

## The Internationalization of Securities Regulation: The United States Government's Role in Regulating the Global Capital Markets

Eric. C. Chaffee

Follow this and additional works at: <http://digitalcommons.law.umaryland.edu/jbtl>

 Part of the [International Law Commons](#), and the [Securities Law Commons](#)

---

### Recommended Citation

Eric. C. Chaffee, *The Internationalization of Securities Regulation: The United States Government's Role in Regulating the Global Capital Markets*, 5 J. Bus. & Tech. L. 187 (2010)

Available at: <http://digitalcommons.law.umaryland.edu/jbtl/vol5/iss2/2>

This Articles & Essays is brought to you for free and open access by the Academic Journals at DigitalCommons@UM Carey Law. It has been accepted for inclusion in Journal of Business & Technology Law by an authorized editor of DigitalCommons@UM Carey Law. For more information, please contact [smccarty@law.umaryland.edu](mailto:smccarty@law.umaryland.edu).

## The Internationalization of Securities Regulation: The United States Government's Role in Regulating the Global Capital Markets

### I. INTRODUCTION

THE FINANCIAL CRISIS THAT BEGAN IN 2008 is arguably the worst financial downturn since the Great Depression.<sup>1</sup> In fact, the recent financial crisis should likely be categorized as a depression, rather than a mere recession because the occurrence of a depression is determined by the severity of the economic downturn, the general sense of crisis, and the radicalism of the government's response.<sup>2</sup> Although the economy of the United States has somewhat rebounded, each of these factors for determining the existence of a depression is arguably met by the financial downturn, based on the initial sharp economic decline, the sense of crisis associated with the downturn, and the unprecedented government bailout of the financial services industry.<sup>3</sup>

To grossly oversimplify the crisis, many lenders in the United States began issuing high-risk mortgages, which created a "bubble" in housing prices.<sup>4</sup> The high risk mortgages were then pooled together and sold to special purpose entities.<sup>5</sup> The

---

© 2010 Eric C. Chaffee.

\* Associate Professor and Chair of the Project for Law and Business Ethics, University of Dayton School of Law; J.D., University of Pennsylvania Law School; B.A., The Ohio State University. I would like to thank Christine Gall, Esq. for reviewing drafts of this essay and her encouragement during the drafting process. I would also like to thank the editorial board of the *Journal of Business & Technology Law* for inviting me to contribute to this symposium issue and Professor Michelle M. Harner for extending the invitation on their behalf. The views set forth in this essay are completely my own and do not necessarily reflect the views of any employer or client either past or present.

1. See RICHARD A. POSNER, *A FAILURE OF CAPITALISM: THE CRISIS OF '08 AND THE DESCENT INTO DEPRESSION* vii (2009) ("We are in the midst of the biggest economic crisis since the Great Depression of the 1930s.").

2. See *id.* at x ("It is the gravity of the economic downturn, the radicalism of the government's responses, and the pervading sense of crisis that mark what the economy is going through as a depression.").

3. See *id.*

4. See generally Steven L. Schwarcz, *Understanding the Subprime Financial Crisis*, 60 S.C. L. REV. 549, 549–55 (2009) (providing an overview of how and why the financial crisis that began in 2008 came into being).

5. See Jerry W. Markham, *The Subprime Crisis—Some Thoughts on a "Sustainable" and "Organic" Regulatory System*, 4 FIU L. REV. 381, 387 (2009) ("In a securitization, mortgages 'warehoused' (purchased) by

special purpose entities issued securities to pay for the pools of mortgages and assets that had been transferred to them.<sup>6</sup> Many of the mortgage-backed securities from these special purpose entities were ultimately sold to financial institutions and other institutional investors.<sup>7</sup> When the default rate on the high-risk mortgages increased dramatically, the mortgage-backed securities were devalued.<sup>8</sup> This devaluation resulted in a major decline in the availability of credit in the United States economy because many financial institutions were no longer willing to extend credit due to the uncertainty as to the value of the mortgage-backed securities in their portfolios.<sup>9</sup> As a result of this, the financial crisis ensued.<sup>10</sup>

The causes of the financial crisis that began in 2008 are complex and will be debated for years to come. Some commentators fault the decision of Federal Reserve's Federal Open Market Committee to keep interest rates low in the early years of the new millennia because this decision made large amounts of credit available, which ultimately created the housing bubble that precipitated the downturn.<sup>11</sup> Other commentators fault politicians in the United States for creating the housing bubble because of government subsidies for home purchases and political pressure to force lenders to grant mortgages to those who were unable to repay.<sup>12</sup> Still others blame the behavior of the lenders themselves for almost indiscriminately issuing mortgages.<sup>13</sup> In addition, one should not forget the

---

an investment bank from mortgage originators such as non-bank lenders and mortgage brokers are pooled into collateralized debt obligations ('CDOs') by a special purpose entity ('SPE').").

6. See *id.* at 387–88 (providing an overview of the securitization process used to create mortgage-backed securities).

7. See POSNER, *supra* note 1, at 49 (noting that financial institutions were major purchasers of mortgage-backed securities prior to the financial crisis that began in 2008).

8. See Steven L. Schwarcz, *The Future of Securitization*, 41 CONN. L. REV. 1313, 1317 (2009) (reporting that prior to the financial crisis that began in 2008, an increase in subprime mortgage loan defaults caused many mortgage-backed securities to be devalued).

9. See POSNER, *supra* note 1, at 62 (explaining that uncertainty about the valuation of mortgage-backed securities created a "credit crunch," which yielded "both an immediate drop in economic activity and, in reaction to that drop and in anticipation of a further drop in the near future, a precipitous decline in the stock market"); Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 N.C. BANKING INST. 5, 71–76 (2009) (discussing the "freeze up" of the credit markets as a result of uncertainty regarding the valuation of many mortgage-backed securities).

10. See Markham, *supra* note 5, at 393 (stating that the "economy fell into recession" as the "[c]redit markets [became] frozen and liquidity became absent").

11. See, e.g., Robert T. Miller, *Morals in a Market Bubble*, 35 U. DAYTON L. REV. 113, 136 (2010) ("[T]he financial crisis began at the Federal Reserve, where Alan Greenspan and his colleagues on the Federal Open Market Committee made some mistakes in the early years of this decade by keeping interest rates very low for a very long time.").

12. See, e.g., Robert Hardaway, *The Great American Housing Bubble: Re-Examining Cause and Effect*, 35 U. DAYTON L. REV. 33, 59 (2010) (arguing that preventing a future housing bubble depends upon politicians "eliminating home mortgage tax subsidies for the richest Americans [and] repealing laws pressuring banks to extend mortgages to marginal buyers").

