will be available to any foreign private issuer that meets the exemption's requirements because of the issuer's home country regime.

63. See SEC Rule 10A-3 at <www.sec.gov/rules/final/33-8220.htm>, <www.sec.gov/rules/final/33-8177.htm> and the Securities Act Releases 33-8220 and 34-47235.

form the audit committee pre-approval function required by the Commission's rules on auditor independence. Moreover, the communications required to be made by the issuer's auditor to the Audit Committee under Section 204 of the Sarbanes-Oxley Act must be made to this board or body.

To the extent permitted by the foreign law, this board or body must also have the same authority that the Audit Committee has to engage independent counsel and other advisers, as well as the duty to establish procedures for the receipt, retention and treatment of complaints. The SEC does not mandate specific procedures that the audit committee must establish in regard to complaints. It preferred to leave flexibility to the audit committee to develop appropriate procedures in light of a company's individual circumstances, so long as the required parameters are met.

A foreign issuer that relies on an exemption under the above Rule 10A-3 must disclose it as well as its assessment of whether, and if so, how such reliance materially adversely affects the ability of their audit committee to act independently and to satisfy the other requirements of the Rule 10A-3. Such disclosure needs to appear in, or be incorporated by reference into, annual reports and proxy statements filed with the Commission. To the SEC, it is important for investors to know if an issuer is availing itself of one of these exemptions.

The final rule also addresses the cases of jurisdictions with legal or listing requirements that prohibit the full board of directors from delegating the responsibility for the appointment, compensation, and oversight of the independent auditor to a committee or limit the degree of such delegation. The final rule does not conflict with this kind of prohibition. In this case, the audit committee, or body performing similar functions, must be granted such responsibilities, which can include advisory powers, with respect to such matters to the extent permitted by law, including submitting nominations or recommendations to the full board of directors. If the prohibition includes the ability to submit nominations or recommendations to shareholders, there is no conflict either.

The SEC also provides an additional instruction to clarify that the requirements in the final rule do not conflict with any legal or listing requirement in an issuer's home jurisdiction vesting the responsibilities for the selection of the outside auditor with a government entity or tribunal. Similar to the other instructions, the SEC believes the audit committee should be granted such responsibilities, which can include advisory powers, with respect to such matters to the extent permitted by law.

The new rules on the Audit Committee apply only to issuers whose securities are listed on the NYSE or AMEX or quoted on Nasdaq. The other ones, however, are required to disclose whether their audit committee members are independent. These issuers may choose which definition of independence to use from any of the NYSE, AMEX or Nasdaq listing standards.

As these rules are directed for national securities exchanges and national securities associations to be adopted as listing rules, these organizations are responsible for enforcing compliance with them, and must adopt a self-reporting mechanism that requires a listed issuer to notify them promptly after an executive officer of the issuer becomes aware of any material non-compliance with the rule.

Besides identifying the members of the audit committee, which was already previously required, each foreign issuer must also disclose in its annual report under Forms 20-F or 40-F, that the company either has at least one audit committee financial expert serving on its audit committee, or, if not, the reasons why not. The name of the audit committee financial expert as determined by the board must be disclosed. The names of additional experts are encouraged, but not required, to be disclosed. Moreover, the foreign issuer must disclose whether its

audit committee financial expert is independent, as that term is defined by the self-regulatory organization (SRO) listing standards applicable to that issuer. If a foreign private issuer is not a listed issuer, it must choose one of the SRO definitions of audit committee member independence that have been approved by the Commission in determining whether its audit committee financial expert, if it has one, is independent. It must also disclose which definition was used.

The instructions to the audit committee financial expert disclosure provisions also apply in the case the company has a board of auditors or similar body or statutory auditors instead of an Audit Committee. A foreign government issuer is excluded from the requirement to disclose whether or not it has a separate audit committee.

Finally, the SEC clarifies that the expert's understanding must be of the generally accepted accounting principles used by the foreign private issuer in preparing its primary financial statements filed with the SEC, since the SEC believes that the intent of Section 407 of Sarbanes-Oxley Act is to strengthen audit committee oversight of the preparation and audit of financial statements that are presented to US investors.

d) Executive Certifications[64]

One final rule on the certification under Section 302 was adopted on August 28, 2002, and became effective on August 29, 2002. Section 906 became effective on July 30, 2002. One SEC Rule was recently proposed to require issuers to file the certifications both under Section 302 and Section 906 as exhibits to the periodic reports to which they relate.

In spite of all the requests, no exemptions were granted for foreign issuers in regard to the executive certifications. According to the SEC, because of the broad scope of Section 302 of the Act, the new rules are applicable to all types of issuers that file reports under Section 13(a) or 15(d) of the Exchange Act, including foreign private issuers. Furthermore, this is a matter of disclosure, not a matter of corporate governance, and the SEC believes that, as the maintenance of disclosure controls and procedures is an important part of satisfying the certification requirement, it is appropriate to require foreign private issuers to comply with the new rules with respect to the implementation of the controls and procedures outlined in Section 302.

