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U.S. SECURITIES REGULATION AND GLOBAL COMPETITION

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INTRODUCTION

U.S. securities regulation is in a bind. On the one hand, a demand for tough, intense regulation has been persistent for most of the past decade, ever since the technology stock bubble burst in 2000–2001. The financial reporting scandals of the early 2000s, typified by Enron and Worldcom, led to the Sarbanes-Oxley Act of 2002.¹ Yet within the next few years we encountered more evidence of abuse: first, mutual fund late trading scandals² and second, widespread options back-dating.³ Today, we face a massive financial meltdown stemming from the securitization of risky mortgage debt and related synthetic financial products. Each of these incidents has been painful for the Securities and Exchange Commission (SEC), which was blamed for not seeing the threat in advance, being too slow to respond when the problem appeared, and being too weak when it did respond. Fair or not, in many of these matters, other regulators—New York’s former attorney general Elliot Spitzer being the most familiar—got the credit for effective action and for prodding the SEC to follow up.

On the other hand, in the last few years there has been a strong counterpoint. Various well-publicized, bipartisan blue-ribbon committee reports have criticized U.S. securities regulation for being unduly cumbersome, and, in part, blamed overregulation for a loss of competitiveness in the global capital marketplace.⁴ These reports say that

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1. See Donald C. Langevoort, *The Social Construction of Sarbanes-Oxley*, 105 MICH. L. REV. 1817, 1821 (2007). Closely connected was the scandal associated with sell-side stock analysts whose independence was allegedly compromised by investment banking fees for their firm. Regarding the political background, see Jonathan R. Macey, *The Politicization of American Corporate Governance*, 1 VA. L. & BUS. REV. 10, 30–31 (2006).
 2. See generally Stephen Choi & Marcel Kahan, *The Market Penalty for Mutual Fund Scandals*, 87 B.U. L. REV. 1021, 1027 (2007).
 3. See generally David I. Walker, *Unpacking Backdating: Economic Analysis and Observations on the Stock Option Scandal*, 87 B.U. L. REV. 561, 563 (2007). To be fair, most of this conduct occurred before the Sarbanes-Oxley Act.
 4. See COMMITTEE ON CAPITAL MARKETS REGULATION, INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION 4–5 (2006), http://www.capmktreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf; MICHAEL R. BLOOMBERG & CHARLES E. SCHUMER, SUSTAINING NEW YORK’S AND THE US’ [sic] GLOBAL FINANCIAL SERVICES LEADERSHIP 17 (2007), http://www.nyc.gov/html/om/pdf/ny_report_final.pdf.

capital market transactions are increasingly based in London, Hong Kong or Dubai, rather than in New York. Volumes of empirical data, focusing on such questions as where global IPOs are occurring and how many new listings of foreign issuers are coming to the United States, have been offered as evidence of slippage.⁵ Each report contains diverse recommendations, mainly for pulling back on either the scope or enforcement intensity of U.S. regulation.

One obvious retort is that the recent global financial crisis has demonstrably proved the need for stronger regulation, so that recommendations pointing in the other direction should be seen as rent-seeking by the securities industry and business community that no longer deserves any political traction. The global scale of the current troubles shows that other countries have been too lax as well, so that there should be a ratcheting up of securities regulation not only in the United States, but worldwide.

But the problem is more complex. Because the United States has a unique political economy driven by widespread retail investor participation in the securities markets (whether directly or through financial intermediaries such as mutual funds and retirement accounts), there is a tendency to overreact to scandal, regulating for political consumption rather than for purpose. Thus, the reactions to the meltdown of the financial services industry—for example, overly strict capital adequacy standards applied to investment banking activity—may simply set in motion another round of shifts in economic activity away from the United States.⁶

The three articles that follow in this issue of the *Virginia Law & Business Review* speak to the bind in which U.S. securities regulation finds itself. In this Introduction, I will explore this bind and consider what competitiveness really means in a global capital marketplace. Along the way, I will comment on and show how each of the three contributions fits within the various possible meanings, and within the future of global securities regulation.

