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The Perspective of U.S. Securities Disclosure and the Process of Globalization

Irina Shirinyan*

I. INTRODUCTION

It is difficult to imagine any country or society that has not been impacted to some degree by the trend toward globalization. Communication and technology development, as well as increased trans-border commercial and financial flows are simultaneously, in part, both the causes and consequences of globalization. The Internet and other increased communication abilities have made it easier for companies to raise funds by utilizing the capital market instead of the traditional commercial bank. As a result, securities markets have increased their international scope. The number of companies listing their stock on the foreign financial markets has increased greatly. A good example of the increasing international transactions across different borders is the growth volume of corporate equities transactions. During 2001, the volume of foreign share transactions on the New York Stock Exchange increased by fifteen percent. When compared with 1997, this amounts to an increase in volume by 2.5 times.1

Internationalization of finance has occurred for several reasons. Among them are the growing demands for capital by corporations, the liberalization of capital markets, the decreasing role of banks as the primary corporate financial source, the abatement of trade barriers, and the interrelation between financial markets.2 Because of global trading and financial flows, legislation has to respond to the new de-

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1. The volume of trading in non-U.S. stocks averaged 117.2 million shares a day in 2001, a 16.6% increase over last year’s 100.6 million. Total non-U.S. volume was 29.1 billion shares in 2001, compared with 25.3 billion in 2000. At year-end, total worldwide market capitalization of NYSE’s non-U.S. companies was $4.9 trillion. It represented 53 countries. Available at http://www.nyse.com/about/factbook00.html (last visited Oct.15, 2002).

mands of the global economy. Consequently, a discussion regarding the standard of mandatory disclosure requirements applies not only to companies entering the foreign capital market, but to domestic companies as well. Should these companies be required to reconcile their financial statements to the standards of an exchange where their securities are listed or should they be allowed to prepare their financial statements according to the state or nation of the issuer’s domicile, or another regulatory body, such as the International Accounting Standards Committee?

While securities laws are territorial and differ from country to country, they tend to be universal in their goals. They seek to protect the market as a “social institution” and increase investor confidence in the securities markets by reducing the risk of fraud or unfairness in securities transactions. Mandatory disclosure requirements have been the instrument of choice in realizing these dual goals of securities market regulation. While the goals are similar, the development of regulatory regimes can vary from nation to nation dramatically. Differences in economic development, culture, legal and social environments, and the fact that different legal markets and their corre-

4. See Edmund W. Kitch, Proposals for Reform of Securities Regulation: An Overview, 41 VA. J. INT’L L. 629, 642 (2001) (responding to a question why after many years of a consensus in support of U.S. securities regulation commentators believed that change would be beneficial). Kitch found that “five interrelated developments in recent years have undermined the assumptions that supported the consensus. Id. They are: (1) the movement towards freer international trade and financial flows; (2) changes in communications and transportation technologies; (3) changes in the regulation itself; (4) the failure of the regulation to achieve its objectives; and (5) the collapse of a shared faith in the relevance of the helpless-investor model on which the regulation is based.” Id. Indisputably, all of these five factors occur. Id. At the same time, all of them are a derived result of the changes in technologies and communications that are a part of such a profound process as globalization. Id. The finance of transnational transactions, in its turn, plays one of the leading roles in these global aggregate economic activities. Id.
4 Joel P. Trachtman, Regulatory Competition and Regulatory Jurisdiction in International Securities Regulation, (Dec., 1999) available at http://papers2.ssrn.com/paper.taf (last visited Sept. 25, 2002) (arguing for the proposal that securities law is different from corporate law, and the international setting is different from the U.S. federal setting because the international system has less institutional capacity to enforce a stable equilibrium). Also, Trachtman concludes that the problem of regulatory competition requires a political choice between these preference revelation devices. Id. The political choice should be informed by the likely outcomes, in terms of local societal preferences of the alternatives. Id. While criticizing Professor Romano’s approach, Trachtman points out that Romano does not focus on the problem of externalities in her proposals for greater inter-jurisdictional competition. Id. In her proposal for regulatory competition in the securities field, Romano only considers externalities that arise from competitors’ use of disclosure. See Roberta Romano, Empowering Investors: A Market Approach to Securities Regulation, 107 YALE L. J. 2359 (1998).
6. Id.
sponding regimes develop at different rates of speed and over different periods of time have impeded the development of a more universal approach to disclosure rules and requirements. National differences explain the existence of different levels of "regulatory hierarchy" in the international securities market. They also explain the policy of most countries to require the foreign companies participating in that country's capital market to reconcile their financial statement to standards of the exchanges where the securities are listed. However, the incompatibility of the different national securities regimes creates "regulatory disharmony" within the international market, and hampers the achievement of optimum market efficiency. This paper first addresses the recent developments in the U.S. regulatory regime and its impact on the trend toward an international convergence. The paper will next discuss the various alternative approaches to securities market regulation and examine the merits of these approaches as a means of protecting investors in different domestic financial markets.

II. RECENT DEVELOPMENT OF THE U.S. SECURITIES REGIME AND CONVERGENCE

A. Background

Despite globalization trends and increased transborder financial flows, creating strong financial markets continues to be an important challenge for all economies. Differing approaches to creating strong financial markets exist depending on the general type of financial market a given country has adopted. According to a recent study, there are two prevalent market systems: dispersed ownership and concentrated ownership. While a concentrated share ownership sys-

7. See Marc I. Steinberg & Lee E. Michaels, Disclosure In Global Securities Offerings: Analysis of Jurisdictional Approaches, Commonality and Reciprocity, 20 Mich. J. Int'l L. 207, 265 (1999) (analyzing almost all significant financial markets around the world including United States, United Kingdom, France, Germany, Italy, Canada, Mexico, Japan, and Australia). The article surveys the national securities legislation. Id. While the authors merely described, but failed to compare these systems, nevertheless, having examined the national securities regulations they conclude "although the regulatory systems addressed in this article are based primarily on the goal of providing full and fair disclosure to investors, jurisdictions embrace their own parameters that determine more precisely what constitutes adequate." Id.


tem prevails across Europe and Asia, a dispersed system is limited to the United States and Great Britain. Depending on the broad structure adopted, a country's approach will inherently differ with respect to targeting investment clients, levels of transparency, and regulatory regime development, etc.\textsuperscript{11}

The regime that provides significant protections for minority shareholders predominates in the dispersed ownership pattern. Such characteristics as a strong stock market, strict disclosure regime and high levels of transparency define the dispersed ownership pattern. The concentrated ownership structure provides better monitoring of management and can be characterized by a weak stock market involving controlling block holders, private benefit of control, lenient disclosure regime, and low transparency.

All national disclosure regimes are aggregate systems of social and legal rules, enforced through both public and private institutions.\textsuperscript{12} However, because of differences in ownership patterns, the national disclosure regime that supports these patterns will differ as well.\textsuperscript{13}

According to empirical surveys, a strong capital market is more likely to provide significant protections for minority shareholders.\textsuperscript{14} In economic terms, ownership is a bundle of rights that primarily includes rights of control to maximize the value of the interest held.\textsuperscript{15} In terms of share ownership, it means that dominant shareholders who

\textsuperscript{11} John C. Coffee, \textit{Competition Among Securities Markets: A Path Dependent Perspective} (Working Paper No. 192, 2002). (Examining the competition among securities markets and posing the question: How much does law matter?). Coffee concludes that different exchanges will move in different directions because of a basic path dependent fact: they have different clienteles of listed companies. \textit{Id.}


\textsuperscript{13} The article does not examine an issue whether dispersed ownership has effected a particular model of legal rules or whether the legal rules have effected the pattern of ownership. To adequately examine the issues in this paper it does not matter whether aggregate system of rule and institutions initiated the particular ownership pattern or whether the pattern per se initiated such aggregate system.


exercise more control can extract private benefits from their position. Since their benefits come from the value of a corporation, they in turn can exercise minority shareholder expropriation. In companies where dominant shareholders (blockholder) are a family group that, at the same time, keeps management positions – like in Korean chaebol corporate groups\textsuperscript{16} – minority shareholders’ expropriation becomes more likely through such means as self-dealing. Although it is difficult to control insider trading and self-dealing, almost every country, more or less successfully, makes efforts to restrict such activities.\textsuperscript{17}

In corporations where minority shareholders do not own an interest that enables them to participate in corporate control, minority shareholders consistently receive a lower value per pro rata share. Since minority shareholders’ interests are fractional, lack of control and marketability are usually inherent in their interest.\textsuperscript{18} Consequently, there is a higher capacity to expropriate wealth from minority shareholders in countries with higher control premiums.\textsuperscript{19} Recent research has established that the ability to protect minority shareholders’ interests has a direct correlation to the size, depth, and liquidity of that country’s securities market.\textsuperscript{20} Good protection of minority shareholders induces greater investment participation by outside investors.\textsuperscript{21} The restraining of investor expropriation is an increasingly important determinant in the ability of a country to attract increased investment in its economy through a robust financial market. With the increase in global investing, and the corresponding increase in competition between international financial markets, the different approaches to in-

\begin{footnotesize}
\begin{enumerate}
\item See Curtis J. Milhaupt, Privatization and Corporate Governance in a United Korea, 26 J. CORP. L. 199 (2001).
\item Roberta S. Karmel, Transnational Takeover Talk-Regulations Relation to Tender Offers and Insider Trading in the United States, the United Kingdom, Germany, and Australia, 66 U. CIN. L. REV. 1133, 1149-52 (1998).
\item See Black, supra note 12.
\item Rafael La Porta, et al., Law and Finance (1998), at http://post.economics.harvard.edu/faculty/shleifer/papers/lawandfinance.pdf (last visited Oct. 2002) (examining legal rules covering protection of corporate shareholders and creditors, the origin of these rules, and the quality of their enforcement in forty-nine countries. The authors found that concentration of ownership in the largest public companies is negatively related to investor protections). See also infra notes 50 & 51.
\item See Tatiana Nenova, The Value of Corporate Votes and Control Benefits: A Cross-Country Analysis (Sept. 21, 2000), at http://papers.ssrn.com/sol3/delivery.cfm/000809550.pdf (last visited Nov. 3, 2002). The analysis in this paper shows that control benefits are an important part of the value of the firm, and vary widely across countries. Also, the paper shows that the legal framework does exert a paramount impact on the amount of total firm value that controlling shareholders are able to appropriate.
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vestor protections will continue to play a significant role in a nation's ability to develop robust financial markets.

The U. S. financial market is a market with a dispersed share ownership pattern that has been characterized as a strong security market with a high transparency and rigorous disclosure regime. Since a strong securities market relates to the protection of minority shareholders, easy access to company financial information and protection from managers' self-dealing are crucial aspects of such implementation.22 Each country sets forth its own standards dependent on its regulatory demands and external environment. The U. S. disclosure regime is one of the most rigorous regimes of the international securities markets. During the last few decades the U. S. securities market has soared in comparison to European and Asian markets. Drawing on the U.S. experience, it appears therefore, that rigorous disclosure rules have a positive effect on investor confidence and healthy market conditions.

