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# Harmonization of Disclosure Standards for Cross-border Share Offerings: Approaching an "International Passport" to Capital Markets? (The Earl A. Snyder Lecture in International Law)

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# Harmonization of Disclosure Standards for Cross-border Share Offerings: Approaching an “International Passport” to Capital Markets?\*

J. WILLIAM HICKS\*\*

*On March 1, 2001, Professor Hicks delivered the fifth annual Snyder Lecture at the University of Cambridge in the Lauterpacht Center for International Research.*

It is a great honor and pleasure for me to present this year’s Earl Snyder Lecture in International Law. It is also a delight for me and my wife, Karen, to return to Cambridge, where in 1993 we made many friends during my Sabbatical leave as a Visiting Fellow at Wolfson College. I wish to thank Professor James Crawford for his gracious hospitality to us this week and to thank all of you for coming this evening.

The topic of the inaugural Snyder Lecture, which Professor Sir Eli Lauterpacht delivered in Bloomington in 1997, was “International Law and Private Foreign Investment.” In that lecture, Professor Lauterpacht observed that, “in the treatment of investment, as of so many other topics of international law, there have, in the space of less than fifty years, been changes of which an earlier generation could hardly have dreamed.”<sup>1</sup> For the purposes of that lecture, Professor Lauterpacht limited the term “investment” to cross-border direct investments, such as those cases in which a private investor purchases an entire enterprise, large or small, within the host country. He specifically excluded portfolio investments; that is, ownership interests in a nongovernmental company, such as shares of stock, that do not give the investor control over the direction and management of that private company.<sup>2</sup> I propose to address that form of investment and to consider some of the legal problems of disclosure that are raised when a company, commonly referred to as an issuer, sells its shares to investors in one or more countries other than that

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1. Elihu Lauterpacht, *International Law and Private Foreign Investment*, 4 *IND. J. GLOBAL LEGAL STUD.* 259, 275 (1997).

2. *Id.* at 260.

in which the firm is organized. I also propose to discuss international law, but not in its traditional form. The international law that I am concerned with does not emerge from state-to-state diplomacy; instead, it comes from agreements reached through informal interaction among governments. With these differences in mind, I fully endorse Professor Lauterpacht's observation about changes in the law's treatment of foreign investment, and I will attempt to explore some of the developments which he explicitly omitted. Before turning to the law and its evolving impact on cross-border share offerings, let me begin with some of the changes in the capital markets.

Over the last five decades, the global financial landscape has undergone a significant transformation. These developments have been attributable in part to dramatic changes in the business and political climates, increasing global competition, the development of more market-based economies, and rapid technological improvements. At the same time, the world's financial centers have grown increasingly interconnected.

For most of the second half of the twentieth century, corporations and other business organizations sought capital within their home countries and they usually acquired it in the form of loans from domestic banks. Private firms in some countries, such as the United States and the United Kingdom, supplemented their capital by selling shares of stock to domestic investors; in other countries, such as Japan and Germany, where investors historically prefer the safety of bonds and savings accounts, equity financing from the public was a rarity. When cross-border capital flows occurred in the decades prior to 1990, they usually involved lenders, mostly major international banks, and borrowers from the developed countries in Europe and North America.

In the 1990s, the traditional characteristics of private capital raising shifted dramatically, ushering in a pattern that is likely to become even more pronounced during the twenty-first century. Instead of relying primarily upon borrowed funds from local providers of capital, private firms are acquiring needed capital by selling portfolio investments—equity securities—to public investors and listing their shares on foreign exchanges. And an increasing number of these firms now look for capital beyond their home country's borders. Furthermore, a growing percentage of these issuers of equity securities are from less developed parts of the world, representing what has become known as emerging markets, particularly those in Asia and Latin America.

The shift in focus by capital seekers away from local lenders to foreign equity markets would not have occurred, nor can it continue, without a corresponding interest among investors in both indirect investments, generally,

and indirect foreign investments, more specifically. Many factors have contributed to the growing population of global shareholders, including the record numbers of initial public offerings by high technology firms, the ascendancy of private pension funds and mutual funds throughout the developed world, and the explosive rise of stock markets. This combination of factors has caused many persons, including ordinary individuals, to view portfolio investments as the superior, long-term repository for their savings. Other factors help to explain the growing attraction that foreign indirect investments have for investors. Included among those factors is the on-going technological revolution that allows ordinary persons to use personal computers to explore investment opportunities in the global markets through chat rooms, news groups, bulletin boards, e-mail, and hyperlinks, to acquire company and fund research, as well as current stock quotations, price/earnings ratios, press releases, and analysts' reports, and, in some instances, actually to purchase and sell equities without the assistance of a stock broker.

The interdependence of the world's capital markets and the expanding global equity culture have challenged securities regulators around the world. One of those challenges relates to the legal constraints that regulators in most countries impose on a public offering of shares by the company that created or issued those shares. Public offerings by a company are distinguished from resales by shareholders to other investors, which take place in trading markets. The growth in global trading markets of foreign indirect investments that began in earnest in the early 1990s would not have occurred if significant numbers of private companies had not made cross-border share offerings to the public.

The securities law of most countries distinguishes between public and private offerings. In so-called private placements, a company faces minimal regulation if it limits its securities offerings to sophisticated investors who, because of wealth or experience, are able to protect themselves by demanding the information they need from the issuer. In order to keep nonpublic offerings truly private, the law usually restricts resales of shares purchased in those offerings for a specified period of time. Public offerings are regulated differently. In most countries, indirect investments that can be purchased by any investor, regardless of wealth, sophistication, or experience, are considered "public." Public offerings are usually promoted or sponsored by investment bankers and other market professionals, and sometimes they coincide with the creation of a trading market for the newly offered shares, possibly through a listing on a stock exchange, where purchasers may immediately resell their

shares. The public character of these share offerings calls for more complex regulation.