The only flexibility given to foreign issuers is that, for purposes of Section 302 of the Act, the Form 6-K is to be considered "current report", not "periodic report", and hence does not require officer certification. Thus, the certification reaches only the Forms 20-F and 40-F. The explanation falls under the fact that a foreign private issuer furnishes under cover of Form 6-K material information that it makes public or is required to make public under its home country laws or the rules of its home country stock exchange or that it distributes to security holders. Thus, foreign private issuers may submit interim financial information under cover of Form 6-K pursuant to their home country requirements and not because of a Commission requirement to submit updated financial information for specified periods and according to specified standards. Thus, the certification requirement does not apply to Form 6-K.[65]

It is also worth mentioning that the SEC clarified that while Section 302 requires an issuer's principal executive and financial officers to make specific certifications regarding their responsibilities to establish and maintain internal controls, it does not directly address the issuer's responsibility for controls and procedures

64. See proposed rule at <http://www.sec.gov/rules/proposed/33-8212.htm#P59_5559> and final rule at <http://www.sec.gov/rules/final/33-8124.htm>.

65. See Securities Act Releases 33-8124.

related to the issuer's Exchange Act reporting obligations.

Under the proposed rule, the SEC clarifies that, unlike the Section 302 certifications, the Section 906 certifications may take the form of a single statement signed by an issuer's chief executive and financial officers. Furthermore, as Section 906 merely requires that the certifications "accompany" a periodic report to which they relate, and Section 302 requires the certifications to be included "in" the periodic report, the SEC is proposing to require issuers to "furnish", rather than "file", the Section 906 certifications with the Commission. Thus, the certifications would not be subject to liability under Section 18 of the Exchange Act. Moreover, the certifications would not be subject to automatic incorporation by reference into an issuer's Securities Act registration statements, which are subject to liability under Section 11 of the Securities Act, unless the issuer takes steps to include the certifications in a registration statement.

Although Section 906 does not explicitly require the certifications to be made public, the SEC believes that it is appropriate to require the certifications to accompany a periodic report as it proposes.

The new rules are considered relevant in the sense that, by requiring an issuer's principal executive and financial officers to provide the required certification, investor confidence in the securities markets are expected to be enhanced, thereby leading to a more efficient market. Companies, however, will incur some costs in complying with the new rules, such as conducting periodic evaluations of its internal controls and procedures to record, process, summarize and report, on a timely basis, the information required in periodic reports filed under the Exchange Act. This is also relevant for the CEOs and CFOs, in order to reduce their exposure to the risk of civil liability and criminal penalties.

e) Restatement of Financial Results

No final or proposed rules regarding this topic were issued by now.

f) Executive Loans

No final or proposed rules regarding this topic were issued by now.

g) Enhanced Disclosure

g.1) *Periodic Reports*[66]

Foreign issuers do not have to comply with US GAAP with respect to the preparation of their primary financial statements, but those with Levels II and III ADR programs must reconcile their financial statements to the US GAAP.

Under the Sarbanes-Oxley Act, the SEC defined certain off-balance sheet disclosure requirements by reference to US GAAP. Thus, the non-US issuers that do not report under US GAAP will have to assess its guarantee contracts and variable interests pursuant to US GAAP to identify the types of arrangements required to be disclosed. In fact, foreign private issuers already make a similar assessment, since, under the current rules, a non-US GAAP reporting company's MD&A must include a discussion of the reconciliation to US GAAP and any differences between non-US and US GAAP necessary to understand the financial statements as a whole.

The new rules on off-balance sheet disclosure apply equally to foreign issuers and US companies, since the Sarbanes-Oxley Act does not distinguish between them. Thus, the same types of off-balance sheet arrangements covered by the definition must be discussed in the MD&A regardless of the particular GAAP under

66. See final rule at <www.sec.gov/rules/final/33-8182.htm> and the Securities Act Releases 34-47264; FR-67; International Series 1266.

which a registrant presents its primary financial statements. A foreign private issuer's MD&A disclosure should continue to focus on its primary financial statements despite the fact that its various "off-balance sheet arrangements" have been defined by reference to US GAAP.