B. U.S. Securities Requirements for Foreign Issuers

The Securities and Exchange Commission (SEC) is the U.S. regulatory authority responsible for regulating the U.S. securities market. It primarily regulates publicly traded securities. Foundational to the U.S. regulatory regime are the dual components of public disclosure and securities registration.23 The U.S. security regulations focus on the principle of full disclosure.24 Delivering information about a company's financial health and future business prospects to an individual investor with a controlling interest is a relatively simple matter. However, an important component of the U.S. system is to require this type of information to be fully and publicly disclosed so that all investors can make informed decisions on future investment transactions.25 The second key point of the U. S. securities regulation is that the securities must be registered with the SEC, unless the law provides for an exemption.

The Securities Act of 1933 (the "Securities Act") is the core of the U.S. security regime. Absent an exemption, every security offered for sale, or that is sold, must be registered with the SEC. The Securities Exchange Act of 1934 (the "Exchange Act") extended securities regu-

22. See Black, supra note 12.
24. Id. at S25, *S27, n.9.
25. Id. at *S27, n.9.
lation to trading in previously issued securities, which are already distributed. The 34 Exchange Act requires publicly traded companies to file annual and periodic reports with the SEC, including an audited annual financial statement. It is also provides a private cause of action for purchasers of those securities where the publicly filed information contains material misstatement or omission.

The Security Act also applies to foreign issuers\(^{26}\) that publicly raise capital or list their shares on the U.S. securities market, requiring them to comply with the registration requirements of the Security Act. There are the three principal types\(^{27}\) of primary offerings that foreign issuers can use in the United States: public offerings, private placements, and Rule 144A offerings. The financial registration requirements with which foreign issuers must comply when seeking to publicly raise capital are similar to the registration requirements for domestic companies. Foreign companies disclosure requirements are set forth in form F-1, which is similar to the form S-1 used by domestic companies. The primary differences in the two disclosure requirements concern the disclosure of non-financial information. These differences will be scrutinized below.

Private placement offerings are exempt from registration requirements as long as they meet the requisite private placement requirements.\(^{28}\) These requirements include: public advertising of the offering is prohibited, the offer is made to a limited number of offerees, adequate access to relevant information is provided, and resale of the securities is restricted (but not all together prohibited). The disadvantage of the private placement scheme is its low liquidity for investors.

The low liquidity stems from the fact that private placement securities cannot be traded on the public markets. To reduce the negative impact of private placement rules on investor liquidity and increase market efficiency of private placements, the SEC enacted rule 144A. One of the primary goals of 144A was to increase foreign investment in the U.S. economy through private placement offerings. It allows unrestricted resale of private placement offerings to qualified institutional buyers (QIB).\(^{29}\)

\(^{26}\) Since this paper examines the question whether companies should be required to reconcile their financial statements to standards of an exchange where their securities are listed or be allowed to prepare their financial statements according to the state or nation of the issuer's domicile or another regulatory body, it deems just to consider the U.S. regulation regarding the only foreign issuers.

\(^{27}\) American Depositary Receipts ("ADR") is not covered in this paper.


\(^{29}\) See 17 C.F.R. § 230.144A.
C. Amended International Disclosure Standards

The SEC, a member of the International Organization of Securities Commissions (IOSCO), has participated in harmonization programs sponsored by IOSCO. In 1998, the SEC adopted IOSCO's core set of non-financial disclosure standards for foreign private issuers. The SEC stated the decision to adopt the International Disclosure Standards was based on its conclusion that the "standards were of high quality and that their adoption would provide information comparable to the amount and quality of information that U.S. investors receive today." As a result of this adoption, the SEC considerably changed the non-financial disclosure requirements of Form 20-F and registration

30. New SEC Disclosure Standards:

1) Major Shareholders and Related Party Transactions.

Item 7 of revised Form 20-F requires that "beneficial owner" must disclose information in regard to transactions only for holdings above five percent as opposed to ten percent under the old rule. At the same time, if the issuers' home country requires them to disclose their beneficial owners at an even lower percentage, the foreign issuers must disclose such ownership. See 17 C.F.R. § 239.31, at 53904 (2002). The percentage change puts the required disclosure for foreign issuers on par with the requirements for domestic issuers. See 17 C.F.R. § 229.403(a) (2000). Also, the form now requires additional information regarding related party transactions that have occurred since the beginning of the three financial years preceding the date of the offering document. See 17 C.F.R. § 239.31, at 53918 (2002).

2) Compensation of Directors and Officers.

The new Form-20F requires disclosure of information about the compensation and share ownership of directors and senior management. Also, the new form requires more information about company's employees than the previous one. See 17 C.F.R. § 239.31, at 53917 (2002).

3) Additional Information in Regard to the Trading Market.

The new form requires a description of the offering, the nature of the trading market for the issuer's securities, the plan of share distribution, the disclosure of information regarding person or entity offering to sell the shares, expenses, the lack of liquidity for the issuer's securities, and others. See 17 C.F.R. § 239.31, at 53920 (2002).

4) The age of the Financial Statements.

The new form has more restrictive requirements regarding the permitted age of financial statements. The form requires that issuer's audited financial statements be no older than fifteen months at "the time of the offering or listing," in other words, the effective date of the registration statement. This form can be distinguished from previous Rule 3-19 of Regulation S-X that permitted the SEC to proclaim a registration statement effective with audited financial statements as old as 18 months. Also, when an initial public offering takes place, the audited financial statements must be no older than 12 months from the time when the offering document was filed. This stricter rule for initial public offerings does not apply to foreign issuers offering securities in the United States for the first time if they already are public in their home country. See 17 C.F.R. § 239.31, at 53902 (2002).

31. Issues regarding the International Organization of Securities Commissions (IOSCO) will be viewed below.

statement requirements on Form F-1, F-2, F-3, and F-4. In some cases, the new Form 20-F requires more disclosure than the old rule.

D. Accounting Standards

Because of different accounting traditions around the world, accounting principles vary widely. In the United States, accounting principles have been developed to meet the needs of capital markets. The market regulation approach adopted in the United States is dependent upon supplying high quality financial information to capital market participants in order to facilitate informed decisions by investors.

The Financial Accounting Standards Board (FASB) sets the accounting standards to be used in preparing the financial statements for firms that are registrants with the SEC. Thus, domestic firms that are registrants with SEC must file financial reports using U.S. Generally Accepted Accounting Principles (GAAP). Foreign issuers wanting full access to the U.S. financial market and filing with the SEC can use the U.S. GAAP, their home country GAAP, or international standards—although if they use their home country GAAP or international standards, foreign issuers must provide reconciliation to the U.S. GAAP. Requirements are different depending upon the nature of the foreign entity.

According to Rule 2-02(b) of Regulation S-X, an auditor in compliance with U.S. independence requirements must audit all financial statements in accordance with U.S. GAAP. Foreign private issuers have some exceptions from reconciliation requirements.

While the SEC has revised its disclosure requirements to more closely follow established global financial reporting standards, the basic principles underlying the U.S. regulatory regime of investor prote-
tion continue to be promoted "through [requiring] full and fair disclosure."\textsuperscript{42}

E. \textit{Sarbanes-Oxley Act and Non-U.S. Companies}

On July 30, 2002, the Sarbanes-Oxley Act (the "Act") was signed into law. The Act aims to enhance investor protection by increasing the accuracy and reliability of corporate disclosure. This Act is broad in scope and generally makes no distinction between U.S. and foreign private issuers listed in the United States. It applies to all U.S. and non-U.S. issuers ("reporting companies") that have registered or filed reports with the SEC under the Exchange Act or that have filed a registration statement for a securities offering under the Securities Act, even if the registration statement is not yet effective. The Act will profoundly affect both U.S. and non-U.S. companies. Before this Act was adopted, the SEC had provided foreign private issuers with a number of accommodations. These accommodations consisted of using accounting principles of the home country with reconciliation to U.S. GAAP; applying the international disclosure standards, like reporting aggregate executive compensation disclosure rather than individual disclosure (if an issuer's home country permits it); and exempting non-U.S. companies from the proxy rules. Also, it allowed for interim reporting on the basis of an issuer's "home country and stock exchange practice . . . that are tailored to the needs of foreign private issuers,"\textsuperscript{43} rather than mandated quarterly reports and acquiescence in New York Stock Exchange and National Association of Securities Dealers corporate governance standards.\textsuperscript{44}

Since this Act was adopted, new responsibilities have been imposed on reporting companies, their directors, their lawyers, and their auditors. The Act's provisions affect the internal corporate governance rules and activity of non-U.S. reporting companies, their relationships with their outside auditors, and the information they must provide in the U.S. market. Thus, the Act sets forth requirements for an audit committee of independent directors for non-U.S. listed companies and prohibitions on loans extended to or arranged by a company to its officers and directors. Also, the Act requires foreign public accounting firms that audit SEC-registered issuers, including foreign private issuers, to register with the Public Company Accounting Oversight Board (the "Board") and be subject to its oversight. Many rules of this Act

\textsuperscript{42} See 17 C.F.R. § 239.31, at 8897 (2002).


\textsuperscript{44} Id.
become effective only after their adoption by the SEC or the Board. Certain requirements, such as prohibition on personal loans to executives and forfeiture of certain bonuses and profits, became effective immediately.

Almost all provisions of the Act have become the subject of considerable concern and extensive discussion outside and inside the United States. Most of them have extended to many aspects of the internal rules of corporate governance of foreign companies and their auditors. Moreover, many technical terms of the provisions are stated using U.S. legal concepts. The extraterritorial effects of this Act burden foreign issuers with unjustified requirements and hinder the process of reciprocity and harmonization of international capital markets. The intention of the U.S. Congress to enhance investor protection and to improve the efficacy of the system of regulation is understandable. At the same time, as many opponents have pointed out, “the Sarbanes-Oxley Act has largely ignored the differences in practices and corporate governance regimes between the United States and other countries.” The previous policy of the SEC demonstrated its capability to provide foreign private issuers with a number of accommodations that were not inconsistent with the protection of U.S. investors. Now the SEC, with its latitude in using its rulemaking and interpretive authority to deal with technical matters, must provide a means to accommodate the home country requirements and regulatory approaches of the home jurisdiction of the foreign registrants to avoid conflicts in order to reach a prompt, sensible, and mutually satisfactory outcome. Failure to do so, will likely result in foreign companies’ diminished willingness to look to U.S. markets as an avenue for raising capital.


III. The Securities Regulation Debate: A Variety of Approaches and Their Merits

The last few years have showed an increased debate by academics and market participants about the proper mandatory disclosure requirement to be applied to companies entering the foreign capital market. Should these companies be required to reconcile their financial statements to standards of an exchange where their securities are listed; be allowed to prepare their financial statements according to their domestic rules; or should there be a single international standard governed by an independent international regulatory body? Opinions vary on this issue.

