



U.S. Securities and Exchange Commission

Speech by SEC Chairman: Address to the Security Traders Association 11th Annual Washington Conference

by

Chairman Christopher Cox

U.S. Securities and Exchange Commission

Washington, D.C.
May 9, 2007

Thank you, John [Giese, President of STA] for your kind introduction, and Lisa [Utasi, Chair of STA], for putting together this outstanding conference here in Washington. I know that Erik Sirri, our Director of Market Regulation, joined in your program yesterday, and that several of my colleagues from the Congress have been part of the program as well. And I understand that for your appetizer last night you were fed that unique confectioner's special — Matalin topped with Carville. Now, there's a uniquely Washingtonian combination! [Laughter]

As usual, the STA has shown an impeccable sense of timing when it comes to the season and the location for scheduling these conferences. As you know, you've picked — in meteorological terms — the very best days of the year in the nation's capital. Most of you seem very well versed in the ways of Washington, but in case there are any newcomers in the group, I want to make sure you understand that it's not usually so perfectly pleasant for the lawmakers and regulators and lobbyists who work in D.C. year-round.

I mention the lobbyists, because the word "lobbyist" was coined in this very hotel, where as perhaps you know, the special interests used to hold forth notoriously, in the lobby, during the 19th century. Today, one can only hope that the lobbyists are busy lobbying against global warming — because come summertime, when nature's own oppressive heat is bad enough, the man-made contribution of hot air in this city is more egregious than perhaps anywhere else on earth. Here in Washington, they've perfected the science of man-made global warming. [Laughter]

But today, on this springtime afternoon, it is lovely. And in these beautiful surroundings, we can all understand why so many ambitious people want to come to Washington. It brings to mind Ambrose Bierce's amusing definition

of a Washingtonian: "A Potomac tribesman who exchanged the privilege of governing himself for the advantage of good government." [Laughter]

We've all known a few Potomac tribesmen who've taken advantage. And as for relinquishing the governing of oneself, I hope none of you has given up on the responsibility of governing yourself, just because you are out of town at an STA conference. So far, so good, anyway. At least, I haven't read anything scandalous in the newspapers. [Laughter]

The truth is, the SEC, and our markets, know that traders take self governance seriously, both individually and as an industry. That's why we so very much appreciate the founding motto of the STA, "Dictum Meum Pactum"—"My word is my bond."

It is a remarkable fact of life that, even as our markets continue to expand and integrate across a planetary population of six billion, the same bedrock of trust and confidence that made markets tick in face-to-face trading in the 19th century undergirds the integrity of our highly sophisticated global markets today. It's a lesson worth keeping in mind.

With the acceleration of world trade in securities, the way forward for our capital markets requires a good deal of respect for the investor confidence that's been carefully nurtured over so many years. The changes in our markets we're making today require serious thought, and wise choices.

The upside of getting it right, of course, is enormous. As the world's markets continue to grow and integrate, the entire world stands ready to reap the benefits. Constructing the global markets of the future is an undertaking as ambitious as it is important to the entire world. Even today, our global markets are leading the way to an international cooperation that's building bridges and establishing new bonds of trust that are essential to peace and prosperity.

But there is much more to be done, and the work isn't easy. As our markets become increasingly interconnected, the regulatory friction from different national regimes becomes more significant. And that's challenging regulators to think about what we can do individually and together to help realize the benefits of a global marketplace. At the same time, we have 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, he said, "produces nothing but mischief for thousands and millions." There are always serious consequences when government policymakers get it wrong. So while it's true that 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 afternoon that the thousands of men and women at the SEC are doing just that.

Our deep commitment to investor protection in an era of global markets requires an increasingly close cooperation with our counterpart regulators. The great strides we are making in this area are reflected in the documents I recently signed with the BaFin in Germany, the Financial Services Agency and the Financial Reporting Council in the United Kingdom, and the EU's Commission of European Securities Regulators in Brussels. 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 about regulated entities and financial groups that operate in both countries.

We've also outlined a framework for cooperation in the oversight of markets that operate in multiple countries. We were able to do this because both the European Union and the United States 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 both do a better job of supervising global securities firms and overseeing what are now truly global markets. That same commitment to cooperation and integrity is driving our collaborations with regulators in Asia, Africa, and in our own hemisphere.

Today, when investors look around the world, it's 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 recent announcement that we're taking the next steps on our Roadmap to eliminate the reconciliation requirement in the United States.

In the brief moments we have together this afternoon, I'd like to share with you just a few thoughts on that issue, as well as the related question of mutual recognition of different securities regulatory regimes. And as I do that, it's important first 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 — but it is the oil that greases the wheels. 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 even intentional regulatory arbitrage by governments. Different markets can legitimately have different concerns. And those concerns arise, in many cases, from unique circumstances.

One of America's early icons was a rough-and-tumble frontier lawyer who was also Tennessee's first Congressman. He once memorably said that "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 seventh President. And Andy Jackson's folk wisdom is a good reminder to us today as we tackle the question of when it's better to be the same, and when it's 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 — and few, if any, shareholders own a controlling block in a public company. In Germany and Italy, on the other hand, many public companies have controlling shareholders.

