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SECURITIES REGULATION[1]

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In this part of the course we will be thinking about securities regulation. Securities regulation imposes transaction costs on the raising of capital in the interests of maintaining confidence in the securities markets and protecting investors. Different countries have different systems of securities regulation with different rules. So participants in a cross-border financial transaction may have to worry about the potential application of securities rules in different jurisdictions.

We have already considered how courts in the US have applied the definition of a security in the context of loan participations. Having read *Banco Espanol de Credito* v. *Security Pacific National Bank* we might think that courts in the US would be reluctant to apply the US securities laws in the context of transactions involving sophisticated parties. However, where what is being bought and sold is clearly a security (for example a bond), the US securities laws apply unless there is an applicable exemption. Where an offering of securities takes place entirely outside the US, the registration requirements of s 5 of the Securities Act 1933 do not apply, and there is a regulatory

[1] You may find the University of Cincinnati's Securities Lawyer's deskbook useful: http://www.law.uc.edu/CCL/index.html

safe harbor under Regulation S.[2] Eurodollar denominated eurobond market transactions effected in Europe include US legal opinions that the eurobonds do not need to be registered in the US. We will begin by thinking about the extent to which securities laws can be limited in their effect by reference to territorial boundaries. The internet complicates this issue as it facilitates cross-border transactions.

The EU has addressed issues of potential conflict between rules in different countries by harmonising many of its rules. As you look at the material on EU harmonisation think about whether it makes sense at the global level to resolve differences between the approaches to securities regulation in different countries by agreeing conflicts of laws rules at the international level or by harmonising rules of securities regulation.

We have looked at some of the issues surrounding the definition of the term "security". An issue of securities in the US must be registered with the SEC unless a registration exemption applies, and regulations promulgated by the SEC mandate the provision of certain information to prospective investors. An issue of securities which is a non-public offering is exempt from registration, but the contours of the exemption are uncertain. The SEC has developed safe harbors for non-public offerings in Regulation D. An offering which complies with the requirements for the safe harbor is exempt from registration, although not from the anti-fraud provisions of the securities statutes. The regulation D safe harbors allow sales of securities to accredited investors under certain conditions, including restrictions on general solicitation and general advertising (see Rule 502). An accredited investor is defined in Rule 501 as follows:

Accredited investor. Accredited investor shall mean any person who comes within any of the following categories, or who the issuer reasonably believes comes within any of the following categories, at the time of the sale of the securities to that person:
1.Any bank as defined in section 3(a)(2) of the Act, or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Act whether acting in its individual or fiduciary capacity; any broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934; any insurance company as defined in section 2(a)(13) of the Act; any investment company registered under the Investment Company Act of 1940 or a business development company as defined in section 2(a)(48) of that Act; any Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958; any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of $5,000,000; any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 if the investment decision is made by a plan fiduciary, as defined in section 3(21) of such act, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of $5,000,000 or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors;

[2] Regulatory harbors allow people to conduct business knowing that if they comply with the regulatory conditions of the safe harbor they will not be subject to enforcement action. On Regulation S see below at page 14. Note that the Regulation S safe harbor is a safe harbor in respect of registration, and not fraud liability.

2. Any private business development company as defined in section 202(a)(22) of the Investment Advisers Act of 1940;
3. Any organization described in section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5,000,000;
4. Any director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer;
5. Any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds $1,000,000;
6. Any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;
7. Any trust, with total assets in excess of $5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in rule 506(b)(2)(ii) and
8. Any entity in which all of the equity owners are accredited investors.

Securities sold in a regulation D offering are restricted securities subject to limitations on resale. If they were resold they would need to be registered or to benefit from a registration exemption. Rule 144a does allow for private sales to “qualified institutional buyers” during the period when restrictions apply. The term qualified institutional buyer is defined differently from the term accredited investor in regulation D. But these two sets of exemptions (for issue and resales) illustrate the idea that the rules about registration require less protection for sophisticated parties than for unsophisticated investors, though wealth is used as a proxy for sophistication. The underlying idea is that sophisticated investors are more likely to know what information they need and to ask for it.

Foreign issuers may decide that they want to access the US capital markets directly, rather than issuing securities just outside the US either by listing their securities in the US or by carrying out a private placement in the US. Even if a securities issue is carried out outside the US, in some circumstances the issuer may have to worry about the application of US securities laws. The Regulation S safe harbor for offshore issues of securities may be combined with a Regulation D non-public US offering in a global offering. But Regulation S does not provide a safe harbour in relation to the anti-fraud rules.

EXTRATERRITORIALITY OF THE US SECURITIES LAWS

According to US courts and the SEC the US securities laws have extraterritorial effects. Actions outside the US which defraud US investors may lead to a risk of liability under the US securities laws. Aggressive enforcement of US securities laws (as well as anti-trust and other laws) in the past led many states around the world to enact blocking

statutes.[3]

More recently the US courts seem to have exercised more restraint. A few years ago the US courts were faced with a large number of cases where participants in Lloyds syndicates in the London insurance market argued that they should benefit from fraud remedies under the US securities laws even though the contracts they had signed were subject to English law. In *Stamm* v *Barclays Bank of New York*, 153 F.3d 30 (2d. Cir. 1998) the Second Circuit recognized the enforceability of the English choice of law clause and decided that it did not infringe the non-waiver provisions of the US securities laws as English law provided remedies for fraud.[4] Stamm illustrates that the US Courts ultimately decided not to exercise jurisdiction in these cases, but the litigation took years.

The US does not have the same interest in frauds perpetrated on non-US persons as it does in frauds perpetrated on US persons.

Europe and Overseas Commodity Traders v. Banque Paribas London 147 F.3d 118 (2d Cir 1998)

Europe and Overseas Commodity Traders, S.A. ("EOC"), a Panamanian corporation, appeals from a final judgment dismissing EOC's complaint ... EOC's sole business is the investment of its capital in securities and other ventures. It is wholly owned by Alan Carr, a citizen of Canada. Defendant-Appellees are Banque Paribas ("Paribas"), Paribas Global Bond Futures Fund, S.A. (the "Fund"), Paribas Asset Management Ltd. ("PAM"), and John Arida, a U.K. national who works as an account manager in the London, England, office of Paribas. Paribas is a French bank; the Fund is organized under the laws of Luxembourg; and PAM is a Bahamian corporation which manages the Fund.

The transaction underlying this dispute is entirely foreign inasmuch as there is no U.S. party, but not, strictly speaking, wholly extraterritorial in that EOC alleges that an offer to sell foreign securities was made over the telephone and facsimile to its sole shareholder and agent, Alan Carr, who was in Florida, and both parties agree that orders to purchase securities were placed from Florida. We therefore address the question whether phone calls and facsimiles to a person on U.S. soil provide enough of a connection to the United States to implicate the registration and fraud provisions of U.S. securities laws, and give us jurisdiction thereunder...

A. Registration under the 1933 Act.

EOC claims that the same "conduct and effects test," which this circuit applies to determine the extraterritorial scope of the fraud provisions of the federal securities laws, should be applied to determine the appropriate reach of the federal registration requirements. The relevant "conduct," EOC maintains, was the solicitation and sale of unregistered securities in the United States, and the relevant "effect" was the consummation of the sale of unregistered

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[3] *See*, *e.g.,* Deborah Senz & Hilary Charlesworth, *Building Blocks: Australia's response to Foreign Extraterritorial Legislation*, 2 MELBOURNE J. INT'L L. 69 (2001) http://mjil.law.unimelb.edu.au/issues/archive/2001(1)/04_Senz.pdf

[4] These cases are interesting of an example of US courts' willingness to see contracting parties deciding what law should govern public law issues. See e.g., Philip J. McConnaughay, *The Scope of Autonomy in International Contracts and Its Relation to Economic Regulation and Development*, 39 COLUM. J. TRANSNAT'L L. 595 (2001).

securities to a person within the United States. In other words, EOC appears to argue that any solicitation of unregistered securities within the territory of the United States is within the scope of the registration laws, and thus forbidden, without regard to the identity or nationality of any party.

The decided law of this circuit clearly states that the antifraud provisions may reach certain transactions not within the registration requirements of our securities law... We therefore reject EOC's assertion that the "same standard" applies to the antifraud and registration laws, if EOC means that the registration and fraud provisions are coextensive...

In contrast to the antifraud provisions of the 1934 Act, the SEC has provided some guidance as to the applicability of registration requirement of the 1933 Act to foreign transactions... We turn first to this regulation... However, we acknowledge that our precedent determining the extraterritorial reach of related provisions of the U.S. securities laws may provide some assistance in filling any gaps in the SEC's treatment of the scope of the registration provisions.

Under Regulation S, which was issued by the SEC and became effective on May 2, 1990, there are two ways that a sale of securities could fall outside § 5's registration requirement. First, a transaction could be "outside the United States," and, second, it could fall into either one of two exceptions defined by the SEC. As the SEC explained in the statement accompanying the new rule, Regulation S adopts a "territorial approach" to § 5...It does so by setting out a general rule that offers, offers to sell, and sales of securities made outside the United States are not subject to the registration requirement of § 5, while those within the United States must be registered... The two so-called "safe harbor" exemptions permit the issuance and resale of securities under certain specified conditions. Offerings and resales meeting these conditions are deemed to take place outside the United States for the purpose of § 5...

We first examine the safe harbors to determine if either one clearly applies to this transaction. The issuer safe harbor appears to be the only exemption plausibly available to the Fund. Paribas, acting as an agent for the Fund, distributed shares to the public, bringing the bank within the definition of an issuer... Two general conditions, however, must be met for either of the safe harbors to apply: first, no "directed selling efforts" may be made in the United States. The release defines "directed selling efforts" as marketing efforts such as mailings or seminars in the United States designed to induce the purchase of securities purportedly being distributed abroad... Second, any offer or sale must fit the definition of an "offshore transaction," which requires inter alia that no offer be made to a person in the United States...

Given the facts alleged by EOC in this case, we cannot say that the Fund can clearly rely on the issuer safe harbor. EOC says that Arida's representations made over the telephone and facsimile to Carr in Florida resulted in his entering a purchase order on behalf of EOC. This alleged conduct could qualify as either "directed selling efforts" or a forbidden offer to a person in the United States. For example, the SEC explained in its release, "offers and sales to transients in the United States are transactions in the United States and may not be part of an offering relying on the safe harbors of Regulation S." ... Although Carr was merely an agent acting on behalf of an offshore corporation with its accounts offshore, we cannot say definitively on a Rule 12 motion that such an agent can never qualify as a "person in the U.S." for the purposes of the safe harbors.

A transaction not within either of the safe harbors may still be outside of the United States within the meaning of 17 C.F.R. § 230.901. We believe the purchases by EOC ordered by Carr were such foreign transactions. Proposed versions of Regulation S included a list of factors to be considered in determining whether an offer or sale occurs outside of the United

States, but in response to comments on the proposals, the list was deleted in the final version ...The SEC explained that "the determination as to whether a transaction is outside the United States will be based on the facts and circumstances of each case." Our research has uncovered no case or decision of the SEC construing § 230.901 with respect to transients visiting the United States, so we work on an essentially blank slate.

We believe that the conduct and effects test used to determine the reach of the anti-fraud provisions of U.S. securities laws can be adapted to analyze what is outside the specific safe harbors yet still "outside the United States" under Regulation S. The conduct and effects test was developed by the courts in the absence of clear Congressional guidance as to the jurisdictional reach of the antifraud provisions of the securities laws...To discern "whether Congress would have wished the precious resources of the United States courts and law enforcement agencies to be devoted to" such transactions .. courts have looked to the underlying purpose of the anti-fraud provisions as a guide. See, e.g., Schoenbaum v. Firstbrook, 405 F.2d 200, 206 (2d Cir.) (finding that extraterritorial application of the 1934 Act was appropriate where necessary to protect American investors), modified on other grounds, 405 F.2d 215 (1968) (en banc). The antifraud provisions are designed to remedy deceptive and manipulative conduct with the potential to harm the public interest or the interests of investors... In outlining the extraterritorial reach of these provisions, courts have reasoned that Congress would not want the United States to become a base for fraudulent activity harming foreign investors, or "conduct," ... and that Congress would want to redress harms perpetrated abroad which have a substantial impact on investors or markets within the United States, or "effects." ... However, because it is well-settled in this Circuit that "the anti-fraud provisions of American securities laws have broader extraterritorial reach than American filing requirements," .. the extent of conduct or effect in the United States needed to invoke U.S. jurisdiction over a claimed violation of the registration provisions must be greater than that which would trigger U.S. jurisdiction over a claim of fraud. To adapt the conduct and effects test for use in interpreting the registration provisions, we must take into account Congress's distinct purpose in drafting the registration laws.

Congress passed the registration provisions "to assure full and fair disclosure in connection with the public distribution of securities."... Through mandatory disclosure, Congress sought to promote informed investing and to deter the kind of fraudulent salesmanship that was believed to have led to the market collapse of 1929... The registration provisions are thus prophylactic in nature. Seen in this light, the registration provisions also can be said to aim at certain conduct with the potential for discernible effects. Specifically, the registration provisions are designed to prevent the offer of securities in the United States securities market without accompanying standardized disclosures to aid investors, a course of conduct. This conduct, in turn, has the effect of creating interest in and demand for unregistered securities. To avoid this result, in keeping with Congress's purpose, the registration provisions should apply to those offers of unregistered securities that tend to have the effect of creating a market for unregistered securities in the United States; and by "creating a market" we do not mean to imply that the conduct must be directed at a large number of people.

The Commissioner's release accompanying Regulation S, as well as the early version of Regulation S, support the application of this conduct and effects test. The factors originally listed in Regulation S pertaining to when an offer or sale of a security occurs outside the United States largely pertain to efforts to create a market in the United States for unregistered foreign securities. These factors were "the locus of the offer or sale, the absence of directed selling efforts in the United States, and the justified expectation of the parties to the transaction as to the applicability of the registration requirements of the U.S. securities laws." Offshore Offers

and Sales, Securities Act Release No. 33-6779, 53 Fed. Reg. 22661, 22661-2 (proposed June 17, 1988). Such a test is also consistent with earlier statements by the SEC about the scope of the registration provisions... see also Registration of Foreign Offerings by Domestic Issuers, 1964 SEC LEXIS 95, Securities Act Release No. 33-4708, 1964 WL 3661 (July 9, 1964) (stating that U.S. corporations could safely distribute unregistered securities abroad to foreign nationals, if distribution were effected in a manner that would result in the securities coming to rest abroad)..

The nearly de minimis U.S. interest in the transactions presented in the instant case precludes our finding that U.S. jurisdiction exists under the more limited conduct and effect standard appropriate under the registration provisions of the 1933 Act. Under the facts as alleged by EOC, there was conduct in the United States because Arida called Carr here and Carr executed his order here. However, the conduct was not such as to have the effect of creating a market for those securities in the United States. Carr's presence here was entirely fortuitous and personal, and the actual purchaser of shares in the Fund was an offshore corporation without a place of business here... Although the offer or sale of an unregistered security to an agent of a foreign company in the United States may in some cases tend to create a market for the security in the United States, this is not such a case. EOC was conducting no business in the United States through Carr, nor otherwise benefitting from his presence here. Nor did the transaction involve a U.S. broker or other U.S. financial entity. Arida, on his part, did nothing to encourage a market for securities in the United States. He made no calls or solicitations to individuals he had reason to suspect were American citizens or permanent residents in the United States, and he directed no general sales efforts here. Accordingly, we hold that the securities sold to EOC did not fall under the registration requirements of the 1933 Act, and that we therefore lack subject matter jurisdiction over EOC's § 5 claims.

Of course, we do not attempt in ruling on this case to provide a set of definitive rules to govern future transactions. Nor do we mean to suggest that standards developed under the anti-fraud provisions may be incorporated wholesale into the registration context. The exact contours of the conduct and effects test, as applied to registration cases, must remain to be defined on a case-by-case basis.

B. Investment Company Act of 1940.

The SEC has clearly said that compliance with Regulation S does not excuse non-compliance with the Investment Company Act of 1940... Section 7(d), which governs the Investment Company Act's application to foreign companies, prohibits any investment company which is not organized under the laws of the United States or of a State to use the means of interstate commerce to offer for sale or sell "in connection with a public offering" any security of which it is the issuer. .. Section 7(d) by its terms only prohibits public offerings by foreign investment companies (absent receipt of an order from the Securities and Exchange Commission). EOC has not alleged that Fund shares were sold by Paribas in connection with a public offering in the United States, and there is no evidence to support such a claim. There is no evidence of a general solicitation in the United States or that offers were made to persons who were not wealthy, sophisticated investors... The defendants were, thus, not subject to the Investment Company Act.

C. Antifraud Provisions.

As discussed above, the antifraud provisions of the securities laws have been held to reach beyond the registration requirement of the 1933 Act. Our conclusion with respect to

registration does not therefore eliminate the possibility that jurisdiction could be found under § 10(b) of the 1934 Act (codified at 15 U.S.C. § 78j) and Rule 10b-5 (17 C.F.R. § 240.10b-5)... Congress's power to impose civil penalties for fraud in predominately foreign securities transactions is limited only by the Due Process Clause of the Fifth Amendment. In a long line of decisions stretching back to Schoenbaum, this circuit has recognized that the federal securities laws do not reach this constitutional limit... We have looked for conduct..; effects,... or a combination thereof,... in the United States to arrive at "our best judgment as to what Congress would have wished if these problems [of extraterritorial application] had occurred to it."...

Perhaps the most difficult cases under the conduct test have concerned activity in the United States that causes, or plays a substantial part in causing, harm to foreign interests overseas. By contrast, as stated above, the effects test concerns the impact of overseas activity on U.S. investors and securities traded on U.S. securities exchanges...Telephone calls and facsimile transmissions conveying offers to sell securities and investment information could be characterized as either conduct or effects in the United States...

If evaluated as an effect, the U.S. interest affected by this transaction is indiscernible for reasons already discussed: the plaintiff is a Panamanian corporation; the individual who placed the purchase orders, and who ultimately suffered any losses, is a Canadian citizen; the securities are not traded on a U.S. exchange; and no effect on a U.S. affiliated company is alleged by EOC. There is, thus, no U.S. entity that Congress could have wished to protect from the machinations of swindlers...

The analysis becomes somewhat more difficult when we turn to the conduct test. The conduct test in this circuit has been stated in two parts as follows:

> the anti-fraud provisions of the federal securities laws . . . apply to losses from sales of securities to Americans resident abroad if, but only if, acts (or culpable failures to act) of material importance in the United States have significantly contributed thereto; but . . . do not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses... Bersch, 519 F.2d at 993.

Or, alternatively, we have said more simply that activity in the United States that is "merely preparatory" to a securities fraud elsewhere will not implicate our antifraud laws... EOC's allegations do not fit neatly into either of the two categories outlined in Bersch. Clearly, EOC is not a U.S. entity: even were we to look through the Panamanian corporate identity, its owner, a Canadian citizen, is still foreign. Yet, on the other hand, EOC alleges solicitation and sale of securities within the United States, and the second Bersch category is specifically limited to sales outside the United States. EOC's claim, thus, falls in yet another category which, although identified, was not addressed in Bersch: "losses to foreigners from sales to them within the United States." ... EOC's is a novel factual pattern not squarely governed by any of our decisions to date.

The facts alleged by EOC, nonetheless, satisfy the requirement that U.S. activity directly cause the harm to the foreign interest, which has in the past been the key element of litigation involving the conduct test. Or, stated in the alternative language we have sometimes used, Arida's communications into the United States were more than "mere preparation" for the fraud. EOC alleges that Arida solicited, offered to sell, and accepted a purchase order for securities from Carr when he was in Florida. Carr also says he relied upon the allegedly misleading information given to him from abroad while he was present in the United States, and such reliance was the direct cause of the loss sustained by EOC... The difficult question raised by EOC's allegations is whether Arida's communications to Carr in Florida may be considered activity within the United States for the purpose of the antifraud provisions of the security laws sufficient to support the jurisdiction of this court under the 1934 Act. We believe that they were

not.