The new rules also require that companies include in their annual reports tabular disclosure about contractual obligations, encompassing both on- and off-balance sheet arrangements, as of the latest fiscal year end balance sheet date. The table requires disclosure of the amounts of known contractual obligations, aggregated by type of contractual obligation specified in the table and for the specified time periods, in substantially the following format:

Contractual Obligations	**Payments due by period**				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
[Long-Term Debt]					
[Capital Lease Obligations]					
[Operationg Leases]					
[Purchase Obligations]					
[Other Long-Term Liabilities Reflected on the Company's Balance Sheet under GAAP]					
[Total]					

A company may use other categories of obligations suitable for its business, but the table must include all of the obligations that fall within the specified categories.

Finally, the SEC clarifies that, as the Sarbanes-Oxley Act requires the Commission to adopt off-balance sheet disclosure rules that apply to "each quarterly financial report required to be filed with the Commission", and foreign private issuers are not required to file "quarterly" reports with the Commission, the amendments do not apply to Form 6-K reports submitted by foreign private issuers to provide copies of materials required to be made public in their home jurisdictions. Thus, unless a foreign private issuer files a Securities Act registration statement that must include interim period financial statements and related MD&A disclosure, it will not be required to update its MD&A disclosure more frequently than annually.

g.2) *Pro Forma Financial Information*[67]

The SEC has adopted a new disclosure regulation, Regulation G, which requires public reporting companies that disclose or release non-GAAP financial measures to include, in that disclosure or release, a presentation of the most directly comparable GAAP financial measure and a reconciliation of the two measures. For foreign issuers, the SEC final rule clarifies that, with respect to non-US issuers, GAAP refers to the generally accepted accounting

67. See final rule at <www.sec.gov/rules/final/33-8176.htm> and the Securities Act Release 34-47226; FR-65.

principles under which the issuer's primary financial statements are prepared. Thus, the required reconciliation of the non-GAAP measure is to the comparable home country GAAP measure.

The SEC final rule provides some exceptions for public releases by non-US issuers with securities listed on a stock exchange or inter-dealer quotation system outside the United States. These companies are not required to provide a quantitative reconciliation if (i) the disclosure is made by or on behalf of the issuer outside the United States or is included in a written communication released outside the United States, and (ii) the non-GAAP financial information is not derived from or based on a financial measure calculated and presented in accordance with US GAAP. This exception is available even if (i) a written communication is released in the United States at the same time as or after its release outside the United States so long as it is not targeted at US persons, (ii) foreign or US journalists or other third parties can access the information, (iii) the information appears on websites maintained by the issuer so long as those websites are not available exclusively to or targeted at US persons, and (iv) following its release outside the United States, the information is included in a Report on Form 6-K submitted to the SEC. According to the SEC, these exemptions are intended to allow non-US issuers to continue their ordinary course presentations of information outside the United States or globally and not to interfere with non-US issuer information getting to US investors.

Regulation G applies to US GAAP numbers and to home country GAAP numbers where that information is presented in the United States and is presented in a way that indicates that it is directed or targeted at US investors.

The new rule also prohibits certain pro forma or non-GAAP financial information in filings with the SEC. Companies using allowed non-GAAP information in filings with the SEC are required to provide:

- a presentation, with at least equal prominence, of the most directly comparable financial measure calculated and presented in accordance with GAAP;
- a reconciliation of the two measures;
- a statement describing the reasons why the company's management believes the non-GAAP measures provide useful information to investors; and
- if material, a statement disclosing any additional purposes for which the company's management uses the non-GAAP financial measure presented.

Unlike the Regulation G, there is no limited exception for non-US issuers in this case, but they are allowed to include non-GAAP financial information in Form 20-F filings if it is required or expressly permitted under the GAAP used in the issuer's primary financial statements and it was included in the issuer's annual report or financial statements used in its home jurisdiction or market. The SEC clarified that it intends this exception to cover only situations where the foreign standard-setter affirmatively acts to require or permit the measure, and not situations where the measure is merely not prohibited.

g.3) *Real Time Disclosures*

g.4) *Internal Control Report*

g.5) *Insider Trades*

No proposed or final rules regarding these topics were issued by the SEC by now.

g.6) *Codes of Ethics*[68]

Like a domestic issuer, a foreign private issuer will have to provide the new code of ethics disclosure in its annual re-

68. See final rule at <www.sec.gov/rules/final/33-8177.htm> and the Securities Act Release 34-47235.

port. However, in contrast to a domestic issuer, a foreign private issuer will not have to provide in a current report "immediate disclosure" of any change to, or waiver from, the company's code of ethics for its senior financial officers and principal executive officer. Instead, a foreign private issuer must disclose if any such change or waiver that has occurred during the past fiscal year in its annual report only. This differing treatment reflects the fact that, unlike domestic reporting companies, reporting foreign private issuers do not have any specific interim or current disclosure requirements mandated by the Commission. The SEC, however, strongly encourages prompt disclosure on Form 6-K or the issuer's website. In general, if this disclosure is made within five days of the amendment or waiver, no disclosure would be required in the Form 20-F.