I. ASSESSING COMPETITIVENESS

Of the blue-ribbon reports, the most familiar is the 2006 Interim Report of the Committee on Capital Markets Regulation, directed by Hal Scott of

5. *Id.*

6. Moreover, there is nothing in what we have learned about subprime lending that suggests that regulation is good. Rather the evidence is just that *some* kinds of regulation may be necessary. It would not follow that the existing regulation criticized by the blue-ribbon reports was beneficial.

Harvard Law School.⁷ In November 2007, the Committee produced an update to sound another “alarm bell” for U.S. policymakers.⁸ Together, the two assessments document continued slippage in global IPOs and new foreign listings, and note that U.S. issuers are increasingly likely to seek financing arrangements, such as private equity investments and private capital raising markets, that avoid the need for adherence to anything more than the anti-fraud protections of U.S. securities law.

These are sophisticated reports and, to their credit, they acknowledge that overregulation is by no means the whole story. Other factors, particularly the rapid increase in the quality of capital markets in other countries, play an important causal role as well. In turn, critics of the Committee’s work have said that these other factors explain nearly *all* of the shift.⁹ Moreover, the seemingly dramatic statistical evidence highlighted by the Committee is heavily tilted toward a relatively brief period of time—roughly, the late 1990s to the present—that is historically aberrational.¹⁰ The United States gained an extraordinary advantage in the aftermath of World War II because its capital markets and economic infrastructure were undamaged, while Europe and Japan had to rebuild out of devastation.¹¹ For a few decades, as a result, the potential competitors to the United States were committed to extensive governmental intervention in their economies, which smothered the potential for robust private capital markets for external financing.¹² That did not change appreciably until the 1980s, at which point a growing number of countries—the United Kingdom in particular—made very deliberate efforts to open their financial markets and compete with the United States.¹³ It is hardly a surprise, then, that competition has eroded the United States’ once massive advantage for reasons unrelated to regulation except for the

7. http://www.capmksreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf [hereinafter 2006 INTERIM REPORT].

8. See COMMITTEE ON CAPITAL MARKETS REGULATION: THE COMPETITIVE POSITION OF THE U.S. PUBLIC EQUITY MARKET (Dec. 4, 2007), available at http://www.capmksreg.org/pdfs/The_Competitive_Position_of_the_US_Public_Equity_Market.pdf [hereinafter 2007 REPORT].

9. For a different perspective, see Craig Doidge et al., *Has New York Become Less Competitive than London in Global Markets? Evaluating Foreign Listing Choices Over Time*, J. FIN. ECON. (forthcoming 2008) (journal volume unknown) (ascribing the decrease in firms listing in New York to the changing nature of listing firms).

10. 2007 REPORT, *supra* note 8.

11. This history is explored in Mark J. Roe, *Legal Origins, Politics, and Modern Stock Markets*, 120 HARV. L. REV. 460, 498 (2006).

12. *Id.* at 501.

13. See *id.* at 508 n.140 (citing Brian R. Cheffins, *Mergers and the Evolution of Patterns of Corporate Ownership and Control: The British Experience*, 46 BUS. HIST. 256, 275 (2004)).

increasing quality of what other countries are doing. As global markets improve, U.S. investors, both institutional and retail, have expanded their geographic reach so as to be almost as willing and able to trade in those markets as in New York.

