U.S. Securities and Exchange Commission

Speech by SEC Commissioner : Remarks at Finance Dublin

by

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Thank you for that kind introduction. Céad mile Fáilte! I used that classic greeting when I gave a speech here in Dublin last September, and I have been looking forward to using it again today so that I can take advantage of any chance to practice my very limited Gaelic!

It is a distinct pleasure to be back in Dublin. During my last visit to Dublin, I noted that I was probably the first SEC Commissioner to give an official speech in Ireland, but given your vibrant economy and importance in the U. S. and global markets, I doubted that I would be the last. Well, here I am again - talk about a self-fulfilling prophecy! Before I go on any further, I should say that the views I express here are my own and do not necessarily reflect those of the Securities and Exchange Commission or my fellow Commissioners.

It is an honor and a pleasure for me to be invited to come back to Ireland in these very auspicious surroundings of Dublin Castle. I am particularly honored to be sharing the podium today with Commissioner Charlie McCreevy. As the E.U. Commissioner of Internal Markets and Services, Charlie has been a stalwart in the effort to approach financial services regulation in a rational and pragmatic manner. I truly admire what he has accomplished, and I hope that the E.U. as it passes its milestone of 50 years of peace and progress will maintain the course that Charlie has set far into the future.

From my perspective, Finance Dublin could not have picked a more interesting time to host this event. On both sides of the Atlantic, regulators are actively engaged not only in a process of regulatory introspection, but also "extrospection," if I may use that term. By that I mean that the U.S. and the E.U. are recognizing that because of the increasingly interconnected global financial services sector, we cannot act singularly and without a

thought as to what other countries are doing. You may call this cooperation, competition, mutual respect, or whatever. Certainly there are elements of all four. The result is that the actions that one government takes cannot be viewed in isolation. We need each other's cooperation and assistance to fight fraud, manage risk, and maintain low costs and efficiency for the ultimate benefit of investors, workers, and taxpayers.

Here in Europe, you are laying the groundwork for a financial services regulatory system that will influence national regulatory policy far into the future. In the U.S., we are being called upon to engage in a holistic review of our regulatory framework, with an emphasis on particularly problematic aspects of our laws and regulations. All the while, there is a louder-than-ever clamor for increased transatlantic cooperation on regulatory issues, as highlighted by German Chancellor Angela Merkel's initiative for a transatlantic economic partnership. Having spent many years living and working in Europe earlier in my career, I have been particularly interested in transatlantic regulatory issues since I arrived at the Commission almost five years ago. So, I look forward to our engaging the efforts to increase the level of cooperation between transatlantic regulators, including our ongoing interaction with Commissioner McCreevy's efforts to move to convergence and increased cooperation in financial services regulation.

Two weeks ago, I had the pleasure of meeting in Washington with Brian Patterson, Patrick Neary, and others from the Irish Financial Regulator (IFR). We had a very informative discussion about regulatory concerns affecting both the IFR and the SEC. Their mandate is to create a rational, predictable regulatory environment for financial services in Ireland. That they are up to the task is evidenced by the great progress that they have already made in their endeavor to build the IFR. I am looking forward to working with them and the IFR. Because of Ireland's growing importance in the global financial services market, it is critical that Ireland be a part of the global dialogue.

The Irish government, as well as the European Commission, have had the enviable opportunity to organize their respective regulatory structures from first principles. Indeed, a white paper issued by the Irish government in 2004 entitled "Regulating Better," set forth six basic, but critically important principles of better regulation: necessity, effectiveness, proportionality, transparency, accountability, and consistency. Underlying the articulation of these principles was an understanding that a nation's regulatory framework has a very fundamental impact on its competitiveness. The following passage is indicative of the white paper's approach:

Direct intervention by Government always requires careful consideration. The State should avoid the "regulatory impulse" whereby it adopts programmed, default responses to situations that arise, to the exclusion of other possible solutions.

Not surprisingly, the Irish approach is paying dividends through tremendous growth. Clearly you have created an attractive place for financial services firms to do business, and I suspect that is in no small part related to IFR's

vision of operating "in a cost effective and responsive regulatory system that facilitates innovation, competitiveness and growth both in Ireland and internationally."