Although phone calls (or any other communications into the United States) soliciting or conveying an offer to sell securities ordinarily would be sufficient to support jurisdiction, it would be inconsistent with the law of this circuit to accept jurisdiction over this dispute, because the surrounding circumstances show that no relevant interest of the United States was implicated. In other words, a series of calls to a transient foreign national in the United States is not enough to establish jurisdiction under the conduct test without some additional factor tipping the scales in favor of our jurisdiction. Without such added weight, the exercise of prescriptive jurisdiction by Congress would be unreasonable within the meaning of the Restatement of Foreign Relations.. §§ 416 (2) and 403 (1987), and is particularly so when the transaction is clearly subject to the regulatory jurisdiction of another country with a clear and strong interest in redressing any wrong. We do not think Congress intended to make the securities laws have such a broad reach or to make U.S. courts available for such suits.

In the past, we have found jurisdiction over a predominantly foreign securities transaction under the conduct test when, in addition to communications with or meetings in the United States, there has also been a transaction on a U.S. exchange, economic activity in the U.S., harm to a U.S. party, or activity by a U.S. person or entity meriting redress... All of these factors are absent from EOC's allegations. AVC Nederland B.V. v. Atrium Inv. Partnership... which Judge Friendly indicated was a very close case... provides the strongest support of EOC's position, but does not go far enough. Nederland concerned the sale of an interest in a partnership formed by Dutch nationals.. for the purpose of investing in U.S. real estate. Plaintiff-purchaser was also Dutch. Much of the negotiation during which the alleged misrepresentations were made occurred in the United States, but the deal was concluded abroad. Even though the consummation of the allegedly fraud-tainted sale occurred outside the United States, Judge Friendly's opinion found jurisdiction, after considering the many factors listed in § 403(2) of Tentative Draft No.2 of the current Restatement... Specifically, the opinion found the extent of the activity within the regulating state and the economic activity connecting both the plaintiff and defendants to the United States weighed in favor of jurisdiction. Presumably, although the opinion does not say as much, it considered the U.S. real estate investments, which were the purpose of the partnership and the subject of the alleged fraud, to be economic activity connecting the parties to the United States within the meaning of § 403(2)(b) of the Tentative Draft. In any event, we find Nederland distinguishable for this reason. The sales by Paribas to EOC have no similar connection to the United States: EOC invested in Europe; and Paribas's offices in and any other connections to the United States have no relevance to these transactions. We therefore find that the slight additional factor of economic activity in the United States, which "tipped the balance" in favor of jurisdiction in Nederland, is absent from EOC's case.

In this case, there is no U.S. party to protect or punish, despite the fact that the most important piece of the alleged fraud -- reliance on a misrepresentation -- may have taken place in this country. Congress may not be presumed to have prescribed rules governing activity with strong connections to another country, if the exercise of such jurisdiction would be unreasonable in the light of established principles of U.S. and international law. See Restatement § 403. And, the answer to the question of what jurisdiction is reasonable depends in part on the regulated subject matter. Id. cmt. c. ("Regulation by the United States of the labor relations of a foreign vessel that regularly calls on the United States may be unreasonable; regulation of the vessel's safety standards may not be unreasonable.")

This case illustrates the kind of circumstances in which it is unreasonable to prescribe rules of conduct with respect to securities fraud, even when a misrepresentation is made in the United States and reliance occurs on U.S. soil. Section 10(b), although it sounds in the common

law tort of fraud, is part of a regulatory system that serves the public interest of the United States in much the same way as banking and currency regulations. This apparent purpose of protecting and regulating an entire system led this court to extend, through the use of the effects test, the antifraud provisions of these laws to activity not ordinarily within the "presumptive" scope of legislation... The very considerations that have led this court to conclude that Congress meant for the securities antifraud laws to reach beyond our shores to certain fraudulent activities abroad militate against finding subject matter jurisdiction over EOC's complaint. It would be ironic if a foreign party seeking redress in a U.S. court could sidestep the effect requirement by stretching our notions of conduct in the United States to include telephone calls from abroad to an agent/owner of that party here fortuitously. The situation is entirely different from the difficult cases under the conduct test in which a U.S. person or entity is the source of misleading information causing harm elsewhere. The U.S. interest in punishing an English malfeasor working at a French bank branch in London who caused no harm here is not apparent. We therefore hold that the alleged solicitation, offer to sell, and purchases occurring while Carr was present in Florida did not bring this otherwise entirely foreign transaction within the antifraud provisions of U.S. securities law.

The decision of the district court dismissing plaintiff EOC's complaint for lack of subject matter jurisdiction is affirmed.

In a more recent case involving credit linked notes, **Nikko Asset Management v UBS AG.** ,[5] the SDNY reached a similar conclusion. Nikko (a Japanese company based in Tokyo) had invested in credit linked notes issued by UBS AG (a Swiss corporation with its head office in Zurich). UBS' Japanese subsidiary, UBS Japan, was also involved in the transaction, as were other entities in the UBS group established in Delaware, England and Jersey.

UBS AG was using the credit linked notes as a way of shifting credit risk: its obligations to pay out on the notes were linked to credit events at Enron:

The CLNs listed Enron as the "Reference Entity" and provided that if Enron suffered a Credit Event, the Notes may diminish in value according to a formula in the Pricing Supplements that essentially tracked the value of certain specified Enron credit obligations... The Pricing Supplements stated that the value of the Notes might "be zero" if a Credit Event occurred...The Supplements further state that "the issuer makes no representations as to the future performance of the Notes either in absolute terms or relative to competing investments," and that "there is no guarantee, protection or assurance for purchasers of the Notes in respect of the credit or performance of the Reference Entity or Reference Obligation.".. The Notes were one of several types of notes issuable under a UBS Warburg programme, and Nikko bought all of the CLNs issued under the Pricing Supplements for these particular CLNs with Enron as the Reference Entity....

The clns were issued outside the US - Nikko wanted to argue that UBS relationship with Enron and fraudulent activity at Enron should allow it to bring claims in the US. The SDNY rejected this claim.

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[5] 2004 U.S. Dist. LEXIS 1769 (SDNY Feb. 17, 2004)

The U.S. conduct that Nikko alleges in this action is UBS's alleged transactions with Enron, which it is claimed provided UBS with advance knowledge of Enron's impending bankruptcy. UBS Warburg LLC, a dealer for the Euro Note Programme, is the only U.S. entity among the Defendants. It is not alleged that UBS Warburg LLC was involved with the issuance of these Notes. The fact that "one defendant . . . is a U.S. citizen" does not suffice to provide this Court jurisdiction.... However, Nikko asserts that "the UBS CLNs were part of UBS's fraudulent dealings with Enron in the United States, were devised and executed in the United States and were intertwined with Enron in the United States."..

According to the CFAC, the Plaintiffs, all Japanese entities, were defrauded by a transaction in Japan by UBS Japan, another Japanese entity, to the detriment of Japanese investors... The fraud is alleged because UBS Japan did not warn Nikko of Enron's financial crisis... The U.S. conduct alleged is that UBS purportedly learned in the U.S. in the course of its Enron-related transactions, that Enron's financials were false, which UBS Japan then allegedly failed to disclose to Nikko during the Japanese transaction between Nikko and UBS Japan...

In circumstances involving allegations of U.S. ties more substantial than those alleged here, the Second Circuit has ruled that subject matter jurisdiction was lacking. In Europe & Overseas Commodity Traders, a § 10(b) action, the Second Circuit ruled that the district court lacked jurisdiction, even though the defendants solicited the plaintiff's representative to buy the allegedly fraudulent securities, and accepted his order for them, while the representative was in the United States... The representative's presence in the United States "did not bring this otherwise entirely foreign transaction within the antifraud provisions of U.S. securities law." .. Here, by contrast, there is no specific allegation that the transactions at issue -- as opposed to the general Programme -- involved any U.S. conduct.

Under the standard established by the Second Circuit and applied by this Court in Societe Nationale, the federal courts have no jurisdiction over the two entirely foreign transactions alleged...

Nikko has alleged that Enron was a large UBS client from which UBS earned millions of dollars in fees, in return for which Enron pressured UBS to lend it approximately $ 300 million to fund its operations and perpetuate its fraud... In support of its theory of the complaint Nikko has further alleged that during May 2001, prior to the issuance of the UBS CLNs, UBS Warburg LLC served as Joint Lead Manager and as Initial Purchaser for three Citigroup credit linked notes tranches that closely resembled the UBS CLNs... As a result of working on the Citigroup credit linked notes transaction, UBS knew that the CLN structure enabled Citigroup to transfer hundreds of million of dollars of Enron risk from Citigroup to third party purchasers. UBS applied what it had learned from Citigroup, to transfer its Enron risk of loss through the sale of its own credit linked notes.

In addition to the loans that UBS advanced to Enron (that were the subject of the Credit Linked Notes), UBS AG purchased $ 250,000,000 face amount and UBS Warburg LLC purchased $ 800,000 face amount, of Enron Zero Coupon Notes in or about February 2001... During 2001, when UBS suspected that Enron would default on its outstanding debt, the Defendants attempted to sell all of their Enron Zero Coupon Notes into the United States Public market, notwithstanding that the Enron Zero Coupon Notes were purchased only months earlier...

Nikko agrees that under the Second Circuit's "conduct test," a district court properly exercises subject matter jurisdiction over foreign purchasers of securities where a defendant's activities in the U.S. were more than "merely preparatory, " and its culpable conduct (or omissions) in the U.S. "directly caused" the claimed losses. Berger, 322 F.3d at 193...

In support of its allegations Nikko points to the economic activity in the United States which it maintains is material to the alleged securities fraud involving the CLNs that UBS loaned to

Enron and served as a joint lead manager and initial purchaser of the hundreds of millions of dollars credit linked notes issued by Citigroup... According to Nikko, the totality and materiality of UBS's conduct distinguishes its action from cases cited by Defendants.
Here.. there is no dispute that the two Japanese transactions in Yen-denominated CLNs occurred in Japan.. Here.. there is no allegation that there was any U.S. structuring, marketing, or transactional activity in connection with the Notes Nikko bought from UBS Japan.. or indeed any U.S. activity at all, leaving aside the fact that the U.S.D. Bank Trust Association is alleged to have been the Registrar for the Programme...
In searching for a jurisdictional hook, Nikko asserts that (i) the Note transactions were part of the Programme, (ii) "a substantial amount of conduct . . . material to the Note Programme" occurred in the United States, and (iii) the Programme's U.S. contacts therefore suffice to provide jurisdiction... However, the Programme itself had no connection to Enron. As described in the Information Memorandum, the UBS Programme allowed various UBS entities to issue many types of debt securities with a wide variety of terms and conditions in myriad geographic locations, including the United States, but this action alleges fraudulent conduct with regard to only two specific Notes issued under the Programme... Taking Nikko's allegations as true, the Programme is an example of non-fraudulent preparatory activity, and does not suffice to create jurisdiction...
Nikko also asserts that UBS Warburg LLC, the lone U.S. defendant in this action, was involved in the issuance of these Notes because UBS Warburg LLC was listed in the Information Memorandum as a potential dealer of securities under the Programme... However, as disclosed in the Pricing Supplements, UBS Warburg LLC was not a dealer, and did not play any other role, in issuing the Notes Nikko bought in Japan...The allegation that UBS Warburg LLC was authorized to deal securities under the Programme does not constitute UBS Warburg as the dealer for the Notes sold to Nikko in Japan.
Domestic conduct that is "merely preparatory to a securities fraud elsewhere will not implicate our antifraud laws." Europe & Overseas Commodity Traders.. The alleged fraud happened in Japan; at most, the knowledge that made the transaction fraudulent was gained in the United States. Because the UBS activity in the United States, even if fraudulent, was merely preparatory, there is no conduct in the United States that directly caused the damage of which Nikko complains.
Taking all of Nikko's allegations as true, its losses were also not "directly caused" by any fraudulent conduct in the United States. Nikko neither had contact with Enron nor held any Enron-issued securities, and Enron was not involved in these Note transactions. Enron's financial fraud was at most an indirect cause of Nikko's losses, whereas the Note transactions, conducted in Japan between Japanese financial institutions for the benefit of Japanese investors was the direct cause of Nikko's losses...
Nikko has therefore failed to "put forward allegations of conduct in the United States of sufficient centrality to the claim of fraud to warrant an exercise of jurisdiction...

Is this the right answer? Does the US have no interest in transactions such as this if no US persons are harmed? How does the idea of the pre-existing fraud in this case relate to Armco?

Contrast, for example, ***DiRienzo v. Philip Services Corporation***[6] in which the Second

[6] 294 F.3d 21 (2d. Cir. 2002)

Circuit reversed the Southern District of New York's dismissal of a suit on forum non conveniens grounds. The Second Circuit pointed out that because "defendants sought out business opportunities in this country by registering stock on American exchanges, filing statements with the SEC and conducting the bulk of its business in the United States -- as well as the claim that most plaintiffs conducted their stock transactions within the United States -- a legitimate interest exists in trying this securities fraud litigation here." In assessing whether there was a US local interest in the litigation the Court said:

> The district court found the local interest factor "weighed heavily in favor of litigation in Ontario."... It based its conclusion, for the most part, on the factual finding that "this case predominantly concerns the conduct of a major Canadian corporation in Canada, notwithstanding the involvement of some American entities and persons." ..
>
> This finding is clearly erroneous. It fails to acknowledge as a factual matter that plaintiffs' amended complaint alleges the majority of their securities transactions were conducted entirely in the United States, by Americans, in American dollars, on American stock exchanges. For example, plaintiffs claim that nearly 80 percent of Philip's shares sold during the class period were traded on exchanges in the United States.
>
> As the SEC argues in its amicus brief, dismissing this case is no more appropriate than dismissing a products liability case brought in the United States against Toyota simply because the design and manufacture of the automobile took place in Japan. While the complaint alleges a fraud that was largely executed in Ontario, neither the dissemination of the allegedly misleading statements nor the plaintiffs' losses were localized there.
>
> Further, the trial court stated that "parties who choose to engage in international transactions, as plaintiffs did here, 'cannot expect always to bring their foreign opponents into a United States forum.'"... But, the cases cited for this proposition either do not bind us or involve easily distinguishable facts. Hence, the district court's conclusion advances a legal principle inapplicable to the bulk of DiRienzo plaintiffs.
>
> In Diatronics, Inc. v. Elbit Computers, Ltd...an American corporation had purchased a majority interest in one Israeli corporation from a second Israeli corporation. The contracts at issue had been negotiated and executed in Israel, and the purchaser had hired an Israeli attorney for the negotiations...The district court held that the case should be dismissed in favor of Israel as a forum... Similarly, the First Circuit's decision in Howe emphasized that the Canadian stock at the center of the alleged securities fraud was traded only on Canadian stock exchanges, and that its sellers had made no effort to market it in the United States except in response to unsolicited inquiries...
>
> In contrast to Diatronics and Howe, DiRienzo does not involve Americans who sought out involvement with a foreign forum. It was Philip who came to them by registering its stock on American exchanges, filing statements with the SEC, and conducting the bulk of its business -- including multiple corporate acquisitions -- in the United States. Plaintiffs are involved in this lawsuit precisely because of aggressive selling techniques by Philip within the United States that targeted United States investors as potential purchasers of its stock....
>
> ...a district court's erroneous understanding of facts central to a case can preclude a reasonable balancing of the ... factors and form the basis for reversal on appeal...
>
> Reversal is further warranted in the circumstances presented here because the district court's ruling falls outside the permissible range of decisions, once the interest of the United States in enforcing its securities laws is factored into the equation...A strong public interest favors access to American courts for those who use American securities markets. The fraud on

the market theory itself illustrates investors' reliance on accurate and complete information..For securities markets to function efficiently, securities fraud law must be clear and enforceable. As the statute explaining the need for regulation and control of transactions in securities exchanges and over-the-counter markets states, these transactions are "affected with a national public interest." ... Thus, those laws must also be applied consistently with regard to the significant majority of the putative class who bought their securities on American markets.

While Ontario has an analogous interest with respect to Canadians who bought their Philip stock in Ontario, they are a small minority of the proposed class and Ontario's interest is correspondingly less...

Hence, the public interest factors favor an American forum for the trial of this securities fraud litigation to a greater degree than recognized by the district court. Combined with the relatively even balance among private interest factors as a result of defendants' failure to show "oppressiveness and vexation . . . out of all proportion to plaintiff[s'] convenience,"..and the skepticism which should accompany defendants' forum non conveniens motion, we think the district court erred as a matter of law when granting the motion to dismiss this case in favor of it being brought in Canada.

ISSUES OF SECURITIES OUTSIDE THE US

The EOC case illustrates that US securities regulators have tended to take a broad view of the territorial reach of the US securities laws (perhaps the discussion of the law in the case rather than the result). As a result, a US legal opinion is necessary for US $ denominated eurobond issues. In 1998 the SEC amended Reg. S (63 Fed. Reg. 9632 Feb 25, 1998) because of concerns that Reg S was being used “as a guise for distributing securities into the US markets without the protection to US investors of registration” under the 33 Act. Reg S is set out below. As mentioned above, Reg. S sets out registration safe harbors rather than safe harbors in relation to fraud liability. Think about the way that the regulations deal with different circumstances. Do you think the rules go too far? Not far enough? What about the interests of other countries in regulating issues of securities that take place in their jurisdictions? Is it a problem if issues of securities are subject to the rules of more than one jurisdiction?

Regulation S – Rules Governing Offers and Sales Made Outside the United States Without Registration under the Securities Act of 1933, 17 CFR § 230...

Preliminary Notes

1. The following rules relate solely to the application of Section 5 of the Securities Act of 1933 (the "Act") [15 U.S.C. § 77e] and not to antifraud or other provisions of the federal securities laws.
2. In view of the objective of these rules and the policies underlying the Act, Regulation S is not available with respect to any transaction or series of transactions that, although in technical compliance with these rules, is part of a plan or scheme to evade the registration provisions of the Act. In such cases, registration under the Act is required.
3. Nothing in these rules obviates the need for any issuer or any other person to comply with the securities registration or broker-dealer registration requirements of the Securities Exchange Act (the "Exchange Act"), whenever such requirements are applicable.
4. Nothing in these rules obviates the need to comply with any applicable state law relating to the offer and sale of securities.

5. Attempted compliance with any rule in Regulation S does not act as an exclusive election; a person making an offer or sale of securities may also claim the availability of any other applicable exemption form the registration requirements of the Act. The availability of the Regulation S safe harbor to offers and sales that occur outside of the United States will not be affected by the subsequent offer and sale of these securities into the United States or to U.S. persons during the distribution compliance period, as long as the subsequent offer and sale are made pursuant to registration or an exemption therefrom under the Act.
6. Regulation S is available only for offers and sales of securities outside the United States. Securities acquired overseas, whether or not pursuant to Regulation S, may be resold in the United States only if they are registered under the Act or an exemption from registration is available.
7. Nothing in these rules preclude access by journalists for publications with a general circulation in the United States to offshore press conferences, press releases and meetings with company press spokespersons in which an offshore offering or tender offer is discussed, provided that the information is made available to the foreign and United States press generally and is not intended to induce purchases of securities by persons in the United States or tenders of securities by United States holders in the case of exchange offers. Where applicable, issuers and bidders may also look to § 230.135e and § 240.14d-1(c) of this chapter.
8. The provisions of this Regulation S shall not apply to offers and sales of securities issued by open-end investment companies or unit investment trusts registered or required to be registered or closed-end investment companies required to be registered, but not registered, under the Investment Company Act of 1940 [15 U.S.C. § 80a-1 et seq.] (the "1940 Act").

