

Finishing the Race to the Bottom: An Argument for the Harmonization and Centralization of International Securities Law

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I. INTRODUCTION

In June 2009, the United States Department of the Treasury issued its white paper report, *Financial Regulatory Reform: A New Foundation* (“Report”).¹ The Report contains the Obama Administration’s proposed regulatory response to the economic downturn that began in 2008.² Notably, the drafters of the Report characterized the economic downturn as the “most severe financial crisis since the Great Depression.”³ The severity of the economic downturn has led some commentators to refer to the financial crisis as the “Great Recession.”⁴ Other commentators have gone so far as to term the economic downturn as a “depression” itself because of the depth of the downturn, the radicalism of the government’s response, and the general sense of crisis.⁵ Even though the economy in the United States has

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¹ U.S. DEP’T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION (2009), available at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf.

² *Id.*

³ *Id.* at 2.

⁴ But see Catherine Rampell, ‘Great Recession’: A Brief Etymology, *ECONOMIX* (Mar. 11, 2009, 5:39 PM), <http://economix.blogs.nytimes.com/2009/03/11/great-recession-a-brief-etymology> (“Nobody can take credit for coining the term ‘The Great Recession’ Why? Every recession of the last several decades has, at some point or another, received this special designation . . .”).

⁵ See RICHARD A. POSNER, A FAILURE OF CAPITALISM: THE CRISIS OF ‘08 AND THE DESCENT INTO DEPRESSION x (2009) (“It is the gravity of the economic downturn, the

somewhat rebounded, these indicators of a depression have arguably still been met because of the initial sharp economic decline, the federal government's unprecedented bailout of the financial services industry, and the panic that the financial crisis has created.⁶

In the shadow of the financial downturn that began in 2008, the Report details the Obama Administration's five main policy objectives for preventing a future crisis:

- Promote Robust Supervision and Regulation of Financial Firms
- Establish Comprehensive Regulation of Financial Markets
- Protect Consumers and Investors from Financial Abuse
- Provide the Government with the Tools it Needs to Manage Financial Crises
- Raise International Regulatory Standards and Improve International Cooperation⁷

The stated goal that underlies these policy objectives is to "build a new foundation for financial regulation and supervision that is simpler and more effectively enforced, that protects consumers and investors, that rewards innovation and that is able to adapt and evolve with changes in the financial market."⁸ The drafters of the Report suggest broad and sweeping financial regulatory reform because of the numerous causes of the financial crisis.⁹

In regard to raising international regulatory standards and improving international cooperation, the drafters of the Report state the following:

As we have witnessed during this crisis, financial stress can spread easily and quickly across national boundaries. Yet, regulation is still set largely in a national context. Without consistent supervision and regulation, financial institutions will tend to move their activities to jurisdictions with looser standards, creating a race to the bottom and intensifying systemic risk for the entire global financial system.¹⁰

radicalism of the government's responses, and the pervading sense of crisis that mark what the economy is going through as a depression.").

⁶ *Id.*

⁷ U.S. DEP'T OF THE TREASURY, *supra* note 1, at 1.

⁸ *Id.* at 2.

⁹ See *infra* Part II.B (discussing the causes of the financial crisis that began in 2008).

¹⁰ U.S. DEP'T OF THE TREASURY, *supra* note 1, at 80.

Put another way, patchwork regulation does not work to regulate the emerging global financial markets¹¹ because it generates a race-to-the-bottom in which nations ratchet down their systems of regulation and enforcement to suboptimal levels in an attempt to gain a competitive advantage over other nations.¹²

Through the Report, the Obama Administration proposes the following international regulatory reforms:

- Strengthen the International Capital Framework
- Improve the Oversight of Global Financial Markets
- Enhance Supervision of Internationally Active Financial Firms
- Reform Crisis Prevention and Management Authorities and Procedures
- Strengthen the Financial Stability Board
- Strengthen Prudential Regulations
- Expand the Scope of Regulation
- Introduce Better Compensation Practices
- Promote Stronger Standards in the Prudential Regulation, Money Laundering/Terrorist Financing, and Tax Information Exchange Areas
- Improve Accounting Standards
- Tighten Oversight of Credit Rating Agencies¹³

Despite this lengthy and ambitious list, the specific proposals in the Report do little to remedy the problems created by fragmented regulation of the emerging global financial markets, even after the drafters of the Report expressly recognized the problems that regulatory fragmentation creates.¹⁴

Of major concern is the lack of a concrete proposal for working toward the harmonization and centralization of international securities law. The goals relating to international reform chiefly focus on

¹¹ See *infra* Part II.A (describing the transition from national capital markets to global capital markets).

¹² See Roberta S. Karmel & Claire R. Kelly, *The Hardening of Soft Law in Securities Regulation*, 34 BROOK. J. INT'L L. 883, 946–47 (2009) (“The absence of a single international securities law regulator creates the potential for a classic regulatory race to the bottom. Race to the bottom theorists assume that regulatory competition and the lack of a single mandatory framework will encourage managers to incorporate in jurisdictions that have the least demanding regulatory structure.”).

¹³ U.S. DEP'T OF THE TREASURY, *supra* note 1, at 80–88.

¹⁴ *Id.* at 80 (“As we have witnessed during this crisis, financial stress can spread easily and quickly across national boundaries. Yet, regulation is still set largely in a national context. Without consistent supervision and regulation, financial institutions will tend to move their activities to jurisdictions with looser standards, creating a race to the bottom and intensifying systemic risk for the entire global financial system.”).

the regulation of financial firms,¹⁵ despite the fact that mortgage-backed securities were at the heart of the financial crisis.¹⁶ The Report declares that “the United States must continue to work with our international counterparts to raise international standards for OTC [(Over-the-Counter)] derivatives markets, further integrate our financial market infrastructures, and avoid measures that may result in market fragmentation.”¹⁷ But the Report fails to provide concrete proposals as to how such harmonization can be achieved. In fact, the only specific securities regulation reform that the drafters of the Report propose is the tightening of oversight on the credit rating agencies that rated the mortgage-backed securities, which gave birth to the financial crisis.¹⁸ This does little to address the systemic weakness and race-to-the-bottom that the regulatory fragmentation of international securities law creates.

This Article advocates for the harmonization and centralization of international securities regulation as a means of preventing future financial crises. In other articles, I have discussed the opportunity that the financial crisis that began in 2008 presents for reimagining international securities regulation,¹⁹ the need for comprehensive domestic and international regulatory reform to prevent future crises,²⁰ the United States federal government’s role in reimagining international securities regulation,²¹ the need for a centralized global securities regulator,²² and the evolutionary method by which a centralized

¹⁵ See *id.* at 80–88 (containing the Obama Administration’s goals relating to international reform in response to the financial crisis that began in 2008); see also *supra* note 13 and accompanying text.

¹⁶ See *infra* notes 56–62 and accompanying text (describing the role of mortgage-backed securities in the financial crisis that began in 2008).

¹⁷ U.S. DEP’T OF THE TREASURY, *supra* note 1, at 81.

¹⁸ See *id.* at 87 (stating that the Obama Administration via the United States Department of the Treasury “urge[s] national authorities to enhance their regulatory regimes to effectively oversee credit rating agencies (CRAs), consistent with international standards and the G-20 Leaders’ recommendations”).

¹⁹ See Eric C. Chaffee, *A Moment of Opportunity: Reimagining International Securities Regulation in the Shadow of Financial Crisis*, 15 NEXUS 29 (2010).

²⁰ See Eric C. Chaffee, *A Panoramic View of the Financial Crisis that Began in 2008: The Need for Domestic and International Regulatory Reform*, 35 U. DAYTON L. REV. 1 (2009).

²¹ See Eric C. Chaffee, *The Internationalization of Securities Regulation: The United States Government’s Role in Regulating the Global Capital Markets*, 5 J. BUS. & TECH. L. 187 (2010).

²² See Eric C. Chaffee, *Evolution, Not Revolution, in International Securities Regulation: A Modest Proposal for a Global Securities and Exchange Commission* (forthcoming).

global securities regulator might emerge.²³ This Article adds to the existing scholarship in three main ways. First, it provides an in-depth discussion of the arguments for harmonization and centralization of international securities regulation—including that harmonization and centralization will help minimize risk in the emerging capital markets,²⁴ increase market efficiency,²⁵ and pool the expertise and experience of the world's securities regulators.²⁶ Second, this Article provides an in-depth discussion of the arguments against harmonization and centralization—including that harmonization and centralization do not yield the same benefits as regulatory competition,²⁷ cannot be implemented in the current international regulatory environment,²⁸ and would result in a loss of autonomy for the United States.²⁹ Third, this Article concludes that harmonization and centralization offer the best path forward in international securities regulation and discusses the evolutionary process through which a harmonized and centralized system might emerge.

The remainder of this Article is structured as follows. Part II of this Article examines the emerging global capital markets and the need to reform international securities regulation. Part III provides various arguments in favor of the harmonization and centralization of

²³ See Eric C. Chaffee, *Contemplating the Endgame: An Evolutionary Model for the Harmonization and Centralization of International Securities Regulation*, 78 U. CIN. L. REV. (forthcoming 2010).

²⁴ See *infra* Part III.A (discussing why the harmonization and centralization of international securities law will help to minimize risk in the emerging global capital markets, including that such an approach will end the international race-to-the-bottom in securities regulation, create a seamless system of regulation that reduces regulatory and enforcement gaps, and reduce spillover risks from regional or national financial crises).

²⁵ See *infra* Part III.B (discussing why the harmonization and centralization of international securities law increases market efficiency, including that such an approach reduces transaction costs, removes barriers to efficiency, and increases investor confidence).

²⁶ See *infra* Part III.C (discussing why harmonization and centralization of international securities law is beneficial because it pools the expertise and experience of the world's securities regulators).

²⁷ See *infra* notes 176–181 and accompanying text (responding to criticisms that the harmonization and centralization of international securities law would prevent the benefits of regulatory competition).

²⁸ See *infra* notes 182–190 and accompanying text (responding to criticisms that the harmonization and centralization of international securities law would be impossible to implement).

²⁹ See *infra* notes 191–192 and accompanying text (responding to criticisms that the harmonization and centralization of international securities law would not be in the best interests of the United States because it would result in a loss of autonomy for the United States).

international securities law, and Part IV analyzes various arguments against such harmonization and centralization. In Part V, this Article concludes that harmonization and centralization offer the best method of regulating the emerging global capital markets, and although such harmonization and centralization is unrealistic in the short-term, the United States and other nations should begin the slow evolutionary process toward a harmonized and centralized system of international securities law.

II. THE EMERGING GLOBAL CAPITAL MARKETS AND THE NEED TO REFORM INTERNATIONAL SECURITIES REGULATION

The world's capital markets are transitioning from being national or regional in nature to being global.³⁰ This transition creates new challenges in terms of international securities law because securities regulation remains fragmented between regulators in individual nations or regions.³¹ As discussed in the previous section, patchwork regulation will not work to effectively regulate the emerging global markets.³² This section explores the reasons for the transition from national and regional capital markets to global markets, how this transition contributed to the financial crisis that began in 2008, and the various models that might be used to regulate the emerging global markets.

A. *The Transition to Global Capital Markets*

In recent years, the world's capital markets have experienced a dramatic transformation as they have shifted from being national or regional in nature to being global. For much of the twentieth century, many viewed the United States as having the world's premier

³⁰ See Susan Wolburgh Jenah, *Commentary on A Blueprint from Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 69, 69–70 (2007) (“Globalization is a fact. Innovative technologies are driving faster and more efficient trading, and they do not recognize national borders. Capital market participants are expanding their business activities into foreign markets. Investors are seeking international investment opportunities. The impact of these changes is profound and not yet fully realized.”); Roberta S. Karmel, *The Case for a European Securities Commission*, 38 COLUM. J. TRANSNAT'L L. 9, 31 (1999) (“[S]ecurities trading has become globalized and stock exchanges conduct business in a manner that transcends national boundaries.”).

