

Resolving regulatory conflicts between the capital markets of the United States and Europe

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Key points

- Despite the global nature of today's capital markets, regulatory conflicts still impede cross-border activity between the largest capital markets in the world—the US and the EU. Now is an opportune time for the US and the EU to work towards more integrated transatlantic capital markets. In order to achieve this integration, efforts should be directed at resolving conflicts through mutual recognition as opposed to harmonization wherever possible.
- This article begins by reviewing the existing differences in approach to capital markets regulation in the EU and the United States. It then summarizes the recent progress in resolving conflicts between them, including a description of the effects of portions of the Financial Services Action Plan.
- The progress on resolving conflicts to date has been done on an ad hoc basis and the results have not been uniform. With respect to accounting standards there has been sufficient progress that mutual recognition should be achievable in the next few years. In the areas of audit and auditor standards, non-financial disclosure in connection with securities offerings, the regulation of securities intermediaries and exchanges and the technical exceptions to market manipulation prohibitions for offering-related activity, significant progress to date should be followed with additional efforts to achieve mutual recognition. There are a number of areas where the EU and the US do not seem to be converging but where increased cooperation between regulators would be efficacious.
- The EU and the United States should create an agenda composed of several achievable steps and implement it in order to integrate further transatlantic securities markets. This article concludes by suggesting the topics for the US–EU agenda.

1. Introduction

While the capital markets have become truly global, the United States and Europe still have the most developed markets in the world. They are also the most regulated. Until relatively recently, however, little had been done to resolve the multitude of conflicts between the securities regulations that artificially separate these two markets. With the recent attention to the declining competitiveness of the US capital markets in attracting foreign issuers,¹

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1 Eg Remarks of Treasury Secretary Henry M. Paulson on the Competitiveness of the US Capital Markets at the Economic Club of New York (20 November 2006); Interim Report Of The Committee On Capital Markets Regulation (30 November 2006) [hereinafter, Committee on Capital Markets Regulation Interim Report] available at <http://www.capmktreg.org/research.html>. In addition, the US Chamber of Commerce has created a Commission on Regulation of Financial Services in the 21st Century and officials in New York have released a report on this issue and its impact on New York, Sustaining New York's and the US' Global Financial Services Leadership (available at http://schumer.senate.gov/SchumerWebsite/pressroom/special_reports/2007/NY_REPORT%20_FINAL.pdf).

now is the time to resolve these conflicts and work towards a truly transatlantic market for securities.

The potential benefits of resolving these conflicts and integrating these markets are significant. Investor interest in foreign securities is large and growing.² Investors' portfolios, however, both in the United States and Europe continue to lack optimal diversification and remain overweighted in securities of domestic issuers.³ If the US and EU securities markets were fully integrated, substantial expenditures (such as the costs of accounting reconciliations, and preparing multiple prospectuses and periodic disclosure reports) would be reduced or eliminated, lowering the overall cost of raising capital. Moreover, it has been estimated that by combining the greater automation found in European trading systems with the greater efficiency of US intermediaries, it may be possible to decrease the cost of trading in a fully unified transatlantic securities market by 60 per cent, which could reduce the overall cost of capital by up to 9 per cent.⁴

There are two broad approaches to resolving international regulatory conflicts and achieving convergence. One approach is harmonization, which seeks to achieve substantial similarity in multiple regulatory systems so that market participants face no additional burden in pursuing cross-border activities. Another approach involves a determination by a regulator that another jurisdiction's regulatory regime is sufficient to regulate market participants from that jurisdiction without the imposition of additional regulation by the host country regulator to protect its investors. Recognition of the regulatory equivalence of another jurisdiction's regulatory regime can be either unilateral or mutual, if reciprocity is granted by the other jurisdiction. Wherever possible, approaches based on mutual recognition should be pursued as the more practical means to maximize efficiency and remove unnecessarily duplicative regulations. This article proposes several areas where the EU and the US should seek to implement mutual recognition. Mutual recognition is controversial because jurisdictions differ in regulatory approach and effectiveness. It also involves making distinctions that can generate controversy. But it holds more promise than waiting for harmonization, which is a long way away.

This article begins by reviewing the existing differences in approach to capital markets regulation in the EU and the US. It then summarizes the recent progress in resolving conflicts between them. Finally, it proposes several steps to integrate further transatlantic securities markets including the creation of a formal convergence agenda

2 Eg *Appetite for Foreign Equities Breaks Records*, Fin. Times at 1 11 October 2006. Even excluding mutual fund holdings, the total holdings of US equity securities by non-US investors has increased from approximately \$550 billion in 1995 to approximately \$2.3 trillion 2005; in the same period, the total holdings of non-US equity securities (including ADRs) by US-investors increased from approximately \$790 billion to approximately \$3.0 trillion. See Board of Governors of the Federal Reserve, *Flow of Funds Accounts of the United States, Annual Flows and Outstandings: 1995–2005*, 82 tbl. L.213 (7 December 2006) available at <http://www.federalreserve.gov/releases/z1/Current/annuals/a1995-2005.pdf>.

3 Eg Catherine L. Mann and Ellen E. Meade 'Home Bias, Transaction Costs and Prospects for the Euro: A More Detailed Analysis', Institute for International Economics Working Paper 02-3, available at www.iie.com/publications/wp/02-3.pdf (finding that transaction costs have a significant influence on US portfolio holdings).

4 Benn Steil, *Building a TransAtlantic Securities Market* 29 (International Securities Market Association and Council on Foreign Relations 2002); see also *TransAtlantic Business Dialogue, Special Report Prepared in Advance of the EU-US Summit TransAtlantic Trade and Investment: Growth, Jobs and Innovation*, 8–10 (June 2006) (quantifying potential benefits of a barrier-free transatlantic capital market).

between the EU and the US and suggests certain topics for an agenda for discussions between the appropriate regulators.

2. US and EU regulatory models

United States regulatory model

The regulatory model in the United States, particularly the model used by the primary securities regulator of the US capital markets, the Securities and Exchange Commission (SEC), is one of national treatment; that is, in the interests of protecting US investors, the SEC generally applies a uniform standard to every market participant.⁵ The Sarbanes-Oxley Act is a classic example of national treatment, even though the SEC did eventually grant some minor concessions to foreign private issuers after vigorous protest by foreign issuers subject to regulation in the US.⁶

The SEC has granted limited concessions to foreign private issuers in other situations as well. For example, foreign companies are, as a general matter, exempt from the US proxy rules,⁷ requirements regarding quarterly reporting,⁸ reporting requirements regarding transactions by statutory insiders pursuant to Section 16 of the Exchange Act,⁹ and requirements regarding disclosure of the compensation of individual officers and directors.¹⁰ In addition, these issuers are permitted to report in the United States using financial statements prepared in accordance with local accounting standards instead of the US Generally Accepted Accounting Principles ('GAAP').¹¹ This last concession, however, is of limited value to foreign private issuers because the local financial

5 For example, the definitions of 'issuer' under both § 2(a)(4) of the Securities Act of 1933, as amended (the 'Securities Act') and s 3(a)(8) the Securities Exchange Act of 1934, as amended (the 'Exchange Act') generally include any person who issues or proposes to issue any security and neither refer to the jurisdiction of organization of such person. See Securities Act § 2(a)(4), 15 U.S.C. § 77b(a)(4); Exchange Act § 3(a)(8), 15 U.S.C. § 78c(a)(8). The term national treatment originated in the context of trade negotiations, where countries generally seek to have their exports treated the same as the products made in the importing country. For further discussion of the national treatment approach in US securities regulation, see Edward F. Greene *et al.*, *The Future for the Global Securities Market: Legal and Regulatory Aspects* (Fidelis Oditah, ed., Oxford University Press 1996).

6 A foreign private issuer is generally a foreign issuer other than a government as long as the majority of its outstanding voting securities are not held directly or indirectly of record by residents of the USA and the issuer meets at least one of certain additional criteria. Rule 3b-4 under the Exchange Act. A foreign private issuer can become subject to the periodic reporting requirements of the Exchange Act both by issuing securities directly into the USA and, unless otherwise exempt, by issuing securities in respect of which ADRs are issued. Concessions to foreign private issuers under the Sarbanes-Oxley Act include an exemption, in certain circumstances, from the requirements of Reg G, 17 C.F.R. §§ 244.100–244.102, regarding disclosure of Non-GAAP Financial Measures. These issuers were also given additional time to meet: (i) the requirements for management certification of periodic reports promulgated under § 302 of the Sarbanes Oxley Act, 15 U.S.C. § 7242; (ii) the requirements for attestations regarding internal controls and procedures under § 404 of the Sarbanes Oxley Act, 15 U.S.C. § 7262; and (iii) the requirements regarding an independent Audit Committee set out in Rule 10A-3 under the Exchange Act, 17 C.F.R. § 240.10A-3.

7 Rule 3a12-3(b) under the Exchange Act, 17 C.F.R. § 240.3a12-3(b). Foreign private issuers with securities listed on a national securities exchange thereby become subject to certain proxy requirements. For example, pursuant to r 402.04 of the NYSE Listed Company Manual, actively operating companies are required to solicit proxies for all meetings of shareholders, although an exception may be made where applicable law precludes or makes virtually impossible the solicitation of proxies in the USA.

8 Rule 13a-10(g) under the Exchange Act, 17 C.F.R. § 240.13a-10(g).

9 Rule 3a12-3(b) under the Exchange Act, 17 C.F.R. § 240.3a12-3(b). Foreign insiders of US issuers, however, are not exempt, so that shareholders, including foreign corporations, are subject to s 16, 15 U.S.C. § 78p, with respect to the applicable equity securities of US issuers that they own.

10 Form 20-F Item 6.B.1 under the Exchange Act, 17 C.F.R. § 249.220f available at <http://www.sec.gov/about/forms/form20-f.pdf>.

11 Ibid Item 17.C.

statements must be audited under US auditing standards, by auditors satisfying US independence standards and, most importantly, must be reconciled to US GAAP.¹²

The SEC has explored other approaches. Almost 20 years ago, it considered the approach of equivalence and unilateral recognition in its concept release proposing Rule 15a-6 (the '15a-6 Concept Release').¹³ The 15a-6 Concept Release drew substantial objections from market participants, who complained that foreign broker-dealers would have a competitive advantage (particularly because foreign affiliates of US broker-dealers were excluded and would thus continue to be subject to dual regulation by home and host country) and that evaluation of alternative regulatory regimes would be subjective, and therefore raise sensitive political issues. As a result, the SEC did not pursue this approach.

Equivalence has, however, been adopted in other areas of the US market. In contrast to the SEC, the Commodity Futures Trading Commission ('CFTC') adopted an equivalence-based approach for regulating foreign futures commission merchants and commodities trading advisors with its Part 30 rules.¹⁴ Under these rules, the CFTC may exempt a non-US intermediary from CFTC regulations based upon the intermediary's compliance with comparable requirements imposed by its own regulator.¹⁵ The non-US regulator must make an initial application to the CFTC; thereafter the CFTC undertakes a comparative regulatory examination to determine if the local regulation is comparable, or broadly equivalent, to the CFTC regulations imposed on US firms. Significant regulatory differences, if any, are addressed in the final order issued by the CFTC, which may impose conditions on its approval. After the non-US intermediary receives approval from its foreign regulator, that intermediary can file a short form application with the National Futures Association, the body to which the CFTC has delegated the authority to verify the fitness of, and representations made by, firms applying for such relief and to confirm the availability of that relief. This exemption permits the intermediary to serve US clients without meeting the CFTC's registration requirements for US firms. Beginning in 1988, the CFTC has granted exemptions of this nature for futures commission merchants designated by regulatory and self-regulatory authorities in Australia, Singapore, Canada, the United Kingdom, France, Japan, Spain, New Zealand,

12 In addition to these concessions, there is an exemption from the normal US periodic disclosure requirements providing relief for foreign issuers not listed in the US that would otherwise be subject periodic reporting in the US because of the number of holders of its securities in the US. With certain exceptions, Rule 12g3-2(b) under the Exchange Act provides that a foreign private issuer, no class of securities of which is held by 300 or more holders resident in the US, is exempt from § 12(g) of the Exchange Act if the issuer furnishes to the SEC its home country disclosure and meets certain other requirements.

13 Recognition of Foreign Broker-Dealer Regulation, SEC Release No. 34-27018, 43 SEC Docket 2110 (18 July 1989). For a detailed discussion of Rule 15a-6 and its shortfalls, see generally John Ramsay, *Rule 15a-6 and the International Marketplace: Time for a New Idea*, 33 Law & Pol'y Int'l Bus. 507 (2002).

14 Part 30 of the CFTC Regulations, 17 C.F.R. pt 30, App. A.

15 Appendix A to pt 30 of the CFTC Regulations, 17 C.F.R. pt 30, App. A, sets forth the minimum elements of a comparable regulatory programme: (i) registration, authorization or other form of licensing, fitness review or qualification of persons through which customer orders are solicited and accepted; (ii) minimum financial requirements for those persons that accept customer funds; (iii) protection of customer funds from misapplication; (iv) recordkeeping and reporting requirements; (v) minimum sales practice standards, including disclosure of the risks of futures and options transactions and, in particular, the risk of transactions undertaken outside the jurisdiction of domestic law; and (vi) compliance.

Germany and Brazil.¹⁶ With respect to its regulation of non-US exchanges, the CFTC recently issued a policy statement affirming its use of a no-action process to permit non-US exchanges to have direct access to US investors without registering with the CFTC based on a similar recognition approach.¹⁷ In short, the CFTC provides a useful precedent that could be followed by the SEC, in which it examines the foreign regulatory structure on a case-by-case basis and permits foreign market participants to access US investors if their home country regulatory structure is sufficient to protect US investors.¹⁸

It could be maintained that the CFTC faced fewer obstacles in adopting the approach of equivalence than did the SEC because the CFTC's regulatory regime is more limited both in subject matter and in breadth than the SEC's, and because investors in the markets regulated by the CFTC are generally more sophisticated investors. Nevertheless, the CFTC's adoption of equivalence in this area has taken place without significant controversy,¹⁹ and should serve as a model for SEC reconsideration of this approach (as discussed in more detail later in this article).