National securities laws protect investors in public offerings by requiring issuers to make full and fair disclosure about themselves and the securities being sold. The framework for this regulation differs from country to country. However, in most countries, a public offering by a company that is incorporated or organized in the country where the offering occurs is subject to a regime of regulation that encompasses three important stages: (1) the preparation of a disclosure document, sometimes referred to as a prospectus; (2) the scrutiny of disclosure materials by the appropriate regulatory body; and (3) the publication and distribution of the disclosure document to members of the public in accordance with rules that address the manner for making offers and sales.

In some jurisdictions, the regulator is empowered to approve or reject a proposed disclosure document; in other jurisdictions, the regulator does not approve a company's prospectus but is authorized to delay the time when sales of the new shares may occur if the regulator is not satisfied that the prospectus contains all of the required disclosures. Common to all of these regulatory schemes that apply to public offerings is the belief that judgments as to the merits of a particular investment offering are for investors to make. The role of securities regulators is to ensure that all of the disclosure items mandated for inclusion in the prospectus are fairly and fully presented so that ordinary reasonable investors can use that information to make an intelligent investment decision.

The globalization of capital markets presents many regulators with a dilemma. How is the securities regulator of a particular country to accommodate its mandate of investor protection to the growing interest of domestic investors in diversifying across the globe and to the interests of that country's financial community in having foreign issuers use the domestic capital markets?<sup>3</sup> How is the regulator to adapt to meet the needs of market participants while maintaining current levels of investor protection and market integrity?<sup>4</sup> In the context of cross-border public share offerings, this dilemma

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3. Bevis Longstreth, *A Look at the SEC's Adaptation to Global Market Pressures*, 33 COLUM. J. TRANSNAT'L L. 319, 320 (1995).

4. See, e.g., Regulation of International Securities Markets, Sec. Act Release No. 6807 (Nov. 14, 1988) [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,341, at 89,576, available at 1988 WL 902407 (warning that "[t]he challenge facing regulators of these global securities markets is to ensure efficiency and honesty").

involves the disclosure rules for foreign issuers, including those rules that prescribe the scope and content of a prospectus.

In the absence of uniform disclosure standards, domestic securities regulators have a tough choice to make when they are faced with the prospect of public offerings of indirect investments by foreign issuers. One policy-based option for such regulators is to conclude that domestic investors in foreign securities should be supplied with information equal as nearly as possible and practicable to that which is provided to those who invest in domestic securities.

However, if the disclosure standards of a jurisdiction are perceived by foreign companies as too strict, the costs of compliance with those more onerous disclosure rules might cause foreign issuers to go elsewhere in search of capital.

Furthermore, a country's tough disclosure standards for foreign issuers might lead regulators in other countries to retaliate by denying or limiting access to their markets to issuers, market intermediaries, and investors from the more demanding state.

On the other hand, a decision by securities regulators to soften their disclosure standards for foreign issuers creates its own set of problems.<sup>5</sup> For example, reducing disclosure requirements for foreign share offerings, without a corresponding modification for domestic share offerings, gives foreign issuers lower compliance costs, as compared with domestic issuers. Depending upon the compliance cost gap, this type of reform might drive domestic companies abroad in search of cheaper capital. Furthermore, the relaxation of disclosure standards has the potential of creating regulatory competition among national securities authorities. Regulatory competition can be beneficial to society. It can produce diversity among international regulatory systems, which in turn might yield regulations that are creative in shaping the business culture. However, there is a possible down side to this form of competition. Authorities in individual countries might be led by economic interests to attract as many issuers of indirect investments as possible and, in order to accomplish this goal, to reduce their disclosure rules for foreign companies in response to regulatory changes in other countries. The logical outcome of a process where national

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5. An intermediate approach, such as reducing disclosure requirements for some foreign issuers but not for all of them, has been advanced. See, e.g., David S. Ruder, *Effective International Supervision of Global Securities Markets*, 14 HASTINGS INT'L & COMP. L. REV. 317, 326 (1991), where the author, a former chairman of the SEC, states that some lowering of U.S. standards for foreign issuers may be desirable, "particularly with regard to securities of well-known, widely followed, highly capitalized corporations, sometimes known as 'world class securities.'" According to Ruder, these securities "are subject to analysis and scrutiny worldwide, and it may not be necessary that full disclosure regulations be applicable to them." *Id.*

regulators compete for foreign share offerings might be suboptimal levels of disclosure and unacceptable levels of investor protection in some of the global capital markets. For this reason, some observers have called this form of regulatory competition a "race to the bottom."<sup>6</sup>

Private companies find the current regulatory climate for cross-border share offerings exasperating. Formal international securities law does not exist. There is no global securities regulator in place to coordinate and interpret national rules that apply to these share offerings. As a result, companies planning a multijurisdictional share offering are likely to face the burden of complying with different disclosure requirements in each of the jurisdictions where they expect to sell their shares. There are, however, a few bright signs of actual progress away from this regulatory disharmony.