³¹ See *supra* note 10 and accompanying text (noting that financial regulation is still determined by national regulators, despite the fact that financial distress can now spread easily and quickly across national borders).

³² See *supra* notes 10–12 (arguing that patchwork regulation of the emerging global capital markets creates global systemic risk and a race-to-the-bottom in terms of international securities regulation).

capital markets and premier system of securities regulation.³³ From this dominant position, the United States was able to export its theories of securities regulation and enforcement to other nations and regions.³⁴ During this period, the United States also served as a coordinating force in international securities law because its dominant position allowed it to influence other nations' and regions' capital markets and systems of securities regulation.³⁵ During the twenty-first century, however, the dominance of the United States has been waning as global capital markets have begun to emerge.³⁶ The United States' ability to be a coordinating force in international securities law has also begun to weaken because it no longer acts from a position of dominance.³⁷ The emergence of global capital markets has occurred

³³ See Robert G. DeLaMater, *Recent Trends in SEC Regulation of Foreign Issuers: How the U.S. Regulatory Regime is Affecting the United States' Historic Position as the World's Principal Capital Market*, 39 CORNELL INT'L L.J. 109, 109 (2006) ("Since World War II, the United States has been the world's principal capital market. This market has been uniquely broad and deep, with substantial retail participation by individual investors and small institutions, plentiful capital for equity financing and a willingness to hold long-term debt securities . . ."); Howell E. Jackson, *A System of Selective Substitute Compliance*, 48 HARV. INT'L L.J. 105, 119 (2007) ("For much of the twentieth century, the [SEC] justly considered itself to be the world's premier securities market regulator.").

³⁴ See George W. Madison & Stewart P. Greene, *TIAA-CREF Response to A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 99, 100 (2007) ("The SEC performs its task admirably—and sets the standard against which all other regulators around the globe are judged. . . . The SEC, with its track record and high standards for protecting investors, has historically been a leader in setting benchmarks for market regulation.").

³⁵ *Id.*

³⁶ See Edward F. Greene, *Beyond Borders: Time to Tear Down the Barriers to Global Investing*, 48 HARV. INT'L L.J. 85, 85 (2007) ("There can be no argument that the securities markets are now global and the dominance of the United States as the leading player in the global marketplace is being challenged."); Jackson, *supra* note 33, at 119 ("[T]he capital markets of many other countries have developed and the supervisory capabilities of many jurisdictions have expanded—often with the assistance of advice from the SEC or the International Organization of Securities Commissions. Today, a number of these jurisdictions provide capital market oversight that is substantially equivalent to SEC supervision.").

³⁷ See DeLaMater, *supra* note 33, at 116 ("[T]he U.S. model is not as well regarded as it was a few years ago, it is no longer the gold standard to which other regulatory schemes could only aspire. The U.S. model has been tarnished by the scandals of 2001 and 2002, as all of Enron, WorldCom, Tyco, Adelphia and the other companies so prominent among the scandals were obviously SEC-registered, listed on U.S. stock exchanges, and audited under U.S. generally accepted auditing standards."); Greene, *supra* note 36, at 85 ("The SEC can no longer afford to sit on the sidelines and pretend that the U.S. market is the only game in town. It must acknowledge that other securities markets and regulators have matured to the point where they rival (and some might argue exceed) the United States in sophistication."); Roberta S. Karmel, *The EU Challenge to the SEC*, 31 FORDHAM INT'L L.J. 1692,

for a variety of reasons, including the evolution of securities trading, the rise of other strong new securities markets, and the aggressive regulation of the capital markets in the United States.

The transition from national or regional capital markets to global capital markets has been fueled in large part by the evolution of securities trading. Technology now affords investors with nearly limitless investment opportunities around the globe.³⁸ Although foreign issuers and other sellers may be prohibited from directly soliciting investors within the borders of some nations,³⁹ both retail and institutional investors are free to seek out opportunities abroad and to purchase securities on foreign exchanges.⁴⁰ In the United States, both retail and institutional investors seek out foreign investment opportunities as a means of portfolio diversification and to take advantage of fluctuations in currency exchange rates.⁴¹ Indeed, foreign invest-

1711 (2008) (“Since the SEC has served as the gold standard of securities regulation, it is not surprising that as the EU has striven to improve and integrate European capital markets, it has looked to U.S. securities regulation as a model. Yet, changing economics, and in particular the migration of many international issuers to the London markets, has given the EU more power in influencing the SEC.”); *see also* Eric J. Pan, *Single Stock Futures and Cross-Border Access for U.S. Investors*, 14 STAN. J.L. BUS. & FIN. 221, 228 (2008) (“The capacity of investors and issuers to purchase and sell securities in markets outside of the United States challenges the SEC’s ability to ensure that the raising of capital from U.S. investors is subject to SEC approved standards of investor protection and market integrity.”).

³⁸ *See* Greene, *supra* note 36, at 86 (“The rise of the internet has given investors a new window on the world and access to almost limitless information. A natural outgrowth of this technological revolution, coupled with increasing investor sophistication and the need for financial diversification that transcends home country borders, is the understandable desire of investors to communicate and effect transactions directly with market participants located in other jurisdictions.”).

³⁹ *See* Jackson, *supra* note 33, at 111 (“U.S. retail investors face serious problems receiving information about foreign investment opportunities. Most notably, foreign broker dealers are prohibited from soliciting most U.S. retail investors unless those firms comply with SEC registration and compliance requirements.”); Eric J. Pan, *A European Solution to the Regulation of Cross-Border Markets*, 2 BROOK. J. CORP. FIN. & COM. L. 133, 157 (2007) (“[T]he SEC has prevented foreign exchanges from offering services directly to U.S. investors without registering as a U.S. exchange.”).

⁴⁰ *See* Jackson, *supra* note 33, at 108 (“Increasingly[,] major institutional investors have established offices overseas in key financial centers, like London and Tokyo, and prefer to trade their foreign securities in the home market of issuers Institutions that lack foreign offices also prefer off-shore trading venues for foreign securities and can effect trading on these markets through relationships with foreign brokers”).

⁴¹ *See* Greene, *supra* note 36, at 85–86 (“Investing in non-U.S. markets is no longer the exclusive province of megainstitutions or the ultrawealthy; it is an essential component of prudent portfolio diversification for all investors.”).

ment by both retail and institutional investors in the United States has increased dramatically within the past few years.⁴²

The evolution of securities trading has also fueled the emergence of global capital markets because securities exchanges have begun to evolve into transnational entities. The recent wave of securities exchange demutualization has transformed securities exchanges into for-profit entities that are willing to eschew previous nationalistic and protectionist tendencies in favor of seeking out new profit-making opportunities regardless of whether they are foreign or domestic.⁴³ This wave of securities exchange demutualization has touched off a wave of securities exchange consolidation.⁴⁴ When the merger between the New York Stock Exchange and Euronext was completed on April 4, 2007, the world saw the birth of the first transnational securities exchange.⁴⁵ The ensuing push for the consolidation of other exchanges continues to break down national barriers and to aid in the emergence of a global capital market.⁴⁶

⁴² See Karmel, *supra* note 37, at 1711 (“U.S. investors are buying foreign securities in record numbers and foreign issuers no longer believe they need to make offerings in the U.S. to raise capital.”); see also Pan, *supra* note 37, at 229 (“U.S. investors have become mobile because of new ways for them to be exposed to foreign securities and their changing preferences in favor of foreign securities.”).

⁴³ See Jenah, *supra* note 30, at 71 (arguing that the demutualization of many securities exchanges has “unleashed pressure from shareholders to increase profits through expansion, investment in new technology, and cost cutting, forcing these for-profit entities to eschew nationalistic or protectionist tendencies in the bid for value maximization”); Roberta S. Karmel, *The Once and Future New York Stock Exchange: The Regulation of Global Exchanges*, 1 BROOK. J. CORP. FIN. & COM. L. 355, 356 (2007) (“Another factor in the inevitable globalization of exchanges is that the exchanges have demutualized and become public companies. They need to please their shareholders as well as their customers.”).

⁴⁴ See Pan, *supra* note 39, at 136 (“Demutualization and increased competition has led to a wave of consolidation by the European exchanges.”).

⁴⁵ See generally Bo Harvey, Note, *Exchange Consolidation and Models of International Securities Regulation*, 18 DUKE J. COMP. & INT’L L. 151 (2007) (discussing the evolution of international securities law in the wake of the New York Stock Exchange and Euronext merger); Sara M. Saylor, Note, *Are Securities Regulators Prepared for a Truly Transnational Exchange*, 33 BROOK. J. INT’L L. 685 (2008) (discussing the New York Stock Exchange and Euronext merger and the resulting need to reimagine international securities regulation). But see Pan, *supra* note 37, at 232 (“While the NYSE and Euronext can enjoy the savings of reduced overhead and shared trading technology and systems, the main benefit of the merger will be achieved only when investors and issuers are granted full access to all markets operated by the combined entity.”).

⁴⁶ See Jenah, *supra* note 30, at 71 (“[The] chess game of proposed exchange mergers, capital tie-ups, and alliances being played out on the global stage bears witness to the truism that capital markets are global.”); see also Karmel, *supra* note 37, at 1711 (“The merger of the NYSE and Euronext probably was a wakeup call to both the SEC and the EU signaling the need for convergence of their regulatory systems, increased cooperation among regulators, and a new approach to mutual recognition.”).

The world's capital markets are also transitioning from being national and regional in nature to being global because capital markets outside of the United States have grown in both size and sophistication. Despite the dominance of the United States during much of the twentieth century, the United States now competes with strong markets in Asia, Europe, and South America to attract issuers, investors, and other market participants.⁴⁷ The capital markets in the European Union have grown in both breadth and depth,⁴⁸ and the rise of strong markets in Brazil, Russia, India, and China, which are often referred to as the "BRIC" nations, demonstrates that focus has begun to shift away from the markets in the United States.⁴⁹ The result has been that issuers, investors, and other market participants look for opportunities globally, rather than on a national or regional basis.

The United States also fueled the emergence of global capital markets by pursuing aggressive regulation of its own national capital markets. For example, the United States experienced a significant drop in initial public offerings by foreign issuers as a result of the passage of the Sarbanes-Oxley Act of 2002,⁵⁰ which placed extensive new corporate governance requirements on entities wishing to issue stock in the United States.⁵¹ In addition, many commentators argue that

⁴⁷ See DeLaMater, *supra* note 33, at 117 ("The securities markets outside the United States have grown in breadth and depth of their own over the past twenty years and now afford issuers in their home countries significant opportunities for financing that did not previously exist."); Donald C. Langevoort, *U.S. Securities Regulation and Global Competition*, 3 VA. L. & BUS. REV. 191, 194-95 (2008) ("[C]ompetition has eroded the United States' 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, 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.").

⁴⁸ See Karmel, *supra* note 43, at 363 ("Marketplace developments in recent years also made a U.S. listing less attractive for foreign issuers. The European markets have matured to a point where capital can be raised there to meet the needs of most companies. Foreign, and even some U.S. companies, engaging in IPOs or stock exchange listings have done so in Europe, rather than in the United States.").