European Union regulatory model

The EU has made substantial progress towards achieving convergence among its Member States with respect to its internal regulation of capital markets through implementation of the Financial Services Action Plan ('FSAP').²⁰ Moreover, while its regulatory model has retained some elements of national treatment for non-European market participants, it has adopted the concept of unilateral recognition in certain limited areas. For example, as discussed further, pursuant to FSAP legislation the EU will allow non-EU issuers to use their own disclosure and accounting standards if the European Commission ('EC') or an individual Member State determines that the issuer's home country standards are equivalent to those mandated by the EU.²¹ Still, the effect of the FSAP improvements

16 Commodities Futures Trading Commission, Regulatory and Self-Regulatory Authorities That Have Received Exemptions Under CFTC Rule 30.10 (1 March 2006) available at <http://cftc.gov/opa/backgroundunder/opap30bkoia.htm>.

17 17 C.F.R. pt 140, 71 Fed. Reg. 64443 (2 November 2006).

18 Another regulator in the USA that has adopted a mutual recognition approach is the US Board of Governors of the Federal Reserve System in connection with its determination of whether a non-US bank is subject to 'comprehensive consolidated supervision' by a bank supervisor in that entity's home jurisdiction, See 12 C.F.R. § 211.24(c)(1)(ii) (2006).

19 See Technical Committee of IOSCO, *Regulation of Remote Cross-Border Financial Intermediaries*, p. 7 (February 2004).

20 The FSAP was a comprehensive initiative designed to create a single European market for wholesale financial services, open and secure retail markets and appropriate prudential rules and supervision, comprising many legislative measures, some of which will be discussed subsequently. See Commission of the European Communities, Commission Staff Working Document, *European Commission Single Market in Financial Services Progress Report 2004–2005*, 3, 3 n.1, SEC (2006) 17 (1 May 2006) available at http://ec.europa.eu/internal_market/finances/docs/progress-report/report2004-2005_en.pdf. According to a Commission Staff Working Document, 41 out of 42 (98%) of the directives proposed in the FSAP had been adopted at the European level between 1999, when the FSAP was first proposed, and 2005, the deadline established in the original FSAP proposal. *Ibid* The Directorate General for Internal Markets of the European Commission maintains a website that tracks the state of play of the transposition of European directives into Member State legislation and provides regular updates (http://ec.europa.eu/internal_market/finances/actionplan/index_en.htm).

21 Transparency Directive, Directive 2001/34/EC, Art. 23.1, 2001 O.J. (L184) 1, 15 (EC). Although beyond the scope of this article, another example of FSAP legislation which may permit unilateral recognition of the equivalence of foreign regulatory regimes is provided by the Financial Conglomerates Directive, Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002, Art. 18(1) of which requires certain Member State regulators to determine whether foreign financial conglomerates are subject to prudential supervision that is equivalent to the requirements of such directive.

on transatlantic convergence are tempered by the EU's multi-sovereign institutional context and the consequent difficulty in enacting appropriate legislation.

The FSAP has made securities regulation in Europe more uniform, but it has not to date resulted in complete uniformity of regulations, let alone uniformity of interpretation and application. EU legislation, which is enacted by co-decision of the European Parliament and the Council of the European Union, can take two forms: regulations, which have binding effect and are directly applicable in all Member States on their effective date and directives, which prior to their implementation deadline are binding only as to the result to be achieved, and require each Member State to enact responsive implementing legislation within a set timeframe. In the context of the FSAP, regulations have been used mostly to implement 'primary' legislative policy, such as that reflected in directives, into law. Only some of the FSAP has been enacted through regulations. If the EU were to act solely, or even primarily, through the passage of regulations, assuming it had the power to do so under the EU's current constitutional arrangements, it could achieve uniformity in its implementation of legislation, although there would still be differences in the interpretation and application. This would be a model closer to what is found in the United States.

One advance of the FSAP was streamlining the process for adopting EU-level legislation concerning the financial markets through the adoption of the procedural recommendations made in the Lamfalussy report,²² though the process is still far from simple. The Lamfalussy process involves four levels. Level 1 is broad-scope EU-level framework legislation. Level 1 legislation takes the form either of regulations or one of two types of directives, maximum harmonization directives, which preclude a Member State from imposing requirements additional to those contemplated by the directive or minimum harmonization directives, which require each Member State to enact minimum regulations, but allow Member States to impose additional, 'super-equivalent' requirements. Maximum harmonization directives preclude the practice of 'gold-plating', in which Member States impose additional requirements in implementing EU legislation, which was perceived as a drawback of previous measures. Level 2 involves the EC, with the prior approval of a committee of the EU Member State securities regulators, the European Securities Committee, and with advice from the Committee of European Securities Regulators ('CESR'), issuing detailed legislation implementing Level 1 legislation.²³ Level 3 involves the Member States regulators implementing the Level 1 and 2 measures in cooperation with CESR. Level 4 is EC enforcement if Member States do not properly implement the legislation.

22 Committee of Wise Men, *Final Report on the Regulation of European Securities Markets* (15 February 2001) (prepared by Alexandre Lamfalussy *et al.*) available at http://europa.eu.int/comm/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf.

23 CESR was established as part of the FSAP in 2001 and is principally responsible for improving coordination among securities regulators, ensuring more consistent national implementation of EU legislation, and for assisting the EC, in particular in its preparation of draft legislation. The possibility of streamlined decision-making by the EC in Level 2, without the necessity of co-decision from the European Parliament so long as the measures remain within the scope of authority granted in Level 1 legislation, was a major improvement.

Despite the adoption of the Lamfalussy process, the institutional framework of EU legislation, in which significant authority is retained by Member States, is still a relatively inflexible regime. For example, the annex to the Prospectus Regulation,²⁴ a Level 2 regulation adopted to implement the Prospectus Directive,²⁵ specifies detailed requirements for historical financials, generally requiring them for a period of three years preceding an offering. CESR considered making Level 3 recommendations that national authorities require supplemental information for entities that have undergone corporate transactions that make their historical financial statements unrepresentative. However, because the Prospectus Directive is a maximum harmonization measure, it was not clear that the national authorities had the authority to promulgate such requirements. Accordingly, this seemingly minor change will require legislative action in the form of an amendment by the EC to the Prospectus Regulation.²⁶

3. Recent progress on convergence

In recent years, the topic of convergence has received a lot of attention from a variety of perspectives.²⁷ Unfortunately, the exhortations have not resulted in uniform progress. While the transatlantic capital markets are clearly converging, progress towards regulatory convergence has varied in different areas. In order to prepare the groundwork for a suggested agenda to enhance regulatory convergence, this section examines capital markets regulations in the EU and the US in a number of areas, in decreasing order based on the level of convergence achieved to date. With respect to accounting standards there has been sufficient progress that mutual recognition should be achievable in the next few years. In the areas of audit and auditor standards, non-financial disclosure in connection with securities offerings, securities intermediary and exchange regulation and the technical exceptions to market manipulation prohibitions for offering-related activity, significant progress to date on harmonization should be followed with additional efforts to achieve mutual recognition. There are a number of areas where the EU and the US do not seem to be converging, such as, generally, the regulatory structure of securities offerings, insider-trading provisions and regulatory enforcement. Even though harmonization and mutual recognition may not be achievable in all of these areas, there are a number of more focused areas where progress could still be made. Finally, it is worth noting that confidence that the home country has a comparably robust and comprehensive regulatory environment may be just as important as harmonization of standards in gauging the prospects for mutual recognition between the United States and the various EU Member States in areas where securities regulators retain significant

24 Prospectus Regulation, Commission Regulation 809/2004, 2004 O.J. (L149) 1 (EC).

25 Prospectus Directive, Directive 2003/71/EC, 2003 O.J. (L345) 64 (EC).

26 Eg Committee of European Securities Regulators, *CESR's Advice to the European Commission on a Possible Amendment to Regulation (EC) 809/2004 Regarding the Historical Information Which Must be Included in a Prospectus*, CESR, (05-582), (October 2005). A draft of such an amendment has been proposed.

27 Eg, TransAtlantic Business Dialogue, Report and Recommendations to the 2006 EU-US Summit Leaders (April 2006); Joint Industry Report, below at n. 68; Statement by SEC Staff: A Securities Regulator Looks at Convergence, n 30 below; Building a Transatlantic Securities Market, at n 4 above.

discretion, such as the regulation of securities intermediaries and market abuse. Some portions of the FSAP certainly should bolster this confidence.

Accounting standards

Noteworthy progress towards an equivalence and mutual recognition-based standard has been made in accounting standards under US GAAP and the EU's International Financial Reporting Standards ('IFRS').²⁸ Equivalence is likely to be achieved first with respect to the accounting standards themselves; however, equivalence in auditing standards, auditor independence requirements and auditor qualification and registration requirements, discussed briefly in the following section, is also essential for IFRS to be accepted by the SEC in lieu of reconciliations to US GAAP.

The EU made significant progress towards uniform pan-European accounting standards in July 2002 by mandating an aggressive timetable for the adoption of IFRS by issuers with securities listed on regulated markets in the EU.²⁹ Most of these issuers were required to prepare financial reports in accordance with IFRS for fiscal years beginning on or after 1 January 2005. Mutual recognition became a realistic probability when it became clear that the SEC would only have to recognize one accounting standard for all of the EU (as opposed to one for each Member State).

The extent to which US and EU accounting standards are approaching equivalence was illustrated in an article in April of 2005 by the then-Chief Accountant of the SEC, Donald Nicolaisen, in which he set out a possible roadmap for the acceptance by the SEC of financial statements prepared under IFRS without reconciliation to US GAAP by 2009 or sooner.³⁰ Citing the progress embodied in the Norwalk Agreement and progress in harmonization, the roadmap illustrates a possible path toward SEC recognition of IFRS in the near future. An important first step is the SEC's review during the second half of 2006 of the US GAAP reconciliations of foreign private issuers that maintain accounts under IFRS, which is currently taking place.³¹ Additional steps include the further development of IFRS and its broad adoption. Current SEC Chairman Cox has also declared his commitment to this roadmap; the expectation is that a concordance will be reached as early as 2007 that will allow mutual recognition of IFRS by the SEC and

28 In October 2002, the Financial Accounting Standards Board [hereinafter FASB], the organization that establishes the financing reporting standards constituting US GAAP, and the International Accounting Standards Board [hereinafter IASB], the organization that establishes IFRS, published the so-called Norwalk Agreement, a memorandum of understanding in which the two standard-setting bodies agreed to devote resources to the project of convergence of US GAAP and IFRS. See Norwalk Agreement, Memorandum of Understanding, FASB-IASB, 18 September 2002, available at <http://fasb.org/news/memorandum.pdf>. Joint activities have continued, for instance, the February 2006 joint work project memorandum of understanding, which identifies specific joint projects to be completed by 2008. See A Roadmap for Convergence Between IFRS and US GAAP—2006-2008, Memorandum of Understanding, FASB-IASB, 27 February 2006, available at http://www.fasb.org/mou_02-27-06.pdf.

29 Regulation 1606/2002, 2002 O.J. (L243) 1 (EC) [hereinafter IAS Regulation].

30 Donald T. Nicolaisen, *Statement by SEC Staff: A Securities Regulator Looks at Convergence*, 25 Nw. J. Int'l L. & Bus. 661 (Spring 2005). The roadmap was approved in a meeting between then Chairman of the SEC William Donaldson and the European Commissioner for Internal Market and Services, Charlie McCreevy, on 22 April 2005.

31 According to the Director of the SEC's Division of Corporate Finance, John W. White, the SEC has reviewed the financial statements of 85 issuers that adopted IFRS in 2005 and first filed financial statements prepared in accordance with IFRS in 2006. See Remarks before the Practising Law Institute Sixth Annual Institute on Securities Regulation in Europe, 1/15/07 (available at <http://www.sec.gov/news/speech/2007/spch011507jww.htm>).

US GAAP by the EU Member State authorities.³² The guidance provided by this roadmap is one of the primary reasons for success that has been achieved in this area (as opposed to the rather ad hoc manner in which most other convergence efforts have taken place).

The EU is also eager to see this roadmap implemented and has in effect incentivized the SEC to recognize the equivalence of IFRS by retaining the possibility that US GAAP may not be equivalent to IFRS. This is significant because the IAS Regulation and other applicable EU standards generally require IFRS for all companies with securities admitted for trading in a regulated market in Europe except for issuers that provide financial statements prepared under an accounting system that is determined to be equivalent. In a report commissioned as part of the process of this determination, CESR found US, Canadian and Japanese GAAP to be equivalent to IFRS subject to the inclusion of certain ‘remedies’, which are additional descriptive or quantitative disclosures to facilitate investor understanding.³³ It is not yet clear whether these remedies would be less onerous than reconciliation. The EC Commissioner for Internal Market and Services, Charlie McCreevy, indicated in response to the CESR technical advice that for the time being, the status quo should continue until there has been sufficient convergence so that it is acceptable for issuers to use US GAAP or IFRS in either market without any qualification or reconciliation.³⁴ In December 2006, the EC extended the status quo for two years allowing US, Canadian and Japanese companies issuing securities in the EU to use their home-country GAAP until the end of 2009 without discussing the recommended remedies.³⁵

The limits on the EU’s flexibility concerning equivalence of accounting standards have implications that many non-EU issuers will need to consider. The only systems of accounting that have been identified by the EU as candidates for equivalence, even subject to remedies, are those of Japan, Canada and the United States.³⁶ Moreover, determinations of equivalence will be based on the rules of the issuer’s home country, not the rules an issuer follows in other countries, such as the United States, where its securities may be listed.³⁷ As a result, Asian, Latin American and other non-EU issuers may be able to meet the accounting requirements for either the EU or the US, by adopting IFRS or US GAAP or reconciling to US GAAP, without being able to meet

32 Eg US Sec. and Exch. Comm’n, Accounting Standards: SEC Chairman Cox and EU Commissioner McCreevy Affirm Commitment to Elimination of the Need for Reconciliation Requirements (8 February 2006) available at <http://sec.gov/news/press/2006-17.htm>.