13. Steven A. Ramirez, *Subprime Bailouts and the Predator State*, 35 U. DAYTON L. REV. 81, 84–85 (2010).

In what can only be described as an orgy of reckless financial management, a number of very large financial firms pursued short-term profits without regard to risks borne by their firms in one of the

perceptual failures of most, if not all, individuals to realize that they were operating within a housing bubble that would ultimately burst.<sup>14</sup>

Solely focusing on the role of the housing bubble in creating the financial crisis that began in 2008, however, ignores the part played by mortgage-backed securities in the crisis. Ultimately, the devaluation of mortgage-backed securities led to the grinding halt of the United States economy because of the rapid diminishment in the amount of credit that was available to fuel the economy.<sup>15</sup> This suggests a failure on the part of Congress and, more specifically, the United States Securities and Exchange Commission (“SEC”) to effectively regulate these mortgage-backed securities. Remarkably, when greater regulation of mortgage-backed securities was needed most, the SEC took a “hands off” approach to institutional investors, mortgage-backed securities, and the credit rating agencies that were valuing these mortgage-backed securities.<sup>16</sup> Put another way, the movement to deregulate the financial services industry and securities markets should be viewed as a major cause of the financial crisis that began in 2008.<sup>17</sup>

In recent years, the deregulationist movement in the United States has gained traction as a means to offset the waning dominance of the United States in terms of its capital markets and its role as a securities regulator. During much of the last century, the United States was viewed as having the world’s premier capital markets and as being the world’s premier regulator of securities.<sup>18</sup> In recent years, however, capital markets have become global, which has shifted the focus away from the

---

greatest credit bubbles in history, starting in 2004 and continuing through 2007. Much of this excessively risky credit found its way into the U.S. residential real estate market via subprime loans.

*Id.*

14. See generally, Jeffrey M. Lipshaw, *Disclosure and Judgment: “We Have Met Madoff and He Is Ours”*, 35 U. DAYTON L. REV. 139 (2010) (discussing the role that failures in judgment played in the financial crisis that began in 2008).

15. See *supra* note 9 and accompanying text (discussing the impact of the devaluation of mortgage-backed securities on the United States economy).

16. See Barbara Black, *Protecting the Retail Investor in an Age of Financial Uncertainty*, 35 U. DAYTON L. REV. 61, 77 (2010) (“[W]e must get rid of the ‘hands off’ attitude toward institutional and sophisticated investors that is ingrained into the regulatory climate. For too long, policymakers have thought that some investors are so smart that regulators should not stand in their way, for fear of stifling innovation and investment opportunities.”).

17. See POSNER, *supra* note 1, at xii (“We are learning . . . that we need a more active and intelligent government to keep our model of a capitalist economy from running off the rails. The movement to deregulate the financial industry went too far by exaggerating the resilience—the self-healing powers—of laissez-faire capitalism.”).

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

United States.<sup>19</sup> The securities markets outside the United States have grown in both size and sophistication,<sup>20</sup> and the United States no longer has the world's fastest growing economy.<sup>21</sup> Technology now provides investors with access to nearly limitless investment opportunities around the globe,<sup>22</sup> and retail and institutional investors commonly look beyond the borders of their home countries as a means of portfolio diversification.<sup>23</sup> Moreover, securities exchanges are becoming transnational entities. The relatively recent wave of securities exchange demutualization transformed many exchanges into for-profit entities that are now looking globally to search for opportunities.<sup>24</sup> This wave of securities exchange demutualization has fueled a wave of exchange consolidation that has allowed for the rise of transnational exchanges.<sup>25</sup>

The push for financial deregulation has also been fueled by certain legal realities in the United States. For example, as a result of the passage of the Sarbanes-Oxley Act of 2002,<sup>26</sup> which placed substantial new corporate governance requirements on

19. See Edward F. Greene, *Beyond Borders: Time to Tear Down the Barriers to Global Investing*, 48 HARV. INT'L L.J. 85, 85 (2007) ("There can be no argument that the securities markets are now global and that the dominance of the United States as the leading player in the global marketplace is being challenged.").

20. See DeLaMater, *supra* note 18, at 117 ("The securities markets outside the United States have grown in breadth and depth of their own over the past twenty years and now afford issuers in their home countries significant opportunities for financing that did not previously exist.").

21. *But see* Ethiopis Tafara & Robert J. Peterson, *A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 31, 46-47 (2007) ("[E]ven though the United States is no longer the fastest growing economy in the world, foreign direct investment in the United States remains high, with capital flowing into the country even from the developing world in search of the historically high returns available in the U.S. capital markets.").

22. See Susan Wolburgh Jenah, *Commentary, Commentary on A Blueprint from Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 69, 69-70 (2007) ("Globalization is a fact. Innovative technologies are driving faster and more efficient trading, and they do not recognize national borders. Capital market participants are expanding their business activities into foreign markets. Investors are seeking international investment opportunities. The impact of these changes is profound and not yet fully realized."); George W. Madison & Stewart P. Greene, *Response, TIAA-CREF Response to A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 99, 99 (2007) ("The rapid pace of technological advances is bringing us closer to the reality of a seamless global capital market. In such a world, investors would have access to increased liquidity, greater diversification, and a wider range of investment options regardless of their location.").

23. See Greene, *supra* note 19, at 85-86 ("Investing in non-U.S. markets is no longer the exclusive province of megainstitutions or the ultrawealthy; it is an essential component of prudent portfolio diversification for all investors.").

24. See Jenah, *supra* note 22, at 71 ("Another influential factor is the demutualization of exchanges and their conversion to 'for-profit' entities. This has, in turn, unleashed pressure from shareholders to increase profits through expansion, . . . forcing these for-profit entities to eschew nationalistic or protectionist tendencies in the bid for value maximization.").

25. See *id.* ("This chess game of proposed exchange mergers, capital tie-ups, and alliances being played out on the global stage bears witness to the truism that capital markets are global."). See generally Sara M. Saylor, Note, *Are Securities Regulators Prepared for a Truly Transnational Exchange*, 33 BROOK. J. INT'L L. 685 (2008) (discussing the emergence of transnational exchanges).

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

entities wishing to issue stock in this country, the United States has experienced a significant drop in initial public offerings by foreign issuers.<sup>27</sup> In addition, many issuers, investors, and commentators have become concerned that the capital markets in the United States are being tainted by its culture of shareholder litigation and its history of aggressive enforcement of its securities laws by the SEC.<sup>28</sup>

The financial crisis that began in 2008 and the push for deregulation that precipitated it evidence the fact that an international race-to-the-bottom is occurring in securities regulation. The financial crisis became a global crisis because mortgage-backed securities from the United States were sold throughout the world.<sup>29</sup> Securities regulators in other nations did not ratchet up their securities laws to properly regulate the mortgage-backed securities out of fear that it would hinder their nations' abilities to compete in the emerging global capital markets.<sup>30</sup>

Unless harmonization and centralization of international securities law occurs, this race-to-the-bottom will continue, and more financial crises will ensue.<sup>31</sup> As evidenced by the stock market crash of 1929 and the Great Depression of the 1930s, patchwork regulation does not provide stability to securities markets. Prior to the stock market crash of 1929, the securities markets in the United States were regulated by a patchwork of state statutes, known as "blue sky" laws.<sup>32</sup> In the wake of the stock market crash, Congress passed the Securities Act of 1933 ("Securities Act")<sup>33</sup> and the Securities Exchange Act of 1934 ("Exchange Act")<sup>34</sup> to provide stability to the national securities markets.<sup>35</sup> Except for a handful of recessions, the

27. See Saylor, *supra* note 25, at 708 ("Because Sarbanes-Oxley imposes on companies much more demanding corporate governance standards than regulations in Europe, the United States has lost a significant portion of initial public offerings to foreign stock exchanges in the recent years since its passage."). *But see* Jackson, *supra* note 18, at 108 ("Although many have pointed to the passage of the Sarbanes-Oxley Act of 2002 as damaging the ability of U.S. exchanges to compete for foreign cross-listings, there is ample evidence that the erosion of U.S. market power for foreign listings was already underway well before 2002.").

