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Statement of Robert G. DeLaMater
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U.S.-China Economic and Security Review Commission
"China and the Global Capital Markets"

Mr. Chairman and Members of the Commission:

Thank you very much for the opportunity to be with you here today. As is well known, the investment and capital markets relationships between the United States and China have grown substantially in size and complexity over the past decade, as China has assumed an important role as both a user and recently as a supplier of capital on a global scale. As part of your mandate to review crucial aspects of the U.S.-China relationship, the Commission has an important role to play in helping to ensure that the United States retains a leading position among the world's capital markets, given the essential role played by these markets in providing investment opportunities for American institutional and individual investors and in supplying capital to business enterprises that provide jobs and economic opportunities to American workers and the communities in which they live. Your diligence and care in reviewing developments and in formulating reports and recommendations to Congress in this area is vital, and I wish you success in your efforts.

I have worked for nearly 20 years as a corporate and securities lawyer, and much of my practice has dealt with cross-border securities offerings, investments and acquisitions. In particular, I have worked on many international securities offerings, including offerings by foreign issuers selling securities in public offerings or private placements in the United States. Over the past decade, my responsibilities in my firm's practice in Asia from our offices in Tokyo and Hong Kong have enabled me to observe the approaches to U.S. capital markets taken by various Asian issuers, including companies based in China. Over the past decade, there has been an interesting shift in the practice of these issuers in accessing U.S. capital markets, and it is this change that I wish to discuss today, as it has implications for the position of the United States as the world's principal capital market and as the de facto benchmark for capital markets activity around the world.

During the 1990s there was a sharp rise in securities offerings in the United States by foreign issuers of all nationalities, driven by three significant phenomena: first, a wave of privatization offerings as governments around the world sought to dispose of state-owned enterprises (thereby stimulating private enterprise, improving the focus and governance of the company concerned and raising revenue for the government); second, the technology boom that led to IPOs and other offerings by internet and telecommunications companies; and third, strong economic growth and the adoption of market-oriented economic policies in emerging markets that generated growing capital needs and a desire to meet those needs through international capital markets.

China was an active participant in these trends, as it exhibited all three of these phenomena. This led to dozens of securities offerings in the United States by companies organized in China or having their principal operations there. Many of these companies sought and obtained listings of their shares on the New York Stock Exchange or Nasdaq, and thereby became SEC-reporting issuers subject to the full range of U.S. reporting and disclosure obligations for foreign issuers. In addition to the practical benefit of being able to raise funds in the large and liquid capital market of our country, many Chinese

companies saw an overseas listing in general, and a U.S. listing in particular, as a strategic goal, conferring a seal of approval and accomplishment that could be leveraged into business success beyond mere capital raising. The appeal of a U.S. listing was so great that in the mid-1990s a few Chinese companies listed shares only in New York and did not seek a listing even in Hong Kong.

Even Chinese companies that did not feel immediately ready for the responsibilities of a U.S. listing could raise significant sums in U.S. markets by conducting a private placement under Rule 144A, which offered the opportunity to sell securities to large institutional investors in the United States. Such companies could either continue only with their listings on their home securities market, or could at some opportune time in the future seek a U.S. listing and use the 144A offering as a stepping stone toward full SEC registration.

However, the level of interest among foreign companies in listing in the United States has changed dramatically since 2000, due principally to two developments. First, the significant stock price declines beginning in March 2000 led to reduced interest on the part of U.S. retail investors in investing in initial public offerings. This in turn reduced the benefits to issuers of conducting public offerings and listings of their securities, leading more issuers to choose instead the lower cost, greater speed and increased certainty of a private placement to large institutional investors. Second, the enactment of the Sarbanes-Oxley Act in 2002 inhibited many foreign companies from seeking a listing in the United States, not only because of its significant requirements relating to board composition, corporate governance and internal control review, but also due to concerns about what other new U.S. regulatory requirements might be imposed upon short notice in the future. The various corporate scandals in the United States publicized since 2001 may also have contributed to this, by tarnishing the perceived "seal of approval" effect of listing on a U.S. market.

Moreover, since the early 1990s and particularly in the last few years, other capital markets have been changing and increasing their appeal to companies undertaking cross-border securities offerings and international listings. The Hong Kong Stock Exchange, as the natural listing venue for Chinese companies, has garnered far more of such listings than any other exchange. Companies listing on the Hong Kong Stock Exchange increasingly believe that there may be limited value in seeking another international listing, in light of the enhancements in disclosure requirements and corporate governance requirements in Hong Kong in recent years and the apparent willingness of investors around the globe to invest in Chinese companies listed only in Hong Kong.