33 Committee of European Securities Regulators, *Technical Advice on Equivalence of Certain Third Country GAAP and on Description of Certain Third Countries Mechanisms of Enforcement of Financial Information*, CESR/05-230b (June 2005) available at http://www.cesr-eu.org/index.php?page=contenu_groups&id=46&docmore=1 [hereinafter *Technical Advice on Equivalence*].

34 Charlie McCreevy, European Commissioner for Internal Market and Services, EC Strategy on Financial Reporting: Progress on Convergence and Consistency at the European Federation of Accountants’ (FEE) Seminar on International Financial Reporting Standards (IFRS) (1 December 2005) available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=SPEECH/05/750&format=HTML&aged=0&language=EN&guiLanguage=en>.

35 Commission Regulation (EC) No 1787/2006 of 4 December 2006 amending Commission Regulation (EC) 809/2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements available at http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_337/l_33720061205en00170020.pdf.

36 The Technical Advice on Equivalence, n 33 above.

37 Transparency Directive, Directive 2001/34/EC, Art. 23.1, 2001 O.J. (L184) 1, 15 (EC).

the accounting requirements for the other. Accordingly, choosing a second accounting standard will be an important factor in planning an international offering. For example, in the case of a Korean issuer that prepares its financial statements under Korean GAAP with reconciliations to US GAAP for a US listing, the EU currently would not accept Korean GAAP with the reconciliation to US GAAP as equivalent to IFRS and, therefore, would require financial statements prepared under IFRS for a public offering or listing in the EU. Unless the third country issuer is willing to prepare three sets of financial statements, it must choose between either the US or the EU for its foreign listing.³⁸

The application and interpretation of IFRS will also require continued attention in order to maintain momentum towards equivalence and recognition. CESR's Technical Advice on Equivalence evaluated not only the similarity of the accounting standards in US GAAP and IFRS themselves but also included a discussion regarding adequate enforcement of those standards by regulators.³⁹ In an attempt to facilitate uniform application of IFRS standards throughout Europe, IOSCO announced that it would establish a database by the end of 2006 containing the decisions by European regulators concerning the application of IFRS that will be accessible to each regulator on a confidential basis.⁴⁰ CESR has announced its support for IOSCO's initiative and has also provided written guidance on the enforcement of financial standards on two separate occasions in order to coordinate the uniform application of IFRS in Europe.⁴¹

As for transatlantic convergence, the SEC and CESR recently announced a joint work plan focused on financial reporting.⁴² This work plan, among other things, intends to ensure the 'high quality and consistent application of IFRS around the world.' The SEC confirmed its intention to review application of IFRS as part of its regular review of corporate filings; CESR indicated that it would do the same with respect to US issuers in the EU. The SEC and CESR agreed to consult with each other when issues arise regarding application of these accounting standards. This arrangement is designed to reduce the likelihood (or at least the frequency) of inconsistent applications of accounting standards.

It is still not clear that the uniformity that characterizes US GAAP as a result of SEC oversight will develop in the EU with respect to IFRS. Still, there is momentum on

38 An alternative option would be for the issuer to decide not to do a public offering at all in connection with its foreign listing and instead list on one of the alternative exchanges that do not subject issuers to the Transparency Directive and that are increasing in popularity. See discussion in Section 4 'The US faces an increasing need to be proactive' of this article.

39 For example, CESR's *Technical Advice on Equivalence* emphasizes that its assessment of equivalence is based on the assumption that appropriate quality assurance, enforcement and other filtering arrangements at a third country level are in place and that audit assurance at the listed entity level are effective for investors' purposes. See *Technical Advice on Equivalence*, n 30 above, ¶ 11 at 4.

40 International Organization of Securities Commissions, Regulators To Share Information On International Financial Reporting Standards (4 October 2005) available at <http://www.iosco.org/news/pdf/IOSCONEW92.pdf>.

41 Committee of European Securities Regulators, *Standard No. 1 on Financial Information— Enforcement of Standards on Financial Information in Europe*, CESR/03-073 (12 March 2003) available at; http://www.cmvm.pt/NR/rdonlyres/542657CE-77E4-47A2-BF28-2A18F392C8C7/1559/norma1_inf_financeira.pdf; Committee of European Securities Regulators, *Standard No. 2 on Financial Information—Coordination Of Enforcement Activities*, CESR/03-317c (March 2004) available at <http://www.fma.gv.at/de/pdf/standar2.pdf>.

42 Securities and Exchange Commission, *SEC and CESR Launch Work Plan Focused on Financial Reporting*, SEC Press Release 2006-130 available at www.sec.gov/news/press/2006/2006-130.htm.

both sides of the Atlantic. If this uniformity does develop with respect to IFRS, it should be a small step for each regulator to defer to the other for reviewing application of its home-country accounting standards.

Audit and auditor standards

With respect to audit, auditor qualification and auditor registration issues, the EU enhanced the uniformity of its own rules and moved towards harmonization with the US rules in October of 2005 when the 8th Company Law Directive became effective.⁴³ The objective of this directive is to reinforce the credibility of auditing of financial statements in the EU by: (i) setting out principles for public supervision of audits in all Member States; (ii) requiring external quality assurance and clarifying the duties of statutory auditors; (iii) defining principles for auditor independence applicable to all statutory auditors throughout the EU and (iv) requiring listed companies to set up an audit committee (or a similar body) with clear functions to perform. The directive also provides for the registration and oversight of non-EU audit firms that audit financial statements of issuers with securities listed in the EU. However, the directive does leave open the possibility of mutual recognition because the EU regulators will be able to waive the requirements applicable to a non-EU audit firm if they determine that it is subject to equivalent requirements in its home country and there is reciprocity with that country. In the United States, the Public Company Accounting Oversight Board ('PCAOB') has indicated that it is receptive to mutual recognition.⁴⁴ The critical factor for making progress towards mutual recognition in this area will be the outcome of the discussions that are currently underway among the EU, the SEC, the PCAOB and the new European Group of Auditors' Oversight Bodies, which is the face of the EU audit regulators towards non-EU countries.⁴⁵ The outcome of these discussions should determine whether each side will recognize the other as imposing requirements on audit firms that are equivalent to its own and, therefore, abandon the current requirement of dual registration.

Non-financial disclosure

The transatlantic securities markets may be closest to a harmonized standard, at least as far as the text of the respective regulations is concerned, with respect to non-financial disclosure in securities offerings. Both the EU and the US have adopted the disclosure standards promulgated by the International Organization of Securities Commissions

43 See 8th Company Law Directive, Council Directive 84/253/EEC, 1984 O.J. (L126) 20, 20–26 (EEC) (covering statutory audits of annual accounts and consolidated accounts).

44 Eg Auditor Oversight and its Implications on the Resilience of our Capital Markets, a speech by PCAOB Chairman Mark W. Olson before the Federation des Experts Comptables Europeens (FEE) Conference on Audit Regulation, 12 October 2006, available at http://www.pcaob.org/News_and_Events/Events/2006/Speech/10-12_Olson.aspx (noting in connection with the possibility of mutual recognition between the PCAOB and the new E.U. central audit oversight body, that the PCAOB has 'developed and adopted a framework for oversight that depends, to the maximum extent possible, on cooperation among regulators'.)

45 Eg the remarks of Chairman McGreevy before the same conference, available at <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/06/592&format=HTML&aged=0&language=EN&guiLanguage=en>.

(‘IOSCO’) in 1998 for equity securities, which set out 10 core disclosure areas for prospectuses.⁴⁶

In the United States, the SEC adopted in 1999 the IOSCO standards for the periodic disclosure requirements of foreign private issuers, which are set forth in Form 20-F under the Exchange Act.⁴⁷ In the same release, the SEC conformed the forms used by foreign private issuers to register offerings of securities in the United States to the IOSCO standards.⁴⁸ The requirements for annual reports of US issuers in Form 10-K (which are also the comparable business and financial disclosure requirements for registration statements for US companies) are similar.⁴⁹ In October of 2005, IOSCO sought public consultation on its proposed disclosure principles for debt securities, which are substantially equivalent to the existing requirements in the United States.⁵⁰

The EU disclosure requirements are set forth in the Prospectus Directive with additional detail provided by the Prospectus Regulation. A recital to the Prospectus Directive expressly references the IOSCO disclosure standards as international best practices that will allow cross-border offers of equities using a single set of disclosure standards.⁵¹ The objective of the Prospectus Directive was to create a single passport system allowing the use throughout the EU of a prospectus approved in any member country. The only section of a prospectus that the host EU Member State can require an issuer from another Member State to prepare in a different language is the summary; the body can be prepared in any language ‘customary in the sphere of international finance’.⁵² If the securities regulator of an issuer’s home Member State has approved the prospectus and notice of this approval has been given to the host country regulator, the host country regulator must accept the prospectus without an approval or administrative process.⁵³ As a result, the host Member State cannot add additional disclosure requirements in excess of an issuer’s home Member State. The Prospectus Directive also attempts to facilitate EU-wide public offerings by limiting civil liability predicated on the summary portion of a prospectus to cases where ‘the summary is misleading, inaccurate or inconsistent when read together

46 International Organization of Securities Commissions, *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, (September 1998) available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD81.pdf>.

47 SEC Release No. 34-41936, 70 SEC Docket 1474-3 (28 September 1999); Form 20-F, n 10 above. While several additional disclosure requirements have since been added to Form 20-F, n 10 above, the disclosure items currently required by the form correlate closely to the IOSCO disclosure items. Compare Form 20-F, n 10 above with International Organization of Securities Commissions, *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, n 46 above.

48 SEC Release No. 34-41936, n 47 above; Form 20-F, n 10 above.

49 Form 10-K under the Exchange Act, 17 C.F.R. § 249.30. As noted in the text accompanying n 10 above, the SEC provided some concessions to foreign issuers with the result that there are some differences in the disclosure required by Form 20-F and Form 10-K, such as that US issuers are required to provide more detailed disclosure of executive compensation than foreign private issuers.

50 Technical Committee of the International Organization of Securities Commissions, *Consultation Report: International Disclosure Principles for Cross-border Offerings and Listings of Debt Securities by Foreign Issuers*, Background Information (October 2005) available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD202.pdf>.

51 Prospectus Directive, n 25 above, Recital 22, 2003 O.J. (L345) at 66.

52 Ibid Art. 19.1, 2003 O.J. (L345) at 78. This is expected to include at least English, although French and German have been mentioned as possibilities.

53 Ibid Art. 17–18, 2003 O.J. (L345) at 78.

with the other parts of the prospectus.⁵⁴ Before the Prospectus Directive, EU-wide retail public offerings were problematic because of the need to translate the offering document into local languages. If the Prospectus Directive works as planned, market participants should become comfortable with only translating prospectus summaries, which in turn should make EU-wide retail public offerings possible.

The Prospectus Directive implements the IOSCO standards by directing the enactment of detailed implementing measures with respect to the standards in the field of financial and non-financial information set out by IOSCO and the Annexes to the Prospectus Directive.⁵⁵ The Prospectus Regulation sets forth disclosure requirements in the form of schedules and building blocks that apply different detailed requirements depending on the type of security and the circumstances of an offering.⁵⁶

While the disclosure required by the Prospectus Directive and the Prospectus Regulation is generally similar to that required in the United States by Exchange Act Form 20-F, there are differences. For example, the Prospectus Directive and Prospectus Regulation explicitly contemplate a decreasing level of disclosure from share offerings to retail debt to wholesale debt in such categories as business description, operating and financial review and trend information, whereas Form 20-F contemplates a uniform level of disclosure. Moreover, the Prospectus Directive explicitly provides that home country regulators may permit the omission of information from a prospectus in certain circumstances.⁵⁷

In sum, non-financial disclosure is an area where there has been significant progress towards harmonization and although it would require work, mutual recognition should be achievable. Progress towards mutual recognition in this area will require continued attention to the EU's efforts to create a single European market for securities offerings. Even if the implementation of the Prospectus Directive is similar across the Member States—as noted earlier, the regimes will not be identical since this legislation did not take the form of a regulation—there would be uncertainty as to how it would be applied.⁵⁸ Moreover, the regime for securities law liability is not uniform throughout Europe. Nevertheless, given the progress that has been made through the Prospectus Directive and Regulation in harmonizing the substantive disclosure requirements on both sides of the Atlantic, it is not unreasonable to expect further progress. Just as the United States and

54 Ibid Art. 6.2, 2003 O.J. (L345) at 73. The Prospectus Directive does not, however, preclude other claims, such as fraud, which may be available under the law of the jurisdiction of the issuer or the investor or other applicable law.

55 Ibid Art. 7, 2003 O.J. (L345) at 73. The Prospectus Directive, in Annex I, sets forth the general disclosure requirements for a prospectus in terms that reflect the IOSCO standards. Ibid Annex I, 2003 O.J. (L345) at 83.

56 Within the Prospectus Regulation, the major headings in the disclosure requirements of Annex I, Minimum Disclosure Requirements for the Share Registration Document (schedule), cover the same areas as Form 20-F under the Exchange Act n 10 above, in many cases using the same language. Compare Prospectus Regulation, n 24 above, Annex I, 2004 O.J. (L149) at 24–36 with Form 20-F, n 10 above.

57 Prospectus Directive, n 25 above, Art. 8(2), 2003 O.J. (L345) at 78 (EC). These circumstances include where disclosure of the information would be seriously detrimental to the issuer, provided that, generally, the omission would not be likely to mislead the public. For instance, Art. 8(2) has been used recently by the UK Listing Authority and the Irish Stock Exchange to permit omission of separate financial information for guarantors of debt securities when certain requirements are met.

58 In fact, differences in Member States implementation have already become apparent in such areas as the treatment of employee stock options.

Canada achieved strong elements of mutual recognition in the Multijurisdiction Disclosure System that has been in place since 1991,⁵⁹ the EU and the US should work to leverage the harmonization that has occurred so that issuers in the not-too-distant future will be permitted to use prospectuses satisfying the requirements of either the EU or the US to satisfy the requirements of the other.

