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SEC Reforms May Initiate Movement Back to the US Markets

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It has now been five years since the adoption of the US Sarbanes-Oxley Act. Although the corporate scandals that spurred the introduction of the Act have receded somewhat from the headlines, Sarbanes-Oxley and the compliance requirements it imposes remain fresh in the minds of non-US companies and their advisors. Concerns about US regulation have arguably resulted in fewer non-US companies accessing the US public markets. Certainly, the statistics have shown a clear decline in US exchanges' market share of IPOs by non-US companies. But recent reforms may stem this decline.

For some time after Sarbanes-Oxley was passed, there was more action simply to implement the law than to address the concerns about its implementation. As non-US companies continued to avoid the US markets and domestic market participants struggled to deal with new regulations, however, complaints about the US regulatory regime gained momentum. In particular, the past 12 months have seen members at the highest levels of government call for reforms. In addition to initiatives by the Bush Administration, the US Congress has held a number of hearings, and earlier this year Senator Charles Schumer and New York Mayor Michael Bloomberg issued an extensive report calling for action.

A series of recent initiatives by the US Securities and Exchange Commission (SEC), the main US market regulator, shows that it takes these concerns seriously. These actions could make it much easier for non-US companies to tap the US markets, and might especially benefit small- to medium-capitalisation entities. Some of the more significant recent proposals include:

- **Expanded Private Placement Exemption.** The SEC has proposed to add another exemption under Regulation D, which would allow companies to place securities privately (i.e., without SEC registration or a US listing) with a new category of qualified investors using limited advertising. This exemption may make it easier to market a portion of an AIM or Official List offering to US investors.
- **Simplified Rule 144 Resales.** Generally, securities that have been privately placed in the US are subject to significant restrictions on resale. Rule 144 is one of the main methods US investors use to resell such securities, but it can be up to two years before the rule becomes properly available for companies that are not public in the US. The SEC's proposals would shorten this period substantially, so that investors that are not "affiliates" (basically officers, directors and control parties) of a company could use Rule 144 after one year, or as little as six months if a company is registered with the SEC.
- **Principles-Based Section 404 Disclosure**. The SEC has approved new interpretive guidance for the application of so-called Section 404 reports on internal controls over financial reporting, full versions of which all SEC-registered companies are, or will soon be, required to prepare. The expenses of Section 404 compliance have been one of the most prominent sources of Sarbanes-Oxley related complaints. The new guidance provides a principles-based framework intended to help public companies comply with Section 404 while reducing unnecessary costs, particularly for smaller companies.

- **Elimination of GAAP/IFRS Reconciliation**. The SEC has proposed to accept financial statements prepared in accordance with the English-language version of International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board without reconciliation to US GAAP when contained in SEC filings of non-US companies. Unfortunately the version of IFRS the SEC has referred to differs in some respects from the one implemented in most EU jurisdictions, but hopefully the SEC might correct this issue in the final rules it adopts.
- **Easier Deregistration for Non-US Companies**. In the past, non-US companies that had registered securities in the US, perhaps in conjunction with a dual listing, found it very difficult to deregister. Rules in effect as of 4 June 2007 now make it much easier for non-US companies to terminate their securities registrations with the SEC, exit the SEC's public company reporting regime and quit the US public markets. Because the decision to list in the US is not as irreversible as it was, non-US companies may be more willing to undertake a listing if other factors support it.
- **Mutual Recognition for Non-US Exchanges**. More recently, the SEC has held meetings regarding the possibility of allowing trading screens of non-US exchanges that meet minimum regulatory criteria to be placed in the US, and allowing non-US brokers to deal directly with US investors. This initiative is in its early stages, but it marks a significant departure from past practice that could give non-US companies more direct access to US capital sources.

Will these and other changes by the SEC make the US markets more attractive again? It will probably be some time before any signs of a turnaround become evident, especially because many of the changes remain just proposals. Also, the effects will be most pronounced on the equity markets as there are already deep and liquid (until recently) private markets for debt. Nevertheless, these small changes add up to a major shift in the US approach. As odd as it may sound in the current environment, some non-US businesses might even find it attractive to go public or list in the US.