



## Speech by SEC Chairman: Keynote Address to the 2007 US-EU Corporate Governance Conference

*by*

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Thank you, Prof. Liebman [Lance Liebman, Harvard Law School], for your kind introduction. And if I may, I'd like to return the compliment by commending you for your exceptional work even beyond Europe, in India, Japan, Vietnam, and elsewhere around the globe — all in addition to your leadership as Director of the American Law Institute. Thank you as well to Antonio Borges, for getting us off to a good start, and for your leadership as Chairman of the European Corporate Governance Institute. I especially want to acknowledge Eddy Wymeersch, my regulatory colleague as Chairman of the Committee of European Securities Regulators. I see too that former SEC Commissioner Harvey Goldschmid is with us this morning, and will be a panelist this afternoon, as well as my old congressional colleague, former Sen. Paul Sarbanes. By all of your being here, you have guaranteed that this will truly be a trans-Atlantic summit not only of regulators, but also distinguished academics and business people. To all of you who have made it a point to be here, thank you for your commitment to the broad and enduring partnership between Europe and America that we're focused on strengthening during this Conference.

You have chosen a significant and auspicious date to celebrate trans-Atlantic corporate governance. It was supposedly on this day in the year 1000 that Leif Ericson discovered what many cartographers and historians believe to be the land we now call New England. Our trans-Atlantic partnership has thus prospered over perhaps more than a millennium, and so we have ample tradition to draw upon — and a great deal of experience in contending with the sometimes stormy but more often calm waters that separate us.

The objectives of better integrating our capital markets and promoting prosperity are of course the great underlying aim of this conference. Beyond the unification of Europe and America, our global markets are leading the way to a global cooperation that is just as important to building bridges and understanding, and ultimately to promoting peace and prosperity, as any diplomacy that our foreign ministries and departments of state routinely conduct. And just as with diplomacy and statecraft among nations, the way forward for our capital markets requires not only hope but also patience, thought, and wise choices. As the world's markets continue to grow and integrate, Europeans, Americans, and the entire world stand ready to reap the benefits.

At the same time, as our markets become increasingly interconnected, the regulatory friction from different national regimes becomes more

significant. That friction is often produced by different conceptions and assumptions about corporate governance that are challenging regulators and marketplace actors alike to think about what we can do, individually and together, to help realize the benefits of a global marketplace. It is certainly requiring us at the SEC to think carefully about the consequences of globalization for our fundamental missions of investor protection, capital formation, and the maintenance of orderly markets.

One of Germany's greatest thinkers once said, "I hate all bungling like sin — but most of all bungling in state affairs; that produces nothing but mischief for thousands and millions." There are always serious consequences when government policymakers get it wrong. So while it is true there are remarkable opportunities ahead of us, in embracing those opportunities we've got to keep our principles sharply in focus. I can assure all of you here this morning that the thousands of men and women at the Securities and Exchange Commission are doing just that.

Our deep commitment to investor protection and to an increasingly closer cooperation with our counterpart regulators in Europe is reflected in the several agreements that I have recently signed with CESR and its constituent members. Both Europe and the United States have committed ourselves to a process that will insure far deeper and closer consultation, cooperation, and exchanges of information. We were able to do this because both the SEC and our European counterparts share a commitment to keeping our markets open and fair. We recognize that by sharing information and granting one another access to our own regulatory data, we can all do a better job of supervising global securities firms, regulating public companies, and overseeing what are now truly global markets.

Today, when investors look across the Atlantic, it is possible to see bonds between our markets that are stronger than ever before in history. The combined NYSE and Euronext comprise a transatlantic company that operates six different exchanges catering to many different types of issuers. The International Accounting Standards Board and the U.S. Financial Accounting Standards Board have for years been working on a convergence project to eliminate needless regulatory friction between International Financial Reporting Standards and U.S. Generally Accepted Accounting Principles. And that has made possible the SEC's announcement that we are taking the next steps on our Roadmap to eliminate the reconciliation requirement in the United States, and that we are even considering allowing U.S. issuers to use IFRS.

