Speech by SEC Chairman:
Remarks to the U.S. Chamber of Commerce's First Annual Capital Markets Summit: Securing America's Competitiveness

by

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It is a pleasure to join a star-studded lineup that includes Chairman Dodd, Chairman Frank, Chairman Olson, and Chairman Schapiro today. (It is beginning to appear that no one has been invited who is not a Chairman.)

We really shouldn't be surprised that two prominent Democratic Chairmen are here today, or that Eliot Spitzer has complained that the cost of Sarbanes-Oxley is "simply too great," or that Senator Schumer has warned of the competitive damage from excessive litigation — or that the Chairman of the SEC was invited to speak to the Chamber of Commerce.

Yes, it is unusual, at least in recent times, for the SEC Chairman to be here, given that our two organizations have sometimes held an uneasy acquaintance. Still, we've managed to maintain a cordial relationship, many of us on a first name basis. Defendant. Plaintiff. Appellant. *[Laughter]*

So what's going on here? Are we all suddenly on same page? Is this the dawning of the Age of Aquarius? *[Laughter]*

Well, no. But it is evidence that putting your money on political labels as a predictor of future performance is a bad investment. And as Chairman of the SEC, it's my duty to warn people about bad investments.

So, in keeping with this contrarian theme, I won't play to stereotype either — at least, not to the stereotype of a deregulatory Republican Congressman. Because I come to praise the SEC's mission as a regulator, not to bury it.

In accepting your kind invitation to attend this Capital Markets Summit, I am carrying on a long and noble tradition that began with the very first SEC Chairman, Joe Kennedy. Chairman Kennedy made one of his most important addresses — indeed, one that was carried live on national radio — at the Chamber of Commerce in Boston. He used the opportunity to address criticisms of the new securities laws that created both the Commission, and the system of securities regulations and broker-dealer regulations that they established.

The criticisms will seem familiar to us, because they sound exactly like the criticisms of Sarbanes-Oxley. First, Chairman Kennedy said, business was complaining that the 1933 Act imposes too much liability on officers and directors. Second, the new law was excessively expensive and burdensome. Third, the level of effort that was necessary to comply with the law was all out of proportion to the benefits to investors, to whom much of the disclosure was irrelevant. And fourth, the Commission's regulatory regime was inhibiting capital formation by lengthening the time it took to complete an offering.

Chairman Kennedy's defense of the SEC rings familiar, too. He asked the Chamber members to keep in mind that the law was new — and not only was the Commission learning from experience, but also the lawyers and accountants were being "supercautious." He said that the investors, who own the company, have a right to significant information about its operations, and that far more important than time to market was insuring that investors who were buying only pieces of paper could satisfy themselves about the safety and value of what they were getting. He assured the Chamber that as practice under the new regulations grew more established and the routine was more widely understood, there would no longer be any justification for high legal fees or accounting fees.

And then our first Chairman described the SEC's role, and our relationship to business, in a way that has characterized the yin and yang of the regulator and the regulated for every one of the 73 years since: "We are partners," he said, "of honest business."

I have taken that to mean that if a business is investor friendly, the SEC will be friendly to it.

But he also added that while we are partners to honest business, "we are prosecutors of dishonesty."

That's why I have repeatedly warned that anyone who attempts to drive a wedge between the interests of their business and the interests of investors in that business will forever find themselves confronted by a relentless and powerful adversary in the Securities and Exchange Commission.

The truth is, it isn't necessary for the interests of investors and the interests of business to be in conflict. In the 19th century, Frédéric Bastiat stated the maxim: "If you wish to prosper, let your customer prosper." He recognized that in a free market, a business must serve its customers in order to make a profit.

By the same principle, the degree to which a business serves its investors' interests is a measure of its success. After all, if we're talking about common stock holders, the investors own the business. If the business succeeds, so do they. And if the business fails, they do, too.

But the reason we have an SEC is that what a business does, and what it is in the business's self interest to do, aren't always the same.

From the inception of the idea of the public company 400 years ago, the separation of ownership and control has been simultaneously a source of enormous strength and a moral hazard. This powerful idea of pooling the capital of thousands of individual investors is the same spark that financed the Dutch East India Company's shipbuilding and the 20th century's exploitation of the microprocessor. Embedded within it is the same potential conflict of interest — stemming from corporate managers using "other people's money" — that has given rise to fraud against investors from the South Sea Bubble to Enron.