A non-US issuer must make its code of ethics publicly available by (i) filing a copy as an exhibit to its annual report on Form 20-F; (ii) posting on its web site; or (iii) providing an undertaking in its annual report on Form 20-F to provide a copy upon request.

h) Attorneys appearing and practicing before the SEC[69]

The SEC adopted final rules to implement the Section 307 of the Sarbanes-Oxley Act.

These rules require an attorney of public companies to:

1. report evidence of a material violation "up-the-ladder" within the issuer to the chief legal counsel or the chief executive officer of the company or the equivalent;

2. report the evidence to the audit committee, another committee of independent directors, or the full board of directors, if the chief legal counsel or the chief executive officer of the company does not respond appropriately to the evidence.

The term "evidence of a material violation" is defined according to an objective, rather than a subjective, triggering standard, involving credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing or is about to occur.

As an alternative procedure for reporting evidence of a material violation, an issuer can establish a "qualified legal compliance committee" (QLCC). Such a Committee must consist of at least one member of the issuer's audit committee, or an equivalent committee of independent directors, and two or more independent board members, and must have the responsibility, among other things, to recommend that an issuer implement an appropriate response to evidence of a material violation. One way in which an attorney could satisfy the rule's reporting obligation is by reporting evidence of a material violation to a QLCC.

The SEC clarifies that the rules cover attorneys providing legal services to an issuer who have an attorney-client relationship with the issuer, and who have notice that documents they are preparing or assisting in preparing will be filed with or submitted to the Commission. Foreign attorneys who are not admitted in the United States, and who do not advise clients regarding US law, are not covered by the rule, while foreign attorneys who provide legal advice regarding US law are covered to the extent they are appearing and practicing before the Commission, unless they provide such advice in consultation with US counsel.

The final rules allow an attorney, without the consent of an issuer client, to reveal confidential information related to his or her representation to the extent the attorney

69. See final rule at <www.sec.gov/rules/final/33-8185.htm> and the Securities Act Release 34-47276.

reasonably believes necessary (1) to prevent the issuer from committing a material violation likely to cause substantial financial injury to the financial interests or property of the issuer or investors; (2) to prevent the issuer from committing an illegal act; or (3) to rectify the consequences of a material violation or illegal act in which the attorney's services have been used.

The final rules do not create a private cause of action — the authority to enforce compliance with the rules is vested exclusively with the Commission.

The SEC did not approve the "noisy withdrawal" provisions, which require attorneys, under certain circumstances, to withdraw from representing an issuer and to notify the Commission that they have withdrawn for professional reasons, or, alternatively, require an issuer, rather than an attorney, to publicly disclose the attorney's withdrawal or written notice that the attorney did not receive an appropriate response to a report of a material violation. The SEC approved an extension of the comment period on these provisions.

The attorneys' rules are relevant to foreign issuers to the extent that they may change the fiduciary relationship between the attorney and the client.

IV. The SEC International Enforcement

Jennings *at. al.* teach that "the SEC can bring enforcement actions against broker-dealers, securities attorneys and accountants, and corporate registrants, officers, and directors, employing causes of actions unavailable to private litigants. (...) The Commission also has an extraordinary panoply of remedies available to it. (...) The SEC, however, has no power to bring criminal actions for willful violation of the securities federal law. The Commission's authority is limited to referring potential criminal actions to the Justice Department".[70]

70. Jennings, R.; Marsh, Jr., H.; Coffee, Jr., J.; Seligman, J., *Securities Regulation 1467* (1998).

The remedies available to the SEC are: civil injunctions, administrative procedures, civil fines, cease and desist orders, and corporate bar orders.

One could ask how the SEC can exercise its authority and enforce the federal securities laws and all these new requirements to foreign issuers and gatekeepers. When there is evidence of violation of the federal securities law by foreign issuers or gatekeepers, there are basically two difficulties: (i) conducting the investigation; and (ii) enforcing the decision. One way to enforce compliance with the American rules in the case of foreign companies listed on US stock exchanges is to stop the trading of these securities in the United States. However, this might not be enough and actually hurts the investors. The policy that the SEC has adopted is to enter into agreements with regulators of securities markets around the world to develop cooperative enforcement mechanisms that permit and encourage extensive information sharing.

On its side, the American Congress enacted in 1988 the section 21(a)(2) of the Exchange Act (ITSFEA), which authorizes the SEC to provide assistance to foreign securities authorities to conduct investigations without regard to whether the facts stated in the request constitute a violation of US law. Later, in 1990, the Congress enacted the International Securities Enforcement Cooperation Act (ISECA), which amended the Section 24 of the Exchange Act in order to provide a basis for the SEC to refuse to give disclosure of certain records obtained from a foreign securities authority if this would violate the laws applicable to the foreign authority, except if the information is required by the Congress or a court of the United States. The ISECA also gives the SEC authority to provide foreign and domestic securities authorities with information on records filed with it, if the person receiving it provides assurance of confidentiality as may be deemed appropriate by the SEC.