GENERAL STATEMENT Reg. § 230.901
For the purposes only of section 5 of the Act [15 U.S.C. § 77e), the terms "offer," "offer to sell," "offer for sell," "sell," "sale," and "offer to buy" shall be deemed to include offers and sales that occur within the United States and shall be deemed not to include offers and sales that occur outside the United States.

DEFINITIONS Reg. § 230.902.
As used in Regulation S, the following terms shall have the meanings indicated.
(a) Debt securities. "Debt securities" of an issuer is defined to mean any security other than an equity security as defined in § 230.405, as well as the following:
(1) Non-participatory preferred stock, which is defined as non-convertible capital stock, the holders of which are entitled to a preference in payment of dividends and in distribution of assets on liquidation, dissolution, or winding up of the issuer, but are not entitled to participate in residual earnings or assets of the issuer; and
(2) Asset-backed securities, which are securities of a type that either:
(i) Represent an ownership interest in a pool of discrete assets, or certificates of interest or participation in such assets (including any rights designed to assure servicing, or the receipt or timeliness of receipt by holders of such assets, or certificates of interest or participation in such assets, of amounts payable thereunder), provided that the assets are not generated or originated between the issuer of the security and its affiliates; or
(ii) Are secured by one or more assets or certificates of interest or participation in such assets, and the securities, by their terms, provide for payments of principal and interest (if any) in relation to payments or reasonable projections of payments on assets meeting the requirements of paragraph (a)(2)(i) of this section, or certificates of interest or participations in assets meeting such requirements.
(iii) For purposes of paragraph (a)(2) of this section, the term "assets" means securities,

installment sales, accounts receivable, notes, leases or other contracts, or other assets that by their terms convert into cash over a finite period of time.
(b) Designated offshore securities market. "Designated offshore securities market" means:
(1) The Eurobond market, as regulated by the International Securities Market Association; the Alberta Stock Exchange; the Amsterdam Stock Exchange; the Australian Stock Exchange Limited; the Bermuda Stock Exchange; the Bourse de Bruxelles; the Copenhagen Stock Exchange; the European Association of Securities Dealers Automated Quotation; the Frankfurt Stock Exchange; the Helsinki Stock Exchange; The Stock Exchange of Hong Kong Limited; the Irish Stock Exchange; the Istanbul Stock Exchange; the Johannesburg Stock Exchange; the London Stock Exchange; the Bourse de Luxembourg; the Mexico Stock Exchange; the Borsa Valori di Milan; the Montreal Stock Exchange; the Oslo Stock Exchange; the Bourse de Paris; the Stock Exchange of Singapore Ltd.; the Stockholm Stock Exchange; the Tokyo Stock Exchange; the Toronto Stock Exchange; the Vancouver Stock Exchange; the Warsaw Stock Exchange and the Zurich Stock Exchange; and
(2) Any foreign securities exchange or non-exchange market designated by the Commission. Attributes to be considered in determining whether to designate an offshore securities market, among others, include:
(i) Organization under foreign law;
(ii) Association with a generally recognized community of brokers, dealers, banks, or other professional intermediaries with an established operating history;
(iii) Oversight by a governmental or self-regulatory body;
(iv) Oversight standards set by an existing body of law;
(v) Reporting of securities transactions on a regular basis to a governmental or self-regulatory body;
(vi) A system for exchange of price quotations through common communications media; and
(vii) An organized clearance and settlement system.
(c) Directed selling efforts.
(1) "Directed selling efforts" means any activity undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the market in the United States for any of the securities being offered in reliance on this Regulation S (§§ 230.901 through 230.905, and Preliminary Notes). Such activity includes placing an advertisement in a publication "with a general circulation in the United States" that refers to the offering of securities being made in reliance upon this Regulation S.
(2) Publication "with a general circulation in the United States":
(i) Is defined as any publication that is printed primarily for distribution in the United States, or has had, during the preceding twelve months, an average circulation in the United States of 15,000 or more copies per issue; and
(ii) Will encompass only the U.S. edition of any publication printing a separate U.S. edition if the publication, without considering its U.S. edition, would not constitute a publication with a general circulation in the United States.
(3) The following are not "directed selling efforts":
(i) Placing an advertisement required to be published under U.S. or foreign law, or under rules or regulations of a U.S. or foreign regulatory or self-regulatory authority, provided the advertisement contains no more information than legally required and includes a statement to the effect that the securities have not been registered under the Act and may not be offered or sold in the United States (or to a U.S. person, if the advertisement relates to an offering under Category 2 or 3 (paragraph (b)(2) or (b)(3)) in § 230.903) absent registration or an applicable exemption from the registration requirements;
(ii) Contact with persons excluded from the definition of "U.S. person" pursuant to paragraph

(k)(2)(vi) of this section or persons holding accounts excluded from the definition of "U.S. person" pursuant to paragraph (k)(2)(i) of this section, solely in their capacities as holders of such accounts;
(iii) A tombstone advertisement in any publication with a general circulation in the United States, provided:
(A) The publication has less than 20% of its circulation, calculated by aggregating the circulation of its U.S. and comparable non-U.S. editions, in the United States;
(B) Such advertisement contains a legend to the effect that the securities have not been registered under the Act and may not be offered or sold in the United States (or to a U.S. person, if the advertisement relates to an offering under Category 2 or 3 (paragraph (b)(2) or (b)(3)) in § 230.903) absent registration or an applicable exemption from the registration requirements; and
(C) Such advertisement contains no more information than:
(1) The issuer's name;
(2) The amount and title of the securities being sold;
(3) A brief indication of the issuer's general type of business;
(4) The price of the securities;
(5) The yield of the securities, if debt securities with a fixed (non-contingent) interest provision;
(6) The name and address of the person placing the advertisement, and whether such person is participating in the distribution;
(7) The names of the managing underwriters;
(8) The dates, if any, upon which the sales commenced and concluded;
(9) Whether the securities are offered or were offered by rights issued to security holders and, if so, the class of securities that are entitled or were entitled to subscribe, the subscription ratio, the record date, the dates (if any) upon which the rights were issued and expired, and the subscription price; and
(10) Any legend required by law or any foreign or U.S. regulatory or self-regulatory authority;
(iv) Bona fide visits to real estate, plants or other facilities located in the United States and tours thereof conducted for a prospective investor by an issuer, a distributor, any of their respective affiliates or a person acting on behalf of any of the foregoing;
(v) Distribution in the United States of a foreign broker-dealer's quotations by a third-party system that distributes such quotations primarily in foreign countries if:
(A) Securities transactions cannot be executed between foreign broker-dealers and persons in the United States through the system; and
(B) The issuer, distributors, their respective affiliates, persons acting on behalf of any of the foregoing, foreign broker-dealers and other participants in the system do not initiate contacts with U.S. persons or persons within the United States, beyond those contacts exempted under § 240.15a-6 of this chapter; and
(vi) Publication by an issuer of a notice in accordance with § 230.135 or § 230.135c.
(vii) Providing any journalist with access to press conferences held outside of the United States, to meetings with the issuer or selling security holder representatives conducted outside the United States, or to written press-related materials released outside the United States, at or in which a present or proposed offering of securities is discussed, if the requirements of § 230.135e are satisfied.
(d) Distributor. "Distributor" means any underwriter, dealer, or other person who participates, pursuant to a contractual arrangement, in the distribution of the securities offered or sold in reliance on this Regulation S (§§ 230.901 through 230.905, and Preliminary Notes).
(e) Domestic issuer/Foreign issuer. "Domestic issuer" means any issuer other than a "foreign government" or "foreign private issuer" (both as defined in § 230.405). "Foreign issuer" means

any issuer other than a "domestic issuer."
(f) Distribution compliance period. "Distribution compliance period" means a period that begins when the securities were first offered to persons other than distributors in reliance upon this Regulation S (§§ 230.901 through 230.905, and Preliminary Notes) or the date of closing of the offering, whichever is later, and continues until the end of the period of time specified in the relevant provision of § 230.903, except that:
(1) All offers and sales by a distributor of an unsold allotment or subscription shall be deemed to be made during the distribution compliance period;
(2) In a continuous offering, the distribution compliance period shall commence upon completion of the distribution, as determined and certified by the managing underwriter or person performing similar functions;
(3) In a continuous offering of non-convertible debt securities offered and sold in identifiable tranches, the distribution compliance period for securities in a tranche shall commence upon completion of the distribution of such tranche, as determined and certified by the managing underwriter or person performing similar functions; and
(4) That in a continuous offering of securities to be acquired upon the exercise of warrants, the distribution compliance period shall commence upon completion of the distribution of the warrants, as determined and certified by the managing underwriter or person performing similar functions, if requirements of § 230.903(b)(5) are satisfied.
(g) Offering restrictions. "Offering restrictions" means:
(1) Each distributor agrees in writing:
(i) That all offers and sales of the securities prior to the expiration of the distribution compliance period specified in Category 2 or 3 (paragraph (b)(2) or (b)(3)) in § 230.903, as applicable, shall be made only in accordance with the provisions of § 230.903 or § 230.904; pursuant to registration of the securities under the Act; or pursuant to an available exemption from the registration requirements of the Act; and
(ii) For offers and sales of equity securities of domestic issuers, not to engage in hedging transactions with regard to such securities prior to the expiration of the distribution compliance period specified in Category 2 or 3 (paragraph (b)(2) or (b)(3)) in § 230.903, as applicable, unless in compliance with the Act; and
(2) All offering materials and documents (other than press releases) used in connection with offers and sales of the securities prior to the expiration of the distribution compliance period specified in Category 2 or 3 (paragraph (b)(2) or (b)(3)) in § 230.903, as applicable, shall include statements to the effect that the securities have not been registered under the Act and may not be offered or sold in the United States or to U.S. persons (other than distributors) unless the securities are registered under the Act, or an exemption from the registration requirements of the Act is available. For offers and sales of equity securities of domestic issuers, such offering materials and documents also must state that hedging transactions involving those securities may not be conducted unless in compliance with the Act. Such statements shall appear:
(i) On the cover or inside cover page of any prospectus or offering circular used in connection with the offer or sale of the securities;
(ii) In the underwriting section of any prospectus or offering circular used in connection with the offer or sale of the securities; and
(iii) In any advertisement made or issued by the issuer, any distributor, any of their respective affiliates, or any person acting on behalf of any of the foregoing. Such statements may appear in summary form on prospectus cover pages and in advertisements.
(h) Offshore transaction.
(1) An offer or sale of securities is made in an "offshore transaction" if:

(i) The offer is not made to a person in the United States; and
(ii) Either:
(A) At the time the buy order is originated, the buyer is outside the United States, or the seller and any person acting on its behalf reasonably believe that the buyer is outside the United States; or
(B) For purposes of:
(1) § 230.903, the transaction is executed in, on or through a physical trading floor of an established foreign securities exchange that is located outside the United States; or
(2) § 230.904, the transaction is executed in, on or through the facilities of a designated offshore securities market described in paragraph (b) of this section, and neither the seller nor any person acting on its behalf knows that the transaction has been pre-arranged with a buyer in the United States.
(2) Notwithstanding paragraph (h)(1) of this section, offers and sales of securities specifically targeted at identifiable groups of U.S. citizens abroad, such as members of the U.S. armed forces serving overseas, shall not be deemed to be made in "offshore transactions."
(3) Notwithstanding paragraph (h)(1) of this section, offers and sales of securities to persons excluded from the definition of "U.S. person" pursuant to paragraph (k)(2)(vi) of this section or persons holding accounts excluded from the definition of "U.S. person" pursuant to paragraph (k)(2)(i) of this section, solely in their capacities as holders of such accounts, shall be deemed to be made in "offshore transactions."
(i) Reporting issuer. "Reporting issuer" means an issuer other than an investment company registered or required to register under the 1940 Act that:
(1) Has a class of securities registered pursuant to Section 12(b) or 12(g) of the Exchange Act (15 U.S.C. 78l(b) or 78l(g)) or is required to file reports pursuant to Section 15(d) of the Exchange Act (15 U.S.C. 78o(d)); and
(2) Has filed all the material required to be filed pursuant to Section 13(a) or 15(d) of the Exchange Act (15 U.S.C. 78m(a) or 78o(d)) for a period of at least twelve months immediately preceding the offer or sale of securities made in reliance upon this Regulation S (§§ 230.901 through 230.905, and Preliminary Notes) (or for such shorter period that the issuer was required to file such material).
(j) Substantial U.S. market interest.
(1) "Substantial U.S. market interest" with respect to a class of an issuer's equity securities means:
(i) The securities exchanges and inter-dealer quotation systems in the United States in the aggregate constituted the single largest market for such class of securities in the shorter of the issuer's prior fiscal year or the period since the issuer's incorporation; or
(ii) 20 percent or more of all trading in such class of securities took place in, on or through the facilities of securities exchanges and inter-dealer quotation systems in the United States and less than 55 percent of such trading took place in, on or through the facilities of securities markets of a single foreign country in the shorter of the issuer's prior fiscal year or the period since the issuer's incorporation.
(2) "Substantial U.S. market interest" with respect to an issuer's debt securities means:
(i) Its debt securities, in the aggregate, are held of record (as that term is defined in § 240.12g5-1 of this chapter and used for purposes of paragraph (j)(2) of this section) by 300 or more U.S. persons;
(ii) $1 billion or more of: the principal amount outstanding of its debt securities, the greater of liquidation preference or par value of its securities described in § 230.902(a)(1), and the principal amount or principal balance of its securities described in § 230.902(a)(2), in the aggregate, is held of record by U.S. persons; and

(iii) 20 percent or more of: the principal amount outstanding of its debt securities, the greater of liquidation preference or par value of its securities described in § 230.902(a)(1), and the principal amount or principal balance of its securities described in § 230.902(a)(2), in the aggregate, is held of record by U.S. persons.
(3) Notwithstanding paragraph (j)(2) of this section, substantial U.S. market interest with respect to an issuer's debt securities is calculated without reference to securities that qualify for the exemption provided by Section 3(a)(3) of the Act (15 U.S.C. 77c(a)(3)).
(k) U.S. person.
(1) "U.S. person" means:
(i) Any natural person resident in the United States;
(ii) Any partnership or corporation organized or incorporated under the laws of the United States;
(iii) Any estate of which any executor or administrator is a U.S. person;
(iv) Any trust of which any trustee is a U.S. person;
(v) Any agency or branch of a foreign entity located in the United States;
(vi) Any non-discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary for the benefit or account of a U.S. person;
(vii) Any discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary organized, incorporated, or (if an individual) resident in the United States; and
(viii) Any partnership or corporation if:
(A) Organized or incorporated under the laws of any foreign jurisdiction; and
(B) Formed by a U.S. person principally for the purpose of investing in securities not registered under the Act, unless it is organized or incorporated, and owned, by accredited investors (as defined in § 230.501(a)) who are not natural persons, estates or trusts.
(2) The following are not "U.S. persons":
(i) Any discretionary account or similar account (other than an estate or trust) held for the benefit or account of a non-U.S. person by a dealer or other professional fiduciary organized, incorporated, or (if an individual) resident in the United States;
(ii) Any estate of which any professional fiduciary acting as executor or administrator is a U.S. person if:
(A) An executor or administrator of the estate who is not a U.S. person has sole or shared investment discretion with respect to the assets of the estate; and
(B) The estate is governed by foreign law;
(iii) Any trust of which any professional fiduciary acting as trustee is a U.S. person, if a trustee who is not a U.S. person has sole or shared investment discretion with respect to the trust assets, and no beneficiary of the trust (and no settlor if the trust is revocable) is a U.S. person;
(iv) An employee benefit plan established and administered in accordance with the law of a country other than the United States and customary practices and documentation of such country;
(v) Any agency or branch of a U.S. person located outside the United States if:
(A) The agency or branch operates for valid business reasons; and
(B) The agency or branch is engaged in the business of insurance or banking and is subject to substantive insurance or banking regulation, respectively, in the jurisdiction where located; and
(vi) The International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the United Nations, and their agencies, affiliates and pension plans, and any other similar international organizations, their agencies, affiliates and pension plans.
(l) United States. "United States" means the United States of America, its territories and possessions, any State of the United States, and the District of Columbia.

OFFERS OR SALES OF SECURITIES BY THE ISSUER, A DISTRIBUTOR, ANY OF THEIR RESPECTIVE AFFILIATES, OR ANY PERSON ACTING ON BEHALF OF ANY OF THE FOREGOING; CONDITIONS RELATING TO SPECIFIC SECURITIES. Reg. § 230.903.
(a) An offer or sale of securities by the issuer, a distributor, any of their respective affiliates, or any person acting on behalf of any of the foregoing, shall be deemed to occur outside the United States within the meaning of § 230.901 if:
(1) The offer or sale is made in an offshore transaction;
(2) No directed selling efforts are made in the United States by the issuer, a distributor, any of their respective affiliates, or any person acting on behalf of any of the foregoing; and
(3) The conditions of paragraph (b) of this section, as applicable, are satisfied.
(b) Additional Conditions.
(1) Category 1. No conditions other than those set forth in § 230.903(a) apply to securities in this category. Securities are eligible for this category if:
(i) The securities are issued by a foreign issuer that reasonably believes at the commencement of the offering that:
(A) There is no substantial U.S. market interest in the class of securities to be offered or sold (if equity securities are offered or sold);
(B) There is no substantial U.S. market interest in its debt securities (if debt securities are offered or sold);
(C) There is no substantial U.S. market interest in the securities to be purchased upon exercise (if warrants are offered or sold); and
(D) There is no substantial U.S. market interest in either the convertible securities or the underlying securities (if convertible securities are offered or sold);
(ii) The securities are offered and sold in an overseas directed offering, which means:
(A) An offering of securities of a foreign issuer that is directed into a single country other than the United States to the residents thereof and that is made in accordance with the local laws and customary practices and documentation of such country; or
(B) An offering of non-convertible debt securities of a domestic issuer that is directed into a single country other than the United States to the residents thereof and that is made in accordance with the local laws and customary practices and documentation of such country, provided that the principal and interest of the securities (or par value, as applicable) are denominated in a currency other than U.S. dollars and such securities are neither convertible into U.S. dollar-denominated securities nor linked to U.S. dollars (other than through related currency or interest rate swap transactions that are commercial in nature) in a manner that in effect converts the securities to U.S. dollar-denominated securities.
(iii) The securities are backed by the full faith and credit of a foreign government; or
(iv) The securities are offered and sold to employees of the issuer or its affiliates pursuant to an employee benefit plan established and administered in accordance with the law of a country other than the United States, and customary practices and documentation of such country, provided that:
(A) The securities are issued in compensatory circumstances for bona fide services rendered to the issuer or its affiliates in connection with their businesses and such services are not rendered in connection with the offer or sale of securities in a capital-raising transaction;
(B) Any interests in the plan are not transferable other than by will or the laws of descent or distribution;
(C) The issuer takes reasonable steps to preclude the offer and sale of interests in the plan or securities under the plan to U.S. residents other than employees on temporary assignment in the United States; and
(D) Documentation used in connection with any offer pursuant to the plan contains a statement

