

PROCEEDINGS FROM

# Securities Regulation in the Global Internet Economy

A Major Issues Conference  
presented by the  
Securities and Exchange Commission Historical Society  
in cooperation with the  
United States Securities and Exchange Commission  
with the support of  
Northwestern University School of Law

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PANEL DISCUSSION

Disclosure and Accounting:  
Are Changes in Disclosure and Accounting Regulation  
Necessary in a Global Market?

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November 14–15, 2001  
Washington, D.C.



## Disclosure and Accounting: Are Changes in Disclosure and Accounting Regulation Necessary in a Global Market?

This topic was split into two separate panels, one on disclosure issues and one on accounting issues.

### Disclosure

The panel addressed the following two questions:

- Can improvements in SEC disclosure requirements be made that will better facilitate capital raising in global markets without sacrificing investor protection?
- How can trading of unregistered securities be brought “onshore” while ensuring a level playing field between foreign and U.S. markets?

The panel discussed these issues in the context of a proposal for U.S. securities law reform set out in a paper prepared by Mr. Greene and Ms. Quinn, proposals for securities law reform made by the American Bar Association’s (the “ABA”) Business Law Section and proposals currently pending in the EU.

### Public vs. Private Offers

Each of the EU, the ABA and Mr. Greene and Ms. Quinn (“Greene and Quinn”) proposals have suggested that an unambiguous bright-line test be developed to distinguish private offerings from public offerings. The EU and Greene and Quinn both propose that this standard should be uniform across markets. Greene and Quinn specifically suggested that in addition to offers to specified institutions being deemed private offers, individual investors should be permitted to participate in the private market, but eligibility should be based on the investor’s investment experience and the amount of securities held by the investor, rather than his or her overall wealth or income.

The panel contrasted the proposals with various exemptions currently available for smaller offerings in Canada and the United Kingdom and the panelists asked whether EU or U.S. regulators would adopt a similar approach. In addition, it was noted that under the existing U.K. regime, privately sold securities that are part of the same class as publicly traded securities are eligible for public trading immediately. A concern was voiced

### DISCLOSURE PANEL CHAIRS

Edward F. Greene, Cleary, Gottlieb, Steen & Hamilton

Linda C. Quinn, Shearman & Sterling

### DISCLOSURE PANELISTS

David A. Brown, Chairman, Ontario Securities Commission, and Chairman, IOSCO Technical Committee

David B. H. Martin, Jr., Director, Division of Corporation Finance, U.S. Securities and Exchange Commission

Jose L. Osorio, Presidente, Comissao de Valores Mobiliarios

William Underhill, Slaughter and May

William J. Williams, Jr., Sullivan and Cromwell

**ACCOUNTING PANEL CHAIR**

Alan B. Levenson, Fulbright &  
Jaworski

**ACCOUNTING PANELISTS**

Edmund L. Jenkins, Chairman,  
Financial Accounting Standards  
Board

John Mogg, Director General,  
European Commission Internal  
Market Directorate

John Morrissey, Deputy Chief  
Accountant, U.S. Securities and  
Exchange Commission

David S. Ruder, William W. Gurley  
Memorial Professor of Law,  
Northwestern University School of  
Law

James Turley, Chairman, Ernst &  
Young

Lynn E. Turner, Professor, College of  
Business, Colorado State University

Sir David Tweedie, Chairman,  
International Accounting Standards  
Board

that this practice allows initial investors to act as a conduit for redistribution of securities to the public market. The panel also raised the question of whether publicly traded companies should continue to have access to the private market if they have unfettered access to the public market.

**Regular Reporting to the Market:  
Periodic vs. Continuous Disclosure**

Both the EU plan and the Greene and Quinn proposal favor quarterly reporting requirements for both foreign and domestic issuers. With regard to an issuer's duty to update its prior statements, the EU has proposed an ongoing continuous reporting regime, under which issuers would have a duty to update prior statements, with no exception for sensitive, arguably premature disclosures. In contrast, Greene and Quinn proposed that issuers be required to disclose specified forward-looking information and be subject to a duty to update such information when specific events occur. Greene and Quinn proposed that any such disclosures be protected by appropriate safe harbors for the forward-looking information and a presumption of good-faith with regard to the timing of any updates. Greene and Quinn also proposed that section 18 liability attach to all mandated filings by foreign and domestic issuers.

