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Ms Nancy Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-9303
The United States of America

**Subject: Proposed Rules on Termination of a Foreign Private Issuer's Registration of a Class of Securities under Section 12(g), and Duty to File Reports under Section 15(d), of the Securities Exchange Act of 1934 – File Number: S7-12-05**

Dear Ms Morris,

This letter constitutes the response of the European Commission to the call for comments made by the U.S. Securities and Exchange Commission (hereinafter, the SEC) in relation to its proposed rules on termination of a foreign private issuer's registration of a class of securities under Section 12(g) and duty to file reports under Section 15(d) of the Securities Exchange Act of 1934 (hereinafter, the Exchange Act).

The observations in this letter reflect extensive consultations with governments and securities regulators of the 25 Member States of the European Union, associations representing European issuers, individual companies and other stakeholders. Accordingly, this response is supported by the European Securities Committee, representing the governments of all 25 Member States of the European Union. The views put forward by the European Commission in this response are also supported by the Committee of European Securities Regulators (CESR), representing 27 securities regulators in the European Economic Area.

For some time the European Commission, on behalf of the Member States of the European Union, has signalled to the SEC the need for revision of the existing SEC rules on deregistration which have proved burdensome and impracticable for European companies listed on the US capital markets that seek to terminate that listing. The principal problems posed for such issuers by the current SEC rules are the temporary nature of deregistration, the counting rules by which the eligibility of a foreign private

issuer to deregister is determined, and the scope of availability of deregistration. We are pleased that the SEC's proposal attempts to tackle these three key issues.

Solving this issue of the deregistration of foreign issuers will be a clear signal that the transatlantic financial markets regulatory dialogue can deliver tangible results and could have positive effects in the context of other ongoing transatlantic discussions. We believe both Europe and the United States will benefit from more open and competitive markets, where European issuers are not kept in an asymmetric situation of being able to enter U.S. capital markets but virtually unable to exit them, whereas U.S. issuers do not encounter the same difficulties in the EU. **Based on our analysis and numerous consultations, however, we do not think the proposed rules resolve the deregistration issue.**

## 1. GENERAL REMARKS

The European Commission welcomes the announcement by the SEC of a proposal to modify the rules on termination by a foreign private issuer of its registration of a class of securities under Exchange Act Section 12(g) (and its resulting Section 13(a) reporting obligations), and of the reporting obligations of such an issuer under Section 15(d) of that Act.

We welcome in particular the SEC's view that **the permanent nature of deregistration** should be a fundamental principle of the new deregistration rules. The current mechanism of dormant registration gives rise to legal uncertainty and we appreciate that the SEC has endeavoured to change it.

We also support the changes proposed by the SEC in relation to **the counting method** used to determine the size of the interest held by U.S. residents in a foreign private issuer. Given the nature of contemporary "dematerialised" securities markets, it is reasonable to permit foreign issuers to rely on the information provided by third party information services providers. For the same reasons, we agree with the SEC that, rather than being required to "look through" the holdings of "nominees" (brokers, dealers, banks etc.) worldwide, foreign private issuers should be allowed to limit their inquiry regarding the amount of securities represented by accounts of customers resident in the U.S. to "nominees" located in the U.S., in the issuer's jurisdiction of incorporation or, if different, the jurisdiction of the issuer's primary trading market.

**However, our analysis has shown that, as drafted, the new rules would only assist very few European firms to deregister, and we therefore urge the SEC to reconsider some details of its proposal.**

Information compiled by market participants, as well as estimates we have received from Member States, individual European companies and their associations, confirm that only a fraction of European companies currently registered with the SEC would be able to terminate their registration under the proposed rule changes. Specifically, according to estimates provided to the European Commission, of some 70 issuers incorporated in the Member States with the greatest market capitalisation and presence on the US capital markets, not more than 2 issuers from France, 2 from the United Kingdom, 1-2 from

Italy, 1 from the Netherlands and probably none from Germany[1] would be eligible to benefit from the new rules. There is a broad consensus in Europe that the technical reason for the restricted availability of permanent deregistration is that Rule 12h-6(a)(4), as proposed, sets the applicable threshold of U.S. shareholder interest much too low. Available data derived from a sample of large EU companies registered with the SEC indicates that typically US investors hold 21% of equity in such a company, with a 20 to 1 split between institutional and retail shareholders.