Developments in other markets have also contributed to issuers' seeking to diversify the markets in which they raise capital and as a result to less reliance on the United States. One development that has been an important feature of some of the recent large Chinese privatization offerings has been what is known as the "public offer without listing" or POWL in Japan. This offering structure permits a company to conduct a public offering without being required, following the offering, to assume the burdens of a public listing and the ongoing disclosure and other obligations that a public listing would entail. In

some of these offerings the amount of demand in Japan reportedly has exceeded a few billion dollars and may have accounted for a larger proportion of the offering than that sold in the United States. This obviously reduces the importance of the United States market as the key source of incremental demand for these offerings. Another development has been the increased effort by the London Stock Exchange to solicit listings by Chinese companies. The London Stock Exchange has been actively marketing listing in London as an alternative to the increased disclosure and governance requirements, and risk of securities class action lawsuits, claimed to be inherent in listing in New York. Some Chinese issuers, such as Air China last year, have been convinced to list their shares in London rather than in New York. In addition, steps taken by the European Union to harmonize prospectus requirements and to adopt International Financial Reporting Standards have also helped to move the Euromarkets closer to being a more unified capital market and a practical alternative to the United States.

As a result, many Chinese and other foreign companies in the last few years have decided to forego seeking a U.S. listing. For example, there have been no initial public offerings listed in the United States by Japanese companies since the enactment of Sarbanes-Oxley in 2002, and listings by European issuers have been very few. Interestingly, China remains one of the more active sources of companies seeking to list on the New York Stock Exchange or Nasdaq, but this is only by comparison to a dramatic decline from other countries.

It is also noteworthy that in recent years those Chinese companies that have listed in the United States have principally been smaller, technology-oriented companies seeking to list on Nasdaq. There have been over 15 of these IPOs since 2002. A very well-known current example is Baidu.com, famous for rising nearly 400% on its opening day of trading last Friday. This opening day gain was reported to be the largest ever for a foreign company in the U.S. markets, and the largest for any company since 1999. But leaving aside this extraordinary performance, in many respects the company is typical of Chinese technology companies seeking to list in the United States. Although its headquarters and business operations are in China, it is incorporated in an offshore jurisdiction, the Cayman Islands. It is not a state-owned enterprise: its principal shareholders are its individual founders and management as well as a number of U.S.-based venture capital and private equity funds. The offering was also relatively small, raising about $100 million. Far from being methods for funding the Chinese government, these offerings are rewarding the entrepreneurs who built the company and the early investors, often U.S. investors, who financed them.

In contrast, since 2002 only a handful of Chinese state-owned enterprises have sought U.S. listings and SEC-registered IPOs. The initial public offerings and NYSE listings by China Netcom in 2004 and China Life in 2003 echoed the Chinese privatizations that commonly were listed on the New York Stock Exchange through 2002. The other large initial public offerings by state-owned enterprises that have been completed in recent years have listed only in Hong Kong or London and have gained access to U.S. investors by means of a private placement to institutional investors, including growing numbers of hedge funds and private equity funds, pursuant to Rule 144A.

Reliable and detailed data regarding securities offerings are difficult to assemble, particularly for private placements and other unregistered offerings, because public reporting of the distribution of the offering by jurisdiction is generally not required. Also, there can be problems in properly classifying issuers, because many companies having their principal operations in China are incorporated in Hong Kong or a Caribbean jurisdiction. Nevertheless, such data as are available make clear that offering methods have changed significantly in the nearly five-year period since 2001 compared with the five-year period from 1996 through 2000. My analysis of data gathered by Thomson Financial Corporation indicates clearly that both the number and value of initial public equity offerings by Chinese issuers registered with the SEC have declined from the first period to the second, while both the number and value of offerings that involved a 144A tranche have increased. For example, these data suggest that from 1996 through 2000, there were 28 SEC-registered IPOs by companies organized in the PRC and Hong Kong. From 2001 to date, there have been only 20. By comparison, there were 10 IPOs by such companies that included offerings pursuant to Rule 144A in the earlier period, and 32 in the latter period. The data based upon offering value are less precise but also clearly show the change.