28. See Jenah, *supra* note 22, at 71 ("Some claim that the increased regulatory burden in the United States, combined with mounting concerns over exposure to U.S.-style class actions and more aggressive enforcement, may be driving companies to raise capital in foreign markets.").

29. See Black, *supra* note 16, at 61 ("The year 2008 was a devastating one for all investors as the financial meltdown wreaked havoc on the world's economy and left no form of investment unscathed."); Miller, *supra* note 11, at 133 (explaining that securitization of mortgages allowed investors around the world to invest in the housing bubble in the United States).

30. Donald C. Langevoort, *U.S. Securities Regulation and Global Competition*, 3 VA. L. & BUS. REV. 191, 193 (2008) ("The global scale of the current troubles shows that other countries have been too lax as well, so that there should be a ratcheting up of securities regulation not only in the United States, but worldwide.").

31. See *infra* Part II (discussing the need for harmonization and centralization of international securities law).

32. See Eric C. Chaffee, *Standing Under Section 10(b) and Rule 10b-5: The Continued Validity of the Forced Seller Exception to the Purchaser-Seller Requirement*, 11 U. PA. J. BUS. L. 843, 851 (2009) (discussing regulation of the securities markets in the United States prior to the passage of the Securities Act and the Exchange Act).

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

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

35. See Eric C. Chaffee, *Beyond Blue Chip: Issuer Standing to Seek Injunctive Relief Under Section 10(b) and Rule 10b-5 Without the Purchase or Sale of Security*, 36 SETON HALL L. REV. 1135, 1139 (2006) (describing

securities markets in the United States remained relatively stable until the emergence of a global capital market and the financial crisis that began in 2008.<sup>36</sup> The financial crisis should be attributed in large part to the patchwork of international regulation that is being used to regulate the global capital markets because, as the stock market crash of 1929 and the Great Depression demonstrate, patchwork regulation is inadequate to regulate securities markets.<sup>37</sup>

The United States government should push for the harmonization and centralization of international securities regulation to end the race-to-the-bottom in international securities law and to avoid another financial crisis. In other articles, I have discussed the opportunity that the financial crisis that began in 2008 presents for reimagining international securities law,<sup>38</sup> the need for comprehensive international and domestic regulatory reform to prevent a future financial crisis,<sup>39</sup> the importance of harmonization and centralization of international securities regulation and enforcement,<sup>40</sup> the need for a centralized global securities regulator,<sup>41</sup> and the evolutionary method by which a centralized global securities regulator might emerge.<sup>42</sup> This Article advances the existing scholarship in three main ways. First, it analyzes the United States government's current approach to international securities law. Second, it advocates that the United States government take a more aggressive approach to the harmonization and centralization of international securities regulation and enforcement. Third, it provides a handful of concrete proposals as to actions that the United States government might take to bring about the harmonization and centralization of international securities law.

The remainder of this Article is structured as follows. Part II provides various possible models for international securities regulation and advocates for an approach based on harmonization and centralization of international securities law. Part III examines the United States government's current approach to international securities regulation, and Part IV discusses the United States government's potential role in fueling the harmonization and centralization of international securities law.

---

Congress's reasons for passing the Securities Act and the Exchange Act, including "the fear of national emergencies created by unreasonable fluctuations in securities prices").

36. See *supra* notes 1–3 and accompanying text (discussing why the current financial downturn should be characterized as a depression, rather than a mere recession).

37. But see *supra* notes 11–17 and accompanying text (suggesting that a variety of other factors may also have played a role in the financial crisis that began in 2008).

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

39. See Eric C. Chaffee, *A Panoramic View of the Financial Crisis That Began in 2008: The Need for Domestic and International Regulatory Reform*, 35 U. DAYTON L. REV. 1 (2010).

40. See Eric C. Chaffee, *Finishing the Race to the Bottom: An Argument for Harmonization and Centralization of International Securities Law*, 40 SETON HALL L. REV. (forthcoming 2010).

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

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

Ultimately, this Article concludes that the United States government can play a major role in the harmonization and centralization of international securities regulation and has strong incentive to do so to help preserve its role as a leading securities regulator and to prevent future economic crises.

## II. THE IDEAL OF GLOBAL HARMONIZED AND CENTRALIZED REGULATION

The best model for international securities regulation is one based upon regulatory harmonization and centralization. Five different approaches exist to international securities law, which include regulatory competition, regulatory convergence, regulatory mutual recognition, regulatory harmonization, and centralized global regulation.<sup>43</sup> These five approaches can be placed on a spectrum based on the degree of cooperation and coordination required for each approach with regulatory competition at one endpoint and centralized global regulation at the other endpoint. In traveling from regulatory competition to centralized global regulation, one would pass through regulatory convergence, regulatory mutual recognition, and regulatory harmonization, with each of these approaches requiring a greater degree of cooperation and coordination. Although the five approaches to international securities regulation are distinct, they are not mutually exclusive, and they often overlap and blur.

Under a regulatory competition approach to international securities regulation, nations adopt their own individual systems of securities law and then compete to attract issuers, investors, and other market participants to their individual nations.<sup>44</sup> A regulatory competition approach creates a variety of problems. First, it allows for a race-to-the-bottom to occur as nations ratchet down their levels of regulation in the attempt to compete for issuers and investors.<sup>45</sup> Second, it creates enforcement and regulatory gaps because nations compete, rather than act in a cooperative and coordinated manner to address issues that transcend national borders.<sup>46</sup> Third, it generates free rider problems in which nations ignore pressing international

---

43. See *infra* notes 44–68 and accompanying text (describing and discussing each of these approaches to international securities regulation).

44. See James D. Cox, *Rethinking U.S. Securities Laws in the Shadow of International Regulatory Competition*, 55 LAW & CONTEMP. PROBS. 157, 158–59 (1992) (explaining that regulatory competition pressures countries to adopt a regulatory approach that is attractive to issuers, investors, and other market participants).

45. See also Jenah, *supra* note 22, at 77 (arguing that the “challenge” in terms of international securities regulation is “to strike the right balance between a healthy degree of regulatory competition and the proverbial ‘race to the bottom’”).

