Session 5 – Making Corporate Governance work across the Atlantic

Michael Traynor
Senior Counsel, Cooley Godward Kronish LLP
President, The American Law Institute

The theme of our discussion this afternoon is making corporate governance work across the Atlantic. A couple of questions that our speakers may touch on today are whether there really still are tensions between our country and Europe and whether they have diminished, and, second, whether there's a basis for a transatlantic agenda and, if so, what the competing alternatives might be and whether there are useful intermediate approaches to consider.

I will say a few words of introduction of our four speakers in the order in which they will present, and then ask each of them to come up in that order.

First is Paul Sarbanes, the distinguished senator from Maryland. He served for 30 years in the United States Senate, the longest of any senator from Maryland, and before that he had a distinguished record as a legislator, both in the House of Representatives and in the Maryland legislature. He was an extraordinary leader in fashioning the Sarbanes-Oxley Act that has been the subject of our conference. In college, he graduated from Princeton and then, as a Rhodes scholar, attended Oxford. And then he and I met in the famous class of Harvard Law School of 1960, where we became good friends, classmates, and study mates.

One of our classmates, Paul Brountas, an extraordinary corporate lawyer based in Boston, has recently written a book called "Boardroom Excellence." Paul Sarbanes has written the foreword to that book, and I'll quote just a sentence from Paul's foreword. Paul identified "an urgent need for greater public understanding of just what caused the crisis in corporate governance, of the reforms that corporate management and directors must now adopt, and of the expanding opportunities for shareholders to make their voices heard in the boardroom."

Our second speaker is Pierre Delsaux who is a director of Free Movement of Capital, Company Law, and Corporate Governance in the Internal Market and Services Directorate General of the European Commission. In addition to his law studies at the University of Liege, he obtained his Master's degree in law at Northwestern University.

Our third speaker will be Jaap Winter, who has his PhD from the University of Groeningen in the Netherlands. He's a professor at Erasmus University in Rotterdam, as well as a visiting professor at Columbia Law School. He's a member of the board of the ECGI. He's a partner in the De Brauw Blackstone Westbroek firm. He's a chair of the EU high-level group of company law experts and, in addition to all these attributes, he's a champion sprinter and soccer player.

Our last speaker, accustomed to being on this podium as a commissioner of the SEC, is Harvey Goldschmid. He has also served as general counsel of the SEC. He's the Dwight

Professor of Law at the University of Columbia. And very importantly to The American Law Institute, he, together with John Coffee and Mel Eisenberg, were reporters on our project on corporate governance, a project that took 13 years, from 1980 to 1993. I want to say another word or two about Harvey. He's the author of numerous publications on corporate securities, corporations, antitrust law. He's a frequent lecturer at national and international legal programmes and seminars. He received the 1999 Chairman's Award for Excellence from the SEC, and several teaching awards, including Columbia Law School's Willis L.M. Reese Award for Excellence in Teaching.

With that brief introduction, let me ask Paul Sarbanes to help set the stage for our discussion this afternoon and say a few words to us. Paul.

Paul Sarbanes
Former US Senator;
co-sponsor of the Sarbanes-Oxley Act of 2002
I'm pleased to be here with you. I'll try to be quick. As Elizabeth Taylor said to her seventh husband, I won't keep you long. Let me say also what a pleasure it is for me to be under the chairmanship of Mike Traynor, who's a dear friend from when we were at Harvard Law School together.

I want to take just a few moments at the outset to put some of this in context, particularly Sarbanes-Oxley. You couldn't sit here all day long, as I did, beginning with Chairman Cox, and not want to respond to some of what was said, and as we move along I'm going to try to do some of that. I think there's a tendency - you know, the Dow Jones is now over 14,000, and so forth and so on - and we tend to lose sight of what happened and forget about it.

Arthur Levitt and Paul Volcker, writing in the Wall Street Journal some time back, warned us of falling into a collective amnesia towards the real pain and loss that investors suffered. And if we go back to that time, we lost trillions of dollars in the market value of public companies, thousands of jobs were lost, retirement savings dried up, people who thought they'd provided adequately for their retirement all of a sudden were in dire circumstances.

Enron, in the first quarter of 2001, reported a 20% increase in earnings; the second quarter, reported another 20% in increase in earnings over the first quarter. I mean, it was going up like a sky rocket when you charted its stock price on the charts. By October, it restated its earnings. November, it restated its earnings again. The first week in December, it declared bankruptcy - the largest bankruptcy in US history up to that point, exceeded and eclipsed by WorldCom some six months later.

And it turned out that Enron was a canary in the mineshaft. A number of major companies were engaged in convoluted, often fraudulent, devices to inflate earnings, hide losses, and drive up the stock prices. So I just want to set a reference point for some of the discussion. The Wall Street Journal at the time concluded: the scope and scale of the corporate transgressions of the late 1990s now coming to light exceed anything the US has witnessed since the years preceding the Great Depression. Fortune magazine said: “phony earnings, inflated revenues, conflicted Wall Street analysts, directors asleep at the switch”. This isn't just a few bad apples we're talking about here. This, my friends, is a systemic breakdown. And Money magazine said: a total failure by everyone, a complete breakdown in the system in all of the checks and balances.

I think there was obviously a real investor crisis in investor confidence with respect to the US markets, and of course, it was having an impact around the world. Now, we had to decide how to proceed, and the committee - I'd only recently become the chairman of the banking committee, because Jim Jeffords of Vermont had switched sides and shifted the majority, and I was the senior Democrat and I became chairman of the committee. When I went to the Congress, I was very critical of the seniority system, but I have to say to you that, as time went by, I increasingly came to see the virtues in the workings of the seniority system. I took over the chairmanship. That was in June 2001. When I met with the press, I didn't have anything like this on my agenda. We talked about investor protection, which has always been an important issue to me, but we had no sense of what was coming, and so, as a new chairman, I had to figure out how to proceed.