In the brief moments we have together this morning, I'd like to share with you just a few thoughts on how corporate governance questions factor into this calculus. And as I do so, it is important to make one basic point as a foundation for those topics.

As regulators, we have to be aggressive in our role as market referees and protectors of investors' interests. And at the same time we have to be humble in recognizing that regulation is not the fuel that drives our markets — though it undoubtedly is the oil that greases the gears. Too little regulation, and investors demand a premium for their money to compensate them for the greater risks they face in a lawless market. Too much regulation, and the costs outweigh the benefits — robbing investors of return and making markets less efficient. When that happens, not just investors but consumers and entire national economies pay. So it is always important that regulators strike a balance between under-regulation, which carries with it the risk of fraud, abuse, and a loss of investor confidence, and over-regulation, which saps the economic vitality of otherwise vibrant markets.

What isn't so obvious is that this balance can be achieved in different ways. The differences in national systems of regulation aren't necessarily

reflective of regulatory competition, or worse yet, intentional regulatory arbitrage by governments. Different markets can legitimately have different concerns. And those concerns arise, in many cases, from unique circumstances.

In America, our system of federal regulation has been built upon a foundation of laws and rules established by 50 state governments as well as U.S. territories and their respective courts of law. Fundamental corporate governance policies, such as the duties of care and loyalty that the board of directors owes to the corporation and its shareholders, are established not by federal but by state law. The SEC's rules complement state law, principally by focusing on the requirement of full, fair, and accurate disclosure of material information about public companies to their shareholders. We do not, generally, tell companies what to do. Rather, the SEC is primarily concerned that companies tell investors what they do. That is a different point of departure for the discussion of corporate governance than exists in Europe. The difference does not mean that we cannot align our systems of regulation, but it means that we have to be sensitive to the underlying reasons that we sometimes do things differently.

One of America's early icons was a rough-and-tumble frontier lawyer who was also Tennessee's first Congressman. He once memorably said, "It is a damn poor mind indeed that cannot think of at least two ways to spell the same word." Old Hickory, as he came to be known, was our nation's seventh President. Andy Jackson's folk wisdom is a good reminder to us today as we tackle the question of when it is better to be the same, and when it is better to be different.

The European Union itself is a vivid demonstration of why differences in markets can sometimes justify differences in regulation. In the United Kingdom and the Netherlands, for example, ownership of most public companies is widely diffused. There are few, if any, shareholders that own a controlling block of a public company's shares. In Germany, many public companies have controlling shareholders. Traditionally, those have been large banks. In Italy, the controlling shareholders are often entrepreneurial families. Even in markets that seem similar, we often see differences that profoundly affect how our markets work. For example, like the United States, the United Kingdom has many companies owned by large numbers of shareholders, none of whom owns enough to constitute control. But unlike the United States, the UK market historically has not had a very large retail component. Over the past few decades, the investors that predominate are not retail investors but large financial institutions, all located within a few blocks of each other in the City of London.

There are historical reasons for all of these differences, of course, and regulators need to take them into account. The important point is this: when it comes to securities regulation, differences in market structure will necessarily give rise to different problems, and it is up to the national regulator to diagnose and treat them.

For example, in markets with large blockholders, or markets where retail investment isn't common, regulators will naturally focus first on protecting minority shareholders from possible abuses by controlling shareholders. In other respects, they're more likely to take a "caveat emptor" approach to oversight. On the other hand, in markets with diffuse share ownership and heavy retail participation, regulators tend to focus on areas such as auditing standards and internal controls, to help these shareholders guard their interests against possible managerial abuses.