The ability to raise billions of dollars from offerings to institutional investors in the United States by using Rule 144A has led many foreign issuers to conclude that there is no need for the incremental retail demand afforded by SEC registration. In other words, when even the largest securities offerings can be completed by Chinese and other foreign issuers without SEC registration, to U.S. institutional investors who are willing to accept a foreign market such as the Hong Kong Stock Exchange as the sole listed market trading venue, foreign issuers are less willing to incur the cost and ongoing disclosure and governance requirements of SEC registration and U.S. listing.

Having spent my entire professional career as a U.S. securities lawyer, my purpose today is not by any means to criticize the Sarbanes-Oxley Act or the other elements of the U.S. securities regulatory scheme that apply to foreign issuers. Those regulations, and the manner in which they have been administered by the SEC and its highly professional staff, historically have made accommodations that enhanced the attractiveness of the U.S. capital markets to foreign issuers by taking into account the specific or unusual needs of foreign issuers compared with U.S. domestic issuers. For example, very shortly after the adoption of the Securities Exchange Act of 1934, foreign issuers were exempted from the proxy rules of Section 14 and the insider transaction reporting and short-swing profit disgorgement requirements of Section 16 of that Act. Foreign issuers are entitled to use registration forms different from those that apply to U.S. issuers, which in their disclosure requirements take some account of the differences between U.S. and foreign disclosure regimes and practices (for example, by not requiring foreign companies to disclose individual compensation paid to the top five executive officers, and by limiting the need to report financial information by business segments). The annual reports on Form 20-F required of SEC-reporting foreign issuers are due within six months of year end, as opposed to not more than 90 days for the Form 10-K reports by U.S. issuers.

During the 1990s, the SEC and its staff implemented other accommodations that had the effect of making it easier and more attractive for foreign issuers to make the transition to SEC reporting status. The longstanding requirement that foreign issuers reconcile their home country financial statements to U.S. generally accepted accounting principles was modified to permit foreign issuers upon their initial registration to reconcile only the most recent two fiscal years of financial results rather than the latest five years. The SEC staff made it a routine practice to review foreign issuer registration statements on a confidential basis, rather than requiring that they be publicly filed in order to commence the SEC staff review process, as is the case for U.S. issuers. This was intended to allow foreign issuers to resolve SEC comments privately and to manage the significant change to their home country disclosure that they might face in the initial transition to U.S. GAAP and SEC disclosure requirements. Also, when Regulation FD was adopted, which required full disclosure of information formerly communicated selectively to securities analysts or institutional investors, foreign issuers were exempted from this in recognition of the different regulations or practices in such communications that might exist in overseas markets compared with the U.S. market. The SEC staff also permitted foreign issuers to employ registered exchange offers to give holders of their privately placed equity securities the opportunity to exchange for identical, freely tradable securities in a registered public offering. U.S. issuers are permitted to use this technique only for debt securities. This allowed foreign issuers to take what became known as the "stepping stone" approach to entering U.S. markets, by first issuing equity in a Rule 144A placement to institutions and then following some time later with an SEC registered offering when they were ready to meet all the requirements. Even the Sarbanes-Oxley regime as it has been implemented by the SEC has sought to take account of the particular problems of foreign issuers under their local laws and to reach appropriate accommodations between the burdens faced by foreign issuers and the needs of investor protection in the United States. It should be noted that, with the exception of Canada, due to its proximity and similarity to the United States, U.S. federal securities regulation has generally not made distinctions among foreign issuers on the basis of nationality, but instead has treated all foreign issuers in the same manner.

My point is, however, to emphasize that the importance of a particular nation's capital market to the global capital market is not something that is fixed, and it can fluctuate with changes in relative economic development, changes in regulation and many other factors. One instructive example is that of Japan, which during the 1980s enjoyed an economic boom that attracted investment interest around the world. By 1991 there were 127 foreign companies listed on the Tokyo Stock Exchange, drawn by the promise of a huge pool of liquid savings in a country that was then challenging the United States for world economic leadership. Today, after over a decade of economic difficulty, during which there were very few new foreign entrants seeking listing on the Tokyo Stock Exchange and a number of delistings, there remain only about two dozen foreign companies still listed on the Tokyo Stock Exchange. This has occurred despite the strong increase in recent years of capital raisings in Japan through the mechanism of the public offer without listing that I described earlier.