We note that the SEC's preliminary analysis delivered more encouraging results: some 26% of foreign private issuers would be able to deregister under the new rules[2]. Given the apparent difference between the data, and the fact that we are doubtful that the proposals will work for EU issuers, we would welcome a more detailed explanation from the SEC of the **methodology** used to obtain those figures, the **geographical breakdown** of the results, and information which European companies would be eligible to deregister.

Moreover, even if the SEC's estimate that 26% of foreign private issuers would be eligible to deregister permanently under the proposed new rule proves to be accurate, we would consider this to be an **unambitious target** for a jurisdiction such as the United States, that has consistently argued together with the European Union for the development of global, open and liquid financial markets. **The SEC's figures also mean that 74% of foreign private issuers cannot deregister.** It is, in our view, significant that no European Union Member State has similarly restrictive rules for the exit of foreign issuers from their financial markets to be necessary for the purposes of investor protection. We consider that "captive" measures are not a good way to maintain long term presence or attractiveness of securities markets. Similarly, we are sure that open access to deregistration would not make all foreign issuers leave U.S. markets but it would increase confidence and encourage free flow of capital between the EU and the US.

For these reasons, we believe that the SEC should **consider revising the eligibility criteria** for deregistration by foreign private issuers in the proposed Rules 12h-6(a)(4)-(6). Our extensive consultations with European stakeholders, together with our own analysis, suggest a number of options for amending the proposed rules so as to ensure an effective balance between adequate investor protection and open capital markets. These options as well as other considerations relating to the quality of reporting standards in the EU are outlined below.

## 2. INVESTOR PROTECTION

We appreciate that with the proposed rules the SEC aims to ensure the adequate protection of investors in the U.S. We fully share that objective. Indeed, in the past years the European Union has put in place a **comprehensive framework of disclosure and**

[1] In total, it is estimated that a maximum of 4 smaller German companies would be eligible to use the new rules.

[2] Page 34 of the introduction to the proposal.

**reporting requirements imposed on issuers of securities, which should be considered by the SEC to be comparable and equivalent with U.S. disclosure rules.**

Before they may publicly offer securities or request their admission to trading on regulated European exchanges, European issuers must publish an exhaustive **prospectus**, drawn up in accordance with detailed requirements as to its form and its content which are identical throughout the EU, and which reflect IOSCO standards. Before the prospectus can be published, it must be approved by an independent competent authority which ensures that it complies with the applicable requirements[3].

Subject to appropriate exemptions, all issuers with securities admitted to trading on a regulated market are required to comply with **extensive transparency rules**[4] which require the publication of the following periodic financial information and reports:

- **the annual financial report** – to be made public by the issuer no later than four months after the end of each financial year;

- **the half-yearly report,** which is obligatory for issuers of shares or debt securities: this covers the first six months of the financial year and must be made public as soon as possible after the end of the relevant period, but at the latest two months thereafter;

- **interim management statements**: relating to each six month period of a financial year, and consisting of an explanation of material events and transactions which have taken place during that period, and a general description of the financial position and performance of the issuer and any entities which it controls. The statement must be made public during the third or fourth month of the six-month period to which it relates by any issuer that does not **already publish quarterly financial reports**.

The annual and half-yearly financial reports must be made available to the public for at least five years.

From 2005 all listed EU companies (including banks and insurance companies) have been required to prepare their consolidated financial statements in accordance with **IFRS**[5].

The harmonised EU regime regulating market transparency also requires full notification of all **acquisitions or disposals of major shareholdings** and major proportions of voting rights in traded companies, and ensures that such information is made public in a timely manner.