The last ten years have been especially unique in a number of respects. The late 1990s were the height of the technology stock boom, wherein U.S. markets were extraordinarily attractive because of the money flowing to technology innovators. The non-technology sector shared the halo created by the technology industry as foreign issuers flocked here and foreign markets sought to imitate the United States' success. In 2001, the technology bubble burst and the halo quickly disappeared. In the years since, the world's major wealth gains have not occurred in real economic activity in the United States, but rather in oil producing regions such as Russia and the Middle East, and economic newcomers like India and China. There, the two stories converge: the wealth and economic activity from those regions of the globe no longer needed to come to Wall Street because they could do quite well in London or Hong Kong. As a result, a data line from 1998 to 2007 naturally shows a precipitous drop in the United States' share of capital market activity.¹⁴

We could argue endlessly about whether the data says much of anything about regulatory quality in the United States, but my sense is that this argument is not worth having for two reasons. First, even if we were to accept that some significant portion of capital market activity is avoiding or escaping the United States because of its distaste for U.S. regulation, it could be that many of those firms are "lemons" who fear that the expropriation of private benefits of control by either insiders or controlling shareholders is likely to be exposed and punished more effectively in the post Sarbanes-Oxley legal environment. In other words, Sarbanes-Oxley and contemporaneous reforms could have shifted the balance that owners face when choosing between private benefits of control and enhanced financing opportunities for the firm. And, if that is so, then the United States has simply induced a more cleanly defined separation that allows the oranges and other sweeter fruit to distinguish themselves from the lemons, presumably leading to a greater level of investor protection to the extent that the oranges are now more readily available to domestic investors, and the lemons are not. This leads to less business for Wall Street institutions, but that is not necessarily a bad thing for investors.¹⁵ Though I would not put this forth as a

14. 2007 REPORT, *supra* note 8, at 26–27.

15. See John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229, 237–38 (2007). There is extensive literature discussing the private benefits question

full explanation for the data, it likely has some purchase, and shows how difficult it is to draw clear normative conclusions even if the data is read to support a regulation-driven account.

The second reason for moving beyond arguments about the data is that it probably does not matter why the United States is losing market share. The self-evident implication of the foregoing, no matter how the story is told, is that the United States no longer has a significant competitive advantage *vis-à-vis* other world markets in terms of technology, talent, or access to global wealth. In other words, the United States no longer has rents that can compensate for—and thus mask—any suboptimal regulation. Getting the regulatory balance right is therefore increasingly crucial. My sense is that it is important to take the need for possible regulatory reform seriously even if convinced that, in general, U.S. securities regulation has been done reasonably well in the past. So much is changing that the mix of regulatory costs and benefits shifts constantly.

The three articles that follow in this issue are a matched set insofar as they take up the challenges of regulatory obsolescence and regulatory arbitrage in three distinct domains: private capital raising, international accounting standards, and market regulation. Let us now turn to each of these to consider some of the lessons to be learned.

II. JACKSON & PAN: PRIVATE MARKETS FOR GLOBAL ISSUERS

In 2001, Howell Jackson and Eric Pan published the first part of a study evaluating capital raising transactions by European issuers drawn from interviews with key legal and business people involved in structuring those offerings.¹⁶ They undertook this project partly in response to what is still a powerful claim by some legal academics: that capital market efficiency is best promoted by giving issuers the freedom to choose the securities regulation that applies to them, rather than be captive to control by a regulator asserting monopolistic territorial jurisdiction.¹⁷ What Jackson and Pan found was fascinating, but does not necessarily offer strong support to either side in the “issuer choice” debate. They discovered that issuer capital raising transactions

and its relationship to the Sarbanes-Oxley Act *See, e.g.*, Christian Leuz et al., *Why Do Firms Go Dark? Causes and Economic Consequences of Voluntary SEC Deregistrations*, 45 J. ACCT'G & ECON. 181, 202–04 (2008).

16. Howell E. Jackson & Eric J. Pan, *Regulatory Competition in International Securities Markets: Evidence from Europe in 1999—Part 1*, 56 BUS. LAW. 653 (2001).