46. See also Robert Wai, *Transnational Liftoff and Juridical Touchdown: The Regulatory Function of Private International Law in an Era of Globalization*, 40 COLUM. J. TRANSNAT’L L. 209, 250 (2002) (arguing that regulatory gaps and regulatory competition are significant obstacles to effective international regulatory coordination).

regulatory and enforcement issues in hopes that other nations will address them.<sup>47</sup> Fourth, it creates a bystander effect in which nations witnessing international regulatory and enforcement issues assume that other nations will address the problem.<sup>48</sup>

Under a regulatory convergence approach, nations converge on similar systems of securities regulation.<sup>49</sup> Regulatory convergence can occur in both weak and strong forms. Under a weak regulatory convergence approach, nations naturally converge on similar systems of securities regulation.<sup>50</sup> For much of the twentieth century, the world took a weak regulatory convergence approach to international securities law because nations looked to securities regulators in the United States for guidance.<sup>51</sup> For example, the European Union was influenced heavily by the United States in formulating the European Union's system of securities regulation.<sup>52</sup> A weak regulatory convergence can be effective, if a dominant securities regulator exists. In fact, if a dominant regulator exists, a race-to-the-top may occur, and an optimal level of regulation may be achieved.<sup>53</sup> As explained in the previous section, however, the dominance of the United States in terms of its securities markets and role as a securities regulator has been waning, which has given birth to a race-to-the-bottom in international securities law.<sup>54</sup> Moreover, a weak regulatory convergence approach also creates enforcement and regulatory gaps, free rider issues, and other collective action problems because regulation remains fragmented.<sup>55</sup>

47. See also Robert Wai, *Transnational Private Law and Private Ordering in a Contested Global Society*, 46 HARV. INT'L L.J. 471, 479 (2005) (noting that free rider problems often impede collective action on the international level).

48. See Tal Z. Zarsky, *Thinking Outside the Box: Considering Transparency, Anonymity, and Pseudonymity as Overall Solutions to the Problems of Information Privacy in the Internet Society*, 58 U. MIAMI L. REV. 991, 1008 (2004) (explaining that the "bystander effect" is a term used to describe a phenomenon involving diffusion of responsibility in which each party assumes another party will take responsibility and deal with a problem).

49. See Daniel K. Tarullo, *Norms and Institutions in Global Competition Policy*, 94 AM. J. INT'L L. 478, 495 (2000) (providing an overview of the regulatory convergence approach to international financial regulation).

50. See Donald C. Langevoort, *Introduction: Issue on the Harmonization of the Securities Laws*, 33 LAW & POL'Y INT'L BUS. 439, 439-40 (2002) (noting that in a natural form of regulatory convergence, "countries follow the lead of the one that has chosen a dominantly efficient strategy").

51. See *supra* note 18 and accompanying text (reporting that for much of the twentieth century the United States was viewed as having the world's premier system of securities regulation).

52. See Roberta S. Karmel, *The EU Challenge to the SEC*, 31 FORDHAM INT'L L.J. 1692, 1711 (2008) ("Since the SEC has served as the gold standard of securities regulation, it is not surprising that as the EU has striven to improve and integrate European capital markets, it has looked to U.S. securities regulation as a model.").

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

54. See *supra* notes 18-30 and accompanying text (explaining that the waning dominance of the United States in terms of its capital markets and role as a securities regulator has helped to produce a race-to-the-bottom in international securities law).

55. Cf. Daniel K. Tarullo, *Law and Governance in a Global Economy*, 93 AM. SOC'Y INT'L L. PROC. 105, 110-12 (1999) (noting various limitations of a regulatory convergence model for international financial law,

Under a strong regulatory convergence approach, nations agree to certain general regulatory norms via treaties or other agreement, and then the signatories structure their systems of securities regulation based upon those norms.<sup>56</sup> If the norms are properly structured, a race-to-the-bottom may be avoided because securities regulators are no longer incentivized to ratchet down their securities laws to suboptimal levels in hopes of attracting issuers and investors.<sup>57</sup> Even if a race-to-the-bottom is prevented in terms of the systems of laws, however, a race-to-the-bottom may still occur in enforcement.<sup>58</sup> Nations may have adequate systems of securities regulation but opt not to enforce them adequately as a means of attracting issuers, investors, and other market participants.<sup>59</sup> In addition, because some degree of regulatory fragmentation remains, a strong convergence approach to international securities regulation also leaves regulatory and enforcement gaps between nations, free rider problems, and other collective action problems.<sup>60</sup>

Regulatory mutual recognition offers another approach to international securities law. Under a mutual recognition approach, nations enter into treaties or other agreements in which compliance with one signatory's securities laws is viewed as being equivalent to compliance with all signatories' securities laws.<sup>61</sup> Thus, an issuer who registers an offering in one country would be free to sell securities both in that country and in all of the countries that are signatories of the treaty or other agreement. If the underlying treaty or agreement contains a requirement that all signatories have equivalent regulation and enforcement, then the race-to-the-bottom can be avoided. However, regulatory and enforcement gaps, free rider

---

including the difficulty of achieving universal standards); *see also supra* notes 44–48 and accompanying text (discussing various problems created by using a regulatory competition model in international securities law).

56. *See* Tarullo, *supra* note 55, at 108 (providing a description of the regulatory convergence approach to international financial regulation).

57. *See also id.* at 108–09 (implying that a race-to-the-bottom can be avoided in a regulatory convergence system because “[o]ver time, and as a result of sustained interaction and argument, the beliefs of the participants as to the principles and techniques underlying sound banking or antitrust regulation significantly converge”).

58. *See* Jackson, *supra* note 18, at 115 (“As it turns out, countries with quite similar regulatory systems may expend very different amounts of resources on supervisory oversight.”).

59. *Id.*

60. *See* Tarullo, *supra* note 55, at 110–11 (discussing various limitations of the regulatory convergence approach to international securities regulation).

61. Edward F. Greene, *Beyond Borders Part II: A New Approach to the Regulation of Global Securities Offerings*, in *FOREIGN ISSUERS & THE U.S. SECURITIES LAWS 2008: STRATEGIES FOR THE CHANGING REGULATORY ENVIRONMENT* 607, 613 (Practising Law Inst. ed., 2008).

[In a mutual recognition scheme, w]here a domestic regulator determines that a foreign jurisdiction provides comparable regulation of certain market participants, reasonably sufficient to protect domestic investors, there is no need for the domestic regulator to impose additional requirements or insist that such foreign market participants comply with the domestic regulatory scheme in order to access domestic markets. Instead, the domestic regulator permits the foreign market participant to comply with the comparable foreign regulatory scheme rather than the domestic regulatory scheme.

*Id.*

problems, and other collective action problems still remain problems because of regulatory fragmentation.<sup>62</sup>

Under a regulatory harmonization approach, nations agree via treaty or other agreement to make their systems of securities regulation equivalent or identical.<sup>63</sup> Although regulatory harmonization has similarities to a strong regulatory convergence approach, regulatory harmonization differs because it mandates that the securities laws be identical or equivalent, rather than simply requiring nations to conform to certain regulatory norms. Because securities regulators are acting in a coordinated manner under a regulatory harmonization approach, the race-to-the-bottom is prevented. In addition, regulatory harmonization also lessens regulatory and enforcement gaps between nations because securities regulators are acting in a coordinated manner. Even under a regulatory harmonization approach, however, regulatory and enforcement gaps still exist in regard to transnational problems.<sup>64</sup> These regulatory and enforcement gaps are deepened by the free rider and other collective action problems that remain under a regulatory harmonization approach because market regulation remains fragmented between nations.