When considering the capital markets as providers of capital, it is also important to note that secondary trading of outstanding securities, not merely primary offerings of newly issued securities, contributes to capital formation. Investors are more apt to purchase newly-issued securities if they expect that there will be a liquid trading market for those securities when they wish to sell. Secondary market purchases by U.S. investors thus can indirectly support capital-raising in overseas markets, by adding incrementally to global trading volume. Every day, investors in the United States invest large sums in the securities of foreign companies that are not listed in this country and may never have completed even a private placement here. Even individual investors are free to invest in securities of foreign companies that they acquire in the secondary market in the issuer's home country, as the United States, like most developed nations today, imposes no capital controls on money invested abroad. In essence, this is an age of highly mobile capital, in which substantial sums can be raised and many large securities offerings completed without the need for foreign companies to list their securities in the market in which investors are located.

This willingness to invest across borders in companies not listed in the investor's home country will only increase as securities and accounting regulators around the world pursue programs to converge accounting standards, governance requirements and disclosure requirements. The substantial progress that has been made to date and undoubtedly will be made in the near future to converge U.S. generally accepted accounting principles and International Financial Reporting Standards is one example. In addition, local securities regulators in various countries are requiring that audit committees comprise independent directors and are imposing greater disclosure requirements. For example, more countries now join the United States in requiring the disclosure of individual compensation of top executives, rather than only aggregate compensation of the management group. Thus U.S. investors, either directly or through mutual funds, pension funds, hedge funds, private equity funds and other collective investment vehicles, are likely to grow even more willing to deploy their capital in securities of issuers listed only outside the United States.

There are a number of disadvantages for the United States if it is not the overseas listing venue of choice for Chinese and other foreign companies. First, to the extent that global accounting, governance and disclosure requirements have not fully converged, the United States loses its ability to apply its own higher requirements if companies do not choose to list their securities in this country. Secondly, there is a benefit to the United States if it is perceived as the global leader and benchmark for sound, consistent, efficient securities market regulation and capital markets activity, as it then enjoys the ability to encourage others to adopt similarly high standards and efficient practices, both as a result of competitive considerations as well as peer pressure. Thirdly, U.S. financial institutions and other intermediaries and advisors who are involved in the capital markets, particularly the securities offering process, benefit significantly from foreign companies accessing U.S. capital markets. This constitutes a significant export of services by U.S. entities that provides American jobs and incrementally helps our trade balance. There is also a more intangible international relations benefit to the United States through the choice of U.S. law and practices to govern international capital markets transactions,

which often is the case if a substantial portion of the offering is conducted in the United States. My own experience in Asia suggests that the United Kingdom continues to benefit from the legacy of the British Empire and the widespread use of English law and choice of London as a center for dispute resolution. Finally, the desire to diversify investments, which is one of the tenets of modern portfolio management, will strongly encourage U.S. investors to invest in foreign companies, and it is certainly better for our investors if those companies are as engaged as possible in the U.S. securities regulatory and reporting regime.

In conclusion, I believe that any capital markets regulatory regime, in order to attract participants and capital on an ongoing basis, needs to strive for clear and consistent regulations that are administered on a practical, even-handed and transparent basis. When we consider the regulation of securities offerings in this country by foreign issuers, including Chinese issuers, I believe it is important to keep in mind that these issuers may obtain the capital they need elsewhere. As many commentators, including Chairman Greenspan, have noted, there appears to be a global glut of savings, and China itself is a major supplier of capital to the United States as a purchaser of U.S. Treasury securities. This global savings glut leads to the phenomenon that those who seek capital are readily able to find it, and those who wish to have attractive investment opportunities to which they can provide capital may need to compete in order to do so. As I noted earlier, success in this competition may fluctuate over the years due to changes in relative economic developments as well as changes in regulation. Our ability to control economic movements, particularly those in other countries, is somewhat limited, but we do retain the ability to shape and administer our own regulatory regime.

I suggest that it is vitally in the interest of the United States that our capital markets regulatory regime be shaped and administered in a way that encourages access to U.S. capital markets by foreign issuers, including Chinese issuers, while at the same time protecting U.S. investors. Many of the most attractive investment opportunities in the world today are in Asia in general, and China in particular. Always assuming that our regulations meet the threshold requirement to provide appropriate levels of investor protection, we would not be serving the interests of the millions of Americans who depend upon the investment performance of their pension managers, insurance companies, mutual funds and financial advisors if we lead Chinese and other foreign companies to avoid U.S. capital markets in favor of listings in London, Japanese retail offerings or other offerings in Europe and the international markets.

Thank you again for the opportunity to be here today and for your dedication to careful analysis of the U.S.-China relationship.