Finally, "**market abuse**" legislation[6] introduces an exacting regime designed to prevent market manipulation, including insider trading, and market distortions caused by

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[3] Cf. Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC and Commission Regulation 809/2004 on Prospectus.

[4] Cf. Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive2001/34/EC.

[5] Cf. Regulation 1606/2002 on the application of international accounting standards.

[6] Cf. Directive 2003/6/EC on insider dealing and market manipulation and its implementing directives (2003/124/EC, 2003/125/EC, 2004/72/EC).

information imbalances. Accordingly, this regime requires issuers to make public all information which is likely to have a significant effect on the prices of their financial instruments or related derivative instruments. Issuers must ensure that such information is made public in a manner which enables fast access and complete, correct and timely assessment of the information by the public. Managerial transactions must also be properly disclosed.

Compliance with these requirements is subject to stringent **scrutiny of independent competent authorities**, well empowered to ensure that investor protection is not compromised.

This letter does not set out to provide a complete overview of relevant European legislation. However, the brief overview is intended to illustrate that European issuers with securities traded on regulated markets in the EU are subject to stringent disclosure and reporting requirements.

The reliability and quality of EU disclosure regimes seen from the perspective of U.S. investors is reflected in the high levels of U.S. investment in EU issuers which are traded only in EU markets, with no U.S. listing[7]. Furthermore, as an example of both jurisdictions working towards equivalence determinations, we note the on-going work in both the U.S. and Europe towards the mutual recognition of accounting standards – a model that should be considered here.

**Against the background of this comprehensive EU disclosure regime, it is disappointing to discover the low eligibility of European issuers under the new deregistration proposals.**

It should also be mentioned that European securities law[8] is particularly open since it allows third country issuers to satisfy mandatory disclosure and reporting requirements with financial reports and information prepared in accordance with the accounting standards of their home jurisdiction, provided that those standards are considered as equivalent to those of the EU. The European Commission is satisfied that such a recognition of equivalent third country standards does not compromise the protection of European investors. By the same token, **we consider that it would be reasonable and reciprocal for the SEC to recognise that the information provided in accordance with EU law by EU issuers is sufficient to satisfy the information needs of U.S. investors.**

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[7] EU companies that are not traded on the U.S. capital markets account for nearly half of the investments of major European equity funds managed by major American mutual fund groups with the most significant Western European exposures (conclusion based on data valid for end of 2005). Overall U.S. equity investment in the EU stood at 947 bn USD in 2003. In the same year total U.S. portfolio investment in the EU-25 securities amounted to as much as $1.5 trillion (IMF data).

[8] Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (Article 20) and Commission Regulation 809/2004 on Prospectus (Annexes); Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive2001/34/EC (Article 23).

**We urge the SEC to take full account of the standard of disclosure required under the EU regime, when considering the modifications to the eligibility criteria.** This is because with the EU reporting and disclosure rules U.S. investors will continue to have access to high quality, reliable information. There are precedents for an approach of this kind: Rule 12g3-2(b) already recognises the utility to U.S. investors of disclosures made in accordance with the requirements of other jurisdictions.

## 3. SUGGESTED MODIFICATIONS TO PROPOSED RULES

### 3.1. Exclusion of institutional shareholders

Institutional investors constitute the overwhelming majority of U.S. shareholder interest in European companies. These entities are included in the calculation of U.S. residents' shareholding in the outstanding voting and non-voting equity securities for the purposes of the reporting obligation under Section 13(a) or 15(d) of the Exchange Act. The proposed rules state that if an issuer can demonstrate that shares held by the U.S. residents represent no more than 5% of an issuer's worldwide public float (or 10% for well known seasoned issuers), the issuer may be eligible to deregister. This inclusion of institutional investors, holding on average 20% of the equity in large European companies, in the calculation of U.S. shareholding constitutes the major obstacle for European issuers to terminating their SEC registration and associated reporting obligations.