A regulatory centralization approach offers another alternative for international securities regulation. Under a regulatory centralization approach, a centralized global regulator would be responsible for or take a leading role in monitoring, regulation, and enforcement.<sup>65</sup> The race-to-the bottom would be prevented because a cohesive system of securities law would regulate the global capital markets.<sup>66</sup> Even if this centralized global securities regulator simply sets a baseline of regulation and enforcement and individual nations were allowed to opt for higher levels of regulation, a centralized global regulator could provide greater stability. This type of system has worked effectively in the United States where the federal government has promulgated a cohesive system of securities law, and states can promulgate higher levels of regulation through their blue sky laws.<sup>67</sup> In addition, a centralized

---

62. See also Eric J. Pan, *Single Stock Futures and Cross-Border Access for U.S. Investors*, 14 STAN. J.L. BUS. & FIN. 221, 225 (2008) (“The difficulty in putting mutual recognition into place lies in balancing the SEC’s goal of maintaining high standards of investor protection and market integrity and its desire to respond to market pressure by lowering the costs of trading and owning securities across borders.”).

63. See Greene, *supra* note 61, at 612 (“Harmonization . . . addresses duplicative or overlapping regulations by making them identical or, at the very least, consistent.”); Sidney A. Shapiro, *International Trade Agreements, Regulatory Protection, and Public Accountability*, 54 ADMIN. L. REV. 435, 436 (2002) (“Harmonization involves the adoption of an international standard that adjusts the regulatory standards or procedures of two or more countries until they are the same.”).

64. See Greene, *supra* note 61, at 612–13 (explaining the difficulties in achieving complete regulatory harmonization of international securities law).

65. See Howell E. Jackson, *Centralization, Competition, and Privatization in Financial Regulation*, 2 THEORETICAL INQUIRIES L. 649, 656–57 (2001) (explaining the concept of regulatory centralization).

66. See *id.* (describing the role that regulatory centralization could play in combating the “race-to-the-bottom” problem that is currently occurring because of the fragmentation of international securities law).

67. See *supra* notes 32–37 and accompanying text (discussing the emergence of federal securities law in the United States).

regulatory approach to international securities regulation also eliminates or greatly lessens regulatory and enforcement gaps, free rider problems, and other collective action issues because a centralized global regulator would provide a coordinating force among securities regulators around the world.<sup>68</sup>

Ideally, the world should adopt a system of international securities regulation based on harmonization and centralization. A centralized global securities regulator should be created with monitoring, regulatory, and enforcement powers. Individual nations should harmonize their laws to permit for the existence of a centralized global securities regulator, and this global regulator should provide a baseline of regulation and enforcement from which nations can upwardly depart, if they desire.

The creation of such a system of international securities regulation would have to be a slow evolutionary process, rather than an immediate revolutionary process because of the current nationalistic and protectionist attitudes of most countries.<sup>69</sup> Although this might seem like a drastic and unrealistic approach to international securities law, if one considers the long-term, regulatory harmonization and centralization makes sense because regulatory fragmentation is inefficient, does not adequately regulate the global capital markets, and will lead to future crises.<sup>70</sup> The transition would likely take decades, but regulatory harmonization and centralization is the best result for international securities law.

### III. THE UNITED STATES FEDERAL GOVERNMENT'S CURRENT STANCE ON INTERNATIONAL SECURITIES REGULATION

Strong incentives exist for the United States federal government to push for the harmonization and centralization of international securities law because it would stabilize the global securities markets, assist the United States in maintaining its dominance, and benefit market participants. The world is currently taking a regulatory competition approach to international securities regulation.<sup>71</sup> The

---

68. See Patrick B. Griffin, *The Delaware Effect: Keeping the Tiger in Its Cage. The European Experience of Mutual Recognition in Financial Services*, 7 COLUM. J. EUR. L. 337, 339 (2001) (discussing various arguments in support of centralized regulation of transnational financial markets).

69. See Donald C. Langevoort, *U.S. Securities Regulation and Global Competition*, 3 VA. L. & BUS. REV. 191, 205 (2008).

Even in the face of crisis and scandal, we will not see a global securities and financial services regulator . . . anytime soon. But we may well see joint task forces wherein regulatory personnel from various countries are detailed to a central location to coordinate enforcement efforts aimed at some kind of threat, and if that becomes routine, there will be further small steps toward a permanent regulatory institution, until it already exists de facto and is less threatening politically.

*Id.*

70. See *id.*

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

financial crisis has fueled an interest in international financial regulatory reform.<sup>72</sup> As evidenced by recent statements of the SEC and the United States Department of the Treasury, however, the federal government is at best timidly moving toward the harmonization and centralization of international securities law. Although harmonization and centralization will likely need to be a long-term evolutionary process, the United States federal government should take a more aggressive approach and work for greater cooperation and coordination among the world's securities regulators.

The United States federal government should push for the harmonization and centralization of international securities law for three main reasons. First, harmonization and centralization would help to stabilize the global capital markets. Within the past few decades, the capital markets have transitioned from being national or regional to being global.<sup>73</sup> Technology is rapidly eliminating the significance of national borders,<sup>74</sup> and many investors now diversify their portfolios by looking for opportunities globally, rather than in just their home countries.<sup>75</sup> As explained in the previous section, harmonization and centralization of international securities law offer the best solution to regulating the global capital markets because it limits or eliminates the race-to-the-bottom, regulatory and enforcement gaps, free rider problems, and other collective action issues that are created by the current patchwork of regulation.<sup>76</sup>

Second, the United States federal government should aggressively work toward the harmonization and centralization of international securities law because it assists in maintaining the dominance of the United States in terms of its role as a securities regulator. As discussed previously, the dominance of the United States in terms of its role as a securities regulator has been waning.<sup>77</sup> Even from this weakened position, if the United States acts quickly and pushes for the harmonization and centralization of international securities law, the United States would have greater leverage in shaping any new approach to international securities

---

72. See Karmel, *supra* note 52, at 1711 (arguing that greater convergence and cooperation in international securities law may occur because the “[c]urrent market turmoil caused by the sub-prime mortgage crisis and other events is . . . a dynamic which leads to regulatory reform”); see also Tafara & Peterson, *supra* note 21, at 51 (“The history of financial legislation, from the Bubble Act of 1720 to the Sarbanes-Oxley Act of 2002, shows that it is usually the child of crisis.” (footnote omitted)).

73. See Tafara & Peterson, *supra* note 21, at 31 (“[C]apital markets are global. Greater investor wealth and education have created the demand for such markets, and technology, in particular, has made globalized markets feasible.”).

74. *Id.*

75. *Id.* (“Investors now search beyond their own borders for investment opportunities and, unlike the past, many of these investors are not large companies, financial firms, or extremely wealthy individuals.”).

76. See *supra* Part II (explaining why harmonization and centralization constitute the best approach to international securities regulation).

77. See *supra* notes 18–28 and accompanying text (discussing the waning dominance of the United States in terms of its capital markets and its role as a securities regulator).

law.<sup>78</sup> If the United States federal government moves quickly, it would be in a better position to export its theories of securities regulation in building any new international securities law regime.<sup>79</sup> The United States would be able to act as the leader in the process of reforming international securities law, rather than a mere contributor.