Regulation of securities intermediaries and exchanges

Investors' access to foreign securities products is most directly affected by the regulation of their interface to those products, the limitations on the activities of foreign securities intermediaries in host countries and on interconnection with foreign markets. It is not surprising, then, that this is an area in which mutual recognition is more difficult. Still, progress in the EU through the FSAP holds promise for further efforts towards mutual recognition in the not too distant future.

The EU adopted a sweeping overhaul of its market regulation rules with the Markets in Financial Instruments Directive ('MiFID').⁶⁰ Among other things, MiFID requires Member States, as a general matter: to regulate investment firms,⁶¹ to perform ongoing supervision of investment firms,⁶² to require, with certain exceptions, investment firms to comply with certain business conduct rules,⁶³ to require investment firms to take all reasonable steps, subject to certain considerations, to obtain the best possible execution of client orders⁶⁴ and to permit the performance of investment services and advice without regulation in the host Member State by any investment firm authorized by another Member State.⁶⁵ These rules are a significant step towards a pan-European market for investment services, though there is still significant doubt concerning the ability of the various EU Member States to achieve consistent application of these rules absent a centralized EU securities regulator. Depending on the implementation of MiFID by the Member States, it may create a more robust regulatory environment in many EU Member States that may facilitate a determination by the SEC of comparability with the regulation of broker-dealers in the United States. As a general

59 The Multijurisdictional Disclosure System between the SEC and provincial securities regulators in Canada represents an early SEC effort to recognize another jurisdiction's offering regime. However, this regime has a somewhat tortured history (the concept was first introduced in 1985 and rules were not adopted until 1991), does not represent a true mutual recognition approach and should not be viewed as a model for mutual recognition in the future. See Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers, Securities Act Release No. 6,902, Exchange Act Release No. 29,354, Investment Company Act Release No. 18,210, 56 Fed. Reg. 30,036 (1 July 1991); Facilitation of Multinational Securities Offerings, Securities Act Release No. 6,568, 50 Fed. Reg. 9281 (7 March 1985) (Request for Public Comment). See also Edward F. Greene *et al.*, U.S. Regulation of the International Securities and Derivatives Market § 9.01 (8th ed 2006).

60 Markets in Financial Instruments and Investment Services, Council Directive 2004/39/EC, 2004 O.J. (L145) 30 (21 April 2004) (EU).

61 An investment firm is defined generally as a person whose regular business is providing to third parties investment services or activities. Investment services or activities are defined generally as the reception or transmission of orders for financial instruments, execution of orders on behalf of clients, dealing, portfolio management, investment advice, underwriting or firm-commitment placement of financial instruments, placing of financial instruments or operation of multilateral trading facilities. *Ibid.* Art. 5 *et seq.*, 2004 O.J. (L145) at 5–44.

62 *Ibid.* Arts 16 *et seq.*, 2004 O.J. (L145) at 16–44.

63 *Ibid.* Art. 19, 2004 O.J. (L145) at 17–18.

64 *Ibid.* Art. 21, 2004 O.J. (L145) at 18–19.

65 *Ibid.* Arts 31 *et seq.*, at 25–44.

matter in the US broker–dealers are required to join a self-regulatory organization and the Securities Investor Protection Corporation, to meet certain net capital requirements and to comply with the SEC’s rules concerning recordkeeping, fiduciary duties and anti-fraud rules, and they are subject to the SEC’s broad enforcement authority, which, importantly, allows the SEC to have detailed knowledge of conditions in the industry.⁶⁶

As noted earlier, the SEC adopted only a limited safe-harbour for activities of foreign securities intermediaries in the United States in the Rule 15a-6 Adopting Release.⁶⁷ One of the reasons that the SEC did not adopt the approach of unilateral recognition it considered in the 15a-6 Concept Release was political opposition that arose from concerns about the competitive disparity that would arise between firms with and without US affiliates because the latter were to be excluded from the scope of the contemplated relief.⁶⁸ Now, however, any proposal from the SEC to grant an exemption permitting sales of foreign securities to US investors by foreign-regulated broker–dealers subject to comparable regulation may well receive more support from securities industry participants than was the case in 1989. In September 2005, a group of industry associations with the support of the Corporation of London published a paper with several recommendations for further convergence in the area of market regulation, including a call for further harmonization of securities intermediaries regulation.⁶⁹ In addition, because of the directives that have been implemented by the EC, creating a regulatory regime in Europe that is increasingly comparable to that in the United States, at least some of the politically sensitive questions that the SEC sought to avoid in 1989 are no longer present. Although the potential political implications of recognizing another country’s regulation of securities intermediaries as comparable to that of the United States will not entirely disappear, the details of Member State implementation of MiFID might provide the SEC with a more objective framework for determining the equivalence of EU regulation of securities intermediaries, and a basis for recognizing this regulation as sufficient for access to the US.

In this vein, two senior level officials, Ethiopis Tafara and Robert J. Peterson, of the SEC recently wrote a provocative article proposing a new framework for regulating

66 Eg Registration Requirements for Foreign Broker–Dealers, SEC Release 34-27017, 11 July 1989 (the ‘15a-6 Adopting Release’), which was adopted on the day the 15a-6 Concept Release was issued.

67 Currently Rule 15a-6 permits an entity, as a general matter, to engage in the following four types of activities without registering a broker–dealer as with the SEC: (i) unsolicited transactions (although the definition of solicitation is sufficiently broad that this is of limited usefulness to foreign entities engaged in the business of securities intermediation); (ii) providing research to certain institutional entities (subject to a variety of limitations on any resulting trades); (iii) transactions with certain institutional investors (subject to ‘chaperoning’ requirements that mean an SEC-registered broker–dealer must generally intermediate and maintain records of the transaction) and (iv) transactions for certain financial and multi-national institutions. See 17 C.F.R. § 240.15a-6(a).

68 See Ramsay n 13 above at 522.

69 The Transatlantic Dialogue in Financial Services: The case for Regulatory Simplification and Trading Efficiency (sponsored by The Corporation of London and The American Bankers Association Securities Association, the Bankers’ Association for Finance and Trade, the British Bankers Association, the Futures Industry Association, the Futures and Options Association and the Securities Industry Association with assistance from Clifford Chance [hereinafter Joint Industry Report]) available at <http://www.cliffordchance.com/expertise/publications/details.aspx?FilterName=@URL&contentitemid=9028>.

non-US securities intermediaries that seek access to US investors.⁷⁰ As discussed in more detail later in this article, this proposed framework, if adopted by the SEC, would eliminate some of the barriers between US financial markets and comparably regulated financial markets outside the United States. Non-US securities intermediaries would be able to obtain exemptions from registration with the SEC based on their compliance with substantively comparable non-US securities regulations and laws and supervision by a substantively comparable non-US securities regulator. With the benefit of this registration exemption, US investors would have better and less costly access to a wider array of diversified investment opportunities and reciprocal exemptions for US financial service providers will afford the same benefits to non-US investors.⁷¹

Setting aside matters with far-reaching implications for market integrity, such as net capital regulations and fiduciary and anti-fraud measures, the efficiency of transatlantic securities markets could be improved by harmonization in a number of more prosaic areas, such as (i) the formulation of a common set of customer definitions for the purposes of classification, solicitation and documentation; (ii) a common approach to core investor protection objectives such as 'know your customer' rules and (iii) the development of a common set of examination and registration requirements. As the Joint Industry Report notes, under Rule 15a-6, a foreign broker-dealer may only solicit business by sending research reports to US institutional customers that have more than \$100 million under management.⁷² Meanwhile, in the UK a corporate body or partnership with net assets of at least £5 million is treated as an intermediate, rather than retail, customer, and is therefore afforded fewer regulatory protections.⁷³ Finally, CFTC regulations define an 'eligible swap participant' as 'any natural person with total assets exceeding at least \$10,000,000'.⁷⁴ The implementation of homogeneous 'Know Your Customer' or related investor protection rules brings with it a different set of problems. In that case, there is well-developed law and practice in the US and the EU regarding investor protection, but it is so dependent on the type of instrument being traded and the particular situation of each investor that it is difficult to catalogue, much less harmonize among jurisdictions.⁷⁵ Even within the United States itself, because of the bifurcated regulatory roles of the SEC and CFTC in securities futures regulation, and a history of jurisdictional acrimony between the two agencies (which while recently showing signs of abating is likely to continue in the future), standards of care may differ for the same

70 Ethiopis Tafara and Robert Peterson, *A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 *Harv. Int'l L. J.* 1, 31 (2006); see also Susan Wolburgh Jenah, *Commentary on A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 *Harv. Int'l L. J.* 1, 69 (2006); Edward F. Greene, *Beyond Borders: Time to Tear Down the Barriers to Global Investing*, 48 *Harv. Int'l L. J.* 1, 85 (2006); George W. Madison and 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.* 1, 99 (2006); Howell E. Jackson, *A System of Selective Substitute Compliance*, 48 *Harv. Int'l L. J.* 1, 105 (2006).

71 *Beyond Borders: Time to Tear Down the Barriers to Global Investing*, n 70 above at 85.

72 See 17 C.F.R. § 240.15a-6(a)(2) (prohibiting solicitation); 17 C.F.R. § 240.15a-6(b)(4) (defining 'major institutional investors' as those with \$100 million or more under management); see also Joint Industry Report, vol. I, 27 at ¶ 49 (discussing the arbitrary nature of net worth requirements).

73 See Joint Industry Report, Vol. II § 6.2 (summarizing European and US customer classifications).

74 17 C.F.R. § 35.1(b)(2)(xi).

75 Joint Industry Report, Vol. II § 12 n 28.

customer who wishes to purchase a security and a future based on the same underlying instrument.⁷⁶ As the regulatory regimes move towards convergent definitions of market actors like ‘qualified institutional buyers’ and the like, it will become easier for regulators to set appropriate standards of treatment for differently qualified customers. Finally, self-regulatory organizations in the United Kingdom and the United States have already taken the first steps towards simplifying registration and testing requirements for professionals who wish to work on both sides of the Atlantic. In July 2005, the NASD, NYSE and the UK’s Securities and Investment Institute announced their agreement to create a single qualification exam that would allow market professionals to move between the United States and the United Kingdom more easily.⁷⁷ Although still subject to approval by the securities regulators of each nation, the authors of the Joint Industry Report rightly view this agreement as a significant step towards a single transatlantic system of registration of market professionals.⁷⁸

The other significant component to controlling access of investors to securities traded outside their home market is the regulation of securities exchanges. With regard to the convergence of the regulation of securities exchanges, the SEC has in the past noted a number of concerns over insufficient investor protection as the reason for preventing foreign securities exchanges that do not comply with US requirements to have direct contact with US investors through trading screens or otherwise. The SEC issued a concept release concerning access to foreign securities exchanges from the United States almost a decade ago.⁷⁹ It considered three basic approaches: (i) deferring to home country regulation of foreign securities exchanges, (ii) requiring a foreign securities exchange seeking direct access to US investors to register as a national securities exchange, or apply for an exemption, pursuant to Section 6 of the Exchange Act⁸⁰ and (iii) regulating the intermediary that provides access for US investors to the foreign exchange, such as by requiring them to register with the SEC as broker-dealers, to comply with the requirements of Rule 15a-6 or to register with the SEC pursuant to Section 11A of the Exchange Act as Securities Information Providers. In this release, the SEC’s concern over inadequate protection of investors by foreign regulators weighed against deferral to home country regulation. The SEC specifically mentioned such issues as foreign securities regulations not (i) requiring a foreign securities exchange to establish rules that describe its trading processes, file those rules and enforce them fairly, (ii) preventing insider

76 Eg Jerry W. Markham, *Super Regulator: A Comparative Analysis of Securities and Derivatives Regulation in the United States, the United Kingdom, and Japan*, 28 *Brook. J. Int’l L.* 319 (2003).

77 Joint Industry Report, Vol. I, 28 ¶¶ 53–57.

78 *Ibid.*

79 SEC Release No. 34-38672; S7-16-97; Regulation of Exchanges.

80 Such registration may at first glance seem appropriate given that § 5 of the Exchange Act makes it illegal ‘for any broker, dealer, or exchange, directly or indirectly, to [use jurisdictional means] for the purpose of using any facility of an exchange within or subject to the jurisdiction of the United States to effect any transaction in a security, or to report any such transaction, unless such exchange (1) is registered as a national securities exchange under section 6 of this title, or (2) is exempted from such registration upon application by the exchange because, in the opinion of the SEC, by reason of the limited volume of transactions effected on such exchange, it is not practicable and not necessary or appropriate in the public interest or for the protection of investors to require such registration’. Nevertheless, the difficulty of a foreign market meeting the requirements for registration pursuant to s 6 is shown by the fact that the SEC has only granted such registration to two institutions in its history. Steil n 4 above at 49.

trading or other forms of market manipulation, (iii) ensuring market transparency by requiring market makers and specialists to have firm quotes or to display certain customer limit orders, (iv) providing for timely transaction reporting by requiring exchanges and certain participants to report most trades for public dissemination within 90 seconds or (v) providing for T+3 clearance and settlement.

In this connection, it is noteworthy that under MiFID Member States must require, generally, that the operator of a regulated market meet certain suitability requirements, that a regulated market identify any conflict of interest between itself, its owner or operator and its sound functioning and have adequate risk mitigation arrangements, adequate technical operation arrangements, rules for fair and orderly trading and efficient execution of orders, effective arrangements for the finalization of transactions, sufficient financial resources, transparent rules for admitting financial instruments for trading and the ability to suspend or withdraw a financial instrument from trading.⁸¹ Member States are further obligated to require that regulated markets establish non-discriminatory rules for membership in or access to regulated markets, including suitability and other rules for access by market participants that are not EU regulated investment firms or credit institutions and to require that regulated markets have effective arrangements for regularly monitoring the compliance with their rules of their members or participants, including monitoring transactions for violations, disorderly trading conditions or conduct that may involve market abuse.⁸² MiFID also directs the EC to adopt measures to implement the general obligation for regulated markets continuously to make public current bid and offer prices and the depth of trading interests at those prices and to make public in real time the price, volume and time of transactions that have been executed.⁸³ While there are national and commercial competition issues that make the outcome of these changes unclear, MiFID may, in fact, improve the efficiency of secondary trading in EU markets by enhancing competition between different types of trading platforms (regulated exchanges, multilateral trading facilities and investment firms) given the new pan-European requirements for reporting trades.