The SEC has entered into more than 30 formal information-sharing agreements with foreign counterparts (See Appendix 1). The Commission and foreign regulators share information and cooperate directly with each other in investigating and prosecuting cross-border securities fraud. Based on information gathered abroad or involving activities taking place in other countries but having effects in the United States, the SEC has brought a number of significant enforcement actions. In 2002, a record number of enforcement actions involved international elements — the SEC made 448 requests to foreign authorities and responded to 353 requests from abroad.[71]

The following example[72] gives an idea of the cooperative work among the SEC and foreign regulators. In *SEC v. ACLN, Ltd. et al.*, Civil Action n. 02-CIV-7988 (S.D.N.Y.); Litigation Release n. 17776 (Oct. 8, 2002), the Commission filed a civil injunctive action in the United States District Court for the Southern District of New York against ACLN, Ltd., a Cypriot Corporation operating from Antwerp, Belgium that purportedly shipped used vehicles to North and East Africa and new cars in that region. The SEC sued three of ACLN's officers and its Cyprus auditor. The complaint alleges that ACLN was the vehicle for an elaborate financial fraud (overstating assets/revenue, nonexistence of new car line of business) that resulted in losses of hundreds of millions of dollars to investors in the United States and abroad. The fraud included the falsification of bank records to distort the company's financial picture, and the sale of at least $ 80 million of ACLN stock by company principals when they knew the financial disclosures were fraudulent. The Commission received assistance from several foreign government agencies in Belgium, Denmark, Luxembourg, Monaco, the Netherlands, Norway and the United Kingdom to freeze approximately $ 45 million in bank accounts. The SEC will be seeking to have proceeds returned to defrauded investors.

Besides the cooperative work in investigating and prosecuting cross-border securities fraud, some initiatives have also been taken to prevent frauds. For example, in the countries where American firms have a significant presence (such as the United Kingdom, Switzerland, Germany and Japan), the SEC periodically reviews the financial, operational and management controls used by selected securities firms in conjunction with foreign regulators. Moreover, the Commission offers comprehensive technical assistance and training programs for senior regulatory and stock exchange officials in emerging and developed securities markets.

The SEC has been working to improve its international enforcement with the assistance of foreign authorities to protect investors from cross-border fraud. The basic idea is to improve the mutual cooperation, not only through information-sharing agreements, but also through training programs with foreign counterparts. This has been considered the most efficient way to combat cross-border fraud.

V. Possible responses of the market to the Sarbanes-Oxley Act

a) ADR Programs

Nowadays American investors can buy foreign issuers' securities abroad or, more easily, in the US through the acquisition of American Depositary Receipts. ADRs are certificates representing home-market securities, which are traded freely in the United States as US securities and in American dollars. The ADR programs were created to meet the demand of American investors for foreign securities. The objectives of an ADR program for the issuer are: access to deeper capital markets, better

71. Practising Law Institute (PLI), *The SEC's International Program*. The SEC Speaks in 2003, 1233 (2003).

72. Id., p. 1.234.

share valuation, flexible funding, broader shareowner base, protection against unwanted mergers and acquisitions, and increasing name recognition. For the investors, the advantages are: increasing diversification, quotation in US dollars, payments of dividends or interests in US dollars, clear and settle according to US standards, overcoming foreign investment restrictions, eliminating global custodian charges, possibility of tax efficiency, enhancing liquidity, and improving information flow.

There are four kinds of ADR Programs:

a) Offering of existing shares (secondary market):

• Level I (over-the-counter): It does not require reconciliation of the issuer's financial statement to US GAAP. The issuer must give in the United States the same disclosure it gives in the home country.

• Level II (exchange listed): It requires reconciliation of the issuer's financial statement to US GAAP and extensive disclosure.

b) Offering of new shares (primary market or secondary market of a large block of shares):

• Level III (exchange listed public offering): It requires reconciliation of the issuer's financial statement to US GAAP and extensive disclosure.

• Rule 144A/Regulation S (private placement offerings): It is restricted to QIBs (qualified institutional buyers[73]) and it is exempted from registration with the SEC.

As mentioned before, the Sarbanes-Oxley Act and the new SEC rules apply basically to the foreign issuers with Levels II and III ADR Programs.

b) Alternatives to ADR Programs

Foreign issuers with Levels II and III ADR Programs are subject to greater regulatory burdens by the Sarbanes-Oxley Act. The SEC, however, has been trying to accommodate some of the complaints of the foreign issuers, especially those related to the inconsistencies between home-country laws and the provisions of the Act, as is the case of the final rule on the Audit Committee. Some complaints, however, were not heard, such as those related to the executive certifications. The SEC justifies this different treatment by the fact that the first one is related to corporate governance, while the second one is a disclosure requirement. Other issues still have to be addressed by the SEC, such as the prohibition on personal loans to executives.