Likewise, at the E.U. level, Commissioner McCreevy promotes a flexible and transparent regulatory system that should benefit all member countries. I applaud the steps that the E.U. has taken under his leadership towards creating a vibrant internal market in financial services, especially the regulatory impact and ex-post analysis requirements that are built into the rulemaking processes. Critical to this process is your recognition that "open, deep financial markets are a key to competitiveness and growth."[1]

As compared to these efforts to create new structures, the SEC is the old man of the financial services regulatory scene. Next year will mark the 75th anniversary of Congress's first vesting of the authority under the securities laws in a predecessor agency to the SEC. The SEC was officially set up as a separate agency a year later. Because of this seven-decade legacy, sometimes it may seem that the SEC approaches regulatory changes like an old man weakened by the progression of years - our arms are heavy with the weight of regulatory precedent and our wrinkles have formed through the repeated motion of applying policy traditions according to precedent, regardless of how the world and the marketplace have evolved. I am happy that is changing.

In recent months, the SEC has been called upon by no less than three distinguished policy groups to reconsider the ways in which we fulfill our statutory mandates of investor protection and the promotion of efficiency, competition, and capital formation. Each of these groups was established to analyze and issue reports on the reasons why the U.S. capital markets have become less competitive. A constant theme is that excessive, overlapping, and unnecessary regulation in the U.S. is a major reason for our loss of market share in the global capital markets.

Earlier this month, the Commission on the Regulation of U.S. Capital Markets in the 21st Century, a group organized by the U.S. Chamber of Commerce, issued its report with recommendations, including a substantial number of recommendations dealing with the policy and internal processes at the SEC. In January, Senator Charles Schumer and New York City Mayor Michael Bloomberg issued a report prepared by McKinsey Consulting on the state of the financial services industry in New York and the U.S. as a whole. The report made a number of recommendations related to the SEC. Last November, the Committee on Capital Markets Regulation, which is chaired by Glenn Hubbard and John Thornton and directed by Hal Scott, issued an interim report that similarly recommended specific reforms to be implemented by the SEC. As if this chorus of discontent was not enough, many of the SEC-related concerns found in the three reports were echoed - and even amplified - in a recent summit meeting of business and governmental leaders sponsored by U.S. Treasury Secretary Hank Paulson.

Although the perspectives and findings of each group were unique, there is a

common thread of very important SEC-related issues among them. Among other things, each report recommended: (1) quick and substantial changes to the rules and guidance implementing section 404 of the Sarbanes-Oxley Act, (2) streamlined and coordinated regulatory processes that require meaningful cost benefit analyses, and (3) involvement jointly by the President's Working Group (which is made up of the Secretary of the Treasury and the chairmen of the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission, and the Commodity Futures Trading Commission) to provide transparency and predictability in the enforcement process.

We at the SEC cannot and should not ignore these findings and recommendations. We must clear the cobwebs and incorporate how the world has changed through technology and innovation when we consider whether to shed some of our weighty regulatory precedent. We need to ask ourselves a question that Secretary Paulson has recently posed: "Have we struck the right balance between investor protection and market competitiveness - a balance that assures investors the system is sound and trustworthy, and also gives companies the flexibility to compete, innovate, and respond to changes in the global economy?"[2] The reports can help us answer this question.

I believe that the Commission is duty-bound to analyze, understand, and - if warranted - respond to each recommendation that pertains to us. Unfortunately, a coalition of contrarians - we can call it the "What-me-worry?" Crowd - has recently begun a campaign to mute the calls for action in the three reports. As I understand it, they contend that the U.S. capital markets are perfectly fine and that there is little haste needed to examine the calibration of our regulations and how we implement them.

To support this position, they have been citing, among other things, a three-page research report that purportedly contradicts the findings of the three policy groups. The report states that "foreign IPO issuers continue to flock to US-based exchanges." [3] Strangely, that statement is inconsistent with the study's own statistics, which show the high-water mark was in the late 1990s. Moreover, this study is merely a tabulation of the number, size, and proportion of foreign IPOs in the US market during the past 20 years, apparently without adjustment for inflation. A fundamental flaw in this simplistic view is that it looks at the US market in isolation, something that the three policy groups have stressed that we no longer have the luxury to do. As Commissioner McCreevy himself recently pointed out in an excellent opinion piece in the Wall Street Journal, the US share of global IPOs has fallen from 57% in 2001 to 16% in 2006, while Europe's has increased from 33% to 63% during the same years.

I am happy to have useful statistics for the debate, rather than empty rhetoric. I certainly am also happy that this debate takes place in times of great market conditions - the Dow near its all-time high, strong macro-economic fundamentals, and healthy investor interest. We must remember that listing in the US markets offers foreign firms many benefits including

deep liquidity, visibility to US investors, transparency, and corporate finance and business strategy opportunities. But, at the same time, other markets have grown and liberalized during the past couple of decades, narrowing the advantages of our markets. This is ultimately for the good of all. In the end, companies are rational - they expect benefits to exceed costs. If that is not the case, they will go elsewhere or raise capital in the deep and flexible US private markets. Our job as regulators is to examine the costs that we impose on market participants through our regulations to make sure that those costs do not exceed the benefits.

