REGULATING TRANSATLANTIC STOCK EXCHANGES

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Abstract This paper examines the regulatory questions surrounding transatlantic stock exchange consolidation. Underlying these questions is, in essence, a problem of fit between, on the one hand, the market space and, on the other hand, the regulatory space. Legislation which has predominantly a domestic focus is outdated in view of the increasingly global focus of financial market actors. High-profile mergers such as NYSE Euronext have brought the problem of the regulation of transatlantic or indeed global stock exchanges to the fore. Which national securities laws apply? What consequences does technological integration have for the regulatory position of exchanges and financial market actors? What are the extraterritorial implications? This article takes these questions as a starting point for investigating the problems of, and solutions to, transatlantic stock exchange consolidation.

I. INTRODUCTION

This is a time of intense change for stock exchanges. After demutualization shook their organizational foundations, a merger wave is now sweeping through their industry. Transatlantic consolidation are the new buzzwords. The merger between the NYSE and Euronext, the recently completed combination of NASDAQ with OMX, which followed NASDAQ's failed bid for the London Stock Exchange, or the merger between Eurex and ISE are prominent examples of this trend.[1] This is an intense time for regulators as well, as they seek to grapple with global and increasingly competitive financial markets and demands for greater and cheaper cross-border access by exchanges and financial market actors.[2] The US Securities and Exchange Commission (SEC) has come face to face with such demands, for especially the US approach to securities regulation has come under review following consolidation efforts within the exchange sector and a growing interest of US

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[1] Note that the terms 'merger', 'combination' and 'consolidation' are used fairly loosely hereafter.

[2] By financial market actors, I mean investment firms, such as broker-dealers, that operate on exchanges.

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investors for foreign securities, but also as a result of a general feeling that US regulatory requirements are at the expense of the competitiveness of US securities markets. The source of the problem is well known: financial market and exchange actors increasingly seek to operate across borders, but regulators are having difficulties in coming to terms with this market logic. Each of the above transactions has thus an important transatlantic dimension and has given rise to questions and speculation regarding the precise interplay of national regulatory laws. Which national securities laws apply?[3] What consequences does technological integration have for the regulatory position of financial market and exchange actors? What are extraterritorial effects? This article takes these questions as a starting point for investigating the problems of, and the solutions to, transatlantic stock exchange consolidation.

Underlying questions about the precise regulatory implications of transatlantic stock exchange consolidation is, in essence, a problem of fit between, on the one hand, the market space and, on the other hand, the regulatory space. As noted earlier, the source of the problem is well known.[4] Legislation which has predominantly a *domestic* focus is outdated in view of the increasingly *global* focus of financial actors. Yet, three reasons prompt us to revisit this problem. The first reason concerns its implications for transatlantic stock exchange consolidation. Mergers of the magnitude of NYSE Euronext have contributed to bringing the problem of the lack of fit between the market and the regulatory space back to the forefront of policy discussions. Because of the mismatch between the market and the regulatory space, they cannot currently deliver the full benefits which transatlantic integration promises. A second reason relates to current discussions on regulatory reforms. Indeed, discussions on reforming US securities regulation have gathered pace in recent months. Long thought to be at best a distant prospect, discussions on adopting some form of mutual recognition have risen to prominence. In 2007, the SEC organised a roundtable on mutual recognition, shortly after the publication by senior SEC staff of a proposal for allowing foreign exchanges and broker-dealers greater access to US markets.[5] Finally, in August 2008, the SEC and Australian authorities signed a first 'pilot' framework agreement on mutual recognition.[6] These are significant developments with potentially important

[3] eg statutory laws such as the US Securities Act of 1933 and the Securities Exchange Act of 1934 including the Sarbanes-Oxley Act, or the UK Financial Services and Markets Act, but also rules and regulations made by national securities authorities such as the US SEC or the UK Financial Services Authority (hereafter, the FSA).

[4] eg E Tafara and R Peterson, 'A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework' (2007) 48 Harvard International Law Journal 31; A Nazareth, 'Remarks Before the Securities Industry and Financial Markets Association Annual Meeting' (9 November 2007 Florida) <http://www.sec.gov/news/speech/2007/spch110907aln.htm> visited 13 January 2008.

[5] 'A Blueprint for Cross-Border Access to U.S. Investors' (n 4).