⁴⁹ See Karmel, *supra* note 37, at 1711-12 ("The new strong capital markets in Asia and South America, and in particular in the so-called BRIC countries (Brazil, Russia, India, and China), challenge both the EU and the SEC to shape their regulatory approaches to foreign issuers and foreign financial institutions so as not to lose their competitive places as market regulators.").

⁵⁰ See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified at 15 U.S.C. §§ 7201-7266 (2006)).

⁵¹ See Karmel, *supra* note 43, at 356-57 ("[T]he primary reasons why the NYSE has been losing listings are that foreign issuers are disenchanted with the U.S. stock market because of the costs of compliance with the requirements of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) and because of the U.S. culture of shareholder litigation."). *But see* Jackson, *supra* note 33, at 108 ("Although many have pointed to

issuers, investors, and other market participants have been driven abroad because of the United States' culture of shareholder litigation and history of aggressive enforcement by the United States Securities and Exchange Commission ("SEC"), which create expenses for issuers that are ultimately passed on to the holders of their securities.⁵²

B. International Securities Law and the Great Recession

As discussed in the introduction of this Article, the financial crisis that began in 2008, which some have termed the "Great Recession," resulted in part from a race-to-the-bottom in international securities law.⁵³ The causes of the financial crisis are complex and will be debated for years to come. Although a thorough and complete analysis of the financial crisis is beyond the scope of this Article, a few words ought to be included about how the financial crisis came into being and why the current system of international securities law is in part to blame. The origins of the financial crisis are important because they demonstrate the inherent systemic weakness in the current dominant model of international securities regulation.

To grossly oversimplify, the financial crisis resulted from the devaluation of mortgage-backed securities. In the early years of the twenty-first century, lenders began issuing large numbers of high-risk mortgages to individuals and other entities that were unlikely to repay.⁵⁴ This created a "bubble" in housing prices.⁵⁵ The high-risk mortgages were then pooled together with other assets and sold to special purpose entities, which allowed the lenders to quickly realize

the passage of the Sarbanes-Oxley Act of 2002 as damaging the ability of U.S. exchanges to compete for foreign cross-listings, there is ample evidence that the erosion of U.S. market power for foreign listings was already underway well before 2002.").

⁵² See Jenah, *supra* note 30, at 71 (arguing that "the increased regulatory burden in the United States, combined with mounting concerns over exposure to U.S.-style class actions and more aggressive enforcement, may be driving companies to raise capital in foreign markets").

⁵³ See sources cited *supra* notes 10–12 (arguing that patchwork regulation of the emerging global capital markets will result in a race-to-the-bottom in terms of international securities law).

⁵⁴ See David Schmudde, *Responding to the Subprime Mess: The New Regulatory Landscape*, 14 *FORDHAM J. CORP. & FIN. L.* 709, 710–11 (2009) ("As the real estate bubble inflated and creative mortgage methods were invented, all proven rules were ignored. . . . Consumers, ignoring basic financial advice, were entering into mortgages they simply could not repay. Everyone seemed to think that real estate prices would rise forever.").

⁵⁵ *Id.*

a profit and to continue issuing high-risk mortgages.⁵⁶ To pay for the pools of high-risk mortgages and other assets, the special purpose entities began issuing mortgage-backed securities.⁵⁷ The mortgage-backed securities were then sold both domestically and abroad, and many financial institutions purchased these securities.⁵⁸ When the housing “bubble” burst, the default rate on the high-risk mortgages rose dramatically,⁵⁹ and the mortgage-backed securities were devalued.⁶⁰ The financial institutions that had purchased the mortgage-backed securities were no longer willing to extend credit because of the uncertainty of the value of the mortgage-backed securities in their portfolios.⁶¹ Because of the lack of available credit, the United States economy ground to a halt.⁶² A financial crisis ensued and cascaded around the rest of the world.⁶³

Many commentators focus on the housing “bubble” when discussing the causes of the financial crisis that began in 2008. Some fault the Federal Reserve’s Federal Open Market Committee for keeping interest rates low in the early years of the twenty-first century because it made large amounts of credit available, which ultimately

⁵⁶ See Steven L. Schwarcz, *The Future of Securitization*, 41 CONN. L. REV. 1313, 1316 (2009).

In the most basic form of mortgage securitization, mortgage-backed securities (MBS) are issued by a special-purpose vehicle (SPV), and payment on the securities is derived directly from collections on mortgage loans owned by the SPV. More complex forms of mortgage-backed securities include collateralized debt obligation (CDO) securities in which payment derives directly from a mixed pool of mortgage loans and sometimes, also, from other financial assets owned by the SPV; and ‘ABS CDO’ securities in which payment derives from MBS and CDO securities owned by the SPV. . . .

Id.

⁵⁷ *Id.*

⁵⁸ See generally Aaron Unterman, *Exporting Risk: Global Implications of the Securitization of U.S. Housing Debt*, 4 HASTINGS BUS. L.J. 77 (2008).

⁵⁹ See Schwarcz, *supra* note 55, at 1317 (explaining that the mortgage-backed securities were devalued when real estate “bubble” burst and the default rate on the underlying mortgages increased dramatically).

⁶⁰ *Id.*

⁶¹ See Jerry W. Markham, *The Subprime Crisis—Some Thoughts on a “Sustainable” and “Organic” Regulatory System*, 4 FLA. INT’L U. L. REV. 381, 393–94 (2009) (explaining that as a result of the devaluation of many mortgage-backed securities “[c]redit markets were frozen and liquidity became absent” because the financial institutions that had purchased the mortgage-backed securities were unsure how to assess the mortgage-backed securities’ worth).

⁶² *Id.*

⁶³ See *id.* (explaining that as a result of the credit market being frozen the United States economy fell into recession).

created a “bubble” in housing prices.⁶⁴ Other commentators fault politicians for creating the “bubble” that precipitated the financial crisis because of government subsidies for home purchases and because of government pressure on financial institutions to grant mortgages to individuals who were highly unlikely to repay.⁶⁵ Still other observers blame the financial crisis on the financial institutions themselves and allege that the financial institutions issued high-risk mortgages based on both recklessness and greed.⁶⁶ Finally, a few commentators hold no one morally accountable for the financial crisis; instead, they blame the crisis on the perceptual failure of the individuals operating within a “bubble” to realize that the “bubble” existed and would burst.⁶⁷

Solely focusing on the causes of the housing “bubble,” however, ignores the role played by mortgage-backed securities in the financial crisis. As previously explained, the financial crisis occurred because many financial institutions had purchased mortgage-backed securities that were devalued when the housing “bubble” burst.⁶⁸ Because many financial institutions were no longer sure of how to value the mortgage-backed securities in their portfolio, these entities stopped extending credit, and the United States economy consequentially

⁶⁴ See, e.g., Robert T. Miller, *Morals in a Market Bubble*, 35 U. DAYTON L. REV. 113, 136 (2009) (concluding that the financial crisis “began at the Federal Reserve, where Alan Greenspan and his colleagues on the Federal Open Market Committee made some mistakes in the early years of this decade by keeping interest rates very low for a very long time”).

⁶⁵ See, e.g., Robert Hardaway, *The Great American Housing Bubble: Re-Examining Cause and Effect*, 35 U. DAYTON L. REV. 33, 59 (2009) (arguing that the best way to prevent a future housing “bubble” is by “eliminating home mortgage tax subsidies for the richest Americans [and] repealing laws pressuring banks to extend mortgages to marginal buyers”).

⁶⁶ See, e.g., Steven A. Ramirez, *Subprime Bailouts and the Predator State*, 35 U. DAYTON L. REV. 81, 84–85 (2009) (“In what can only be described as an orgy of reckless financial management, a number of very large financial firms pursued short-term profits without regard to risks borne by their firms in one of the greatest credit bubbles in history, starting in 2004 and continuing through 2007. Much of this excessively risky credit found its way into the U.S. residential real estate market via subprime loans.”).

⁶⁷ See, e.g., Miller, *supra* note 64, at 137 (“Moralizing critics blame virtually everyone involved in the housing market [for the financial crisis that began in 2008], but in reality virtually all of these people were entirely innocent. They were trapped in a market bubble, and certainly none of these people, whether individually or even collectively, engaged in any moral wrongdoing that caused the bubble and the burst.”). But see Jeffrey M. Lipshaw, *Disclosure and Judgment: “We Have Met Madoff and He is Ours,”* 35 U. DAYTON L. REV. 139, 144 (2009) (arguing that the financial crisis that began in 2008 resulted from failures in human judgment, rather than failures of the laws and regulations mandating disclosure of information).

⁶⁸ See *supra* notes 58–63 and accompanying text.

ground to a halt.⁶⁹ Therefore, in addressing the root causes of the financial crisis, one must also consider what went wrong with the mortgage-backed securities.

The issues created by mortgage-backed securities resulted from under-regulation of these securities by Congress, and, more specifically, the SEC. Remarkably, when more aggressive regulation and enforcement was needed, the SEC was taking a “hands off” approach to institutional investors, mortgage-backed securities, and the credit rating agencies that were valuing mortgage-backed securities.⁷⁰ The SEC’s “hands off” approach resulted in large part from the deregulationist movement in the United States that gained traction in the early years of the twenty-first century. As Judge Richard Posner, a major proponent of deregulation, admits in *A Failure of Capitalism: The Crisis of ‘08 and the Descent into Depression*, “[t]he movement to deregulate the financial industry went too far by exaggerating the resilience—the self-healing powers—of laissez-faire capitalism.”⁷¹ Put simply, the financial crisis that began in 2008 can in large part be traced to a deregulationist movement that was too successful in advocating for a “hands off” approach to securities regulation and enforcement.

The deregulationist movement gained traction in the early years of the twenty-first century because the dominance of the United States had been declining in terms of its capital markets and role as a securities regulator.⁷² International regulatory competition was emerging as the dominant model for international securities regulation,⁷³ and a race-to-the-bottom was occurring as regulators ratcheted down their levels of regulation and enforcement in hopes of attracting issuers, investors, and other market participants to their jurisdic-

⁶⁹ See *supra* notes 61–63 and accompanying text (explaining that many financial institutions were unwilling to extend credit when the mortgage-backed securities that they held were devalued because the financial institutions were unsure how to assess the mortgage-backed securities’ worth).

⁷⁰ See Barbara Black, *Protecting the Retail Investor in an Age of Financial Uncertainty*, 35 U. DAYTON L. REV. 61, 77 (2009) (arguing that to prevent future financial crises the United States must “get rid of the ‘hands off’ attitude toward institutional and sophisticated investors that is ingrained into the regulatory climate”).

⁷¹ See POSNER, *supra* note 5, at xii.

⁷² See *supra* notes 36–37 and accompanying text (explaining that the dominance of the United States has been waning in terms of its capital markets and its role as a securities regulator).

⁷³ See Chris Brummer, *Stock Exchanges and the New Markets for Securities Laws*, 75 U. CHI. L. REV. 1435, 1435–36 (2008) (arguing that the emerging system of international securities regulation is based on regulatory competition).

tions.⁷⁴ In the early years of the twenty-first century, no regulator wanted to increase the level of regulation on mortgage-backed securities out of fear that it would disadvantage their nation or region from participating in the housing “bubble” in the United States. The result, of course, was the financial crisis that began in 2008.

C. *Six Possible Models for International Securities Law*

The financial crisis that began in 2008 evidences the systemic risk that is created if the world takes a regulatory competition approach to international securities law. As the financial crisis demonstrates, patchwork regulation does not provide an optimal level of regulation for the emerging global securities markets. This reality raises the question: What are the available approaches for international securities law? This section discusses six possible models for international securities law. These models are privatization, competition, convergence, mutual recognition, harmonization, and centralization.⁷⁵ These approaches can be placed on a spectrum based on the amount of international cooperation and coordination that is required to bring each of them into existence and to maintain them. On this spectrum, regulatory privatization would be at one endpoint because it requires the least cooperation and coordination among securities regulators, and regulatory centralization would be at the other endpoint because it requires the most cooperation and coordination. When traveling from regulatory privatization to centralization on this spectrum, one would pass through competition, convergence, mutual recognition, and harmonization. Obviously, these approaches can and do overlap and blur.

