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# U.S. Securities Regulation and Global Competition

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## U.S. Securities Regulation and Global Competition

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# Introduction: U.S. Securities Regulation and Global Competition

*Donald C. Langevoort*<sup>\*</sup>

U.S. securities regulation is in a bind. On one hand, a demand for tough, intense regulation has been persistent for most of the past decade, ever since the tech stock bubble burst in 2000-01. The financial reporting scandals typified by Enron and Worldcom that appeared in quickly led to the Sarbanes-Oxley Act of 2002.<sup>1</sup> Yet within the next few years we encountered more evidence of abuse: first, the mutual fund late trading scandals,<sup>2</sup> and then widespread options backdating.<sup>3</sup> Today, we face a massive financial meltdown stemming from the securitization of risky mortgage debt and related synthetic financial products. Each of these has been painful for the 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. Fair or not, in many of these matters, other regulators—New York’s Elliot Spitzer being the most familiar—got the credit for effective action and for prodding the SEC to follow on.

Yet 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.<sup>4</sup> Capital markets transactions are increasingly based in London, Hong Kong or Dubai, rather than in New York, they say.

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<sup>1</sup> See Donald C. Langevoort, *The Social Construction of Sarbanes-Oxley*, 105 Mich. L. Rev. 1817 (2007). Closely connected was the scandal associated with sell-side stock analysts whose independence was allegedly compromised by investment banking fees for their firms, also addressed in Sarbanes-Oxley. On the political background, see Jonathan Macey, *The Politicization of American Corporate Governance*, 1 Va. L. & Bus. Rev. 10 (2006).

<sup>2</sup> See generally Stephen Choi & Marcel Kahan, *The Market Penalty for Mutual Fund Scandals*, 87 B.U. L. Rev. 1021 (2007).

<sup>3</sup> See generally David Walker, *Unpacking Backdating: Economic Analysis and Observations on the Stock Option Scandal*, 87 B.U. L. Rev. 561 (2007). To be fair, most of this conduct occurred before Sarbanes-Oxley.

<sup>4</sup> See INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION (Nov. 30, 2006), available at [www.capmksreg.org](http://www.capmksreg.org); SUSTAINING NEW YORK’S AND THE U.S.’ GLOBAL FINANCIAL SERVICES LEADERSHIP (2007), available at [www.ci.nyc.ny.us/html](http://www.ci.nyc.ny.us/html).

Volumes of empirical data, focusing on such questions as where global IPO's are occurring and how many new listings of foreign issuers are coming to the United States, have been offered as evidence of slippage. Each of the reports 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 debacle 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 U.S., but worldwide.

But the problem is more complex. Because the U.S. 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 here to overreact to scandal, regulating for political consumption rather than purposefully. If so, then the reactions to the meltdown of the financial services industry—e.g., 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 U.S.<sup>5</sup>

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 the bind a bit more deeply 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 in 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, chaired by Hal Scott of Harvard Law School. In November 2007, the Committee produced an update to sound another “alarm bell” for U.S. policymakers. Together, the two assessments document continued slippage in global

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<sup>5</sup> Moreover, there is nothing in what we have learned about subprime that says that regulation is good: rather that *some* kinds of regulation may be necessary. It would not follow that the existing regulation criticized by the blue ribbon reports was beneficial.

IPO's and new foreign listings, and note that U.S. issuers as well are increasingly likely to seek financing arrangements (e.g., private equity investments and private capital raising markets) that avoid the need for adherence to anything more than the antifraud protections of U.S. securities law.

These are sophisticated reports, and to their credit, 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.<sup>6</sup> Moreover, the seemingly dramatic statistical evidence highlighted by the Committee is heavily tilted toward a relatively brief period of time—roughly the late 1990's to the present—that is historically aberrational. The U.S. 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.<sup>7</sup> For a few decades, as a result, the U.S.' potential competitors were committed to extensive governmental intervention in their economies, which smothered the potential for robust private capital markets for external financing. That did not change appreciably until the 1980's, at which point a growing number of countries—the U.K. in particular—made very deliberate efforts to open their financial markets and compete with the U.S. It is hardly a surprise, then, that competition has eroded the U.S.' once massive advantage, for reasons unrelated to regulation except for the increasing quality of what other countries are doing. As global markets improve, U.S. investors (institutional and even retail) have expanded their geographic reach so as to be willing and able to trade in those markets almost as easily as in New York.

The last ten years have been especially unique in a number of respects. The late 1990's were the height of the tech stock boom, wherein U.S. markets were extraordinarily attractive because of the money flowing to technology innovators. The non-technology sector shared the halo as foreign issuers flocked here and foreign markets sought to imitate the U.S. success. In 2001, the tech 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 U.S. but rather in

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<sup>6</sup> 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).