The panel discussed how other jurisdictions have addressed continuous reporting to the market and the concerns it raises for companies facing sensitive developments or financial difficulties. The panel discussed how sensitive disclosures are handled in the United Kingdom and Canada in particular. It was noted that in countries with less stringent liability regimes or which do not permit class action securities litigation, continuous reporting to the market (which is not mandated in the United States) is less problematic as the consequences of inaccurate or untimely disclosure are less serious. The panel agreed that, in general, it is difficult to apply a continuous reporting system in practice. The panel also agreed that investors are interested in receiving more forward-looking information from issuers.

**Regulatory Review of IPOs, Offerings by  
Seasoned Issuers and Periodic Reports**

Both the EU and Greene and Quinn proposed that home country review, that is review by the relevant jurisdiction in the country where the issuer is located, eventually replace host country review, that is review in the jurisdiction in which the issuer wishes to issue securities. Greene and Quinn suggested that IPOs and periodic reports should be rigorously reviewed, but, to facilitate rapid access to the market, offering materials by seasoned issuers should not. The panel questioned the practicality of relying on home country review at this stage noting, first, that foreign

"The reform goals we articulate in the paper are high quality, timely and relevant information for investors, free movement of capital across borders, and the broadest possible range of investment opportunities in the whole market. By this we mean that we believe that markets will become increasingly competitive in trying to attract issuers to raise money, and the U.S. has got to adapt to that and make its markets competitive as other markets integrate and develop more fully, and we think there needs to be accountability fairly calibrated to participants' actual responsibilities in the distribution process."

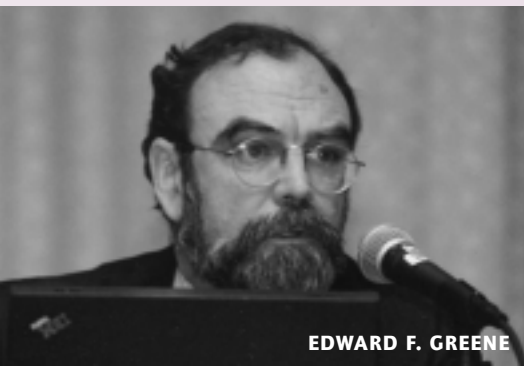
– EDWARD GREENE

"Well, not surprisingly, like David Martin, I believe that review is necessary, and particularly, IPO review, but I also think in this globalization era, regulators have got to be comfortable in relying more and more on one another to perform some of these tasks. I think the converse of that is that there will be multiple reviews with the possibility of inconsistent results and inconsistent application. So I think our long-term goal has got to be to move to a situation where we can rely on one another to a far greater extent than we do. But there are two conditions precedent to that and I think the paper addresses one of these very nicely. That is that our rules and regulations have to converge. We can't be relying on one another if we are imposing different regulations or different principles. So we have to move to a situation where the rules have converged around the world. And secondly, we have to be comfortable in relying on the skills and diligence of the regulators in the other jurisdictions. And that is going to be a tougher objective to achieve. There are already, through IOSCO and through the SEC, a number of initiatives to try to make sure that regulators in jurisdictions around the world are up to and performing to the same standards."

– DAVID BROWN

"So that is why you find that, in the European system, there aren't detailed resale restrictions because the assumption is, if we have a traded security, then there has been some kind of prospectus process at some stage in order to get the security eligible for that market. Indeed, that is one of the key proposals in the new European prospectus directive, which would be that a prospectus is needed either for public offer or for the admission of securities to trading on a regulated market. In other words, we may have a purely private distribution, but still require a prospectus. In terms of our existing regime, and it is not clear yet whether this will be replicated in the new regime, that provides a certain amount of flexibility, and there is still a private market which exists partly for this reason. Having established a class of securities as eligible for trading on a regulated market, generally speaking, an offering which increases the size of that class by 10 percent or less will not require the production of a prospectus document. And what that means is that there is a quick and efficient mechanism for issuers who are, to the extent seasoned, already admitted to a regulated market to tap a capital market, to go and undertake a primary offering, very much in the same way that you might do a large secondary trade, by talking to a small number of brokers who will then place the securities. And that can all be done in the space of one morning with no more documentation than an announcement."