[6] 'Mutual Recognition Arrangement between the United States Securities and Exchange Commission and the Australian Securities and Investments Commission, together with the Australian Minister for Superannuation and Corporate Law' (Washington 25 August 2008)

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implications for the regulatory and the market space. But focusing only on regulatory reforms arguably obscures the more subtle processes which are currently ongoing. Thus, this article also seeks to identify and chart different processes of change and especially the subtle processes of adaptation and adjustment which are ongoing within the regulatory space. As with the regulatory reforms per se, transatlantic exchange consolidation is contributing to driving these processes. But the point is broader here. These processes also tell us something more fundamental about the future of national securities regulators in a world in which financial market actors seek to reap the benefits of cross-border and transatlantic operations. Indeed, they may hold valuable information about what securities authorities should look like in the 21st century. Thus, the third and final aim of this article: to make a few process-based suggestions about how securities authorities should organize in the future in order to better respond and adjust to global markets.

A word of caution on the scope of this article is warranted. This article does not deal with those derivative exchanges which fall under the jurisdiction of the US Commodity Futures Trading Commission (CFTC).[7] The CFTC is known for its willingness to give foreign exchanges easier access to US capital markets. The regulatory arrangements underpinning the CFTC's policy approach cannot, however, be reviewed within the scope of this article. It is important to bear in mind that because of the more accommodating approach of the CFTC, derivative exchanges do not face the same obstacles as 'ordinary' stock exchanges. Finally, clearing and settlement are also outside the scope of this article. The problems raised by clearing and settlement systems are so significant that clearing and settlement merit a work of their own.

This article is divided into six parts. Part Two turns to the market space and examines the processes of change which have taken place within the exchange sector. Part Three examines the regulatory space and discusses the jurisdictional principles governing the application of US securities regulation and UK financial markets regulation. Part Four contrasts the market and the regulatory space and examines the problems which the mismatch of the two spaces raise for the consolidation of stock exchanges. Part Five examines recent developments within the regulatory space and identifies a number of strategic considerations which are likely to influence exchange actors (contemplating exchange consolidation) and regulators (contemplating regulatory responses to stock exchange mergers). Finally, Part Six concludes and offers a few general suggestions regarding the future organization of securities regulators.

<http://www.sec.gov/about/offices/oia/oia_mututal_recognition/australia/framework_arrangement.pdf> visited 28 August 2008.

[7] For an evaluation of the CFTC's approach to market access, see, for instance, R Karmel, 'The Once and Future New York Stock Exchange: The Regulation of Global Exchanges' (2007) 1 Brooklyn Journal of Corporate, Financial & Commercial Law 355; H Jackson, A Fleckner and M Gurevich, 'Foreign Trading Screens in the United States' (2006) 1 Capital Markets Law Journal 54.

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II. TRANSATLANTIC STOCK EXCHANGE MERGERS AND THE MARKET SPACE

In an increasingly integrated world economy, the exchange industry is undergoing major changes. Technological progress has transformed the way in which exchanges are organized and operate. Traditionally, exchanges organized their activities around a trading floor on which exchange members—the brokers and dealers[8]—met in order to trade and execute orders. But floor-based trading is increasingly outdated and being replaced by electronic trading.[9] Innovations in telecommunication have indeed greatly improved the speed of communication and facilitated the spread of information. Evolutions in trading technology have made access to securities markets easier and challenged the traditional trade intermediation role of the exchange members. The trading systems (or trading platforms) are computer systems, a combination of hardware and software which matches and executes orders.[10] Access is electronic—that is, via computer terminals that give access to the system. Trading systems have become an important competitive and commercial tool. Key performance measures are handling capacity (ie the amount of volume that can be handled) and speed (ie how quickly it can be done). Bought 'off the shelf' from technology providers or developed 'in-house' by exchanges, they are known and marketed under their own brand names: NSC and LIFFE CONNECT for Euronext, SETS for the London Stock Exchange, and Xetra for Deutsche Börse. Indeed, even the most reluctant floor-based exchanges have been forced to adapt their trading models. The NYSE has thus sought to integrate electronic trading into its model.

Technological progress combined with deregulation have had other important effects. First, they have facilitated competition.[11] In Europe, the Markets in Financial Instruments Directive (hereafter, Mifid) seeks to promote competition between traditional exchanges, operating as so-called regulated markets, and alternative execution venues which are known, under Mifid, as Multilateral Trading Facilities or MTFs.[12] The dimensions along which actors

[8] The former acting as agents, buying and selling securities for the account of others (investors), and the latter trading as principals, that is for their own account.

[9] A good introduction to electronic trading and the issues it raises is given by H Stoll, 'Electronic Trading in Stock Markets' (2006) 20 The Journal of Economic Perspectives 153.

