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Consumer Federation of America

Consumers Union

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The Honorable Christopher J. Dodd Chairman, Committee on Banking, Housing and Urban Affairs U.S. Senate Washington, D.C. 20510	The Honorable Richard C. Shelby Ranking Member, Committee on Banking Housing and Urban Affairs U.S. Senate Washington, D.C. 20510

Dear Chairman Dodd and Ranking Member Shelby:

Last week, activity reached fever pitch in the attack on investor protections in the name of global competitiveness. As you know, investors pick up the tab for corporate governance regulations, and they pay the price when those regulations go unheeded or unenforced. Despite their vital interest in these issues, however, investors have to date been given no more than token representation in the debate over the effect of investor protection regulation on the health of U.S. markets, and their concerns have been all but ignored. We are writing on behalf of the nation's leading consumer organizations to ask for your help in redressing that imbalance.

Specifically, we urge you to hold a hearing in the very near future to showcase the investor viewpoint on these issues. Also, as you plan additional hearings on related issues in the future, we urge you to keep in mind the need to provide fair representation of investors in any such hearings. Finally, because much of the deregulatory agenda relies on regulatory rather than legislative action, we urge you to use the committee's oversight powers to ensure that the SEC maintains a strong investor protection focus in its approach to both regulation and enforcement.

The war that is being waged on investor protections is based on the fallacy that U.S. markets are losing their competitive edge and that the U.S. enforcement and regulatory environment is a key reasons why. Nothing could be further from the truth. In fact, our markets are thriving even in the face of the growing strength of foreign competitors. They are able to do so not despite but because of the world class investor protections they offer. Because the advocates of a regulatory rollback misdiagnose the problem, they prescribe a dangerous "cure" that threatens to undermine the very basis on which our markets are best able to compete – their unrivaled ability to attract capital, to provide investors with a safe and profitable place to invest, and to provide companies with the lowest cost of capital in the world.

The absurdity of the regulatory rollback argument ought to be evident from the fact that Treasury Secretary Paulson's roundtable last week took place on the very day when a page one

article in *The Wall Street Journal* noted the return of tech stock IPOs from companies that are "bleeding red ink." As one chief investment officer quoted in the article said, "We've had four years of unbelievable capital discipline. Now we've entered a bit more of a speculative environment again." One would hope that this would serve as a wake-up call, but for the proponents of this argument, facts are inconvenient things – best ignored when they cannot be manipulated or misrepresented. With that in mind, we would like to offer a few facts to counteract the misinformation being spread by the advocates of a regulatory rollback.

1) Sarbanes-Oxley has contributed to our markets' recovery, not their decline.

The central tenet of the regulatory rollback argument is that burdensome requirements of the Sarbanes-Oxley Act, combined with overly aggressive enforcement and the threat of private litigation, are prompting both foreign and some domestic companies to avoid a U.S. listing. The proof for this argument is found in a drop in the U.S. share of the global IPO market between 2000 and 2006. That the U.S. share of the world IPO market has declined is true, as far as it goes. But it does leave out a few relevant points.

- Since the implementation of the Sarbanes-Oxley Act, the number of U.S. IPOs has risen dramatically. According to a recent article in *Barron's*, for example, last year's $40.6 billion in IPOs represents a 22 percent increase over 2005 and a 170 percent increase from 2003.

- During that same period, the number of foreign companies listing in U.S. markets and the amount of money they raised here have also risen. In fact, a recent study examining 20 years of IPO statistics found that foreign companies accounted for 16 percent of IPOs in the United States last year, the highest percentage in the 20 years studied. The $10.6 billion foreign companies raised through IPOs last year represented a 23 percent share of U.S. IPO volume, the highest level since 1994.

When you look more closely at the IPO statistics, it quickly becomes clear that any damage to U.S. markets' competitiveness in recent years came from the bursting of the tech stock bubble and the analyst, accounting, and mutual funds scandals that followed in rapid succession. Passage of the Sarbanes-Oxley Act, and the strong enforcement response that accompanied it, were responsible for our markets' recovery, not their demise.

Even the advocates of a regulatory rollback have been forced to acknowledge that global economic and market trends are the chief cause of recent declines in the U.S. share of the IPO market. However, they have been reluctant to explore these issues more fully. For example, while they often note that the United Kingdom passed the United States in number of IPOs for the first time last year, they rarely point out that new listings on London's AIM market are primarily responsible and that most of the companies listing on AIM are simply too small and too speculative to contemplate a U.S. listing. In fact, these are not for the most part companies for which we are losing the competition. Rather, they are companies for whose listings U.S. markets have chosen not to compete.

2) London's "prudential" approach to regulation short-changes investor protection.