First, some cooperation among national securities regulators has actually been achieved. In 1991, the securities regulators of the United States and Canada entered into a reciprocal agreement that created what is known as the Multijurisdictional Disclosure System (MJDS).<sup>7</sup> Under the MJDS, which continues in operation today, both the United States and Canada have agreed to recognize the prospectus and registration statements of established companies that are prepared under the other's disclosure requirements. Even though the MJDS does not include agreement on standards of disclosure, securities regulators of these two countries have determined that their respective disclosure standards are sufficiently similar for mutual recognition of each other's disclosure documents in cross-border public offerings. To be accorded mutual recognition under MJDS, a prospectus must have been previously scrutinized and accepted by the appropriate home country regulator. Once that regulatory acceptance has occurred in the issuer's home country, the issuer's prospectus can be used in the host country without a substantive review of the disclosure document by the host country regulator.

Regulatory cooperation among national securities regulators also exists in the European Union, where, as a result of several Directives, disclosure

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6. See, e.g., 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, 263 (1999); Uri Geiger, *The Case for the Harmonization of Securities Disclosure Rules in the Global Market*, 1997 COLUM. BUS. L. REV. 241, 293. There is reason to doubt whether such a race to the bottom has occurred or is likely to occur. See generally Howell E. Jackson & Eric J. Pan, *Regulatory Competition in International Securities Markets: Evidence from Europe in 1999-Part I*, 56 BUS. L. 653 (2001).

7. Sec. Act Release No. 6902 (June 21, 1991), [1999 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,812, available at 1991 WL 285685. The SEC proposed the MJDS in Sec. Act Release No. 6841 (Aug. 4, 1989), [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,432, available at 1989 WL 1000327.

documents, consisting of listing particulars or prospectuses, that are published in one Member State may be used freely in another Member State, based on the principles of mutual recognition.<sup>8</sup> As compared to the MJDS, the EU plan is more ambitious. The EU plan is not only based on mutual recognition, as the MJDS is, but is also grounded on minimum disclosure standards. Instead of reciprocity between two sovereign nations, the EU arrangement, although not global, connects seventeen Member States and their capital markets. Finally, unlike the MJDS, which excludes certain foreign issuers, such as newly organized or unseasoned companies, EU reciprocity does not discriminate among cross-border issuers from Member States. Each Member State of the European Union is free to supplement the minimum disclosure standards with additional disclosure requirements that it believes are appropriate for the needs of its markets. However, each Member State, regardless of the strictness of its own disclosure standards, must accept the disclosure documents prepared by a foreign issuer from another Member State so long as those documents satisfy the minimum disclosure requirements.

A second sign of hope for more compatible regulation of cross-border share offerings comes from the International Organization of Securities Commissions, known as IOSCO, which is an international, nonprofit association of governmental securities regulators, securities regulatory organization personnel, and private-sector observers.<sup>9</sup> Founded in 1983, IOSCO has 158 members from more than ninety countries. In 1998, the membership of IOSCO endorsed a proposal by one of IOSCO's technical committees that establishes a core set of disclosure standards for nonfinancial statement portions of an international offering document. It is entitled "International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers."<sup>10</sup> According to IOSCO, the new standards "will allow issuers to prepare a single disclosure document that will serve as an 'international passport' to capital raising and

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8. The principal EU securities law directives in connection with share offerings are the Listing Conditions Directive (1979), the Listing Particulars Directive (1980), the Mutual Recognition Directive (1987), and the Public Offer Prospectus Directive (1989). *See generally* HAROLD S. BLOOMENTHAL & SAMUEL WOLF, 10E INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION § 9A.01[1] (2001).

9. The history and description of activities of IOSCO can be found on the IOSCO website. *See generally* Int'l Org. of Securities Comm'ns [IOSCO], at <http://www.iosco.org/iosco.html> (last visited Mar. 3, 2002).

10. For the full text of the standards endorsed by IOSCO, see IOSCO Standards, at [http://www.iosco.org/docs-public/1998-intnl\\_disclosure\\_standards.html](http://www.iosco.org/docs-public/1998-intnl_disclosure_standards.html) (Sept. 1998) [hereinafter IOSCO Standards]. It is organized in two parts. Part I contains the introduction, a glossary of defined terms, and the items of disclosure to be used by companies in connection with cross-border public offerings. Part II sets forth disclosure issues outside the scope of the standards, consisting of a sample compilation of national requirements that issuers will have to satisfy in certain jurisdictions.



listing in more than one jurisdiction at a time.”<sup>11</sup> As this quotation indicates, the endorsement by the IOSCO membership communicates two separate recommendations: (1) an explicit proposal for common disclosure standards; and (2) an implicit proposal for total harmonization through mutual recognition by national regulators. It is these two recommendations that are the primary focus of the remainder of my lecture.

The international disclosure standards, which were formally proposed by IOSCO, consist of ten core disclosure items<sup>12</sup> and a glossary of defined terms.<sup>13</sup>

Included among the ten core disclosure items is mandated information about the terms and timetable of the offering,<sup>14</sup> major shareholders,<sup>15</sup> the company and its business,<sup>16</sup> and its directors and senior management.<sup>17</sup> Also required are specified financial statements and an explanation by management of factors that have affected the company’s financial condition.<sup>18</sup> The IOSCO standards assume that all information contained in a disclosure document will be provided in a language acceptable to the host country.<sup>19</sup>

The ideal regulation of cross-border share offerings, as envisioned in the IOSCO recommendation, is relatively simple to describe. A company planning a cross-border share offering will prepare a core disclosure document that reflects the common set of disclosure standards which are used by all participants in international offerings. The prospectus will be reviewed and accepted by the regulator of one of the countries involved in the multinational offering. Thereafter, that document will be given mutual recognition by regulators in all other countries where the foreign issuer attempts to sell its shares. Although some minor tailoring of the prospectus may be necessary to

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11. Press Release, IOSCO Announces the Release of Four Documents of Vital Interest to Securities Regulators and Market Participants (May 27, 1998), <http://www.iosco.org/iosco.html>.