that the securities have not been registered under the Act and may not be offered or sold in the United States unless registered or an exemption from registration is available.
(2) Category 2. The following conditions apply to securities that are not eligible for Category 1 (paragraph (b)(1)) of this section and that are equity securities of a reporting foreign issuer, or debt securities of a reporting issuer or of a non-reporting foreign issuer.
(i) Offering restrictions are implemented;
(ii) The offer or sale, if made prior to the expiration of a 40-day distribution compliance period, is not made to a U.S. person or for the account or benefit of a U.S. person (other than a distributor); and
(iii) Each distributor selling securities to a distributor, a dealer, as defined in section 2(a)(12) of the Act (15 U.S.C. 77b(a)(12)), or a person receiving a selling concession, fee or other remuneration in respect of the securities sold, prior to the expiration of a 40-day distribution compliance period, sends a confirmation or other notice to the purchaser stating that the purchaser is subject to the same restrictions on offers and sales that apply to a distributor.
(3) Category 3. The following conditions apply to securities that are not eligible for Category 1 or 2 (paragraph (b)(1) or (b)(2)) of this section:
(i) Offering restrictions are implemented;
(ii) In the case of debt securities:
(A) The offer or sale, if made prior to the expiration of a 40-day distribution compliance period, is not made to a U.S. person or for the account or benefit of a U.S. person (other than a distributor); and
(B) The securities are represented upon issuance by a temporary global security which is not exchangeable for definitive securities until the expiration of the 40-day distribution compliance period and, for persons other than distributors, until certification of beneficial ownership of the securities by a non-U.S. person or a U.S. person who purchased securities in a transaction that did not require registration under the Act;
(iii) In the case of equity securities:
(A) The offer or sale, if made prior to the expiration of a one-year distribution compliance period, is not made to a U.S. person or for the account or benefit of a U.S. person (other than a distributor); and
(B) The offer or sale, if made prior to the expiration of a one-year distribution compliance period, is made pursuant to the following conditions:
(1) The purchaser of the securities (other than a distributor) certifies that it is not a U.S. person and is not acquiring the securities for the account or benefit of any U.S. person or is a U.S. person who purchased securities in a transaction that did not require registration under the Act;
(2) The purchaser of the securities agrees to resell such securities only in accordance with the provisions of this Regulation S (§§ 230.901 through 230.905, and Preliminary Notes), pursuant to registration under the Act, or pursuant to an available exemption from registration; and agrees not to engage in hedging transactions with regard to such securities unless in compliance with the Act;
(3) The securities of a domestic issuer contain a legend to the effect that transfer is prohibited except in accordance with the provisions of this Regulation S (§§ 230.901 through 230.905, and Preliminary Notes), pursuant to registration under the Act, or pursuant to an available exemption from registration; and that hedging transactions involving those securities may not be conducted unless in compliance with the Act;
(4) The issuer is required, either by contract or a provision in its bylaws, articles, charter or comparable document, to refuse to register any transfer of the securities not made in accordance with the provisions of this Regulation S (§§ 230.901 through 230.905, and Preliminary Notes), pursuant to registration under the Act, or pursuant to an available

exemption from registration; provided, however, that if the securities are in bearer form or foreign law prevents the issuer of the securities from refusing to register securities transfers, other reasonable procedures (such as a legend described in paragraph (b)(3)(iii)(B)(3) of this section) are implemented to prevent any transfer of the securities not made in accordance with the provisions of this Regulation S; and
(iv) Each distributor selling securities to a distributor, a dealer (as defined in section 2(a)(12) of the Act (15 U.S.C. 77b(a)(12)), or a person receiving a selling concession, fee or other remuneration, prior to the expiration of a 40-day distribution compliance period in the case of debt securities, or a one-year distribution compliance period in the case of equity securities, sends a confirmation or other notice to the purchaser stating that the purchaser is subject to the same restrictions on offers and sales that apply to a distributor.
(4) Guaranteed securities. Notwithstanding paragraphs (b)(1) through (b)(3) of this section, in offerings of debt securities fully and unconditionally guaranteed as to principal and interest by the parent of the issuer of the debt securities, only the requirements of paragraph (b) of this section that are applicable to the offer and sale of the guarantee must be satisfied with respect to the offer and sale of the guaranteed debt securities.
(5) Warrants. An offer or sale of warrants under Category 2 or 3 (paragraph (b)(2) or (b)(3)) of this section also must comply with the following requirements:
(i) Each warrant must bear a legend stating that the warrant and the securities to be issued upon its exercise have not been registered under the Act and that the warrant may not be exercised by or on behalf of any U.S. person unless registered under the Act or an exemption from such registration is available;
(ii) Each person exercising a warrant is required to give:
(A) Written certification that it is not a U.S. person and the warrant is not being exercised on behalf of a U.S. person; or
(B) A written opinion of counsel to the effect that the warrant and the securities delivered upon exercise thereof have been registered under the Act or are exempt from registration thereunder; and
(iii) Procedures are implemented to ensure that the warrant may not be exercised within the United States, and that the securities may not be delivered within the United States upon exercise, other than in offerings deemed to meet the definition of "offshore transaction" pursuant to § 230.902(h), unless registered under the Act or an exemption from such registration is available.

OFFSHORE RESALES.Reg. § 230.904.
(a) An offer or sale of securities by any person other than the issuer, a distributor, any of their respective affiliates (except any officer or director who is an affiliate solely by virtue of holding such position), or any person acting on behalf of any of the foregoing, shall be deemed to occur outside the United States within the meaning of § 230.901 if:
(1) The offer or sale are made in an offshore transaction;
(2) No directed selling efforts are made in the United States by the seller, an affiliate, or any person acting on their behalf; and
(3) The conditions of paragraph (b) of this section, if applicable, are satisfied.
(b) Additional conditions.
(1) Resales by dealers and persons receiving selling concessions. In the case of an offer or sale of securities prior to the expiration of the distribution compliance period specified in Category 2 or 3 (paragraph (b)(2) or (b)(3)) of § 230.903, as applicable, by a dealer, as defined in Section 2(a)(12) of the Act (15 U.S.C. 77b(a)(12)), or a person receiving a selling concession, fee or other remuneration in respect of the securities offered or sold:

(i) Neither the seller nor any person acting on its behalf knows that the offeree or buyer of the securities is a U.S. person; and
(ii) If the seller or any person acting on the seller's behalf knows that the purchaser is a dealer, as defined in Section 2(a)(12) of the Act (15 U.S.C. 77b(a)(12)), or is a person receiving a selling concession, fee or other remuneration in respect of the securities sold, the seller or a person acting on the seller's behalf sends to the purchaser a confirmation or other notice stating that the securities may be offered and sold during the distribution compliance period only in accordance with the provisions of this Regulation S (§§ 230.901 through 230.905, and Preliminary Notes); pursuant to registration of the securities under the Act; or pursuant to an available exemption from the registration requirements of the Act.
(2) Resales by certain affiliates. In the case of an offer or sale of securities by an officer or director of the issuer or a distributor, who is an affiliate of the issuer or distributor solely by virtue of holding such position, no selling concession, fee or other remuneration is paid in connection with such offer or sale other than the usual and customary broker's commission that would be received by a person executing such transaction as agent.

RESALE LIMITATIONS. Reg. § 230.905
Equity securities of domestic issuers acquired from the issuer, a distributor, or any of their respective affiliates in a transaction subject to the conditions of § 230.901 or § 230.903 are deemed to be "restricted securities" as defined in § 230.144. Resales of any of such restricted securities by the offshore purchaser must be made in accordance with this Regulation S (§§ 230.901 through 230.905, and Preliminary Notes), the registration requirements of the Act or an exemption therefrom. Any "restricted securities," as defined in § 230.144, that are equity securities of a domestic issuer will continue to be deemed to be restricted securities, notwithstanding that they were acquired in a resale transaction made pursuant to § 230.901 or § 230.904.

If Nestlé S.A. issues US $ denominated bonds in Europe, what does it have to do to comply with Regulation S?

How would Regulation S apply to an issue of US$ denominated bonds by Alliance Boots?

Would it make a difference in either case if the bonds were denominated in euro?

How would Regulation S apply to an issue of equity securities by either of these issuers?

The SEC has issued no-action letters to exchanges in other parts of the world in relation to securities issues listed on those exchanges. See, e.g., the ASX (Australian Stock Exchange) document[7] :

ASX Guidance Note 7 - US Entities - Regulation S Offerings on ASX
Introduction
1. This Guidance Note is published to do the following. Give an overview of relief available for

[7] http://www.asx.com.au/ListingRules/guidance/GuidanceNote7.pdf

offerings by United States (US) entities under the safe harbour provisions of Regulation S under the US Securities Act 1933 and the no-action letter dated 7 January 2000 given to ASX by the United States Securities and Exchange Commission (SEC). Provide guidance about the conditions and processes that apply to US entities considering an ASX listing using this relief.
2. In 1999 ASX approached the SEC with a request for“no-action” relief for Regulation S offerings and sales of securities on ASX. The request was made because it is considered that such relief may provide significant benefits for a particular type of US entity.
3. These entities are generally (but not always) smaller, privately owned, non-reporting (SEC), growth oriented entities. This type of entity may have difficulty competing for attention in US securities markets, which may make it difficult for the entity to raise capital on suitable terms through a US public offering. In addition, the cost of raising capital on ASX may be lower and “time-to-market” may be shorter.
4. The no-action letter states that enforcement action would not be recommended where equity securities of non-reporting United States entities are offered and sold in initial public offerings offshore pursuant to Regulation S in connection with a listing on ASX, where certain alternative restrictions and arrangements (as agreed between the SEC and ASX) to Regulation S are met.
5. The no-action letter means that US incorporated entities can raise capital on the ASX market without registering their securities under the US Securities Act, provided certain conditions in relation to the offering and trading of those securities on ASX are met.

Regulation S - underlying policy
6. In general terms, Regulation S provides that offers and sales of securities by US entities made outside the United States will not trigger the registration requirements of the US Securities Act. The exemption applies where there are reasonable procedures in place to prevent public distribution of Regulation S securities in the United States to US residents, both at the time of the offer and in any secondary market.
7. The applicability of Regulation S usually turns on the circumstances of a specific transaction or offer. The no-action letter applies generally to all offerings by US entities in connection with a listing on ASX, provided the conditions described in the no-action letter are met.

Conditions
8. The conditions discussed in this Guidance Note are not an exhaustive list of the conditions applicable to Regulation S offerings under the no-action letter. US entities should contact ASX for a full copy of the no-action letter and a more detailed summary of conditions and procedures.

Prospectus
9. The conditions imposed by the no-action letter include a requirement for disclosure of certain information in the prospectus used in the offering of Regulation S securities. The disclosure required includes the following.
All purchasers from a distributor in the offering will be deemed to have made representations concerning their non-US status or other exempt status and agreements regarding restrictions on resale and hedging under Regulation S.
The securities have not been registered under the US Securities Act, and, subject to certain limited exceptions, may not be offered, sold or delivered in the United States or to, or for the account or benefit of, any US person, as such terms are defined in Regulation S under the US Securities Act.

10. The prospectus should also state that while ASX and the Securities Clearing House (SCH) maintain the procedures and systems as outlined in the no-action letter and agreed with the staff of the SEC, neither ASX nor SCH is responsible for any failure by an entity to comply with those procedures.
11. Entities seeking a listing on ASX in reliance on the no-action letter should liaise with ASX at the earliest opportunity to discuss the wording that must be included in the prospectus. US legal counsel should also be retained to assist with the preparation of the prospectus. In certain cases ASX may ask for US legal counsel's opinion that an offer complies with US securities laws.

Foreign Ownership Restriction (FOR) facility
12. The FOR facility is a facility offered by ASX which enables ASX listed entities to electronically monitor foreign ownership levels on a continuous basis. This is achieved by "flagging" holder records as either "domestic" or "foreign". In the case of a Regulation S security, "foreign" means "US person" as that term is defined in the US Securities Act.
13. Through the FOR facility, a US entity can immediately identify where a violation of the FOR rules has occurred, and effectively reverse a transaction that is in breach of the terms of Regulation S, by taking divestment action.
14. The FOR facility also provides a way of informing ASX market participants that special restrictions and conditions apply to transactions in Regulation S securities.
15. The conditions of the no-action letter include the following in relation to Regulation S securities and the FOR facility.
The FOR provisions of the SCH Business Rules must be applied to the relevant securities.
The securities must be identified on ASX trading screens as being "FOR US" securities. This identification means that the securities are subject to the restrictions advised by the entity. This information is also disseminated to information vendors in order that the notation "ORD US PROHIBITED" will appear in relation to the securities.
16. The existence of restrictions and the nature of the restrictions are advised to the market by ASX and SCH circular.
17. In order that the restrictions can be put in place, a US entity must request that SCH include its securities in Schedule 1 of the SCH Business Rules as FOR securities, before the commencement of quotation and trading of those securities. The following information must be provided with the request.
All classes of securities to be included as FOR securities.
The relevant Foreign Ownership Percentage Level in respect of the securities. In the case of Regulation S securities, the level will always be zero.
The number of times the US entity will take divestiture or forfeiture action in respect of securities determined to be in breach of the conditions. In the case of Regulation S securities, it is assumed that this action would be immediate.
A summary of the definition of "Foreign Person" to assist in the "flagging" of holder records. For Regulation S securities, the definition must be specified as ownership by a US person, as that term is defined in Regulation S. and the full text of the definition must be provided in full. This is advised to the market by ASX circular.

Distribution compliance period
18. The distribution compliance period (ie the period during which conditions apply) is nominally one year. However, it is not a foregone conclusion that US persons would be permitted to invest in an entity's securities free of all restrictions based in the US securities laws. In certain circumstances, the one year period must effectively be extended. If in future an entity requests

that ASX remove its securities from Schedule 1 of the SCH Business Rules, effectively lifting the restrictions, ASX will require the entity to provide an opinion of US legal counsel that the restrictions may be removed. In applying to be admitted to the ASX official list on the basis that it will be a Regulation S entity, an entity acknowledges and accepts this condition.

CHESS Depositary Interests[8]
19. Under US company law, CHESS cannot be used for transferring Regulation S securities or holding legal title to those securities. Instead, depositary instruments can be used to allow transactions in Regulation S securities to be cleared and settled through CHESS. These instruments are called CHESS Depositary Interests (CDIs). A US entity must issue CDIs over its securities if a security holder asks for CDIs to be issued, refer Guidance Note 5 - CHESS Depositary Interests (CDIs).

Timing
20. In order that the market is fully informed, and to give market participants enough time to effect changes to residency indicators within the FOR structure, an entity must submit its request to ASX and SCH with all necessary information no later than 10 Business Days prior to the anticipated date for commencement of quotation and trading of the securities.
21. ASX recommends that an entity appoint an Australian registry at the earliest opportunity, to assist with the establishment of both the FOR facility and the issuing of CDIs.

Why does the ASX want to attract these US issuers to its market? How successful do you think the ASX is likely to be? What would make a difference?
Approximately half of Australian adults own shares in their own name or through a managed fund (and taking account of superannuation (pensions) the ownership figures are even higher.[9] In 2003 19% of the ASX's revenues came from listings (compared with 27% in 1998).

Exchanges compete with other exchanges. Thierry Foucault and Christine Parlour suggest that an exchange chooses "a listing fee and trading organization to maximize both the sum of its listing revenue and trading revenue from trading fees and the trading revenue of its members".[10]

Consider, for example this statement from the London Stock Exchange's Chairman, Chris Gibson-Smith :

Through the power of our global brand and our position at the heart of the City of London, with its effective and trusted regulatory environment and governance regime, we have attracted

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[8] CHESS is the ASX' Clearing House Electronic Subregister System. See http://www.asx.com.au/investor/shares/how/chess_faq.htm

[9] On share ownership in Australia see, e.g., Robert White et al, *Share Ownership in Australia: the Emergence of New Tensions?* 40 JOURNAL OF SOCIOLOGY 99 (2004). Around half of Americans invest in stocks. Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances at http://www.federalreserve.gov/pubs/bulletin/2006/financesurvey.pdf

[10] Thierry Foucault & Christine A. Parlour, *Competition for Listings*, 35 RAND. J. ECON 329, 330 (2004).

companies of all sizes from all corners of the world. It is clear that London has become the international listing venue of choice, outstripping every other global equity market by a large margin.
It is also clear that, as well as experiencing strong market conditions, equity markets are undergoing a period of profound change that we are helping to drive. The development of complex trading strategies, coupled with a step change in technological innovation, places a premium on increased market efficiency and lower transaction costs. As a result of investing in next generation technology and by focusing on customer service, product innovation and competitive pricing we have been rewarded with the highest order book trading volume growth of the major exchanges, extending London's advantage over other equity markets.[11]

The London Stock Exchange is aggressive in attracting listings:

It was a record year for primary listings on the London Stock Exchange. Issuer Services is the division responsible for attracting companies and supporting them before, during and after listing. This year 107 companies listed on the Main Market and five on the new Professional Securities Market (PSM). 510 joined AIM – an increase of 18 per cent. 409 of the new companies joining our markets were IPOs, representing 67 per cent of all those in Western Europe. A total of £21.1 billion was raised, 136 per cent more than last year. At 31 March 2006, there were 3,141 companies traded on our markets with a total market capitalisation of £4.3 trillion. In the bond markets we increased our share of listed debt by nine per cent, with over 900 additional securities admitted to our markets. London now accounts for 14 per cent of all bonds listed in Europe.
These figures reflect the step change in our product development and marketing activity which saw Issuer Services increase its focus on promoting London listings in the UK and other key markets across the world.
There are many strands to this effort – explaining the benefits of a London listing to the widest possible audience; working with companies to choose the right market for their listing, before helping them maximise the value of the listing. At the same time we are constantly liaising with regulators and governments, to ensure effective and proportionate regulation that helps make London a compelling and cost-efficient place to raise money and maintain a listing.
Unique among major international exchanges, London offers a real choice of markets. This choice is widening: as well as the different options for listing on the Main Market and AIM we introduced this year the PSM for major corporate debt and depositary receipt issuers. We have also successfully lobbied the Treasury for Real Estate Investment Trusts to be a Main Market listed product. Expanding our markets and making them more efficient is a direct response to our customers' requirements: that is why it is central to our strategy. It is hard to overestimate the role of our secondary markets in attracting issuers to the primary markets. For most companies issuing equity or debt is not only about raising money or profile, it is also about investors being able to trade securities easily. The liquidity and fast growing volumes on the London Stock Exchange – especially in smaller stocks – are an important consideration for issuers. For the Exchange there is a crucial interdependence between primary and secondary markets.[12]

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[11] London Stock Exchange, Annual Report 2006, 4 (2006) *available at* http://www.londonstockexchange-ir.com/lse/finperformance/reports/results/ar06/ar06.pdf

[12] Id. At 8-9.

EU HARMONIZATION OF SECURITIES LAWS

European markets offer US issuers access to much larger numbers of potential investors than do the Australian markets. The EU has been trying to achieve a single market in financial services since the beginning of the 1990s, and has harmonised many of its financial services rules. From 2005 EU issuers have been required to produce their financial statements in accordance with International accounting standards[13]:

It is important for the competitiveness of Community capital markets to achieve convergence of the standards used in Europe for preparing financial statements, with international accounting standards that can be used globally, for cross-border transactions or listing anywhere in the world.[14]

At the end of 2002 FASB and the IASB agreed in the Norwalk Agreement to work on making US GAAP and International Financial Reporting Standards (IFRS) converge. In 2006 FASB and the IASB published a Memorandum of Understanding setting out convergence goals for 2008.[15] The MOU states:

At their meetings in April and October 2005, the FASB and the IASB reaffirmed their commitment to the convergence of US generally accepted accounting principles (US GAAP) and International Financial Reporting Standards (IFRSs). A common set of high quality global standards remains the long-term strategic priority of both the FASB and the IASB.

The FASB and the IASB recognise the relevance of the roadmap for the removal of the need for the reconciliation requirement for non-US companies that use IFRSs and are registered in the United States. It has been noted that the removal of this reconciliation requirement would depend on, among other things, the effective implementation of IFRSs in financial statements across companies and jurisdictions, and measurable progress in addressing priority issues on the IASB-FASB convergence programme. Therefore, the ability to meet the objective set out by the roadmap depends upon the efforts and actions of many parties—including companies, auditors, investors, standard-setters and regulators.[16]

Banks, securities firms and insurance companies should be able to carry on business throughout the EU by exercising Treaty rights to freedom of establishment and

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[13] See the International Accounting Standards Board website at http://www.iasb.org

[14] Recital 5 of IAS Regulation (EC)1606/2002, OJ No. L 243/1 (Sept. 11, 2002) concerning the application of international accounting standards was adopted on 19 July 2002 available at http://europa.eu.int/eur-lex/pri/en/oj/dat/2002/l_243/l_24320020911en00010004.pdf

[15] See http://www.fasb.org/mou_02-27-06.pdf

[16] The SEC welcomed the announcement of the MOU. See http://www.sec.gov/news/press/2006-27.htm .

freedom to provide services throughout the EU. A large number of directives implement these rights, but in many areas national rules still impede the effective exercise of rights of establishment and to provide services. The early directives left scope for Member States to apply their own domestic rules which are necessary for the general good.