I decided we'd do it the old-fashioned way: we'd hold some good, solid, substantive hearings that people in this room would participate in. John Coffee, for one, participated in those hearings and we started off, actually, with five former chairmen of the SEC at the witness table, appointed by both Democratic and Republican presidents, and that was really a terrific panel. Then we went from there. Over a two-and-a-half-month period, we held these very intensive, in-depth, substantive hearings about what had gone wrong with the system.

Some were asserting that the only thing we needed to do was to punish the bad actors. That would be deterrence, and deterrence alone would be enough. The most extreme example of this was Paul O'Neill, the Secretary of the Treasury. They asked him what he thought ought to be done and he said, well, he thought these malefactors ought to be taken out and hung from the nearest tree. Now, frankly, I thought that was a little lacking in due process myself, but we decided to come at this and try to examine whether there was a systemic breakdown, or whether if you just increase the punishments, that would be enough as a strong deterrent.

Of course, once you get a bad apple, the damage, by definition, has already been done. My own view, of course, is if the system is really working well, it ought to screen out as much of this as possible. You can't guarantee it, because you're always going to have people who will cut every corner, and cheat and lie, and everything else, particularly if there's big money at stake, but it seemed to us, and we concluded at the end of our hearings, that there were systemic problems.

The difficulty with the deterrence approach alone was told to us by a wonderful story by John Coffee when he testified in front of the committee, and one of my colleagues said to him: What about deterrents? Just give them heavy penalties? And he said: Well, we should punish the bad actors, but that's not enough: you've got to strengthen the system. He said: Let me tell you a story. In 18th century London - and John can get up and correct me if I don't tell the story well - but in 18th century London, the punishment for pickpocketing was death by hanging. And the hangings were public hangings on Tyburn Hill near the Tower of London. So this pickpocket was caught, apprehended, he was tried and convicted, and sentenced to death by hanging. Now, hangings were public, so huge crowds would gather to see the hanging. So, the morning of the scheduled hanging of this convicted pickpocket, thousands gathered on Tyburn Hill to see the hanging of this convicted pickpocket. And working the crowd were hundreds of pickpockets. So much for deterrence!

So we moved ahead and with these hearings we relied heavily on previous studies that had been done. I have to share just one story with you and then I'll move on quickly. We had one hearing where we had three former chief accountants of the SEC at the witness table. They were now retired chief accountants. I have to tell you, it was very dry and technical testimony. And at one point a colleague of mine sitting over on this side, perhaps not realising the microphone was open, said this is really boring. Well, he was right, but he shouldn't have said it, particularly with an open microphone so it resounds throughout the room. At which point another colleague of mine, Senator Mike Enzi from Wyoming, who's the only Republican from Wyoming and who later worked very closely with us in moving this bipartisan legislation forward. Enzi’s the only CPA in the United States Senate. Of 100 members of the Senate, he's the only one who's a CPA. So when this comment was made about how boring this testimony of these three chief accountants at the witness table was, Enzi, so unlike him, he leaps into the discussion, and he says, it may be boring to you, but I haven't had this much fun since I came to the United States Senate! That gives you some sense of the definition of fun in the United States Senate.

Well, we moved through, and in the end we were able to move the legislation through by an overwhelming margin. Clearly a bipartisan piece of legislation. I'm not going to go through its various provisions and of course it's now been the law for five years, and we think it's made a big difference.

Chairman Cox not long ago spoke to a group and he said, we have come a long way since 2002. Investor confidence has recovered, there is greater corporate accountability, financial reporting is more reliable and transparent, auditor oversight is significantly improved. And one of the things that is happening, and it's relevant here to the subject of this panel, is that it is being picked up around the world. The SEC - the Office of International Affairs - prepared a study on the global influence of the Sarbanes-Oxley Act. And this is an overview that traces the extent to which the key provisions of SOX have been translated into recent regulatory reforms in other large capital markets, namely the EU, UK, Germany, France, Hong Kong, China, Japan, Brazil, Australia, Canada, and Mexico.

The overview focuses on the following four major components of SOX:

- The establishment of a public oversight body independent of the audit profession - which is probably the single biggest change we made in this legislation, because the auditors had been self-regulating up to that point. You had peer review but there was no oversight from any outside body.
- The strengthening of auditor independence.
- The strengthening of audit committee requirements. One of the things we did is, the audit committee now has to be made up of independent directors, and the auditors are hired, fired, and compensated by the audit committee, and not by the management of the corporation, whose practices the auditor is overseeing.
- The augmentation of internal control requirements with respect to financial reporting.

And in their appendix, they set out what's being done in each of these countries that I just listed and there are really quite some extensive provisions going on. I commend this publication to you.

Now, we've had two strong kickbacks against this legislation, which I think are pertinent here today. Some actually have been referred to earlier. One is the complaint about the cost of the internal financial controls under Section 404. We're trying to address that problem The SEC and the Public Company Accounting Oversight Board (PCAOB), our independent oversight group, have now provided new auditing standard direction, which is intended to focus on material risk and get away from dotting every ‘I’, crossing every ‘T’, and checking all the boxes, which people have been complaining about as being very expensive.

All the legislation - so this is the statute. So it's not - you know, it's pretty slim, actually, when you think, compared to some of the things we enact. And 404 is just these paragraphs right here. And one paragraph says that, if you're a public company - legislation only applies to a public company - but if you're a public company, you have to have a system of internal financial controls. I mean, it seems to me that that's an unarguable concept. If someone came to you and wanted you to invest money in his company, and you said to him, well, how's your system of internal financial controls, and he said, oh, I don't have a system of internal financial controls, I don't believe in anything like that, it's oppressive, and it costs us money, and it hampers our entrepreneurial drive, I doubt very much you'd put your money in his company.