<sup>7</sup> This history is explored in Mark Roe, *Legal Origins, Politics and Modern Stock Markets*, 120 Harv. L. Rev. 460 (2006).

oil producing countries 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 can do quite well in London or Hong Kong. As a result, a data line from 1998-2007 naturally shows a precipitous drop in the U.S.' share in capital markets activity.

We could argue endlessly, then, about whether the data says much of anything about regulatory quality in the U.S. 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 because of distaste for U.S.-style 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, SOX and contemporaneous reforms could have shifted the balance that owners face when trading off private benefits of control against enhanced financing opportunities for the firm. And if that is so, then the U.S. has simply induced a more cleanly defined separation that allows 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 not. There is less business for Wall Street institutions as a result, but that is not necessarily a bad thing for investors.<sup>8</sup> Though I would not put this forth as a 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 U.S. is losing market share. The self-evident implication of the foregoing, no matter how the story is told, is that the U.S. no longer has a significant competitive advantage vis-a vis other world markets in terms of technology, talent or access to global wealth. In other words, the U.S. no longer has rents that can compensate for—and thus mask—any suboptimal regulation. Getting the

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<sup>8</sup> See John C. Coffee, *Law and the Market: The Impact of Enforcement*, 156 U. Pa. L. Rev. 229, 237-38 (2007). There is an extensive literature discussing the private benefits question and its relationship to SOX. 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 (2008).

regulatory balance right is therefore increasingly crucial. My sense, then, 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.<sup>9</sup> They undertook this project partly in response to what still is 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.<sup>10</sup> What Jackson and Pan found was fascinating, but not necessarily offering strong support to either side in the “issuer choice” debate. They discovered that issuer capital raising transactions 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.

The article the same authors have written here is the second part of that project, based on the same 1999 investigation, this time dealing with European issuers’ decisions as to whether to sell to U.S. investors, and if so, how. They 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

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<sup>9</sup> Howell Jackson & Eric Pan, *Regulatory Competition in International Securities Markets: Evidence from Europe in 1999*, 56 Bus. Law. 653 (2001).

<sup>10</sup> E.g., Stephen Choi & Andrew Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. Cal. L. Rev. 903 (1998).

the various blue-ribbon groups. They note that Rule 144A 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 U.S.

On the other hand, *something* was driving the growing preference for the 144A alternative, and we know from the recent data that that 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 so that we should see foreign capital raising gradually return to them, or whether something else is now at work as a deterrent. As to the latter, one 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.<sup>11</sup> 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 U.S. based on home country disclosure regulation. U.S. antifraud law would still apply, however. Hence the importance of Jackson and Pan's question.

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<sup>11</sup> See JOHN WHITE, CORPORATION FINANCE IN 2008—INTERNATIONAL INITIATIVES (Jan. 2008), available at [www.sec.gov/news/speech/2008/spch011408jww/htm](http://www.sec.gov/news/speech/2008/spch011408jww/htm). Howell Jackson has written extensively on mutual recognition. See, e.g., Howell Jackson, *A System of Selective Substituted Compliance*, 48 Harv. Int'l L.J. 105 (2007).



If regulatory requirements like those found in Sarbanes-Oxley 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 and turn it 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 U.S.; rather, they suggest various tweaks to the system. 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 (e.g., arbitration) in place of litigation. 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 U.S.? It sounds radical and troubling from an investor protection perspective, an invitation to fraud from abroad. But many commentators today believe that the fraud-on-the-market lawsuit is mainly just an investor insurance mechanism, and a costly and inefficient one at that.<sup>12</sup> By and large, the money paid in judgments, settlements and legal fees comes out of either the corporate treasury or an insurance policy, and 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 to 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—are probably far less likely to over-invest in a foreign company than a domestic one.

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<sup>12</sup> See, e.g., John C. Coffee, *Reforming the Securities Fraud Class Action: An Essay on Deterrence and its Implementation*, 106 Colum. L. Rev. 1534 (2006); Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions*, 48 Stan. L. Rev. 1487 (1996); Paul G. Mahoney, *Precaution Costs and the Law of Fraud in Impersonal Markets*, 78 Va. L. Rev. 623 (1992). But see Alicia Davis Evans, *The Investor Compensation Fund*, 33 J. Corp. L. 223 (2007)(agreeing with the criticism of fraud on the market lawsuits but arguing in favor of some compensatory device).

I think a case can be made for some pull back in terms of antifraud liability exposure in private actions, so addressing what foreign issuers seem mainly worried about. The lingering problem is whether that pull back would eliminate too much in the way of deterrence.<sup>13</sup> 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 U.S. except for having listed shares here.<sup>14</sup> 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 to the U.S. issuers currently reluctant to come here. There may be ways of trying to solve 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.