This inclusion of institutional investors implies that those investors require the same level of protection as retail investors. The logic of this inclusion seems to be that, when investing in foreign securities, large U.S. institutional investors are exposed in same way as retail shareholders to the risks associated with, for example, access to relevant information on the issuer's activity on the basis of home country reporting and disclosures; understanding of periodic reports and financial information drawn up in accordance with the rules of the issuer's home jurisdiction; or the effective and efficient use of shareholder's rights.

This degree of protection for institutional issuers is not proportionate, nor economically justified. Large institutional investors have the necessary expertise and resources to make effective use of the information provided by foreign issuers in the disclosures and financial reporting required under the law of their home jurisdiction. The significant presence of U.S. institutional investors in EU financial markets shows that they consider EU reporting and disclosure rules sound enough to enable them to take major investment decisions.

As a result, we cannot agree that the SEC's requirement to maintain registration and contingent reporting – only because of a high share of institutional shareholding in the foreign issuer's equity – is a suitable answer to investor protection concerns. At the same time, this requirement imposes disproportionate costs of disclosure on EU issuers. These costs will not be appreciated by the U.S. institutional investors and may have a systematic negative effect on their investment returns from European securities.

For these reasons, we believe the SEC should in the first place consider excluding institutional investors from the calculation of U.S. resident shareholders' interest for the purposes of determining the eligibility of foreign private issuers to deregister. In practical terms, we suggest the **exclusion of Qualified Institutional Buyers (QIBs)** as defined in Rule 144A. Rule 144A demonstrates that, in appropriate cases, U.S. securities law[9] treats U.S. shareholders differently, depending on their status. Subject to the SEC's specific concerns, this exclusion could apply **to the entire class of QIBs, or to a sub-class** based on quantitative criteria (e.g. the 10 largest QIBs, QIBs with a minimum investment of $10 m etc.). We are convinced that an exclusion of this kind would best address the concerns of the SEC in terms of adequate U.S. investor protection while at the same time ensuring conditions for deregistration that are satisfactory to European issuers.

Alternatively, exclusions of the kind suggested (the 10 largest or the ones with a minimum investment of $10 m) could be **applied to the whole investor community** without discriminating between institutional and other shareholders. We also think that the exclusion of certain shareholders should be optional (in order not to burden those issuers with U.S. interest already below the thresholds with unnecessary costs of shareholding analysis) and should only cover U.S. investors.

Finally, as an alternative, the calculation of U.S. shareholder interest might be limited to **ADR programmes**, as these constitute the most significant evidence that a company has taken active steps to reach US investors.

### 3.2. Raising the thresholds

As an alternative to excluding institutional shareholders from the calculation of the U.S. shareholder base, a practical way to make the proposed rules workable would be to increase the thresholds that determine the eligibility of foreign private issuers to deregister. As indicated in the first section of this letter, European companies typically have much higher levels of US institutional shareholders than the current thresholds of 5% and 10%.

Consequently, we suggest that the **public float thresholds set in Rule 12h-6(a)(4)-(5) should be increased to 25%**. The revised threshold would apply to foreign private issuers irrespective of their size (entities other than well-known seasoned issuers would also be eligible to use it). Any lower percentage would fail to ensure an adequate level of eligibility for deregistration for European issuers.

[9] Rule 12g3-2(b) which offers exemption from registration of foreign private issuers whose securities are offered to QIBs fulfilling Rule 144A conditions, demonstrates that differentiated treatment of QIBs may extend to the Exchange Act.