Among the recommendations included in both the Chamber Report and the Schumer/Bloomberg Report were recommendations related to International Financial Reporting Standards (IFRS). The reports urged the SEC towards speedy elimination of our reconciliation requirement. This would be a welcome development for many in this room who are suffering under the burden of the reconciliation requirement. It would also be a welcome development for U.S. investors since removing the reconciliation requirement will also mean one less barrier for foreign private issuers thinking about raising capital in the U.S.

So how far along the road to reconciliation are we now? I believe that we are well on our way to eliminating the reconciliation requirement.[4] Thanks to Commissioner McCreevy's leadership, the European Commission bolstered the move towards equivalence by extending an exemption to make reconciliation of U.S. GAAP to IFRS unnecessary. Just imagine how counter-productive it would be to our mutual recognition efforts if the E.U. would impose a new reconciliation requirement, essentially saying that the two are not equivalent! Think how difficult it would be for us to then disagree with our friends and determine the opposite - that they are in fact equivalent.

Meanwhile, the SEC has been gaining its first insights into just how IFRS is working in practice. Last summer, our staff began reviewing the filings that we received from foreign private issuers that adopted IFRS in 2005. Our staff is working with the Committee of European Securities Regulators pursuant to a joint work plan that the chairmen of CESR and the SEC announced last summer.[5]

The objective of the SEC staff's reviews is to see how closely IFRS filers in fact are adhering to IFRS standards. The purpose is not to attempt to dictate how IFRS ought to be applied. The purpose is also not to turn IFRS from principles-based accounting standards into rule-based standards. Rather our staff is looking at whether IFRS filings are complete and adhere to IFRS standards. I suspect that many of the problems that we have seen in these areas are a natural by-product of the first year of IFRS implementation and will disappear as companies and their auditors become more accustomed to IFRS.

The SEC staff is also looking at whether IFRS filers are using a single set of standards. Filings made in accordance with home country versions of IFRS could jeopardize our goal of quickly ending the reconciliation requirement,

since we could find ourselves back in a world of multifarious GAAPs, each with its own idiosyncrasies. National regulators, for their part, need to resist the natural impulse to develop nationally-tailored versions of IFRS and need to cooperate with one another in implementing IFRS. Now is the time during which the groundwork must be laid to ensure high-quality standards and consistent application of IFRS across all of the nations in which it is used. As Commissioner McCreevy explained back in 2005, the transition to IFRS and efforts to secure its consistent implementation hurt now, but the efforts "will work, and ... the pain is well worth the gain."[6]

We must remember that an important measure of success of all of these efforts is whether they deliver to users of financial statements a clear and accurate picture upon which sound investment decisions can be based. When we recognize IFRS as an acceptable set of standards for foreign companies to use in their US filings, why should it not be equally acceptable for US companies to use as well? If nothing else, this could add some long-absent accountability for the standard setters themselves.

Investors' ability to rely on financial statements turns not only on the quality of the accounting standards pursuant to which they are prepared, but also on the quality of the audit of those financial statements. The Schumer/Bloomberg and Chamber of Commerce reports called for convergence of auditing standards along with their calls for convergence of accounting standards. In some respects, auditing standards are more important than accounting standards from the investors' perspective. This is a goal that is part of the mission of the Public Company Accounting Oversight Board (PCAOB) in the United States. In line with the SEC's oversight role, we must ensure that the PCAOB is working to meet that goal. It is helpful to have input from others, as well. I note that Commissioner McCreevy has initiated discussions with the PCAOB that are aimed at achieving mutual reliance in auditor oversight.[7] This should also ease concerns about the potential extraterritoriality of the PCAOB's inspection program.

Now that I have mentioned the PCAOB, I am compelled to discuss briefly the Sarbanes-Oxley Act, and its world-famous Section 404.[8] Section 404 requires management to complete an annual internal control assessment and requires the company's outside auditor to attest to, and report on, management's assessment. It has been extremely burdensome to implement. The implementation difficulties surprised a lot of people. The Senate committee report on Sarbanes-Oxley observed that high quality audits already "incorporate extensive internal control testing" and that the committee did not expect the internal control provision to be the basis for any increased fees or charges by outside auditors.[9] Similarly, the SEC estimated that implementation of Section 404 would cost an average of $91,000 per company, for a total of one and a quarter billion dollars.[10] Estimates have put actual average costs at more than 20 times that amount.