Even in markets that seem similar, we often see differences that profoundly affect how our markets work. For example, both the U.S. and the UK have many companies owned by large numbers of shareholders, none of whom owns enough to control the companies. But the U.S. market historically has had a very large retail component, while in the UK over the past few decades, the shareholders who predominate aren't retail investors, but large financial institutions — almost all located within a few blocks of each other in the City of London.

There are historical reasons for all of these differences. The point that regulators should bear in mind, however, is this: differences in market structure will necessarily give rise to different problems that a regulator must diagnose and treat. For example, in markets with large blockholders, or markets where retail investment isn't common, regulators naturally focus first on protecting minority shareholders from possible abuses by controlling shareholders. And 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 retail 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 — the job of mutual cooperation will be made needlessly more difficult. 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 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.

Any regulator that engages in a serious and critical self examination will undoubtedly conclude that some of its regulations that differ from those in other countries are necessary because they're tailored to the markets in that particular jurisdiction, and they address very real problems. And that same regulator would also likely find that some of its regulations are the result of legislative mandates that simply can't be changed by the regulator. But it might also discover that some of its regulations are simply redundant, or are merely the remnants of problems that have long since been resolved. When that's the case, it behooves us all to eliminate the redundant rules and the legacies that have ceased to serve their original purposes.

And when the regulator finds that its rules are different from other jurisdictions, but that the way others have chosen to solve the same problem is different in form rather than substance, then conforming the rule to what counterpart regulators are doing will achieve all of the benefits of the current regulation, while reducing costs for the benefit of investors and businesses alike.

As our markets evolve and globalize, we find that we now have more things in common than we used to. The need to get help from our neighbors when we deal with cross-border fraud in the Internet age 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's fools' 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 should never forget that our rapidly globalizing markets present not only splendid new opportunities, but serious new dangers of fraud and unfair dealing. And here's the risk in addressing 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.

It's easy to imagine that conformity with a single standard has many advantages — and sometimes it does. In many cases the comparability and simplicity of having just one approach may well outweigh the benefits that accrue from regulatory experimentation. But that's not always the case, and we regulators should become comfortable diagnosing the differences.

We should also 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 America's securities laws are built. That's why ensuring that both retail and institutional investors are properly informed is so central to the SEC's investor protection mission.

So our task is to secure 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; 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 in Europe, Asia, 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 would permit investors anywhere on earth 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 different accounting standards from many jurisdictions, and it would eliminate one of the significant barriers to raising capital outside one's borders. IFRS promises to integrate our markets, but that promise is jeopardized unless IFRS is applied faithfully and consistently across all jurisdictions. Regulators have to beware of the impulse to develop nationally-tailored versions of IFRS, and we've got to cooperate with one another in implementing a set of standards that is faithfully and consistently applied.

In early 2005, the SEC staff published a "Roadmap" that I formally endorsed as Chairman in February 2006, aimed at eliminating the requirement that foreign private issuers reconcile their IFRS financial statements to U.S. GAAP. We have traveled far along that road. The SEC has already been gaining insights into how IFRS works in practice by reviewing the filings we received from those foreign private issuers that adopted IFRS in 2005. Meanwhile, our staff is cooperating with the Committee of European Securities Regulators under a joint work plan that we announced just last summer. We also recently hosted an SEC Roundtable on these topics, and the feedback was extremely positive. 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, if not earlier.

The SEC has also been mindful of the other ways in which U.S. laws and regulations affect the interface between U.S. and global 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've twice extended the compliance deadline for certain foreign private issuers. We've been sensitive to the particular needs of foreign private issuers, and we've worked to minimize the burdens that 404 may impose on them. I also want to point out that the new deregistration rule takes effect early 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. That means foreign private issuers can withdraw from our markets rather than comply with 404, if they so desire. But we don't think that many will, because the concerns raised by foreign private issuers about 404 weren't unique to them—and so the Commission has formally proposed new guidance for implementation of 404 that should rationalize this process for domestic and foreign issuers alike.

Very soon, the SEC will issue new guidance in final form to assist management in evaluating their internal controls over financial reporting, and the PCAOB is on the threshold of repealing the existing auditing standard under 404 in its entirety, and replacing it with a new principles-based standard that is risk-based, top-down, reliant on the work of others where appropriate, scalable for companies of all sizes, and focused not on a check-the-box exercise, but rather on what is truly material to the financial statements. The SEC will vote on our new management guidance in exactly two weeks, and the PCAOB will vote on their new auditing standard the following day. The result of these important changes, I am absolutely certain, will be to vastly reduce the unnecessary compliance burden associated with 404, while significantly improving the focus on what matters most to investor protection. Our markets, our companies, and our nation's investors will be much the better for it.