12. IOSCO Standards, *supra* note 10, at Part I.

13. The Glossary of Defined Terms contains definitions of the following terms: “affiliate,” “beneficial owner,” “company,” “directors and senior management,” “document,” “equity securities,” “group,” “home country,” “host country,” and “pre-emptive issue.” *Id.*

14. *Id.* at Items II, IX.

15. *Id.* at Item VII.

16. *Id.* at Item IV.

17. *Id.* at Item VI.

18. *Id.* at Items V, VIII. In addition to the items of disclosure referred to in the text, the IOSCO Standards also require disclosure of information as to the identity of directors, senior management and advisers, *Id.* at Item I; key information as to selected financial data, capitalization and indebtedness, reasons for the offer and use of proceeds, and risk factors, *Id.* at Item III; and additional information as to share capital, Memorandum and Articles of Incorporation, material contracts, exchange controls, taxation, dividends and paying agents, any statement by experts, documents on display and subsidiary information, *Id.* at Item X.

19. *Id.* at Part I, Intro., Presentation.

satisfy specific national requirements, a foreign issuer's prospectus will serve as an "international passport," giving it access to the world's capital markets. Under this theoretical scheme, foreign issuers in search of capital will move quickly across political borders, passing through the regulatory checkpoints of any country with minimal cost and inconvenience.

The model of global harmonization that is captured in the concept of an "international passport" merits serious attention for at least three reasons. First, it carries the endorsement of IOSCO, which is the most influential nongovernmental body that is concerned with major international regulatory issues related to international securities transactions. Because of its status among global securities regulators and policymakers, IOSCO is the only such organization that has a realistic chance of coordinating practical responses to those concerns, including disclosure standards for cross-border share offerings.

Second, IOSCO's vision of an international passport, as the best method for eliminating regulatory burdens for foreign capital raising, has garnered support from key securities regulators. In November 1999, the U.S. Securities and Exchange Commission (SEC) adopted the IOSCO disclosure requirements for foreign issuers as part of the U.S. federal securities laws.<sup>20</sup> In adopting these standards, the SEC stated that the IOSCO disclosure standards "are a good first step toward creating a framework for an 'international passport' to the world's capital markets."<sup>21</sup> Support for the IOSCO proposals has also come from Europe. In 1997, the Forum of European Securities Commissions (FESCO) was established by seventeen of the region's securities regulators. FESCO has no legal powers, but it seeks to clarify how existing EU rules should be interpreted. In a letter to the U.S. SEC, dated June 15, 1999, FESCO expressed its members' support for IOSCO's disclosure standards and for efforts to create an international passport.<sup>22</sup> In May 2000, FESCO sought to replicate the IOSCO proposal on a regional basis, calling for harmonization of disclosure standards in a core disclosure document that would serve as a "European

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20. International Disclosure Standards, Sec. Act Release No. 7745, [1999-2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,208 (Sept. 28, 1999), available at 1999 WL 770251 [hereinafter Release No. 7745]. The SEC proposed the international disclosure standards in Sec. Act Release No. 7637 (Feb. 2, 1999), [1999 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,112, available at 1999 WL 44076 [hereinafter Release No. 7637].

21. SEC Press Announcement (Sept. 29, 1999), available at 1999 WL 6696702.

22. Letter from IOSCO, to the U.S. SEC (June 15, 1999). FESCO's letter to the SEC was in response to requests by the SEC for public comment on the proposed international disclosure standards as set forth in Release No. 7637, *supra* note 20.

passport” and facilitate cross-border offerings by companies organized in the European Union.<sup>23</sup>

A third reason to take the IOSCO initiative seriously is that it offers numerous benefits to issuers and investors that are not presently available. Unlike any current efforts towards regulatory cooperation, the IOSCO proposal contains the seeds of total harmonization. It offers both commonality (a common set of disclosure rules) and reciprocity (mutual recognition by foreign regulators). Both MJDS and the EU arrangement require reciprocity but not commonality. The agreement between the United States and Canada was based on similar disclosure rules but there is no required alignment of disclosure standards. The EU plan does provide for minimum disclosure standards but, because individual Member States may supplement those requirements, the disclosure rules in the European Union are far from uniform.

Each of the component parts of the IOSCO proposal holds out a promise of improvement. The commonality component of the proposal, if implemented in full, would eliminate the need for regulatory arbitrage by national authorities seeking to attract foreign issuers with more lenient rules and, by ending the race to the bottom for mandated disclosure rules, the IOSCO standards would provide higher levels of investor protection. Uniform disclosure standards would lighten a foreign issuer’s burdens when selling its shares in multiple jurisdictions, thereby lowering the issuer’s cost of capital. Widespread adoption of the IOSCO disclosure standards might also encourage emerging markets to shape their laws accordingly.

The reciprocity part of the IOSCO proposal, which is not formally articulated but which is crucial to the notion of an international passport, would open up many more capital markets for foreign issuers. It would necessarily encourage greater communication among national authorities in ways that might produce more efficient regulation. It also has the benefit of familiarity. Other models for addressing regulatory disharmony among disclosure rules for cross-border share offerings have been advanced,<sup>24</sup> but because the IOSCO

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23. See <http://www.europefesco.org>; *Fesco Plans a Quiet Revolution*, FINANCIAL NEWS, May 22, 2000, available at 2000 WL 9074698.