Third, the United States federal government should push for the harmonization and centralization of international securities law because it would benefit market participants. The current patchwork of international securities regulation impacts the efficiency of the emerging global capital markets.<sup>80</sup> Harmonization and centralization would benefit market participants by reducing the transaction and administrative costs required to comply with the various systems of securities regulation of multiple nations.<sup>81</sup> Issuers in the United States would gain access more easily to foreign sources of capital, and investors could more easily diversify their portfolios.<sup>82</sup>

As of the writing of this Article, the world is transitioning to a regulatory competition approach to international securities law.<sup>83</sup> During much of the twentieth century, the world took a weak regulatory convergence approach to international securities regulation because the United States occupied a dominant position as a securities regulator, and other nations mimicked its securities laws.<sup>84</sup>

78. See Eric J. Pan, *A European Solution to the Regulation of Cross-Border Markets*, 2 BROOK. J. CORP. FIN. & COM. L. 133, 166 (2007) (“The United States must defend its position as the leading securities market in the world. To do so, it must look outward and embrace the free flow of investor capital across borders through open competition and regulatory cooperation.”).

79. *Id.* (“Seeking mutual recognition . . . is an example of the type of bold policy that must be pursued in this changing market environment. The goal . . . would be to ensure that foreign countries adopt the substance of U.S. requirements to provide a level of investor protection acceptable to the SEC.”).

80. See Tafara & Peterson, *supra* note 21, at 32 (“Our markets are now interconnected and viewing them in isolation—as we have for so long—is no longer the best approach to protecting our investors, promoting an efficient and transparent U.S. market, or facilitating capital formation for U.S. issuers.”); see also Greene, *supra* note 19, at 97 (“The SEC must acknowledge that the securities markets have evolved beyond jurisdictional borders and that its current regulatory regime has resulted in barriers to competition and placed roadblocks in the way of investor access to cross-border investment opportunities that have contributed to increased cost and market inefficiencies.”).

81. See Tzung-bor Wei, *The Equivalence Approach to Securities Regulation*, 27 NW. J. INT’L L. & BUS. 255, 255–56 (2007) (discussing the advantages of regulatory harmonization, which include reduced transaction costs).

82. See *id.* (explaining that in addition to reducing transaction costs, harmonization “reduces the cost of information, internalizes externalities across jurisdictions, achieves economies of scale, enhances the mobility of market participants, and prevents a regulatory ‘race to the bottom’”).

83. See generally Frank Partnoy, *Multinational Regulatory Competition and Single-Stock Futures*, 21 NW. J. INT’L L. & BUS. 641 (2001) (recognizing the trend towards regulatory competition in international financial markets).

84. See Donald C. Langevoort, *Structuring Securities Regulation in the European Union: Lessons from the U.S. Experience* 4, 6 (Georgetown Pub. Law Research Paper No. 624582, ECGI—Law Working Paper No. 41/2005, 2005), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=624582](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=624582) (noting that “firms in countries with insufficient investor protection choose to cross-list their securities in U.S. markets so as to

As the dominance of the United States has begun to wane, a regulatory competition approach has emerged because nations are now competing to adopt systems of securities regulation that will attract issuers and investors.<sup>85</sup>

The United States and other nations have flirted with the idea of taking a more coordinated approach to international securities regulation, but these efforts have been weak at best. For example, in 1983, eleven securities regulation agencies from North and South America gathered together to form the International Organization of Securities Commissions (“IOSCO”).<sup>86</sup> Since 1983, the membership of IOSCO has expanded drastically, and members of IOSCO currently regulate more than ninety percent of the world’s securities markets.<sup>87</sup> The principle purpose of IOSCO is to foster cooperation among securities regulators throughout the world and to promote just and efficient markets.<sup>88</sup> IOSCO has experienced some success in achieving this purpose. In 1998, for example, IOSCO adopted its Objectives and Principles of Securities Regulation, which is an influential set of advisory standards for the regulation of securities markets.<sup>89</sup> In addition, in 2002, IOSCO unveiled a Multilateral Memorandum of Understanding, which is designed to coordinate enforcement and the sharing of information among the numerous countries that have been willing to sign it.<sup>90</sup>

Despite IOSCO’s successes, as it is currently composed, IOSCO is unable to achieve the harmonization and centralization necessary to regulate the emerging global capital markets. The organization mainly serves a monitoring function, rather than providing a centralized force for regulation and enforcement.<sup>91</sup> On very rare occasions, IOSCO has publicly identified countries with poor systems of

---

submit voluntarily to SEC jurisdiction” and that “[i]n the last decade or so, more than a hundred countries have adopted laws that largely mimic those found in the EU or the U.S.”).

85. See *supra* note 71 and accompanying text (discussing the emergence of regulatory competition as the dominant approach to international securities regulation).

86. See Int’l Org. of Sec. Comm’ns, IOSCO Historical Background, <http://www.iosco.org/about/index.cfm?section=history> (last visited Mar. 7, 2010) (stating that eleven securities regulatory agencies from North and South America created IOSCO in 1983 by transforming an inter-American regional association into an international cooperative body).

87. *Id.* (noting that IOSCO regulates more than ninety percent of the world’s security markets and is recognized as the “international standard setter” for securities markets and the world’s most significant international forum for securities regulatory agencies).

88. See Int’l Org. of Sec. Comm’ns, General Information on IOSCO, <http://www.iosco.org/about/> (last visited Mar. 7, 2010) (stating that the member agencies in IOSCO have resolved “to cooperate together to promote high standards of regulation in order to maintain just, efficient[,] and sound markets”).

89. See Int’l Org. of Sec. Comm’ns, *supra* note 86 (stating that in 1998, IOSCO adopted Objectives and Principles of Securities Regulation, which are recognized as the international regulatory standards for all securities markets).

90. *Id.* (“In 2002[,] IOSCO adopted a multilateral memorandum of understanding (IOSCO MOU) designed to facilitate cross-border enforcement and exchange of information among the international community of securities regulators.”).

91. See Int’l Org. Sec. Comm’ns, *supra* note 88 (providing an overview of IOSCO’s major purposes, which focus on monitoring and coordination, rather than regulation and enforcement).

securities regulation.<sup>92</sup> This type of public shaming does little to limit or eliminate the race-to-the-bottom, regulatory and enforcement gaps, free rider problems, and other collective action issues that are created by the current patchwork of regulation.

In addition, the United States has also flirted recently with the idea of mutual recognition. In 2007, Ethiopis Tafara and Robert Peterson, two staff members in the SEC's Office of International Affairs, published an article in the *Harvard International Law Journal* proposing a new legal framework that was designed to allow foreign financial service providers easier access to the United States capital markets.<sup>93</sup> To grossly oversimplify the framework, foreign stock exchanges and foreign broker-dealers would be permitted to operate in the United States without registering with the SEC, if they were in compliance with the securities laws of their home countries, and if those securities laws were substantively similar to the securities laws in the United States.<sup>94</sup> After the publication of the article in 2007, the SEC under the leadership of Chairman Christopher Cox showed some interest in implementing the proposed framework.<sup>95</sup> Subsequent to the confirmation of Chairman Mary Schapiro on January 20, 2009, however, the SEC appears to have tabled or rejected the proposal.<sup>96</sup> Of course, even if the SEC were to move toward a mutual recognition regime, it would only be a step in the right direction toward harmonization and centralization of international securities law. Mutual recognition does little to cure the regulatory and enforcement gaps, free rider issues, and other collective action problems that are created by trying to regulate the emerging global capital markets with patchwork regulation.