The truth is, our nation — and our modern world — would not have attained the levels of technological improvement, wealth creation, knowledge, and productivity that we have without publicly financed business.

At the same time, it is also true that wherever there is money — especially large amounts of other people's money — dishonest people will show up with plans to get their hands on it.

So it is in the interest of every one of us to safeguard the good that our capital markets produce by steadfastly policing the abuses that can and do occur.

The Dutch East India Company had existed for almost two centuries when Adam Smith made this very observation in *The Wealth of Nations*, in 1776. He noted that public companies attract much greater investment than partnerships, because they offer limited liability and large pools of capital. But they also create conflicts of interest, Smith said, because the managers and directors of public companies are managing "other people's money" rather than their own. And as a result, they don't have the same incentive to watch it carefully as do partners watching over their own money.

I harken back to Holland in the 17th century and Adam Smith in the 18th and Bastiat in the 19th not because I enjoy history — which I do. I bring them up to highlight the fact that these are not novel issues.

The 1930s creation of the SEC may be closer in time to the Civil War than to the 21st century, but the evils of fraud and unfair dealing which we were created to fight against are as old as the public company and will endure long after we are gone.

Just a recap of our most recent enforcement actions includes cases alleging secret slush funds; forgery; stock option grants to fictitious employees; falsified corporate documents; self-dealing; self-enrichment; attempted cover-ups; and lying to auditors. Earlier this month we filed the largest insider trading case against Wall Street professionals since the days of Ivan Boesky and Dennis Levine, involving major Wall Street firms as well as hedge funds.

And so, as this Conference focuses on how to improve the competitiveness of America's capital markets — a goal I not only share, but which Congress has charged the SEC to work to achieve — it must be remembered that aggressive law enforcement by the SEC is critical to the continued success of our markets.

Without the work of the SEC, America's capital markets as we know them today simply couldn't exist. Our markets thrive because of the global trust we've earned. That makes the SEC itself a key part of America's capital markets that helps secure a quality of life and freedom not only to millions of Americans but to countless people the world over. But the SEC can only continue in this role if we constantly update our rules, our policies, and our own way of operating to keep pace with the increasingly rapid changes in the world of finance that we regulate. For that reason, we are grateful for the nearly two years of work that your bipartisan Commission has done in order to provide your views and recommendations.

Yours is not the first, nor will it be the last, outside group to tell us that there are significant direct and indirect costs that come along with the benefits of Sarbanes-Oxley. The SEC's own analyses of Section 404 of Sarbanes-Oxley are in general agreement with what the Government Accountability Office, the Schumer-Bloomberg report, the Hubbard-Thornton report from the Committee on Capital Markets Regulation, and your own Commission have found: that while a portion of the first-year compliance experience of Sarbanes-Oxley undoubtedly reflected start-up costs — and, in many cases, long-neglected maintenance by companies of their internal control systems and procedures — it is undeniable that much of the cost was attributable to excessive, duplicative, or misdirected efforts.

As your report noted, we're working to eliminate the unnecessary costs of 404 compliance. We are serious about it, and so is the PCAOB.

That said, it is wrong to conflate the implementation problems of 404 with the entirety of the Sarbanes-Oxley Act. While it's a handy whipping boy, overall the law has had important positive effects. It may fairly be credited with correcting the most serious problems that beset our markets just a few years ago. It has played a significant and valuable role in restoring integrity to our markets. Remember where we were, and what happened. We needed decisive action. Sarbanes-Oxley delivered.

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 despite the fact that the global capital markets, consisting of over 50 exchanges worldwide with a total market capitalization of more than $46 trillion, are more competitive today than ever before, the United States continues to be the market leader with the largest global share.

Having effectively addressed the crisis in our markets, we can now look ahead at how best to continue to insure that our system of regulations maintains the highest standards of integrity while honing our competitive edge for the benefit of investors.

Your report this week points out that the U.S. market share for worldwide listings has been declining steadily since 1997, at the rate of about 2% a year. That steady trend significantly pre-dates Sarbanes-Oxley, and even includes the tech boom of the late 1990's. So it's hard to blame Sarbanes-Oxley for the decline. Obviously, other factors were at work — including increasingly competitive opportunities for global listings.