A. International Uniformity

Dr. Uri Geiger, CEO of GalayOr Networks Inc., in his writings on the internationalization of the world securities markets, focuses on the significant changes in the nature of these markets. Dr. Geiger proposes that given the nature of these changes, the time has come for the development of an alternative regime structure. Economic globalization has altered the way business is conducted. Barriers resulting from the differences in the way the various regimes regulate their domestic markets will not only obstruct economic progress in the individual domestic markets, they will stunt global economic growth as a whole. Dr. Geiger advocates for replacing the present domestic disclosure regulatory regimes with “unified disclosure standards to be used by domestic and foreign issuers in all developed markets.” Evaluating two existing models of harmonization, the European Union harmonization plan and United States-Canadian Multijurisdictional Disclosure System, Geiger concludes that although both of these models provide a “good case study for the applicability and effectiveness of harmonized disclosure rules,” they suffer from several problems.


49. Dr. Uri Geiger, Co-founder and CEO GalayOr Networks Inc. and an adjunct professor at Tel Aviv Business School, where he lectures on entrepreneurial and venture capital, and the author of two books: Startup Companies and Venture Capital (Tel Aviv University, 2001) and From Concept to Wall Street (Fin. Times, 2002). He has his PhD in Law and Economics from Columbia University.


51. Id. at 1790.
His approach is to establish a Global Prospectus along with a Global Coordinator as a substitute for the existing models of harmonization. According to Dr. Geiger, reciprocity as a form of harmonization is less efficient than commonality for the harmonization of securities disclosure rules in the global market. Because it is envisioned that the common standards should be applied to domestic as well as multinational offerings, Dr. Geiger proposes a two part Global Prospectus approach: a Basic Form and a Global Form. Companies that do not trade their securities in foreign markets should use the Basic Form. The Global Form should be used for multinational offerings. The disclosure philosophy of the Global Prospectus "would be based on two special requirements: . . . detailed line item requirements . . . [and] . . . a general requirement to disclose any information that may be necessary to make the information . . . not misleading." For administrative purposes, Dr. Geiger proposes an international regulatory body - the Global Coordinator. It would supervise the "implementation, interpretation, and enforcement of the unified standards by domestic regulators;" however, the Global Regulator would not be a substitute for domestic regulators. Having examined a comparative analysis of the disclosure requirements in the world's "Major Markets," Dr. Geiger finally concludes harmonization is not only feasible but highly advantageous over the present approaches.

First, Dr. Geiger's proposal of adopting a combined universal global prospectus and a universal basic form prospectus for use by purely domestic companies seems unrealistic. Domestic cultural and political concerns alone are enough to render the implementation of such a proposal unworkable. Uniformity would result in outside forces having a monopoly on regulation without any concern for an individual nation-state's national peculiarities. Many of the differences in the present market regulation regimes are a product of these economic, historical, and cultural peculiarities. Thus, in Germany a supervisory board has to have one half of the seats allocated to labor. The presence of labor affects many business decisions in terms of employee protection and has an impact on regulatory rules also. The provisions of the German takeover regulation differ significantly from Great Britain's. The difficulty experienced by the European Union in its at-

52. Id. at 1807.
53. Id. at 1800.
54. Id. at 1807.
tempts to harmonize regulation regimes is evidence of how daunting a task it would be to implement a uniform global system. EU-countries were not successful until a consensus of national concepts was obtained among its members.57

Second, corporate and securities laws cannot be created as pure new institutions without using or adapting institutions from countries with well developed regulation systems. However, experience has shown that piggybacking on other countries' institutions does not work well. The experience of borrowing American corporate and securities laws by other countries has not been successful.58 Law cannot be simply translated into another language or resettled to another country. Law as an institution, as well as its individual provisions, must mesh with the local institutions. For example, Professor Amir Licht examined an issue related to listing of Israeli companies on the U. S. stock market and “the dual listing project” enacted by the Israeli legislature, concluded that there is “doubt on the desirability of piggybacking on foreign markets. Sometimes . . . piggybacking can be a ride to the bottom.”59

Professor John Coffee argues in favor of functional convergence.60 His approach rests on the path dependency, political ability, and economic self-interest.61 These three important constituents produce significant national variations in the structure and design of economic, legal, and social institutions, which are able to reform “local law in order for functional convergence to occur.”62 According to Professor Coffee, one of the varieties of convergence can be achieved as the result of private action, such as a “bonding mechanism.”63 At present,

57. See John C. Coffee, The Future as History: the Prospects for Global Convergence in Corporate Governance and its Implications, 93 Nw. U. L. Rev. 641 (1999). The author strongly agrees with the thesis that “law matters” and “trust is efficient. Protecting the expectations of the minority may be the essential prerequisite to an effective securities market.” Id.
58. See Black, supra note 12.
59. Amir N. Licht, David’s Dilemma: A Case Study of Securities Regulation in a Small Open Market (2001) at http://www.faculty.idc.ac.il/licht/papers.htm (last visited Oct. 20, 2002). This article is an analysis of an Israeli regulatory program aimed at getting back home Israeli companies listed only on U.S. stock markets, to facilitate dual listing of their stocks on the Tel Aviv Stock Exchange. Id. Also, the article casts some doubt on the desirability of piggybacking on foreign markets. Id. Sometimes, it turns out, piggybacking can be a ride to the bottom. Id.
60. See Ronald J. Gilson, Globalizing Corporate Governance: Convergence of Form or Function, 49 Am. J. Comp. L. 329 (2001) (examining the functional convergence by contract. This technique provides “accountability to investors through private governance mechanisms imbedded in the design of the security rather than through traditional public governance mechanisms such as investor voting or capital market surveillance.”) Id.
61. Coffee, supra note 57, at 656-661.
62. Id. at 673.
63. Id. at 674.
foreign issuers enter into listing agreements with the U. S. exchanges before listing their stock on the U.S. financial markets. By entering into the listing agreement, a foreign issuer agrees to be bound by those provisions of the U.S. securities laws that are not mandated by the foreign issuer's domestic regulatory regime's security or corporate laws. Entering into the agreement is a necessary condition precedent to having their securities traded on U.S. exchanges.

According to the present state of affairs, Professor Coffee believes that it is through the voluntary accession to security and corporate law by foreign issuers that willingly enter into these listing agreements, that global convergence of securities and stock exchange regulatory norms is more likely to occur.

While the listing agreement is an existing functional device, it is questionable whether a governmental regulatory regime would accept them as a means of navigating around a domestic law. The premise that self-regulatory organizations (SROs), like the New York Stock Exchange, the American Stock Exchange (AMEX), or NASDAQ, are able to supersede or pre-empt another government regulatory oversight body, such as the SEC, seems unlikely. The SEC is empowered to be the U.S. regulatory authority responsible for regulating the U.S. securities market. The domestic securities regulatory regime is an inherent part of a national regulatory system which serves a national consumer market and protects its participants. This function of the national regulatory regime is determinative of its superiority for securities transactions in the territory. Stock exchanges, as self-regulatory organizations, play a critical role as standard setters. At the same time, because SEC regulations and laws supercede SROs' rules, SRO rules must be compliant with the national law and regulations to have any legal standing.

The approaches examined above are not the only ones that have been presented. There are a number of worthwhile approaches that

64. Id. at 687.
65. Higher disclosure, accounting, and market transparency standards and the enforcement mechanisms are among them.
are subject to debate among academicians. Professor Stephen Choi and Professor Andrew Guzman, whose proposal was one of the first published, set forth a system in which issuers freely choose from among regulatory disclosure regimes of an applicable national jurisdiction. Similar to the approach advocated by Professor Romano, they give investors, not a regulator, the power to decide what, if any, protections they need. Thus, Professor Choi advocates, "rather than harmonization or internal reform measures, simply opening up a country to competition (whether product, financial, or regulatory) may have the greatest positive impact on investor welfare and the development of financial markets."

Professor Paul Mahoney suggests that the securities exchanges themselves, where the securities are listed, should regulate disclosure. According to this approach exchanges should be the "primary writers and enforcers" of regulatory regimes. He argues, "the benefits of regulatory competition would be most effectively achieved by devolving more regulatory authority to the bodies that were the first regulators—the securities exchanges themselves."

Professor Marc Steinberg, along with his disciple Lee Michaels, developed a proposal combining elements of mutual recognition and harmonization. According to this proposal, the International Organization of Securities Commissions (IOSCO) should promulgate a common prospectus or offering document. These documents should be devised with different standards for companies from developed, semi-developed, and emerging markets. Issuers from countries that are not in any of the IOSCO working groups would be required to meet the standards established by the appropriate working group to make

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71. Id. at 1453.


73. Id.

74. Id. at 263.
its offering.\textsuperscript{75} Also, "[e]ach nation's antifraud provisions would apply to enable regulators (and where authorized aggrieved investors) to pursue relief where alleged disclosure deficiencies or other wrongs exist."\textsuperscript{76}

Professor Alan Palmiter focuses on a system of disclosure choice. He proposes, "the adoption of an enabling legal structure in which issuers can choose the disclosure level appropriate to their securities offerings"\textsuperscript{77} under the 1933 Securities Act. For instance, "an issuer able to attract investors with only Regulation D disclosure, but unable to meet all the exemption conditions, could choose this optimal disclosure."\textsuperscript{78}

Professor Hal Scott argues that "in fully internationalized securities markets, issuers in public primary markets should be able to issue securities to investors worldwide using one set of optimal distribution procedures and disclosure documents, and subject to one set of liability standards and enforcement remedies."\textsuperscript{79} He advocates in favor of the creation of an off-shore free-zone, in which countries would permit issuers to offer securities to the public (including residents of their own countries) offshore, subject only to minimum disclosure standards.\textsuperscript{80}

Professor Douglas Arner argues in favor of global shares.\textsuperscript{81} He explains, "under the global share structure, companies issue a single, inter-changeable and freely tradable class of shares, which are in turn listed on multiple exchanges pursuant to the individual requirements of the individual exchanges."\textsuperscript{82} These shares should be created pursuant to the law of the jurisdiction of incorporation. Enforcement of securities violations should be pursuant to the rules and structures of the jurisdictions in which the listings would take place.\textsuperscript{83}

\textsuperscript{75} Id. at 265.
\textsuperscript{76} Id. at 262 – 264.
\textsuperscript{78} Id. at 5.
\textsuperscript{79} Hal S. Scott, Internationalization of Primary Public Securities Markets, 63-SUM LAW & CONTEMP. PROBS. 71, 71 (2000).
\textsuperscript{80} Id.
\textsuperscript{82} Id. at 1587.
\textsuperscript{83} Id.
B. Nationality Approach

Professor Merritt Fox, in contrast, proposes "the superiority of the issuer nationality" approach. The core of this approach rests on the concept that each country has "socially optimal levels of disclosure." Since a national disclosure regime aims to serve primarily the national capital market and protect all national investors purchasing in that market, a country whose disclosure regime corresponds with optimal level of disclosure has capital utilizing enterprises that produce higher returns per costs of disclosure and increased productive activity. This approach benefits only the "domestic entrepreneurs and labor," not foreign ones. Only the company's country of incorporation has a principal benefit. According to Professor Fox, U.S. residents are interested in disclosure of all U.S. issuers, even those whose shares are offered or traded among foreigners. At the same time, because the U.S. economy does not benefit from foreign issuers participating in the U.S. securities market, the U.S. has very little interest in applying the U.S. disclosure regime to foreign issuers whose shares are listed on the U.S. exchanges. With respect to U.S. investment risk caused by holding a foreign issuer's shares, Professor Fox suggests that that risk could be minimized through a diversification of the investment portfolio.