### 3.3. Increase of the 300 shareholders standard

**In addition** to any modification that the SEC might decide to make to the public float thresholds, we think that it is also necessary to revise the quantitative benchmark of 300 shareholders. The SEC acknowledges that the proposed rules should reflect the increased internationalisation of the U.S. financial markets, and provides interesting data on the development of those markets which indicate the exponential increase in the presence of foreign issuers, and the increasing prevalence of foreign securities in investment portfolios of U.S. equity investors[10]. We would also note that in 1967 (when the 300 shareholders standard was adopted) foreign equity held by U.S. residents amounted to only $5.2 bn, while in Q3 of 2005 it reached $ 2,821.1 bn[11]. The quantitative benchmark of 300 shareholders no longer reflects current market conditions, and we would encourage the SEC to consider how it should be amended to take proper account of the internationalisation of the U.S. financial markets during the four decades since its adoption.

Given the scale of growth of foreign equity markets in the U.S. since 1967, we think it would be reasonable to set the **new threshold at, as a minimum, 3000, and preferably higher**.

### 3.4. Self-tender by the issuer

The SEC has requested comments whether as an additional requirement to Rule 12h-6, issuers should provide for a self-tender for securities held by the U.S. residents[12]. In our opinion such requirement could **constitute an additional, separate deregistration option, available as an alternative** to the public float benchmark and to the record holder threshold. Such self-tender would be directed to U.S. holders of ADRs at a certain record date and the issuer would have to remain listed on its primary market for a sufficient time. Foreign issuers would be able to choose from other deregistration options if it would be illegal under home country law to limit the self-tender facility to U.S. shareholders.

### 3.5. Additional observations

**In addition** to the modifications indicated above that we believe are needed to increase the availability of deregistration, we have identified other issues which should also be addressed if the proposed rules are to provide for a workable solution.

**Proposed Rule 12h-6**, which sets out the eligibility requirements for a foreign private issuer to terminate its Exchange Act reporting obligations, contains several quantitative and qualitative criteria which, we believe, might create unnecessary obstacles to the

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[10] A four-fold increase in the number of foreign issuers subject to the SEC reporting from 1984; a four-fold increase from 1985 in the number of foreign companies listed on the New York Stock Exchange as percentage of all listed companies; a two-fold increase in the average daily trading volume of NYSE-traded foreign securities from 1991 (page 9 of the introduction to the proposed measures).

[11] Data extracted from 'Flow of Funds Accounts of the United States. Annual Flows and Outstandings' for 1965-1974 and for Q3 2005, facilitated by the Board of Governors of the Federal Reserve System, 8 December 2005.

[12] Page 22 of the introduction to the proposal.

deregistration of interested European issuers. We are concerned, in particular, by the treatment of smaller issuers, the calculation of the average daily trading volume for well-known seasoned issuers, the definition of "affiliates" for the purposes of determining the percentage of the worldwide public float held by U.S. issuers and the scope of offers covered by the 12 month dormancy condition. These are discussed in turn:

- **Deregistration for smaller issuers –** the smaller issuers face relatively higher costs of compliance with U.S. reporting requirements. In our opinion, the new deregistration rules should be more adjusted to their tight situation. We think that **extending the options available to well known seasoned issuers (notably, higher public float thresholds) also to smaller issuers would be desirable**, since these deregistered entities would still be obliged to facilitate their home country reporting in English as desired by the SEC.

- **Primary market reference** – One of the eligibility criteria which must be met by well-known seasoned issuers is that the U.S. average daily trading volume has been no greater than 5% of that class of securities in its primary trading market during the recent 12 month period. Given the specificities of the European equity markets, where issuers may have significant trading in more than one Member State, such solution is suboptimal. **We therefore request the SEC to consider a solution by which the U.S. trading volume is referred to worldwide trading volume.**

- **Definition of "affiliates"** – A foreign private issuer may be eligible to deregister if U.S. residents hold no more than 5% (or, in the case of a well-known seasoned issuer, 10%) of the issuer's worldwide public float, excluding securities held by affiliates of the issuer. We consider that, for the purposes of this condition, further precision is required in the definition of the "affiliates". The current definition, which originates in Rule 12b-2, does not provide sufficient legal certainty for foreign issuers wishing to calculate the US interest share in their worldwide public float, and might be clarified by some objective criteria. Such criteria would enable issuers to identify with certainty persons who may be discounted as "affiliates" and could, in our view, include **persons holding a share of at least 20% in the issuer's equity, or persons who are officers or directors of the issuer.**