– WILLIAM UNDERHILL



EDWARD F. GREENE



LINDA C. QUINN



DAVID A. BROWN



DAVID B. H. MARTIN, JR.



JOSE L. OSORIO

issuers, particularly those from developing countries, may find that the rigor of SEC or European regulatory review is a useful discipline, and, second, that SEC review arguably serves to increase the quality of issuers' disclosure as the SEC review process usually involves helping issuers to comply with disclosure requirements. A concern was raised that multi-jurisdictional issuers may forum-shop for a friendlier review regime.

### **Ready Access to the Market for Seasoned Issuers and Prospectus Formats and Delivery Requirements**

Mr. Greene covered two other proposals set out in the Greene and Quinn paper, one regarding access to the market for seasoned issuers and one regarding prospectus formats and delivery requirements. Under both the EU and the Greene and Quinn proposals, so long as an issuer is current in its periodic disclosure, only information related to the new securities being offered, plus an update of previously disclosed information about the business, would need to be given to investors. In addition, both the EU and Greene and Quinn proposed a new prospectus format consisting of: a registration document containing information about the issuer, a securities note containing information about the securities to be offered, and a summary. Under both proposals, pricing and size of offer information would be contained in a supplement to be delivered separately. Both the EU and Greene and Quinn also propose that the International Organization of Securities Commissions ("IOSCO") standards should also be the disclosure standards for issuers.

### **Changes to and Easing of Restrictions on Communications**

The panel generally agreed that restrictions on communications outside the prospectus should be eased. The EU proposal would permit communications outside the prospectus, although advertisements would need to be reviewed. The ABA has suggested allowing communications in offerings by registered issuers, but maintaining a blackout for communications by first-time issuers. Greene and Quinn suggested removing limitations on communications generally, provided investors receive the ultimate document to which liability would attach.

Panelists generally agreed that restrictions on communications outside the prospectus should be eased, but voiced concerns that antifraud regulations, alone, may not provide sufficient protection if restrictions were lifted entirely. Some feared that investors would rely on the advertisements, rather than the prospectus, for information. Panelists suggested that if restrictions on communications were to be relaxed, it would be beneficial to have a financial intermediary monitor communications prior to and during an offering.

“One of the most difficult issues, I think, in moving to a continuous reporting system is going to be a judgment as to whether it is going to be implemented leaving that basic principle in place, which is no general duty to speak and simply increasing the number of prescribed duties to speak, or whether you go to a system that says there is a general ongoing duty to speak unless I have prescribed an exception. In a system where you have the potential for litigation so great, my own thought is that going to a system that says you have a duty to speak unless I can find a specific exception will substantially change how cases are brought, when cases are brought, what the defenses are, and in a fashion, I think that is the principal difference between what I see the European model to be proposing and what I think you would see, at least in terms of Ed’s and my paper, proposing to say you continue to have no duty to speak unless you find a duty, and that the SEC, or whoever the regulator is, would prescribe more specific instances of having to speak as a way of getting continuous disclosure.”