Few arguments put forward by the advocates of a regulatory rollback are more deceptive than the notion that London's more "prudential" regulatory approach offers investor protections that are roughly comparable to those in the United States. The lack of comparability is evident both in London's approach to the competition for listings and in its approach to enforcement. In contrast to U.S. markets, the AIM market allows companies to list with no minimum size, no minimum public float, no minimum share value, and no government review of company disclosure documents. Though this fact has been widely reported, it is not often highlighted in global competitiveness reports.

It seems to be even less well known that the London Main Market competes for listings of foreign companies by exempting them from its combined code of corporate governance. As a result of this "light touch" regulatory approach, controlling shareholders in these companies can, and have siphoned off IPO proceeds to enrich themselves rather than the company; they can, and have engaged in related party transactions on terms that are not in the best interests of minority shareholders without fear of repercussion; and they can, and have continued to deny minority shareholders fair representation on the board. In short, only a wholesale abandonment of U.S. listing standards would allow us to compete for listings of many of the companies that have chosen to list in London – companies such as PartyGaming, Rosneft, and Kazahkmys. And that is something the advocates of a regulatory rollback adamantly deny seeking.

Meanwhile, the case of Prestbury Holdings offers an apt illustration of how London's "prudential" approach to enforcement works in real life. The company was reportedly in the middle of placing a convertible loan stock on the AIM market when it became aware that its financial performance was likely to fall significantly short of market expectations. It duly prepared a news release containing the bad news. However, when its investment banker, Durlacher, advised the company to withhold the release until after the offering was complete, Prestbury chose to follow that advice. Once the announcement finally was made, Prestbury's shares lost nearly 75 percent of their value in the first two days of trading. The punishment meted out for this clear violation of market rules? None for Prestbury. Durlacher's misconduct was considered so serious, however, that it merited an "unprecedented" public rebuke.

This willingness to respond to knowing violations of the law, and violations that result in considerable investor harm, with a slap on the wrist is likely behind the oft-cited huge disparity in monetary sanctions imposed by the Securities and Exchange Commission and by the U.K.'s Financial Services Authority. Undoubtedly, it also helps to explain why financial services executives prefer the U.K.'s enforcement environment. In the end, however, it suggests that London's prudential approach to regulation and enforcement is not so prudent for investors.

Finally, in comparing U.S. and U.K. markets, it is worth noting that U.S. markets have been the clear winners for investors. In the ten years through early March, for example, the NYSE was up 99.0 percent, the NASDAQ was up 79.5 percent, and the Dow was up 72.2 percent. During the same period, the FTSE 100 was up a lackluster 38.7 percent, and the FTSE AIM was down 2.8 percent. Does that really seem like a market we should rush to emulate?

3) Litigation against auditors has all but disappeared.

Another tenet of the deregulatory agenda is that audit firms are at risk of going under in

the face of skyrocketing lawsuit settlements and are therefore in need of new protections from liability. There are several holes in this argument. One is that it fails to acknowledge that skyrocketing settlements are directly attributable to increased investor losses to fraud and do not reflect any change in the litigation environment. It also fails to recognize the dramatic decrease that has occurred in the number of lawsuits filed, particularly those citing auditors. In fact, only 110 securities class action lawsuits were filed in 2006, down 38 percent from 2005 and 43 percent below the ten-year historical average. Although 68 percent of those cases alleged accounting violations, only one cited the auditor. Meanwhile, roughly 40 percent of cases filed are dismissed before they go to trial.

This is hardly the picture of a litigation system run amok. To the degree that policy makers believe there is a risk here that must be addressed, they should not look to solutions that further limit already minuscule recoveries of defrauded investors. Nor should they look to solutions that risk a return to the shoddy audit practices that led to the current "crisis."

4. Our investor protections offer U.S. markets a competitive edge.

No one would deny that U.S. markets face growing foreign competition. It is equally clear, however, that until investment banks and other professional advisers are willing to lower their fees and unless we are willing to throw out our rule book entirely, a U.S. listing will never be the low-cost, most convenient option. Fortunately, the added costs that accompany a U.S. listing are more than made up for by the valuation premium companies receive for listing here. That valuation premium derives from the fact that investors are willing to pay more for shares of companies that are willing and able to meet our standards. And, while it has not returned to market bubble levels, the valuation premium that companies receive for listing here has increased, not decreased, since the passage and implementation of the Sarbanes-Oxley Act.

We urge you, therefore, not to be taken in by the deceptive global competitiveness arguments being spread by the advocates of a regulatory rollback. If policy makers were to follow their recommendations, we would not only make our markets less safe, we would ultimately make them less competitive. That would be a sad legacy to try to defend when the next Enron or WorldCom inevitably followed.

Respectfully submitted,

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