Under a regulatory privatization approach, stock exchanges would have the power to develop their own internal systems of securi-

⁷⁴ See Langevoort, *supra* note 47, at 193 (“The global scale of the [financial crisis that began in 2008] 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.”).

⁷⁵ In my previous scholarship discussing the possible models for international securities law, I chose to omit regulatory privatization because privatization involves regulation by non-governmental entities, rather than among nations. See Chaffee, *supra* note 19, at 35–39; Chaffee, *supra* note 21, at 193–97. After thinking about it more, I have opted to include a discussion of regulatory privatization in this Article because it adds to the discussion of how the emerging global capital markets might best be regulated. In addition, because of the rise of transnational exchanges, privatization should properly be viewed as a type of international securities law.

ties regulation that would govern their exchanges.⁷⁶ Issuers, investors, and other market participants would then opt to subject themselves to these privatized systems of securities regulation by engaging in transactions on a particular exchange.⁷⁷ Although this idea might seem novel, the United States used this approach prior to the passage of the first blue sky laws in the early 1900s.⁷⁸ Even though regulatory privatization was once the law of the land in the United States, reinstating this approach either in the United States or internationally would likely be extremely difficult because the world has grown accustomed to regulation on a national level by governmental entities.⁷⁹

A second approach to international securities regulation can be founded on regulatory competition. Under a regulatory competition approach, individual nations develop systems of securities regulation and compete to attract issuers, investors, and other market participants.⁸⁰ The world is currently transitioning to a regulatory competition approach to international securities law.⁸¹ As previously discussed, for much of the twentieth century, the United States was viewed as having the world's premier capital markets and premier system of securities regulation.⁸² The United States was able to serve as a coordinating force in international securities law by exporting its theories of market regulation and enforcement to other nations.⁸³ As

⁷⁶ See generally Paul G. Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453 (1997) (arguing that securities exchanges should be the primary source of securities regulation).

⁷⁷ *Id.*

⁷⁸ See Howell E. Jackson, *Centralization, Competition, and Privatization in Financial Regulation*, 2 THEORETICAL INQUIRIES L. 649, 661 (2001) (“[A]dvocating the full privatization of securities regulation, would, in the United States, turn back the clock nearly a full century, not just before the New Deal, but further back, before the dawning of the first Blue Sky laws of the early 1900s.”).

⁷⁹ See *id.* at 660 (describing privatization as a “radical school of thought” because it “challenge[s] the question of whether governments should even play a role in the development of securities regimes”).

⁸⁰ See Tzung-bor Wei, *The Equivalence Approach to Securities Regulation*, 27 NW. J. INT’L L. & BUS. 255, 256 (2007) (“[A]dvocates of regulatory competition assert that countries should not restrict themselves to a one-size-fits-all approach. Different countries should be able to enact different laws to accommodate different preferences and experiences. The regulatory competition model allows countries to tailor their laws to country-specific circumstances.”).

⁸¹ See Brummer, *supra* note 73.

⁸² See *supra* note 33 and accompanying text (explaining that for much of the twentieth century the United States was viewed as having the world's principal capital markets and premier system of securities regulation).

⁸³ See *supra* notes 34–35 and accompanying text (arguing that because of its dominance in terms of its capital markets and system of securities regulation during the

the dominance of the United States has begun to diminish, regulatory competition has begun to emerge as the dominant approach to international securities law.⁸⁴ Consequently, nations are under-regulating their securities markets in a race-to-the-bottom to attract issuers, investors, and other market participants.⁸⁵

Regulatory convergence is a third approach to international securities regulation. Regulatory convergence can be bifurcated into both weak and strong forms. Under a weak regulatory convergence approach, nations naturally gravitate toward similar systems of securities regulation.⁸⁶ If a dominant nation exists that is viewed as having the world's best capital markets and best system of securities law, then this may actually lead to a race-to-the-top in which the dominant nation can pick and choose the best practices from other nations and construct an optimal system of regulation and enforcement.⁸⁷ Other nations will then converge on the dominant nation's system of securities regulation.⁸⁸

Throughout much of the twentieth century, the world took a weak regulatory convergence approach to international securities regulation. During this period, other nations viewed the United States as having the world's best capital markets and best system of securities regulation.⁸⁹ The United States was able to use its dominance to export its theories of securities regulation, and other nations

twentieth century, the United States was able to influence other nations' and regions' systems of securities regulation).

⁸⁴ See *supra* notes 36–37 and accompanying text (arguing that dominance of the United States has begun to wane in terms of its capital markets and role as a securities regulator).

⁸⁵ But see Wei, *supra* note 80, at 256 (“[R]egulatory competition fosters innovation because countries must compete with each other to attract market participants . . .”).

⁸⁶ See Daniel K. Tarullo, *Norms and Institutions in Global Competition Policy*, 94 AM. J. INT'L L. 478, 495 (2000) (“[The regulatory convergence] approach involves a system of structured international activities through which national laws and regulations are made more congruent, the enforcement of similar laws is coordinated internationally, or both. This approach may often not include a formal international agreement. It relies instead on contact and cooperation between national regulatory officials.”).

⁸⁷ See Kal Raustiala, *The Architecture of International Cooperation: Transgovernmental Networks and the Future of International Law*, 43 VA. J. INT'L L. 1, 61 (2002) (“The incentives to converge regulatory policies also vary given the distribution of regulatory power. Concentrated regulatory power can make efforts at harmonization easier, because other jurisdictions will often have strong incentives to adopt the dominant actor's model.”).

⁸⁸ *Id.*

⁸⁹ See *supra* note 33 and accompanying text (reporting that for much of the twentieth century the United States was viewed as having the world's premier capital markets and premier system of securities regulation).

were willing to make their securities laws converge with those of the United States.⁹⁰ Although the United States continues to try to export its theories of securities via the SEC,⁹¹ the dominance of the United States has begun to wane, and regulatory competition has become the dominant model of international securities law.⁹²

Under a strong regulatory convergence model of international securities law, nations agree to certain regulatory norms through treaties or other agreements.⁹³ Nations then adopt codes of securities regulation based on these regulatory norms, and these norms cause the individual nations to converge upon similar systems of securities regulation.⁹⁴ Although strong regulatory convergence has never been the dominant model for international securities law, in certain instances, nations have entered multilateral memorandums of understanding and other agreements that require the signatories to comply with certain basic regulatory norms in regard to their systems of securities regulation and enforcement.⁹⁵

A fourth approach to international securities law is founded on regulatory mutual recognition. Under a regulatory mutual recognition approach, nations enter into treaties or other agreements under which compliance with one signatory's securities laws is viewed as being equivalent to compliance with all signatories' securities laws.⁹⁶

⁹⁰ See *supra* note 34 and accompanying text (arguing that for much of the twentieth century the United States was able to use its dominance in terms of its capital markets and system of securities regulation to export its theories of securities regulation to other nations and regions).

⁹¹ See U.S. Sec. & Exch. Comm'n, *Securities and Exchange Commission's International Technical Assistance Program*, http://www.sec.gov/about/offices/oia/oia_emergtech.shtml (last visited May 12, 2010) (describing the SEC's international technical assistance program, a program that is "helping improve market development and enforcement capacity around the world through its flagship International Institutes, bilateral missions, and regional training programs").

⁹² See *supra* note 37 and accompanying text (explaining that the United States' ability to be a coordinating force in international securities law has waned because its dominance in terms of its capital markets and system of securities regulation is receding); *supra* note 73 and accompanying text (arguing that the world is transitioning to a regulatory competition approach to international securities regulation).

⁹³ See Tarullo, *supra* note 86, at 495 (noting that under a strong regulatory convergence model, "[e]ven where formal agreements do exist, they are generally not binding as a matter of international law, and are often tantamount to points of reference for the ongoing cooperative activities rather than a code of conduct").

⁹⁴ *Id.*

⁹⁵ See, e.g., *infra* note 116 and accompanying text (discussing IOSCO's Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information to which many nations have become signatories).

⁹⁶ See Alicia Davis Evans, *A Requiem for the Retail Investor?*, 95 VA. L. REV. 1105, 1127 (2009) ("Under a 'mutual recognition' regime, certain foreign issuers would be

For example, an issuer who registers an offering in one nation with a mutual recognition agreement with a second nation would be free to sell its securities in that second nation, even though the securities are registered only in the first nation.⁹⁷

The United States has flirted with the idea of taking a mutual recognition approach to international securities regulation. In 2007, Ethiopis Tafara and Robert Peterson, two staff members in the SEC's Office of International Affairs, published *A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework* in the *Harvard International Law Journal*.⁹⁸ In the article Tafara and Peterson propose a new legal framework to allow foreign financial service providers (e.g., foreign stock exchanges and foreign broker-dealers) to operate in the United States based on compliance with their home country's securities laws.⁹⁹ To ensure that high standards of regulation would be maintained, Tafara and Peterson propose to limit this system of substitute compliance to countries with similar regulation and enforcement practices as the United States.¹⁰⁰ Initially, the SEC, under the leadership of Chairman Christopher Cox, warmly received Tafara and Peterson's proposal and convened meetings regarding how the proposal might be implemented.¹⁰¹ After the confirmation of Chairman Mary Schapiro in January 2009, however, the Tafara and Peter-

permitted to list their shares on U.S. exchanges and sell shares to U.S. investors without being subject to the full panoply of U.S. securities laws and regulations. These issuers would be subject only to the laws of their home country.”).

⁹⁷ *Id.*

⁹⁸ Ethiopis Tafara & Robert J. Peterson, *A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 31 (2007).

⁹⁹ *See id.* at 32 (“This Article proposes a new framework to apply to foreign financial service providers accessing the U.S. capital market Rather than requiring such foreign stock exchanges and foreign broker-dealers to register with the SEC, as is currently the case, the proposed framework relies on a system of substituted compliance with SEC regulations.”).

¹⁰⁰ *See id.* (“By constructing a new model for international cooperation between the SEC and certain like-minded foreign securities regulators, the framework will facilitate the SEC's ability to protect U.S. investors and lead to a collaborative effort in promoting high-quality regulatory standards in a globalized market.”).

¹⁰¹ *See* Karmel, *supra* note 37, at 1708–09 (“Following the publication of the Tafara article and favorable comments upon it, the SEC held a Roundtable on Mutual Recognition. . . . Mutual recognition of foreign markets and broker-dealers was also promoted in speeches by the Director of the Division of Market Regulation.”); Pan, *supra* note 37, at 223 (“Since the publication of this proposal, SEC Chairman Christopher Cox and other senior SEC officials have openly discussed and endorsed the merits of mutual recognition, and the SEC has held public meetings to discuss how such a proposal should be implemented.”).

son proposal appears to have been tabled or even outright rejected by the SEC.¹⁰²

A fifth approach to international securities regulation is founded on regulatory harmonization. Under a regulatory harmonization approach, nations agree via treaty or other agreement to make their securities laws identical and equivalent.¹⁰³ Although harmonization is very similar to a strong regulatory convergence approach, harmonization is different because strong convergence sets only basic regulatory norms and allows the individual nations to construct their own systems of securities laws based on those norms.¹⁰⁴ A harmonization approach requires that the securities laws of all signatory nations be identical and equivalent without providing individual nations the ability to experiment in how to achieve the norms underlying the regulatory system.¹⁰⁵ Regulatory harmonization can be used either to set a floor of regulation, which allows individual nations to upwardly depart, or it can be used to set out a comprehensive system of regulation.¹⁰⁶

Finally, regulatory centralization is a sixth approach to international securities law. Under a regulatory centralization approach, nations would join together to create an international organization that would have monitoring, regulatory, and/or enforcement responsibilities relating to the emerging global capital markets.¹⁰⁷ The extent of the monitoring, regulatory, or enforcement powers of this centralized global regulator would ultimately be determined by the nations agreeing to subject themselves to its authority.¹⁰⁸ For example, this centralized global regulator could be given solely monitoring func-

¹⁰² See Dan Jamieson, *Schapiro Cool to 'Mutual Recognition' Efforts*, INVESTMENT NEWS (Feb. 1, 2009), <http://www.investmentnews.com/article/20090201/REG/302019997> ("Bold efforts by the Bush administration Securities and Exchange Commission to open the doors to foreign brokerage firms are likely to be put on hold by new Chairman Mary Schapiro.")