17. *E.g.*, Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 907 (1998).

had more similarities than differences regardless of location, and the costs associated with European deals, though less, were far closer than expected to U.S. public offerings, especially to one convinced of severe U.S. overregulation.¹⁸

The article which the same authors have written here is the second part of that project. Based on the same 1999 investigation, the current article deals with European issuers' decisions as to whether to sell to U.S. investors, and if so, how. The authors delayed publication for nearly a decade out of concern that intervening events had changed the markets so much that their research was stale. But with the recent calls for greater competitiveness taking on so much visibility, they decided to publish the results and comment—in a postscript from today's perspective—on the relationship between what they found back then and the data put forth by the various blue-ribbon groups. They note that Rule 144A¹⁹ was quickly emerging as the capital raising vehicle of choice for the portion of a deal directed at U.S. investors, rather than a registered public offering. This undermines the suggestion that the Sarbanes-Oxley Act and other mid-2000 regulatory innovations can explain foreign issuer aversion to tapping public markets in the United States.

However, *something* was driving the growing preference for the 144A alternative, and we know from the recent data that the preference became even stronger in the following decade. Jackson and Pan's interviewees told them that the preference was based mainly on the fact that such transactions gave them access to the institutional investors who make up the bulk of buyers in any offering, public or private. As a result, it made sense to take the somewhat less costly and burdensome route. As to the regulatory burdens being avoided, the most common complaint had to do with the obligation to reconcile results under European accounting standards to U.S. GAAP. Although fear of litigation was mentioned, Jackson and Pan were relatively surprised to find that it was not stressed, and that some participants even downplayed it as a causal factor.

This is important because in the last couple of years, many of the regulatory burdens that the interviewees objected to—including U.S. GAAP reconciliation—have been removed for foreign issuers coming to the U.S. public markets. Thus, we should wonder whether the public markets are now attractive enough to see the raising of foreign capital gradually return to them, or whether something else is now at work as a deterrent. As to the latter, one

18. See Jackson & Pan, *supra* note 16, at 655.

19. 17 C.F.R. § 230.144A (2000). Modifies requirements for privately placed securities traded among qualified institutional buyers which results in increased liquidity.

possibility is Sarbanes-Oxley. Another is that the litigation environment has changed so that foreign issuers today feel far more threatened than they did in 1999. Jackson and Pan seem inclined more toward the latter explanation.

This question is crucial for many reasons, including the emergence of a new regulatory proposal—a successor to issuer choice—that the SEC is now actively considering, generally referred to as mutual recognition.²⁰ If broadly implemented, this would allow issuers from jurisdictions whose securities regulation the SEC finds sufficiently comparable to its own to make their securities available in the United States based on home country disclosure regulation. U.S. antifraud law would still apply, however. Hence, the importance of Jackson and Pan's question becomes apparent. If regulatory requirements like those found in the Sarbanes-Oxley Act are mainly driving any remaining aversion, then mutual recognition could well overcome it. If it is more the fear of litigation, on the other hand, neither mutual recognition nor any other substantive deregulation will help all that much in attracting foreign issuers. We know that plaintiffs' lawyers can quite easily turn nearly any concealed form of corporate misconduct into a fraud claim.

The various blue-ribbon reports recognize this, and so each makes litigation reform a central goal. They do not reject antifraud liability entirely for foreign issuers accessing the United States. Rather, they suggest various tweaks to the system.²¹ The Capital Markets Regulation Committee does suggest one bold move, which would allow issuers to use charter or by-law provisions to cause investors to agree to alternative dispute resolution mechanisms (for example, arbitration) in place of litigation.²² Unfortunately, they can point to no current arbitral system that is well-suited to address complex, multi-party claims by large classes of fraud victims.

Could we be even more bold, and simply eliminate U.S. type private liability exposure—in other words, the fraud-on-the-market class action device—for foreign issuers whose shares are traded in the United States? It sounds radical and troubling from an investor protection perspective—essentially like an invitation to fraud from abroad. But many commentators today believe that the fraud-on-the-market lawsuit is mainly just an investor

20. See John W. White, Dir., Div. of Corp. Fin., SEC, Corporation Finance in 2008 – International Initiatives (Jan. 14, 2008), *transcript available at* <http://www.sec.gov/news/speech/2008/spch011408jww.htm>. Howell Jackson has written extensively on mutual recognition. See, e.g., Howell E. Jackson, *A System of Selective Substituted Compliance*, 48 HARV. INT'L L.J. 105, 117 (2007).