And the other paragraph, of course, says that you have to have them attested to in order to be assured that it's not a phony system of internal financial controls. But we're having difficulty getting it into place. The SEC has tried. Chairman Cox, and speaking to the Chamber of Commerce a while back, when there was a lot of agitation to change the law, said, and I quote him: we don't need to change the law; we need to change the way the law is implemented. It is the implementation of the law that has caused the excessive burden, not the law itself. That's an important distinction. I don't believe these important investor protections, which are only a few years old, should be opened up for amendment, or that they need to be.

And, of course, I agree very strongly with that sentiment. And we think we're getting at this problem now. The SEC, up to now, has deferred compliance by domestic companies with a market cap below $75-million, and they've deferred compliance for overseas companies altogether up to this point, but now they're moving to implement it. But they're now moving to do so with the new auditing guidance that has now been formulated, and we think that will give them, we hope, a reasonable balance between meeting the investor protections that were aimed at with the legislation, and not having an excessive or an overburdening cost in order to do it.

The other thing we've encountered - and it's been referenced here, you had a whole panel on it this morning - is whether it's affecting the competitive ability of the US capital markets. And you saw the competing presentations. Antonio Borges, who's the chairman of the European Corporate Governance Institute, is also vice-chairman of Goldman Sachs International. So I thought maybe it would be appropriate here to quote from the Goldman Sachs Global Economics Weekly on this very point, so I brought that along. The article is headed: Is Wall Street doomed? And just to relieve your anxiety, I'll read the conclusion first. So, is Wall Street doomed? Certainly not! And then, let me just go back for a moment about some of what's in here. The point that's made is: for years, we've been urging other countries to develop their capital markets. I mean, this is the model. This is how we make the free enterprise system work. So they've started developing their capital markets.

And, secondly, there's liquidity elsewhere in the world. There's been economic growth and economic prosperity elsewhere: the Middle East, the Far East, Europe. And so they're in a position to have the capital to do some of these IPOs. So I think you have a situation of market maturation and economic growth which is a natural consequence, and I think we're, in effect, facing that development. That's been taking place over a number of years, well before Sarbanes-Oxley and the rap that it's the excess regulation. It's interesting the markets overseas played to this tune of excess regulation and that one ought to come to them and, at the same time, as this SEC study shows, they're putting in place a lot of the same requirements in order to enhance investor protection in the market.

Now, usually the comparison is with London. The growth in London has been in the AIM market, not in the main market. In the Financial Times back earlier in the year, a group of large institutional investors expressed worries about the ability of companies with weak corporate governance standards to raise capital on the London Stock Exchange. And a group of important investors - institutional investors, primarily - warned the FSA - I'm quoting it from the Financial Times now: The quality of the market was under threat. In a less benign economic environment, some decisions being taken now might come back to haunt the regulators, the fund manger told the FSA.

And they're now looking into this thing. The AIM market, of course, is known for having loose regulatory standards, and many, many of the companies going on there could never qualify for being listed on the US exchanges. That leads me towards drawing to a conclusion. I want to underscore that, as we talk about regulation - and we're trying to see how we move ahead in what is an increasingly integrated world economy - one of the questions is, is the competition in these capital markets going to be at a high standard, or are you going to go to the lower standard? Are you going to devalue your regulatory standards in an effort to try to attract the business?

Now, from the US point of view, we've always regarded our capital markets as a very important economic asset and we've also coupled that with saying we have the most open, honest, transparent, integrity markets in the world. Now, Enron and WorldCom blew that concept up for a while, but we're trying to restore it and get back to it. And actually, it's something of a tribute for the reputation that we continue to be attractive even though we've been through this experience. But I think it's very important to think through the question of how do you compete, at what level, and by what standards.

And it seems to me, we would all be well-advised to ensure that we're competing at a level that does the maximum to keep out the cheaters and the liars because it has, obviously, widespread impact. If the public loses confidence in those markets - we saw what happened in this country in 2002. And I think the problem is getting more serious because, as you democratise investment, you have more and more ordinary investors, the ordinary family. In the US now, well over half of our people have money in the stock market, most of it indirectly through mutual funds, some of it directly, but that's a very significant change from what used to be the case. And as that happens, I think it becomes even more imperative to assure that things are being done according to high standards. And I think the same thing is going to happen elsewhere. It is happening elsewhere around the world. And I think, as that takes place, the amount of volatility in the markets responding to the sort of Enron, WorldCom type of situation is going to increase very markedly.

You have a lot of people now coming in as investors that are not really sophisticated investors. These things happen, they go into a semi-panic, and you can't withstand it. I mean, you have to forestall it, not let it happen. Just switch for a moment, look at what's happened now with the collapse of the sub-prime market. And Mervyn King, the head of the Bank of England, said, well, we're not going to put any money in that's contributing to moral hazard. They should take the consequences of what they've done. Northern Rock - the depositors were lined up at all their offices, all the way down the street. They had a bank panic - the first run on a bank since 1866, and Mervyn King, the head of the Bank of England, reversed his position 180 degrees within 48 hours. I bring that in just to underscore the sensitivity of this sort of situation and to make the point that in my view, the imperative necessity of going to high standards and holding to high standards.

Let me just close with this quote from Bill Donaldson, for whom I have enormous respect. I thought he did an excellent job leading the SEC for two-and-a-half years. He spoke at the National Press Club and this is an attitude which, I think, we need to keep in mind here, in Europe, in Asia, anywhere around the world, as we face this situation. He says: Suggestions, including in the press, of the recent crackdowns on corporations and executives by criminal and civil authorities, including the SEC, have discouraged honest risk-taking. On the contrary, Donaldson said, Sarbanes-Oxley and the other steps that have accompanied it will lead to an environment where honest business and honest risk-taking will be encouraged and rewarded. Successful corporate leaders must strive to do the right thing in disclosure, in governance, and otherwise in their business, and they must instil in their corporations the attitude of doing the right thing. They should make this approach part of their companies' DNA.