¹⁰³ See Sidney A. Shapiro, *International Trade Agreements, Regulatory Protection, and Public Accountability*, 54 ADMIN. L. REV. 435, 436 (2002) ("Harmonization involves the adoption of an international standard that adjusts the regulatory standards or procedures of two or more countries until they are the same.")

¹⁰⁴ See Edward F. Greene, *Beyond Borders Part II: A New Approach to the Regulation of Global Securities Offerings*, in FOREIGN ISSUERS & THE U.S. SECURITIES LAWS 2008: STRATEGIES FOR THE CHANGING REGULATORY ENVIRONMENT 607, 612 (Practising Law Inst. ed., 2008) ("Harmonization . . . addresses duplicative or overlapping regulations by making them identical or, at the very least, consistent.")

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ See Jackson, *supra* note 78, at 656–57 (explaining the regulatory centralization approach to international securities law).

¹⁰⁸ *Id.*

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tions or could be charged with creating and enforcing a baseline of regulation from which participating nations could opt to upwardly depart.

Although the world is transitioning to a regulatory competition approach to international securities law, because of the increasing inability of the United States to fuel convergence of national systems of securities regulation and enforcement,¹⁰⁹ many nations have expressed at least a limited interest in a centralization approach to international securities regulation.¹¹⁰ For example, many securities regulators engage in bilateral or multilateral dialogues with securities regulators from other nations to promote coordination and cooperation regarding transnational securities regulation and enforcement issues.¹¹¹ Moreover, a number of international organizations have emerged to promote coordination and cooperation among national securities regulators.¹¹²

The most significant of these organizations is likely the International Organization of Securities Commissions (“IOSCO”). IOSCO was founded in 1983 as a successor to an inter-American organization that promoted coordination and cooperation among securities regu-

¹⁰⁹ See *supra* note 73 and accompanying text (arguing that the world is transitioning to a regulatory competition approach to international securities regulation); *supra* note 37 (arguing that the United States’ ability to act as a coordinating force in international securities law has begun to diminish because of its waning dominance in terms of its capital markets and system of securities regulation).

¹¹⁰ See Hannah L. Buxbaum, *Personal Jurisdiction over Foreign Directors in Cross-Border Securities Litigation*, 35 J. CORP. L. 71, 72 (2009) (“The regulatory community has developed a range of mechanisms that explicitly address securities fraud as a global issue. These include cooperation and coordination instruments such as bilateral memoranda of understanding between regulatory agencies, as well as the work of multilateral organizations such as the International Organization of Securities Commissions.”).

¹¹¹ See Jerry W. Markham & Daniel J. Harty, *For Whom the Bell Tolls: The Demise of Exchange Trading Floors and the Growth of ECNs*, 33 J. CORP. L. 865, 928 (2008) (“In the international arena [of financial regulation], cooperation among regulators has evolved from bilateral agreements to multilateral agreements in the form of participation in international organizations.”); *but see* Aaron Unterman, *Exporting Risk: Global Implications of the Securitization of U.S. Housing Debt*, 4 HASTINGS BUS. L.J. 77, 111 (“While a range of bilateral and multilateral agreements exist between nations they deal mostly with issues of cross border enforcement and assistance with securities investigations. There is currently no international treaty in force which specifically focuses on the global capital market.”).

¹¹² See Langevoort, *supra* note 47, at 205 (“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.”).

lators in North and South America.¹¹³ Currently, IOSCO's members regulate more than ninety percent of the world's securities markets and represent more than one hundred jurisdictions.¹¹⁴ Throughout IOSCO's history, it has served as a centralizing force in international securities law in a variety of circumstances. For example, in 1998, IOSCO adopted an influential set of advisory standards and benchmarks for regulating securities markets, called the Objectives and Principles of Securities Regulation ("Principles").¹¹⁵ Moreover, in 2002, IOSCO adopted a multilateral memorandum of understanding ("Memorandum of Understanding") designed to facilitate transnational enforcement and information sharing among securities regulators throughout the world.¹¹⁶

IOSCO, however, fails to provide the regulatory harmonization and centralization that is necessary to regulate the emerging global capital markets. IOSCO mainly serves coordinating and monitoring functions, rather than being a centralized force for regulation and enforcement in international securities law.¹¹⁷ In terms of regulation, compliance with IOSCO's Principles or Memorandum of Understanding, which IOSCO touts among its greatest successes, are voluntary until an individual nation chooses to adopt them.¹¹⁸ In terms of enforcement, IOSCO's Principles on very rare occasion have been used publicly to identify nations with poor systems of securities regu-

¹¹³ See *IOSCO Historical Background*, OICV-IOSCO, <http://www.iosco.org/about/index.cfm?section=background> (last visited Sept. 25, 2010) ("[IOSCO] was created in 1983 with the decision to change from an inter-American regional association (created in 1974) into a global cooperative body. Eleven securities regulatory agencies from North and South America took [sic] this decision in April 1983 at a meeting in Quito, Ecuador.")

¹¹⁴ *Id.* ("Its membership regulates more than 95% of the world's securities markets and it is the primary international cooperative forum for securities market regulatory agencies. IOSCO members are drawn from, and regulate, over 100 jurisdictions and its membership continues to grow.")

¹¹⁵ INT'L ORG. OF SEC. COMM'NS, OBJECTIVES AND PRINCIPLES OF SECURITIES ORGANIZATION (Sept. 1998), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD82.pdf>.

¹¹⁶ INT'L ORG. OF SEC. COMM'NS, MULTILATERAL MEMORANDUM OF UNDERSTANDING CONCERNING CONSULTATION AND COOPERATION AND THE EXCHANGE OF INFORMATION (May 2002), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD126.pdf>.

¹¹⁷ *The International Organization of Securities Commissions*, OICV-IOSCO, <http://www.iosco.org/about> (last visited Sept. 25, 2010) (explaining that IOSCO's main purposes are to coordinate among securities regulators and monitor the global securities markets, rather than providing an independent source of regulation and enforcement).

¹¹⁸ See *supra* notes 115–16.

lation, but beyond this type of public shaming, IOSCO lacks the power to enforce any of the standards that it establishes.¹¹⁹

III. THE ARGUMENT FOR THE HARMONIZATION AND CENTRALIZATION OF INTERNATIONAL SECURITIES LAW

The world should adopt an approach based on harmonization and centralization to international securities law. Nations throughout the world should harmonize their securities laws to allow for the creation of a centralized global securities regulator. Then, nations should negotiate treaties and other agreements to allow a centralized global securities regulator with robust monitoring, regulatory, and enforcement powers to come into being. The centralized global securities regulator should then set a baseline of securities regulation from which nations can choose to upwardly depart, if they desire. Although this approach may seem drastic and unrealistic based on the current global political climate and the probable unwillingness of most regulators to cede power,¹²⁰ a harmonized and centralized system of international securities regulation offers the best approach to international securities law because it would minimize systemic risk, increase efficiency of the emerging global capital markets, and pool the expertise and experience of the world's securities regulators.

A. *Harmonization and Centralization of International Securities Law Minimize Risk in the Emerging Global Capital Markets*

The emergence of global capital markets has caused the emergence of global systemic risk. Global capital markets offer a variety of benefits. Investors are afforded breadth and depth of investment opportunities and new options for portfolio diversification.¹²¹ Issuers can seek capital from a wider variety of sources, and the amount of

¹¹⁹ See Chris Brummer, *Post-American Securities Regulation*, 98 CALIF. L. REV. 327, 340–41 (2010) (“Noncompliance with IOSCO rules is not generally met with any retaliation, though it has led to overt economic sanctions in one context. In 2000 and 2001, international authorities publicly identified twenty-three countries as having poor regulatory governance, due in part to their nonobservance of IOSCO standards.”).

¹²⁰ See Langevoort, *supra* note 47, at 205 (arguing that “we will not see a global securities and financial services regulator—something as dramatic as a Global Financial Services Commission—anytime soon”).

¹²¹ See Madison & Greene, *supra* note 34, at 99 (“The rapid pace of technological advances is bringing us closer to the reality of a seamless global capital market. In such a world, investors would have access to increased liquidity, greater diversification, and a wider range of investment options regardless of their location.”).

capital available is greater.¹²² In addition, broker-dealers, investment advisors, and other market participants can make additional profits by providing new services.¹²³ Despite all of these benefits, the globalization of capital markets also creates additional global systemic risks. As the financial world has become more interconnected, financial crises are more likely to be global events, rather than national or regional occurrences.¹²⁴ Harmonization and centralization of international securities law helps to reduce systemic risk because it ends the race-to-the-bottom that is occurring in international securities regulation, provides a seamless system of regulation that prevents regulatory and enforcement gaps, and reduces spillover risks from regional or national financial crises.

A harmonization and centralization approach to international securities regulation will end the race-to-the-bottom in international securities law. The financial crisis that began in 2008 occurred in part because no nation wanted to ratchet up the level of regulation on the mortgage-backed securities that were at the heart of the crisis.¹²⁵ The United States did not want to increase the level of regulation out of fear that it would impact the prosperity that it was experiencing and that it would render it less competitive in the emerging global capital markets.¹²⁶ Other nations did not increase the level of regulation on mortgage-backed securities out of fear that it would render their nations less competitive because they would be unable to receive the benefits of the United States' prosperity.¹²⁷ A harmonized and centralized approach to international securities regulation would end the race-to-the-bottom because it would create a centralized global securities regulator to create a baseline of regulation and en-

¹²² See Steven M. Davidoff, *Regulating Listings in a Global Market*, 86 N.C. L. REV. 89, 90–91 (2007) (“Finance is now global. The halcyon days when the U.S. capital markets were the primary place to raise capital and list securities are over. Non-U.S. capital markets have matured; issuers have increasing latitude and choice as to where they list and obtain capital. They have exercised this freedom with a vengeance.”).

¹²³ See RICHARD DALE, *RISK AND REGULATION IN GLOBAL SECURITIES MARKETS* 1 (1996) (“Within the past two decades international financial markets have been transformed by three key developments: globalization of the financial services industry; functional integration of banking and securities business; and financial innovation, particularly in the derivative product area.”).

¹²⁴ See Karmel, *supra* note 30, at 33 (“Stock market crashes and financial firm failures have become international, just like trading markets.”).

¹²⁵ See *supra* Part II.B (discussing the relationship between international securities regulation and the Great Recession and crediting the Great Recession to a race-to-the-bottom in international securities law).

¹²⁶ See *supra* Part II.B.