21. 2006 INTERIM REPORT, *supra* note 7; 2007 REPORT, *supra* note 8, at 32.

22. 2006 INTERIM REPORT, *supra* note 7, at 18.

insurance mechanism, and a costly and inefficient one at that.²³ By and large, the money paid in judgments, settlements, and legal fees comes out of either the corporate treasury or an insurance policy, and is thus funded by the company's shareholders, not the individual wrongdoers. Seen in that light, the question of whether or not to have such suits seems far less threatening, one that could reasonably be left for shareholders to decide. Although it is fair to ask why, if this makes sense, it should be limited to foreign issuers, note that the one group most likely to benefit from fraud insurance—less-diversified retail investors—is probably far less likely to over-invest in a foreign company than a domestic one.

I think a case can be made for some pull back in terms of antifraud liability exposure in private actions, thereby addressing the issue about which foreign issuers seem the most worried. The lingering problem is whether that pull back would eliminate too much in the way of deterrence.²⁴ To be sure, there is still the possibility of SEC enforcement, but is that enough? Elsewhere, I have expressed doubts about whether the SEC can be expected to do a sustained, systematic job of policing foreign issuers that have little direct presence in the United States, except for having listed shares here.²⁵ If fraud-on-the-market suits have a deterrence value, eliminating them entirely for foreign issuers does not seem very appealing.

This is not the place to explore this problem in depth, but it strikes me that without serious litigation reform, Jackson and Pan's question bodes ill for mutual recognition as a way of attracting currently reluctant issuers to come to the United States. There may be ways of solving the deterrence problem, but, as applied to foreign issuers, they probably depend on the evolution of a well-resourced global securities enforcement capacity that, as yet, simply does not exist.

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23. See, e.g., John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and its Implementation*, 106 COLUM. L. REV. 1534, 1585 (2006); Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions*, 48 STAN. L. REV. 1487, 1487 (1996); Paul G. Mahoney, *Precaution Costs and the Law of Fraud in Impersonal Markets*, 78 VA. L. REV. 623, 625 (1992). But see Alicia Davis Evans, *The Investor Compensation Fund*, 33 J. CORP. L. 223, 223 (2007) (agreeing with the criticism of fraud-on-the-market lawsuits, but arguing in favor of some compensatory device).
 24. See Donald C. Langevoort, *On Leaving Corporate Executives "Naked, Homeless and Without Wheels": Corporate Fraud, Equitable Remedies, and the Debate Over Entity versus Individual Liability*, 42 WAKE FOREST L. REV. 627, 661 (2007).
 25. See Donald C. Langevoort, *Structuring Securities Regulation in the European Union: Lessons from the U.S. Experience*, in INVESTOR PROTECTION IN EUROPE: CORPORATE LAW MAKING, THE MIFID AND BEYOND 485, 487 (Guido Ferrarini & Eddy Wymeersch eds., 2006).

III. FLECKNER: THE POLITICS OF ACCOUNTING STANDARDS

As Jackson and Pan observe in their postscript, one of the most important disclosure developments in the past few years was the SEC's decision to allow foreign issuers to report financial results under international financial reporting standards (IFRS) adopted by the International Accounting Standards Board (IASB) without reconciliation with U.S. GAAP (which are promulgated by the Financial Accounting Standards Board in the United States).²⁶ That was followed in August 2008 by the SEC's long-awaited announcement of a roadmap designed to have U.S. domestic issuers adhere to IASB standards by 2014, so long as various milestones in the governance and structure of the IASB and convergence of IASB and FASB standards were met in the meantime.²⁷ If it were not for the current financial crisis that is offering significant distraction, this would surely be bigger news in the world of securities regulation. In fact, the conclusion—essentially, that the United States was prepared within six years to cede to an international body the ability to set the central financial disclosure rules—is revolutionary.