Currently, the SEC, under the leadership of Chairman Schapiro, appears to be promoting a weak regulatory convergence approach to international securities law

---

92. See generally Int'l Org. of Sec. Comm'ns, Library of Public Documents: A Collection of IOSCO Press Releases, Publications, and Reports, <http://www.iosco.org/library> (last visited Mar. 9, 2010) (providing IOSCO's public documents).

93. See Tafara & Peterson, *supra* note 21.

94. *Id.* at 32.

This Article proposes a new framework to apply to foreign financial service providers . . . Instead of being subject to direct SEC supervision and U.S. federal securities regulations and rules, foreign stock exchanges and broker-dealers would apply for an exemption from SEC registration based on their compliance with substantively comparable foreign securities regulations . . . .

*Id.*

95. See Pan, *supra* note 62, at 223 ("Since the publication of this proposal, SEC Chairman Christopher Cox and other senior SEC officials have openly discussed and endorsed the merits of mutual recognition, and the SEC has held public meetings to discuss how such a proposal should be implemented." (footnote omitted)).

96. See Dan Jamieson, *Schapiro Cool to 'Mutual Recognition' Efforts*, INVESTMENTNEWS, Feb. 1, 2009, <http://www.investmentnews.com/article/20090201/REG/30201997> ("Bold efforts by the Bush administration Securities and Exchange Commission to open the doors to foreign brokerage firms are likely to be put on hold by new Chairman Mary Schapiro."); Mark D. Perlow, *SEC Chair Nominee Sets Forth Regulatory Agenda*, K&L GATES: NEWSSTAND, Jan. 28, 2009, <http://www.fmocklaw.com/newsstand/Detail.aspx?publication=5257> ("Ms. Schapiro sided with the critics [of mutual recognition] and questioned whether mutual recognition was 'headed in the right direction.'").

with an emphasis on exporting the theories of the United States regarding regulation and enforcement. For example, the SEC's Office of International Affairs operates an extensive technical assistance program that provides training related to market regulation and enforcement issues to regulators and law enforcement officials in over one hundred countries.<sup>97</sup>

Even though the SEC appears to currently be taking a weak regulatory convergence approach to international securities regulation, the SEC has undertaken some initiatives to increase cooperation and coordination among securities regulators throughout the world. For instance, the SEC's Office of International Affairs provides assistance to foreign securities regulators in cross-border securities investigations and prosecutions,<sup>98</sup> and the United States has entered memoranda of understanding with other nations to allow for the sharing of information among their securities regulators.<sup>99</sup> The SEC also participates in a variety of international securities regulation organizations, including IOSCO, the Council of Securities Regulators of the Americas, the Joint Forum, the International Accounting Standards Committee Foundation Monitoring Board, the Financial Action Task Force, the Organization for Economic Cooperation and Development, and the Financial Stability Board.<sup>100</sup> In addition, the SEC is also engaging in a number of bilateral dialogues regarding regulation and enforcement with securities officials in China, the European Union, Japan, Korea, and India.<sup>101</sup> Finally, the SEC has been exploring the use of International Financial Reporting Standards and the possible convergence of those international standards with Generally Accepted Accounting Principles in the United States.<sup>102</sup> If these efforts are successful, it could allow for the emergence of uniform global accounting standards.

Although the SEC has taken some steps to increase cooperation and coordination among securities regulators throughout the world, the harmonization

97. U.S. Sec. & Exch. Comm'n, Securities and Exchange Commission's International Technical Assistance Program, [http://www.sec.gov/about/offices/oia/oia\\_emergtech.shtml](http://www.sec.gov/about/offices/oia/oia_emergtech.shtml) (last visited Feb. 22, 2010).

98. See U.S. Sec. & Exch. Comm'n, International Enforcement Assistance, [http://www.sec.gov/about/offices/oia/oia\\_crossborder.shtml](http://www.sec.gov/about/offices/oia/oia_crossborder.shtml) (last visited Feb. 22, 2010) ("Today, the SEC can assist foreign securities authorities in their investigations using a variety of tools, including exercising the SEC's compulsory powers to obtain documents and testimony . . .").

99. *Id.* ("The SEC has approached enforcement-related information sharing on a multilateral, bilateral, and *ad hoc* basis. Multilateral and bilateral information sharing arrangements operate on the basis of memoranda of understanding (MOU) between securities authorities. Such MOUs . . . create a framework for regular and predictable cooperation in securities law enforcement.")

100. U.S. Sec. & Exch. Comm'n, SEC Participation in International Organizations, [http://www.sec.gov/about/offices/oia/oia\\_intlorg.shtml](http://www.sec.gov/about/offices/oia/oia_intlorg.shtml) (last visited Feb. 22, 2010).

101. U.S. Sec. & Exch. Comm'n, SEC Participation in Bilateral Dialogues with Foreign Regulatory Authorities, [http://www.sec.gov/about/offices/oia/oia\\_bilateraldialogs.shtml](http://www.sec.gov/about/offices/oia/oia_bilateraldialogs.shtml) (last visited Feb. 22, 2010) ("The [bilateral] dialogues are intended to facilitate identification and discussion of common issues of regulatory concern, enhance enforcement cooperation, and in some cases, expand on existing training and technical assistance efforts.")

102. U.S. Sec. & Exch. Comm'n, SEC International Initiatives, [http://www.sec.gov/about/offices/oia/oia\\_initiatives.shtml](http://www.sec.gov/about/offices/oia/oia_initiatives.shtml) (last visited Feb. 22, 2010).

and centralization of international securities law is unlikely to result from the financial crisis that began in 2008. Historically, financial crises yield increased regulation.<sup>103</sup> In terms of the financial crisis that began in 2008, although securities regulation and enforcement will definitely not be left untouched, the United States federal government appears to be focused on increasing regulation of the banking industry.<sup>104</sup>

In June 2009, the United States Department of the Treasury issued its white paper report, *Financial Regulatory Reform—A New Foundation: Rebuilding Financial Supervision and Regulation* (the “Report”).<sup>105</sup> The Report details the Obama Administration’s proposed regulatory reforms in response to the recent financial crisis and announces the following five policy objectives underlying these reforms:

- Promote Robust Supervision and Regulation of Financial Firms
- Establish Comprehensive Regulation of Financial Markets
- Protect Consumers and Investors from Financial Abuse
- Provide the Government with the Tools It Needs to Manage Financial Crises
- Raise International Regulatory Standards and Improve International Cooperation.<sup>106</sup>

The purpose of the proposed regulatory reform is to “build a new foundation for financial regulation and supervision that is simpler and more effectively enforced, that protects consumers and investors, that rewards innovation and that is able to adapt and evolve with changes in the financial market.”<sup>107</sup>

In regards to raising international regulatory standards and improving international cooperation, the drafters of the Report correctly identify the problems with fragmented international financial regulation but fail to deliver a solution. The drafters of the Report acknowledge:

*As we have witnessed during this crisis, financial stress can spread easily and quickly across national boundaries. Yet, regulation is still set largely in a national context. Without consistent supervision and regulation, financial institutions will tend to move their activities to jurisdictions with looser*

---

103. See DeLaMater, *supra* note 18, at 119 (“History has shown that we go through periods of boom followed by bust, with the bust followed by increased regulation . . . . [R]egulators are persuaded to accommodate various practices and the economy and capital markets enter another period of boom. The cycle repeats.”).