To function as intended, the internal controls mandate would have had to have been implemented through principles-based regulations. The SEC's rule was intended to be principles-based. The same cannot be said for PCAOB's

Audit Standard No. 2 (AS 2)[11]. The standard has made it difficult for auditors to employ professional judgment in assessing internal controls and encouraged them instead to use a time-intensive, materiality-insensitive, bottom-up approach.

Troubled by the implementation problems, the SEC and the PCAOB set out to craft a new approach that recognizes the tremendous importance of internal controls, but also appreciates the need for balance. In a world of limited resources, the more that companies spend on things like internal controls assessments, the less they can invest in developing and marketing products, hiring and retaining talent, and embracing new technologies.

In December 2006, the SEC proposed additional guidance for management's assessment of internal control.[12] We have sought to provide management with guidance of their own so that their assessments are not driven by the auditors, who have been operating under the PCAOB's much more prescriptive standard. To complement these changes, the PCAOB has proposed a new auditing standard to *replace* AS2.[13] The proposed standard affords auditors greater room for judgment and employs a risk-based framework to direct their efforts.

Both the SEC and the PCAOB have received numerous comment letters in response to our proposals. I am encouraged by the commentary that we have received. -not only by the positive comments, but by the comments that provide insight as to how we can further improve the SEC's management guidance and the PCAOB's audit standard. The PCAOB and we are working to align the new audit standard with our management guidance. Additional changes that commenters have called for include the elimination of the many "shoulds" and "musts" that are prescriptive vestiges of AS2, the elimination of the unnecessary focus on significant deficiencies, a more workable approach to scalability, refinements to the definition of "material weakness," and further facilitation of auditors' reliance on the work of others. As many commenters have pointed out, implementation will be the true determinant of success. Management, auditors, and the PCAOB's inspection staff all need to come to terms with the fact that the Section 404 landscape is changing in a manner that demands a new approach in carrying out their respective roles under Section 404.

We recognize that time is of the essence, and our staffs are working hard to determine what changes need to be made in response to the comments. As we work on developing the new approach, the SEC has given smaller companies and foreign issuers additional time before they have to comply with the Section 404 requirements. If we are unable to make the necessary changes quickly, we may find that further extensions are necessary.

We have an incentive to act quickly. Just last week, we adopted long-awaited changes to the escape route by which foreign private issuers can exit the U.S. capital markets. In a unanimous vote, the Commission approved final rules that should greatly ease the burden for U.S.-registered foreign issuers looking to exit the U.S. markets.

Under the SEC's former rules, a non-U.S. issuer could only terminate its U.S. registration if fewer than 300 record holders of the issuer's equity securities were U.S. residents.[14] Foreign issuers found it difficult to meet this standard even if there was relatively little investor interest in the United States. Thus, there was a widespread perception that a decision to list in the U. S. could never be reversed - the aptly named "roach motel." This perception, in turn, serves as a disincentive to list securities in the U.S. in the first place.

In late 2005, we published for comment a proposed rule that would have expanded the criteria for a non-U.S. issuer's termination of its reporting requirements beyond the 300-holder test.[15] As originally proposed, one of the key tests would have examined the percentage of U.S. ownership of the foreign issuer's worldwide public float.

We received many comment letters in response to that proposal.[16] Because I did not believe that our original proposal addressed the situation as well as it should, I was sympathetic to many of the comments raised. So I was very pleased that, in December 2006, we voted to issue a revised deregistration proposal.[17] The December proposal allowed a non-U.S. issuer to de-register its equity securities if its U.S. trading activity was less than 5% of the issuer's "primary market" trading activity. The revised proposal was much more philosophically sound than 2005 proposal. In my mind, the proper approach should allow issuers to de-register unless their shareholder base includes a large number of U.S. residents who bought the securities in the U. S. and who therefore have a reasonable expectation of being able to trade in the U.S. markets. U.S. residents who execute their trades abroad should not have the expectation that U.S. securities laws will apply to those overseas transactions.

The final rules approved last week are substantially similar to those proposed in December. The main difference is the change from a "primary market" trading volume denominator to a "worldwide" measure. I believe it was appropriate to focus on worldwide trading volume, and I hope the final rules will be flexible enough to remain viable even as the world's market structures change. I suspect a good test will be the post- MiFID European markets.