– LINDA QUINN

“There is an underlying premise of this old versus new debate, that frauds don’t take place under the existing regime, and we all know that that is not the case. The Enforcement Division keeps very busy, notwithstanding all the restrictions in the current regime. The second thing is that there is a great fear of what will happen. Well, I notice that Larry Bergmann is sitting here in the audience. In connection with the adoption of Regulation M, there was concern about the effect of exempting from the manipulation rule securities with a large Average Daily Trade Volume. The exemption was adopted, and the world hasn’t come to an end. I have not heard of any manipulation abuses. The final thing I would say is that if we do what the ABA and the Greene/Quinn proposals suggest, companies, both domestic and foreign, can have websites that address what they are doing in the financial arena, what securities they are selling. Underwriters can freely use websites to sell securities. Road shows can be made available to

everybody on both real time and repeat bases. Brokers will be able to send e-mails to all their customers, with a short synopsis of what a new issue is about in order to find out who is interested in it. There are a lot of good things that can happen. I think they are worth taking the risk, and I don’t think the world will come to an end.”

– WILLIAM WILLIAMS

“Of course I think regulatory review is a good thing. No, we think about this a lot because I think you always want to go back to first principles. And I think what gets lost in these discussions is the fact that a huge majority of our time is not spent on regulating or disciplining people in their disclosure, but it is helping them with disclosure. If you don’t change the liability system, people want to get what the Commission prescribes right. And we spend a lot of time answering questions. We spend a lot of time helping issuers and underwriters craft disclosure that is compliant. Sure, on the margins, we take on tough issues and get crosswise with people, but I would guess if you looked at most of our regulatory review time, it is spent helping issuers comply with the law. And I think if you take that out, you are going to subject the marketplace to a lack of discipline, but also a lack of help in terms of negotiating the liabilities and the risks.”

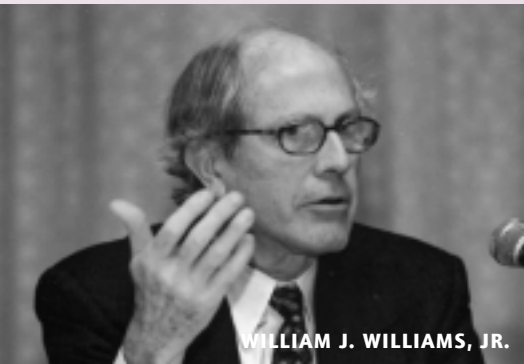
– DAVID MARTIN

“The Brazilian companies that have issued securities abroad are typically in the U.S. market and the U.S. market has more detailed requirements than does the Brazilian market. By complying with U.S. requirements, Brazilian issuers are actually learning through MD&A and other disclosure something that they would not have learned had they remained only in the Brazilian markets instead of being listed on the New York Stock Exchange. So for countries that don’t have a sophisticated market, I think we can learn a lot from the host country that typically is a more developed market.”

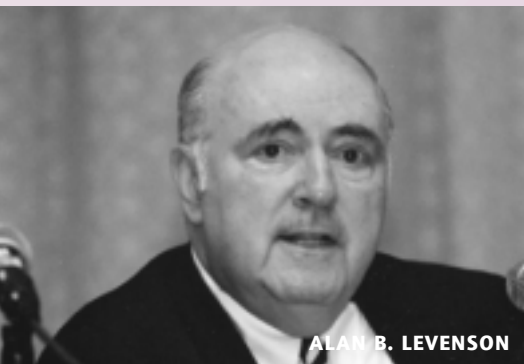
– JOSE OSORIO



WILLIAM UNDERHILL



WILLIAM J. WILLIAMS, JR.



ALAN B. LEVENSON



EDMUND L. JENKINS



JOHN MOGG

## Accounting

The panel addressed the following two questions:

- How can audit firms be encouraged to improve global quality assurance?
- Assuming the standards promulgated by the International Accounting Standards Board ("IASB") and the U.S. Financial Accounting Standards Board ("FASB") converge into a set of global high quality accounting standards, what steps can be taken to ensure that registrants and their auditors, as well as standard setters and regulators interpret and apply those standards in a consistent and effective manner? Who will oversee compliance and enforcement?

The panelists largely agreed on the needed steps for convergence and the concerns and barriers to convergence.