The EU has recently been working on a number of initiatives in this area, including implementing a market abuse directive adopted in 2003,[17] amending the investment services directive (which is designed to allow securities firms, including exchanges to operate across borders in the EU) with a directive on markets in financial instruments (MiFID directive) adopted in 2004,[18] and introducing a new Prospectus directive in 2003 (see below).

At the beginning of 2001, a Committee of European "Wise Men" recommended new allocations of responsibility for EU rule-making for financial services,[19] including a distinction between framework rules which should be a matter for the Council and the Parliament, and more detailed rules to implement the framework which should involve the European Securities Committee and a Committee of European Securities Regulators (CESR).[20] This new structure for making EU rules (the Lamfalussy approach) for financial services is meant to be more flexible, more efficient and more transparent than was the case before.[21]

The EU harmonised rules for prospectuses and listing particulars a number of years ago, but the directives do not eliminate fragmentation of the market in the EU. A new prospectus directive was adopted in November 2003. This directive was required to be implemented by the Member States by July 2005[22] and should enable a prospectus produced in accordance with the rules of one member state to be used as a

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[17] The directive is at http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/l_096/l_09620030412en00160025.pdf For information about implementation of the directive see http://europa.eu.int/comm/internal_market/securities/abuse/index_en.htm

[18] See http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/l_145/l_14520040430en00010044.pdf for the directive. For implementation see http://europa.eu.int/comm/internal_market/securities/isd/index_en.htm

[19] *See* Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, (Feb. 15, 2001) *available at* http://europa.eu.int/comm/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf

[20] CESR is the re-named Fesco, the Forum of European Securities Commissions. *See* http://www.cesr-eu.org/

[21] *See*, *e.g.*, recital 7 of the 2003 prospectus directive:"The Stockholm European Council of 23 and 24 March 2001 endorsed the final report of the Committee of Wise Men and the proposed four-level approach to make the regulatory process for Community securities legislation more efficient and transparent."

[22] As of March 2006 the Czech Republic, Italy and Portugal had not notified the Commission that they had implemented the prospectus directive.

selling document for securities throughout the EU. The EU's Prospectus Directive, Directive 2003/71/EC,[23] is attached to the back of this handout. (If you are using an electronic copy of this handout be sure to read the Prospectus Directive).

The 2003 prospectus directive is a Lamfalussy approach directive, and CESR participated in developing more detailed rules under the directive.[24] National authorities have subsequently developed national rules to implement the directive and the subordinate detailed rules within the national legal systems, although the prospectus directive allows the national authorities much less discretion in implementation than other directives have in the past. The UK's Financial Services Authority described the Prospectus directive as a maximum harmonisation measure.[25]

The process of developing the prospectus directive and the implementing rules was controversial. Some raised concerns about whether the new rules would interfere with existing arrangements about the sale of eurobonds - the directive includes exemptions for sales to qualified investors to address this issue (cf with accredited investors in the US). Commentators expressed concern that the new rules would have an adverse impact on smaller enterprises by increasing the regulatory burden on them.

After the prospectus directive was adopted it was discovered that there was a regulatory gap relating to issuers with complex histories:

A possible deficiency in relation to this provision became apparent when regulators were faced with issuers that have a complex financial history. We use this term to refer to cases where financial information covering the principal business undertaking of the issuer, for the whole of the period for which historical financial information is required, is not included in the financial statements drawn up by the issuer, but is provided, either in whole or in part, in financial statements drawn up by other entities. A case of this kind could arise, for example, where an issuer had made a major acquisition during the relevant period and the acquired company or business was not yet represented in the issuer's own financial statements. Alternatively, it could arise where the issuer is a newly incorporated holding company inserted over established entities which have produced their own financial statements. In such cases, disclosure of financial information relating to other entities – those acquired or from which a business has been acquired by the issuer, or those pre-existing subsidiaries of the newly incorporated issuer – may be necessary to enable an investor to make a proper assessment of the issuer and the securities in question.
There is some uncertainty as to whether the requirement under item 20.1 of Annex I, and the other relevant provisions of the Regulation, is restricted to financial information relating to the issuer, or whether it extends to historical financial information in respect of entities which are legally separate from, but which are closely linked to the issuer. Since Article 3 of the Regulation prohibits competent authorities from requesting the inclusion of information which is

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[23] OJ L 345/64 , (Dec. 31, 2003) *available at* http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/l_345/l_34520031231en00640089.pdf

[24] *See* http://europa.eu.int/comm/internal_market/securities/prospectus/index_en.htm

[25] Financial Services Authority, The Listing Review and Implementation of the Prospectus Directive, 11, Consultation Paper 04/16 (Oct 2004) at http://www.fsa.gov.uk/pubs/cp/cp04_16.pdf

not included in the Annexes, it is essential to clarify the scope of those provisions to ensure that competent authorities have the ability to require all the information which is necessary in any particular case, and that issuers and their advisers can be certain about what is properly required of them. The provision of the full range of financial information which is relevant in a particular case is essential for proper investor protection. Furthermore, any lack of legal certainty about the scope of a statutory or regulatory requirement could be detrimental to the efficient functioning of markets and can impose additional compliance costs on issuers. Accordingly, the Commission proposes to amend Regulation (EC) No. 809/2004 so as to eliminate uncertainty as to the scope of those provisions and to ensure that the requirements in relation to historical financial information extend to the entire range of information which may be necessary to enable investors to make an informed assessment of the issuer and the securities, in any case where financial information relating to legal entities other than the issuer may be relevant to the financial condition and prospects of the issuer itself.
The draft amendment is based upon advice provided by CESR.4 That advice recommended that Regulation (EC) No. 809/2004 should be amended to enable competent authorities to require issuers that have a complex financial history to provide financial information relating to entities or business undertakings which, when that information was drawn up, were legally separate from the issuer but which form part of its business at the time the prospectus is produced. The advice does not prescribe the information which should be required. Rather, the intention is to allow competent authorities sufficient discretion to deal flexibly with cases which, by their nature, are atypical and may be unique. The draft amendment retains the necessary element of flexibility to determine, on a case by case basis, the additional financial information that must be included in a prospectus where the issuer has a complex financial history.[26]

This example illustrates that the costs of maximum harmonisation include a loss of flexibility on the part of domestic regulators - EU level rules are necessary to address regulatory gaps, and agreement on EU level rules takes time.

In a **Consultation Document on the Prospectus Directive** in 2004,[27] the UK Treasury described the Prospectus directive as follows:

2.3 The Directive identifies two circumstances where a prospectus is required; firstly, when an offer of securities is made to the public and secondly when securities are admitted to trading on a regulated market. The existing legislative framework for listed securities will remain and Member States will be able, but not obliged, to impose additional obligations on listed issuers.
2.4 The Directive introduces the concept of a single "passport" for issuers, where a prospectus approved by one competent authority is available for use throughout the EU, without additional approval or administrative arrangements from competent authorities of other Member States.

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[26] EU Commission, Background Note on the Draft Commission Regulation amending Commission (EC) No. 809/2004 implementing Directive 2003/71/EC ('the Prospectus Directive') as regards supplementary financial information in prospectuses where the issuer has a complex financial history, *available at* http://ec.europa.eu/internal_market/securities/docs/prospectus/background_809-2004_en.pdf. The draft regulation is at http://ec.europa.eu/internal_market/securities/docs/prospectus/draftreg_809-2004_en.pdf.

[27] HM Treasury, UK Implementation of the Prospectus Directive 2003/71/EC (Oct. 2004) at http://www.hm-treasury.gov.uk/media/DFE/27/DFE27339-BCDC-D4B3-16FD311B308ABF54.pdf

The effect of this means that once the competent authority in one relevant Member State has approved the prospectus, it will then be accepted elsewhere in the EU.
2.5 The relevant Member State is determined by the issuer's home (or host) Member State. Once this has been determined, the competent authority for that Member State is responsible for vetting the prospectus and for ensuring that the obligations for issuers and others under the Directive are met. The host member state is identified when an offer to the public or admission to trading is sought outside the home member state, (in certain circumstances at the issuer's choice).
2.6 The Directive seeks to improve the efficiency of the capital raising process in a number of ways, for example by introducing a new procedure for a more flexible, tripartite format of a prospectus and by applying differing disclosure requirements for equity and non-equity securities. In addition the Directive seeks to enhance investor protection by requiring harmonised high standards of disclosure and requiring competent authorities approval of prospectuses in all circumstances...
2.8 An important requirement of this Level 2 regulation is that all EU issuers, and (post 1 January 2007) all non-EU issuers, will have to present their historical financial information in accordance with International Accounting Standards or "equivalent" accounting standards.3 The Committee of European Securities Regulators, CESR, has been charged by the Commission with providing advice on the issue of equivalence to International Accounting Standards of US, Canadian and Japanese accounting standards...
2.10 The Directive determines the circumstances in which a prospectus must be produced and the manner in which a prospectus needs to be approved by the competent authority. Member States will not be able to allow a public offer or admission to a regulated market within their territories without prior publication of a properly approved prospectus.
2.11 A prospectus will need to be filed for approval with the competent authority and published in one of two circumstances; when there is an 'offer of securities to the public' or when an application for 'admission to trading on a regulated market' is made.
2.12 Under the existing prospectus regime, there are differing definitions across the EU as to what constitutes a 'public offer'. This situation was viewed as discouraging firms from raising capital on an EU-wide basis as a transaction might be considered as a public offer in one Member State (and therefore requiring a prospectus) but as a private placement in another Member State. In order to encourage common interpretations across the EU, the Directive introduces for the first time, a pan-European definition of an offer of securities to the public:
.."a communication to persons in any form and by any means, presenting sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe to these securities. This definition shall also be applicable to the placing of securities through financial intermediaries"
2.13 This definition is very broadly worded and potentially captures a broad range of transactions, especially when taken together with the provisions regarding resale of securities. Under the Directive, any subsequent resale of securities, which were previously the subject of one or more of the exemptions... shall be regarded as a separate offer and the above definition re-applied in determining whether the resale is a 'public offer'...
2.15 The Directive imposes the requirement upon those persons seeking admission of securities to trading on a regulated market to produce a prospectus. The regulated markets in the UK are set out below, analysed between those operated by the London Stock Exchange (LSE) and others. The LSE also operates a range of non-regulated markets. It should be noted that the London Stock Exchange announced that the Alternative Investment Market (AIM) ceased to be a regulated market from 12 October 2004...
2.18 There are ..a number of exemptions from the obligation to publish a prospectus for certain

types of offer...The following types of offer are exempt from the obligation to file and publish a prospectus:
.... an offer of securities addressed solely to qualified investors..;
.... an offer of securities addressed to fewer than 100 natural or legal persons per Member State, other than qualified investors;
.... an offer of securities addressed to investors who acquire securities for a total consideration of at least 50,000 euros per investor, for each separate offer;
.... an offer of securities whose denomination per unit amounts to at least 50,000 euros;
.... an offer of securities with a total consideration of less than 100,000 euros, which limit shall be calculated over a period of 12 months...
2.19 The most significant change introduced by the Directive in relation to public offers is that any offer of securities to the public where the consideration is less than 2.5 million euros, calculated over a 12-month period, is outside the scope of the Directive.
2.20 The Directive allows ‘Qualified Investors’ to be exempt from the obligation to publish a prospectus. Such investors are no longer simply financial institutions as the Directive allows Member States to choose to authorise natural persons who are resident in the Member State and who expressly ask to be considered, as qualified investors... public offers solely to ‘Qualified Investors’ are exempt from the obligation to publish a prospectus. If a Member State decides to take up this option, the competent authority is required to ensure that mechanisms are in place for a register of these investors. These persons must meet at least two of the following criteria:
.... the investor has carried out transactions of a significant size on securities markets at an average frequency of, at least, ten per quarter over the previous four quarters;
.... the size of the investor's securities portfolio exceeds 0.5 million euros; or
.... the investor works or has worked for at least one year in the financial sector in a professional position which requires knowledge of securities investment ..
2.28 The Directive prescribes that Member States shall ensure the responsibility for the information given in a prospectus attaches to at least one of:
.... the issuer; or
.... its administrative, management or supervisory bodies; or
.... the offeror, the person asking for the admission to trading on a regulated market or the guarantor, as the case may be.
The Directive does not prevent Member States from attaching responsibility to parties other than those specified.
2.29 The persons responsible shall be clearly identified in the prospectus by their names and functions or, in the case of legal persons, their names and registered offices.
The statement shall also include declarations by them that, to the best of their knowledge, the information contained in the prospectus is in accordance with the facts and that the prospectus makes no omission likely to affect its importance.
2.30 The Directive requires Member States to ensure that their laws, regulations and administrative provisions on civil liability apply to those persons responsible for the information given in a prospectus.
2.31 The Directive also prescribes that responsibility is attached to those persons who have tabled the summary of the prospectus. However, this liability extends to the summary, but only if the summary is misleading, inaccurate or inconsistent when read together with the rest of the prospectus..
2.33 Central to the Directive is the concept that the competent authority of a single Member State is responsible for the approval of a prospectus. Identification of the responsible Member State is determined by who is the ‘home’ or ‘host’ Member State for that issuer. Once a

prospectus has been approved, it provides the issuer with the ability to access markets in other EU Member States, using the same prospectus without other competent authorities imposing additional obligations.
2.34 The Directive defines Home Member State for EU issuers as the Member State where the issuer has its registered office. A distinction is made for issuers of nonequity securities where the denomination per unit amounts to at least 1,000 euros (or near in another currency). For these securities, the home competent authority is determined on a case by case basis where the issuer, the offeror or the person asking for admission to trading can choose the home Member State.The availability of choice in these circumstances reflects the nature of these types of securities and their investors.
2.35 The Directive also determines the home Member state for non-EU issuers. This is defined as where the securities are first offered to the public or where admission to trading is first sought following the date of entry into force of the Directive.
2.36 Host Member State' is defined as the Member State where an offer to the public is made or admission to trading is sought, when different from the home Member State.
2.37 The competent authority of the home Member State may transfer the approval of a prospectus to the competent authority of another Member state if, in all circumstances, it is considered to be in the best interests of the investors.

Article 19(2) of the Prospectus directive provides:
Where an offer to the public is made or admission to trading on a regulated market is sought in one or more Member States excluding the home Member State, the prospectus shall be drawn up either in a language accepted by the competent authorities of those Member States or in a language customary in the sphere of international finance, at the choice of the issuer, offeror or person asking for admission, as the case may be. The competent authority of each host Member State may only require that the summary be translated into its official language(s).

Thus, Member States can choose whether to require the translation of summary prospectuses. Austria, Luxembourg and the Netherlands have decided to accept summary prospectuses in English.[28] Languages accepted by the Irish regulator are Irish and English and the regulator will require summaries to be translated into either Irish or English.[29]

The UK's FSA has proposed the following approach to the question of when a language is a language customary in the sphere of international finance:

Language customary in the sphere of international finance
4.1.5A G The FSA will consider a language to be customary in the sphere of international finance if documents in that language are accepted for scrutiny and filing in at least three international capital markets in each of the following:
(1) Europe;

[28] See, e.g., http://www.fsa.gov.uk/pubs/ukla/factsheet4.pdf

[29] Financial Regulator, Prospectus Rules, (Mar. 2006) *available at* http://www.ifsra.ie/data/in_mark_prospdir/FINAL%20Prospectus%20Rules%2015.02.06%20for%20Board.pdf

(2) Asia; and
(3) the Americas.[30]

Article 20 of the 2003 Prospectus directive suggests that competent authorities of Member States may approve prospectuses produced in third countries for use in the EU under certain circumstances. Why would the EU want to do this?

FOREIGN ISSUERS IN THE US

If the SEC wishes to limit investments by US investors in foreign securities issued outside the US (Reg. S) then it has to think about the conditions under which foreign issuers can access the US securities markets. US investors can achieve international diversification by buying securities in secondary markets outside the US and by investing in mutual funds which invest in foreign securities but they may also wish to invest in primary distributions of securities. International diversification of an investment portfolio should protect an investors against risks associated with a particular region (although convergence in the performance of different regions, and of investments in different regions, due to globalization may make such diversification less useful).

Foreign issuers which wish to issue securities in the US are likely to be large corporates which have already issued securities in their home markets. They will therefore be subject to a range of different regulatory requirements at home: corporate law, accounting regulations and securities regulation. These rules may be different from the rules which generally apply to issuers in the US. If the US required foreign issuers to comply with all of the US rules that normally apply to US issuers in addition to their home rules this would involve significant expense for little regulatory benefit and might discourage foreign issuers from entering the US markets thus depriving US investors of access to those securities or forcing them to move offshore. If US rules are inconsistent with home rules (so that a foreign issuer would be unable to comply with both sets of rules) foreign issuers will be prevented from accessing the US markets. On the other hand if foreign issuers can access US capital markets with lower costs than domestic issuers, domestic issuers may migrate to markets outside the US.

US rules do not always impose greater burdens on domestic issuers, however. US issuers with more than $10 million in assets which have not carried out a primary distribution of securities in the US become subject to US reporting obligations under §12(g) of the 34 Act if 500 investors hold their securities "of record".[31] Foreign issuers whose securities are held by more than 300 US investors are also subject to this reporting requirement under Rule 12g3-2(a)(1):

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[30] Financial Services Authority, Amendments to the Prospectus and Listing Rules, Annex A, Consultation Paper 06/17 (Oct. 2006) *available at* http://www.fsa.gov.uk/pubs/cp/cp06_17.pdf

[31] Given that investors often hold securities in street name under the name of their broker this requirement is not as onerous as it might otherwise appear.

Securities of any class issued by any foreign issuer shall be exempt from Section 12(g) of the Act if the class has fewer than 300 holders resident in the United States. This exemption shall continue until the next fiscal year end at which the issuer has a class of equity securities held by 300 or more persons resident in the United States. For the purpose of determining whether a security is exempt pursuant to this paragraph, securities held of record by persons resident in the United States shall be determined as provided in Rule 12g5-1 except that securities held of record by a broker, dealer or bank or nominee for any of them in the United States for the accounts of customers resident in the United States shall be counted as held in the United States by the number of separate accounts for which the securities are held. The issuer may rely in good faith on information as to the number of such separate accounts supplied by all owners of the class of its securities which are brokers, dealers or banks in the United States or a nominee for any of them.

For foreign issuers we want to know how many US investors own the securities beneficially, for US issuers we don't care. In July 2003 a group of investors petitioned the SEC to amend the rules to include people who hold securities in street name in the category of holders of record for the purposes of reporting under the 34 Act, noting that the more onerous requirements for foreign issuers did not seem to have caused any problems:

For reasons that are not entirely clear, the Commission imposed a different requirement on foreign issuers. Exchange Act Rule 12g-3(a)(1) requires foreign private issuers to count each account held in street name by a broker or bank to determine whether their stock must be registered because it is held of record by more than 300 US investors. There is no evidence to suggest that this requirement for foreign private issuers has imposed an undue burden on either issuers or the banks and brokerage firms that have been required to respond to such requests.
The contrasting treatment for US domestic issuers and foreign issuers under the rules adopted pursuant to Section 12(g)(5) of the Exchange Act produces inconsistent and perverse results. Investors in US issuers are deprived of the disclosures and protection provided under the Exchange Act to investors in foreign companies.
The 38 years since Rule 12g5-1 was adopted have witnessed monumental changes in clearing and settlement procedures. The transformation of clearing and settlement procedures have caused, among many other things, a dramatic increase in the percentage of beneficial owners holding equity securities in street name. In contrast to conditions that prevailed in 1965, it is now unusual for a beneficial owner to appear on the corporate books as a holder of record or hold a stock certificate. As a result, Rule 12g5-1 fails to properly effectuate the Congressional intent expressed in Section 12 or the policy goals of the Exchange Act. [32]

But meanwhile, foreign issuers, concerned that it was easier for US issuers to reduce the regulatory costs of Sarbanes Oxley by going private than for them, argued that the SEC should change the rules to make it easier for non-US issuers to go private. In December 2005 the SEC published a **Proposed Rule on Termination of a Foreign**

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[32] http://www.sec.gov/rules/petitions/petn4-483.htm

Private Issuer's Registration of a Class of Securities under Section 12(g):[33]

Representatives of foreign companies and foreign industry associations have recently voiced their concerns to the Commission about the rules that govern whether a foreign private issuer may exit the Exchange Act registration and reporting regime. These representatives maintain that, due to the increased internationalization of U.S. investor interest, the "300 U.S. resident shareholder" standard has become outdated and too easily exceeded by a foreign company that may have engaged in very little recent selling activity in the United States. According to these representatives, after a few years of listing its securities in the United States, a foreign company may discover that there is little U.S. market interest in its securities. Yet because it has not been able to reduce the number of its U.S. shareholders to below 300, it must continue to incur the costs of being an Exchange Act reporting company.