Your report this week also notes that non-technology IPOs in the United States — which had experienced a steady decline beginning in 1996 — have actually experienced an increased since 2003, after Sarbanes-Oxley became effective.

And our exchanges have experienced significant overall growth as well. For the 10 year period from 1995 to 2005, starting from a base year when equity values were riding high and ending in the current post-tech bubble, post-Sarbanes-Oxley era, the value of shares listed on the NYSE grew almost 135%, while the value of the Nasdaq grew almost 210%. The value of the shares listed on the London Stock Exchange, by way of comparison, increased by 127% in the same period.

In addition to our U.S. markets experiencing significant growth, America's exchanges continue to claim the dominant share of global market capitalization. The NYSE and Nasdaq by themselves represent 38% of the total global market capitalization. Of the 50 global exchanges, the NYSE remains the single largest exchange, representing 30% of the world's total market capitalization. This compares to 28% for the entire Asia-Pacific region and 27% for Europe.

A good deal of the current focus on capital markets competitiveness is premised on thenotion that foreign jurisdictions have looser regulations. And it's certainly true that Sarbanes-Oxley is being used in marketing campaigns abroad as a reason for foreign companies to list elsewhere. But the truth is that many countries, including the United Kingdom, offer stockholders a very broad set of rights. And many of those same countries are adopting provisions of the Sarbanes-Oxley Act as part of their own regulatory regimes.

Imitation is the sincerest form of flattery. The fact is, America's markets continue to set the standard for the rest of the world.

So as we consider the effect of Sarbanes-Oxley on U.S. competitiveness, it is important to keep in mind how much of it has been emulated overseas. And with good reason. Competitiveness is driven by far more than ease of doing business — it's driven by the integrity of the market and investor confidence. That's America's sterling competitive edge.

In the short time since the passage of Sarbanes-Oxley, governments in the major markets around the world have followed America's lead in establishing independent auditor oversight bodies like PCAOB. For example, the European Union recently adopted a directive requiring all EU members to create an auditor oversight body. There is now widespread agreement that to improve audit quality, auditor oversight bodies should be independent of the industry they oversee.

Other major capital markets have also recognized the conflicts of interest that some non-audit services create, and the need to place restrictions on these services to improve audit quality. The European Union, the United Kingdom, France, Hong Kong, China, Japan, Australia, Canada, and Mexico have all passed reforms requiring mandatory audit partner rotation, although they vary regarding the details about how this rotation works.

Audit committee independence is another increasingly common theme around the world. The United Kingdom, Hong Kong, Australia, Canada, and Mexico have all introduced reforms since 2002 requiring that all members of the audit committee be independent of management.

One of the principal objectives of the Act was to improve executive responsibility and the "tone at the top" at public companies. We can credit two sections of the Act in particular for helping to achieve that objective: Sections 302 and 906. Under the rules implementing these sections, whenever a public company files a quarterly or annual report with Commission, both the principal executive officer and the principal financial officer must personally certify that they have reviewed it.

Think what a similar provision might do for Congress.

A fraudulent Section 302 certification is subject to civil enforcement by the Commission, and a fraudulent Section 906 certification carries criminal penalties enforceable by the Department of Justice. These dual certification requirements are designed to ensure that the company's top leaders are personally involved in the disclosure process. That's an enormously important measure for investors. On the heels of so many major corporate scandals, Americans had little confidence that the key players responsible would ever be held accountable. This change goes a long way to help restore their confidence. The "Col. Klink defense" no longer cuts it.

One of the hallmark accomplishments of Sarbanes-Oxley is that it has implemented the corporate equivalent of President Truman's oft-cited aphorism: "The buck stops here." Thanks to Sarbanes-Oxley, the responsibility for the truthfulness of public company reports and disclosures stop on the desks of our corporate leaders.

Yet another significant improvement brought about by Sarbanes-Oxley is the change to real-time disclosure of material information by companies and insiders. Today, thanks to changes mandated by the Act, investors are entitled to review reports of insiders' transactions in their company's securities — including receipt of option grants from their companies within two business days after the transaction occurs — and all of these reports are now required to be filed on the Commission's electronic reporting system. These changes led to the discovery — and the prompt cleanup — of corrupt practices surrounding the back-dating of options, were we are continuing to bring enforcement actions.