The implementation of the market regulation provisions of the MiFID described earlier, if it can be accomplished in a consistent manner throughout the EU, should address some of the concerns of the SEC regarding direct access in the United States to European securities exchanges through foreign exchange trading screens or foreign

81 MiFID tit. III Arts 37–41.

82 Ibid. tit. III Arts 42–43.

83 Ibid. tit. III Arts 44–45. MiFID also has requirements applicable to investment firms that match trade orders internally and multilateral systems that facilitate third-party buying and selling interests, both of which lack the ability of regulated markets to admit shares to trading. Under MiFID, Member States will have the obligation generally to require systematic internalizers, which are defined generally as investment firms that on an organized, frequent or systematic basis, deal on their own account by executing client orders outside a regulated market or a multilateral trading facility, to publish firm public bids in certain circumstances, to require investment firms that conclude transactions outside a regulated market in shares admitted to trading on a regulated market to make public the volume and price in real time, and to ensure certain pre- and post-trade transaction reporting and other transparency requirements are met by multilateral trading facilities. Ibid Arts 27–30, 2004 O.J. (L145) at 22–24.

securities intermediaries.⁸⁴ The SEC also expressed concern that direct access to foreign exchanges could expose investors to listed companies with financial and other disclosure that is inferior to the disclosure required of issuers listed on an exchange in the United States. This concern, however, also has been alleviated, at least as far as securities exchanges in the EU are concerned, as a result of the convergence in disclosure standards discussed earlier. Tafara and Peterson, in their recent article, propose that the SEC adopt a regulatory model for non-US exchanges substantially the same as their proposal for non-US securities intermediaries, which, if adopted by the SEC, would allow non-US securities intermediaries to obtain exemptions from registration with the SEC based on their compliance with substantively comparable non-US securities regulations and laws and supervision by a substantively comparable non-US securities regulator.⁸⁵

It is worth noting that direct access to foreign exchanges is another area in which CFTC has been willing to make determinations of equivalence.⁸⁶ Following the initial no-action letter provided to Deutsche Terminbörse ('DTB'), the CFTC provided no-action relief to a number of other foreign boards of trade allowing them to locate electronic trading terminals in the United States.⁸⁷ The CFTC recently re-evaluated its policy of providing no-action relief in light of changes including product innovations and affirmed the use of its existing procedures for no-action relief.⁸⁸

External events are also relevant to considerations of the regulation of securities exchanges. A variety of recent changes in exchange governance are also moving international securities markets towards further integration. Several major stock exchanges have demutualized, or are in the process of doing so, which results in a transfer of ownership from the firms that trade on the exchange or self-regulatory organizations to stockholders. NASDAQ demutualized in 2000, the NYSE in 2006, and the American Stock Exchange, Euronext, the London Stock Exchange and Deutsche Börse are planning to follow.⁸⁹ This change in ownership of markets promotes competition by making the price-finding and reporting functions of markets a profit-making product and providing markets with the ability to engage in mergers. As a result, there has been a significant increase in exchange merger activity recently, with NASDAQ seeking to take over the London Stock Exchange in 2005 (and acquiring

84 In addition, Steil argued that even prior to the adoption of the MiFID, in a number of trade execution characteristics EU markets may, in fact, be more favourable to investors than US exchanges, including post-trade reporting that is often, in practice, faster despite the 90 second rule imposed on US markets and the general requirement in the EU of strict price-time priority for trade execution, which is not required in the USA. See Steil n 4 above.

85 A Blueprint for Cross-Border Access to US Investors: A New International Framework, n 70 above.

86 DTB, the predecessor of Eurex, Germany's electronic futures and options market, installed computer terminals in the USA for trading non-US futures products. See Letter from Andrea M. Corcoran, Director, Division of Trading and Markets, Commodity Futures Trading Commission, to Lawrence H. Hunt, Jr, Esq., Sidley and Austin (29 February 1996) (no-action letter authorizing DTB to install and use computer terminals in the United States in connection with the purchase and sale of certain futures and options contracts). See also, Beyond Borders: Time to Tear Down the Barriers to Global Investing, n 70 above at 87; Jackson *et al.* *Foreign trading screens in the U.S.*, Capital Markets Law Journal Advance published 3 August 2006.

87 Access to Automated Boards of Trade, 64 FR 32829 (18 June 1999).

88 Boards of Trade Located Outside of the United States and No-Action Relief From the Requirement to Become a Designated Contract Market or Derivatives Transaction Execution Facility. 17 CFR pt 140, 71 FR 64443 (2 November 2006).

89 Robert Glauber speech 21 June 2006 before the Harvard Business School Global Leadership Forum, available at (NASD Press Room).

25 per cent thereof) and again in the Fall of 2006 and the NYSE agreeing to merge with Euronext.⁹⁰ Fortunately, the US and EU regulators appear motivated to address any potential regulatory conflicts cooperatively and have established a joint working group to address potential regulatory issues that would arise from the consummation of a cross-border exchange merger.⁹¹

Market misconduct regulation

With respect to regulations designed to prevent market misconduct, both the EU and the United States appear to be committed not only to national treatment but also to extraterritorial application of laws prohibiting market misconduct to conduct that occurs outside the home country if it affects financial instruments in the home country.

The FSAP legislation addressing market misconduct is the Market Abuse Directive ('MAD').⁹² Perhaps, the most important point for market participants in the United States to understand is that the provisions of MAD generally apply to worldwide conduct affecting securities admitted to trading on a regulated market in the EU.⁹³

MAD addresses two general categories of market misconduct, trading on inside information and market manipulation. Regarding the first category, MAD generally requires Member States to prohibit any person who acquires 'inside information' from using the information to trade financial instruments to which the information relates.⁹⁴ This standard is stricter than the application of Rule 10b-5 in the United States because there is no need to show misappropriation or a breach of fiduciary obligation and instead improper use of inside information is sufficient to constitute a violation.

90 Ibid.

91 Roel Campos, US SEC Commissioner, *The Current Role of Capital Market Regulation*, Speech 5 September 2006 available at <http://www.sec.gov/news/speech/2006/spch090506rcc.htm>.

92 On Insider Dealing and Market Manipulation (Market Abuse), Council Directive 2003/6/EC, 2003 O.J. (L 96) 12 (2003) [hereinafter MAD]. Several pieces of implementing legislation for MAD have been adopted: (i) Commission Directive 2003/125/EC of 22 December 2003 implementing MAD as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest, Commission Directive 2003/125/EC, 2003 O.J. (L 339) 73 (22 December 2003); (ii) Commission Directive 2003/124/EC of 22 December 2003 implementing MAD as regards the definition and public disclosure of inside information and the definition of market manipulation, Commission Directive 2003/124/EC, 2003 O.J. (L 339) 70 (22 December 2003); (iii) Commission Directive 2004/72/EC of 29 April 2004 implementing MAD as regards accepted market practices, the definition of inside information in relation to directives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions, Commission Directive 2004/72/EC, 2004 O.J. (L 162) 70 (29 April 2004); and (iv) Commission Regulation (EC) 2273/2003 of December 22 2003 implementing MAD as regards exemptions for buy-back programmes and stabilization of financial instruments, Commission Regulation No. 2273/2003, 2003 O.J. (L 336) 33 (22 December 2003) [hereinafter Stabilization Implementation Regulation].

93 Ibid Arts 9–10, 2003 O.J. (L96) at 23. Article 10 provides in part 'Each Member State shall apply the prohibitions and requirements provided for in this Directive to: (a) actions carried out on its territory or abroad concerning financial instruments that are admitted to trading on a regulated market situated or operating within its territory . . .'

94 MAD, n 91 above, Arts 1–4, 2003 O.J. (L96) at 21. Inside information is defined broadly by MAD to include information 'of a precise nature' that relates 'directly or indirectly' to a financial instrument or issuer and that could significantly affect price. The EC has further specified that information is of a precise nature 'if . . . it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of financial instruments . . .', (Commission Directive 2003/124/EC of 22 December 2003 implementing MAD) Moreover, CESR provided additional guidance on what constitutes inside information. Market Abuse Directive, Level 3-second set of CESR guidance and information on the common operation of the Directive to the market CESR/06-562 (November 2006). MAD's prohibitions on using inside information apply, among others, to any person who possesses inside information by virtue of certain relationships such as being a member of management or who knows or should have known that the information is inside information.

The implementation in the Member States of the provisions of MAD prohibiting trading on inside information will be of particular interest to investors in the United States who trade stock of companies listed in the EU, since it appears that conduct that is not a violation of US insider trading law could still constitute a violation that is subject to prosecution in the EU.⁹⁵

In addition, in order to further reduce the incidence of insider trading, MAD imposes significant new ongoing requirements on issuers to disclose inside information promptly.⁹⁶ MAD takes a step towards a system of continuous disclosure by establishing a general rule that inside information must be disclosed subject only to limited exceptions.⁹⁷ This contrasts with the US approach where there is an affirmative obligation only to make periodic disclosures and to disclose certain events.⁹⁸ As a result, a US public company with securities admitted to trading on an EU regulated market may under these rules find itself required to disclose material non-public information earlier than it would otherwise have to do under the rules of the SEC, either because the type of information required to be disclosed is not covered by Form 8-K or because the deadline for disclosure (ie as soon as possible) is earlier than Form 8-K requires (ie generally within four business days). MAD approaches the issue of disclosure of corporate information to a limited group of people, such as securities analysts, without full dissemination to the market in a manner similar to the requirements in the United States. It requires complete and effective public disclosure of inside information if it is disclosed, whether or not intentionally, to any third party not subject to a confidentiality obligation.⁹⁹ MAD goes further than Regulation FD, however, by requiring issuers to maintain and regularly update a list of persons with access to inside information, a requirement for which there is no analogue in the United States.¹⁰⁰

On the second point, MAD provisions restricting market manipulation,¹⁰¹ there is an opportunity for further harmonization with the US rules, despite the general rule

95 In the US, insider trading is addressed by the general prohibition on fraudulent and manipulative conduct set forth in s 10(b) of the Exchange Act and Rule 10b-5, while a substantial case-law fills in the contours of the duty to abstain from trading while in the possession of material non-public information. As a very general matter, the consensus view is that there must be a breach of a duty in order for insider trading conduct to constitute fraud under Rule 10b-5. For a more extensive discussion, see Greene, *et al.*, *U.S. Regulation of the International Securities and Derivatives Markets* § 6.01[5](b) (8th edn 2006).

96 Member States must ensure that each issuer of financial instruments informs the public as soon as possible of inside information directly concerning the issuer. MAD Art. 6(1) at 21.

97 An issuer may delay disclosure in order to avoid prejudicing its legitimate interests if it can ensure the confidentiality of the inside information and doing so is not likely to mislead the public, though a Member State may require an issuer to inform the regulator of a decision to delay disclosure. *Ibid.* Art. 6(2), at 21.

98 See the new form 8-K.

99 In the US, Rule 100 of Regulation FD, as a general matter, requires an issuer that discloses any material non-public information regarding the issuer or its securities, whether or not intentionally, to make public disclosure of that information.

100 MAD Art. 6(3), at 22.

101 *Ibid.* Art. 5. Market manipulation is defined generally as (i) transactions or orders that give false or misleading signals as to the supply, demand or price of financial instruments or secures the price of one or more financial instruments at an artificial level without a legitimate reason or contrary to accepted market practices, (ii) transactions or orders that employ deception or (iii) dissemination of information that gives false or misleading signals as to financial instruments, where the person doing so should have known that the information was false or misleading.

of extraterritorial application, because MAD and the Stabilization Implementation Regulation establish safe-harbours that are similar in many respects to the applicable US regulations for certain stabilization and other trading activity in connection with an offering. In the United States, Section 9 of the Exchange Act specifically prohibits pegging, stabilizing or fixing the price of a security in ways other than those allowed by SEC rule for the protection of investors.¹⁰² The SEC rules defining allowable stabilizing activity during the offering period are set forth in Regulation M.¹⁰³ The SEC requires that the existence, and even the possibility, of stabilizing activity be disclosed to the counter-party in a securities transaction, to the market on which a stabilizing bid is entered and, in some cases, to the self-regulatory organization that oversees the principal market for the offering.¹⁰⁴ Regulation M also governs the substance of the stabilization itself, dictating that a stabilizing bid cannot be entered for more than the offering price.¹⁰⁵ Finally, stabilizing is absolutely prohibited in at-the-market offerings.¹⁰⁶ The rules, as a whole, are designed to give the issuer and underwriter protection from price fluctuations that can often follow an offering, while avoiding the potential for manipulation by a relatively high bid that could send inaccurate signals about the security's price and liquidity.¹⁰⁷

In the EU, MAD and the Stabilization Implementation Regulation have a similar purpose and implementing structure. Like the rules in Regulation M, stabilization may take place during the offering period, although, unlike in the US, there is a fixed period of 30 days following the commencement of an offering defined in the regulation.¹⁰⁸ Furthermore, the rules require disclosure of the possibility of stabilizing activity to the market before the offering is made, and if stabilizing is done, the disclosure of that fact within a week after the stabilizing period ends.¹⁰⁹ Finally, the regulations set the same price ceiling for stabilizing offerings of equity securities as Regulation M: no stabilizing bid can be made above the offering price of the security.¹¹⁰

102 Exchange Act §9(a)(6), 15 U.S.C. 78i(a)(6) (2006).

103 Regulation M, 17 C.F.R. pts 200, 228–230, 240, 242, comprises a definitional section and five rules that regulate the market activities of issuers, selling security holders, underwriters and other participants in an offering and related parties. Unless there is an exception, Rule 101, 17 C.F.R. §242.101, and Rule 102, 17 C.F.R. §242.102, of Regulation M, generally prohibit activities whereby participants in an offering could artificially raise the price of the offered securities. They resemble MAD in that they apply to worldwide activities of participants in any transaction that includes a 'distribution' in the USA and their related parties. The SEC did, however, grant no-action relief in order to permit members of the London Stock Exchange to engage in passive market making customary for that exchange while they or their affiliates were engaged in a distribution of the related covered securities.