¹²⁷ See *supra* Part II.B.

forcement. A floor of regulation and enforcement would be set, and nations and regions could not adopt a level of regulation below it.

Harmonization and centralization also minimize global systemic risk because they create a seamless system of regulation that eliminates the regulatory and enforcement gaps that exist under all other approaches to international securities law. As previously explained, the world is transitioning to global capital markets.¹²⁸ Although these capital markets are far from seamless because of the barriers created by the current patchwork of national and regional regulation, the emerging global capital markets are sufficiently international that a seamless system of regulation is needed to eliminate the regulatory and enforcement gaps created by the current patchwork of regulation.¹²⁹ The other approaches to international securities regulation discussed earlier in this Article all involve some degree of regulatory fragmentation, which permits regulatory and enforcement gaps to exist.¹³⁰ A harmonized and centralized approach to international securities law would provide the type of seamless regulation necessary to eliminate regulatory and enforcement gaps because a centralized global securities regulator would be charged with robust monitoring, enforcement, and regulatory powers to prevent such gaps.

In addition, a harmonized and centralized system provides the type of seamless regulation necessary to prevent the collective action problems that exist under other approaches to international securities law. Regulatory fragmentation invites free rider problems in which nations purposefully fail to invest adequate money and resources in regulation and enforcement in the hope that other nations will address problems that arise.¹³¹ Furthermore, other models of international securities regulation can create a bystander effect in which nations witnessing the same problem fail to act because they assume that some other nation will deal with the issue.¹³² A harmoni-

¹²⁸ See *supra* Part II.A (discussing the transition from national or regional capital markets to global capital markets).

¹²⁹ See Tafara & Peterson, *supra* note 98, at 32 (“[T]he current international environment has enforcement and oversight gaps that present risks that do not exist in a domestic context.”).

¹³⁰ See *supra* Part II.C (discussing six possible models for international securities law).

¹³¹ See Langevoort, *supra* note 47, at 204 (“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.”); see also Jackson, *supra* note 33, at 115 (“As it turns out, countries with quite similar regulatory systems may expend very different amounts of resources on supervisory oversight [of their securities markets].”).

¹³² See Damien Schiff, *Samaritans: Good, Bad and Ugly: A Comparative Law Analysis*, 11 ROGER WILLIAMS U. L. REV. 77, 112 (2005) (explaining that the bystander effect

zation and centralization approach to international securities law would remedy these and other collective issues because it would create a centralized global securities regulator that would serve as a focal point for action on monitoring, regulation, and enforcement.

Harmonization and centralization of international securities law also helps to minimize global systemic risk because it reduces spillover risks from regional or national financial crises. Because capital markets are global,¹³³ any future financial crisis is likely to be global as well.¹³⁴ Issues in national or regional markets can quickly and easily spill into other nations and regions.¹³⁵ The creation of a centralized global securities regulator would reduce this risk because such a regulator would provide an additional layer of monitoring, regulation, and enforcement that would help to prevent or lessen the impact of any national or regional financial crisis.

*B. Harmonization and Centralization of International Securities Law
Increase Market Efficiency*

Obtaining an optimal level of regulation involves not only reducing systemic risk but also considerations of market efficiency.¹³⁶ A market can be regulated in a manner that almost completely eliminates systemic risk but creates a level of regulation that is so onerous and inefficient that no one will want to participate in that market.¹³⁷

occurs in situations in which “[r]esponsibility for affirmative conduct is perceived as diffused among all present; fear of being reproved by others or of impeding a better rescuer discourages rescue activity from individuals within a bystander group”); Elizabeth C. Tippett, *The Promise of Compelled Whistleblowing: What the Corporate Governance Provisions of Oxley Mean for Employment Law*, 11 EMP. RTS. & EMP. POL’Y J. 1 (2007) (describing the bystander effect as “where groups fail to act in emergencies because individuals assume that others will intervene or that others are failing to act because the situation does not merit attention”).

¹³³ See *supra* Part II.A (explaining that capital markets have transitioned from being national or regional in nature to being global).

¹³⁴ See *supra* note 124 and accompanying text (suggesting that globalization of capital markets creates increased risk that financial crises will be global events, rather than national or regional occurrences).

¹³⁵ See Jackson, *supra* note 33, at 112 (“An interesting challenge in the regulation of foreign investments is the possibility of spillover effects in the United States when things go wrong overseas, like the Parmalat scandal on the Asian financial crisis of 1997.”).

¹³⁶ See Vern R. Walker, *Risk Regulation and the “Faces” of Uncertainty*, 9 RISK 27, 38 (1998) (“Risk regulation is, in the end, regulation, and the optimal combination of effectiveness, efficiency and equity is all we can ever hope to achieve.”).

¹³⁷ See Rodney A. Smolla, *Contemplating the Meaning of “The Rule of Law”*, 42 U. RICH. L. REV. 1, 6 (2007) (“Over-regulation of economic markets acts as a drag on investment and entrepreneurial enterprise; over-regulation of political systems inter-

A harmonization and centralization approach to international securities regulation would increase market efficiency over the current approach to international securities law, which is based on regulatory competition, because it would reduce transaction costs, remove barriers to efficiency, and increase investor confidence.

Harmonization and centralization of international securities law would reduce a variety of transaction costs created by the current system of regulatory competition. Under the current system, issuers must pay the initial costs of determining which national regulatory regimes apply to their offerings and under which national regulatory regimes it would be most beneficial to issue securities.¹³⁸ Then, issuers must pay the costs of complying with the registration and anti-fraud provisions in each nation in which they choose to make an offering.¹³⁹ Similarly, broker-dealers, investment advisors, and other market intermediaries must pay the cost of complying with the law in each nation in which they choose to operate. The costs of issuers, broker-dealers, investment advisors, and other market intermediaries are then passed along to investors.¹⁴⁰ Additionally, investors must bear information gathering costs that are created by operating within a regulatory system in which different nations require different levels of disclosure and have varying definitions of what constitutes securi-

feres with democracy and discourages civic participation; over-regulation of the marketplace of ideas stifles creativity and discovery in the arts and sciences.”).

¹³⁸ See Jackson, *supra* note 33, at 118 (“To date, most economic research on globalization of capital markets has explored the benefits of cross-border financings to issuers. Hence, a common measure of the benefits of globalization is the reduction in cost of capital for issuers.”).

¹³⁹ Greene, *supra* note 36, at 88 (noting that one of the benefits of breaking down regulatory barriers between nations is that “[i]ssuers, both within and outside the United States, will gain access to a wider pool of investors and benefit from a reduced cost of capital”).

¹⁴⁰ See Greene, *supra* note 36, at 88 (“Breaking down the barriers between U.S. financial markets and comparably regulated non-U.S. financial markets will benefit both U.S. and non-U.S. market participants. U.S. investors will benefit from more efficient execution of transactions in non-U.S. securities. Non-U.S. investors will similarly benefit from more efficient execution of transactions in U.S. securities.”); Taffara & Peterson, *supra* note 98, at 48.

U.S. investors are free to purchase such securities on foreign stock exchanges, and many do. Indeed, over the past two years, U.S. retail investment abroad has surged dramatically, mostly as a result of investors seeking higher overseas returns made possible by the devaluation of the U.S. dollar. However, the process can be cumbersome and comparatively expensive.

Id.

ties fraud.¹⁴¹ Investors also have the added costs of determining what restrictions are placed upon the resale of any securities that they purchase.¹⁴² Finally, the current system of regulatory competition places an added financial burden on regulators who must engage in transnational monitoring of fraud, which is made more difficult by the current system of regulatory fragmentation.¹⁴³ A harmonization and centralization approach to international securities law eliminates or reduces all of these costs by creating a standardized, cohesive system of regulation that does not vary from nation to nation (i.e., market participants must comply with only one standard).

Transitioning to a harmonization and centralization approach to international securities regulation also increases market efficiency by removing barriers to the free flow of capital. As previously explained, capital markets have become global.¹⁴⁴ This does not mean, however, that these capital markets are seamless and that capital can flow freely and efficiently throughout the world.¹⁴⁵ The world saw the birth of the first transnational stock exchange with the completion of the merger between the New York Stock Exchange and Euronext on April 4, 2007,¹⁴⁶ and this merger has created a push for stock exchange consolidation throughout the world.¹⁴⁷ Securities regulation, however, remains set at a national or regional level, creating barriers

¹⁴¹ See Jackson, *supra* note 33, at 111 (“Aside from technical barriers, U.S. retail investors face serious problems receiving information about foreign investment opportunities. Most notably, foreign broker-dealers are prohibited from soliciting most U.S. retail investors unless those firms comply with SEC registration and compliance requirements.”).

¹⁴² See generally Kenneth B. Davis, Jr., *The SEC and Foreign Companies—A Balance of Competing Interest*, 71 U. PITT. L. REV. 457 (2010) (discussing the rules placed upon foreign companies wishing to raise capital in the United States, including restrictions that are placed upon investors who purchase and want to resell their securities).

¹⁴³ See Greene, *supra* note 36, at 86 (“The SEC must find a way to work with its counterparts outside the United States to eliminate barriers to cross-border investment. . . . The current U.S. regulatory scheme makes cross-border investment costly and inefficient.”).

¹⁴⁴ See *supra* Part II.A (analyzing the transition from national or regional capital markets to global capital markets).

¹⁴⁵ See Greene, *supra* note 36, at 97 (“The SEC must acknowledge that the securities markets have evolved beyond jurisdictional borders and that its current regulatory regime has resulted in barriers to competition and placed roadblocks in the way of investor access to cross-border investment opportunities that have contributed to increased costs and market inefficiencies.”).

¹⁴⁶ See *supra* note 45 and accompanying text (discussing the merger between the New York Stock Exchange and Euronext).

¹⁴⁷ See *supra* notes 44–46 (discussing the push for stock exchange consolidation throughout the world that was touched off by the New York Stock Exchange and Euronext merger).

to the seamless operation of these newly emerging transnational exchanges.¹⁴⁸ In the absence of harmonization and centralization of international securities regulation, the emerging global securities markets will operate less efficiently because of the barriers created by having to comply with fragmented national securities regulation.¹⁴⁹

Transitioning to a harmonization and centralization approach to international securities regulation also increases market efficiency because it increases investor confidence, which yields both market participation and market stability. One of the key requirements for creating an efficient market for securities is having a large number of market participants.¹⁵⁰ Investor confidence is important because investors will not invest in a market, or hold the securities that they do purchase for a long period of time, if they believe that they have inadequate information or that they are going to be the victim of fraud.¹⁵¹ The current system of international securities regulation engenders such negative beliefs because regulatory competition makes

¹⁴⁸ See Pan, *supra* note 39, at 137 (“The utmost economic benefits of the [New York Stock Exchange and Euronext] merger will be realized only if the exchanges are able to consolidate trading into one platform with a single order book, thereby achieving economies of scale and maximizing liquidity.”).

¹⁴⁹ See Susanne Kalss, *Recent Development in Liability for Nondisclosure of Capital Market Information*, 27 INT’L REV. L. & ECON. 70, 76 (2007) (“The benefit of centralising fragmented supervisory powers for the securities markets lie in improving cost efficiency for the benefit of the supervised institutions as well as for consumers of financial services.”); Tafara & Peterson, *supra* note 98, at 32 (“Our markets are now interconnected and viewing them in isolation—as we have for so long—is no longer the best approach to protecting our investors, promoting an efficient and transparent U.S. market, or facilitating capital formation for U.S. issuers.”).

¹⁵⁰ See Tafara & Peterson, *supra* note 98, at 46 (“An efficient capital market also requires a degree of egalitarianism and blindness to national origin. *Ceteris paribus*, the larger the pool of investors bidding on a company’s securities, the more efficiently the price of those securities will be set and the more liquid the market for them will be.”).