Andreas Fleckner's contribution to this issue is an instructive comparison of the institutional framework in which the IASB and FASB operate. His focus is on the comparative independence of (and threats to) the work of those two bodies. He stresses two features. The first is funding. The FASB has had governmentally mandated funding support from issuers ever since the Sarbanes-Oxley Act, while the IASB relies on variable sources of funding from constituents around the world, most of whom donate on a voluntary basis. The second has to do with how the standards of the two bodies become authoritative. Because of the closer nexus between the FASB and the SEC, FASB pronouncements become authoritative unless abrogated by the Commission. By contrast, the IASB purports to set the standard for the world's issuers, not just one country's, and so the process varies. In Europe—plainly, the IASB's biggest client—IASB standards only become authoritative if and when adopted by the European Commission. Fleckner shows that each

26. See Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to U.S. GAAP, Securities Act Release No. 33-8879, 73 Fed. Reg. 986, 988 (Jan. 4, 2008).

27. See Press Release, Sec. & Exch. Comm'n, SEC Proposes Roadmap Toward Global Accounting Standards to Help Investors Compare Fin. Info. More Easily (Aug. 27, 2008), available at <http://www.sec.gov/news/press/2008/2008-184.htm>.

of these gives political actors in both the United States and Europe (and lobbyists who can influence them) a fair amount of power to compromise the purely accounting judgments the two bodies might otherwise be inclined to make. Noting specific instances of such pressure, he concludes that neither is well positioned to resist.

It is worth thinking about the SEC's roadmap within the political framework Fleckner describes. The SEC's decision seems jarring. It was not based on acceptance of IFRS as "just as good" as U.S. GAAP. Critics have pointed out many substantial differences between the standards, leading to more conservative accounting in the United States than under IFRS.²⁸ The numbers, in other words, differ considerably depending on which system is used, and key indicators—earnings and revenue—tend to be lower here. In the aftermath of Enron and Worldcom, and now the subprime valuation crisis, the dangers of liberal "fair value" accounting seem palpable. So why concede now?

One purely political possibility within the United States is that managers, frustrated by the conservatism and discipline of U.S. GAAP, simply want to get rid of it, and have used political muscle to prompt the shift. There may be something to that public choice story. But there is probably more than just that, and it relates directly to competitiveness. As the U.S. portion of the global securities marketplace shrinks, standard-setting by the IASB independent of U.S. influence threatens a number of unfortunate consequences. One is that the IASB's largest client, the European Union, gains de facto control over those standards. Fleckner hints at this possibility. The creeping "Europeanization" of international accounting standards would hardly be to the United States' competitive advantage. Another concern is that U.S. issuers do not compete as well with other global companies when their earnings and revenues look weaker rather than stronger.

In that sense, I suspect that the SEC has made a strategic bet, and may be willing to let go of some disclosure quality to win it. By allowing foreign issuers to use IFRS without reconciliation—and soon U.S. issuers as well—the SEC has stepped forward as a new and very powerful IASB client. Because the potential for Europeanization does not set well with Asian and

28. See Lawrence A. Cunningham, *The SEC's Global Accounting Vision: A Realistic Appraisal of a Quixotic Quest*, 87 N.C. L. REV. (forthcoming Dec. 2008); James D. Cox, *Coping in a Global Marketplace: Survival Strategies for a 75-Year-Old SEC*, 95 VA. L. REV. (forthcoming 2009); Am. Acct. Ass'n Fin. Acct. & Reporting Section of the Fin. Reporting Policy Comm., *Response to the SEC Release, "Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to U.S. GAAP File No. S7-13-07"*, 22 ACCT. HORIZONS 223, 224 (2008).

other countries who feel pressured to conform but do not have the European Union's leverage, the United States may well have allies with whom to join in trying to counter Europe's influence. Fleckner describes pending constitutional changes to the IASB's governance structure toward greater diversity as compromising professional independence. But that may be the price for building a truly international institution. In other words, the politics we see at work may be just the sort of institution-building that will characterize global securities regulation over the next decades, essential even if far from perfect.