According to Professor Fox, because of differences among countries not only in corporate structure but also in external environments, each country has different optimal levels of disclosure. Since the U.S. has a very strict disclosure regime, countries with lower disclosure requirements will have a higher cost of compliance with the U.S. disclosure regime. Applying Professor Fox's issuer nationality approach, countries that seek to raise capital in the U.S. market will be able to

87. Id.
88. Id. at 696, 822.
89. Id.
90. Fox, supra note 84.
91. Id.
92. Id.
93. Id.
94. Id.
use their domestic disclosure regime and keep their cost of disclosure the same. On the other hand, this approach does not reduce the volume of share transactions effected in the United States.

When comparing advantages of issuer nationality approach with the international uniformity approach, Professor Fox concludes that in a world which is becoming global, uniform disclosure standards will be more useful and beneficial than other approaches.⁹⁵ At the same time, it will be less effective at reducing investment barriers “than a nationally based system using the issuer nationality approach . . . [because] a nationality based system using the issuer nationality approach would be significantly more convenient administratively than an international regime.”⁹⁶

The national disclosure regime approach⁹⁷ differs from the international uniformity approach because the first presumes to apply domestic disclosure regimes to companies that seek to raise their capital in foreign capital markets instead of following a single uniform standard. It is an ideal situation for an issuer to reduce its cost of compliance with a foreign disclosure regime, which could be higher than its benefit. It also increases interaction with and accessibility to capital markets as well as its competition. On the other hand, a domestic securities regulation regime with an optimal⁹⁸ level of disclosure is a part of the domestic social and legal rules, and private and public institutions. It would be very different for such institutions to fit into foreign external environments. In some countries, such institutions differ conceptually. Because of these significant differences, these notions are not even comparable. Thus, an accounting system is an important part of disclosure requirements and good accounting rules should be designed to provide helpful information. In some countries accounting rules are designed as a control tool to facilitate tax collection⁹⁹ and does not aid domestic investors in evaluating a company. Such differences might constitute a considerable part of a domestic regulation system. After all, this complex system aims to protect domestic investors and ensure them sufficient level of honesty of a domestic issuer. Consequently, an intention to protect domestic investors puts investors from foreign capital markets in an unjust position that increases their risk. Viewing this risk as diversification¹⁰⁰ of investment is un-

⁹⁵. Id.
⁹⁶. Fox, supra note 85, at 567, 593.
⁹⁷. Fox, supra note 84; Fox, supra note 85; Fox, supra note 86.
⁹⁸. Id.
¹⁰⁰. See Fox, supra note 97.
convincing. Certainly, there is a way to inform investors of foreign financial markets about such lax-regulated companies to protect them and ultimately keep them from buying such stock. Under such circumstances, there is no reason for these companies to enter the foreign market.

Another issue related to the nationality approach is how to administer enforcement actions. Professor Fox argues that it is easier to administer a nationally based system than an international one.101 However, administrative costs should not be the primary consideration. Businesses entering a market will want a degree of certainty as to their liability exposure. In a global market place regulated at the domestic level, certainty is lost. A company's disclosure policies could be consistent with the requirements of one regime and violate another. If a disclosure violates the regulatory regime of one country, but the violation itself took place on the territory of another country, which regulatory regime would enforce the violation? Challenging Professor Fox's approach, Professor James Cox points out that enforcement issues "would raise a serious question of international law. Prevailing international law recognizes the power of a nation to enforce its standards against conduct that occurs exclusively in another nation only when that conduct poses a threat to its national security or substantially interferes with its governmental functions."102 It is doubtful a securities disclosure violation would qualify as to either of these exceptions.

C. Competition by Jurisdiction

Professor Roberto Romano argues that the current approach to securities regulation is mistaken.103 She advocates fundamental reform of the current securities regulation system and proposes an approach under which a company would be free to select its "securities regulator from among the fifty states . . ., the SEC, or other nation."104 A point of departure of her approach is competitive federalism. Professor Romano believes that the federal mandatory disclosure regime does not raise investors' welfare.105 She maintains the advantages of regulatory competition are the fastest means to correct this policy mis-

101. Fox, supra note 84; Fox, supra note 85; Fox, supra note 86.
102. Cox, supra note 55, at 1240.
104. Id.
A single regulator cannot do it quickly. Competition in the securities regulation would separate regulation from those imposed by the SEC and, at the same time, expand the states' role in this development. Implementation of the market approach to securities regulation, according Professor Romano, would require legislative reform. Such reform would include congressional legislation to impose a choice of law rule. "Congressional action is the preferred mechanism for implementing the securities domicile choice-of-law rule, . . . because it is the most expeditious method for achieving that end, as it does not require coordination by fifty state courts or legislatures."110

Professor Romano believes that a market-oriented approach is useful for the international securities market as well.111 She supports her arguments by the fact that a uniform international regulatory scheme is presently absent. Developing this idea, she proposes the international securities regulation should be open to jurisdictional competition as well.113 Thus, the market-oriented approach would make the U.S. market more attractive to non-U.S. issuers. The ability for non-U.S. issuers to enter the U.S. market without reconciling their financial statements to a U.S. GAAP and without complying with the SEC requirements would have a positive effect. It would decrease disclosure costs for non-U.S. firms and at the same time, U.S. investors would have the opportunity to buy foreign shares on U.S. exchanges. Under this approach foreign companies would be able to apply "their securities domicile for U.S. trading purposes."117

The regulatory competition approach at the state level within the United States has been extensively debated. Its aim generally is to give companies' more flexibility by lowering entry barriers to other jurisdiction's markets and to benefit states. The notion that compe-
tition among the fifty states, the SEC, or other foreign nations produces a regulatory "race to the top"\textsuperscript{120} is question begging. First, Professor Romano analogizes such institutions as state regulatory regime and national regulatory regimes as being equivalent. This comparison is flawed because such comparison violates the hierarchy of regulatory jurisdiction. When examining "regulatory regime", the author takes jurisdiction as a basis for her classification. Jurisdiction refers to "government's general power to exercise authority over all persons and things within its territory.\textsuperscript{121} It is well accepted that national authority is superior to state authority as well as national jurisdiction is superior to state jurisdiction. Therefore, it is necessary to study the jurisdictions that fall within the same authorities. The national jurisdiction should be compared to other national jurisdictions, so that the national regulatory regime can be compared to a regime of the same authority. Hence, the German national security regulation regime should be compared with the Japanese regulatory regime, not, for example, the Wakayama\textsuperscript{122} security regulation regime.

In the U.S. case, at first, it is necessary to clarify whether there is state, federal, or concurrent federal and state regulation. A state's, take for example Texas, regulation might be compared to and compete with the hypothetic Wakayama security regulation regime and the U.S. federal regime with the Japanese national one. The partly state and partly federal regime should be correctly compared to the Japanese national and a local one such as the Wakayama hypothetical.

Second, even if one focuses on the same level of authority, a regulatory regime is part of a complex set of social and legal rules, and private and public institutions. In each country this set of rules fits into national external environments. National culture, namely the values that reflect a society's preferences and priorities, plays an important role. Although the regulatory regime of each country aims to protect investors and ensure sufficient honesty of an issuer, the group of protected investors might differ as well as the means by which this goal is being implemented. Thus, if a regulatory regime intends to protect minority shareholders, such regime creates efficient tools to reach this goal. If a regulatory regime has been established to protect controlling shareholders, appropriate tools will be employed. Consequently, in

\textsuperscript{120} Id.
\textsuperscript{121} Black's Law Dictionary 855 (7th ed. 1999).
\textsuperscript{122} Wakayama is one of the Japanese prefectures located in the southern part of the Kinki Region on the Kii Peninsula. It is hypothetic assumption that Wakayama's security regulation regime exists. There are some strong doubts whether it exists some day.
spite of their superficial resemblance, national regulation regimes differ profoundly.

When discussing the possibility of applying the fifty state regulatory regimes to promote the “race to the top”, the question becomes whether these differences in regimes will produce conditions, which will lead to a “race to the top” or “race to the bottom”? Based on the premise that the regulatory regime is an aggregate of social and legal rules, and private and public institutions, the regulatory regime of each state must be viewed as a combination of such rules and institutions. A considerable number of such rules and institutions are a part of the single U.S. national system. Thus, the U.S. media is an important source of information that, at the same time, is a part of the U.S. financial market regulatory regime. Each state is deeply involved in this system. A legislative system of each state has been influenced by the U.S. constitution. Furthermore, the political, social, cultural, and historical experiences of each state are an inherent part of the national one. If one looks at each of fifty state’s regulatory regime in terms of path dependency, one notices the same evaluation of the economic system. Of course, California differs from South Dakota, but these differences are not of major consequence. Even more so, the close interaction between states as the parts of the single nation creates a system that compensates for such differences. If a hypothetic state would invest great effort to create a completely different regulatory or any other kind of regime, it would be almost impossible to fulfill this goal because of the external environments driving an important role in this process. All foregoing aspects support an inference that differences between the fifty state regulatory regimes diminish the difference between “bottom” and “top”. Therefore, there are no meaningful reasons to talk about competition with respect to the different states since there is really no competition. If one state has a rigorous disclosure regime and another state has lax one, and all other factors — path dependency, external environments, group protected investors — are the same, it will not impact the U.S. financial market as a whole whether a

123. John C. Coffee, Competition Among Securities Markets: A Path Dependent Perspective (Working Paper No. 192, 2002). "[T]his article rejects the simple scenario under which intermarket competition produces an all-encompassing, regulatory "race to the top." Id.

124. Coffee, supra note 61. Coffee discusses a role of path dependence and states that national variation in corporate governance reflects the impact of path dependency upon the evolution of economic systems.

125. See Black, supra note 12.
company applies one regime or another. Therefore, the impact on a financial market would not be considerable because marginal cost would be insignificant. However, the effect would be different if a company would chose between regulatory regimes of one of the U.S. states and a Barbary Coast state. Even if both of these regimes protect the same investors' group, the path dependency and external environments dissimilarity would make the distance between "bottom" and "top" significant.

IV. The Two Tier Approach

The above discussion serves to illustrate that the question of how best to regulate securities markets in a global economy is receiving wide attention and finding a solution is relevant to efficient development of emerging market structures. However, all the proposals addressed in this paper share a common weakness. They focus on harmonization of securities regulation regimes without addressing the underlying reality of existing regimes -- the existing disclosure regimes are an intricate part of an aggregate system of social and legal rules, as enforced by private and public institutions. It is within the context of the aggregate system that investors are protected and issuers are incentivized toward honesty.