I couldn't agree more. Thank you all very much.

Pierre Delsaux
Director, Free Movement of Capital, Company Law and Corporate Governance,
DG, Internal Market and Services, European Commission

Thank you very much. It has been a very long day, but also interesting day. The question for today's panel is, of course, very ambitious: making corporate governance work across the Atlantic. I do not believe that I have an answer, and I wonder whether someone has an answer, and if someone has an answer, I would like to know it.

So, what I would like to do is just to do a modest contribution to this issue, and bring to your attention a certain number of elements which I believe needs to be taken into account.

First of all, we need to agree on the general objective. We need to agree on the fact that we need to work on a transatlantic basis. In other words, the US and Europe should understand that we no longer live in isolation. We live in a global world where markets are volatile, capital, financial markets can move around the world, and there is also a growing competition between the different countries in the world. We have to take that dimension into account. And we are talking about relationship between the US and Europe, but we have also to talk about China, Japan, India, and others which are emerging.

Second element: we need to accept our differences. One size does not fit all. We know that in Europe. We have 27 member states - not only UK: we have 26 other member states - with different backgrounds, different experiences, and different contexts. For instance, the structure of shareholding is different across the different member states. Dispersed shareholding exists in certain countries; block shareholding in other countries. Company law is different. One-tier, two-tier systems - do exist.. Taxation, labour law - many things are different, but still we are able to build something in common in the European community.

We need to accept some diversity, but also we need to have some common standard, some minimum rules, which are necessary to protect investors. Now, let's be clear: differences are not weaknesses. It's not because we are different that we are weaker.

Let me come back to the question of internal control. I agree with Senator Sarbanes. Of course, who would be against internal control? That's normal. And we have a rule in the States; we have a rule in Europe. But we can achieve the same goal by different means, and still achieve it. You might decide to have detailed rules adopted by the SEC, to define how to achieve internal control; or you might take the road that we have taken in Europe: comply-or-explain. Auditing is another example. In Europe, we are building public oversight bodies which will achieve exactly the same role, exactly the same objectives as the PCAOB, but in a different manner. Is it wrong? No. Simply different.

Accounting: another example. We have moved to IFRS because we consider it's a good accounting standard, it's global, it's international. And, of course, I was pleased to hear what the Chairman Cox said this morning. But despite the fact that we are imposing IFRS on our listed companies, we are also accepting other accounting standards in Europe. Why? Simply because we consider that some - not all - some of these accounting standards basically achieve the same objective. They give the same kind of information to investors. And that's why we accepted, and we still accept, US GAAP in Europe.

Third element: this morning I had sometimes the feeling that there is no money laundering legislation in Europe. Actually, we are bound by exactly the same international standards as the US. There is an organisation, FATF, which defines these standards, and these standards are being implemented in the European community. But maybe the way we have implemented the same standards is different, and we have taken a risk-based approach, meaning that maybe you have less notification off suspicious transactions. Is it good or is it bad? Talking to some regulators, I know that, before we took this risk-based approach, they were flooded by notifications, and to some extent they were unable to monitor to which extent these notifications were really dangerous or not from the point of view of money laundering.

More generally, I do not want to talk at length about enforcement It has been a long day! I know I will be simplistic and provocative, but do you judge that a country is safe by the number of death penalty, or by the number of crimes being committed? In other words, what is more important? The number of sanctions, or the fact that the market are functioning efficiently, protecting investors and protecting issuers. I do not want to spend too much time on this question, but probably it's something on which we need to come back.

Now, this brings me to my fourth element:. Convergence is certainly an objective that we need to achieve. But let us be realistic: it's a very long-term objective. As it was said this morning by Chairman Cox, diversity is there. We cannot imagine that one single set of rule could be the same everywhere in the world. The right approach is more mutual recognition. Accepting that, despite the fact that we are different, we achieve the same goal by different means, but the result is exactly the same for investors, for issuers, and for the market as a whole. That should be the key of the way forward.

Fifth element: we need also to have a framework. We need to have some kind of places where we can discuss, like this conference, of course. But we need to institutionalise, to a certain extent, cooperation between European community and the USA. We have done it.

We have created certain of these bodies, too many of these bodies. By the mere fact that we talk on a regular basis, that we meet every six months to discuss certain common issues, we create understanding, we build confidence in each other, and, at the end of the day, we can solve the question which has been asked today.

I will have three conclusions.

First of all, we need, all of us, remain modest. We need to learn from each other. And not only from each other, but also from the rest of the world. We do not have magic solutions which are good for everybody, and we can learn from the experiences of the others.

Second conclusion: One former president of the Commission said we need to define the level of our ambition. And that is what we need to do here: we need to define where we want to go, when we want to do, to go there, and how we want to, we want to achieve this objective. That is fundamental: we need to agree on the process and where we want to go; otherwise, we can keep talking and talking and talking without reaching any result.

And my final point: If we are successful - and it's a big if, of course - but if we are successful, if we are able to build some kind of corporation model between us, I really believe that that could be a model also for others. We could try to use this model, not to impose it - let's be clear, not to impose it - but to show it to others, to China, India, and Japan.

Thank you very much.

Jaap Winter
Partner, De Brauw Blackstone Westbroek
Nearing the end of this, almost hardly anything to say that hasn't been said by anybody else. Nonetheless, I will try not to be too brief, make some, some comments. Hopefully they're relevant.