These representatives have further criticized the exit rules' reliance on the number of U.S. resident shareholders because, with the advent of book-entry recording, it is difficult and costly to arrive at an accurate count of a foreign company's U.S. resident shareholders. These representatives also are critical of Rule 12h-3 because it merely suspends rather than permanently terminates a company's section 15(d) reporting obligations. As such, years after filing a Form 15, a foreign company may find that it has once again exceeded the 300 U.S. resident shareholder threshold, and thereupon again become subject to section 15(d) reporting duties, without regard to its U.S. market activity.

Finally, these representatives disagree with the fact that our current rule does not permit a foreign private issuer to obtain the Exchange Act Rule 12g3-2(b) exemption if during the previous 18 months, it has had a class of securities registered under section 12 or a reporting obligation, suspended or active, under section 15(d) of the Exchange Act....

In light of the increased internationalization of the U.S. securities markets that has occurred, we believe that it is time to reconsider the rules allowing a foreign private issuer to exit the Exchange Act registration and reporting regime. We propose to amend Rules 12g-4 and 12h-3 to eliminate the provisions that primarily condition a foreign private issuer's eligibility to cease its Exchange Act reporting obligations on whether the number of its U.S. resident security holders has fallen below the 300 or 500 person threshold. In their place, we propose new Exchange Act Rule 12h-6 that would permit a foreign private issuer that meets the conditions discussed below to achieve the following:

- termination of the registration of a class of equity securities under section 12(g) and its resulting section 13(a) reporting obligations;
- permanent termination of its section 15(d) reporting obligations regarding a class of equity securities; and
- permanent termination of its section 15(d) reporting obligations regarding a class of debt securities.

A foreign private issuer would be eligible to terminate its Exchange Act reporting obligations regarding a class of equity securities under proposed Rule 12h-6 if it met the following conditions:

- the issuer has been an Exchange Act reporting company for the past two years, has filed or furnished all reports required for this period, and has filed at least two annual reports under section 13(a);
- the issuer's securities have not been sold in the United States in either a registered or

[33] 70 Fed Reg 77688 (Dec. 30, 2005) at http://a257.g.akamaitech.net/7/257/2422/01jan20051800/edocket.access.gpo.gov/2005/pdf/05-24618.pdf

unregistered offering under the Securities Act during the preceding 12 months other than securities:

- sold to the issuer's employees;
- sold by selling security holders in non-underwritten offerings;
- exempt from registration under section 3 of the Securities Act, except section 3(a)(10); and
- constituting obligations having a maturity of less than nine months at the time of issuance and offered and sold in transactions exempted from registration under section 4(2) of the Securities Act; and
- for the preceding two years, the issuer has maintained a listing of the subject class of securities on an exchange in its home country, as defined in Form 20-F, which constitutes the primary trading market for the securities.

Rule 12h-6 would further permit a foreign private issuer seeking to terminate its registration and reporting obligations regarding a class of equity securities to meet one of a set of alternative benchmarks, which are not based on a record holder count, and which depend on whether the issuer is a well-known seasoned issuer. If a well-known seasoned issuer, then a foreign private issuer could terminate its Exchange Act registration and reporting obligations as long as either:

- the U.S. average daily trading volume of the subject class of securities has been no greater than 5 percent of the average daily trading volume of that class of securities in its primary trading market during a recent 12 month period, and U.S. residents held no more than 10 percent of the issuer's worldwide public float at a date within 60 days before the end of that same period; or
- regardless of U.S. trading volume, U.S. residents held no more than 5 percent of the issuer's worldwide public float at a date within 120 days before the filing date of the Form 15F, which is the form that a foreign private issuer would have to file to certify that it meets the conditions for terminating its Exchange Act registration and reporting obligations under proposed Rule 12h-6.

If not a well-known seasoned issuer, then a foreign private issuer could terminate its Exchange Act registration and reporting obligations regarding a class of equity securities as long as, regardless of U.S. trading volume, U.S. residents held no more than 5 percent of the issuer's worldwide public float at a date within 120 days before the filing date of the Form 15F.

Under proposed Rule 12h-6, if a foreign private issuer is unable to meet one of these proposed benchmarks, but satisfies the other conditions of the rule, it could still terminate its Exchange Act registration and reporting obligations regarding a class of equity securities as long as that class of securities is held of record by less than 300 persons on a worldwide basis or less than 300 persons resident in the United States at a date within 120 days before the filing date of the Form 15F.

A foreign private issuer would be eligible to terminate its section 15(d) reporting obligations regarding a class of debt securities under proposed Rule 12h-6 if it met the following conditions:

- the issuer has filed or furnished all required reports under section 15(d), including at least one annual report pursuant to section 13(a) of the Act; and
- at a date within 120 days before the filing date of the Form 15F the class of debt securities is either held of record by less than 300 persons on a worldwide basis or less than 300 persons resident in the United States.

Rules 12g-4 and 12h-3 currently require the filing of Form 15 by which an issuer certifies that it meets the conditions for ceasing its Exchange Act reporting obligations. Unlike Form 15, proposed new Form 15F would require a foreign private issuer to provide specified information regarding several items that would enable investors to obtain information regarding the issuer's decision to terminate its Exchange Act reporting obligations. In addition, proposed new Form 15F would help Commission staff to assess whether the issuer qualifies for termination of its Exchange Act reporting obligations. As under current Rules 12g-4 and 12h-3, the filing of Form

15F would automatically suspend an issuer's reporting duties. If the Commission has not objected, the suspension would become a permanent termination 90 days after the filing of the Form 15F.
Proposed Rule 12h-6 would further require a foreign private issuer, no later than fifteen business days prior to the filing of the Form 15F, to publish a notice, such as a press release, in the United States that discloses its intent to terminate its section 13 reporting obligations, and to submit a copy of the press release either under cover of a Form 6-K, before or at the time of filing of the Form 15F, or as an exhibit to the Form 15F.
Finally, we propose to amend Exchange Act Rule 12g3-2(d) to permit a foreign private issuer to establish the Rule 12g3-2(b) exemption for a class of equity securities that is the subject of a Form 15F immediately upon the effectiveness of termination of Exchange Act reporting pursuant to Rule 12h-6. As a condition to maintaining this exemption, a foreign private issuer would have to publish in English the home country materials required by Rule 12g3-2(b) on its Internet web site or through an electronic information delivery system that is generally available to the public in its primary trading market. We recognize that U.S. investors benefit from the investment opportunities provided by the registration of foreign private issuers with the Commission and listing and publicly offering securities in the United States. The current exit process may serve as a disincentive to foreign private issuers accessing the U.S. public capital markets because of the burdens and uncertainties associated with terminating registration and reporting under the Exchange Act. We believe that these changes to the exit process for foreign private issuers, if adopted, should provide those issuers with a meaningful option to terminate their Exchange Act reporting obligations when, after electing to access the U.S. public capital markets, they find a diminished level of U.S. investor interest in their securities. As a result, foreign private issuers should be more willing initially to register their securities with the Commission when there is a clearly defined process with more appropriate benchmarks by which they can terminate their Exchange Act reporting obligations if after a period of time U.S. investor interest is not significant relative to non-U.S. investor interest.
In addition, we believe the conditions under proposed Rule 12h-6 are consistent with the interests of U.S. investors in other ways. The two-year reporting and the one-year dormancy conditions are intended to provide sufficient time periods of Commission reporting and of not promoting U.S. investor interest through recent capital raising. The conditions relating to trading on a non-U.S. securities exchange and the benchmarks based on relevant U.S. public float and (for well-known seasoned issuers) relative U.S. trading volume support our view that foreign private issuers that would terminate Exchange Act reporting under proposed Rule 12h-6 should be subject to an ongoing disclosure and financial reporting regime, and have a significant market following, in their home market. The conditions relating to the publication of a press release or other notice, the filing of proposed Form 15F, and the immediate availability of the exemption under Rule 12g3-2(b) promote transparency of the exit process as well as access by U.S. investors to ongoing home country information about issuers that terminate their Exchange Act reporting obligations.

In response to the proposal, the ABA's Committee on Federal Regulation of Securities, emphasised the complexity of the proposal, and urged the SEC to "consider undertaking a comprehensive review of the effect of U.S. regulation on the willingness of foreign issuers to list or offer securities publicly in the U.S., and whether the interests of U.S. investors are adequately served if such issuers choose not to have a U.S.

presence."[34] Pricewaterhouse Coopers, also noting the complexity of the proposal said: "As a general principle, subject to certain conditions, we believe a foreign private issuer should be able to terminate its registration when no more than 10 percent of the class of voting and non-voting equity securities is held by U.S. residents."[35] Commentators suggested that in considering US ownership of foreign issuers the interests of qualified institutional buyers should be excluded.[36]

Does it make sense to apply the reporting requirements differently to domestic and foreign issuers? Commentators on the SEC's proposal seem to think that it does, because of the need to make US markets attractive to foreign issuers. The UK Listing Authority suggested that it was necessary to adopt a differentiated approach in order to facilitate issuer access to UK markets:

We believe that to satisfy our regulatory objectives and, in particular, our objective of formulating and enforcing Listing Rules that *facilitate access to listed markets for a broad range of enterprises*, we should continue to maintain a differentiated regime for overseas issuers. Our objective of providing an appropriate level of protection for investors in listed securities is also important.[37]

We have seen that the EU is moving to a system where issuers from one Member State should be able to use disclosure documents prepared for one domestic market in another EU market with limited adjustments. Since 1991 the US and Canada have in place a Multi-jurisdictional Disclosure System (MJDS) which allows Canadian issuers which have filed with Canadian regulators to access US markets and US issuers which have registered securities with the SEC to access Canadian markets without having to go through a new registration process. In recent years the SEC has suggested it might change the eligibility requirements for Canadian issuers to use the MJDS by increasing the minimum public float requirement.[38] The Sarbanes-Oxley Act (see below) changes how the MJDS applies, but two commentators suggested in 2003 that even with the changes the MJDS provided substantial benefits to Canadian

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[34] http://www.sec.gov/rules/proposed/s71205/abacfrs030806.pdf

[35] http://www.sec.gov/rules/proposed/s71205/pricewaterhouse030306.pdf

[36] See, e.g., comments of The Hundred Group of Finance Directors and the General Counsel Hundred Group at http://www.sec.gov/rules/proposed/s71205/100group022806.pdf

[37] Financial Services Authority, Review of the Listing Regime, ¶ 7.5 (Oct. 2003) *available at* http://www.fsa.gov.uk/pubs/cp/cp203.pdf

[38] http://www.sec.gov/rules/proposed/337606a1.txt . This was part of the SEC's "Aircraft Carrier" proposal which was never adopted.

issuers.[39] However, since the SEC's Offering Reforms, Canadian issuers are not eligible to be considered WKSIs.[40]

Canada was an obvious choice for a mutual recognition agreement for the US, but the US has been reluctant to extend the experiment. Non-Canadian foreign issuers of securities in the US are required to reconcile their financial disclosures to US GAAP. The obligation to reconcile financial statements prepared in accordance with foreign accounting rules to US accounting rules involves significant expense. Reconciliation of financial statements to US standards would allow investors who read financial statements to compare the financial positions of a US issuer and a non-US issuer more easily. Differences in accounting standards can produce different statements of financial results. But in recent years there has been an increased effort at harmonising accounting standards.[41] In 2004, the SEC suggested that was prepared to think about doing away with the requirement to reconcile disclosures to GAAP:

In February 2000, the Commission issued a Concept Release on International Accounting Standards, seeking public comment on the elements necessary to encourage convergence towards a high quality global financial reporting framework while upholding the quality of financial reporting domestically.The release also sought comments as to the conditions under which the Commission should accept financial statements of foreign private issuers that are prepared using IFRS, including the issue of reconciliation of financial statements prepared under IFRS to U.S. GAAP. The Commission has not proposed or adopted any rules as a result of the concept release, and continues to monitor international developments in the subject areas that are discussed in the release. The staff has encouraged the efforts of the Financial Accounting Standards Board ("FASB") and the IASB to work towards achieving greater convergence between U.S. GAAP and IFRS to achieve a common set of high-quality accounting standards. While convergence towards such a common set of standards, together with other developments promoting uniform interpretation and effective enforcement in respect of IFRS, would provide an opportunity for us to consider acceptance of financial statements prepared under IFRS without reconciliation to U.S. GAAP, we are not at this time proposing to eliminate the U.S. GAAP reconciliation.
Several countries in the European Union ("EU") and elsewhere throughout the world currently allow their domestic issuers, or foreign issuers, or both, to prepare financial statements for securities regulatory purposes using IFRS. In June 2002, the EU adopted a regulation requiring companies incorporated under the laws of one of its Member States, and whose securities are publicly traded within the EU ("listed EU companies"), to prepare their consolidated financial statements for each financial year starting on or after January 1, 2005 on the basis of accounting standards issued by the IASB. This regulation applies to listed EU companies in all present and future EU Member States, and the EU Member States may extend the requirements to non-public companies. Other countries, including Australia, also have

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[39] Poonam Puri & Anindya Sen, *A Cost Benefit Analysis of the Multi-Jurisdictional Disclosure System*, (June 10, 2003) *available at* http://www.osc.gov.on.ca/Regulation/Confidence/pic_20030627_cba-disclosure-system.pdf

[40] See http://www.sec.gov/divisions/corpfin/faqs/securities_offering_reform_qa.pdf

[41] *See*, *e.g.*, http://www.iasplus.com/index.htm

adopted similar requirements mandating the use of IFRS by public companies for all periods beginning after January 1, 2005.
In accordance with these requirements, listed EU companies in those countries not currently using IFRS must convert from the existing national accounting standards to IFRS no later than 2005. The companies also will have to provide financial statements and transitional disclosures as directed by IFRS and by national securities regulators and other authorities in those countries. It has been estimated that these requirements will affect approximately 7,000 companies in the EU.[42]

Since 2004 the SEC has moved closer to doing away with reconciliation. Meanwhile, Canada has allowed foreign issuers to use International Accounting Standards since the end of March 2004.[43] Is the Canadian securities market therefore more attractive for foreign issuers than the US market? Barbara Stymiest (then) of the Toronto Stock Exchange suggested in 2003 that the EU and Canada should co-operate to create a transatlantic securities market:

But the perception that the only trans-Atlantic opportunities are American and the only solutions are bilateral hides the real and positive potential that lies in other dimensions of the relationship. It has long been a goal of both the European exchanges and our exchange to gain greater access to American equity markets.
The fact is that Canadian and European brokers have access to American equities through their trading screens. But our equities do not appear on their screens.
And the problem goes deeper than that. It goes to an American approach that views free trade in securities as everybody else abiding by American rules....
What we will be proposing, in general terms, is that major companies on each participating exchange be able to trade on all the participating exchange under home market standards and reporting requirements. By major company, I mean a company that is in the primary index of the participating exchange. For TSX Group, that would mean the TSX/S&P 60.This would have the effect, in the first phase at least, of broadening the market for these listed companies while concentrating liquidity for each company in its home market.
It is the equivalent, if you will, of providing these companies with a superpassport. But this super-passport would come at significantly lower cost to the issuer than the inter-listing and depository receipt processes that now prevail and that can, rather than increasing liquidity, actually fragment the market and diminish liquidity.
This has real value to participating exchanges, of course, and to investors with a taste for trans-border investments because it would reduce the number of intermediaries and therefore the fees, commissions and other costs.
But the greater value may well be for the participating issuers who would gain, through this super-passport, access to new sources of capital at lower costs.
Our business plan envisions a premium annual listing fee to reflect this added value.

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[42] SEC, Proposed Rule First-Time Application of International Financial Reporting Standards, Mar. 11, 2004, *available at* http://www.sec.gov/rules/proposed/33-8397.htm (footnotes omitted)

[43] National Instrument 52-107 Acceptable Accounting Principles, Auditing Standards and Reporting Currency, (2004) 27 OSCB 764 (Jan. 16, 2004) *available at* http://www.iasplus.com/resource/canada0401.pdf

This revenue, like increased trading and data revenues would accrue to the home market once the initial costs were accounted for. These costs, however, are intended to be minimal, because this plan envisages no new trading platforms, minimal regulatory changes, and minimal interference with domestic franchises.

I referred to what we propose as Phase 1. In this phase, we would envisage a small number of European and North American partners, including American partners if they were able. In phase 2, we believe that a demonstrably successful partnership such as this would be attractive to other exchanges including those in the Asia Pacific region and access should be extended to those who meet the quality standards we establish.

Over time, we might well extend the super-passport to issuers on the secondary indices in each exchange.That is what we propose in outline.

If it is to proceed, there is work to be done, including a great deal of technical work on issues such as order routing and messaging platforms, liquidity enhancement, clearing and settlement, foreign exchange and so forth. We will also want to refine the business plan and model the economics.

What I hope will transpire tomorrow morning is that FESE or a group of, let us say, a half dozen interested exchanges establish with us a working group to do the spadework that is required and break the ground in terms of regulatory, legal, accounting and other issues. I would propose, too, that we set a deadline for that work of, let us say, the fourth quarter of this year, so that exchanges can decide together whether such an approach is a go, or a no go.

Our objectives in proposing this are clear. We want to accelerate progress toward freer trade in securities and especially between the two biggest markets on the planet – the United States and Europe.

We believe we have a contribution to make, given our familiarity our affinity for U.K. and European approaches and our proximity to American markets. We compete with the NYSE and NASDAQ for trading in inter-listed stocks, after all, and we're the third largest exchange in North America. We believe we can create tangible value for all the participating exchanges and we can do so with minimal investment, risk and complexity.

Most of all, we can create tangible value for the increasingly sophisticated investors and issuers that characterize our markets – investors and issues that are not served by the existing protectionist barriers that exist in all national markets.

Bringing down these barriers is an objective worth seeking. It is possible, of course, that our reach will exceed our grasp and that a model based on a small group followed by a more global expansion of that group will not be immediately achievable.

In that case, all the bilateral options before us now will still be there. Whatever the outcome, we're intent on building a stronger presence in Europe and stronger trans-Atlantic linkages to complement our clear and obvious interest in the American market.[44]

The SEC's non-financial disclosure requirements for international issuers have been conformed to the IOSCO requirements.[45] In adopting the new rules the SEC said:

Many of our initiatives for foreign issuers have had the goal of reducing barriers to cross-border

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[44] Speech to the FESE Convention at the Guildhall in London on Thursday, 12th June 2003 by Mrs. Barbara Stymiest, CEO of the Toronto Stock Exchange, TSX, at http://www.fese.org/efmc/2003/report/efmc_stymiest.htm.

