

More From the SEC on Globalization

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On August 27, 2008, which is now a few centuries ago in financial market time, the SEC adopted three rules to address the increasing globalization of securities markets. You may recall that three whole weeks ago, Lehman Brothers was still standing, Merrill Lynch was independent, and Fannie Mae, Freddie Mac and AIG, now owned by the government (Socialist, by any other name), were private companies funded by private capital, rather than the public purse. Indeed, it may seem odd to write about globalization rules at a time like this.

The fact remains, though, that globalization continues on apace in spite of all the calamities that currently beset the markets. The only question is the extent to which the United States will be a major player in financial markets, which largely depends on our response to the forces of globalization. As contagion sweeps the US markets, it would certainly be a bad idea to lose our grip on the global economy. The rules adopted on August 27 are three steps in the right direction.

Some of the rules approved by the SEC on August 27 did not represent a change in policy. For at least a decade, the SEC's staff has been issuing no-action positions to permit US investors to participate in tender offers for foreign issuers when those offers are not necessarily in compliance with US rules. Foreign issuers are, of course, subject to the acquisition rules of their country of origin, which often conflict with the Williams Act regime instituted in the US in the 1970s. The SEC's staff was therefore faced with the Hobson's choice of either providing relief from the conflict, or keeping US shareholders out of the transaction. Wisely, the SEC has been providing relief, which is commemorated in a series of no-action letters. On August 27, the SEC adopted the positions developed in these no-action letters, which means the foreign issuers can now save the legal expense involved in preparing no-action requests.

The SEC also increased disclosure requirements for foreign issuers with shares listed on US exchanges. On the other hand, in prior rule changes, the SEC permitted foreign issuers to prepare financial statements using IFRS, rather than requiring reconciliation with GAAP. This change in financial reporting standards greatly reduced the cost of preparing financial statements for foreign issuers. In contrast, the rules adopted in August requires issuers to file within four months of the end of their fiscal year, rather than six, requires issuers to report disagreements with their public accountants and impose certain other disclosure enhancements that are

relatively minor by comparison. All in all, it was a good trade for foreign issuers and US investors.

The big gorilla in the room involved changes to Exchange Act Rule 12g3-2(b), which governs the disclosure requirements for foreign issuers of securities traded in the OTC market, particularly on Pink Quote (formerly, the Pink Sheets.) The former rule required these issuers to file with the SEC in paper the information that it makes publicly available in its home jurisdiction. The new rule automatically provides an exemption from Exchange Act registration for issuers that make this information available on their website in English.

The proposal, originally promulgated by the SEC in February 2008, would have required foreign issuers to register if more than 20% of the trading volume for their securities, calculated annually, occurred in the United States. Pragmatism prevailed, and the SEC decided not to impose this registration requirement.

The effect of all of these rules will be to reduce the cost of compliance for foreign issuers with substantial US investor interest, while increasing the quantity and improving the quality of disclosure provided to US investors. This can be expected to result in more foreign issuers dipping their toes in the US markets. US investors, in turn, should be exposed to a greater range of investment products and will have access to better information about their issuers. US trading desks, particularly those trading OTC equities, will have more products in which to deal, which should improve their profitability – a rare bit of sunlight in these otherwise dark times.

This is all welcome during a period when any kind of good news is hard to come by.

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