104 Regulation M, r 104, 17 C.F.R. §242.104.

105 Regulation M, r 104(f), 17 C.F.R. §242.104(f); see also Greene, *et al.*, *U.S. Regulation of the International Securities and Derivatives Markets* § 6.01[5](b) (8th edn. 2006).

106 Regulation M, r 104(e); 17 C.F.R. § 242.104(e).

107 Hazen, 2 *Law of Securities Regulation* § 6.2[1] (5th edn. 2006).

108 Stabilization Implementation Regulation Art. 8.

109 *Ibid* Art. 9.

110 *Ibid* Art. 10.

One area where these technical rules differ is in their treatment of syndicate covering transactions.¹¹¹ While the SEC has proposed amending Rule 104,¹¹² at present syndicate covering transactions are generally permitted, subject to certain record-keeping requirements, without the requirement for public notice. Moreover, while there is a fixed 30-day period for stabilization in Europe, Rule 104 applies to stabilization ‘in connection with an offering’ but generally does not extend beyond the completion of an offering. In contrast, under the Stabilization Implementation Regulation, syndicate short covering transactions are considered ancillary stabilization subject to timing and disclosure requirements and there is an absolute limit of five per cent on syndicate naked short positions.¹¹³

In order to secure the application of these requirements, MAD requires each Member State to designate a single regulator to apply them,¹¹⁴ specifies certain powers Member States must grant the regulator (including the power to receive a copy of any document and the power to require the cessation of any practice that is contrary to the provisions adopted pursuant to MAD),¹¹⁵ and requires Member States to ensure that administrative procedures are available, without prejudice to their criminal law, to enforce the requirements of MAD and to provide for appeal of the regulator’s administrative measures to a court.¹¹⁶

With the potential exception of offering stabilization and syndicate covering transaction rules, national treatment of the more core varieties of market misconduct will continue and, while harmonization has happened, further harmonization, to say nothing of any form of equivalency finding or recognition of a foreign regulatory regime, is unlikely. Regulators simply are not likely to ignore foreign conduct that violates their own market abuse standards merely because it is legal in the jurisdiction where the conduct occurred.¹¹⁷ Even if foreign conduct violates regulations in both the EU and the US, it seems unlikely that either regulator would limit its response to relying on the other in cases where its investors are harmed. Rather, the challenge in this case will be

111 Rule 104 distinguishes stabilization from syndicate covering transactions, which are bids or purchases on behalf of the sole distributor or the underwriting syndicate or group to reduce a short position created in connection with an offering. Short positions commonly arise in offerings of securities, especially equity securities, because underwriters often overallocate the offering to ensure there is sufficient demand for resales of the securities to maintain the market immediately after the offering. While underwriters commonly hold a green shoe, or overallocation, option to purchase up to 15% of the amount of securities they committed to underwrite, the offering overallocation may exceed 15%, in which case the syndicate as a whole has a naked short position that must be covered through market purchases.

112 In this release, the SEC observed that syndicate covering transactions have replaced stabilizing bids as a means of supporting aftermarket prices, perhaps because they are not subject to the price and other conditions that apply to stabilization under r 104, and in particular the contemporaneous market disclosure of the bidding and purchasing activity. Amendments to Reg M: Anti-Manipulation Rules Concerning Securities Offerings, SEC Release No. 33-8511 (9 December 2004).

113 Stabilization Implementation Regulation Art. 11. In addition, unlike in the USA, ancillary stabilization under MAD does not cover market purchases, which are outside the safe harbour.

114 *Ibid.* Art. 11, at 23.

115 *Ibid.* Art. 12.

116 *Ibid.* Arts 13–14, 2003 O.J. (L96) at 23–24.

117 In fact, there is precedent for regulators taking action against such foreign conduct. For example, in connection with the acquisition of Santa Fe International by the Kuwait Petroleum Corporation in 1981, the SEC sought prosecutions based on trading in Switzerland that was legal there but violated US insider trading standards.

for regulatory cooperation when cross-border conduct violates MAD or the analogous provisions under US law.

Regulation of public offerings of securities

With respect to the regulation of offers to the public, there has been a widening rather than a narrowing of the gap between the approaches of the EU and the US. In the EU, the Prospectus Directive contemplates that all public offerings will be subject to review by competent authorities, with only a limited version of shelf registration. Except in the case of certain debt issuance programs, for which a 'base prospectus' can be used together with the final terms of the securities being offered, a prospectus must comprise three sections: the summary, the registration document, which is the general description of an issuer and its business, and the securities note, which is the description of the terms of the offered securities.¹¹⁸ Once approved by a regulator, a registration document can be used more than once during the period of 12 months for which it is valid.¹¹⁹ Still, the summary and securities note must be separately approved for all public offerings though certain debt offerings qualify for a reduced level of disclosure, which means that even large, well-followed companies may face some level of review by a regulator before being able to offer securities to the public.¹²⁰

In contrast, the SEC has for many years been moving towards a system of continuous, integrated disclosure in which issuers can meet their disclosure obligations in respect of an offering of securities under the Securities Act with the same filings they use to satisfy their periodic disclosure requirements under the Exchange Act as public companies, so that there are fewer hurdles to market access for established issuers. This approach is based on a recognition of the efficient markets hypothesis, which proposes that the price of a liquid, widely held stock reflects all publicly available information about the issuer.¹²¹ Because larger, established issuers are more heavily followed, and 'tend to have a more regular dialogue with investors and market participants through the press and other media,'¹²² the SEC has sought to make the securities offering process more streamlined and flexible for such issuers.¹²³ In the early 1980s, the SEC made the disclosure in annual and quarterly reports equivalent to that contained in a registration statement and adopted the shelf registration system.¹²⁴ While not ultimately adopted,

118 Prospectus Directive, n 25 above, Art. 9.3, 2003 O.J. (L345) at 75.

119 Ibid.

120 Ibid. Art. 9.4, 2003 O.J. (345) at 75.

121 Eg Henry T.C. Hu, *The New Portfolio Society, SEC Mutual Fund Disclosure, and the Public Corporation Model*, 60 Bus. Law. 1303, 1304-05 (2005) (comparing the SEC's embrace of the efficient capital markets hypothesis regarding public company registration and disclosure and the 'backwater' state of mutual fund registration).

122 Securities Offering Reform, Securities Act Release No. 8591, Exchange Act Release No. 52,056, Investment Company Act Release No. 26,993, International Series Release No. 1294, 70 Fed. Reg. 44721, at 44,727 (19 July 2005), [hereinafter Securities Offering Reform Release].

123 Ibid. at 44,726 n 40.

124 See Adoption of the Integrated Disclosure System, SEC Release No. 33-6383, 24 SEC Docket 1262-1 (3 March 1982); Delayed or Continuous Offering and Sale of Securities, SEC Release No. 33-6423, 26 SEC Docket 2-02 (2 September 1982); Shelf Registration, SEC Release No. 33-6499, 29 SEC Docket 138-01 (17 November 1983); see also Edward Greene, *Determining the Responsibilities of Underwriters Distributing Securities Within an Integrated Disclosure System*, 56 Notre Dame L. Rev. 755 (1981).

the SEC's aircraft carrier proposal also contemplated streamlining the offering process by, among other things, eliminating review of registration statements of certain seasoned issuers and adopting a system of 'company registration'.¹²⁵ In its latest securities offering reform measures,¹²⁶ the SEC determined that such Well Known Seasoned Issuers ('WKSIs') should have instant market access, without prior review or approval of the offering documents by the SEC.¹²⁷ For these issuers the SEC will instead focus its attention on their continuous periodic disclosure to the marketplace.¹²⁸ In light of the SEC's long-time trend towards removing obstacles to public offerings for large, well-followed public companies, it is unfortunate that the EU determined not to adopt this approach.¹²⁹

The minimum requirements for on-going disclosure by companies with securities admitted to trading on a regulated exchange in the EU are set forth in the Transparency Directive.¹³⁰ With certain exceptions, the Transparency Directive requires issuers to publish annual and semi-annual and, in most cases, consolidated financial statements prepared under IFRS or another basis deemed equivalent and also requires issuers that do not publish quarterly reports to publish, in the period between the annual and semi-annual reports, interim management reports on material developments.¹³¹ In contrast to the maximum harmonization provided under the Prospectus Directive, the Transparency Directive is a minimum harmonization directive that permits an issuer's home state to exceed the minimum requirements the directive sets forth for publication of annual and semi-annual financial reports and shareholder holdings information (although it prohibits host Member States from requiring disclosure in excess of that required by the issuer's home state).¹³² Unfortunately, the Transparency Directive does not move towards a system of integrated disclosure in which an issuer's periodic disclosure requirements could meet the requirements for disclosure in connection with an offering. For example, there is no requirement that the periodic reports of an issuer with securities admitted for trading include the management discussion and analysis disclosure that is required for equity prospectuses under the Prospectus Directive, although many large European issuers do include such disclosure in their annual reports voluntarily.

125 Regulation of Securities Offerings, SEC Release No. 33-7606, 68 SEC Docket 835 (3 November 1998).

126 Securities Offering Reform Release at 44724-25.

127 *Ibid.* at 44,722. A WKSI is defined, generally, as an issuer that: (i) is required to file reports under the Exchange Act, (ii) is current, and has for the preceding 12 months been timely, in filing those reports, (iii) is eligible to use Form S-3 or F-3, (iv) has \$700 million in equity or \$1 billion in debt outstanding and (v) is not otherwise ineligible. The SEC estimates that in 2004, WKSIs were only 30% of all listed issuers, but accounted for about 95% of the total US market capitalization and 96% of the total debt raised by issuers on major exchanges or equity markets over the last eight years. *Ibid.* at 70 Fed. Reg. 44727.

128 The SEC is required by § 408 of the Sarbanes Oxley Act, 15 U.S.C. § 7266, to review the periodic disclosure of issuers that report under s. 13(a) of the Exchange Act, 15 U.S.C. § 78m, and that have a class of securities listed on a national securities exchange or traded on an automated quotation facility of a national securities association not less frequently than every three years.

129 Some in the industry would argue that the EU rightly determined that the level of disclosure required of public companies on an on-going basis should be less than that required in connection with an offering of securities, however this reflects a fundamentally different regulatory approach than that of the SEC.

130 Council Directive 2004/109/EC, 2004 O.J. (L 390) 38 (15 December 2004) (EU).

131 *Ibid.* Art. 4-6, 2004 O.J. (L 390) at 44-46.

132 *Ibid.* Art. 3, 2004 O.J. (L 390) at 44.

The lack of an integrated disclosure system in the EU means that the US is now a more efficient market for large, frequent issuers, though this may not be enough to change the negative view of the US public market held by many European companies.

Cross-border regulatory enforcement

For several years, some commentators have recommended that the EU develop a centralized administrative body to oversee the European securities markets.¹³³ One advantage of such a system is that it would further the unification of European securities law, and facilitate planning by issuers and securities purchasers.¹³⁴ For example, even though MAD contains a duty-to-disclose provision regarding inside information, there is no method for disclosing that information effectively upon which all European regulators agree.¹³⁵

Even where regulators agree on the appropriate interpretation of MAD, there are still systemic inefficiencies caused by the lack of a European equivalent to the SEC. In situations in which investors in more than one EU Member State make allegations of market abuse, the lack of a single EU securities regulator with full authority to administer these rules means that market participants are exposed to multiple investigations of the same transaction. There is also no formal mechanism to facilitate cooperation or coordination in the investigations; rather each regulator will generally conduct its own parallel investigation. This process results in duplicative requests for information and decisions based on inconsistent levels of information. Moreover, the roles of regulators differ, with some European regulators having no power to settle matters—a power that the Financial Services Authority ('FSA') in the United Kingdom and the SEC have and use extensively. For example, the German regulator, the Federal Financial Supervisory Authority, is required to report facts giving rise to suspicion of certain criminal offences, generally including intentional market manipulation with a demonstrable effect on the market, to the competent public prosecutor's office, which limits the German regulator's ability to resolve allegations of criminal market abuse on its own.¹³⁶ Notwithstanding any language included in a settlement with

133 Eg Pierre-Marie Boury, 'Does the European Union need a Securities and Exchange Commission?' 1 Capital Markets Law Journal 184 (2006); Roberta S. Karmel, 'The Case for a European Securities Commission,' 28 Colum. J. Transnat'l L. 9 (1999) (arguing that the regulation of securities in Europe by numerous Member State regulators only leads to a fragmented, inflexible system susceptible to local biases); Manning Gilbert Warren, III, *Global Harmonization of Securities Laws: The Achievements of the European Communities*, 31 Harv. Int'l L.J. 185, 231 (1990). From the contrary perspective others emphasize the difficulties that would attend the establishment of a central EU securities regulator such as the possibility that drawing personnel from all member states, including those with less developed capital markets, could result in a regulator that does not have as much industry experience as the regulators in jurisdictions with more developed capital markets.

134 Eric Engle, 'The EU Means Business: A Survey of Legal Challenges and Opportunities in the New Europe,' 4 DePaul Bus. & Com. L.J. 351, 379–81 (2006).