24. For example, Roberta Romano, Stephen Choi, and Andrew Guzman have advocated a system under which issuers, regardless of the country of organization, would be free to choose their securities regulator for all securities transactions and reporting obligations. Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L. J. 2359 (1998); Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903 (1998). As an alternative to this so-called “portable reciprocity” approach, Merritt Fox supports reciprocity but proposes national regulation of home-country issuers, as determined by the issuer’s nationality, without

plan builds on traditional notions of regulation, it is arguably the least threatening to national securities regulators.

In light of these actual or potential benefits in the IOSCO proposal, a threshold issue for anyone urging reform of the international regulatory regime for foreign share offerings is whether the IOSCO proposal constitutes a fair and realistic solution to problems that the present regulations create. The question that is included as part of the title of this lecture was intended to raise both factual and normative issues. Is it realistic to assume that IOSCO's international disclosure standards will produce a single disclosure document for cross-border share offerings and is that goal worth pursuing? Even if the commonality form of harmonization is meritorious, is IOSCO's expectation for reciprocity among regulators workable and is that goal worth pursuing?

As the benefits of harmonization mentioned earlier suggest, the commonality aspect of the IOSCO initiative has much to recommend it. It has already earned the general support of global securities regulators. To be truly effective, however, those standards must be mandatory. Some regulators, such as the U.S. SEC, have used these standards to replace existing disclosure requirements for foreign issuers. Other regulators have accepted these standards as an alternative to existing requirements and have permitted foreign issuers to choose between the IOSCO standards and the existing standards which, in most instances, contain less demanding disclosure requirements.<sup>25</sup> The possibility remains, however, that eventually all regulators will mandate these standards as the exclusive disclosure rules for foreign issuers. But even if such uniformity were to be realized, the IOSCO disclosure standards do not encompass all of the information required of a "passport" to cross-border capital markets.

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regard to where issuers sell their securities. See, e.g., Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, 95 MICH. L. REV. 2498 (1997). Hal Scott rejects harmonization as unworkable, and favors instead the establishment of an offshore free zone where domestic regulators would permit resident investors to participate in the offshore market for primary share offerings free of restrictions other than minimum disclosure requirements. Hal S. Scott, *Internationalization of Primary Public Securities Markets*, 63 LAW & CONTEMP. PROBS. 71 (2000). Uri Geiger believes that the solution to regulatory disharmony lies in the creation of an international super-regulator that would select the disclosure rules. Uri Geiger, *Harmonization of Securities Disclosure Rules in the Global Market—A Proposal*, 66 FORDHAM L. REV. 1785 (1998).

25. See Technical Comm. Int'l Org. Secs. Comm'ns, *The Report on Implementation of International Disclosure Standards*, May 2000, available at [http://www.iosco.org/docs-public-2000/2000-internal\\_disclosure.html](http://www.iosco.org/docs-public-2000/2000-internal_disclosure.html).

To begin with, the IOSCO proposal does not include accounting standards.<sup>26</sup> These standards are crucial for providing financial statements in a prospectus that are prepared in the same manner as those by issuers from other countries. The development of international accounting standards is the subject of a separate project by IOSCO, and many accounting professionals who are associated with that undertaking are optimistic that a satisfactory solution is within reach.<sup>27</sup> Assuming, however, that an accord is possible on a core set of financial standards and that they too are adopted by securities regulators as mandatory for foreign issuers, the road to commonality has at least two other obstacles.

The first problem stems from the flexibility that the IOSCO disclosure standards explicitly grant to the securities regulators of the host country in a cross-border share offering. These standards contemplate that the core disclosure document will undergo “a minimum of tailoring to fit national requirements.”<sup>28</sup> But the extent of national tailoring permitted under those standards could be extensive. The IOSCO standards specifically acknowledge that supplemental disclosure by foreign issuers will sometimes be necessary in certain host countries because of local custom and practice and because of wide variation in the type of information required by regulators for certain industries (such as banking, insurance, and oil and gas companies), for certain unusual forms of equity securities (such as depositary shares and voting trust certificates) and for certain forms of information (such as earnings projections and other forward-looking information).<sup>29</sup> The core standards also leave room for host country regulators to permit information to be omitted in certain limited circumstances, “as in the case of information that is required by law to be kept secret, that may not be disclosed for public policy reasons or that represents a trade secret or proprietary information.”<sup>30</sup> As a result, an IOSCO-compliant

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26. The IOSCO standards “relate to non-financial statement disclosure requirements and do not address the issue of which bodies of accounting or auditing principles may be followed by the issuer in preparation of its financial statements.” IOSCO Standards, *supra* note 10, at Part I., Intro., Scope of Standards.

27. *See, e.g., Lee Berton, Countdown to Harmonization*, INSTITUTIONAL INVESTOR, June 1, 1999, available at 1999 WL 13840004. The IOSCO undertaking to create uniform accounting and auditing standards is based in large part on the efforts of the London-based International Accounting Standards Committee. The SEC is a major participant in both of these projects. *See, e.g., SEC Concept Release, International Accounting Standards*, Sec. Act Release No. 7801, [1999-2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,237 (Feb. 16, 2000), available at 2000 WL 190008.

28. Commission Announcements, *SEC Adopts New Disclosure Requirements*, SEC DIGEST, Sept. 29, 1999, available at 1999 WL 6696702.