The national disclosure regime is the part of the national system of institutions that not only imposes regulative rules and supports them, but also enforces them. Most of these provisions -- authoritative principles and procedural rules -- consist of the legal standards imposed by a regulator. The other rules -- listing standards, audit, accounting standards and others -- are set forth by other institutions.

In each country, this set of rules fits into an overall national framework where culture -- more precisely, values that reflect a society's preferences and priorities -- plays an important role. A country can

126. For an overview of the state disclosure requirements, and more importantly in this context, their exemptions, see Mark A. Sargent, \textit{State Disclosure Regulation and the Allocation of Regulatory Responsibilities}, \textit{46 MD. L. REV.} 1027 (1987).


128. This name was borrowed from James D. Cox's article. See James D. Cox, \textit{Regulatory Duopoly in U.S. Securities Markets}, \textit{99 COLUM. L. REV.} 1200, 1200 (1999).

129. Black, \textit{supra} note 12.

130. \textit{Id.}

131. \textit{Id.}

132. \textit{Id.}

133. See e.g., Amir N. Licht, \textit{The Mother of all Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems}, \textit{26 DEL. J. CORP. L.} 147 (2001) (introducing the...
have sufficient legal rules and at the same time a lax enforcement system or a specific cultural attitude towards law or dispute resolution. Although such fundamental issues of securities regulation, like the regulation of self-dealing, insider trading, and disclosure, have similar text reproduction; at the same time, they have divergence in values in different countries.

When one takes into account the reality of the role history, culture, and social norms play in the development of securities regulatory regimes, it becomes clear that any approach for solving the issues affected by new global environments should include two levels. First, domestic rules have to exist which will not be supplanted by the convergence process. Second, as a final outcome of the convergence, a suitable framework should be established conceptually. Such a concept should include a set of basic premises which would serve ownership market patterns (dispersed or concentrated) appropriately according to their features. These basic guidelines could be either adopted by countries as additional principles of their domestic systems and would be applied along with domestic rules (the SEC has already executed this method by adopting IDS); or, if countries have not yet established their domestic regulatory regime, they would adopt these principals and, simultaneously, be flexible to establish additional domestic regulatory rules that take into account the features of their securities markets.

A. First Tier — Domestic Regulatory Regime

Prima facie, it would appear abnormal to discuss whether a domestic securities regulatory regime has to be superior. In terms of the previous debate regarding what approach would be more profitable for the market, it is constructive to state that the domestic securities regulatory regime is an inherent part of a national regulatory system which serves a national consumer market and protects its participants. This function of the national regulatory regime is determinative of its framework of cultural value dimensions (CVD) of cross-cultural psychology and demonstrating its potential usefulness for analyzing problems); Amir N. Licht, International Diversity in Securities Regulation: Roadblocks on the Way to Convergence, 20 CARDOZO L. REV. 227 (1998) (critically assessing conflicting trends of diversity and convergence in international securities regulation and the degree to which they may be reconciled); Amir N. Licht, Genie in a Bottle? Assessing Managerial Opportunism in International Securities Transactions, 2000 COLUM. BUS. L. REV. 51 (2000); Amir N. Licht, Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets, 38 VA. J. INT’L L. 563 (1998).


135. Law enforcement is an inherent part of a national regulatory system.
superiority for securities transactions in the territory. The particular nature of securities among other commodities dictates the existence of a mandatory disclosure regulatory regime. In order to support the thesis regarding superiority of the national regulatory regime, first, it is germane to illustrate the distinctive nature of securities as commodities and then to demonstrate why the domestic regulatory regime is more proper for domestic consumers’ transactions than foreign ones.

Professor Joel Seligman put forth five principal arguments in favour of a mandatory corporate disclosure system. He advocates that voluntary disclosure would ease concealment or misrepresentation of information material to investment decisions. Underwriting costs, insiders’ salaries, and other benefits would be excessive. Investors’ confidence in the market would decrease. In the absence of a mandatory corporate disclosure system, neither state laws or private associations, nor civil or criminal actions will be able to ensure optimal levels of corporate disclosure.

A mandatory disclosure system is of critical importance to a robust securities market because of the nature of securities as a commodity. Securities differ from other goods primarily because they do not have an intrinsic value in themselves. Securities represent rights in something else and their value is derived from the future earnings potential of that “something.” This intangibility makes it difficult to measure the value of securities at the time of its purchase. It is only through access to adequate information that a purchaser is able to make an informed decision as to a particular security’s value and it is the issuer of the security that has control over the information the purchaser needs to make an informed decision.

A consumer buying ordinary goods, like a table, a car, or anything else, almost always has self-help remedies, such as, inspecting goods before purchasing them. Initially, a consumer has a chance to visibly estimate a prospective purchase by seeing its color, shape, size, weight, etc., or even touching it. When purchasing a car, a buyer can take a test drive to check whether or not he feels comfortable driving this car. Through this first inspection, a consumer cannot obtain full information regarding an item. Because of the incomplete nature of the initial stage, there is a second stage where a consumer utilizes his purchase. The second stage serves as a safeguard for buyer satisfac-

136. See Seligman, supra note 5, at 9.
137. Id.
138. Id.
139. Id.
140. Id.
tion. An unsatisfied buyer has a window of time, through warranty provisions, where he can either replace his purchase or get his money back.

Such features do not pertain to securities. A consumer/investor can neither tangibly estimate securities – no self-help remedies are available- nor inspect them while utilizing the product. The incomprehensibility and complexity of a securities purchase differentiates securities from the rest of commodities. However, this fact does not have to deprive investors of their rights to be protected. The investors need standardized and uniform information regarding the issuer’s conditions in order to be able to ascertain the value of that security, as well as be able to compare it with other securities on the market. Just as state and federal laws and other rules protect a regular consumer from dishonest and fraudulent sales of ordinary goods on the consumer market, the mandatory disclosure system has the same social function and protects the consumers/investors from fraud and misrepresentation.

The next question to be addressed is whether the national disclosure regime of the territory where securities transactions occur must be superior to other disclosure regimes. The domestic securities regulatory regime aims to protect the investors on the domestic securities market from fraud and misrepresentation. It has to be superior and cannot be superseded by another regulatory regime. The function of the national regulatory regime necessitates its superior role in the territory where securities transactions occur and demands that it not be superseded or pre-empted by another regulatory regime. The following features support this conclusion:

1. The intangible nature of securities makes it difficult to measure value during the purchase process. Standardized and uniform information regarding the issuer’s conditions is the most effective means to protect investors in the market. The mandatory disclosure system aims to protect the consumers/investors from fraud and misrepresentation.

There are those who maintain that it is unnecessary for the SEC to regulate the expectation interests of private investors and that the market should be left to regulate itself. A company’s desire to attract private investors’ capital and the need to compete with other companies for that capital will provide the necessary business incentive to disclose information without government oversight. In this way, the private investor, and not the government, is left with the responsibility of determining how much disclosure is necessary to protect the investor’s interest. If the investor believes the regulatory regime of some
other jurisdiction provides sufficient protection, then the investor should be free to make that choice without government interference.

The same can be said for any government regulatory oversight body. For example, one U.S. regulatory agency deeply involved in business practices is the Federal Trade Commission, which is charged with the responsibility of maintaining a competitive marketplace through the prohibition of unfair trade practices and anti-competitive behavior. It is never suggested that a consumer or business


142. In order to protect consumers from unfair method of competition and an unfair and deceptive act or practice in commerce, the Commission sets forth a statute, such as the Textile Fiber Products Identification Act. See 15 U.S.C.A. §70a, k. This Act deals with mandatory content disclosure in the labeling, invoicing, and advertising of textile fiber products. Moreover, unless exempted, the Federal Trade Commission has authority to enforce provisions of this Act. See 15 U.S.C.A. §70e. The Act contains a criminal penalty provision under which any person who willfully breaks the provisions of this Act "shall be fined not more than $5,000 or be imprisoned not more than one year, or both, in the discretion of the court." See 15 U.S.C.A. §70i. This Act extends through the all territories of the United States, that is, it is also applicable to the importation into the United States. See 15 U.S.C.A. §70e.

The Textile Fiber Products Identification Act aims to protect fear method of competition on the marketplace. Competition is one of the most important and inherent constituents of the economically developed consumer market. That means that the rules which regulate such "small" issues like labeling, are to appear on the market where they are important to consumer choice and such rules are able to be enforced. In an undeveloped market, there is a lack of the economic and social appreciation of competition. It does not mean that developing economies underestimate competition as a social institution. No. The developing markets often suffer for many reasons from a shortage of an offer on the marketplace. That shortage, in turn, might occur due to a deficiency of financial sources in the market. Under conditions of shortage of offers in the market, the labeling problems hardly could exist. In other words, each market responds to economic, social, cultural, and even historical environments in establishing its regulatory rules. Because of this, the participants of each market act pursuant to the conditions existing on the market where they act. A corollary is that textile fiber imported from any country into the United States is a subject of labeling under the Textile Fiber Products Identification Act.

One can argue that the labeling is too small of an issue for the market, is inexpensive to reconcile, and therefore does not merit discussion. The point concerning the labeling is not whether or not this issue is significant, the point is that market participants have to comply with the applicable market rules. If the labeling is more about fair competition, performance standards for electronic products which emit radiation provides protection for the public from unnecessary exposure to potentially harmful radiation. In October 1968 the United States Congress adopted the Radiation Control for Health and Safety Act, now incorporated in the Federal Food, Drug, and Cosmetic Act, See 21 U.S.C.A. § 321, to protect the public from unnecessary exposure to potentially harmful radiation, including microwaves emitting electronic products. This Act prescribes different and individual performance standards, to the extent appropriate and feasible, for different electronic products so as to recognize their different operating characteristics and uses. These standards are mandatory to comply with and they are the subject of regulation by Part 1030- Performance Standards for Microwave and Radio Frequency Emitting Products of the Code of Federal Regulations Food and Drugs (CFR). See 21 C.F.R. 1030.10. As provided by this Part, there is a requirement for an "application of electromagnetic energy at frequencies assigned by the Federal Communications Commission in the normal ISM [Industrial, Scientific and Medical (ISM) Frequency Bands] heating bands ranging from 890 megahertz to
6,000 megahertz.” See 21 C.F.R. 1030.10. This provision also applies to imported electronic products into the United States because the frequencies differ from country to country. As provided by the Federal Food, Drug, and Cosmetic Act, unless exempted, the district courts of the United States are authorized to restrain violations of the Act’s provisions. See 21 U.S.C.A. § 360pp. The maximum civil penalty imposed on any person under this Act shall not exceed $300,000. See 21 U.S.C.A. § 360pp (b)(1). The remedies provided for in this Act “shall be in addition to and not in substitution for any other remedies provided by law.” See 21 U.S.C.A. § 360pp (f).