135 Roberta S. Karmel, 'Reform of Public Company Disclosure in Europe,' 26 U. Pa. J. Int'l Econ. L. 379, 400 (2005).

136 See Wertpapierhandelsgesetzes [Securities Trading Act], 17 September 1998 BGBl. I at s. 4(5) of the Securities Trading Act (Gesetz über den Wertpapierhandel/Wertpapierhandelsgesetz - WpHG) as published in the announcement on 9 September 1998 (Federal Law Gazette I, p. 2708) last amended by Art. 10a of the Law of 22 May 2005 (Federal Law Gazette I, p. 1373), an unofficial translation of which is available at http://www.baweb.de/gesetze/wphg_en.htm#p38. In France, as well, the financial markets regulator, the Autorité des Marchés Financiers, refers suspected criminal offences, including suspected cases of market manipulation (price manipulation, misinformation and insider trading), to the public prosecutor for the Paris regional court, which has sole jurisdiction in such cases. See, eg http://www.amf-france.org/affiche_page.asp?urldoc=lesmissionsamf.htm&lang=en&Id_Tab=0.

a regulator in a jurisdiction with such rules, the settlement can only compound the problem in other jurisdictions where the regulator must decide whether the activity requires it to bring the matter before an independent tribunal.¹³⁷

4. The US faces an increasing need to be proactive

The implementation of the FSAP has both fostered the uniformity, and improved the regulation, of the EU market for financial instruments and contributed in several ways to convergence with US regulation. As described in the preceding section, there appears to be sufficient engagement in the area of accounting standards that mutual recognition is foreseeable. In several other areas—audit and auditor standards, non-financial disclosure in connection with securities offerings, securities intermediary and exchange regulation and the technical exceptions to market manipulation prohibitions for offering-related activity—the FSAP legislation, subject to the details of implementation in the Member States, holds promise for further convergence that could facilitate determinations of mutual recognition. And there are several areas where unnecessary regulatory divergence continues to divide the transatlantic market even after the FSAP reforms—the structure of regulation of securities offering, insider-trading provisions and regulatory enforcement. The United States should now undertake to address these areas and build on the progress achieved by the FSAP.

The importance of reducing arbitrary regulatory barriers—whether by harmonization, unilateral recognition or mutual recognition—is increasing from the US perspective. While European and other non-US issuers were previously willing to subject themselves to US regulation in order to access the capital markets in the United States, this willingness appears to be decreasing.¹³⁸ In recent years non-US issuers considering cross-border financings are increasingly seeking foreign listings outside the United States.¹³⁹ The statistics available with respect to initial public offerings are abundant.¹⁴⁰ For example, in 2005, 23 non-US companies chose US exchanges for their IPOs, raising a total of \$3.8 billion (€3 billion), while 126 non-EU companies (including 13 from the United States) chose European exchanges for their IPOs, raising \$12.2 billion (€9.6 billion).¹⁴¹ Foreign issuers have continued to access the US capital markets, but

137 For an interesting discussion of the enforcement actions regarding the Citigroup MTS Eurozone government bond trades involving 13 jurisdictions, see Bradley J. Gans, “Enforcement Cooperation: Lessons of MTS”, *International Financial Law Review*, Oct. 2006, p. 44.

138 For an extensive discussion on the decreased competitiveness of the U.S. capital markets for non-US issuers, see Committee on Capital Markets Regulation Interim Report, n 1 above at 23–58.

139 *Eg LSE raises record £28bn listings*, *Fin. Times*, 2 January 2007 (which reported that the LSE raised a record £28 billion in listings in 2006, including £9 billion in new listings), and *Demise of the ADR*, *Fin. Times*, 12 March 2006 (which reported that 35 companies with ADRs listed on the NYSE, 7% of the total, delisted in 2005 and that according to Bank of New York, of the 106 non-US companies that started depositary receipt programmes in 2005, only 29 chose the US).

140 *Eg* Committee on Capital Markets Regulation Interim Report, n 1 above.

141 *PricewaterhouseCoopers, IPO Watch Europe—Review of the Year 2005* 16 (2006). Moreover, according to testimony on 26 April 2006 by Marshall Carter, Chairman of NYSE Group, Inc., before the Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises of the US House of Representatives, the proportion of equity raised on US exchanges in worldwide IPOs by non-US companies declined from approximately 50% in 2000 to approximately 5% in 2005, and only 1 of the top 24 global IPOs in 2005 was registered in the USA.

they have done so through private placements that are limited to institutional investors and exempt from most US regulation.¹⁴² There are a number of reasons for this shift including the passage of the Sarbanes-Oxley Act, class action litigation in the United States, the general regulatory environment in the United States, underperformance of US stocks and the relative cost and complication of a New York listing, as well as the availability of alternative markets and the geographical location of recent issuers.¹⁴³ In addition to which market is more attractive to third-country issuers, a significant indication of the future competitiveness of the US and EU securities markets will be provided by the extent to which the EU will permit the development of alternative exchanges that do not subject an issuer to the disclosure and accounting standards required for listing on regulated exchanges. Such exchanges are already active in London and Luxembourg.¹⁴⁴ The relative competitiveness of securities markets is not merely a matter of prestige given that financial services make an increasingly large portion of the economies of developed countries.

The SEC must seriously consider whether the US market will remain competitive with respect to non-US companies. The Committee on Capital Markets Regulation made several recommendations in its Interim Report including moving to a more principles-based regulatory regime with more coordination between state and federal authorities, clarifying and improving certain aspects of securities enforcement actions, improving shareholder rights and easing some of burdens created by the implementation of Sarbanes Oxley.¹⁴⁵ To the extent US institutions are being subjected to additional and different regulation under the FSAP, there is an incentive for those institutions to urge the SEC to negotiate rational arrangements involving mutual recognition. Moreover, the EU has forced the SEC to begin bargaining by making clear that findings of equivalence of US standards are not a foregone conclusion. An example is the EU

142 In 2005, foreign companies raised \$53.2 billion in equity in US private offerings compared to only \$4.7 billion in equity in US public offerings. Committee on Capital Markets Regulation Interim Report, n 1 above at x. There are similar signs in other sectors of the market. As Member of Parliament Ed Balls recently observed London is now the location for 70% of the global secondary bond market, over 40% of the derivatives market, over 30% of world foreign exchange business, over 40% of cross-border equities trading and 20% of cross-border bank lending. Ed Balls MP, Economic Secretary to the Treasury, *The City as the Global Finance Centre: Risks & Opportunities*, Address at Bloomberg (14 June 2006), available at http://www.hm-treasury.gov.uk/newsroom_and_speeches/press/2006/press_42_06.cfm.

143 Eg Committee on Capital Markets Regulation Interim Report, n 1 above. It has also been suggested one factor may be the higher fees charged by investment banks in the USA, though others have questioned whether these fees are significant enough to influence the cross-border listing decision. Compare Alan Murray, *Fees May Be Costing Wall Street Its Edge in Global IPO Market*, Wall St.J., 2 August 2006 at A2 with Commission on Capital Markets Regulation Interim Report, n 1 above at 49 ('underwriting fees alone cannot explain the significant drop in the US share of global IPOs'). Although it is beyond the scope of this article, another reason for the unattractiveness of the US markets for non-US issuers is the difficulty of exiting the US markets even if there is little investor interest for the issuers securities. The SEC has recently re-proposed new rules to address this problem. See SEC, *Termination of a Foreign Private Issuer's Registration of a Class of Securities Under Section 129 g) and Duty to File Reports Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934*, Release No. 34-55005, International Series Release No. 1300 (22 December 2006). For a more detailed discussion of this subject and the SEC's recent proposals in this area, see Edward F. Greene and Robert Underhill, *Deregistration Issues for Foreign Private Issuers* (upcoming publication in the Capital Markets Law Journal); Committee on Capital Markets Regulation Interim Report, n 1 above.

144 According to a study by the London Stock Exchange, in 2005, 52% of the European IPOs were listed on the LSE's AIM, which is not a regulated market for the purposes of the Prospectus Directive. *The Cost of Capital: An International Comparison*, June 2006, available at http://www.londonstockexchange.com/NR/rdonlyres/B032122B-B1DA-4E4A-B1C8-42D2FAE8EB01/0/Costofcapital_full.pdf.

145 Committee on Capital Markets Regulation Interim Report, n 1 at xii.

determination, mentioned earlier, that the status quo with respect to US GAAP continue only until the end of 2008. EU regulation has also resulted in SEC action with respect to the issue of consolidated supervision, which is imposed on all groups providing financial services in Europe under the Directive on Financial Conglomerates.¹⁴⁶ After the passage of this directive, US broker–dealers, which have operated in Europe through different legal entities that are not supervised by the SEC, were faced with group-wide supervision by the FSA. In response, the SEC adopted amendments to the net capital rule permitting holding companies of US broker–dealers to register with the SEC as Consolidated Supervised Entities. Companies making such registration, in addition to being permitted to use an alternative method for computing net capital, will be recognized by the EU as being subject to regulation equivalent to that imposed on EU financial holding companies.¹⁴⁷ If the United States does not adequately respond to the challenges to the competitiveness of US markets, US retail investors will be most disadvantaged since US institutional investors have a global presence and access to unregistered and other foreign markets.

5. Proposed agenda

In light of these circumstances, more attention should be paid to approaching EU–US convergence in a programmatic fashion designed to lead quickly to mutual recognition. In the past, transatlantic convergence has taken place in an inefficient case-by-case, issue-by-issue ad hoc manner. Instead an agenda, much like the FSAP and the accounting roadmap, should be created between the United States and the EU to identify and facilitate transatlantic securities regulation convergence in the short-term and longer term.¹⁴⁸ Since 2002, the United States and the EU have held high-level discussions, in the forum of the US–EU Financial Markets Dialogue, between the staff of the US Department of Treasury, the SEC and the Federal Reserve Board and the European Commission.¹⁴⁹ This dialogue should adopt such a formal agenda with timelines for achieving each step and a formal process of progress reports.

The agenda should include continued monitoring of the progress of the applicable institutions in the areas that seem to be on track for mutual recognition: accounting standards, audit and auditor standards and non-financial disclosure requirements for securities offerings, which are already almost completely harmonized. In addition,

146 Council Directive 2002/87/EC, 2003 O.J. (L 35) 1 (2002) (EC).

147 Alternative Net Capital Requirements for Broker–Dealers That Are Part of Consolidated Supervised Entities, SEC Release No. 34-49830, 82 SEC Docket 3515 (8 June 2004) and Supervised Investment Bank Holding Companies, SEC Release No. 34-49831, 82 SEC Docket 3578 (8 June 2004).

148 Others have proposed frameworks for coordination on securities regulations between the USA and the EU. For example, in 2004 the SIA outlined five areas for increased cooperation—public offering documents, broker–dealer registration, credit-rating agencies, anti-money laundering standards and corporate governance. SIA Press Release U.S. Securities Industry Urges SEC, EU to Forge Framework to Achieve Regulatory ‘Convergence’, 4 April 2004 available at http://www.sia.com/press/2004_press_releases/html/pr_convergence.html.

149 An introduction to the activities of the dialogue can be found on the website of the US Mission to the EU at http://useu.usmission.gov/Dossiers/Financial_Services/Mar0906_Sobel_Financial_Dialogue.asp.

it should include the following matters to address the areas described earlier where more progress is necessary in order to achieve convergence.

Mutual recognition of regulation of securities intermediaries and securities exchanges

One of the first areas in which the EU and the US should work towards a mutual recognition approach to regulation is with respect to securities intermediaries and securities exchanges. The current approach to regulation in the United States to both of these areas makes cross-border investment costly and inefficient. Mutual recognition will increase investors' access to foreign investments and eliminate burdensome and duplicative regulation. This will be especially important for retail investors who cannot otherwise access foreign markets and will promote optimal diversification.

As mentioned earlier, Tafara and Peterson have proposed a bold new framework for the regulation of non-US securities intermediaries and securities exchanges. The proposed framework, if adopted by the SEC, would exempt a non-US intermediary or exchange seeking to access US investors from SEC registration and prudential oversight if (i) it is subject to a regulatory regime that the SEC has determined offers comparable regulatory oversight, and (ii) the SEC and its home country regulator have entered into an agreement that allows for prudential and enforcement information-sharing and contains an undertaking by the non-US regulator describing how any regulatory pre-conditions set by the SEC are met (and a reciprocal undertaking by the SEC regarding any regulatory preconditions set by the non-US regulator). This exemption from SEC registration would be limited to transactions in foreign securities and would be the subject of a detailed review and reassessment process every five years. As a condition of the exemption the foreign financial service provider would be required to make available to US investors and the SEC a description of the differences between the legal and regulatory protections provided by its home country regulator and those provided under US law with respect to US intermediaries or exchanges (as applicable). Finally, although the foreign financial service provider would remain subject to the rules and regulations of its home jurisdiction with respect to its activities in the United States, and the SEC would not enforce those rules and regulations, the foreign financial service provider's US securities activities would be subject to the anti-fraud provisions of the US securities laws, which would continue to be enforced by the US federal authorities (including the SEC).¹⁵⁰

This proposal should be pursued so that securities intermediaries that are regulated in EU Member States with comparable regulation, regardless of whether or not they are affiliated with US registered broker-dealers, are able to provide services in respect of European securities products to US investors without registering with the SEC. Given the CFTC's experience with its Part 30 Rules, and the evolution

150 See *Beyond Borders: Time to Tear Down the Barriers to Global Investing*, n 70 above at 89 (citations and footnotes omitted) (describing the proposal contained in *A Blueprint for Cross-Border Access to US Investors: A New International Framework*, n 70 above),

of the international securities and regulatory environment over the last 20 years, it should not be too controversial to permit a securities intermediary registered in one jurisdiction to provide services, at least to some classes of investors in the other jurisdiction, more freely than is currently permitted under Rule 15a-6. In addition, each of the US and the EU should allow financial institutions in its jurisdiction direct access to securities exchanges that are regulated by authorities in the other without imposing a registration requirement on such exchanges, where existing regulation is comparable. Although this has been and will continue to be a hotly debated point of contention on both sides of the Atlantic, the markets may have advanced to a point where the SEC's regulation could be argued to serve at least as much to protect US markets as US investors.¹⁵¹

Mutual recognition of intermediaries and exchanges may once again raise issues of political sensitivities since it will require the SEC to base judgment on the regulatory structures of the EU Member States. One potential solution would be for the SEC to review only the directives an EU state has implemented in order to determine whether its regime is sufficiently comparable. However, it is highly unlikely that the SEC would be willing to limit its review in this manner. Absent a single securities regulator for the EU, any evaluation for purposes of mutual recognition will need to be done Member State by Member State.