One of the things that strikes me when I listen to the debates today is that we have so many different definitions of what we're talking about. I've heard two discussions about corporate governance today: one by US academics, and one by European academic Eddy Wymeersch in a different position as well. The US academics focus on enforcement - mandatory rules and enforcement, and what level of enforcement is appropriate, and whether it's too much enforcement or not enough enforcement in other jurisdictions, and how do we measure this. Europeans, if you listen to Eddy, focus on the relationship between shareholders and boards. Eddy did not mention the word enforcement, I think. He was talking about shareholders: their rights within the company, their rights which are much stronger in Europe than they are in the United States, where the boards are responsive to that, and whether that system actually works in Europe or not, and whether we have too much shareholder right - shareholder activism, which is actually destructive rather than stimulating appropriate corporate governance.

These are two fundamentally different approaches to what we think is governance. Even on what is enforcement, we have different discussions. If I listen to Eilís, she has a completely different view, represent - I'm not sure the word represent is good - but you at least explained what the UK feeling about enforcement is, which is fundamentally different than enforcement from a UK, from a US perspective.

To give one tiny little example of that approach in my own little jurisdiction, the Netherlands, I'm no the board of the Dutch securities regulator, the AFM. Not executive. I'm merely one of the non-executives. The key enforcement mechanism of the Dutch AFM is what they call - and it's a bad translation in English - but they call it a norm-transferring conversation. You know what that is? A norm-transferring conversation. Those who are in breach of the rules, you talk with them, and you tell them, don't do this again. That's the primary enforcement mechanism of the Dutch regulator. Yes, they have fines. Yes, they can punish people. That's not what they do: the practice is to speak, to talk, to sometimes publicly punish, deal with reputational issues, and, to some extent - and that's difficult to measure - it works. But it's fundamentally different from the enforcement discussion we've had from the US perspective.

This also has to do with different ways that we look at rules and principles. The US approach seems very much to be to make sure that where areas of concern arise and are identified, we have mandatory rules and we have strict compliance and enforcement if compliance is not strict. In Europe, we try to avoid all of this. We deliberately did not follow the mandatory rules of Sarbanes-Oxley initially. We came out with suggestions to have corporate governance codes, comply-or-explain flexibility.

And to summarise the two approaches in perhaps two phrases: the United States is key on accountability for compliance; Europe is turning on on accountability for behaviour. Two fundamental different approaches. It is not for me to say which of these two is more effective, and Pierre has said that already - anybody here knows what is more effective. The difficulty for us lawyers is - actually this is a trap that most of the people in this room, including myself, are in today - when we are lawyers - and I'm one of those - we focus on rules and enforcement systems, because that's the sort of thing we are trained to recognise. We know what they mean; we know differences in legal systems; we know differences in enforcement systems, private or public, what have you.

Economists focus on numbers: what you can express in numbers is reality. If you can't express it in numbers, it may be a reality, but not for economists, not for their academic review. The combination of lawyers and financial experts - economists looking at governance - is a very single-minded focus on some elements of the corporate governance system that we can understand because we know the rules and we know some data of how it works.

The reality of how a corporate governance system works is much more complex than that. It goes way beyond the rules which are on the book. It even goes way beyond on how it is enforced. It is about culture. It is how people behave in complex environments which are socially and sociologically, have grown through different practices in history. We have only a tiny little understanding of all these other factors. At least certainly I have, as a lawyer, and I claim, at least for this little speech, that most of the economists have that same limited understanding of what really happens in the corporate governance system. That, indeed, forces us to be very modest when we think about what is good in a corporate governance system, or what is bad in a corporate governance system. It should make us very modest in imposing whatever system we think is good on anybody else's system.

I'm not trying to be reproachful against one or other side of the Atlantic. The claim of the Europeans is that Sarbanes-Oxley has basically imposed the American way of looking at the governance issue on European companies who deal with it in a different way. We do our own thing in Europe. We do it in the privacy area: we impose privacy rules across the world and expect the rest of the world to live up to our standards. And if you don't, too bad for your European subsidiaries: you will no longer be able to find out who your employees are and what money they make, because we protect their privacy, whether you like it or not.

In a different way, much more in the corporate environment, we do it sneakily, actually. We don't do it explicitly, but very sneakily. And this wonderful 13th Directive on Takeover Bids we have included the great principle of reciprocity, and it basically means, every non-EU company which makes a takeover bid for a European company, even when that company has, by force of law or by free choice, abandoned its defensive mechanisms, that company can uphold those defensive mechanisms against a non-EU company, read, an American company. That was the whole understanding in the European parliament in the compromise struck by member states. All of this is bad behaviour, I think: bad behaviour for what we're trying to achieve. We're trying to achieve that there is a wide access to capital markets for companies and investors to reduce cost of capital.

Now, looking at all these differences, how do we get to some sort of solution? Is there one? After today, I'm more doubtful than I was before today, basically because we discussed different things, and we should learn to discuss the same things, or at least compare the two. Why are you discussing this and why am I discussing that? What's the relation between these two. Nonetheless there are at least four basic approaches.

One approach has been dismissed by every speaker today, which is harmonisation convergence across the Atlantic. I don't want to spend any more time on this; let's dismiss it. It's unpractical; it's not going to happen. We won't see our cultures or legal systems or economic systems converge so much that we simply have the same rules. We might achieve this in very tiny, specific, probably very technical areas. Maybe the accounting standards are at that sort of area, but, apart from that, unrealistic.