The Textile Fiber Products Identification Act (the Textile Act) and the Federal Food, Drug, and Cosmetic Act (FFA) are an insignificant part of the national regulatory system that aims to protect the consumers on the national market from dishonest and fraudulent sales. Through mandatory disclosure of useful, accessible, and sufficient information regarding goods along with the remedies provided for these Acts, the regulators assure an indispensable level of protection. Federal levels of standards make the information standardized and uniform, and avoids obstacles that could lead to customers’ confusion. It is necessary to underscore that the above-mentioned Acts are not rare for consumers’ markets throughout the world. Most European countries have similar regulation rules to protect their markets. Their similarity does not mean that such rules could be superseded or pre-empted another. The objective reality that the similar text reproduction might have value divergence in different countries (For instance, ISM Frequency Bands), does not advocate a discussion regarding applying foreign rules. The regulatory rules on the particular consumer’s market are supported by an aggregate system of social and legal rules, and private and public institutions that together aim to protect the market and its participants from deception. That is, the regulatory rules sufficiently correlate with the corresponding level of economic development of each country.

Technical Electronic Product Radiation Safety Standards Committee (TEPRSSC) is an advisory committee of Center for Devices and Radiological Health (CDRH). It was established in accordance with the Radiation Control for Health and Safety Act of 1968. This committee advises the Food and Drug Administration regarding proposed performance standards for electronic products which emit radiation. Mandatory performance standards currently exist for television receivers, cold-cathode gas discharge tubes, diagnostic x-ray systems and their major components, radiographic equipment, fluoroscopic equipment, computed tomography equipment, cabinet x-ray systems, microwave ovens, laser products, sunlamp products and ultraviolet lamps intended for use in sunlamp products, high-intensity mercury vapor discharge lamps, and ultrasonic therapy products. See Technological Electronic Product Radiation Safety Standards Committee, at http://www.fda.gov/cdrh/teprsc.html (last visited Feb. 15, 2002).

The Food and Drug Administration (FDA) is one of the nation’s consumer protection agencies. Its mission is to promote and protect the public health by helping safe and effective products reach the market in a timely way, and monitoring products for continued safety after they are in use. See http://www.fda.gov (last visited Feb. 15, 2002).

See FCC Office of Engineering & Technology, Questions and Answers about Biological Effects and Potential Hazards of Radiofrequency Electromagnetic Fields, 56 OET BULLETIN (Aug. 1999); at http://www.fcc.gov/Bureaus/Engineering_Technology/Documents/bulletins/oet56/oet56e4.pdf (last visited Feb. 28, 2003). In North America and most of Europe exposure standards have generally been based on exposure levels where effects considered harmful to humans occur. Not all standard guidelines throughout the world have recommended the same limits for exposure. For example, some published exposure limits in Russia and some eastern European countries have been generally more restrictive than existing or proposed recommendations for exposure developed in North America and other parts of Europe. In the United States, although the Federal Government has never itself developed such exposure standards, the FCC has adopted and used recognized safety standards for evaluating frequencies environmental exposure since 1985. Federal health and safety agencies, such as the Environmental Protection Agency (EPA), the Food and Drug Administration (FDA), the National Institute for Occupational Safety and Health (NIOSH) and the Occupational Safety and Health Administration (OSHA) have also been actively involved in monitoring and investigating issues related to frequency exposure. U.S. federal, state, and local governmental agencies and other organizations
should be free to choose what jurisdiction’s competition regulatory scheme provides sufficient protection because it is understood that it is not an individual consumer or business that is being protected but the integrity of business and the economy as a whole. The same is true of the SEC regulation. It is for this reason that it is necessary that a nation’s securities regulatory scheme be superior.

2. The regulatory rules must sufficiently agree with the corresponding level of economic development of each country. Regulatory rules of each country are designed to relate to business transactions that occur in that country’s market and they benefit the market when they are able to serve it.

Only regulatory rules and consumers’ transactions that originate from the same consumer market are able to suit each other properly. Accordingly, a national regulatory system will be best suited to advance national economic development better than any other.

3. Securities regulations and corporate law supplement each other. The supplementary nature of their interrelation makes it impracticable to supersede or pre-empt the domestic securities regulatory regime by a foreign regulatory regime of another jurisdiction. The interrelationship between U.S. securities regulations and U.S. corporate law evidences the inherently important role the national regulatory system plays in protecting investor interests and incentivizing

have generally relied on exposure standards developed by expert non-government organizations.

143. The most evident illustration of the previous thesis that the regulatory rules and market generally correspond to each other is the Telemarketing and Consumer Fraud and Abuse Prevention Act. See 15 U.S.C. §§ 6101-6108. The Act requires the Commission to promulgate regulations (1) defining and prohibiting deceptive telemarketing acts or practices; (2) prohibiting telemarketers from engaging in a pattern of unsolicited telephone calls that a reasonable consumer would consider coercive or an invasion of privacy; (3) restricting the hours of the day and night when unsolicited telephone calls may be made to consumers; and (4) requiring disclosure of the nature of the call at the start of an unsolicited call made to sell goods or services. The law expressly authorizes the Commission to include within the rules’ coverage entities that “assist or facilitate” deceptive telemarketing practices. The Commission’s rules can be found at 16 C.F.R. Part 310. “The term ‘telemarketing’ means a plan, program, or campaign which is conducted to induce purchases of goods or services by use of one or more telephones and which involves more than one interstate telephone call.” See 15 U.S.C. § 6106. 4. The originality of this Act lies in the fact that an appearance of such regulatory rules tightly relates to the maturation of the consumers’ market. Telemarketing differs from other sales activities. Such differences assume that the market has to have availability to reply to telemarketing transactions with well-developed communication systems. Not every market is developed enough to absorb such business due to different economic capacities. In turn, regulatory rules also relate to business transactions that occur on the market. Regulatory rules benefit the market where they are able to serve the being transactions. It is outside the scope of the present discussion what are the primary the regulatory rules or the consumers’ transactions; the subject is only that the regulatory rules and the consumers’ transactions that are originated from the same consumer market are able to suit each other properly. This proceeds on the premise that the national regulatory system corresponds to a level of national economic development superior to any other system.
issuer honesty. Corporations have a long history of being subject to state regulations. Until the enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934, corporate securities sales, as part of corporate activities, had also been regulated by state corporate law. From the time the 1933 and 1934 Acts were enacted, the role of the state corporate law has considerably diminished. The 1933 and 1934 Acts replaced a hodge podge of state security regimes with a centralized uniform set of rules and regulations governing fraud enforcement, proxy regulations and corporate obligations to investors.  

There have been periodic debates regarding the need for greater uniformity in corporate law. The debate on this issue flashed again recently after Congress enacted the Sarbanes-Oxley Act. Through this Act, State control over corporate activity was further degraded. Section 402 of the Act amends section 13 of the Securities Exchange Act of 1934 and prohibits personal loans to public company directors and executive officers. This provision conflicts with section 143 Delaware General Corporation Law, which permits corporations to loan money to employees and officers. However, state corporate law continues to regulate other corporate activities, such as shareholder suffrage and fiduciary duties. In this way, federal security laws and state corporate law supplement each other.

State corporate law standards are not uniform. This variance provides flexibility to incorporate a company dependent upon management priorities. While such flexibility has some advantages, it also increases potential manipulation in government regulation of a corporation that could be harmful to shareholders' interests. To avoid manipulation, uniform federal regulation pre-empts contradictory state laws and regulations. This interrelationship between U.S. federal corporate securities laws and U.S. state corporate governance laws is further evidence of why a regime would allow a national securities regime be superseded or pre-empted by a foreign regulatory regime. In the U.S. system, not only would a federal disclosure regime be su-

144. In 1968, Congress enacted new amendments to the federal Securities Act known as the Williams Act that addressed the tender offer.


147. 8 Del. C. § 143.

148. The supplementary nature of their interrelation causes debate regarding whether a domestic issuer has a choice to apply securities regulation of a different jurisdiction in order to get an advantage of a regulatory competition. For example, a company located in France would apply Japanese labor law merely because Japanese labor rules are more desirable for the company's profitability.
perseded, but so would fifty state corporate governance regimes. Such a process would undermine the certainty that is important to business planning, growth, and investor confidence.

4. The dispersed share ownership nature of the U.S. securities market where investors are deeply involved in the market transactions makes this market unique. The existence of such a high percentage of the population participating in the market as investors makes it necessary to have a centrally organized regulatory regime able to protect investors and ensure them of the sufficient honesty of issuers.

The U.S. securities market's history has demonstrated a close correlation between stock market volatility and national economic health. A significant portion of the U.S. population is invested in the stock market and much of the investment is in the form or retirement savings through pension plans. These features explain why the U.S. securities market is such a high matter of public interest. This fact makes the U.S. pension system different from others developed countries.

In Germany and Italy, for instance, retirement provisions are based on three "pillars": state pension, occupational pension, and private retirement. It corresponds to 69%, 20.26%, and 10.74% of the

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150. Id. From 1992 the number of private investors participating in the U.S. stock market has grown by 15.2%. According to Federal Reserve Bulletin, January 2003, data shows the following:

<table>
<thead>
<tr>
<th></th>
<th>Families with Stock holding</th>
<th>Share of family's financial assets in stock</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1992</td>
<td>2001</td>
</tr>
<tr>
<td></td>
<td>1992</td>
<td>2001</td>
</tr>
<tr>
<td>All families</td>
<td>36.7</td>
<td>51.9</td>
</tr>
<tr>
<td></td>
<td>33.7</td>
<td>56.0</td>
</tr>
</tbody>
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As this chart shows, a significant percentage of Americans are invested in the stock market and a significant portion of this investment is its retirement savings. The U.S. stock market plays an important role in the private pension system. More than 40% of the United States population relies on the stock market as one of the primary sources of income for retirement.


152. Angelo Paulli & Mara Tagliafiele, Pension System and Gradual Retirement in Italy: Towards an Active Aging, at http://www.issa.int/pdf/helsinki2000/topic2/tagliafiele.PDF. The first pillar is the basic state pension. State pensions are the most important source of income for most Italian old people. The second pillar, occupational pension, involves only a very small part of employees, 7.1%. The third pillar is voluntary private pension. In Italy it is considered a form of saving alternative to other forms of financial investments, rather than a future supplementary pension. "20.4% of Italian families have a life-insurance and only 5.8% of families, composed by old people, have an insurance policy." Id. (last visited Mar. 30, 2003).
total retirement income.\textsuperscript{153} State pensions\textsuperscript{154} are the most important source of income during retirement. Retirement provisions in the United States are also based on these three "pillars". However, the first, pillar is not as significant as in Germany or Italy. Most Americans are dependent on personal savings to support them in their retirement years. If one looks at data regarding mutual fund investment per capita in the U.S. and in the several European countries, it is easy to see how significant a role personal savings play in the U.S. financial market in contrast to other countries.\textsuperscript{155}

\textbf{Mutual Fund Investment per Capital}\textsuperscript{156}

\begin{tabular}{|l|c|c|}
\hline
Country/Year & 2000 & 2001 \\
\hline
France & 13.209 & 13.655 \\
Germany & 5.154 & 5.079 \\
Italy & 7.811 & 7.008 \\
UK & 6.981 & 6.887 \\
US & 27.570 & 28.138 \\
\hline
\end{tabular}

As evidenced by the chart, compared to other industrialized economies, U.S. individuals participate in the stock market in significantly higher numbers. Consequently, the U.S. regulatory regime - - an aggregate system of social and legal rules, and private and public institutions - - must place a high premium on protecting investors and incentivizing issuer honesty.