### 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 decision by the SEC to allow foreign issuers to report financial results under international financial reporting standards (IFRS) adopted by the International Accounting Standards Board, without reconciliation with U.S. GAAP (which are promulgated by the Financial Accounting Standards Board in the U.S.).<sup>15</sup> 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 in the meantime.<sup>16</sup> But for the financial crisis that was accelerating at the time and thus offered

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<sup>13</sup> 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 (2007).

<sup>14</sup> 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* 285 (Guido Ferrarini & Eddy Wymeersch, eds., 2006).

<sup>15</sup> See Sec. Act Rel. 8879, Dec. 21, 2007.

<sup>16</sup> See *SEC Proposes Roadmap Toward Global Accounting Standards*, SEC Press Rel. 2008-184, Aug. 27, 2008.

significant distraction, this would be bigger news in the world of securities regulation. In fact, the conclusion—essentially, that the U.S. 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 thereto) the work of those two bodies. He stresses two features. One is funding: whereas the FASB has had governmentally mandated funding support from issuers ever since the Sarbanes-Oxley Act, the IASB relies on variable sources of funding from constituents around the world, most of it voluntary. The other has to do with how their standards 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 of these gives political actors in both the U.S. 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 U.S. than under IFRS.<sup>17</sup> The numbers, in other words, differ considerably depending on which system is used, and key indicators—earnings, revenue—tend to be lower here. In the aftermath of Enron/Worldcom and now the subprime debacle, the dangers of liberal "fair value" accounting seem palpable. So why concede now?

One possibility is purely political within the U.S.: 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

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<sup>17</sup> For further discussion, see Lawrence Cunningham, *The SEC's Global Accounting Vision: A Realistic Appraisal of a Quixotic Quest*, 87 N.C. L. Rev. --- (forthcoming, 2008); James D. Cox, *Coping in a Global Marketplace: Survival Strategies for a 75 Year Old SEC*, 95 Va. L. Rev. --- (forthcoming, 2009); Peter Hopkins et al., *Response to the SEC Release*, 22 Acct'g Horizons 223 (2008).

may be something to that public choice story. But there is probably more than this, 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 E.U., gains de facto control over it, as Fleckner hints. The creeping "Europeanization" of international accounting standards would hardly be to the U.S. competitive advantage. Another concern is that U.S. issuers hardly compete well with other global companies when their earnings and revenues look weaker.

In that sense, I suspect that the SEC has made a strategic bet, and may be willing let go of some disclosure quality to win it. By allowing foreign issuers 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 other countries who feel pressured to conform but do not have the E.U.'s leverage, the U.S. strategy 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, which he decries 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's contribution to this issue adds to the criticism by comparing and contrasting the European approach on the same issues in the MiFID Directive, finding 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 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 into public view trading interest 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 (i.e., fully automated) execution capacity. That 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 assure 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 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. There is more flexibility abroad.

The differences in approach are not hard to understand. The national market system in the U.S. is a legacy of a vision 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.<sup>18</sup> The most noteworthy convergence results from the mergers and affiliations that have been occurring among U.S. and European exchanges. But even

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<sup>18</sup> See Roberta Karmel, *The Once and Future New York Stock Exchange: The Regulation of Global Exchanges*, 1 Brook. J. Corp. Fin. & Comm. L. 355 (2007); see also REENA AGGARWAL ET AL., U.S. SECURITIES REGULATION IN A WORLD OF GLOBAL EXCHANGES, Harvard Olin Center Discussion Paper 569, available at <http://papers.ssrn.com/abstract=950530>.

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 (e.g., 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 the exceptionalism in an effort to gain greater influence over market structure evolution around the world.

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 instead, 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 10 or 20% 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.

## V. 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,<sup>19</sup> 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.<sup>20</sup>

For the U.S. to engage globally in securities regulation, it has to accept this, and has a variety of strategies for accommodating institutional demand. Thus, 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), but the gradual effect of this is to diminish the public markets as the exceptions grow to rival the base. The alternative is to 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 IOSCO—the international organization of securities commissions—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.<sup>21</sup> Even Canada has failed thus far in its effort to move beyond provincial regulation and enforcement.<sup>22</sup> 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

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<sup>19</sup> For a deeper exploration of this point, see Donald C. Langevoort, *The SEC, Retail Investors and the Process of Institutionalization*, 95 Va. L. Rev. --- (forthcoming, 2009).

<sup>20</sup> Id.

<sup>21</sup> See Gerard Hertig & Reuben Lee, *Four Predictions About the Future of EU Securities Regulation*, 3 J. Corp. L. Studies 359 (2003).

<sup>22</sup> See CALLY JORDAN, POLITICAL PRISONER: A SECURITIES REGULATOR FOR CANADA—AGAIN? (U. of Melbourne Res. Paper No. 345), available at [www.ssrn.com/abstract=1143516](http://www.ssrn.com/abstract=1143516).

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 for to coordinate enforcement efforts aimed at some kind of threat, and if that becomes routinized, 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 U.S., 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.