[45] SEC, International Disclosure Standards, 64 Fed. Reg. 53900, Oct. 5, 1999.

offerings and listings in the United States, while preserving or enhancing existing investor protections. In addition to our own initiatives, we, as a member of the International Organization of Securities Commissions, referred to as IOSCO, have participated in international initiatives intended to facilitate the cross-border flow of securities and capital by promoting the use of a single disclosure document that would be accepted in multiple jurisdictions. In 1998, IOSCO endorsed a core set of disclosure standards for the non-financial statement portions of a disclosure document, and encouraged its members to take whatever steps would be necessary in their own jurisdictions to accept disclosure documents prepared in accordance with those standards.
We believe IOSCO's disclosure standards represent a strong international consensus on fundamental disclosure topics, and that they can be used to produce offering and listing documents that will contain the same high level of information we traditionally have required. Today we are revising our existing foreign issuer integrated disclosure system to incorporate fully the international disclosure standards. We are adopting the revisions to our foreign integrated disclosure system essentially as proposed,16 with a few changes prompted by the suggestions of commenters. The international disclosure standards replace most, but not all, of the previous requirements of Form 20-F, the combined registration and annual report form for foreign private issuers under the Exchange Act.

Foreign issuers of securities in the US are now required to file disclosures through the Edgar system.[46] The reason is that "[i]nvestors have also come to expect electronic access to financial and business information about public companies, regardless of their country of origin, and to financial information about foreign governments. Because of these developments, we believe that the time is right to adopt rules mandating EDGAR filing for foreign issuers." Originally the SEC had proposed to require that all foreign language documents be translated into English for filing through EDGAR, but it modified its approach in reaction to comments. Some documents must be translated in full, and others may be summarized in English (a "fair and accurate English summary").

§ 240.12b-12 Requirements as to paper, printing and language.
(d)(1) All Exchange Act filings and submissions must be in the English language, except as otherwise provided by this section. If a filing or submission requires the inclusion of a document that is in a foreign language, a party must submit instead a fair and accurate English translation of the entire foreign language document, except as provided by paragraph (d)(3) of this section.
(2) If a filing or submission subject to review by the Division of Corporation Finance requires the inclusion of a foreign language document as an exhibit or attachment, a party must submit a fair and accurate English translation of the foreign language document if consisting of any of the following, or an amendment of any of the following:
(i) Articles of incorporation, memoranda of association, bylaws, and other comparable documents, whether original or restated;
(ii) Instruments defining the rights of security holders, including indentures qualified or to be qualified under the Trust Indenture Act of 1939;
(iii) Voting agreements, including voting trust agreements;
(iv) Contracts to which directors, officers, promoters, voting trustees or security holders named in a registration statement, report or other document are parties;

[46] 67 Fed. Reg. 36677 (May 24 2002)

(v) Contracts upon which a filer's business is substantially dependent;
(vi) Audited annual and interim consolidated financial information; and
(vii) Any document that is or will be the subject of a confidential treatment request under [sect] 240.24b-2 or [sect] 230.406 of this chapter.
(3)(i) A party may submit an English summary instead of an English translation of a foreign language document as an exhibit or attachment to a filing or submission subject to review by the Division of Corporation Finance, as long as:
(A) The foreign language document does not consist of any of the subject matter enumerated in paragraph (d)(2) of this section; or
(B) The applicable form permits the use of an English summary.
(ii) Any English summary submitted under paragraph (d)(3) of this section must:
(A) Fairly and accurately summarize the terms of each material provision of the foreign language document; and
(B) Fairly and accurately describe the terms that have been omitted or abridged.
(4) When submitting an English summary or English translation of a foreign language document under this section, a party must identify the submission as either an English summary or English translation. A party may submit a copy of the unabridged foreign language document when including an English summary or English translation of a foreign language document in a filing or submission. A party must provide a copy of any foreign language document upon the request of Commission staff....

Foreign issuers that have not chosen to access the US capital markets but would become subject to the Exchange Act's continuous disclosure requirements may benefit from an exemption from these requirements under 17 CFR 240.12g3-2(b). The foreign issuer must provide the SEC with information about its home country disclosure requirements and about its U.S. shareholders. The exemption is conditional on providing home country disclosures to the SEC on an ongoing basis. Such filings do not need to be made electronically through EDGAR.

In November 2001 Harvey Pitt, then Chairman of the SEC, gave a speech where he suggested that the SEC should recognize the global nature of the securities markets[47]:

We stand on the threshold of remarkable changes in our capital markets. If there ever was a time when we could view U.S. Capital Markets as if they existed in a vacuum, that time is long past. We live in a global economy, with global markets, engaged in fierce global competition, with boundaries that are expanding exponentially given the Internet and changing technology.

If there ever was a time when we could view the world solely through the prism of U.S. securities regulation, that time is also long past. Major financial markets operate around the globe, governed by local securities regulators under local rules. No one regulator's experience can, or should, dictate the responses or approaches others take. We can, and must, learn from each other, especially in circumstances where we are attempting to expand the universe of securities traded in our markets; we need to recognize that we in the U.S. will have to make appropriate accommodations to differing regulatory and accounting standards worldwide.

I wish I could dramatically unveil for you this evening a framework for global regulation

47 http://www.sec.gov/news/speech/spch523.htm

in the 21st century - how the global community could regulate the global marketplace and create a veritable seamless web of interconnectedness - with logic that would be obvious to all. Unfortunately, I cannot lay claim to such prophetic vision and, realistically, the forces at work in today's marketplace belie a simple solution or easy fix...

During the past 70 years, the Securities and Exchange Commission has been guided by certain fundamental regulatory objectives: protecting investors; maintaining market integrity, liquidity and transparency; and promoting capital formation. While our commitment to these principles has not wavered, the means of accomplishing them must change along with markets. Securities regulators around the globe must regularly reexamine the purpose and efficacy of regulation, and the methods chosen to accomplish their goals.

An integral part of this reexamination must be the recognition that every nation's regulatory authority has limits, but the markets we regulate transcend those limits. We must also acknowledge our inherent shortcomings: the changes in our markets are so dynamic that, the more specific the regulatory approach we adopt, the more likely it is to become obsolete -- unless we craft flexible approaches that permit and foster innovative methods of regulation and compliance that are fully capable of evolving with the markets.

Let me take a few minutes to highlight some of the marketplace developments, at home and abroad, that require us to rethink our approaches to regulation. In our national marketplace, a confluence of events has resulted in the blurring of more than just geographic distinctions. The elimination of clear boundaries separating categories of investment intermediaries and types of investment products has created an environment ripe for regulatory inconsistencies, and worse, regulatory arbitrage.

Here in the US, the passage of the groundbreaking Gramm-Leach-Bliley Financial Modernization Act eliminated barriers that traditionally separated U.S. financial industry professionals into discrete regulatory segments. In this regard, we have trailed most of the rest of the world, which seems to have gotten along just fine without the harsh separation we used to impose between commercial and investment banking.

Similarly, the distinctions between banking, insurance, commodity and securities regulation have been shifting. Because of this, the financial services industry has seen firms consolidate, while watching the services these firms offer expand. And, the growth of for-profit electronic trading networks has put a new spin on old issues, like market fragmentation and competition.

At the international level, investors in any nation can now access foreign markets more easily than ever before. This, in turn, has profound implications for an issuer's need to list on foreign markets in order to raise capital there, and on the ability of a regulator to oversee the markets in which its investors operate.

Investors too are, in many ways, very different from investors of days past. Today's investors have new and greater expectations as their investment needs have evolved. The transition from defined benefit retirement plans to defined contribution retirement accounts has brought more investors into our markets and imposed greater demands on these investors to understand investment risk theory, portfolio management and asset allocation.

Recent studies show that roughly one out of every two U.S. households invests in securities. While retail investors today have greater access, via electronic technology, to financial information and execution systems, it is an open question whether these same investors have sufficient training and adequate time to use these tools.

Just as investors' needs are changing, market professionals are rethinking and reinventing the services they provide, their role and their compensation structure. For example, a proposed Commission rule would permit brokers who provide portfolio advice to receive asset-based compensation rather than commissions. Brokers and investment advisers are

offering financial services that seem more and more alike.

Similarly, collective investment vehicles, like hedge funds, mutual funds and on-line investment portfolios are given very different regulatory treatment although, increasingly, they appear to be providing comparable services to similar types of investors. We must ascertain whether our regulations continue to keep pace with the new and evolving products, changes in the roles played by financial intermediaries, or changes in our markets' structures. If we conclude that they do not, then it is our challenge as regulators to find new approaches to keep pace with innovation and the increasing role of technology.

For this reason, I have already announced that we are rethinking our approach to one of the fundamental contributions of the federal securities laws, full and fair disclosure. In my view, we need to supplement the static periodic disclosure model - that has long served investors well, but in today's world results in the delivery of information that is often stale upon arrival, and impenetrable to many of those who receive it.

I believe we need to move toward a dynamic model of current disclosure of unquestionably material information. We need to clarify and sharpen financial disclosure, so that every investor can readily understand a company's true financial picture. In short, we need to come up with an approach that is less burdensome, but more meaningful, than our current system. We must also be frank in recognizing that reconciling the dichotomy between '33 Act and '34 Act disclosure necessarily requires addressing, in an intelligent fashion, the thorny issue of liability standards.

We must also recognize that the issuer population subject to our standards is increasingly a global issuer community. Consider that in 1981 we had 173 foreign companies registered with the SEC. By 1991 that number had increased to 439, and today, by the end of 2001, we expect to reach 1400 foreign companies registered with the SEC.

Although U.S. markets have had success in attracting foreign companies to our public markets, we cannot rest on our laurels. U.S. investors already invest around the globe, and therefore their interests will be best served if foreign companies can be brought into our markets, which offer the protections of fair trading, and full and fair disclosure, by the companies whose securities trade in those markets. We must make it inviting for global businesses to offer and trade their securities in our markets, but without sacrificing necessary investor protections. This is a consistent Commission message, but sometimes it has been obscured, so I want to make it unequivocally clear - we are determined to find a way to make our markets as hospitable as possible to issuers around the world, while adhering to our mandate of investor protection.

We also must note that our past regulatory successes in facilitating the private offering process now compel us to reexamine regulations that are causing seasoned public companies to opt for private offerings over public offerings. Entities raising capital in a private offering have far fewer regulatory hurdles than those that access public markets. We need to ask whether these discrepancies are in keeping with our regulatory objectives. Should we treat new issuers differently from seasoned issuers? Conversely, if we make changes in the public offering process for seasoned issuers, can we foresee how they will then affect the attractiveness of the private offering process? These are just some of the many issues we must face as we move forward.

What is key is that we address these issues and issuers, foreign vs. domestic, public vs. private, seasoned vs. unseasoned, in a comprehensive manner, so that our regulatory fixes do not have unintended consequences. While the area is of enormous importance, the solution we choose should be consistent with our overarching goal - certainly not more regulation, and not necessarily less regulation, but smarter regulation, regulation that allows markets the greatest amount of flexibility to innovate and create while still preserving and meriting investors'

confidence.

Not surprisingly, foreign markets also are experiencing dynamic change. Domestic and foreign investors alike are showing considerable interest in other marketplaces. To put this growth in perspective, consider the following numbers from the Securities Industry Association: U.S. Holdings of foreign securities reached $2.48 trillion by year-end 2000, up 692% from 1991. Foreign holdings of U.S. securities were approximately $4.2 trillion, up 340% over the same period.

Given the sheer size of these numbers, we want to encourage and facilitate access by foreign issuers to our markets. As we embark on our own modernization of our offering and disclosure processes, we will need to consider how any changes we make to our procedures will affect foreign as well as domestic issuers and investors. In this way, we can certainly work to break down all non-essential access barriers to our markets.

At the same time, we must examine and expand the areas in which we can work together with our foreign regulatory counterparts to come to common approaches to address issues of mutual interest. The growth of foreign markets forces us to recognize that the days when we could establish policy without considering the competitive implications of our policies on our markets have long since passed.

Many of our efforts to date in the international realm have involved working with foreign regulators in a systematic and coordinated way to craft comprehensive policies that make sense for us all. Regulators around the globe have worked cooperatively to forge excellent working relationships. These relationships have proven invaluable, but they need to be expanded to cover the entire gamut of securities regulation and capital raising.

Similarly, we are inspired and encouraged by all of the cooperative efforts aimed at crafting high quality international accounting standards. While work remains to be done, we are certainly well on the road toward creating the type of standards in which investors can have confidence. Looking into the future, we also must appreciate that compatible core accounting standards will lose some of their value unless we work together toward consistency among nations in interpretation and application of these standards.

There are, of course, numerous other subjects worthy of future international efforts. Some have suggested the possibility of examining the development of multi-national positions on subjects, such as minority shareholder rights and the use of audit committees. I am confident that many similarly provocative thoughts will percolate out of this conference.

Over the years, our international successes have been achieved in a variety of ways - through unilateral efforts by us or by other regulators, through bi-lateral agreements, such as MOU's, and through multi-lateral projects, such as those sponsored by IOSCO. Each approach has merits and may be successful, depending upon the nature of the issue or goal, and we will continue to use all three approaches in the future. Underlying each approach is, of course, a foundation of long-standing, informal and close working relationships among regulators. It will continue to be the key to our own efforts and to the success of what I hope will be an increasing number of joint projects.

This is the first conference in two decades devoted to a broad examination of fundamental securities regulation issues; it could not be more timely. At the start of my stewardship of the SEC, we recognize the need for a fundamental reexamination of our regulatory framework. And, we would be naïve if we believed that we could conduct this examination in isolation.

All of us must consider changes in our markets in a global context. While we will not, and cannot, always share the same vision on every issue, there is much we can learn from one another, and much that requires us to work together. The cooperative spirit that has served us so well in the past must be our guiding principle as we marshal our collective resources to meet

the challenges that lie ahead. Today, and here and now, we begin that process anew.

Some months after this speech Congress enacted the Sarbanes-Oxley Act of 2002. The Act has significant implications for foreign issuers that are reporting issuers in the US.[48] For example, the Act says that the SEC must require securities exchanges and securities associations to prohibit listing of an issuer that does not comply with requirements relating to audit committees. Audit committees are responsible for hiring and overseeing the auditors. Audit committee members must be independent. The criteria for independence are as follows:

In order to be considered to be independent for purposes of this paragraph, a member of an audit committee of an issuer may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee — (i) accept any consulting, advisory, or other compensatory fee from the issuer; or (ii) be an affiliated person of the issuer or any subsidiary thereof." (§ 301)

In some countries rules corporate law would be inconsistent with this idea of independence. The statute seems particularly intrusive as commonly corporate governance rules are a matter for the state of incorporation rather than for the state in which securities are traded. The SEC's release proposing the audit committee independence rule stated:

a. Foreign Issuers

For many years, U.S. investors increasingly have been seeking opportunities to invest in a wide range of securities, including the securities of foreign issuers, and foreign issuers have been seeking opportunities to raise capital and effect equity-based acquisitions in the U.S. using securities as the "acquisition currency." The Commission has responded to these trends by seeking to facilitate the ability of foreign issuers to access U.S. investors through listings and offerings in the U.S. capital markets. We have long recognized the importance of the globalization of the securities markets both for investors who desire increased diversification and international companies that seek capital in new markets.

Section 10A(m) of the Exchange Act makes no distinction between domestic and foreign issuers. With the growing globalization of the capital markets, the importance of maintaining effective oversight over the financial reporting process is relevant for listed securities of any issuer, regardless of its domicile. Many foreign private issuers already maintain audit committees, and the global trend appears to be toward establishing audit committees. The proposed rule, therefore, would apply to foreign private issuers as well as domestic issuers.

However, we are aware that the proposed requirements may conflict with legal requirements, corporate governance standards and the methods for providing auditor oversight in the home jurisdictions of some foreign issuers. Several foreign issuers and their representatives have expressed concerns about the possible application of Exchange Act Section 10A(m). In our proposal, we attempt to address these concerns in specific areas in which foreign corporate governance arrangements differ significantly from general practices

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[48] And also for auditors. The statute requires foreign auditors of companies which are public companies in the US to be registered with the PCAOB (the new US accounting regulator). *See*, *e.g.*, http://www.pcaobus.org/Rules/Rules_of_the_Board/Section_2.pdf .

among U.S. corporations.

For example, we understand that some countries, such as Germany, require that non-management employees, who would not be viewed as "independent" under the proposed requirements, serve on the supervisory board or audit committee. Having such employees serve on the board or audit committee can provide an independent check on management, which itself is one of the purposes of the independence requirements under the Sarbanes-Oxley Act. Accordingly, we are proposing a limited exemption from the independence requirements to address this concern. We would provide that non-management employees could sit on the audit committee of a foreign private issuer if the employee is elected or named to the board of directors or audit committee of the foreign private issuer pursuant to home country legal or listing requirements.

We also note that certain foreign private issuers have a two-tier board, with one tier designated as the management board and the other tier designated as the supervisory or non-management board. In this circumstance, we believe that the supervisory or non- management board would be the body within the company best equipped to comply with the proposed requirements. We propose to clarify that in the case of foreign private issuers with two-tier boards of directors, the term "board of directors" means the supervisory or non-management board. As such, the supervisory or non-management board could either form a separate audit committee or, if the entire supervisory or non-management board was independent within the provisions and exceptions of the proposed rule, the entire board could be designated as the audit committee.

Controlling shareholders or shareholder groups are more prevalent among foreign issuers than in the United States, and those controlling shareholders have traditionally played a more prominent role in corporate governance. In jurisdictions providing for audit committees, representation of controlling shareholders on these committees is common. We believe that a limited exception from the independence requirements can accommodate this practice without undercutting the fundamental purposes of the proposed rule. In particular, we would propose that one member of the audit committee could be a shareholder, or representative of a shareholder or group, owning more than 50% of the voting securities of a foreign private issuer, if the "no compensation" prong of the independence requirements is satisfied, the member in question has only observer status on, and is not a voting member or the chair of, the audit committee, and the member in question is not an executive officer of the issuer. This limited exception is designed to accommodate foreign practices, would assure independent membership and an independent chair of the audit committee and would still exclude management from the committee.

Similarly, foreign governments may have significant shareholdings in some foreign private issuers or may own special shares that entitle the government to exercise certain rights relating to these issuers. However, due to their shareholdings or other rights, these representatives may not be considered independent under our proposals. To accommodate foreign practices, we believe that foreign governmental representatives should be permitted to sit on audit committees of foreign private issuers. As a result, we propose a limited exception that one member of the audit committee could be a representative of a foreign government or foreign governmental entity, if the "no compensation" prong of the independence requirement is satisfied and the member in question is not an executive officer of the issuer. As with the proposed exemption for controlling shareholder representatives, this limited exception is designed to accommodate foreign practices and still exclude management from the committee.

Finally, while as noted above there is a trend toward having audit committees in foreign jurisdictions, several foreign jurisdictions require or provide for auditor oversight through a board of auditors or similar body, or groups of statutory auditors, that are separate from the

board of directors. We believe that these boards of auditors or statutory auditors are intended to be independent of management, although their members may not in all cases meet all of the independence requirements set forth in Section 10A(m) of the Exchange Act. In addition, while these bodies provide independent oversight of outside auditors, they may not have all of the responsibilities set forth in our proposals.

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. Accordingly, we propose an exemption from certain of the requirements for audit committees for boards of auditors or statutory auditors of foreign private issuers that fulfill the remaining requirements of the rule, if those boards operate under legal or listing provisions that are intended to provide oversight of outside auditors that is independent of management, membership on the board excludes executive officers of the issuer and certain other requirements are met. Specifically, foreign private issuers with boards of auditors or similar bodies or statutory auditors meeting these requirements would be exempt from the requirements regarding the independence of audit committee members and the audit committee's responsibility to oversee the work of the outside auditor. The remaining proposed requirements regarding procedures for handling complaints, access to advisors and funding for advisors would apply to these issuers, with the requirements being applicable to the board of auditors or statutory auditors instead of an audit committee. Also, such board or body would need to be, to the extent permitted by law, responsible for the appointment and retention of any registered public accounting firm engaged by the listed issuer.