These days, companies are completing their annual 10-Ks faster, with large-cap companies doing so within 60 days. This provides information to investors sooner. More timely financial statements are more useful financial statements — and more useful financial statements mean stronger capital markets.

Despite the recommendation in your report, and in the Schumer-Bloomberg study, that Congress amend the Sarbanes-Oxley Act, I want to state clearly this morning that I disagree. While of course it's up to the Congress to determine its legislative priorities, both the House and the Senate have formally asked my advice on this point, in hearings on the subject of Sarbanes-Oxley, and I have repeatedly given it. 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 even now only a few years old, should be opened up for amendment, or that they need to be.

The SEC has the power and the necessary flexibility to implement the law in a way that makes sense for investors and markets. And your input is a valuable tool in helping us make those changes so that Section 404 operates as intended. In particular, we've been able to phase in the application of the internal controls requirements of Section 404, with appropriate deferrals for public companies of different sizes — so that even today, nearly five years after the Act, smaller public companies are not yet required to comply with this provision.

We've done the same for foreign private issuers. Just last August, the Commission granted appropriately tailored relief from Section 404(b) compliance for certain foreign private issuers that are accelerated filers. The Commission's data indicate that about 23% of the approximately 1,200 foreign private issuers will receive the one-year extension of the compliance dates. That is exactly the kind of flexibility we need.

And in May of last year, after carefully evaluating all of the public commentary on the Section 404 requirements, the SEC announced a plan to re-balance Section 404 compliance by all of the companies that fall under our jurisdiction — large and small, foreign and domestic. We are working closely with the PCAOB on their extensive rewrite of the auditing standard that led to such high costs in the initial application of 404.

And in December the Commission adopted provisions, which are now effective, that permit IPOs and foreign issuers to use their first year of public reporting to achieve compliance with 404. In other words, the expenses of a new offering or an initial US GAAP reconciliation need not be paid at the same time that a company is subject to a full 404 audit.

As for smaller companies, we've postponed 404 compliance until our work with the PCAOB is done.

The SEC will continue to work with other regulators around the world for effective regulatory standards that encourage capital formation, job creation, and economic growth, while at the same time offering a high degree of investor protection. As the Congress well appreciated when it passed Sarbanes-Oxley, these are not inconsistent goals, but rather, highly complementary ones.

It is up to all of us to work together to see to it that just as a well-run business considers that the customer is always right, so too will that business govern itself based on the premise that its investors are always right.

When I was a young boy, Charlie Wilson was the Chairman of General Motors. He famously told a congressional hearing that "What's good for General Motors is good for the rest of America."

I'm not sure how accurate that ever was, but I'm certain that those days are long gone. When Charlie Wilson made his statement, investing wasn't common for working Americans.

But today, as your report this week points out, the majority of America's workers are participants in our capital markets. It is increasingly true — and increasingly apparent — that what's good for American investors is good for the American people.

The vast majority of businesses get it — and conduct themselves accordingly. We at the SEC will continue to focus relentlessly on the ones that don't.

Sixty years after Joe Kennedy's address to the Chamber of Commerce in Boston, another SEC Chairman also addressed the Chamber there. Arthur Levitt spoke of the endless change that has always been the hallmark of our markets, and he pointed out that the SEC has succeeded by recognizing that fact, and responding to it.

In that spirit, we welcome the opportunity to study the work product of the bipartisan Commission that you have convened, which is focused on the profound changes underway in our capital markets. I can speak for every member of the Commission and our professional staff in saying that we appreciate the energy and effort you have brought to this task.

And at the same time, to help us keep our bearings amidst this perpetual change, it seems fitting to recall Chairman Levitt's words to the Chamber of Commerce just a few years ago:

"[D]espite the uncertainties ahead, there is one thing of which you can be sure — that the SEC will be as vigilant, as responsive, and as effective in guarding U.S. markets in the years ahead as it has in years past."

So, to each of you, thank you for what you do. Thank you for the honor of joining you in the mission of protecting America's financial markets. As Chairman Kennedy so aptly put it, we are proud to be the partners of honest business.

http://www.sec.gov/news/speech/2007/spch031407cc.htm