IV. GADINIS: GLOBAL MARKET REGULATION

One of the SEC's most sustained projects over the last thirty years has been building a so-called "national market system" that tries to balance two inconsistent goals: the centralization of investor order flow so that trades get the best available price and execution, while at the same time encouraging marketplace innovation by having competing markets rather than monopolistic ones. Few academic commentators have been particularly pleased with the compromises that the SEC has made in pursuit of this goal, including the most recent comprehensive regulatory initiative adopted in 2004, Reg NMS. Stavros Gadinis' contribution to this issue adds to the criticism by comparing and contrasting the European approach on the same issues in the MiFID Directive, and finds the MiFID preferable along most dimensions.

Market regulation is highly complex and technical, largely because traders' needs are so diverse. Retail investors who are price takers are simply interested in a best price/execution cost mix. Institutional investors' needs are more complex, ranging from the traditional block positioning concern with avoiding market impact and the risk of being front-run, to being able to signal that the trader does not possess non-public information, to being able to arbitrage small price differentials very quickly through computerized trading. Gadinis points out that U.S. and European regulation is similar in one strategy—trying to force trading interest into public view in the form of limit order quotes so that the price can reflect available supply and demand at increments a little higher or lower than the last sale. Reg NMS goes one step further, however, by forcing the trade-through of orders to the market with the best displayed price, so long as that market has fast (that is, fully automated) execution capacity. This is required for two reasons: first, to give protection to and thereby encourage the display of quotations and limit orders; second, as a mechanism to try to ensure that brokers offer their

customers best execution. In contrast, European market regulation does not have a trade-through regime, and leaves best execution to negotiation between broker and customer. For obvious reasons, many institutional investors feel hampered by Reg NMS, and many investors, brokers, and trading sites have taken advantage of exceptions in the regulation to accommodate so-called “dark pools”—undisclosed trading interest—and trading that is based on non-price preferences.

The differences in approach are not hard to understand. The national market system in the United States is a legacy of public markets wherein retail investors are protected not only from the abuses of monopolistic trading sites but also from being elbowed aside by large traders in an increasingly institutional marketplace. Europe has little direct retail participation, and so that legacy is not present. What Gadinis describes there is precisely what one would expect from markets that have been built in recent years almost entirely for the benefit of the institutional trade.

Though the side-by-side comparison is certainly interesting, the real challenge is what happens as the two systems converge.²⁹ The most noteworthy convergence results from the mergers and affiliations that have been occurring among U.S. and European exchanges. But even without these formal combinations, the increasing ability of U.S. brokerage firms to direct customer orders to foreign exchanges means that more and more trading activity is taking place under the more flexible, less protective European approach anyway. U.S. institutional investors have ways of moving trading abroad when the domestic regulatory burdens are too much.

As a result, Reg NMS is probably quite unstable. To date, the SEC has conditioned the cross-border mergers of exchanges (for example, New York Stock Exchange and Euronext) on keeping them separate for purposes of compliance with domestic market regulation. But that is inefficient, and probably hopeless in the long run. The right vision is no longer of a national market system but a global market system, and there is simply no way the SEC can impose its retail investor legacy extraterritorially. One suspects that it is simply a matter of time before the SEC does in this area what it did with IFRS: abandon exceptionalism in an effort to gain greater influence over market structure evolution around the world.

29. See Roberta S. Karmel, *The Once and Future New York Stock Exchange: The Regulation of Global Exchanges*, 1 BROOK. J. CORP. FIN. & COM. L. 355, 358 (2007); see also Reena Aggarwal et al., *U.S. Securities Regulation in a World of Global Exchanges* 4–5 (Eur. Corporate Governance Inst., Working Paper No. 146, 2006), available at http://papers.ssrn.com/abstract_id=950530 (discussing the regulatory issues that arise when global exchange systems converge).