Some argue that the new requirements of the Sarbanes-Oxley Act might:

a) cause some foreign companies that trade on US stock exchanges to delist and discourage others considering to list on American stock exchanges;

b) give force to initiatives to improve the trading of securities abroad, such as the Global Equity Market and the Transatlantic Securities Market.

Analyses of both of them, as well as of the likelihood of each one, are provided below.

b.1) *Deciding to Delist or not to List on US Stock Exchanges*

Companies that perceive the new requirements as too onerous could be dissuaded from seeking or maintaining a listing for their securities in the United States. By making this decision, companies must take into consideration that they might be sending a bad message for the market, since

73. QIBs are defined in Rule 144A, basically as investors who own and invest in a discretionary basis more than $ 100 million. For dealers, this limit is $ 10 million or there is no limit, if the dealer is acting in a riskless principle transaction for QIBs. For banks and savings and loan associations, there is an additional requirement of audited net worth of at least $ 25 million.

it will appear that they cannot or are unwilling to comply with the new American Corporate Governance standards. Moreover, they will be losing access to the biggest capital market of the world. In 2001, the American capital market capitalization was almost half the world's stock market capitalization — $ 13,876.6 billions out of $ 28,875.1 billions.[74]

The decision on delisting can impact capital formation and negatively impact the transparency and liquidity of its securities, since many shareholders, mainly the small ones, might dump. The possibility of these effects and their magnitude if they were to occur are difficult to quantify.

Finally, a listed company must also consider that it is harder to withdraw the American market than not to enter, and, even after delisting, it may still be subject to securities laws and regulations in the US

b.2) *Initiatives to Improve the Trading of Securities Abroad*

Even if some non-US companies decide to delist and others are discouraged from listing on American stock exchanges, the demand for their securities would remain. Investors would have to trade foreign securities at each local market, bearing the costs of trading at different currencies and under different regulations. On this token, some believe that the increase of the level of regulation in the United States will stimulate some initiatives to facilitate the trading of foreign securities, such as those already taken by the New York Stock Exchange and Nasdaq some years ago.

The NYSE announced in 2000 that it had invited stock exchanges from Australia, Belgium, Brazil, Canada, China, France, Japan, Mexico and Netherlands to provide a 24-hour market for the biggest multinational stocks. This is the so-called Global Equity Market — GEM.[75] Investors would be able to access the GEM through their domestic stock exchanges. Participant exchanges' trading systems would be interconnected in a way that order-driven trading in blue chips from the 10 exchanges would be traded in an order book passed from one time zone to the next, with regulation for each listing still coming under its domestic supervisory body. Participation in the GEM would be open to all stock exchanges, which adhere to the principles of transparency, self-regulation, and the agency auction structure. In turn, Nasdaq has been negotiating technological integrations with foreign stock exchanges, such as the London Stock Exchange and the Deutsche Borse. Both initiatives would keep the need of two brokers, one in the country where the investor is located, and another one where the issuer's securities are traded. Despite the fact that the first agreements started in 2000, both initiatives are still in very early stages, and many issues still need to be addressed, such as the clearing and settlement systems and minimal requirements for listing on these global markets.

A deeper integration between the American and the European capital markets was recently proposed through the creation of the so-called Transatlantic Securities Market, defined as "an open market in which European and American investors and traders can buy and sell financial products of companies and firms on the other side of the Atlantic as easy as if they were buying or selling domestic financial products at home, with equivalent levels of appropriate investor protection".[76]

74. IMF, *Global Financial Stability Report*, 121 (2003), at <http://www.imf.org/external/pubs/ft/gfsr/2003/01/pdf/appendix.pdf>, march 2003.

75. NYSE, *The Formation of a Global Equity Market*, (2000) at <http://www.nyse.com/content/articles/1043269646746.html>.

76. Gunter Burghardt, *A Transatlantic Securities Market Would Benefit Everyone*, European Affairs (2003).

A report *Building a Transatlantic Securities Market*[77] published by the International Securities Market Association (ISMA) in cooperation with the independent New York-based research center, the Council on Foreign Relations, on December 2002 urges a US-EU accord on transatlantic exchange access to jumpstart integration of the two mammoth securities markets. The report proposes a regulatory regime based on mutual recognition, allowing exchanges authorized on one side of the Atlantic to give direct trading access to professional investors on the other side. It is argued that unnecessary regulation inflates trading costs for US investors in Europe and vice versa, and such an accord would significantly cut transatlantic trading costs as well as the cost of capital for American and European companies.