29. IOSCO Standards, *supra* note 10, at Part I., Intro., Scope of Standards.

30. *Id.* at Part I., Intro., Omission of Information.

prospectus, which is prepared in accordance with the disclosure rules of one host country, may not satisfy the disclosure standards of another host country.

A second problem with the IOSCO core document standards concerns commonality of disclosure rules for domestic issuers. Many national regulators have adopted the IOSCO standards, but only for foreign issuers. Domestic share offerings are subject to different rules. One consequence of disparate disclosure rules is the loss of comparability of information. Investors and market professionals need comprehensive information to analyze and value securities. Unless share offerings in the global capital markets are made by issuers that use a prospectus that reflects disclosure standards that are substantially similar to disclosure rules for domestic share offerings, investors and securities analysts will continue to have difficulty acquiring information that they need to compare foreign issuers with domestic issuers.

The second part of the IOSCO recommendation, the expectation of reciprocity, is also flawed. The IOSCO plan to create an international passport contemplates cross-border share offerings in which a foreign issuer's common disclosure document is accepted in one jurisdiction and then receives quick acceptance by regulatory authorities in other parts of the world. There are, however, at least three major impediments to the realization of this IOSCO goal.

Although IOSCO desires the widespread use of a common prospectus, the proposal for international disclosure standards does not attempt to impose a uniform approval procedure on global securities regulators. The IOSCO initiative clearly states that every core disclosure document is to be "subject to the host country review or approval process."<sup>31</sup> In adopting the IOSCO international disclosure standards, the U.S. SEC was careful to note that "there will be no change in our current procedures and practices for reviewing and commenting on filed documents."<sup>32</sup> The review process of disclosure materials differs among securities regulators. In the United States, for example, the review process of disclosure materials, which are to be used in connection with a public share offering, varies widely depending upon whether the company is a first-time issuer, when the filed documents receive a thorough review, or an established public company, when the offering documents receive either a more limited review or no review at all. A full review of share offering materials includes a careful examination by several members of the SEC's legal and

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31. *Id.* at Part I., Intro., Background.

32. Release No. 7745, *supra* note 20, at n.19.

accounting staff to determine not only whether the filed documents contain all of the required disclosures, but also whether the presentation of the required information is adequate under the facts and circumstances of the particular transaction. In performing such a review, the SEC staff draws on its institutional experience with its own rules. It also draws on its experience in dealing with the lawyers, the accounting firm, and the investment bankers that are participating in the due diligence process of a particular offering. The SEC staff's perception of the reputation of those professionals can be either a source of comfort or a cause for concern.

The practical implication of the review process, for purposes of mutual recognition by regulators, was addressed by one of the critics of the IOSCO proposal, a major U.S. law firm, which communicated its views in writing to the U.S. SEC prior to the SEC's adoption of those standards. That critic observed:

The review process in developed markets such as the United States develops its own body of "lore." Even though a filing might include information responding to all the IOSCO core disclosure standards, experienced U.S. lawyers will still be able to point to a particular item of disclosure and correctly say "the SEC is going to issue a comment on that." The comments that will be issued by the various reviewing authorities will tend to differ, and thus the IOSCO standards, supplemented by experience, will begin to diverge from jurisdiction to jurisdiction.<sup>33</sup>

The IOSCO plan for reciprocity also suffers from the absence of a single arbiter for resolving disputes over how the IOSCO disclosure standards are to be interpreted, amended, and enforced. Consider, for example, the concept of "materiality" as it relates to the disclosure items in the core offering document of a foreign issuer. The IOSCO standards contain a requirement that is a traditional part of most countries' disclosure rules. They state that in addition to the information expressly required to be included in the core document, a company must disclose such further material information, if any, necessary to keep the mandated disclosure provided pursuant to specific requirements from

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33. Comments by Rogers & Wells LLP, *SEC Proposes to Revise Form 20-F to Incorporate IOSCO Disclosure Standards*, Feb. 1999, filed with the SEC in response to Release No. 7637. Release No. 7637, *supra* note 20.

being misleading.<sup>34</sup> To illustrate the significance of the materiality rule, consider Item No. VI.A. of the IOSCO standards, which instructs a foreign issuer to provide specified information about the company's directors and senior management that will allow investors to assess those individuals' experience and qualifications.<sup>35</sup> A foreign issuer that accurately detailed all of this information in its cross-border disclosure document would appear to be in compliance with this disclosure item. However, because of the materiality rule, that foreign issuer's prospectus would not satisfy Item VI.A. if it omitted material information that caused the statements about its directors and senior management to be misleading, such as, to use an extreme example, failing to disclose that all of them were felons who had been convicted of securities fraud and had served five years in prison.

As the IOSCO standards acknowledge, the formulation of the materiality concept varies in different countries. However, even if a uniform definition of that term existed, it is impossible for standardized disclosure rules to anticipate, let alone resolve, every factual situation that raises an issue of materiality. In the United States, the SEC staff members, who are involved in the review process of a foreign issuer's disclosure document and who must decide if that document is complete, are able to draw upon decades of judicial and administrative interpretations of the materiality concept as applied to hundreds of varied factual situations.<sup>36</sup> Unlike the U.S. SEC, regulators in many other countries do not have the same reservoir of experience or authority to help them make those decisions. Even with that experience, their judgments that a disclosure document is or is not materially deficient might be different.