It will be important for both jurisdictions to evaluate each other's regulatory regimes at the appropriate level. Evaluation must be a high-level, principles-based assessment in order to be successful. For example, at the heart of any comparable regulatory scheme must be a general investor protection mandate, and, in addition, the regulator must have robust supervision and enforcement mechanisms. A detailed, rule-by-rule examination of how each regulator implements these principles and achieves its goals would most likely become too entangled in the details and differences between the two regimes to ever result in a determination that the regulatory regimes are sufficiently comparable, and a requirement to harmonize the two regimes, while perhaps academically appealing, is simply not realistic, nor—given inevitable differences in application and enforcement—is it achievable.¹⁵² In order to facilitate this level of review, the SEC and the EU (possibly under the auspices of CESR) should agree upon a set of fundamental principles that should be present in each jurisdiction.¹⁵³

151 See Foreign trading screens in the USA, n 86 above.

152 See *Beyond Borders: Time to Tear Down the Barriers to Global Investing* n 70 above at 89–92.

153 For example, the CFTC has identified six basic elements for comparable regulation of intermediaries, see n 15 above. The CFTC has also identified a similar set of basic elements for evaluations of foreign exchanges seeking to access US investors. See 71 Fed. Reg. at 64446.

After agreeing on the basic principles, the EU and the United States should agree on one or several EU Member States for a pilot programme that could be implemented in short order. Consideration should be given to EU Member States that already have comprehensive information sharing agreements in place, such as the UK.¹⁵⁴ Access to US investors by EU intermediaries and exchanges (and to EU investors by US intermediaries and exchanges) under the pilot programme could also be limited to those large institutional investors that the SEC and the EU agree are sufficiently sophisticated and able to fend for themselves. These investors likely have considerable experience with cross-border investment and should be able to evaluate the regulatory differences (which would be detailed in a disclosure statement provided by the relevant intermediary or exchange) and the potential risks and rewards of dealing directly with financial service providers located in jurisdictions outside their home markets.¹⁵⁵

The pilot programme should provide the SEC and the EU sufficient time (eg three to five years) to evaluate the efficacy of the programme and to determine whether it should be expanded to include additional jurisdictions and/or other types of investors. The knowledge gained from observing how the participants in the pilot programme interact will also help to identify strengths and weaknesses in the regulatory regimes of each participating jurisdiction and provide a meaningful framework for the assessment of other potential participants.¹⁵⁶ This programme might have the added benefit of encouraging EU states to harmonize their own definitions of different investor classes, and the US would have some leverage and input into that process.

In addition, the EU and the US should work together to implement the recommendations of the Joint Industry Report for creating a wholesale market for securities intermediaries. There should be common treatment of wholesale equities and equities derivatives customers of market intermediaries and the other conduct of business issues addressed in the Joint Industry Report, with view to having an almost seamless wholesale market where regulation can be lighter. In some cases this may be as simple as regulatory cooperation to harmonize financial measures used as a proxy for investor sophistication.

The EU recognizes that wholesale trading is an area where equivalence is nearer. The October 2004 Himalaya report noted that different sectors of the EU securities market have integrated and are integrating at different speeds, with, for example, more extensive integration in sectors such as corporate debt securities, equity of 'blue-chip' issuers and certain markets for wholesale financial products.¹⁵⁷ The report notes that

154 See Memorandum of Understanding between the United States Securities and Exchange Commission and the United Kingdom Financial Services Authority Concerning Consultation, Cooperation and the Exchange of Information Related to Market Oversight and the Supervision of Financial Services Firms (14 March 2006), available at http://www.sec.gov/about/offices/oia/oia_multilateral/ukfsa_mou.pdf.

155 See *Beyond Borders: Time to Tear Down the Barriers to Global Investing* n 70 above at 92–95.

156 *Ibid.* at 95.

157 Committee of European Securities Regulators, *Annual Report of the Committee of European Securities Regulators to the European Commission of the European Parliament and the EcoFin Council*, CESR Ref. 04-333f (2004).

a central obstacle to CESR's principal goal of promoting convergence of policy, supervision and enforcement in financial markets is the variety of views among national regulators on matters such as the level of risk acceptable to investors, how active regulators should be, the weight attached to the benefits of market innovation and the role of regulation in restoring market confidence. These concerns seem less relevant in the case of a wholesale market.

Home country regulation of stabilization and related issues

The EU and United States should resolve the overlapping requirements of MAD and the safe harbour for stabilization established by the Stabilization Implementation Regulation and applicable US law.

As discussed earlier, both the EU and US regimes apply these rules to worldwide stabilizing activities connected to a domestic public offering.¹⁵⁸ Instead of requiring global offerings to comply with both regimes, there should be a single set of rules on stabilization and syndicate covering transactions that govern in cross-border offerings. This would represent an extension of principles in place prior to MAD. Under Rule 104 of Regulation M, the SEC permits stabilization outside the United States during an offering in the US subject, generally, to (i) the stabilization price not exceeding the US offering price and (ii) the stabilization activities being carried out in a jurisdiction with comparable stabilization regulation.¹⁵⁹ The SEC concluded that the United Kingdom had comparable rules.¹⁶⁰ Similarly, the UK rules in effect prior to the effectiveness of MAD permitted stabilization in the United States in compliance with Rule 104 of Regulation M.¹⁶¹ As discussed earlier, the purpose and requirements concerning timing, disclosure and price of the EU stabilization rules are substantially similar to the US rules, and the US and the EU should work towards convergence on the treatment of naked short positions and syndicate covering transactions. In addition, the US and EU should agree that a single set of rules apply to stabilization and syndicate covering transactions, which could either be the rules of the issuer's home jurisdiction or, if different, the jurisdiction to which the largest share of the offering is allotted. This would allow issuers and underwriters to operate with the efficiency and certainty afforded by a single set of rules.

Home country regulation of WKSIs

Another important area that should be addressed is the raising of capital. Companies of a certain size should be able to access markets across borders using the disclosure and accounting standards, as well as the prospectus format, mandated by their home

158 See MAD Art. 10, n 95 above (applying MAD to extraterritorial actions); Reg M, r 104(g), 17 C.F.R. § 242.104(g) (foreign stabilization activities related to a US public offering allowed only if the safe harbour provisions of this section are met).

159 17 C.F.R. pts 200, 228–230, 240, 242.

160 SEC Release No. 34-38067, 63 SEC Docket 1141 (20 December 1996).

161 The current rules in the UK recognize Regulation M to a limited extent. FSA Handbook Market Conduct 2.5 (available at <http://fsahandbook.info/FSA/html/handbook/MAR/2/5>).

country. While they could be subject to the liability and market abuse regimes of the host country,¹⁶² they would not be subject to ongoing disclosure or governance requirements in the host country, such as the requirement under the Sarbanes-Oxley Act for management certification of periodic disclosure and internal controls, as a result of making an offer.¹⁶³ Under this proposal, US WKSIs would receive this treatment in Europe and EU companies with at least \$1 billion of voting and non-voting equity held by non-affiliates that are eligible to use Form F-3 to register with the SEC would receive this treatment in the United States without in fact having to register, including the ability to provide financial disclosure prepared in accordance with IFRS. There can be no doubt that the disclosure provided by these companies in both markets under the current rules is equivalent, in part driven by investor demand for information about well-followed companies.¹⁶⁴ Reliance should be on the home regulator as to whether any review of the offer document is necessary wherever the offering takes place. The EU should accept the SEC's decision to examine only the periodic disclosures of WKSIs and not their offering documents. Similarly, EU home regulators could review prospectuses of eligible EU issuers or adopt the US approach.

Coordination of enforcement

Finally, the EU and the SEC should create a coordination mechanism for enforcement. While a spectrum of proposals has been put forth in the EU, the mechanism should provide the maximum possible authority for streamlined decision-making, preferably through a single decision-maker. IOSCO has promulgated a multilateral memorandum of understanding that coordinates information sharing among members.¹⁶⁵ The March 2006 memorandum of understanding between the FSA and the SEC on market oversight and the supervision of financial services firms is a helpful step by providing liberally for sharing information and coordinated examinations, which encourages the

162 The importance to foreign firms considering raising capital in the USA of retaining home country liability standards could become less important if the recommendations of the Committee on Capital Markets Regulation Interim Report, n 1 above, are adopted. The report suggests that the securities law liability exposure in the USA could be made more rational by, among other things, resolving uncertainties in the interpretation of r 10b-5, eliminating duplication of recoveries in private and SEC actions, and allowing shareholders of US corporations to elect arbitration or waive trial by jury in connection with shareholder derivative actions. See, pp. 11–17. If adopted, these recommendations would further decrease the disincentives for foreign firms to raise capital in the USA.

163 Sarbanes Oxley Act §§ 302 & 404, 15 U.S.C. § 7266 (2002). It is worth noting that recently both the SEC and the PCAOB have taken measures designed to reduce the burden of compliance with § 404 of the Sarbanes Oxley Act. See SEC Release 33-8762, Management's Report On Internal Control Over Financial Reporting (20 December 2006) and the PCAOB's Proposed Auditing Standard—An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements, Proposed Auditing Standard—Considering and Using the Work of Others and Proposed Rule 3525—Audit Committee Pre-approval of Services Related to Internal Control (19 December 2006).

164 The SEC may require some assurance that this disclosure is available to US investors as a practical matter; however, the EU continues to work toward a system such as the SEC's EDGAR to provide uniform, easily available disclosure. In its June technical advice CESR recommended a networked approach in which each jurisdiction would be responsible for establishing its own electronic mechanism, subject to minimum standards on a variety of matters, including interoperability, 24-hour accessibility and the use of a language commonly used in international finance, along with the local language. Whether the mechanisms will be public or private remains a political issue. Committee of European Securities Regulators, *CESR's Final Technical Advice On Possible Implementing Measures Concerning The Transparency Directive: Storage Of Regulated Information And Filing Of Regulated Information*, CESR/06-292 (June 2006) available at http://www.cesr-eu.org/data/document/06_292.pdf.

165 Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD126.pdf> with a list of current signatories available at http://www.iosco.org/library/index.cfm?section=mou_siglist.

environment necessary for joint or deferred enforcement, while appropriately limiting the availability of shared information for enforcement.¹⁶⁶ What is needed, however, is a more robust model of international cooperation in which allegations of market abuse can be resolved promptly by a single representative regulator from the EU and the United States.¹⁶⁷

To this end, the SEC and the EC should enter into an MOU that would provide that if there is a cross-border investigation involving the US and more than one EU market, the SEC and the EC would agree which EU regulator would take the lead and act with the SEC on behalf of all European regulators, with fines being allocated pursuant to an agreed formula. There is precedent for such cooperation, including the cooperation between the FSA and the SEC in the resolution of the Shell matter.¹⁶⁸ This, however, is not a perfect example because although the resolution of the Shell matter was done cooperatively, the investigations appear to have been parallel. While the EU has implemented provisions to encourage the cooperation of the securities regulators in Member States,¹⁶⁹ there is no indication that Member State securities law regulators have yet considered deferring their involvement in an investigation to a lead regulator. In order to have a truly unified marketplace within the EU, the securities regulators will need to better coordinate enforcement actions in order to achieve more consistent outcomes within the EU IOSCO has recently discussed the need for lead regulators in cross-border regulatory enforcement actions on a more global basis. However, before there can be progress on a global basis, the EU must create a mechanism to coordinate the activities of the multitude of securities regulators within the EU. Because a single EU securities regulator is not likely in the near future, the regulators of the various Member States should agree to defer to a lead regulator in enforcement actions that involve multiple jurisdictions.

6. Conclusion

Although political factors may impede changes in the regulation of cross-border activities, the markets themselves and the institutions that participate in them will continue to become more global. It will be incumbent on the regulators of the various jurisdictions involved in these markets to view regulation more globally. This article has addressed the prospects for removing arbitrary regulatory barriers and proposed several

166 Available at http://sec.gov/about/offices/oia/oia_multilateral/ukfsa_mou.pdf. The memorandum provides that when one party wants to use information for enforcement purposes prior consent must be sought from the other party. Use will be subject to the terms and conditions of the arrangements referred to above concerning cooperation in enforcement matters.

167 Eg Bradley J. Gans, n 137 above.

168 The Royal Dutch Shell Group entered into separate settlements based on largely the same facts with both the SEC and the FSA on 24 August 2004. The FSA settlement is available at http://www.fsa.gov.uk/pubs/final/shell_24aug04.pdf and the SEC settlement is available at <http://sec.gov/litigation/admin/34-50233.pdf>. For a more in-depth discussion of the Shell matter, see Gans, n 137 above.

169 MAD Art. 16 provides that regulators in Member States must cooperate, including by exchanging information and, subject to a requested state's judgment that doing so would adversely affect its sovereignty, security or public policy, cooperating in investigation activities within the territory of the requested state. The members of CESR had previously entered into the Multilateral Memorandum of Understanding on the Exchange of Information and Surveillance of Securities Activities (26 January 1999). However, neither MAD nor the memorandum provides a mechanism for the selection of a lead regulator for investigations of alleged market abuse.

steps that should be taken. In sum, the first step is for the US and EU to create an agenda to facilitate transatlantic securities regulation convergence in the short term. The US–EU Financial Markets Dialogue should play a key role in this connection. Determinations of equivalence of regulation, and consequent deferral to home country regulation, should be possible in the areas of the regulation of secondary trading, especially in the wholesale securities markets, stabilization and other offering execution matters, and the structure of regulation of securities offerings by large, well-followed issuers. There should also be closer coordination in enforcement and deferral to a lead regulator on enforcement matters. These steps should not be overly onerous or controversial to implement and will significantly improve existing regulation. More importantly for the long term, accomplishment of these steps could encourage securities regulators in both the US and the EU to view securities regulation in a more global manner. A truly transatlantic securities marketplace will reduce costs, increase investment returns, facilitate more efficient deployment of capital and promote global economic growth.