## U.S. Issues

The panel discussed the prospect of the U.S. adopting International Accounting Standards, now called International Financial Reporting Standards (IFRS), without requiring a U.S. GAAP reconciliation for foreign issuers as well as the prospect of the U.S. adopting IFRS for U.S. issuers. Mr. Morrissey said that, for foreign issuers, keeping multiple sets of records under various GAAPs or undertaking reconciliations between U.S. GAAP and their home country, GAAP often proved costly and burdensome. Some panelists suggested that steps to harmonize standards between U.S. GAAP and IFRS should begin with those specific items for which a reconciliation to U.S. GAAP is currently required. In line with an SEC 2000 concept release, panelists expressed concern over the quality of IFRS, users' experiences with IFRS financial statements, the adequacy of interpretive support for the standards, and the quality of auditing and enforcement of IFRS. A consistent theme in discussing U.S. issues was the quality of auditing standards in other jurisdictions. Mr. Morrissey also stated that before the United States would agree to a multilateral standard such as IFRS, certain concerns regarding accounting standards must be resolved, including whether an international standard would require substantially similar auditing practices in all nations, whether the international standard will include the U.S. concept of auditor independence, and whether the international standard will adopt the SEC's approach to auditor review.



“Full and fair disclosure is necessary to both primary and secondary offerings and to capital formation, and the success of capital formation in a global market gets us back to investor confidence. Investor confidence is promoted when we attach reliability to the disclosure of information. The accounting profession plays a key role in adding reliability to information by ordering and reporting on financial statements of issuers.”

– ALAN LEVENSON

“So in a sense, the word ‘convergence’ includes not only the convergence of accounting standards, but the convergence of auditing standards, the convergence of independence standards, and the convergence of regulatory review standards. My own personal view, which comes through in a very lighthearted way in my paper, is that the Commission’s goal ought to be to seek the use of IFRS standards, assuming convergence, in the United States, and that for a period of time, at least, the Commission ought not to be as strict about auditing and independence standards as it can be, and that the goal of worldwide accounting standards being used throughout the world is such an important goal that the Commission ought to be willing to relax what might be its more strict view in another setting.”

– DAVID RUDER

“The Commission is about the only regulator worldwide that has the enforcement mechanisms and the statutory endorsement authority and responsibility to ensure that the standards and transparency actually do occur. As David Cairnes has noted and it is noted in the paper, surveys time and time again show that people in Europe are not following the standards, and it is not just Europe, it is elsewhere.”

– LYNN TURNER

“In practice, our direct application of endorsed IFRS standards will ensure that convergence with IFRS is actually quicker and certainly more easily understood by capital markets and with perhaps a distant, but nevertheless IASB goal of global uniformity in mind: a single set of high quality standards for all. We hope one day that the U.S. will be able to feel the same confidence in these standards and make them genuinely global.”

– JOHN MOGG

“We do have a global capital market system today and we do need one set of high quality financial reporting standards to serve that global capital market system. I think this is as simple as the fact that it is going to be driven by demand. Both companies and investors deserve to have to deal with only one set of high quality standards, rather than multiple sets, as they go about their business. Companies are increasingly seeking capital and acquisitions outside of their home country and investors are seeking diversification and higher returns by doing the same thing. And there certainly is a clear connection between efficient and effective capital markets and high quality financial reporting standards. Thus, we, at the FASB, are strongly supporting the implementation of the new structure.”

– EDMUND JENKINS



## IASB Reforms

Sir David Tweedie's presentation on the IASB highlighted the IASB's aims to create convergence of accounting standards across all markets, with each country adopting the same international reporting standards (to be created by IASB). To ensure uniform and appropriate application of IFRS, good auditing standards across all markets will be required. In addition, appropriate enforcement of IFRS in all markets is necessary. Mr. Jenkins discussed the necessary aspects of an effective standard setting body, including that it must be independent, it must provide for adequate due process, it must have adequate staff, its fund raising must be independent from its technical body and it should be subject to independent oversight. Mr. Jenkins elaborated on the protocols and procedures established between IASB and FASB to assist in the convergence process between the two standards. Panelists voiced concern that differing interpretations of IFRS could emerge in different jurisdictions. IASB considers that IOSCO may be able to assist in the enforcement of IFRS.