The goal of mutual recognition is illusive for still another reason. An international passport to the world's capital markets is useful only if the holder of that passport can reach its desired destination. For a foreign issuer making a share offering, the destination is a group of foreign investors who might purchase its shares. Even if the IOSCO standards were to be adopted verbatim and a foreign issuer were able to pass quickly through all of the regulatory checkpoints with an approved disclosure document, the path to potential investors might not be immediately accessible in some of the desired markets.

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34. IOSCO Standards, *supra* note 10, at Part I., Introduction. The IOSCO standards acknowledge that the formulation of the materiality concept varies somewhat in different countries and they provide a more detailed description of the materiality principle in Part II, Item I.

35. *Id.* at Part I, VI.A.

36. SEC Rule 408 of Regulation C (17 C.F.R. § 230.408) is the U.S. counterpart to the materiality rule of the IOSCO standards.



As mentioned earlier, national securities laws regulate not only the content of a prospectus but also the manner by which issuers may effect their share offerings. These distribution rules determine when offers can be made, what written offering materials may be used during the registration and review process, and when final sales may occur.<sup>37</sup> Each country has its own unique set of distribution rules. As a result, a foreign issuer that is planning a share offering to investors in several countries is likely to encounter inconsistent rules regarding the use of written materials, other than the prospectus, and the moments in time when valid offers and sales may occur. The IOSCO standards make no effort to harmonize distribution rules.

I return now to the questions I raised earlier about the IOSCO proposal. Is it likely to produce an international passport to the capital markets some time soon, and should global regulators and policy makers pursue that objective? As my assessment of the IOSCO proposal to this point indicates, that proposal contains fundamental limitations. But the IOSCO proposal suffers from more than just these inherent problems.

First, full implementation of the proposal is, I believe, politically impossible. The divergence that exists on issues relating to the review process, interpretation and enforcement, distribution rules, and the procedures for amending and reforming regulations that affect cross-border share offerings, is unlikely to disappear without a reduction in the number and authority of securities regulators. It is also unlikely to vanish until a limited number of regulators are vested with authority to oversee securities activities that extend beyond political boundaries. Neither of these forms of regulatory restructuring can be expected to occur in the near future. In November 2000, a European Commission task force proposed a powerful new committee to supervise the EU securities markets but stopped short of urging the creation of a single EU regulator. Nonetheless, the task force proposal prompted some EU regulators,

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37. Under U.S. federal securities laws, for example, prior to filing its disclosure materials with the SEC, an issuer may not make offers, publish advertisements about the proposed offering, or do anything that would condition the market for its shares. During the period of time when the SEC staff is reviewing the filed documents, the so-called waiting period, oral offers are permitted, but generally written offers may be communicated only in the form of the preliminary prospectus that is on file with the SEC. Other selling literature is prohibited. Once the SEC staff has completed its review of an issuer's prospectus, sales may occur but a copy of the final prospectus must be delivered to each investor. 15 U.S.C. § 77e (1933). Furthermore, where a change of circumstances makes an issuer's prospectus materially misleading during the distribution process, the prospectus must be updated so as to reflect all material developments. 15 U.S.C. § 77q (1933). The U.S. registration and distribution rules apply only to offers and sales of securities that occur in the United States. 17 C.F.R. § 230.901 (1933).

including the Federation of European Stock Exchanges<sup>38</sup> and Sir Howard Davies, chairman of the Financial Services Authority, to express their strong opposition to a pan-European securities regulator.<sup>39</sup> Furthermore, no one can seriously believe that the U.S. SEC is likely to cede any of its regulatory authority to a regional or global regulator.

Second, the experience in Canada, the United States, and the European Union with mutual recognition of cross-border share offerings suggests that reciprocity on a global basis is probably unattainable. Mutual recognition requires continuing confidence by participating national regulators that their regulatory counterparts in other countries will fairly and adequately apply and enforce standards. Where that confidence is eroded, support for reciprocity disappears, as it did in the United States in the late 1990s. During that period of time, some Canadian regulators were forced to operate with inadequate budgets and inexperienced or overworked staff, conditions that sometimes prevented them from fully enforcing their securities laws. Canadian companies continued to raise capital, and many of them raised money in share offerings that were limited to investors in the United States, a type of offering that came to be called the "southbound-only deal."<sup>40</sup> Too often during the late 1990s, disclosure documents for this type of cross-border offering, which were filed with provincial regulators in Canada, especially the Ontario Securities Commission, were approved without a proper review because of budgetary constraints. Under the MJDS, the U.S. SEC was obligated to recognize the Canadian approval process as final. Nonetheless, the SEC staff occasionally performed spot audits of these filings and discovered serious deficiencies in the cross-border disclosure materials. As a result, the MJDS between the United States and Canada nearly collapsed.<sup>41</sup>

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38. See, e.g., Silvia Ascarelli, *LSE Plans OM Defense Amid Strategy Struggle*, WALL ST. J. EUR., Sept. 25, 2000, at 13, available at 2000 WL-WSJE 21071164.

39. See, e.g., Stephen Castle, *EU Committee Is to Supervise Exchanges*, INDEPENDENT (London), Nov. 10, 2000, at 22, available at 2000 WL 26289164. See also Anthony Hilton, *Anthony Hilton Column*, EVENING STANDARD (London), Jan. 18, 2001, available at 2001 WL 10112912; *Lamfalussy Group Calls on EU to Urgently Set Up Securities Committee*, AFX NEWS (U.K.), Nov. 9, 2000, available at 2000 WL 29246304; *Financial Regulators Focus on Extending Co-operation*, FINANCIAL NEWS, Sept. 25, 2000, available at 2000 WL 9075765; *Exchanges Call for Closer Regulatory Integration*, FINANCIAL NEWS, June 7, 1999, available at 1999 WL 24778158.