A foreign private issuer availing itself of any of these exemptions would be subject to specific disclosure requirements.. In proposing these exemptions, we recognize that some foreign jurisdictions continue to have historical structures that may conflict with maintaining audit committees meeting the requirements of Section 10A(m) of the Exchange Act. We encourage foreign issuers that access the U.S. capital markets to continue to move toward internationally accepted best practices in corporate governance.

As mentioned below, we request comment on whether there are other areas, in either one country or in many countries, in which the rules we are proposing are inconsistent or inappropriate in a significant way with foreign corporate governance arrangements. If there are other areas, do those arrangements adequately address the problems to be addressed under Exchange Act Section 10A(m)? As proposed, there would be no other ability for an SRO to exempt or waive foreign issuers from the proposed requirements. [49]

After receiving more than 185 comments on this proposal, the SEC adopted final rules on audit committee independence in April 2003.[50] The SEC stated in adopting the final rules:

Even before we published the Proposing Release, several foreign issuers and their representatives had expressed concerns about the possible application of Exchange Act Section 10A(m). The Proposing Release prompted many thoughtful comments from dozens of foreign private issuers and their representatives from around the world. These commenters

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[49] http://www.sec.gov/rules/proposed/34-47137.htm

[50] SEC, Standards relating to Listed Company Audit Committees, 68 Fed. Red. 18788 (Apr. 16, 2003) *available at* http://a257.g.akamaitech.net/7/257/2422/14mar20010800/edocket.access.gpo.gov/2003/pdf/03-9157.pdf

expressed overwhelming support for the Commission's approach of providing tailored exemptions and guidance where the requirements of Exchange Act Section 10A(m) could result in a direct conflict with home country requirements. In our final rules, we have attempted to address commenters' concerns regarding the specific areas in which foreign corporate governance arrangements differ significantly from general practices among U.S. corporations...

i. Employee Representation

We understand that some countries, such as Germany, require that non-management employees, who would not be viewed as "independent" under the requirements, serve on the supervisory board or audit committee. Having such employees serve on the board or audit committee can provide an independent check on management, which itself is one of the purposes of the independence requirements under the Sarbanes-Oxley Act. Accordingly, we are adopting as proposed a limited exemption from the independence requirements to address this concern, so long as the employees are not executive officers, as defined by Exchange Act Rule 3b-7.

Commenters expressed support for this exemption. Some commenters, however, recommended extending the exemption to include also non-executive employees that serve on the supervisory board or audit committee as a result of an issuer's governing law or documents or an employee collective bargaining or similar agreement. Under the final rule, non-executive employees can sit on the audit committee of a foreign private issuer if the employee is elected or named to the board of directors or audit committee of the foreign private issuer pursuant to the issuer's governing law or documents, an employee collective bargaining or similar agreement or other home country legal or listing requirements.

ii. Two-Tier Board Systems

Some foreign private issuers have a two-tier board system, with one tier designated as the management board and the other tier designated as the supervisory or non-management board. In this circumstance, we believe that the supervisory or non-management board is the body within the company best equipped to comply with the requirements. Our final rule clarifies that in the case of foreign private issuers with two-tier board systems, the term "board of directors" means the supervisory or non-management board for purposes of Exchange Act Rule 10A-3. As such, the supervisory or non-management board can either form a separate audit committee or, if the entire supervisory or non-management board is independent within the provisions and exceptions of the rule, the entire board can be designated as the audit committee. Commenters supported this clarification.

iii. Controlling Shareholder Representation

Controlling shareholders or shareholder groups are more prevalent among foreign issuers than in the U.S., and those controlling shareholders have traditionally played a more prominent role in corporate governance. In jurisdictions providing for audit committees, representation of controlling shareholders on these committees is common. As proposed, we believe that a limited exception from the independence requirements can accommodate this practice without undercutting the fundamental purposes of the rule. We proposed that one member of the audit committee can be a shareholder, or representative of a shareholder or group, owning more than 50% of the voting securities of a foreign private issuer, if the "no compensation" prong of the independence requirements is satisfied, the member in question has only observer status on, and is not a voting member or the chair of, the audit committee, and the member in question is not an executive officer of the issuer.

Several commenters requested that the exemption be extended. Some believed the 50% ownership threshold was too high, arguing that a shareholder can exercise control through lower levels of ownership or through non-ownership means. Others requested the ability to have more than one representative if there is more than one controlling shareholder. A few

objected to the observer-only status provided by the proposed exemption.
In response to commenters' concerns, we are making minor modifications to the exemption. We are expanding the types of controlling persons covered by the exemption, but we continue to believe that it is appropriate that such representatives have only observer status on, and not be a voting member or chair of, the audit committee. Under the final rule, an audit committee member can be a representative of an affiliate of the foreign private issuer, if the "no compensation" prong of the independence requirements is satisfied, the member in question has only observer status on, and is not a voting member or the chair of, the audit committee, and the member in question is not an executive officer of the issuer. As revised, this limited exception is designed to address foreign practices, assure independent membership and an independent chair of the audit committee and still exclude management from the committee. As the exemption is designed to provide only a limited accommodation for the practices of some foreign private issuers, we are not extending the exemption to domestic issuers, as requested by some commenters.
iv. Foreign Government Representation
Foreign governments may have significant shareholdings in some foreign private issuers or may own special shares that entitle the government to exercise certain rights relating to these issuers. However, due to their shareholdings or other rights, these representatives may not be considered independent under the final rule. To address foreign practices, we believe that foreign governmental representatives should be permitted to sit on audit committees of foreign private issuers. Commenters supported our proposal to exempt one member of the audit committee that is foreign government representative, provided the "no compensation" prong of the independence requirements is met and the member in question is not an executive officer of the issuer. As with the exemption for controlling shareholder representatives, this limited exception is designed to address foreign practices and still exclude management from the committee. However, some believed the exemption should not be limited to just one foreign government representative if the representatives are otherwise independent and are not executive officers of the issuer. Under the final rule, any audit committee member can be a representative of a foreign government or foreign governmental entity, if the "no compensation" prong of the independence requirement is satisfied and the member in question is not an executive officer of the issuer.
We recognize that foreign governments may have varying arrangements relating to their state holdings. Some governments may hold shares directly, some through various branches or agencies, some through an institution organized under public law, and some by other entities. Several commenters believed the legal form of the entity that holds the governmental shareholdings should not be determinative. We agree. The exemption applies regardless of the manner in which the foreign government owns its interest.
v. Listed Issuers that are Foreign Governments
Several commenters also requested a specific exemption for listed issuers that are themselves foreign governments, as these issuers most likely would not be able to comply with the requirements. Accordingly, we are exempting in the final rule listed issuers that are foreign governments, as defined in Exchange Act Rule 3b-4(a).
vi. Boards of Auditors or Similar Bodies
While as noted above there is a continuing trend toward having audit committees in foreign jurisdictions, 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. We believe that these boards of auditors or statutory auditors are intended to be independent of management, although their members may not in all cases meet all of the independence requirements set forth in Section 10A(m) of the Exchange

Act. In addition, while these bodies provide independent oversight of outside auditors, they may not have all of the responsibilities set forth in Rule 10A-3. 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. Accordingly, we proposed an exemption from certain of the requirements for audit committees for boards of auditors or statutory auditors of foreign private issuers that fulfilled the remaining requirements of the rule, if those boards operate under legal or listing provisions intended to provide oversight of outside auditors that is independent of management, membership on the board excludes executive officers of the issuer and certain other requirements were met.

Commenters expressed strong support for the exemption as an appropriate response to address the potential conflicts regarding these alternative structures. However, several suggested refinements to the technical wording in the proposed exemption to ensure that it properly covers the appropriate structures in various jurisdictions. Also, many requested removing the proposed requirement that the issuer must be listed on a market outside the U.S., as the board of auditor requirement often is a home country legal requirement and not a listing requirement. Others believed that the exemption as proposed would not cover the unique situations in some countries where the board of auditors or similar body consists of one or more independent members of the board of directors in addition to one or more non-board members. Without a modification, these commenters believed issuers from such jurisdictions could not satisfy the exemption because of the requirement that the board of auditors must be entirely separate from the board of directors. The overwhelming majority of commenters did not believe a sunset provision for the exemption would be appropriate.

Accordingly, we are making several modifications to the exemption as adopted. Under the final rule, the listing of securities of a foreign private issuer will be exempt from all of the audit committee requirements if the issuer meets the following requirements:

* The foreign private issuer has a board of auditors (or similar body), or has statutory auditors (collectively, a "Board of Auditors"), established and selected pursuant to home country legal or listing provisions expressly requiring or permitting such a board or similar body;
* The Board of Auditors is required 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;
* The Board of Auditors are not elected by management of the issuer and no executive officer of the issuer is a member of the Board of Auditors;
* Home country legal or listing provisions set forth or provide for standards for the independence of the Board of Auditors from the issuer or the management of the issuer;
* The Board of Auditors, in accordance with any applicable home country legal or listing requirements or the issuer's governing documents, is responsible, to the extent permitted by law, for the appointment, retention and oversight of the work of any registered public accounting firm engaged (including, to the extent permitted by law, the resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the issuer; and
* The remaining requirements in the rule, such as the complaint procedures requirement, advisors requirement and funding requirement, apply to the Board of Auditors, to the extent permitted by law.

This revised formulation is designed to address the jurisdictions that provide for boards of auditors or similar structures. In all instances, the requirements described in the revised exemption are to apply consistent with home country requirements. We recognize that while these bodies are designed to provide independent oversight of outside auditors, they may not

meet all of the same requirements or have all of the responsibilities set forth in Exchange Act Rule 10A-3. This approach nonetheless is a preferable method of implementing the protections of the Sarbanes-Oxley Act against the backdrop of this particular category of conflicting home country governance framework.
We have eliminated the requirement that the issuer must also be listed on a market outside the U.S. Also, we are not adopting a sunset date for the exemption. Finally, despite some commenters suggestions, we have not extended the relief to foreign private issuers that have audit committees.
vii. Requests for Other Foreign Exemptions
A foreign private issuer availing itself of the exemptions discussed in this Section will be subject to specific disclosure requirements...Consistent with our proposal, there will be no other ability for an SRO to exempt or waive foreign issuers from the requirements. In adopting these exemptions, we recognize that some foreign jurisdictions continue to have historical structures that may conflict with maintaining audit committees meeting the requirements of Section 10A(m) of the Exchange Act. We encourage foreign issuers that access the U.S. capital markets to continue to move toward internationally accepted best practices in corporate governance. We also understand that corporate governance structures throughout the world will continue to evolve, and that all future conflicts cannot be anticipated at this time. Accordingly, as requested by many commenters, the Commission has the authority to respond to, and will remain sensitive to, the evolving standards of corporate governance throughout the world to address any new conflicts that may arise with foreign corporate governance rules and practices that cannot be anticipated at this time. [51]

This is not the only respect in which the Sarbanes-Oxley Act prejudiced the position of foreign issuers. The Act banned loans to directors of public companies with an exception for loans by US (but not foreign) credit institutions. The SEC extended this exception to loans by foreign credit institutions.[52] But although the SEC has shown some willingness to modify its rules to accommodate the interests of foreign issuers people outside the US continue to think that the US has an excessive tendency to want to apply its rules to securities market activity. Consider the 2003 comments of Frits Bolkestein, (then) the EU's internal market Commissioner:

Congressman Michael Oxley has assured me, and I accept his assurance, that the famous legislation that bears his name, along with that of Senator Sarbanes, was not aimed at hurting European firms. Congress was simply trying to respond to the corporate governance scandals. Yet the inadvertent effect of trying to prevent loopholes has been to penalize firms and auditors from around the globe. Far from being a one-off, this was actually symptomatic of the way in which, in a world with free movement of capital, what we do in one jurisdiction can and will inevitably spill over onto the other. For these reasons, the EU and the USA have much to gain from closer co-operation. While transatlantic relations have been tense of late, in my own field things are actually getting better. This is in no small part due to the 'Financial Markets Regulatory Dialogue' over the past eighteen months between the European Commission and

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[51] *Id*. at 18802-18804 (footnotes omitted).

[52] Foreign Bank Exemption From the Insider Lending Prohibition of Exchange Act Section 13(k) 69 Fed Reg 24016 (Apr. 30, 2004) at http://www.sec.gov/rules/final/34-49616.pdf

US authorities... I understand the fears of exposing institutions to 'unfair competition' and regulatory arbitrage but, frankly, I wonder whether sometimes such fears do little more than justify protectionism. Our experience in the EU is that regulatory diversity can, on the contrary, inject a degree of healthy regulatory competition. This amounts to a significant pooling of regulatory sovereignty and is, therefore, very ambitious. It means a permanent move away from the concept of 'national treatment'–'if you want to play in my market, you play by my rules'.[53]

CREATING A TRANSATLANTIC SECURITIES MARKET?

Formal regulatory co-operation takes place in the context of the Financial Markets Regulatory Dialogue between the US and the EU. It also takes place in the context of bilateral agreements between regulators in different jurisdictions, such as the agreement between the SEC and Japan's Financial Services Agency in January 2006[54] and the MOU between the SEC and the UK's FSA signed in March 2006.[55] Christopher Cox, the Chairman of the SEC, said (about the MOU with the UK's FSA):

This agreement formalizes the already robust collaboration between the SEC and the FSA. Both the SEC and the FSA share a commitment to keeping our markets open, fair, transparent, and sound under constantly changing circumstances. The additional tools for information exchange that we will gain from this arrangement will enhance our mutual ability to oversee the world's largest securities firms and markets. This arrangement also facilitates the SEC's new role as a consolidated supervisor of globally active US investment banks. The information sharing arrangements we are formalizing today will help insure that the SEC's supervision of these firms is as effective as possible.[56]

At the end of 2002 Ben Steil argued for a Transatlantic Securities Market[57] which could be created through mutual recognition of exchange market access so that brokers and institutional investors on each side of the Atlantic could trade in securities on the other side. Steil says that:

A further significant advantage of a mutual recognition regime aimed at exchanges, rather than one aimed merely at making cross-listing cheaper, is that it exempts EU-listed companies from US legislation and regulation intended to apply to US companies, but which catches foreign companies in their net by virtue of their being listed on a US exchange. In particular, the Sarbanes-Oxley Act of 2002 imposed sweeping new corporate governance requirements on all companies listed in the US. Although passed by Congress in direct response to accounting and

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[53] Frits Bolkestein, *Towards a Transatlantic Capital Market*, 6 International Finance 449, 452-3 (2003)

[54] http://www.sec.gov/news/press/2006-14.htm

[55] http://www.fsa.gov.uk/pubs/mou/fsa_sec.pdf

[56] http://www.sec.gov/news/press/2006-36.htm

[57] Ben Steil, Building a Tansatlantic Securities Market, (Dec. 2002) *available at* http://www.cfr.org/content/publications/attachments/steil_isma.pdf .

governance scandals uncovered solely within American companies, the Act applies to all companies listed on US exchanges. These include all 188 EU companies listed on the New York Stock Exchange (NYSE) and 111 listed on Nasdaq.
The Act has not only raised concerns among foreign companies, regulators and governments over the legitimacy of the "extra-territorial" scope of the legislation, but has placed many foreign companies in an untenable position whereby they must violate their home country laws in order to obey US law. German companies listed on the NYSE, for example, cannot comply with the Act's requirements for board and audit committee independence. German companies have separate management boards and supervisory boards. Only the management board has responsibilities comparable to those of a US board of directors, yet it has no outside members. Whereas the supervisory board does have outside members, it is also required to have employee representatives, thus running afoul of the US requirement that the certifying officers report on internal controls to an "independent" body.[58]

Some commentators argue that competition in securities regulation is desirable. For example, Stephen Choi has argued that issuers should be entitled to choose the securities rules that would apply to them.[59] And Paul Mahoney has argued: "that the benefits of regulatory competition would be most effectively achieved by devolving more regulatory authority to the bodies that were the first regulators - the securities exchanges themselves. In particular, exchanges should be the primary writers and enforcers of rules relating to disclosure by listed companies, standards of conduct for member broker-dealers, and market structure."[60]

Can mutual recognition work without harmonisation? Is official (state-centred) harmonization of securities rules a good idea? Should securities rules be developed by private bodies such as Stock Exchanges? Is competition in rule-making a good idea?

Here is an excerpt from a recent speech by Hector Sants, of the UK's FSA. The Speech is addressed to a London Metal Exchange Seminar and is really about commodities markets, but he makes some interesting comments about the relationship between markets and regulation:

Recognised Investment Exchanges in the UK, of which the LME is one, are regulated by us via a principles based regime. This is distinct from the authorised firms' regime under which members firms are regulated. The application and recognition process is more onerous one than firm authorisation. But once recognised exchanges are supervised against the requirement to continue to meet the various recognition criteria. These are pitched at a high level and provide the necessary flexibility for a variety of markets and trading arrangements whilst aiming to provide protection for investors and orderly transparent market conditions in which they can operate. It is not up to the FSA to determine how each exchange meets these requirements.

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[58] Id.

[59] Stephen J. Choi, *Promoting Issuer Choice in Securities Regulation*, 41 VA. J. INT'L L. 815 (2001)

[60] Paul Mahoney, *The Exchange as Regulator*, 83 VA. L REV. 1453, 1455 (1997)

But each exchange must be able to demonstrate that they are able to meet each requirement imposed on them.
In short the regime underpins one of our key beliefs, namely we should facilitate competition through a framework which allows differentiated regulatory platforms.
Thus exchange regulation will focus on the requirements set out in the FSA handbook, with the examples set out on the slide. The monitoring of market activities by exchange staff is of particular importance in exchanges where, such as LME, more than one trading mechanism is available.
It is worth stressing here that the recognised exchange has responsibility for the front line regulation of activity carried out under its rules and through the facilities it provides. Arrangements for market abuse referrals to FSA are in place but the exchange must have its own rules, enforcement and appeals procedures.
FSA will maintain close and continuous regulation of the exchange and its structure, trading activity and monitoring. This involves regular contacts with staff at all levels and is based on a periodic risk assessment, the intention of which is to encourage proportionality and consistency in our regulatory approach...
Our "2010" vision is, we believe, quite simple and quite achievable. It is entirely consistent with the Government's Better Regulation initiative. Realising the vision will, we believe, further enhance the UK's ability to attract and sustain globally competitive financial services business. 2010 is based upon the concept of principles based regulation. It is a more mature, more confident and less mechanistic approach to regulation. Alongside this will come differences in emphasis, and different types of responsibilities for the FSA. We will need to be better able to make the flexible and informed judgments required for principles based regulation. Firms want this flexibility, and we believe they are ready for that kind of relationship with the regulator. Firms need to accept that it requires judgment from them too – judgments that are consistent with the spirit not just the letter of what our rules say. We believe this will achieve better quality regulation and a more appropriate focus on senior management responsibility. Consistency will need to be judged more in terms of outcomes rather than inputs or outputs. It will be inherent in a more principles based system that different firms may adopt different approaches to an issue. But because a common outcome is secured some inconsistency in approach does not ultimately matter.[61]

Consider also ASX's comments to IOSCO on exchange evolution:

Moving regulatory functions from the exchange to the regulator also has the potential to diminish the responsiveness to changing market practices. Given the greater flexibility of exchange rules and the proximity of exchanges to the market, exchanges are often able to amend rules quickly to respond to market evolution, and certainly well in advance of any change to the legislative framework made by the regulator. This responsiveness could be lost if regulatory responsibilities were removed from exchanges.
Efficiency and effectiveness in regulation is the overriding goal and managing conflict of interest is a significant but nonetheless small part of achieving this. The benefits of exchange regulation of trading and listing are considerable and should be carefully weighed against the risks of removing these functions to another regulator before any action is taken.[62]

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[61] http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2006/1009_hs.shtml

[62] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD221.pdf