- **12 month dormancy period** - Rule 12h-6 contains the further requirement that, subject to certain permitted exclusions, a foreign issuer does not sell its securities in the United States, in either a registered or unregistered offering, during the 12 months preceding the deregistration. The inclusion of unregistered offerings would mean that private placements and unregistered rights offerings may invalidate the required dormancy period. However, these offerings are in practice not accessed by the wider public, and it seems disproportionately restrictive to include them in the dormancy condition. Furthermore, the scope of the condition has the potential to impact adversely on U.S. interests, to the extent that it is likely to suppress the level of capital raising activity of EU issuers in the U.S.: if European companies wishing to deregister are obliged to exclude U.S. institutions from their private placements and unregistered rights offerings, these offerings will not be available to U.S. investors and U.S. banks will be less likely to be appointed as underwriters. **Therefore we would appeal for private placements and unregistered rights offerings to be excluded from the 12 month dormancy condition.** Similarly, we would welcome an **extension of the exemption from that condition to those cases which do not raise investor protection concerns** (such as offerings which are already exempted from registration

under Section 3(a)(10) of the Securities Act, used by some EU issuers to perform reorganisations under court supervision).

**In addition** to our concerns in relation to proposed Rule 12h-6, we think that the SEC should have in regard the following points:

- We would urge the SEC to reconsider its policy in relation to some specific instances where permanent deregistration is not currently possible under the proposed rule. **In particular, the right to permanent deregistration might be extended to cases where a foreign issuer acquires or merges with a company listed in the United States (Rule 12g3-2(d)(2)).** The prohibition on permanent deregistration by a foreign private issuer which has issued securities in the course of a transaction to acquire another issuer that had securities registered under section 12 of the Exchange Act, or was subject to a reporting obligation under that Act, may effectively discourage European companies from undertaking acquisitions in the U.S. We are confident that the SEC does not intend to inhibit the M&A activity of European companies on the US markets, and accordingly would advise the elimination of this detrimental measure.

- We also believe that it would be justified to **extend permanent deregistration to those cases where foreign private issuers have already managed to deregister under the existing requirements**. Such companies have already demonstrated their eligibility to deregister under extremely exacting rules and should not be unduly burdened with the risk of renewed reporting requirements with the SEC.

- Pursuant to the decision taken by the SEC on 2nd March 2005, foreign private issuers filing their annual reports on Form 20-F or 40-F are expected to comply with the requirements relating to internal control over financial reporting for its first fiscal year ending on or after July 15, 2006. Given the stage that the work on the proposed rules has reached, we think it is appropriate to extend this compliance date until the Securities and Exchange Commission adopts a final rule on deregistration. **Foreign private issuers that are eligible to deregister under the new rules should be able to avoid the costs of complying with Section 404 of the Sarbanes-Oxley Act of 2002, in particular since such costs are particularly burdensome in the first years of reporting**.

- Finally, given the significance of this issue we would encourage **the SEC to give all interested parties the opportunity to present their observations on the main elements of the proposal at an open hearing**. In such a meeting we would hope that the SEC could present the dataset it used to determine the expected results to be delivered by the proposed rules.

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We hope that the comments and suggestions for amendment that we have put forward will be carefully analysed by the SEC in its further work on the proposed measures with a view to reaching a solution which is workable for European issuers. We are convinced that the more open the new deregistration regime is, the more attractive U.S. capital markets will be to foreign and European issuers. It would also strongly contribute to our shared goal of open, competitive global and transatlantic capital markets.

The European Commission is open to discuss or explain further its concerns as set out in this letter and to work with the SEC in a co-operative framework to find a workable solution.

Yours sincerely,

D.J. WRIGHT
Director

for

Alexander Schaub

Copies to: Christopher Cox, the SEC Chairman

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