# SEC HOLDS ROUNDTABLE ON MUTUAL RECOGNITION

On June 12, 2007, the Securities and Exchange Commission (the "SEC" or the "Commission") held a public roundtable discussion on the benefits, risks and feasibility of implementing a system of selective mutual recognition of regulatory regimes.[1] Under this system, the SEC would permit certain types of foreign financial intermediaries and exchanges that complete an abbreviated registration process to provide services to U.S. investors. Only foreign financial intermediaries subject to supervision in a jurisdiction that the SEC recognized as having a regulatory regime substantially comparable to that in the United States could apply to register under this system.

The roundtable consisted of three panels that addressed the following: (1) the impact on U.S. market participants of increased foreign market access; (2) the impact on U.S. market participants of increased foreign broker-dealer access to U.S. investors; and (3) defining and measuring the comparability of regulatory regimes. Panelists and moderators included, among others, SEC Commissioners; members of the SEC staff; representatives of self-regulatory organizations; representatives from the securities industry, including broker-dealers and exchanges; academics; and lawyers practicing in the securities industry.

## Access to Foreign Markets

Some panelists observed that, despite the globalization of securities markets, many U.S. investors have limited access to foreign securities. The SEC was urged to create a regulatory framework that would provide U.S. investors with greater access to foreign markets. Panel discussions focused broadly on the merits of a system of selective mutual recognition to provide this increased access, with debate over what types of investors should be given access and by what means.

The panelists considered two means by which U.S. investors could gain increased access to issuances of foreign securities: (1) U.S. broker-dealers registered with the Commission under the Securities Exchange Act of 1934 (the "Exchange Act") using trading screens with direct access to foreign exchanges; and (2) foreign broker-dealers selling foreign securities directly to U.S. investors. As noted above, foreign exchanges and foreign broker-dealers would be subject to an abbreviated registration process (the panelists did not describe the details of this process).

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[1] The agenda and listing of panel participants can be found at http://www.sec.gov/news/press/2007/2007-111.htm. Interestingly, the convening of this SEC roundtable resulted from two SEC staff publications: Ethiopis Tafara & Robert J. Peterson, *A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 31 (2007), http://www.harvardilj.org/print/90 (Ethiopis Tafara is the Director, and Robert Peterson is Special Counsel, SEC Office of International Affairs); and *Trading Foreign Shares*, speech by Eric R. Sirri, Director, SEC Division of Market Regulation (Mar. 1, 2007). http://www.sec.gov/news/speech/2007/spch030107ers.htm.

**Direct Access to Foreign Exchanges Through Trading Screens in the United States**

Members of the panels generally supported allowing U.S. broker-dealers to have direct access to foreign exchanges via trading screens located in the United States. Trading screens would permit U.S. investors to purchase foreign securities directly through registered U.S. broker-dealers that would be subject to the full panoply of U.S. investor protection laws, rules and regulations. Representatives of large institutions stated, however, that they generally access foreign markets directly now, so that direct U.S. broker-dealer access to foreign exchanges may not benefit them significantly.

Representatives of exchanges identified competition issues that might arise. These representatives expressed concern that foreign exchanges might be subject to less rigorous regulation in their home jurisdictions, potentially placing the U.S. exchanges at a competitive disadvantage that would force the U.S. exchanges to seek regulatory relief from the Commission. They also said that a mutual recognition regime must allow U.S. exchanges to provide foreign broker-dealers with direct access to their markets via trading screens located in the foreign jurisdictions.

None of the panelists directly addressed whether foreign securities sold to U.S. investors would be subject to registration under the Exchange Act. One inference that could be drawn from the discussion, however, is that the harmonization of accounting and disclosure standards, a process that panelists supported, may make registration unnecessary.

**Providing Foreign Broker-Dealers With Direct Access to U.S. Investors**

Panelists expressed greater concerns with providing foreign broker-dealers with access to U.S. investors, although those concerns related primarily to retail investors. Panelists stated that in general, an institutional investor has the resources and sophistication to determine whether the purchase of a foreign security is in its best interests, and can access foreign markets relatively efficiently under current U.S. and foreign regulatory regimes.