Of course, our work on improving and more closely integrating our regulatory structures isn't limited to accounting standards or Sarbanes-Oxley. Lately, we've even begun to talk about the possibility of a world in which non-U.S. broker-dealers and exchanges could apply for exemptions from SEC registration. The creation of NYSE Euronext, the recent agreement by Eurex to acquire the ISE, the 25% stake that Nasdaq has acquired in the LSE, and the many new alliances that are being struck by exchanges around the world have all highlighted the fact that in this new era of global markets, exchanges could very well find themselves subject to a number of different systems of securities regulation, to the detriment of investor choice and competition.

When a foreign exchange conducts business in the U.S., that immediately implicates our requirements to register both the exchange and the securities trading on the exchange, and that's true even if the exchange actually operates outside the U.S., and even if the securities it lists are all registered

in their home countries. The reason for this is that today, all that matters is whether the regulation is different—not whether the regulation that actually applies is of high quality. That's why the SEC staff are exploring a new approach designed to give U.S. investors more direct access to foreign securities. They're examining, for example, whether foreign exchanges could place their screens with U.S. brokers, in the U.S.—without need of dual or multiple registrations in two or more countries. This is happening because we're now beginning to realize that some of the old ways of doing things may have grown obsolete.

While our historical justification for requiring foreign broker-dealers and exchanges to register with the SEC is sound, it may be that by working with our foreign counterparts, we can find ways to lower costs and increase opportunities for investors while still maintaining the highest standards of investor protection. In an effort to seek out answers to these questions, I have asked the SEC staff to set up a Roundtable that will take place this summer where we can begin to discuss these important issues in earnest.

The overarching objective in all of this is to strike a balance between allowing U.S. investors to avail themselves of the broader choice and better opportunities to diversify their holdings that global markets increasingly offer, and vigorously upholding the underlying purpose of the Exchange Act's requirements—to protect both investors and the integrity of our markets. So as the Commission begins this public dialogue later this summer, we'll be focused on ways to reduce any unnecessary costs and regulatory friction that stand in the way of a healthy global competition among securities exchanges that can benefit investors, while at the same time vindicating the important purposes of our domestic regulatory regime. We'll be particularly interested in pursuing these objectives in ways that can stimulate a broader global effort among foreign regulators to raise standards for investors worldwide.

At this early juncture, I can share with you just a few thoughts about how this might work. A prerequisite for mutual recognition will be to assure protection of U.S. investors. So the threshold question is whether the foreign exchange is comprehensively regulated in its home jurisdiction. That determination will entail an examination of, among other things, whether the home country regulation adequately addresses fair markets, fraud, manipulation, and insider trading, and such issues as current trade reporting.

Another fundamental question will be whether the home jurisdiction provides reciprocal treatment to U.S. exchanges seeking to conduct business in that country. It seems likely that this new approach—at least to start—would be limited to the trading of foreign securities on the foreign markets screens in the U.S. That would of course substantially address our concerns about the impact of this approach on U.S. market activity.

In addition, like U.S. exchanges, the foreign exchange should provide direct access in the U.S. only to registered broker-dealers and to address the issues surrounding the lack of U.S. registrations of the foreign securities that

would become available in this way in the U.S., the Commission might consider limiting these services by brokers to sophisticated U.S. investors, such as large institutions and individuals with substantial investable assets. Of course, the regulation of a foreign exchange in the U.S. would require the Commission and the foreign exchange's home regulator to coordinate their oversight to assure effective regulation in both jurisdictions, and so, the Commission and the foreign regulator would need to enter into a Memorandum of Understanding to coordinate inspections, and regularly share information regarding the exchange, as well as other forms of regulatory cooperation.

These are all just parts of the larger whole when it comes to our international initiative on mutual recognition and what I've just shared with you is very much a snapshot. As we go forward in developing this new approach, it's essential for the Commission to have the benefit of a wide range of views from various markets, and from market participants—especially from you.

I began with a bit of irreverence at Washington's expense, but the truth is that the opportunity we all have as Americans to share our views with our government and to influence the outcome of important decisions and events makes us the most fortunate people on earth. So to the many of you who are visiting from out of town, here's a call to action. Take the opportunity of being here to make your voice heard in the halls of government. You're off to a good start by being here with the Security Traders Association and meeting with regulators at our agency. But don't stop there. Visit your representatives on Capitol Hill, in the House and the Senate. Even if you haven't made an appointment, drop in and talk to the legislative staff. Let them know what you do for a living, and share your expertise on the issues they're grappling with right now that affect not just our capital markets, but job creation, our national savings, our standard of living, and our retirement security, because while all of our regulatory decisions at the SEC are important, in the end they're meant simply to vindicate the policies that are expressed in acts of Congress. So I urge you, not just as a 17-year Member of Congress myself, but as one who has an abiding respect for the role of Congress in establishing the statutory framework for everything we do—make your stay in Washington truly meaningful by doing your utmost to directly participate in our government.

For what you've already done, by sharing your views with SEC here at this conference, thank you sincerely. And thank you, too, for what you do every day as leaders in our capital markets to make America and the world a better place. All of us at the SEC are proud to be your partners.

<http://www.sec.gov/news/speech/2007/spch050907cc.htm>