I'm absolutely certain that we can accommodate these differences as we seek to increase regulatory cooperation around the world. But unless we keep in mind the reasons that legitimate differences can exist — and it's easy for us to forget that, in our increasingly globalized world — then the

job of mutual cooperation will be made needlessly more difficult. Just because capital now flows across borders more easily, and businesses routinely operate on a worldwide basis, doesn't mean that a one-size-fits-all approach to securities regulation is wise. We've got to respect our differences as we build on common ground.

Having said that, recognizing that there are differences doesn't require us to give up on the idea that convergence can be achieved in many important areas, or on the idea that mutual recognition is possible after a significant degree of convergence has been achieved. But it does mean that we regulators have to look closely at our national systems. We have to ask ourselves exactly why we do what we do. And if the answer is because we've always done it that way, that won't be enough.

The point of overarching importance is that as our markets evolve and globalize, we find that we now have more things in common than we used to. The need to get enforcement cooperation from our neighbors when corporate governance problems lead to financial traumas that quickly leap the Atlantic has nearly driven us into one another's arms. We all understand that we can't go it alone, if ever we could before. And as the SEC works with our counterparts overseas, we're increasingly finding that in many areas our regulatory objectives are very much the same.

In fact, we've now reached the point where we can ask: Given that our regulatory objectives are the same, shouldn't our regulations be the same as well? That we can ask the question at all is a testament to just how closely our markets are linked, and a tribute to the efforts that regulators around the world have made in seeking common ground. But let me anticipate the analysis and go straight to the answer to that question:

No. Our regulations shouldn't all be the same.

There is fool's gold here — the notion that a universal, global, single set of regulations would allow businesses, financial firms, and investors to operate in a completely borderless world. However attractive that utopian vision might sound to some, we must never forget that our rapidly globalizing markets present not only splendid new opportunities, but serious new dangers of fraud and unfair dealing.

And here is the risk in meeting the globalization of markets with a plan to merge all the world's securities regulatory regimes into one: Even where our regulatory objectives are the same, regulators are not omniscient. We don't always have the right answers to the problems that lie before us.

Experiments are as valuable to the regulator as they are to the scientist. While it's easy to imagine that conformity with a single standard has many advantages — and indeed, sometimes it does, since in many cases the comparability and simplicity of having just one approach outweighs the benefits that accrue from regulatory experimentation — that is not always the case. As a result, we regulators have to become comfortable diagnosing the differences. In America, that means using the variety that inheres in our federal system as the wind at our backs. We've seen, for example, how majority voting for director elections has advanced under this diversity model. As companies increasingly adopt majority voting standards, and in other cases, shareholders approve shareholder proposals for majority voting, we cannot help but notice that the states in which most U.S. public companies are incorporated make either of these approaches available, just as they permit either majority or plurality voting. Ultimately, shareholders can determine which of these methods they want the corporation to apply.

Both in Europe and America, our systems of regulation should be comfortable with giving investors choices. The idea that informed investors are in the best position to judge for themselves how to allocate their capital

is the bedrock upon which our markets are built. That's why ensuring that both retail and institutional investors are properly informed is so central to the trans-Atlantic regulatory dialogue. Just as disclosure and transparency is a key element of good corporate governance, the cost of obtaining and processing information about the corporation presents a barrier to shareholders that is a systemic problem in corporate governance. The traditional answer to this problem — that the shareholder can rely upon an efficient market to judge the information for him or her — carries with it profoundly unsatisfying implications for the individual investor. That's why at the SEC, we are focusing so much attention on improving the quality of financial reporting through interactive data, which will let ordinary investors obtain information much more quickly, inexpensively, and usefully. Not incidentally, XBRL, the computer language of interactive disclosure, is a truly global phenomenon, deeply rooted in Europe and active in nearly 100 countries around the world.

For the same reason, we are focused on improving the comparability of accounting information in our global capital markets. Protecting the interests of shareholders and other stakeholders in the corporation, and ensuring integrity and ethical behavior by directors and executives, is accomplished time and again by ensuring that all investors have access to clear, factual information. The financial reporting process forms a crucial link in enabling investors to monitor the directors who serve them.