¹⁵¹ See Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781, 783 (2001) (“[T]here are two essential prerequisites for strong public securities markets. A country’s laws and related institutions must give minority shareholders: (1) good information about the value of a company’s business; and (2) confidence that the company’s insiders (its managers and controlling shareholders) won’t cheat investors out of most or all of the value of their investment through ‘self-dealing’ transactions (transactions between a company and its insiders or another firm that the insiders control) or even outright theft.”); see also Troy A. Paredes, *On the Decision to Regulate Hedge Funds: The SEC’s Regulatory Philosophy, Style, and Mission*, 2006 U. ILL. L. REV. 975, 999 (2006) (“The logic of federal securities regulation . . . is that the mandatory disclosure regime of the federal securities laws shores up investor confidence and the integrity of securities markets by redressing information asymmetries and targeting fraud. Mandatory disclosure and federal antifraud provisions, in the conventional view, encourage investors to invest, leading to more efficient and more highly valued securities markets.”).

information gathering more difficult,¹⁵² creates a fragmented system of regulation that is difficult to understand,¹⁵³ and suggests that regulators are going to ratchet down their systems of regulation to attract issuers.¹⁵⁴ A harmonization and centralization approach to international securities regulation increases investor confidence by making information gathering easier, creating a simpler system of regulation, and preventing regulators from ratcheting down their systems of regulation to attract issuers because such an approach creates a single, uniform system regulation on a global basis.

C. *Harmonization and Centralization of International Securities Law Pool the Expertise and Experience of the World's Securities Regulators*

A regulatory competition approach to international securities law creates tension among regulators to attract issuers, investors, and other market participants to their particular nation or region.¹⁵⁵ Although most nations have shown a willingness to participate in international organizations that encourage coordination and cooperation among securities regulators (e.g., IOSCO),¹⁵⁶ a regulatory competition approach to international securities law necessarily creates some reluctance to share technical information.¹⁵⁷ Even if a nation engages in a robust exchange of technical information, this does not guaran-

¹⁵² See *supra* note 141 and accompanying text (explaining that the current patchwork of national securities regulation makes information gathering in emerging global capital markets more difficult).

¹⁵³ See Karmel, *supra* note 30, at 39 (“In globalized capital markets, many violations of securities laws are transnational. This means that unless national laws are given extraterritorial effect, there will be inadequate law enforcement, but if laws are applied extraterritorially, there will be conflict between regulators and confusion on the part of regulated persons as to what are the proper rules.”).

¹⁵⁴ See Pan, *supra* note 37, at 235 (noting the concern “that any difference in regulatory standards between the United States and the foreign jurisdiction will give rise to regulatory arbitrage. Less rigorous foreign regulation will favor foreign exchanges and broker-dealers over U.S. exchanges and broker-dealers and encourage U.S. market participants to establish operations abroad to take advantage of the regulatory differences.”).

¹⁵⁵ See *supra* notes 80–85 and accompanying text (defining and discussing a regulatory competition approach to international securities law).

¹⁵⁶ See *supra* notes 113–19 (providing an overview of IOSCO and its activities).

¹⁵⁷ See Lawrence A. Cunningham & David Zaring, *The Three or Four Approaches to Financial Regulation: A Cautionary Analysis Against Exuberance in Crisis Response*, 78 GEO. WASH. L. REV. 39, 107 (2009) (“There is ongoing and increasing regulatory competition among national securities regulators, operating in part and indirectly through their stock exchanges. That competition is mediated, but only slightly, by efforts to harmonize regulation that the International Organization of Securities Commissions and entities like it have made.”).

tee that the rest of the world will pay attention. For example, the United States engages in vigorous efforts to share its expertise and experience through its Technical Assistance Program,¹⁵⁸ and a race-to-the-bottom has still emerged because the United States has become less able to fuel regulatory convergence in terms of international securities regulation.¹⁵⁹ Harmonization and centralization of international securities law is beneficial because it pools the expertise and experience of the world's securities regulators. Although a centralized global securities regulator would have to be structured in such a way to allow for the effective pooling of technical information, a harmonization and centralization approach offers the best opportunity for sharing the expertise and experience of the United States, the European Union, and the rest of the world.

Although the dominance of the United States is waning in terms of its capital markets and its role as a securities regulator,¹⁶⁰ the United States has a wealth of expertise and experience to offer the rest of the world. The United States entered the twentieth century with a privatized system of securities regulation under which securities exchanges determined the rules governing issuers, investors, and market participants.¹⁶¹ When this approach proved ineffective to prevent fraud, states began adopting securities statutes, which are commonly referred to as "blue sky laws."¹⁶² This model of regulatory competition persisted throughout the 1910s and 1920s until the patchwork of regulation created by the blue sky laws proved ineffective to prevent

¹⁵⁸ Securities and Exchange Commission's International Technical Assistance Program, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/about/offices/oia/oia_emergtech.shtml (last visited July 8, 2010) (providing an overview of the SEC's Technical Assistance Program, which "provides training to nearly 2000 regulatory and law enforcement officials from over 100 countries").

¹⁵⁹ See *supra* notes 36–37 and accompanying text (explaining that the role of the United States as a security regulator and its ability to serve as a coordinating force in international securities law has been waning).

¹⁶⁰ See *supra* notes 36–37 and accompanying text (explaining that the dominance of the United States in terms of its capital markets and role as a securities regulator is waning as global capital markets have begun to emerge).

¹⁶¹ See *supra* note 78 and accompanying text (reporting that prior to the adoption of state codes of securities regulation in the 1910s and the 1920s, the United States employed a privatized system of securities regulation in which the securities exchanges were the primary sources of regulation of market participants).

¹⁶² See THOMAS LEE HAZEN, *THE LAW OF SECURITIES REGULATION* 18–19 (6th ed. 2009) (providing an overview of the adoption of state codes of securities regulation in the 1910s and 1920s in the United States).

the stock market crash of 1929 and the Great Depression.¹⁶³ With the enactment of the Securities Act of 1933¹⁶⁴ and the Securities Exchange Act of 1934,¹⁶⁵ the United States adopted a centralized approach to domestic securities law. Section 4(a) of the 1934 Act created the SEC to serve as a centralized regulatory body within this new regulatory system.¹⁶⁶ As a result of this centralized approach, the securities markets in the United States remained relatively stable until a patchwork of regulation created a race-to-the-bottom on the international level.¹⁶⁷ Based on this history, the United States has a wealth of information to offer to the rest of the world, including expertise and experience regarding transitioning between regulatory models and maintaining relatively stable securities markets under a regulatory centralization model.

Under a harmonization and centralization approach to international securities law, the European Union also can offer a wealth of technical information to the world. Europe spent most of the twen-

¹⁶³ See *id.* at 18 (“Following the enactment of the early state securities laws, federal legislation was successfully resisted for a while. However, the stock market crash of 1929 is properly described as the straw that broke the camel’s back. The era that followed ushered in federal securities regulation.”); see also Eric C. Chaffee, *Standing Under Section 10(b) and Rule 10b-5: The Continued Validity of the Forced Seller Exception to the Purchaser-Seller Requirement*, 11 U. PA. J. BUS. L. 843, 851 (2009) (reporting that the “inconsistent patchwork of securities regulation” created by the blue sky laws had been “largely ineffective in preventing fraud”).

¹⁶⁴ Securities Act of 1933, 15 U.S.C. §§ 77a–77aa (2006).

¹⁶⁵ Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78nn (2006).

¹⁶⁶ *Id.* § 78d(a) (providing for the establishment of the United States Securities and Exchange Commission).

¹⁶⁷ See John M. Fedders, *Policing Trans-Border Fraud in the United States Securities Markets: The “Waiver by Conduct” Concept—A Possible Alternative or a Starting Point for Discussions?*, 11 BROOK. J. INT’L L. 477, 504–05 n.50 (1985).

[P]articipation in the United States securities markets from a foreign country is a direct and intentional act to take advantage of the speed, fairness, stability, and liquidity of the American markets. . . . The effort to preserve the American securities markets springs from a genuine concern for the regulation and integrity of a finite and specific marketplace.

Id.; see also Eric C. Chaffee, *Beyond Blue Chip: Issuer Standing to Seek Injunctive Relief Under Section 10(b) and Rule 10b-5 Without the Purchase or Sale of Security*, 36 SETON HALL L. REV. 1135, 1139 (2006) (explaining that Congress enacted the Securities Act and the Exchange Act in part to provide for the stability of the national capital markets and to prevent “national emergencies created by unreasonable fluctuations in security prices”); James D. Cox, *Choice of Law Rules for International Securities Transactions?*, 66 U. CIN. L. REV. 1179, 1187 (1998) (“The U.S. securities laws were enacted in the aftermath of the Great Depression and their history and content were much influenced by our experience and faith that fair and orderly markets are a cornerstone for not just economic stability, but social stability.”).

tieth century with a number of discrete national securities markets.¹⁶⁸ In 1957, the Treaty Establishing the European Community (“EC Treaty”) helped form the European Communities, which is the predecessor to the European Union.¹⁶⁹ One of the stated goals of the EC Treaty was the development of common capital markets.¹⁷⁰ During the following decades, the European Union adopted various directives that required its member nations to harmonize their securities laws.¹⁷¹ In June 2001, the European Commission opted to create the Committee of European Securities Regulators (“CESR”) to oversee the securities markets in the European Union.¹⁷² As a result of the financial crisis that began in 2008, a proposal has been made to replace CESR with the European Securities and Markets Authority, an entity with more robust monitoring, regulatory, and enforcement powers.¹⁷³ Because of this history, the European Union has a variety of expertise and experience to offer the world, which includes insights on the process of transitioning to a harmonized and centralized regulatory model, the use of directives to harmonize national securities laws, and the need for a centralized securities regulator.

Finally, the creation of a harmonized and centralized system of international securities law would allow for the pooling and sharing of the expertise and experience of those regulating the emerging global capital markets. Strong markets have begun to develop in

¹⁶⁸ See Langevoort, *supra* note 47, at 194.

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. . . . 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.

Id.

¹⁶⁹ Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11.

¹⁷⁰ *Id.* at art. 3(c) (providing that one of the goals of ratifying the EC Treaty was “the abolition, as between Member States, of the obstacles to the free movement of persons, services, and capital”).

¹⁷¹ See Karmel, *supra* note 30, at 14 (“The mechanism chosen for integration of the financial markets [in the European Union] was a series of directives to harmonize essential standards throughout the EU and to enable financial regulators to practice home country control, but oblige them to honor principles of mutual recognition.”).

¹⁷² Commission Decision 2001/527, 2001 O.J. (L 191) 43 (EC) (approving the creation of the Committee of European Securities Regulators to oversee the capital market created by the member states of the European Union).

¹⁷³ *Proposal for a Regulation of the European Parliament and of the Council Establishing a European Securities and Markets Authority*, COM (2009) 503 final (Sept. 23, 2009).

Asia, Europe, and South America.¹⁷⁴ The experiences of regulators in these emerging markets are as important to understand as the experiences of regulators in the United States and European Union. Capital markets have become global.¹⁷⁵ The components of these global capital markets, however, continue to develop. Understanding the experiences of recently developed national securities markets gives insight as to how the global capital markets will develop in the future.

IV. THE ARGUMENT AGAINST THE HARMONIZATION AND CENTRALIZATION OF INTERNATIONAL SECURITIES LAW

Although a strong case exists for the harmonization and centralization of international securities law, critics have posited a number of arguments against harmonization and centralization. These arguments against harmonization and centralization are usually based on claims that such an approach to international securities law prevents the benefits of regulatory competition, is impossible to implement, and results in an unwanted loss of autonomy for the United States. Although each of these arguments has some validity, the case for harmonization and centralization outweighs all of the arguments against it.