As a result, the likely global future is competition for order flow from trading sites in many different countries. Whether there will be gradual centralization in the market that wins the race, or whether there will be continuous fragmentation resulting from innovation and specialization is impossible to predict. But this future suggests that no single national regulator will be in a strong position to exercise control over such a diffused global market. Nor will it have much economic incentive to do so. When trading is heavily fragmented, no nation is able to capture enough of the benefits from investments in quality regulation. It is a classic free rider problem. Thus, for example, I suspect that if global fragmentation becomes the norm, the concept of stock exchange “listings” as a basis for jurisdiction and regulation of issuers will weaken, and eventually disappear. If no exchange has more than ten or twenty percent of the order flow in a particular stock, then neither it nor its national regulator are likely to devote precious resources to policing issuer disclosure simply based on the fact that some (varying) percentage of issuer stock is traded there.

CONCLUSION

My aim in this Introduction was not to describe the authors’ contributions—which deserve to be read in full, and with care—so much as to identify connections among them that contribute to the broader debate over global competition in securities regulation. The common theme is relatively easy to spot. U.S. securities regulation truly is in a bind. It has been built over the last seventy-five years largely to promote the interests of retail investors,³⁰ and the political demand for regulatory responses after every scandal reminds us of this. But globally, few if any other countries have a similarly retail-driven approach. Both markets and regulation in the rest of the world have been built for institutional investors better able to fend for themselves, and have a lighter touch for that reason.³¹

For the United States to engage globally in securities regulation, it has to accept this. It has a variety of strategies for accommodating institutional demand. It can tolerate exceptions (the 144A market that Jackson and Pan focus on, or letting dark pools flourish even though in tension with the Reg NMS philosophy that Gadinis describes) with the gradual effect of diminishing the public markets as the exceptions grow to rival the base. Or, it

30. See Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. (forthcoming 2009).

31. *Id.*

can give up the exceptionalism, as is happening with IFRS, in an effort to have greater voice in the multinational regulatory arena.

If I had to guess, it would be that the latter approach will become the more common. The key to global securities regulation in the future will be the construction of institutions to articulate world-wide standards that command legitimacy and respect. IASB is moving toward being such a standard-setter, and the International Organization of Securities Commissions (IOSCO) is taking shape toward being another. To be sure, the political challenges are daunting, especially when the focus shifts from standard-setting to enforcement. Europe has not achieved consensus on building a pan-European securities enforcer.³² Even Canada has failed thus far in its effort to move beyond provincial regulation and enforcement.³³ So in suggesting such a direction, I do not want to appear naïve.

What leads me to think that progress is likely, even on enforcement, is that we will increasingly suffer the harms that come from the absence of collective action. The global financial meltdown from the subprime crisis is a dramatic example. Even in the face of crisis and scandal, we will not see a global securities and financial services regulator—something as dramatic as a Global Financial Services Commission—anytime soon. But we may well see joint task forces wherein regulatory personnel from various countries are detailed to a central location to coordinate enforcement efforts aimed at some kind of threat, and if that becomes routine, there will be further small steps toward a permanent regulatory institution, until it already exists *de facto* and is less threatening politically. But that will happen only if key countries, particularly the United States, are willing to relax their historic approaches to both regulation and jurisdiction. In the subject areas explored by the authors in the three articles you are about to read, we see places where this movement is starting to occur.

32. See Gérard Hertig & Ruben Lee, *Four Predictions About the Future of EU Securities Regulation*, 3 J. CORP. L. STUD. 359, 359 (2003).

33. See Cally Jordan, *Political Prisoner: A Securities Regulator for Canada – Again?* (U. of Melbourne Legal Stud., Research Paper No. 345), available at <http://www.ssrn.com/abstract=1143516>.