So our task is to promote healthy corporate governance, both here in America and in Europe, as a means of securing the many potential benefits of global markets for investors and issuers alike — while continuing to provide the strong investor protections that our capital markets ultimately depend upon. We've got to be confident in determining that in some cases, convergence and harmonization are the right approach; that in other cases, an intentionally different national approach is best; and sometimes, simply offering investors a choice after full disclosure is the way to go.

Let's consider a concrete example: the move that's afoot throughout Europe and around the world for a truly global set of high quality accounting standards. The vision behind International Financial Reporting Standards is that a single worldwide set of standards will permit investors around the world to benefit from a high level of comparability and a consistently high level of quality in financial reporting. It would eliminate the need for investors and analysts to try to understand financial statements that are prepared using the different accounting standards of many jurisdictions. It would eliminate one of the significant barriers to raising capital outside one's borders. And it would provide a globally enforceable check on corporate governance practices, including executive compensation — where lately the SEC has done so much work.

IFRS promises to integrate our markets. But that promise is jeopardized if IFRS isn't applied faithfully and consistently across jurisdictions. Regulators must beware the impulse to develop nationally-tailored versions of IFRS, and we must cooperate with one another in implementing a set of standards that is faithfully and consistently applied.

Since 2005, the SEC has been following a publicly announced "Roadmap" that charts a path to when issuers would no longer be required to reconcile their IFRS financials statements to U.S. GAAP. We're well down the path charted in the "Roadmap," and we're still very much on track to eliminating the reconciliation requirement by 2009.

The SEC has also been mindful of the other ways in which U.S. laws and regulations intended to deal with corporate governance problems affect foreign issuers in our markets. In particular, we have noted the concerns raised by foreign private issuers about the application of Section 404 of the Sarbanes-Oxley Act. We have repeatedly extended the compliance deadline

for certain foreign private issuers. We've been sensitive to the particular needs of foreign private issuers, and we have worked to minimize the burdens that 404 may impose on them.

I also want to point out that our new deregistration rule took effect this summer, allowing foreign private issuers that have a relatively small U.S. trading volume to withdraw their registration and end their U.S. reporting obligations. In short, foreign private issuers can withdraw rather than comply with 404, if they so desire.

But because the concerns raised by foreign private issuers about Section 404 weren't unique to them, the Commission has formally issued new guidance to assist management in evaluating their internal controls over financial reporting. At the same time, we and the Public Company Accounting Oversight Board completely replaced the existing auditing standard under 404 with a much shorter, risk-based and principles-based approach that will make compliance more rational and efficient, while at the same time better focusing the internal control assessment and auditing effort on what is truly material to the integrity of the financial statements.

The challenges we face are daunting, but I am absolutely certain that by working together, we can build a regulatory framework for corporate governance that supports global markets. After all, working together, our countries have confronted and surmounted challenges far greater than these in the past.

Many of us, as securities regulators, are similarly like-minded and we share common regulatory objectives. Even where our particular tactics differ, we must see ourselves as allies in a united effort to improve our markets together, for the benefit of our investors. We all share a conviction that protecting the property rights of investors is one of society's most effective means of advancing prosperity, and that directors and managers who uphold their traditional duty to operate their businesses in the best interests of shareholders contribute to the economic security of every nation.

Here, and wherever the world's securities regulators share the same objectives, we should relentlessly seek to make common ground. Where possible, we should work closely together to eliminate unnecessary and redundant regulations, to recognize how different regulatory approaches may achieve our shared objectives, and to learn from each other about what works and what doesn't.

And we should learn together to trust the choices investors make as we help ensure that those choices are fully informed.

I know everyone in this room is committed to these objectives. Thank you for inviting me to participate in this important discussion, and for permitting the SEC to host it. Most of all, thank you for what each of you does every day to bring our nations and our world closer together.

*<http://www.sec.gov/news/speech/2007/spch100907cc.htm>*