[10] Note that the term 'trading system' may be defined in more or less broad terms. For instance, a broad definition of a trading system may encompass trade reporting. Increasingly, however, exchanges have standardized reporting systems which may take a feed from the trading system, but are separate. Stoll (ibid 154–5) describes the trading process as a four-step process: (1) the entry of the order into the system; (2) the routing—in other words, the delivery of the order—to a market; (3) the execution of the order and (4) the payment and transfer of ownership.

[11] A Fleckner, 'Stock Exchanges at the Crossroads' (2006) 74 Fordham Law Review 2541, 2566–7.

[12] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC [2004] OJ L145/1. 'Regulated market' is defined in Mifid Art 4(14) as 'a multilateral system operated and/or managed by a market operator, which brings together or

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compete are diverse and include liquidity, the pricing structure of fees charged to customers, the quality and rapidity of trade execution, the quality and performance of systems, reputation and so on. Increased competition has contributed importantly to demutualization, that is the transformation of exchanges from member-owned organisations into 'for profit' companies which are, just like ordinary public firms, owned by shareholders and increasingly listed on-exchange.[13] Demutualization has swept through the exchange sector and radically transformed the governance structure of exchanges. Demutualized exchanges should be able to benefit from intangible assets such as the mindset of a profit-driven and cost-focused management. Thus, as power shifts from members to shareholders, stock exchanges are seen as in a better position to achieve growth and to compete.[14]

It is against this background that transatlantic stock exchange consolidation is currently taking place. Admittedly, cross-border exchange mergers are no new phenomenon. The consolidation wave has been underway for some time: in Europe for instance, Euronext, OMX and more recently the combination of the London Stock Exchange and Borsa Italiana are best known examples. *Transatlantic* exchange consolidation has recently risen to prominence in academic and policy circles as a result of the merger of NYSE and Euronext in early 2007. NASDAQ, following its unsuccessful bid for the London Stock Exchange, turned its attention towards OMX—the European exchange which operates mainly in the Nordic and Baltic regions. The combination went ahead in early 2008. On the derivative side, the acquisition of ISE by Eurex was

facilitates the bringing together of multiple third-party buying and selling interests in financial instruments—in the system and in accordance with its non-discretionary rules—in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorized and functions regularly and in accordance with the provisions of Title III [Mifid]'. 'MTF' is defined in Mifid Art 4(15) as 'a multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments—in the system and in accordance with non-discretionary rules—in a way that results in a contract in accordance with the provisions of Title II [Mifid]'.

[13] eg 'Electronic Trading in Stock Markets' (n 9) 2565; R Karmel 'Motivations, Mechanics and Models for Exchange Demutualizations in the United States' in Asian Development Bank *Demutualization of Stock Exchanges: Problems, Solutions and Case Studies* (Asian Development Bank 2002) 59, 61 <http://www.adb.org/Documents/Books/Demutualization_Stock_Exchanges/chapter_03.pdf> visited 12 January 2008; R Lee 'Changing Market Structures, Demutualization and the Future of Securities Trading' (2003) 5 Annual Brooking/IMF/World Bank Financial Markets and Development Conference 13-6 (examining the potential benefits of demutalisation) <http://www.oecd.org/dataoecd/5/15/18450470.pdf> visited 12 January 2008.

[14] By the same token, members have lost influence over the pricing of trading fees. Steil argues that by reducing the influence which local intermediaries exercise on the exchange's strategic decisions, demutualization facilitates the transition from floor-based trading to electronic trading. He points out that as a member-owned mutual organization, exchanges are more likely to resist the migration to electronic trading because electronic trading does not fit well the members' incentive structure which is based on profit margins of trade intermediation services. See B Steil, 'Changes in the Ownership and Governance of Securities Exchanges: Causes and Consequences' 2002 Brookings-Wharton Papers on Financial Services 61, 63; B Steil, 'Creating Securities Markets in Developing Countries: A New Approach for the Age of Automated Trading' (2001) 4 International Finance 257, 260.

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completed in December 2007. Others will undoubtedly follow. The increase in alliance and merger activity can thus also be positively related to the spread of electronic trading, deregulation, demutualization and, last but not least, increased competition. An optimistic account of exchange consolidation states that integration promises synergies and scale benefits. IT is, for example, a major fixed cost for exchanges. Operational synergies can be achieved by eliminating redundancies associated with the development and operation of several IT systems.[15] Streamlining or harmonizing technology can also be expected to reduce access costs for users which have to maintain connections with different trading systems.[16] Consolidation should further allow the building of a larger liquidity pool by bringing the liquidity from previously separate exchanges together.[17] Moreover, because larger exchanges benefit from economies of scale, exchange integration should reduce trading costs.[18] As a result new participants should enter the market which in turn should have a positive impact on trading volumes and liquidity. Finally, consolidation should hold benefits in terms of staff synergies, branding, improved visibility for companies listed on-exchange and product diversification. It is no secret that NYSE was eyeing Euronext.liffe—the London derivative exchange—and that product diversification was an important impetus for the NYSE Euronext deal.