40. See, e.g., Katherine Macklem, *Concern Grows over Access to Cheap U.S. Capital: Needs a Champion: May Reflect Lack of Confidence in Canadian Regulators*, FINANCIAL POST, Dec. 1, 1999, available at 1999 WL 29437579.

41. See, e.g., Katherine Macklem, *Cross-border Finance Pact Preserved: Helped Raise Billions: Canada's Special Disclosure Status in U.S. Is Saved*, FINANCIAL POST, May 30, 2000, at C1, available at 2000 WL 21836319; John Partridge & Richard Blackwell, *Future of MJDS Looks Brighter*, GLOBE & MAIL,

Even if national regulators are able to fully perform their tasks, a policy of mutual recognition does not guarantee clear sailing for foreign issuers making cross-border share offerings. In June 1999, for instance, Deutsche Telekom effected the first retail share offering across all eleven Euro-area countries; last year the German firm broke new ground again with another share offering, extending it to retail investors in non-Euro markets as well, including those in the United Kingdom and Switzerland. Although both offerings sold out quickly and thus might be described as successful transactions, mutual recognition by EU regulators involved in those offerings did not work smoothly. In some EU countries only the prospectus summary had to be translated; in Italy and Spain, regulators required the entire 145-page Deutsche Telekom prospectus to be translated into their local language. Because EU securities regulators have different rules on prospectus publication, Deutsche Telekom spent months negotiating with regulators for the right to commence the offerings simultaneously. It also had to establish separate timetables for marketing the offerings. Some EU countries forbid marketing of shares before publication of a prospectus. Others, including France, Germany, and Italy, allow it. Even where promotional materials were permitted, Deutsche Telekom advertisements for those share offerings were not always viewed as acceptable. For example, regulators in the United Kingdom and Holland vetoed the use of a magenta upward slash in an ad because it could be interpreted as a rising share price. French regulators rejected a television ad for the Deutsche Telekom shares because it showed a man in a car who was not wearing his seat belt.<sup>42</sup>

Finally, the IOSCO proposal will not work because it is premature. As Bernard Black has pointed out, formal disclosure rules, by themselves, do not make for a strong securities market. The harder task, he notes, is enforcing the rules, and that includes “both direct public enforcement and indirect

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Apr. 7, 2000, at B3; Stephen Handelman, *Newly Limited Partnership Canada Could Lose Its Special Status in U.S. Capital Markets. Maybe That's O.K.*, TIME INT'L, Dec. 13, 1999, at 29, available at 1999 WL 29489278; Andrew Willis, *Hero Needed to Keep Door Open to U.S. Market*, GLOBE & MAIL, Nov. 26, 1999, at B15.

42. See, e.g., Silvia Ascarelli, *Calling Small Investors, Everywhere; Deutsche Telekom's Massive Simultaneous Offering Sets a Precedent; In Global Market for Stocks, Geography Isn't Destiny*, WALL ST. J. EUR., June 16, 2000, at 13, available at 2000 WL-WSJE 21064161; Silvia Ascarelli, *Orders for Pivotal New Issue of Deutsche Telekom, Pushed by U.S. Demand, Exceed Available Shares*, WALL ST. J., June 13, 2000, at C18, available at 2000 WL-WSJ 3032674; William Wright, *Deutsche Telekom Plans First Global Retail Offer*, FINANCIAL NEWS, May 8, 2000, available at 2000 WL 9074342; *Deals of the Year, Equity, European Retail Loves DT*, EUROMONEY, Feb. 10, 2000, at 88, available at 2000 WL 11840382; *International Equity, Deutsche Telekom's Bumpy Ride*, EUROMONEY, Aug. 10, 1999, at 26, available at 1999 WL 10187910.

enforcement through reputational intermediaries, securities analysts, the financial press, and other market institutions.”<sup>43</sup> The capital markets of the world are fundamentally different in character. Some capital markets, such as those of the United States and the United Kingdom, possess all of the core institutions for ensuring good disclosure. In other capital markets, including many in Europe, the equity culture has only begun to emerge among noninstitutional investors. The domestic laws and related institutions are still struggling to give minority shareholders reliable information about the value of a company’s business, and the securities regulators in those markets are just beginning to deal with cross-border share offerings to retail investors. Because of these differences, many capital markets lack the enforcement mechanisms that strong markets require.

Until greater parity can be achieved among the world’s securities markets, harmonization of disclosure standards and mutual recognition are unrealistic and unwise objectives. In the meantime, efforts to eliminate barriers to efficient, cross-border share offerings should continue, but those efforts should leave room for international regulatory systems that are innovative and responsive to different, evolving market and business conditions.

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43. Bernard Black, *The Core Institutions that Support Strong Securities Markets*, 55 BUS. LAW. 1565, 1580 (2000). Professor Black defines the term “reputational intermediaries” as institutions “who vouch for the quality of particular securities.” *Id.* at 1568. According to Black:

These intermediaries—accounting firms, investment banking firms, law firms, and stock exchanges—can credibly vouch for information quality because they are repeat players who will suffer a reputational loss if they permit a company to exaggerate its prospects, that exceeds the intermediary’s one-time gains from permitting the exaggeration. The intermediaries’ backbones are stiffened by the risk of legal liability if they endorse faulty disclosure, and government civil or criminal prosecution if they do so intentionally.

*Id.* (citations omitted).