Many opponents of a model of international securities law based on harmonization and centralization argue that such an approach prevents the benefits of regulatory competition.¹⁷⁶ These opponents claim that such an approach to international securities law creates a suboptimal regulatory regime because a harmonization and centralization approach hinders regulatory innovation and prevents a race-to-the-top as national regulators compete to attract issuers, investors, and other market participants.¹⁷⁷

For a variety of reasons, the benefits of regulatory competition are offset by its harms. First, even if regulatory competition encour-

¹⁷⁴ See *supra* notes 47–49 and accompanying text (reporting that capital markets in Asia, Europe, and South America have grown in both size and sophistication, including the development of strong markets in Brazil, Russia, India, and China, which are commonly referred to as the “BRIC” nations).

¹⁷⁵ See *supra* Part II.A (explaining that capital markets are transitioning from being national or regional in nature to being global).

¹⁷⁶ See generally Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 THEORETICAL INQUIRIES IN LAW 387 (2001) (arguing that regulatory competition is desirable over a uniform international regulatory scheme); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998) (arguing for “competitive federalism” as a system of securities regulation).

¹⁷⁷ See *supra* note 85 (suggesting that regulatory competition results in innovation because regulators must compete to attract market participants).

rages innovation that fuels market efficiency in the emerging global capital markets, the regulatory fragmentation that results adds transaction costs that likely offset any benefits of that innovation.¹⁷⁸ Second, arguments in favor of regulatory competition ignore that issuers serve as a check on over regulation because of the ability of corporations and other business entities to influence the political process.¹⁷⁹ Therefore, the tensions that exist under a regulatory competition model may not be necessary to create an optimal regulatory regime because issuers are able to create the necessary tension. Third, regulatory harmonization and centralization do not necessarily prevent regulatory competition if the centralized regulator creates a floor from which regulators can choose to upwardly depart, if they desire.¹⁸⁰ Fourth, as the Great Depression and Great Recession evidence, regulatory competition and the patchwork of regulation that it generates produce a suboptimal level of regulation.¹⁸¹

Another common argument against the harmonization and centralization of international securities law is that such an approach is impossible to implement. This argument is usually founded on claims that securities regulators are unwilling to cede power¹⁸² and that the theories of securities regulation vary too greatly throughout the world to allow for harmonization and centralization.¹⁸³

¹⁷⁸ See *supra* notes 138–143 and accompanying text (discussing the added transaction costs that are created by the current model of international securities law, which is based upon regulatory competition).

¹⁷⁹ See Black, *supra* note 70, at 77 (“[W]e need never worry about over-regulation; business interests have many well-funded and effective lobbyists, including the securities and accounting industries, small business, and the U.S. Chamber of Commerce, to make sure that this does not happen.”).

¹⁸⁰ See Jenah, *supra* note 30, at 77 (arguing that the “challenge [in international securities regulation] . . . is to strike the right balance between a healthy degree of regulatory competition and proverbial ‘race to the bottom.’”).

¹⁸¹ See *supra* notes 162–163 (arguing that the patchwork of regulation that existed in the United States prior to the stock market crash of 1929 and ensuing depression was ineffective in regulating the national capital markets in the United States); see also *supra* notes 10–12 and accompanying text (arguing that the financial downturn that began in 2008 resulted because the patchwork of national securities regulation that existed at the time was ineffective in regulating the emerging global capital markets).

¹⁸² See Pan, *supra* note 37, at 236 (“Foreign jurisdictions historically have expressed hostility to any extension of U.S. trading and liability standards to their markets, and the SEC has expressed skepticism about the standards of the most prominent foreign exchanges.”).

¹⁸³ See Langevoort, *supra* note 47, at 204.

[The system of securities regulation in the United States] has been built over the last seventy-five years largely to promote the interests of retail investors, and the political demand for regulatory responses after

Although a model of international securities law based on harmonization and centralization is likely unrealistic in the short-term,¹⁸⁴ such an approach makes sense in the long-term. In recent years, the world's securities markets have transitioned from being national or regional in nature to being global.¹⁸⁵ The implications of this transition are still being worked out, including issues of how to regulate the emerging global securities markets. Arguing that the world has to retain a system of securities regulation based on national or regional regulation ignores the fact that regulatory regimes ultimately can and should evolve in response to the subject matter that they regulate.

In addition, financial crises fuel evolution in securities regulation.¹⁸⁶ As evidenced by the financial crisis that began in 2008, patchwork regulation does not work to regulate the emerging global securities markets.¹⁸⁷ Even if the financial crisis does not fuel a leap toward harmonization and centralization, the crisis still created a push for greater coordination and cooperation among the world's securities regulators.¹⁸⁸ The development of harmonization and cen-

every financial 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.

Id.; see Madison & Greene, *supra* note 34, at 100 (“[A]s a result of both historical and cultural influences, other countries may still have differing standards for disclosure that are either less stringent or based on different assumptions than those found in the U.S. markets. For example, some foreign markets may have different cultural or legal views towards insider trading.”); Pan, *supra* note 39, at 137 (“The U.S. regulatory regime tightly controls how exchanges operate, who can conduct business on the exchanges and what are the responsibilities of exchanges to regulate market participants. Unique to the U.S. system, these regulations cannot easily be extended to non-U.S. exchanges.”).

¹⁸⁴ See *supra* note 120 (explaining that the creation of a centralized global securities regulator is likely impracticable in the short term).

¹⁸⁵ See *supra* Part II.A (discussing the reasons that capital markets have transitioned from being national or regional in nature to being global).

¹⁸⁶ See DeLaMater, *supra* note 33, at 119 (“History has shown that we go through periods of boom followed by bust, with the bust followed by increased regulation . . . regulators are persuaded to accommodate various practices and the economy and capital markets enter another period of boom. The cycle repeats.”); Tafara & Peterson, *supra* note 98, at 51 (“The history of financial legislation, from the Bubble Act of 1720 to the Sarbanes-Oxley Act of 2002, shows that it is usually the child of crisis.”).

¹⁸⁷ See Langevoort, *supra* note 47, at 205 (arguing that the financial crisis that began in 2008 is a “dramatic example” of the consequences of the “absence of collective action” in international securities regulation).

¹⁸⁸ See Karmel, *supra* note 37, at 1711 (“Current market turmoil caused by the subprime mortgage crisis and other events is . . . a dynamic which leads to regulatory reform. Open questions include what kind of reform will result from this collapse of

tralization in international securities law is likely going to have to be an evolutionary process that occurs over the course of decades through numerous successor entities with each having greater power until true harmonization and centralization is achieved.¹⁸⁹ Even if harmonization and centralization is not feasible in the short-term, securities regulators should still work toward it in the long-term because it affords the best solution to international securities law.¹⁹⁰

Lastly, some argue that a harmonization and centralization model would result in an unnecessary loss of autonomy for the United States.¹⁹¹ Obviously, this argument is commonly made by proponents of the continued dominance of the United States as a securities regulator. Such an argument, however, ignores the fact that the dominance of the United States is waning both in terms of its capital markets and its role as a securities regulator.¹⁹² Although the creation of a centralized global regulator would require that the United States cede some of its power, the United States has incentive to work quickly toward the creation of a global securities regulator because if it works quickly, it can work from a position of power, rather than simply being another actor in the process. The United States has to acknowledge that the world is changing, and the best result for the United States would be for it to work toward a harmonized and centralized system of securities regulation in which it maintains a significant or dominant role. The United States has more to risk by waiting to act because its dominance continues to fade.

confidence in the markets and whether the SEC or the EU will drive any reform agenda.”).

¹⁸⁹ See Langevoort, *supra* note 47, at 205 (“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.”).

¹⁹⁰ See *supra* Part III (explaining why a model based on harmonization and centralization offers the best approach to international securities law).

¹⁹¹ See also Chris Brummer, *How International Financial Law Works (and How It Doesn't)*, GEO. L.J. (forthcoming 2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1542829 (“The establishment of a global authority [in international securities regulation] would require countries to delegate authority to a supranational authority It is, however, unlikely that the legislatures of most countries would agree to such an infringement on their domestic powers of policymaking and governance, especially with regards to large domestic financial institutions and firms.”).

¹⁹² See *supra* notes 36–37 (explaining that the dominance of the United States continues to wane in terms of its capital markets and role as a securities regulator).

V. CONCLUSION

As explained in the introduction of this Article, the United States government has recognized that patchwork regulation will not work effectively to regulate the emerging global securities markets.¹⁹³ Yet, despite the promise of a new foundation for financial supervision and regulation,¹⁹⁴ the United States and the world's other securities regulators have left in place the cracked and fragmented foundation that was in place prior to the financial crisis that began in 2008.¹⁹⁵

Ideally, the world should adopt the same approach that the United States adopted in the wake of the stock market crash of 1929 and pursue a path of harmonization and centralization in international securities law.¹⁹⁶ Nations throughout the world should harmonize their systems of securities regulation to allow for the existence of a centralized global securities regulator, and then, the nations should work together to bring into existence such a regulator. The regulator should have robust monitoring, regulatory, and enforcement powers and should set a baseline of securities regulation from which nations could choose to upwardly depart, if they desire. Such a model based on harmonization and centralization would have a variety of benefits, including helping to stabilize the emerging global securities market,¹⁹⁷ assisting market participants,¹⁹⁸ and pooling the expertise and experience of the world's securities regulators.¹⁹⁹ Although such a

¹⁹³ See *supra* note 10 and accompanying text (reporting that “financial stress can spread easily and quickly across national boundaries”).

¹⁹⁴ See U.S. Dep’t of the Treasury, *supra* note 1 (describing the Obama Administration’s and the United States Department of Treasury’s promise to “build a new foundation for financial regulation and supervision”).

¹⁹⁵ See *supra* notes 15–18 and accompanying text (explaining that the United States government does not appear to be concentrating on meaningful change to international securities regulation).

¹⁹⁶ See *supra* notes 162–167 and accompanying text (describing the evolution of securities regulation in the United States and explaining that the United States adopted a harmonized and centralized system of federal securities regulation as a result of the stock market crash of 1929 and the Great Depression).

¹⁹⁷ See *supra* Part III.A (explaining that harmonization and centralization of international securities law helps to reduce systemic risk because it ends the race-to-the-bottom that is occurring in international securities regulation, provides a seamless system of regulation that prevents regulatory and enforcement gaps, and reduces spillover risks from regional or national financial crises).

¹⁹⁸ See *supra* Part III.B (arguing that harmonization and centralization of international securities law will increase the efficiency of the emerging global capital markets by reducing transaction costs, removing barriers to efficiency, and increasing investor confidence).

¹⁹⁹ See *supra* Part III.C (arguing that harmonization and centralization of international securities law will be beneficial because it will pool the expertise and experience of the world's securities regulators).

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model does have some drawbacks, these drawbacks are far outweighed by the benefits that harmonization and centralization afford.

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A slow evolutionary process will be required to allow a harmonized and centralized system of international securities regulation to emerge because nations remain unwilling to shed their nationalistic and protectionist tendencies relating to securities regulation. With that said, global capital markets have emerged, and a model of international securities regulation based on harmonization and centralization is the best mechanism to regulate it.

²⁰⁰ See *supra* Part IV (explaining and rebutting a variety of arguments against harmonization and centralization, including that harmonization and centralization do not yield the same benefits as regulatory competition, cannot be implemented in the current international regulatory environment, and would result in a loss of autonomy for the United States).