Second approach: mutual recognition equivalence. These are the words that we've used over the last few years. Allow access to each other's markets if there is at least a comfort of minimum standards of corporate governance having been met on the other side when they come and join your market. For me, this is a much more difficult concept than the debate we've had about it so far, because the debate we've had about it so far is limited to some rules, some enforcement mechanism, and, if you can see these two being equivalent, then perhaps you'll allow it. Reality is, you will not understand whether corporate governance systems really are equivalent if you only look at the rules, if you only look at enforcement. There's much more going on. Maybe something we should spend much more time on than we do today, to really find out what makes our systems more-or-less equivalent. And for me, this is a discussion where I would need other people with other disciplines, other understanding and knowledge, other than just lawyers and economists.

A third approach, which we see every now and then, is to let the market sort it out. Allow somebody else with another corporate governance system on your market, but require full disclosure, and require particularly a disclosure of what elements of that corporate governance system are materially different from the system that you impose in principle on your own market. That's part of the New York Stock Exchange rules. The New York Stock Exchange listing rule on governance, which to some extent go further than the Sarbanes-Oxley rules - they're also about other board committees, for example - they allow companies from other jurisdictions to be on the New York Stock Exchange, but you have to disclose what board practices are different from the one that the New York Stock Exchange listing rules require from US companies. It makes sense, such an approach. It allows for access, and the market can sort it out for itself. One of the things I still don't have an answer to, and I'm not sure anybody has the answer - at least, a perfect answer - to, is whether the market really cares. How confident are we that markets really, fundamentally distinguish between the quality of different corporate governance systems in pricing of the stock? There's a lot of research going on, but real, clear answers to that we actually don't have. And if we don't have it, maybe we should be very careful on what we should impose or not impose.

Last approach - fourth approach - we will sort it out for ourselves. The US for itself, the European Union for itself. That's what we've done so far, and the tendency of this approach which is let's make sure that markets can take care of this themselves; the jurisdictions take care of it themselves in the way that they see fit. There's a tendency to go unilateral, to become protective, and not helpful for creating a global, integrated capital market system if we allow this to continue. That's why we talk, and talk is good. Is it really bad? Who knows? If I listen to the debate this morning, there's little evidence that the Sarbanes-Oxley legislation has actually reduced the competitiveness of US markets. Some believe it has; some, others say it doesn't. We don't know precisely. And even if it has, is that so bad? Maybe that's a good thing, at least for the other markets to feel there is an advantage. They have all become relative Delaware securities markets compared to the US securities market, and have a relative advantage. Who cares? Maybe that's very good. Why worry about it?

As I said, I think until today, we're mainly in this fourth area. We have sorted it out ourselves pretty unilaterally. The problem with that approach is that it's always very arbitrary. It's always subject to being politically hijacked - and that happens, particularly also in the European Union. Let's be very frank about this. It's not a helpful approach, but that's where we are. If we want to do it different, I think at best we can get to a combination of mutual recognition plus extensive disclosure - qualitative disclosure - explain why you're different, then we can allow you on our market. That would be good, to leave the differences, because we don't understand all of the complexity and the factors that we need to understand to really know whether another system is good or bad. And if we don't know it, we should not impose it.

I think it's probably the best way to allow the emerging markets - China and India have been mentioned before - to join the system. We cannot expect these major economies to simply follow our route and do exactly the same things that we have done, that we have found out over centuries, perhaps, sometimes, as a condition to join the system. If we want to have them joined - and I think it is in our interests for them to join the system - we should allow them to find their way, their access to our system, and simply imposing what we thought of and we have discovered is good for us is not going to be helpful.

Finally, it will also take account of the invasiveness of international investment. US investors and EU investors alike, they invest directly in outside markets, and not only in their own domestic markets, and it is simply not true for the European Union, nor for the United States, that you can only protect the investors in your jurisdiction by imposing your laws on whatever happens outside your jurisdiction. We should not do that thing. We should trust others to give appropriate investor protection in other jurisdictions.

How do we get to that sort of combination? I agree with Pierre: it is not enough to simply discuss this. Discuss is a good starting point, and we've learned a lot. I learned a lot again today. But we need some form of infrastructure in which this discussion is more consistent, much wider than the debate is so far. The concern I have is that the people that this building, and the CESR's building, which is relatively small compared to this building, I must say, they can only see part of this debate, which is the securities market and enforcement in market regulation, which, for me, is only whatever percentage of the whole corporate governance debate. If the SEC and CESR are discussing this, we only have the tiny little view of the things that we lawyers and economists have a sense about, but we don't really understand it. The infrastructure should be broader, and it should bring in expertise and people who have knowledge and understanding of wider issues than just markets enforcement, and how you deal with that.

One last thing. I think Jack made the comment as well. Substitute compliance, for me, sounds like unilateral mutual recognition. It is mutual recognition on my terms. It doesn't sound good. Mutual recognition says somebody else is part of the game as well. It is not just comparing somebody's enforcement with my enforcement. It is also trying to understand whether that enforcement is effective in that market, and you cannot measure that by only referring the terms of that enforcement mechanism back to your own market, how we would deal with it. That's not - for me, the word and the language is not the thing that we need in the debate that we need to go forward. Thank you.

Harvey Goldschmid
Dwight Professor of Law, Columbia Law School;
former Commissioner, Securities and Exchange Commission
Let me assure everybody in the room that I know I'm the last speaker on the last panel in a conference that began early this morning. It does bring to mind a line that I associate with Columbia Law School faculty meetings: “everything that could be said has been said, but not everyone has said it.” And I'll keep that very much in mind. Let me give you my sense of what I think is common ground when we think about the regulation of financial markets and corporate governance. There are two basic rules in the game. One, you've got to establish a regulatory framework that maintains and enhances investor faith in the fairness and integrity of markets. You can use different approaches, but fairness, integrity, and investor faith are core values.