This proposal is based on the idea that trading in the ADRs is more costly than trading in the underlying shares if US investors could trade the underlying shares without the layers of redundant intermediaries. Currently, for example, the investor's US broker must pay a second broker — one which is based in Europe and a member of the relevant European exchange — to trade the stocks on behalf of its client. That cost is ultimately borne by the client. Under this proposal, European exchanges would extend membership — and therefore direct, electronic trading access — to brokers in the United States, and vice-versa.

The report proposes to eliminate the regulatory barriers to transatlantic trading which have no useful role in terms of investor protection. The proposal is focused on integrating the secondary equity markets of the United States and the European Union via a system of mutual recognition of exchange and trading regulations combined with home country control and minimal harmonization of corporate financial disclosure rules. This would be accomplished through a mutual recognition agreement that would allow securities exchanges authorized on one side of the Atlantic to offer direct trading access to investors based on the other side, for the purpose of trading listed equities and derivatives based on equities. Under this scheme, US exchanges operating in the European Union would be regulated by the SEC and European Union exchanges operating in the US would be regulated by their respective home market authorities. Direct electronic trading access to the exchanges would be limited to broker-dealers and so-called "qualified institutional buyers", although individual investors would be able to place orders through registered local brokers in accordance with current retail investment law in the investor's jurisdiction.

Under this proposal, it would be permitted US trading of European Union-listed securities meeting International Accounting Standards (IAS) rather than US Generally Accepted Accounting Principles (GAAP) disclosure requirements.

It is also argued that ADR programs would be eliminated. Once European exchanges are permitted to provide trading access in the United States, cross-listed companies will find much of the existing NYSE and Nasdaq trading of their stocks migrating back to the home exchange in Europe. Over time, many of these companies can be expected to drop their redundant US listings. This is based on the evidence from within the European Union itself that the removal of regulatory barriers to crossborder trading leads to repatriation of trading to the home exchange, and delisting from secondary exchanges.

This is a proposed alternative for issuers and investors to avoid regulatory barriers on international trades. Many issues, however, still need to be addressed, such as the clearing and settlement systems and minimal requirements for listing on this market.

77. Benn Steil, *Building a Transatlantic Securities Market*, International Securities Market Association (2002).

This alternative seems unlikely to succeed, since it is very doubtful that the SEC and the NYSE would support it. The SEC would oppose it on the grounds of its responsibility to protect the investors on the American capital markets, while the NYSE, on its turn, would try to avoid losing trading volumes. The SEC, for example, would hardly accept US trading of European Union-listed securities meeting International Accounting Standards (IAS) rather than US generally accepted accounting principles (GAAP) disclosure requirements, despite the convergence of both. Europeans, however, may try to negotiate such an agreement, as it would arguably provide benefits to European companies looking to attract US investor interest, since it would eliminate the necessity of a redundant US exchange listing, thereby allowing them to access American institutional investor capital without having to suffer the costs imposed by extraterritorial US legal initiatives, such as the Sarbanes-Oxley Act. This, however, can already be done through Regulation S.

Currently, investors can choose from 2,100 ADR programs from 80 countries[78] of the five continents. The Transatlantic Securities Market is much more selective, since it would provide American investors with access only to European Union listed companies. It does not seem to be feasible to have similar initiatives worldwide. Another restriction of the Transatlantic Securities Market is that it inter-connects only the secondary markets, while the ADR programs also allow companies to raise capital. Finally, the difficulties of trading at different currencies and under different regulations, which are eliminated in the ADR programs, would still remain in the Transatlantic Securities Market. Therefore, it seems that, even though this initiative could arguably succeed, the ADR programs would not be eliminated, since it appears that US investors would have more difficulties in investing in foreign companies through the Transatlantic Securities Market than through ADR programs, and the Transatlantic Securities Market allows fewer alternatives for issuers if compared to the ADR programs.

In the end, American investors would be able to trade European Union companies on this market or through ADRs and other foreign companies through ADRs or in the local markets at different currencies and under different regulations. This is similar to what happens nowadays, since American investors can trade foreign securities abroad or through ADRs. The main difference would be the elimination of some layers when institutional investors would be trading abroad. However, this can already be done through Regulation S.

Conclusion

The Sarbanes-Oxley Act, aiming to restore the investors' confidence and prevent new corporate scandals, brought many new rules on disclosure and Corporate Governance applicable not only to US issuers, but equally to foreign issuers.

Traditionally, non US-issuers were required to provide some disclosure in the US to access the American capital market, but were exempt from in-house management and control requirements. The SEC could have kept this policy and exempted the foreign issuers from many of the new rules, but did not want to seem to back away.