B. Second Tier - International Regulatory Regime

In spite of the fact that the scope of each national securities regulatory regime is territorial, common goals such as an investors' protection make it possible that a process of regulatory regimes' convergence can be developed. Globalization contributes to this process in many respects as well. Actually, the differences between regulatory regimes do not arise from the wording of the investors' protection principals. Rather, the differences come from the basic distinctions rooted in society's conceptual interpretation of these principals and from the historical development of societies. "Differences in the [. . .] organization of the . . . societies can be consistently ac-


\textsuperscript{154} In other sources it is called as the "public pension".

\textsuperscript{155} See Raab, \textit{supra} note 153.

\textsuperscript{156} France 59,765,983; Germany 83,251,851; Italy 57,715,625; UK 59,778,002; US 280,562,489 at http://www.cia.gov/cia/publications/factbook/ (last visited Apr. 30, 2003).
counted for as reflecting diverse cultural beliefs." That is, cultural differences of societies determine the basic objectives of a corporation as a social institution. Thus, in continental Europe, the focus is predominantly on the need to satisfy societal expectations, the interests of employees, and others. In other countries — particularly in the common law countries — the predominant view is to emphasize the primacy of property rights. Under this view, employees, suppliers, and other creditors have contractual claims on the company, while shareholders have "residual" rights. These basic differences underlie the conception of securities and corporate regulatory regimes of each society.

When discussing the differences of society's historical development it is germane to note that as opposed to the United States securities market, the European market has been predominantly a debt market since the beginning of its history. Despite the fact that the oldest stock exchange, Amsterdam Stock Exchange, and the world's most recognizable international financial center, London, reside in Europe, dispersed securities ownership is not prevalent in Europe. Even in the United Kingdom, "as late as 1980 less than three percent of the population owned company shares." Also, recently, securities regulation in Europe had been "virtually non-existent outside the United Kingdom." Since the time corporate law became well-developed throughout Europe, its stock exchanges have been self-regulating, with little or no direct oversight by national governments. Further, European states have historically lacked full disclosure systems for the distribution or trading of securities. European states have not prohibited insider trading or other market manipulative practices as long as

159. Manning Gilbert Warren III, Global Harmonization of Securities Laws: The Achievements of the European Communities, 31 HARV. INT'L L.J. 185, 194 (1990). The author pointed out several explanations including: "the major economic dislocations resulting from two world wars and other armed conflicts; exchange and capital market controls imposed by European governments; the predominance of bank lending over securities offerings in corporate finance; the relatively small number of listed companies in continental Europe, each with only a minority of shares available in the open market; relatively high transaction costs; insufficient or non-existent transparency and liquidity in European securities markets; the absence of regulation affording investor protection; lack of public confidence in and understanding of securities markets; and popular aversion to the risks of securities investment." Id. at 194.
160. Warren, supra note 159, at 194 n.52.
161. Id.
the United States.\textsuperscript{162} In contrast, standardized and uniform federal securities regulation was enacted in the United States in the 1930s.\textsuperscript{163} As Professor Coffee highlights, "the critical protections for the dispersed shareholder are principally found in the federal securities laws, particularly those provisions regulating corporate control transactions."\textsuperscript{164} That comprehensive regulatory regime is based on the premise of full and fair disclosure of information regarding the issuer's conditions in order to enable investors to compare these conditions with other securities.\textsuperscript{165}

Despite differences underlining national regulatory regimes, endeavors to create a uniform regulatory regime acceptable to all participants of the global stock market have progressed. Regarding the general principles of internationally agreed-upon standards in the areas of securities regulation, a regulatory regime is generally based on three principles: disclosure standards (addressing non-financial statement disclosure requirements but not accounting or auditing principles), accounting standards, and corporate governance. The International Organization of Securities Commissions (IOSCO) is currently comprised of 110 ordinary and associate members that are securities regulators plus a further 61 affiliate members that are stock exchanges, international organizations, and other similar entities.\textsuperscript{166} IOSCO aims to develop a process of harmonization of the international financial market. The Objectives and Principles of Securities Regulation, (IOSCO Principles) adopted in 1998 and updated in 2002, are based on three purposes: protecting investors; ensuring that markets are fair, efficient and transparent; and the reduction of systemic risk.\textsuperscript{167} IOSCO adopted the International Disclosure Standards (IDS) for cross-border offerings.\textsuperscript{168} These standards address non-financial statement disclosure requirements and do not relate to accounting or auditing principles. The basis of IDS is to assist cross-border offerings by creating a single disclosure document to be used by foreign issu-

\begin{itemize}
  \item \textsuperscript{162} Warren, supra note 159, at 195.
  \item \textsuperscript{163} See Warren, supra note 159.
  \item \textsuperscript{164} John C. Coffee, Jr., The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications, 93 Nw. U. L. Rev. 641, 704 (1999).
  \item \textsuperscript{165} Id.
\end{itemize}
In November 1999, the Technical Committee Working Group on Multinational Disclosure and Accounting distributed a survey to determine the extent to which each of the IOSCO members had implemented the IDS. Today about twenty countries around the world have already adopted the IDS. Implementation of these standards by different jurisdictions appears to fall into four groups: adopted for foreign and domestic issuers; optional for foreign and domestic issuers; inapplicable to domestic, applicable to foreign issuers; inapplicable to domestic issuers, optional for foreign ones. This illustration demonstrates the considerable progress in the harmonization of the international financial market regarding disclosure standards that address non-financial statement disclosure requirements and do not relate to accounting or auditing principles.

Accounting standards provide the essential means of disclosing information for valuation of companies to provide a comparison for investors' decisions. The absence of the same accounting language on the global securities market hinders the reduction of investors' burdens of protection. Because of different accounting traditions around the world, accounting principles have developed differently. National accounting systems have been a subject of exploration for many years. As recent research regarding development of accounting standards around the word showed, the variances among accounting principles are based on a number of conditions including historical developments, differences between rules for individual and group accounts, etc. All together it produces a dissimilar result. As far back as in the seventies, it was concluded that Anglo-American systems, especially the American and the British ones, showed high values of information; whereas the Continental European systems with France at the bottom indicated relatively low degrees of information. Several studies in the nineties examined the relationship between disclo-

169. Id. at Part I.
173. Id.
174. d'Arcy, supra note 172.
sure practices and the capital market influence.\textsuperscript{175} Based on the requirements of certain stock exchanges, particular indexes of disclosures were calculated.\textsuperscript{176} It was discovered that the size of the capital market and the size of the participating enterprises were important factors for explaining differences in disclosure practices.\textsuperscript{177} Such significant differences are very costly for issuers to reconcile, as well as a significant impediment to the globalization of capital markets.

In an attempt to promote uniformity in international accounting standards, in 1994 IOSCO completed a review of the accounting principles issued by the International Accounting Standards Committee (IASC).\textsuperscript{178} In May 2000, IOSCO announced its examination of the accounting standards issued by the International Accounting Standards Committee and recommended that its members use thirty IASC standards, as “supplemented by reconciliation, disclosure and interpretation where necessary”\textsuperscript{179} to facilitate cross-border offerings and listings by multinational enterprises.\textsuperscript{180} The global business community responded quickly. The European Commission (EC) mandated that by 2005 all companies with shares trading on stock markets within the European Union (EU) must report to IAS.\textsuperscript{181} For almost 7000 EU listed companies IAS will be the official accounting standard.\textsuperscript{182} In addition, it is expected that companies with listed debt in the EU will be required to report IAS results by 2007.\textsuperscript{183} This requirement may be extended to all companies operating in the EU, even those not listed.\textsuperscript{184} According to research released by the world’s six

\textsuperscript{175} See d’Arcy, Francis, \textit{supra} note 172.

\textsuperscript{176} Id.


\textsuperscript{180} Id.

\textsuperscript{181} Id.


\textsuperscript{183} See International Accounting Standards Committee Standards Press Release, \textit{supra} note 179.

largest accounting firms over ninety percent, of a total fifty-nine countries surveyed, intend to converge with IAS.\(^{185}\)

While a method through which European and other countries to converge with IAS has been found, convergence with the United States has not yet occurred.\(^{186}\) Although the SEC has adopted the international disclosure standards, it has not accepted the international accounting standards. In 2000, the US Securities and Exchange Commission (SEC) issued a Concept Release to consider under what conditions the SEC should accept financial statements of foreign private issuers that are prepared to satisfy the international accounting standards.\(^{187}\) Several crucial points were noted in the Concept Release. The SEC has concluded that it does not propose to accept a process-oriented approach to IASC standards.\(^{188}\) Rather, the Commission intended to continue a product-oriented approach, assessing each IASC standard after its completion.\(^{189}\) The SEC stressed that one of the factors that affects the differences between IASC and the Financial Accounting Standards Board (FASB) standards is that IASC standards are designed to serve international environments versus FASB standards that apply to a domestic one.\(^{190}\) Such differences are not necessarily inappropriate, but they are difficult to compare.\(^{191}\) Also, the SEC maintained its approach not to accept a mutual recognition of

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\(^{186}\) Peter Jeffrey, *International Harmonization of Accounting Standards, and the Question of Off-Balance Sheet Treatment*, 12 DUKE J. COMP. & INT'L L. 341 (2002) (examining issues related to Off-Balance sheet transactions). The author concludes that accounting standards treat securitizations in different ways. The same transaction can be on- or off-balance sheet depending on the accounting regime employed. This inconsistency undermines the purpose of the standards and injures the capital markets. So, without a harmonized accounting standard for securitizations, the securitization market will not develop as rapidly as it could, to the detriment of businesses, capital markets, investors, and regulators. See also d'Arcy, supra note 146. It was discovered that in the USA the individual accounts are not published separately and a goal of consolidation accounting with all other parts of GAAP is assumed. In contrast, in Germany the individual accounts serve the objective of profit measurement and the regulation of profit distribution, because the payments to the owners as well as to the tax authorities depend on the profit figures whereas the sole function of group accounts is to inform about the economic position of the group. It was concluded that for systems where separate objectives for individual and group accounts exist, a different degree of determination according to the two types of accounts is conceivable. Especially, if there is a strong link between tax and financial accounting a differentiated result seems to be likely.

\(^{187}\) See 17 C.F.R. § 239.31 (2002).

\(^{188}\) *Id.*

\(^{189}\) *Id.*

\(^{190}\) *Id.* at 8908 n.53.

