

National Post 12.09

No more Mr Nice Guy
By Lorraine Mallinder

US capital markets hold as much appeal as ever for Canadian companies, but as the country focuses on finding its regulatory feet in the wake of financial shocks, it is becoming a far stricter place to do business.

Deep shifts in mood and mindset have occurred in recent months. As Rob Lando, partner at the New York office of Osler, Hoskin & Harcourt, puts it: “The SEC [Securities and Exchange Commission] will not suffer fools gladly these days.”

The current regulatory revamp will give the regulator more sway over sectors such as the credit derivatives market, credit rating agencies and asset management firms, as well as increasing its firepower to target the lawless and the reckless.

“The discussion on enforcement and oversight has captured the hearts and minds of regulators here,” says Joris Hogan, a New York-based partner with Torys.

One of the most controversial reforms currently rocking corporate America is an overhaul of so-called proxy access rules, which would open company boardrooms to shareholder-nominated directors. Shareholders holding one to five per cent of stock - depending on company size - would be empowered to nominate up to a quarter of board members should the rules, currently under discussion, go through in their current form.

This is the SEC’s third attempt in recent years to introduce more accountability into the boardroom. The subject of aggressive opposition from business groups fearful of opening the door to unions and hedge funds, the proposal “flies in the face of the way things have always been done”, says Mr. Hogan. Despite the corporate outcry, it seems likely the rules will be passed in November.

Canadian companies classified as foreign private issuers - with less than 50 per cent of securities issued in the US - would be exempt. Amid the current clamour for more corporate accountability, however, the issue of whether foreign entities would benefit from voluntarily adopting the measure in the interests of investor relations is a matter of debate among lawyers.

The same could be said of proposals that would require companies to explain the design of compensation schemes in proxy materials - information sent out ahead of annual meetings. The proposed rules would see the regulator, as Mr. Hogan describes it, “indirectly twisting the arms” of company boards, compelling companies to spell out the interplay between financial incentives and levels of risk-taking.

The proposals, which are not applicable to foreign private issuers, look set to be adopted by the end of the year. They are being discussed at a time when the ‘say on pay’ movement is gathering momentum. The SEC is preparing to adopt rules that would require bailout recipients to give shareholders a non-binding vote on executive compensation. And, this fall, the Senate will vote on a bill that would not only tighten regulatory scrutiny over compensation schemes, but would also give shareholders of public companies an advisory vote on pay. It seems that the latter provision would not apply to foreign private issuers, given their exemption from proxy rules.

Enforcement is a key watchword at the newly beefed-up SEC. From late January to August, it opened 525 investigations, a rise of ten per cent over the same period last year. It also filed 397 actions, up 30 per cent on last year. Subprime abuses, market manipulation, insider trading, false disclosures, bribery and penny stock frauds are all in the regulator’s sights.

For Edwin Maynard, a partner at Paul, Weiss, Rifkind, Wharton & Garrison, one of the hottest areas in the enforcement arena right now is overseas corruption. Over three decades old, the Foreign Corrupt Practices Act (the model for Canada’s Corruption of Foreign Public Officials Act) has recently been the subject of

intense interest, with a marked increase in new investigations - up around 20 per cent on last year, according to a recent PricewaterhouseCoopers' report.

Earlier this year, Kellogg, Brown & Root and Halliburton paid a combined settlement of \$579 million related to allegations of foreign bribery. With global corporate accountability now a priority for US regulators, who are stepping up coordination with international partners, the number of probes is expected to increase. Ditto the severity of penalties.

"In certain parts of the world, bribery is a normal part of doing business. Many multinational companies are faced with these challenges every day," says Mr. Maynard, whose office is dealing with a number of related files. "Many of the companies from Canada that are listed here have international operations."

The SEC is also flexing its muscles on financial reporting standards. Seven years after the introduction of the Sarbanes-Oxley Act, or SOX, struck fear into the hearts of the country's corporate elites, the regulator is back on the warpath. It has been made abundantly clear, in particular with last month's charges against General Electric for bending "the accounting rules beyond breaking point", that no company is too big for the rap.

Although Canadian standards now bear a close resemblance to SOX – which applies to foreign private issuers – Mr. Lando advises companies to bear in mind how the US standards have evolved through the courts. "People in Canada will take the view that certain information is immaterial, that it doesn't need to be disclosed, which might be right and proper in Canada. But in the US ... the chances are higher that a judge somewhere will have heard a case on similar facts and the precedent will go against you."

In July, the SEC took the unprecedented step of clawing back bonuses and stock sales profits from a former chief executive whose company's profits were allegedly inflated by fraudulent accounting. This was the first time that the regulator had wielded a provision of the Sarbanes-Oxley law allowing regulators to pursue individuals deemed to have benefitted from fraud without having specifically committed a crime.

The bigger and bolder approach to market regulation is down to a confluence of major events – a recession that exposed gaping holes in regulatory oversight, the damning aftershocks of the Bernie Madoff affair and, last but by no means least, a change of government. Lawyers concur that the US is becoming a more tightly-restricted, but also a safer and fairer, market.

Ends

(1,024)