Most of the new rules represent an extension of federal law into areas that have traditionally been left to state corporate law and, in regard to foreign issuers, to local regulators abroad. Thus, the SEC should be particularly wary of intruding into areas already subject to similar oversight by other legal or regulatory regimes outside the US.

The Act brings new rules to foreign issuers and foreign gatekeepers, such as

78. Data provided by the Bank of New York on a presentation made at Columbia Law School on February 26, 2003.

accountants and attorneys. The SEC has not completely exempted foreign issuers and gatekeepers from the new rules, but has reasonably accommodated some of their requests, especially when the new rules contradict local laws. Moreover, the SEC has also provided more time for foreign issuers to comply with the new requirements in many cases.

Companies now are assessing if the benefits of being traded in the US outweigh the greater regulatory burdens. If not, some of them might decide to delist or be discouraged from listing on US stock exchanges. As a result, new ways to make it easier for American investors to trade foreign securities could develop, such as the Transatlantic Securities Market.

First, if the new requirements discourage some companies to list on US stock exchanges, this would happen only on the short term. It seems to be unlikely that this would continue on the long run and that a lot of companies with ADR programs would delist because of the new regulatory burdens, since this decision would cause the company to lose access to the biggest capital market of the world, and would also send a bad message for the market, by showing its unwillingness or impossibility to provide more disclosure and to follow the new American corporate governance standards. Few companies might delist because of the Sarbanes-Oxley Act, and those that decide to delist might allege this reason, but, in fact, the real cause might be another one.

In thinking about delisting, a company must also consider that this is costly, may decrease the liquidity of its securities, because many small shareholders might dump, and, even after delisting, it may still be subject to securities laws and regulations in the US

Second, the proposed ways for American investors to trade foreign securities, the so-called Transatlantic Securities Market, might be less costly than trading directly abroad or through ADRs, since it requires fewer intermediaries. However, it is very unlikely that the SEC and the NYSE would support it. The first one is concerned with the investor's protection, while the second one would not like the idea of losing trading volumes. Moreover, this would not be perceived to bring benefits to the United States, since US institutional investors are already allowed to trade directly abroad under the Regulation S. It also does not seem to make this kind of trading easier, due to the difficulties of trading abroad at different currencies and under different regulations. If this was not a problem, ADR Programs would not exist.

Finally, ADR programs yet seem to be the easiest way for foreign issuers to access the biggest capital market of the world and for American investors to trade foreign securities, since ADRs are considered securities under the American law, quoted in US dollars and freely traded on the American market. They can be used for companies from all around the world to raise capital or simply to expand the secondary market, by listing on US stock exchanges or trading over-the-counter (OTC). American investors are provided with periodic disclosure in English and, in certain cases, according to the US GAAP. Moreover, the depositary bank also plays a relevant role and makes trading foreign securities easier for American investors due to the services it provides, such as interface with investors, processing corporate actions, responding to inquiries, and tax reporting. The depositary bank is also helpful for the issuers, due to its interface between the company and the investors, and the strategic consulting it provides. It also helps to enhance the visibility of the company, and to promote the program.

In short, for all these reasons, it seems unlikely that foreign issuers will delist and ADR programs will be eliminated. There is no way for those who want or need to access the biggest capital market in the world other than to comply with the American rules.

APENDIX

INDEX OF THE SEC FORMAL INFORMATION SHARING ARRANGEMENTS

Country	Date
Argentina	December 9, 1991
Australia	October 20, 1993
Belgium	January 30, 2001
Brazil	July 1, 1988
Canada	January 7, 1988
Chile	June 3, 1993
China	April 28, 1994
Costa Rica	October 10, 1991
Egypt	February 11, 1996
European Community	September 23, 1991
France	December 14, 1989
Germany	November 22, 1993 March 24, 1994 December 20, 1995 October 17, 1997
Hong Kong	October 5, 1995
Hungary	June 22, 1990
India	March 6, 1998
Indonesia	March 24, 1992
IADB/UNECLAC	September 26, 1991
Israel	February 13, 1996
Italy	May 5&7, 1993
Japan	May 23, 1986 May 17, 2002
Jersey	May 22, 2002
Mexico	October 18, 1990
Netherlands	December 11, 1989 July 1, 1992
Norway	September 24, 1991
Portugal	October 10, 1997
Russia	December 5&6, 1995
Singapore	May 16, 2000
South Africa	March 2, 1995
Spain	July 8, 1992
Sweden	September 25, 1991
Switzerland	August 31, 1982 November 10, 1987 November 3, 1993
United Kingdom	September 23, 1986 September 25, 1991 May 1, 1995

Source: Practising Law Institute (PLI). *The SEC's International Program*, The SEC Speaks (2003).