\(^{191}\) *Id.*
other jurisdictions’ oversight of financial statements prepared in accordance with IASC standards.\textsuperscript{192} Having analyzed the IAS, the SEC describes four possible approaches to recognition of the IASC standards for cross-border offerings and listings:\textsuperscript{193} (i) maintaining the current reconciliation requirements in all respects; (ii) removing some of the current reconciliation requirements for selected IASC standards, and specifying one acceptable treatment; (iii) relying on the IASC standards for recognition and measurement principles, but requiring U.S. GAAP and SEC supplemental disclosure requirements for footnote disclosures and the level of detail for the line items in financial statements; (iv) accepting financial statements prepared in accordance with the IASC standards without any requirement to reconcile to the U.S. GAAP.\textsuperscript{194}

National accounting standards are an essential part of a national financial system that serves financial transactions. Just establishing one single set of high quality international accounting standards will not alone make those standards compatible with national standards. The IAS is not able to take into account particularities of national financial systems that, in their turn, correspond to demands of national financial markets. This state of affairs determines the role of the IAS as establishing basic principles of the international accounting that combine common national principles and at the same time do not conflict with them. If national standards differ significantly from the international standards, it is unlikely that the national standards could be superseded or pre-empted by the others without negatively impacting the national financial system. The US securities market is historically and materially different from securities markets around the world. For instance, significant development of the U.S securities market was triggered by adopting the securities acts of 1933 and 1934. It in turn led to setting accounting standards that corresponded with purposes of the securities act to protect investors. Due to that historical environment, the U.S. GAAP was better able to meet the requirements of securities transactions than accounting standards in other countries. Even though business transactions become more complicated every day and the U.S. GAAP also needs modification to adequately address the current business environment, this fact does not diminish the leading role of the U.S. GAAP for securities transactions. While GAAP is very rule oriented, and therefore very detailed in approach, it lacks the broad based principle orientation of IAS. IAS

\textsuperscript{192} \textit{Id.}

\textsuperscript{193} \textit{Id.} at 8904.

\textsuperscript{194} \textit{Id.} IOSCO Responds to Enron-Related Issues, at http://www.iosco.org/iosco.html.
principles, because of their breadth, provide good general direction but lack the ability to respond to concrete concerns or problems. The U.S. GAAP could be modified to adopt IAS principles without altering its existing rule based orientation. In this way, the two systems could begin the process of accounting standards convergence.

Until this occurs, reconciling to the U.S. GAAP should be mandatory for foreign issuers that are looking to enter the US stock market. Otherwise, allowing their entry would jeopardize the protection that U.S. investors are afforded currently. It is too early to discuss the possibility of a complete convergence of two different systems. Taking into account that a significant number of countries that will accept the IAS as a part of their regulatory regime by 2005, it is appropriate for the USA to allow foreign issuers to apply the ISA with respect to the parts that do not conflict with U.S. GAAP.

When considering the establishment of the general principles of internationally agreed standards in the areas of securities regulation, issues related to the differences in corporate governance often are not taken into account. At times the distinctions represent barriers to the convergence of regulatory rules. Over the past few years, the improvement of corporate governance performance has been one of the principle means for strengthening the international securities market. The Organization for Economic Cooperation and Development (OECD) published the OECD Principles of Corporate Governance to depict the "best practice" of corporate governance in order to attract capital and protect investors. The OECD Principals are a non-binding outline that embraces five areas of corporate governance which are supposed to be the basis for fulfillment of a good corporate governance framework. In spite of the fact that these principles

195. See e.g., Maureen Peyton King, The Sec's (Changing?) Stance on IAS, 27 BROOK. J. INT'L L. 315, 315 (2001). The author analyzes differences between the International Accounting Standards and the U.S. GAAP. She concludes that the IAS' "financial statement standards [...] are unregulated and lack an enforcement mechanism [...] the U.S. standards [...] are promulgated with great detail, interpretation and technical guidance, are audited using well developed audit standards and enforced by a regulatory agency with actual authority." Id. See also Karel Van Hulle, International Convergence of Accounting Standards, 12 DUKE J. COMP. & INT'L L. 357 (2002).

196. If these two systems are combined, it would reduce a higher cost to compliance with the U.S. disclosure regime and enrich the US rules based GAAP with basic guidelines as well.

197. Today twenty-nine countries are members of the OECD. See http://www.oecd.org.


199. These five sections of the OECD Principles cover the rights of shareholders, the equitable treatment of shareholders, the role of stakeholders, disclosure and transparency, and the responsibilities of the board. One of the fundamental conclusions reached through this project
concur with the conception of corporate governance for most countries, the basic objectives of a corporation as a social institution makes these principles inherently different. Movement toward the similar conception of fulfilling the common principles is a favorable process for establishing internationally agreed-upon standards. For example, the board of directors plays a very different role from country to country. In the U.S. boards of directors usually do not have as strong a position, rather they have relatively little powers in comparison to shareholders. Executive directors, with a chief executive officer who is also the chairman of the board, generally control the board of directors. The recently enacted the Sarbanes-Oxley Act provides that the CEO and CFO must sign the annual accounts and other periodic financial statements. By doing so, they certify that the financial statements give a fair representation of the company's financial position, based on sound internal controls. The aims of these requirements are to make the responsibility of the CEO and CFO more explicit. In Europe, responsibility for the company's financial statements usually lies with all board members. These members often are required by law to sign the accounts and other statements, with clear civil liabilities for making misleading statements. The concept of making the CEO and CFO responsible for the accuracy of financial statements is not familiar to Europe.

From the above discussion it is clear the purpose of an international regulatory regime is primarily to serve issuers that enter foreign markets. The framework of these regulatory rules should be based upon the International Disclosure Regime, the International Accounting Standards, and the Principles of Corporate Governance. These basic guidelines could be adopted by countries as additional principles to their domestic systems for foreign issuers and be applied along with domestic rules. If countries have not yet established their domestic regulatory regime, they could adopt these principles and, concurrently, be flexible to establish additional domestic regulatory rules, while taking into account the distinct features of their securities markets.

Since the number of foreign issuers is significantly less than the number of domestic issuers on the domestic market, it is possible to

was the understanding that good corporate governance practices, which include high quality financial and accounting disclosure, are essential to improving shareholder confidence in a company.


adopt regulatory rules that differ from domestic regulatory rules immaterially. In that way, where international regulatory rules differ from domestic rules essentially, priority shall remain on domestic rules. Mandatory reconciliation with the domestic regulatory regime only in the area that differs from the international regulatory rule would decrease issuers’ cost to enter a foreign market.

C. Enforcement of the International Regulatory Regime and Scope of its Application

An enforcement action of the international regulatory regime should be achieved through the framework of an international regulatory oversight body. The IOSCO could function as a proper candidate. Dr. Geiger’s proposal of his Global Coordinator with some modifications could be the basis for fulfillment of a good international regulatory oversight body framework. As Dr. Geiger highlights, such an institution should be charged with three basic powers: decision-making, monitoring, and dispute-resolution. The important feature of the international oversight body’s function should be its close cooperation with domestic regulators.

As stated above, the international regulatory regime could be adopted by countries as additional principles to their domestic systems for foreign issuers and be applied along with domestic rules. If countries have already established their domestic regulatory regime that applies to foreign issuers, the latter could apply either one without diminishing the importance of the other. That is, the fact that a country adopted the international regulatory regime would not deprive foreign issuers of the opportunity to apply domestic rules. Thus, the Security Act applies to foreign issuers that publicly raise capital or list their shares on the U.S. securities market. Once the U.S. would adopt the international regulatory regime for foreign issuers as additional principles to their domestic systems, the foreign issuers have the opportunity to elect whether to apply the international regulatory regime or the U.S. securities regulation. The distinction of such an election would concern only matters of enforcement. The SEC, as government regulatory oversight body, would bring enforcement action against the foreign issuers that infringe the U.S. domestic security regulatory regime. The international regulatory oversight body, possi-

203. Id. at 1801.
204. Specific role of the domestic authorities is caused by the purpose of the national regulatory regime as well as the particular nature of securities among other commodities.
bly the IOSCO, would bring an enforcement action against the issuers that violate the international regulatory regime.

V. Conclusion

Globalization has deeply impacted international capital markets and made them more interactive and interdependent. Inter-market activity needs appropriate regulatory rules that facilitate companies to enter foreign markets. Countries involved in activities to create these regulatory rules have to take into account particularities of the two share ownership patterns - dispersed and concentrated - that exist around the world. The dispersed ownership pattern is characterized by significant protections for minority shareholders and promotes the development of a more efficient market. The concentrated ownership structure effects better monitoring of management and may permit greater investment in human capital. To get both of these systems to work together is a long and difficult process.

The U.S. financial market is a market with a dispersed share ownership pattern that has been characterized as a strong security market with high transparency and a rigorous disclosure regime for both U.S. and non-U.S. issuers. The U.S. national disclosure regime is part of an aggregate system of social and legal rules and private and public institutions that together aim to protect investors and ensure the sufficient honesty of an issuer. At the same time this regime is part of the U.S. national system of institutes that not only enacts and supports regulatory rules, but also enforces them. This whole system has been mostly successful for the last several decades. A significant number of foreign companies are trading on the U.S. capital market and this number increases each year. To date, New York’s stock market has a more successful position than its European rivals, the London and Frankfurt stock markets. The SEC provides foreign private issuers with a number of accommodations - especially Rule 144A — that are not inconsistent with the protection of U.S. investors. At the same time, the foreign companies can also offer their securities publicly.

The convergence process is an objective reality of globalization. Efforts to establish a global financial reporting pattern are timely. The SEC along with the other members of IOSCO is involved in this process. The acceptance of the International Disclosure Standards is a considerable movement towards the harmonization of the mutual efforts to fulfill the common goal. At the same time, despite the importance of the convergence and the rapid process of the economic globalization, today it is premature and potentially detrimental to the U.S. securities market to adopt the regulatory rules that do not fit into
the U.S. securities market external environments. An approach for solving the issues affected by new global environments should include two levels. First, domestic rules have to exist which will not be supplanted by the convergence process. Second, as a final outcome of the convergence, a suitable framework should be established conceptually. Such a concept should include a set of basic premises which would serve both ownership market patterns appropriately according to their features. These basic guidelines could be either adopted by countries as additional principles of their domestic systems and would be applied along with domestic rules – the SEC has already executed this method by adopting IDS; or, if countries have not yet established their domestic regulatory regime, they would adopt these principals and, at the same time, be flexible to establish additional domestic regulatory rules while taking into account the features of their securities markets.

After the bankruptcy of Enron and other high-profile business failures around the world, members of IOSCO (the most of which are the concentrated share ownership market pattern countries and, accordingly, have a lax-regulatory regimes) have regarded with favor the identifying and examining of strategic issues of common interest to securities regulators. This increased interest increases the possibility that a uniform approach to developing strong markets through uniform financial standards will one day be a reality.