And then you've got to keep those frameworks effective and efficient. And that doesn't mean, when I use the word efficient, more regulation and more rules. One of the things I'm proudest of doing in this building, and it was my last meeting with Bill Donaldson as Chairman, was to heavily deregulating our new issue process. We got rid of things that had been developed since 1933 that were wasteful and caused needless wheel-spinning. And deregulation can be all to the good, but you do have to keep that focus on effectiveness and on the integrity of markets. Now, here today, and in other places, there were three reports in the last year in the United States, have come attacks on our allegedly excessive, overly aggressive, and burdensome securities regulation. And for this failure, it was argued, a threat has developed to US competitiveness. So let me turn to these "competitive threat" claims for a few minutes.

Virtually everyone agrees - certainly everyone I think of in the United States - that our financial markets are critical to the effective functioning of what we're doing. It's allocation of capital; it's new industry; it's entrepreneurial spirit. These markets are vital to us in the most important way. But now they're being used as an excuse for turning around much more than just Sarbanes-Oxley: get rid of private litigation, get rid of attorneys-general, limit the SEC, limit enforcement. I find those ideas radical and counterproductive. I always debate between counterproductive and wrongheaded, but you can pick either one. But the rollback ideas make no sense. Remember, we're not talking about making rules for the rest of the world. There are other approaches, and they may be as good, and we shouldn't interfere with what is being done for non-listed companies in foreign jurisdictions. But when someone wants to come here, and take advantage of our capital markets, we've got to think through the implications from the standpoint of keeping those markets effective.

And the truth is, as we've really heard today, there's little basis to these challenges to our global competitiveness. Whether it's scholars here, or various others, the New York Federal Reserve, the Wall Street Journal, Goldman Sachs, or Thomson Financial all have evaluated claims of competitive threat and have concluded that factors other than Sarbanes-Oxley have resulted in any financial market decline that has occurred. As Paul Sarbanes indicated, the various serious studies point to greater prosperity in the rest of the world, to stronger corporate governance elsewhere and to similar matters to explain why people would go elsewhere. They point to the Chinese or French or others willing, to some degree, to go to local markets when they have IPOs. But, you know, the truth of the matter is, as Thomson Financial put it, there doesn't seem to be any really significant deterioration to the US IPO market.

The reality is that Wall Street broadly defined is thriving, except for the subprime lending crisis, which can't be blamed on Sarbanes-Oxley. Aggregate trading on US markets is roughly 50% of the world. That premium for cross-listing, that we talked about this morning, which is roughly 15%, is quite extraordinary.

And though I'll ask this as a question, I don't have much question about the answer: could it be that our aggressive, effective regulatory and enforcement system for securities actually creates a good part of this premium for cross listing, and, more importantly, from the United States standpoint, provides the confidence that has made our financial markets the gem of our economy? Now, in terms of the criticisms - and I'll try not to take long - I've got three basic problems with what we're hearing at times from the business community. One, in these reports, the changes proposed would greatly diminish the fairness and integrity of our markets. And obviously I won't go through them, but I took office here at the SEC on July 31, 2002. It was the day after Sarbanes-Oxley was signed into law. Our financial markets were in turmoil, as Paul was saying, and our corporate community was in disrepute. If helping to turn this around, in terms of trust an confidence, had been the only achievement of Sarbanes-Oxley, we would have to praise what was done, but far more than the atmosphere has changed.

Critical substantive changes have been made in US laws in terms of disclosure, in terms of corporate governance, in terms of the effectiveness of audit committees, in SEC enforcement, in the role of gatekeepers - those all-important lawyers and accountants. In terms of the accounting profession itself, given the success of the PCAOB, why would anyone here want to turn that clock back now? We can refine; we can debate; other approaches are viable. But God help us if we turn back the clock now. Also, there is a cost to the sky is falling hyperbole that has been around in the US during the last year. As I've travelled to foreign countries in the last two years, in Europe and Asia, there is a fair amount of mythology about the US system. We heard some today, about this extreme regulatory overreaching and wild litigation climate.

With the exception of Section 404, and as Paul Sarbanes said, not because of statute, but because of the way it was implemented by issuers and accountants -- and the SEC and PCAOB can take some blame -- but with the exception of 404, there is no significant cost in Sarbanes-Oxley. And 404, as Chairman Cox said this morning, is being worked out in terms of risk, in terms of reliance, in terms of other things, and a dramatic cut has occurred in the cost. In terms of enforcement, in this wild litigation climate, the figures for 2006 are lower in terms of SEC litigation than any year since 2002, and are lower in terms of private enforcement than any time in the last ten years. Thinking of this climate as wild is unrealistic. In terms of European concerns about the US, do think about how careful we're tried to be. The certifications that everyone has worried about in Europe do not add any real legal exposure that's new. CEOs and CFOs were always signing those reports. It doesn't change legally because they now sign it by saying “yes they are accurate.”

In other areas, foreign accountant registration with the PCAOB has worked out. The audit committee provision was drafted so that the Germans could continue their co-determination; for the Italians we worked other things out. In area after area, including privacy, the SEC has taken account of the systems of other nations, and tried to make sure that Sarbanes-Oxley and the rules under it would work well in terms of what was going on. The problem with what has occurred here in the US is that there's too much hyperbole coming from US representatives, from the business community, about how difficult things are. For a group like this, I want to tell you you're <u>welcome</u> here. We will be fair to you. If we foolishly worry you about things that are unrealistic, you will not come to or stay in the U.S. Yes, foreign corporations will cut away, and that will be costly and wasteful for everyone concerned. That 15% premium can be quite crucial to any corporation’s economic health.

The last problem with these reports and the atmosphere they've created is they take our eyes off of legitimate issues and approaches to reform in the US. There are lots of things that can be done, and they've been mentioned over the course of the day. Certainly the globalisation issues are critical to the future of the United States and the rest of the world, and the consolidation of our exchanges with it. We've got to think about how we regulate broker-dealers, and investment advisers, and the overlaps, and we've got to think about what to do with hedge funds. We've got to think about how to get a longer-term perspective from our own domestic corporations in terms of planning and earning and the long-term needs. It would be worthwhile to think about litigation reform, but not in the way these reports generally do it.