The revised approach is consistent with the "territorial approach" to international securities regulation that the Commission has embraced for twenty years. I believe that the territorial approach should continue to be the Commission's guiding principle as we deal with what appears to be an unprecedented series of major international developments in the markets.

The Commission is poised to explore other initiatives that will test the bounds of the "territorial approach." In a recent article, a member of the SEC's staff proposed a dramatic system of mutual recognition for non-U.S. broker-dealers and securities exchanges. I was pleased to see that this proposal triggered a debate on the propriety of the SEC's current rules for non-U.S brokerage and trading activities. Indeed, I have long called for the

Commission to revisit the rules governing the U.S. activities of non-U.S. firms. That said, the proposal faces a stiff challenge in meshing with our investor-protection mandate as well as our duty to promote competitiveness in the US marketplace. Boiler rooms in Berlin or Bucharest or a pump-and-dump scheme run out of Parma or the Dordogne with direct access to US retail investors are a concern. Increased international cooperation is absolutely necessary to combat fraud. We all are short of resources, so we must work together, as we are currently doing. I am confident that the Commission will act to reduce the barriers to entry that unduly restrict foreign firms and exchanges, and unnecessarily restrict the investment choices of U.S. investors. To that end, I was encouraged to see recent comments by our new director of the Division of Market Regulation, Erik Sirri, on this topic.

I welcome your continued involvement in our issues, including your questions and comments. I would be happy to address your comments and questions.

Endnotes

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[1]E.U., *Single Market in Financial Services Progress Report 2006*, at 3 (Feb 2, 2007).

[2]Opening Remarks by Treasury Secretary Henry M. Paulson, Jr. at Treasury's Capital Markets Competitiveness Conference (Mar. 13, 2007) (available at: http://www.treas.gov/press/releases/hp306.htm).

[3]Lab Thomson, *Making It in the USA: Foreign IPO Issuers Continue to Flock to US-Based Exchanges* (Jan. 30, 2007).

[4]Accounting Standards: SEC Chairman Cox and EU Commissioner McCreevy Affirm Commitment to Elimination of the Need for Reconciliation Requirements, SEC Press Release No. 2006-17 (Feb. 8, 2006) (available at: http://www.sec.gov/news/press/2006-17.htm).

[5]SEC and CESR Launch Work Plan Focused on Financial Reporting, SEC Press Release No. 2006-130 (Aug. 2, 2006) (available at: http://www.sec.gov/news/press/2006/2006-130.htm)

[6]Remarks of Commissioner Charlie McCreevy, IFRS - No Pain, No Gain? (Oct. 18, 2005) (available at: http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/05/621 &format=HTML&aged=0&language=EN&guiLanguage=en).

[7]European Union News Release, EU Commissioner McCreevy Meets with PCAOB Chairman Mark Olson On EU-US Cooperation on Audit Regulation (Mar. 6, 2006) (available at: http://www.eurunion.org/News/press/2007/2007022.htm).

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

[9]S. Rep. No. 107-205, Public Company Accounting Reform and Investor Protection Act of 2002 (Jul. 3, 2002), at 31.

[10]Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, SEC Release No. 33-8238 (Jun. 5, 2003) (see Section V(B)).

[11]*See* Notice of Filing of Proposed Rule on Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements, SEC Release No. 34-49544 (Apr. 8, 2004).

[12]Management's Report on Internal Control over Financial Reporting, SEC Release No. 33-8762 (Dec. 20, 2006).

[13]*See* Proposed Auditing Standard - An Audit of Internal Control over Financial Reporting that is Integrated with an Audit of Financial Statements, PCAOB Release No. 2006-007 (Dec. 19, 2006)(available at http://www.pcaobus.org/Rules/Docket_021/2006-12-19_Release_No._2006-007.pdf).

[14]*See* 17 C.F.R. 240.12g-4.

[15]Termination of a Foreign Private Issuer's Registration of a Class of Securities Under Section 12(g) and Duty to File Reports Under Section 15(d) of the Securities Exchange Act of 1934, SEC Release No. 34-53020 (Dec. 23, 2005).

[16]Public comment letters are available on the internet at http://www.sec.gov/rules/proposed/s71205.shtml.

[17]Termination of a Foreign Private Issuer's Registration of a Class of Securities Under Section 12(G) and Duty to File Reports Under Section 13(A) or 15(D) of the Securities Exchange Act of 1934, SEC Release No. 34-55005 (Dec. 22, 2006).

http://www.sec.gov/news/speech/2007/spch032607psa.htm

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