Mr. Mogg discussed reform proposals in the EU. Currently, within the EU, issuers may use home country GAAP or IFRS. Under a Commission proposal, all issuers with securities listed on an exchange would be required to use IFRS to report their financial results by 2005. Under the EU endorsement mechanism, the EU Commission will review and adopt existing and proposed IFRS, but the EU will not cherry-pick among the proposed standards. Instead, the EU will attempt to accept the existing standards in their entirety, but will comment on their development to the degree the EU believes the standards raise public policy concerns. Having commented on the standards, the EU would ensure that IFRS will apply to member states without room for variation. Panelists were somewhat concerned about the implications of the EU Commission being involved in the standard setting process even to this degree and were concerned in particular that the EU Commission would be able to rely on public policy concerns as a means of suggesting changes to IAS when adopted in the EU.

## Industry Responses

Mr. Turley provided some insight into what industry feels is needed to ensure uniform application of IFRS and U.S. GAAP across markets. In particular, he cited the need for a global body that establishes one set of accounting standards for all entities that participate in public securities markets; that all jurisdictions should participate in the standard-setting process; that specific procedures must be established to resolve accounting interpretation issues; that global standards for auditor independence are needed; that adequate training for issuers' internal accounting employees must be provided; and that there need to be ongoing audit quality reviews.

"As everybody said, the aim is very simple. We really want to have one set of high quality global standards, so that it doesn't matter whether a transaction takes place in Singapore, Seattle, Strasbourg, or Sydney, we are actually going to account for it the same way. Where did it come from? Well, first of all, it was the multinationals complaining that they had all these subsidiaries scattered worldwide. They had to have different accounting rules that they had to bring together for their consolidation. But it was the Asian crisis that really woke everyone to the need for international standards because suddenly companies went bankrupt in Asia and yet their accounts looked all right. And investment was withdrawn from other companies that were perhaps perfectly sound, but people wouldn't take the risk. If any company did get cash, then it was at penal rates because of the risk premiums. So growth and investment just stopped."

– SIR DAVID TWEEDIE

"I think what I would like to do is drill down a little bit into one of the issues that has been on everyone's agenda, really, and that is the quality of auditing around the world because the firms are doing a number of things. There is still obviously a long way to go. Individually, I will speak for our firm, but I know the others have similar initiatives going. Major efforts are underway, major investments are being made, continuing investment is needed clearly around methodology, technology, knowledge tools and around making sure that we have consistency in application of each of these around the world. We are making huge progress, as an industry, around this. I, for one, don't view methodology and technology as being frankly a source of sustained competitive advantage, one firm versus the other, but I do believe that the consistency and application around the world is a distinct advantage. And so the commercial realities of this are driving all of the firms to push there very, very quickly. Another area that we are investing quite, quite heavily in is training in the whole

learning environment around the world. Because of Internet capabilities and connectability, we have businesses that our firm has sponsored and owns that are in the learning space driving the programs and driving the tools and driving the technology from the U.S. around the world to really try to enhance the quality of the audits everywhere around the world."

– JAMES TURLEY

"Ensuring that high quality financial information is provided to the capital markets does not depend solely on the body of accounting standards used. Auditors have a key role and responsibility to test and opine on whether the financial statements are fairly presented in accordance with generally accepted accounting principles. For the last several years, the SEC, in a number of international organizations, has begun urging the audit profession, and particularly the major global audit firms, to improve the quality of international auditing. The SEC and other international organizations are among some of the groups that have engaged in a dialogue with the International Federation of Accountants, or IFAC, and with the International Forum of Accountancy Development, or IFAD, to encourage further work on these private sector initiatives. The staff expects to work cooperatively and positively with the audit profession, auditing standard setters, and with other national regulators in the coming year to improve international audit quality. In addition, the SEC has noted the initiatives of IFAC. We have seen the creation of a task force to increase the quality of the standards of the International Auditing Practices Committee, or IAPC, as well as the publication of the draft documents that describe the creation of a self-regulatory mechanism on an international basis."

– JOHN MORRISSEY