The SEC needs various things. The SEC hasn't been mentioned. People worry about it too much, but the truth is, the budget's been flat for three or so years, and that, I can tell you, is dangerous in terms of the capacity of the Commission to keep up with financial regulatory needs. And finally, I agree with everyone who talked about the need for more shareholder voice, more shareholder power, the ability of shareholders to influence. There is some give-and-take, and if the shareholders have the rights they have in the UK and other places, we may be able to take some of the pressure off our regulatory scheme.

Questions & Answers

Antonio Borges
Chairman, European Corporate Governance Institute;
Vice-Chairman, Goldman Sachs International

I just wanted to make a few comments since Paul Sarbanes was kind enough to mention my name and quote Goldman Sachs, and because I do think his comments do deserve a great deal of attention and respect. I wanted to add a few points.

First, I certainly agree with my colleagues in research, that Wall Street is not doomed. But one has to realise that there is a lot more competition today than ever before, even as the US investment banks now have a lot more activity and make a lot more money outside the US than inside the US, which is quite interesting. And the important point is that this was not the case before. In the '80s and '90s, when I was a professor of economics, I used to teach all my students that there was only one capital market in the world, and that anybody with the aspiration to run an international company had to learn how to deal with the US investors and the US regulation and the US markets. Now the story is very, very different.

Now, I don't think this has anything to do with Sarbanes-Oxley - quite the opposite - but there is no question that Europe and those who have evolved very, very rapidly now pose some serious threats to American dominance of the world capital markets. And this is a very interesting question, because normally, normally capital markets very quickly concentrate in one single exchange. And that's how we thought things were going in the '90s, and it has not happened. Maybe the world is now more segmented than before, but this is a new reality. And why is this important? Because I think, personally, that this will leave the American authorities, be they in Congress or in the Administration or in the SEC, to think more about the rest of the world when they come up with new initiatives, and think more about the impact of their initiatives on the US position vis-à-vis the rest of the world That will be a very good thing.

The second point I wanted to make is that this competition does not only come from Europe and Asia. There is also the competition between the stock market and other channels of finance, and one of the most important things that has happened is that both investors and companies have now moved away, to a certain degree, or in a relative sense, from the stock market, and have found different ways of accessing funds and managing risk through hedge funds ,through private equity, through all kinds of other alternative investments and so forth.

Therefore, when we think about the regulations for the stock market, we also have to think how those regulations position the stock market relative to all these alternatives which are now so powerful. Indeed, there is a new world.

And finally, let me say that I do have enormous respect for Sarbanes-Oxley legislation. In practice, I'm on several boards of European, US and Brazilian companies, and I must tell you, the only environment in which I do detect a very serious respect for disclosure is in the US. In companies with a strong audit committee and a strong chairman who cares about governance, we spend more time debating what we have to disclose or not, and whether our information is accurate or not, than anything else, and that I think we owe to the Sarbanes-Oxley legislation.

Jaap Winter
Well, if I could just pick up on Antonio's comments, which I thought were very perceptive, I think that this question of competitiveness is a very complex one, and there are a lot of actors at work, and we need simply to recognise that. The point I'm trying to make, of course, what you have happening in this country, and Harvey alluded to it, is the unreconstructed who would like to do this Sarbanes-Oxley in, who wants to blame everything on Sarbanes-Oxley. That becomes the very simple explanation for any problem we have.

I told one group, when you go home tonight and your spouse starts fussing at you about something, and says “what's the cause of all of this”, say, it's Sarbanes-Oxley that's doing it! Furthermore, say to be precise about it, it's Section 404 of Sarbanes-Oxley!

I'm increasingly concerned about these government-backed investment entities that are now capitalising off the huge build-up of reserves that have. I think Eddy talked about whether those investment decisions were going to be made on straight economic terms, or whether the political dimension was going to enter into it and have a significant impact. And here, of course, I'm particularly thinking about China in that regard. But we face a tougher competitive situation, as it were, across the board, and we need to just recognise that.

Harvey Goldschmid
Just one comment on what Antonio said. The praise for boards that spend more time on audit and on internal control than on anything else, in my perspective, is questionable. Boards should not spend most of their time on audit and compliance, but on overseeing the business and approving or disapproving major decisions, shouldn't they? The audit committee, of course, has special responsibility in this area.

Pierre Delsaux
I have to respond to this. Companies are run by managers. Boards govern the companies. And governing the companies is, to a very large extent, taking care of investors. I suppose you have the forum to discuss it, but anyway. Now, I believe I'm in a country which believes in competition, and, of course, maybe competition in the financial market is something which is relatively new. There is competition between the stock exchanges and to sell and to buy shares and securities. But is it a bad thing? It simply means that we have to change the way we have behaved so far. We need to adapt to new world. But in itself, it's not necessarily a bad thing.

Harvey Goldschmid
One quick comment on Antonio's comment. When I began teaching 100 years ago, which was actually 1970, at Columbia, the great scandal at that time involved the Penn Central Railroad, which was our largest railroad and sixth-largest industrial corporation. Everybody studied its bankruptcy, which was the largest since the Great Depression. What everyone came away realising about Penn Central and the rest of the corporate community was that boards were dead. The average time of a director in those days was 30 or 40 hours a year. Now, you couldn't do a serious job in that kind of time.

Sarbanes-Oxley creates a balance. Moving audit committees to where they're spending 250 hours and seriously looking at the company is doable. But if you push it to 500 or 1,000, it's not do-able and may be counterproductive.