104. See Sewell Chan, *White House in New Push for Changes on Wall St.*, N.Y. TIMES, Feb. 24, 2010, at B1 (describing the Obama administration’s efforts to change the nation’s financial regulations, including efforts to restrict banks’ trading activities and to form a consumer agency to regulate financial products).

105. U.S. DEP’T OF THE TREASURY, FINANCIAL REGULATORY REFORM—A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION (2009), available at [http://www.financialstability.gov/docs/regs/FinalReport\\_web.pdf](http://www.financialstability.gov/docs/regs/FinalReport_web.pdf).

106. *Id.* at 1.

107. *Id.* at 2.

## THE INTERNATIONALIZATION OF SECURITIES REGULATION

*standards, creating a race to the bottom and intensifying systemic risk for the entire global financial system.*<sup>108</sup>

After acknowledging that fragmented international regulation creates a race-to-the bottom, the drafters of the Report list the following regulatory objectives:

- Strengthen the International Capital Framework
- Improve the Oversight of Global Financial Markets
- Enhance Supervision of Internationally Active Financial Firms
- Reform Crisis Prevention and Management Authorities and Procedures
- Strengthen the Financial Stability Board
- Strengthen Prudential Regulations
- Expand the Scope of Regulation
- Introduce Better Compensation Practices
- Promote Stronger Standards in the Prudential Regulation, Money Laundering/Terrorist Financing, and Tax Information Exchange Areas
- Improve Accounting Standards
- Tighten Oversight of Credit Rating Agencies.<sup>109</sup>

Remarkably, after acknowledging the problems that international regulatory fragmentation creates, the proposed regulatory reforms do little to promote the harmonization and centralization of international securities law.<sup>110</sup>

The list of policy objectives in the Report relating to international regulation may imply substantial movement toward the harmonization and centralization of international securities law, but the descriptions of these objectives do little to validate this implication.<sup>111</sup> For example, in regards to improving the oversight of global financial markets, the drafters simply “urge national authorities to promote the standardization and improved oversight of credit derivative and other OTC derivative markets,” rather than develop a comprehensive and cohesive system of international securities regulation.<sup>112</sup> Moreover, in regards to expanding the scope of regulation, the drafters of the Report focus only upon the regulation of financial firms and hedge funds, rather than propose harmonization and centralization of international securities law.<sup>113</sup> In fact, the only specific securities regulation reform that the drafters of the Report propose is the tightening of the oversight of the credit

---

108. *Id.* at 80 (discussing the reasons for raising international regulatory standards and improving international cooperation).

109. *Id.* at 80–88 (detailing the Obama administration’s regulatory proposal to raise international regulatory standards and improve international cooperation).

110. *Id.*

111. *Id.*

112. *Id.* at 81 (explaining the Obama administration’s proposed regulatory reforms to improve the oversight of the global financial markets).

113. *Id.* at 84–85 (describing the Obama administration’s proposed regulatory reforms to expand the scope of regulation to prevent another financial crisis).

rating agencies that rated the mortgage-backed securities that gave birth to the financial crisis.<sup>114</sup>

As evidenced by the recent statements of the SEC and the Department of the Treasury, the federal government is taking a weak regulatory convergence approach to international securities law. To adequately regulate the emerging global capital markets, however, the federal government should aggressively push for the harmonization and the centralization of international securities law because it would stabilize the global securities markets, assist the United States in maintaining its dominance, and benefit market participants.

#### IV. THE PATH FORWARD

Through the statements of the Department of the Treasury, the federal government promises “A New Foundation” for financial supervision and regulation.<sup>115</sup> Ironically, this “New Foundation” is cracked and fragmented. After identifying the problems of international regulatory fragmentation, the drafters of the Report do little to allow for the harmonization and centralization of international securities law.

If the federal government really wants to provide a “New Foundation” for financial supervision and regulation, then it must take a much more aggressive approach to international securities law by pushing for the harmonization and the centralization of monitoring, regulation, and enforcement within the emerging global capital markets. First, the United States should convene a successor organization to IOSCO with more robust monitoring powers and an international task force to regularly report on issues facing the emerging global capital markets. Second, the United States should spearhead the creation of an international agreement on the regulation of securities and exchanges that sets basic regulatory norms for national securities markets throughout the world from which nations could upwardly depart if desired. Third, the United States should begin a discussion regarding how to bring a global securities and exchange regulator into being.

Each of these three proposals is obviously just a step toward harmonization and centralization of international securities law and is likely to be met with resistance. With that said, the dominance of the United States is waning in terms of its capital markets and its role as a securities regulator. Because of this, the United States federal government has a strong incentive to push for harmonization and centralization of international securities law while it has the power to lead the

---

114. See *id.* at 87–88 (explaining the Obama administration’s proposed tightening of oversight of credit-rating agencies).

115. *Id.* at 2 (referencing the Report’s title and stating that the federal government “must build a new foundation for financial regulation and supervision that is simpler and more effectively enforced, that protects consumers and investors, that rewards innovation and that is able to adapt and evolve with changes in the financial market.”).

process, rather than be a mere contributor. If viewed as a short-term process, the harmonization and centralization of international securities law is likely both drastic and unrealistic.<sup>116</sup> Even if that is the case, however, harmonization and centralization is the best solution for international securities law because, as evidenced by the financial crisis that began in 2008, patchwork regulation does not provide an effective means of regulating the global capital markets.<sup>117</sup> The federal government should view the emergence of harmonization and centralization of international securities law as a long-term regulatory goal. In the short-term, however, the federal government should not sit idle while its dominance wanes. The federal government must keep the endgame in mind and push for the harmonization and centralization of international securities law.

---

116. See *supra* notes 69–70 and accompanying text (arguing that harmonization and centralization of international securities law will need to be a long-term evolutionary process, rather than a short-term revolutionary process because of the current nationalistic and protectionist attitudes of most countries).

117. See also Binyamin Appelbaum & Zachary A. Goldfarb, *U.S. Weighs Single Agency to Regulate Banking Industry; Plan Is Key Facet of Sweeping Overhaul*, WASH. POST, May 28, 2009, at A01 (“[O]fficials are considering the creation of a single agency to regulate the banking industry, replacing a patchwork of agencies that failed to prevent banks from falling into the worst financial crisis since the Great Depression . . . .”); Zachary A. Goldfarb, *Credit-Rating Bill Clears Committee; Measure Would Tighten Regulation, Reduce Conflicts at Firms*, WASH. POST, Oct. 29, 2009, at A12 (stating that efforts have been made to “try to improve the patchwork of financial regulation that failed to head off the economic crisis”).