Retail investors present a more difficult case for direct access. The consensus was that U.S. retail investors generally lack the resources to evaluate issuers of foreign securities, making application of U.S. investor protection laws, rules and regulations more important. Foreign broker-dealers might not be subject to the same type of investor protection regime to which U.S. broker-dealers are subject, potentially placing U.S. retail investors utilizing foreign broker-dealers at greater risk of loss.

Some panelists suggested allowing foreign broker-dealers to have access to wealthier retail investors. These panelists reasoned that this type of investor is more likely to be financially sophisticated and better able to absorb losses. Another panelist took the position that a mutual recognition regime should allow all retail investors to purchase foreign securities from foreign broker-dealers. The panelist argued that mutual recognition should focus on the types of foreign issuers whose shares could be sold to U.S. investors (for example, sales to retail investors could be limited to shares of large, well-known foreign issuers).

## Determining the Comparability of Foreign Regulatory Regimes

The panelists agreed that the SEC must develop a framework for evaluating the substantial comparability of foreign regimes before it can implement a system of mutual recognition. An important step in that development would be determination of the key elements of an acceptable regulatory regime. According to the panelists, the SEC should follow a principles-based approach in articulating these elements, and should not develop a set of rigid requirements.

A principles-based framework for evaluating substantial comparability of foreign regulatory regimes should support the continued harmonization of accounting and disclosure standards as a means of furthering comparability of standards. SEC Chairman Christopher Cox indicated that a substantially comparable system should include: (1) a system to prevent fraud, manipulation, and insider trading; (2) sales practice standards; (3) financial responsibility requirements; (4) market surveillance; and (5) market fairness provisions.

If the Commission determined that a foreign regulatory regime were substantially comparable to the U.S. securities regulation regime, it would negotiate a memorandum of understanding ("MOU") or similar agreement with the foreign regulator. Panelists urged the SEC to take a collaborative approach in these negotiations. The MOU or other agreement would set out the terms of foreign access to U.S. markets, whether by exchanges or broker-dealers. The MOU also would provide reciprocity to U.S. exchanges and broker-dealers by allowing them to sell securities of U.S. issuers to foreign investors. The Commission would retain its enforcement powers under the anti-fraud provisions of the federal securities laws and investors would retain the ability to bring private causes of action for securities fraud.

Panelists urged the Commission to act quickly to develop a mutual recognition or other regime that would grant U.S. investors greater access to foreign securities. At the same time, panelists cautioned that the Commission should take an incremental approach to implementing such a regime so as to give the Commission the ability to evaluate the regime's impact on the financial markets and the U.S. system of securities regulation.

## Observations

While there appeared to be a consensus among roundtable participants that the SEC should move expeditiously towards developing a mutual recognition regime, there was no clear consensus on the range of U.S. investors and foreign securities that should be covered by such a regime. At one extreme, institutional investors already have fairly efficient access to foreign markets, and so would not benefit significantly from a mutual recognition environment. On the other hand, there was a consensus that permitting retail investors to interact with foreign markets and broker-dealers would substantially expand the scope of issues that would need to be considered in making assessments of the comparability of investor protections in other jurisdictions. It therefore appears likely that any movement to permit foreign markets and broker-dealers with greater access to U.S. investors will focus initially on larger institutional investors, and perhaps smaller institutions and sophisticated individual investors, although roundtable participants recognized that identifying the constituents of the latter groups will present difficult public policy issues for the Commission. Nevertheless, the

SEC was urged to begin collaborative discussions with their foreign counterparts to explore incremental ways in which opportunities for U.S. investors to invest in foreign markets could be increased.

Chairman Cox indicated that the Commission plans to begin addressing the issue of permitting foreign access to U.S. investors this year. The SEC, however, has not articulated the goals that it hopes to achieve or the process that it would follow in creating a system of mutual recognition. For example, the Commission has not stated whether implementation would occur through legislation, rulemaking, SEC orders, or a combination of approaches.

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If you have any questions concerning the foregoing or would like additional information, please contact Larry E. Bergmann (202-303-1103, lbergmann@willkie.com), Matthew B. Comstock (202-303-1257, mcomstock@willkie.com), or the attorney with whom you regularly work.

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