Exchange integration has thus a priori much to offer. In particular, unified trading systems offering broad access are high on the ‘wish list’ of exchanges. Admittedly, closer technological integration may be pursued independently of any merger intention. Rather than merging, exchanges may, for example, enter into strategic alliances and join forces by developing or sharing technology. So why ‘merge’? Lee notes that in comparison with mergers, cooperative arrangements suffer from two weaknesses. According to the author, the credibility costs are higher in the case of the latter because in comparison with mergers, they do not create the same level of commitment.[19] Gain distribution may create further tensions.[20] Yet, there appears to be an additional (or related) reason for preferring mergers. A single managing board and a single chief executive should make decision-making a lot easier.

[15] J McAndrews and C Stefanadis, ‘The Consolidation of the European Stock Exchanges’ (2002) 8 Current Issues in Economics and Finance 1, 2.

[16] ibid.

[17] Liquidity can be defined as ‘the ability to buy or sell an asset quickly and at a price similar to the prices of previous transactions, assuming no new information is available’. See ‘The Consolidation of the European Stock Exchanges’ (n 15) 2.

[18] ‘Electronic Trading in Stock Markets’ (n 9) 170. See also R Aggarwal and S Dahiya ‘Demutualization and Public Offerings of Financial Exchanges’ (2006) 18 Journal of Applied Corporate Finance 96, 101 (noting that the marginal cost of adding additional trades is close to zero).

[19] R Lee, ‘The Future of Securities Exchanges’ (2002) Brookings-Wharton Papers on Financial Services 11 <http://fic.wharton.upenn.edu/fic/papers/02/0214.pdf> visited 12 January 2008.

[20] ibid.

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To sum up, the above market trends have had a profound impact on financial markets and the exchange sector. In particular, as financial activities have 'dematerialized', the spatial organization of the exchange sector has been re-defined. Physical location has lost much of its significance as an organizing unit for exchange activities. Physical distance is becoming meaningless. Trades are no longer executed in a physical location, but within a computer system. Financial markets thus epitomise what Castells described as a space-of-flows as opposed to a conventional space-of-places:[21] the former is 'based on an electronic network [which] links up specific places':[22] London, New York, Tokyo or Paris, for instance. Flows are flows of data, flows of information, flows of orders and flows of capital. Flows connect, irrespective of geographical location, irrespective of territorial boundaries.[23] The conception of the 'market', as a geographically delimited place *which exists by itself*, has lost its meaning and importance. As Castells notes, in the network 'no place exists by itself':[24] 'the network . . . is the fundamental spatial configuration: places do not disappear, but their logic and their meaning become absorbed in the network'.[25] Stock exchange consolidation responds to this new spatial logic by contributing to realise the economic benefits which interaction within the space-of-flows offers. But as regulators seek to grapple with this cross-border organization of the market space, the organization of the regulatory space is increasingly being challenged for its lack of fit.

III. TRANSATLANTIC STOCK EXCHANGE MERGERS AND THE REGULATORY SPACE

Castells' representation of the market space as a space-of-flows is a useful starting point for discussing the problems of transatlantic stock exchange consolidation. His claim that flows are largely outside regulation, however, strikes one as exaggerated. Admittedly, deregulation has greatly facilitated the 'network of global financial flows'.[26] But deregulation has not equated to 'no regulation' in financial markets. Rather the point is that the regulatory space obeys a different logic. I will start by examining the basic characteristics of the regulatory space (A), after which I will reflect in more detail on the complex jurisdictional questions which cross-border operations raise in a divided regulatory space and the trends which affect its organization (B).

[21] Both terms were coined by Castells when describing the meaning of space from the viewpoint of social theory. See M Castells, *The Rise of the Network Society* (Blackwell, Oxford, 1999); M Castells, *The Informational City: Information Technology, Economic Restructuring and Urban-Regional Process* (Blackwell, Oxford, 1989).

[22] ibid (1999) 413.

[23] cf SEC Chairman C Cox, 'Re-Thinking Regulation in the Era of Global Securities Markets' (34 Annual Securities Regulation Institute, California, 24 January 2007) <http://www.sec.gov/news/speech/2007/spch012407cc.htm> (last visited 3 August 2007) noting that '. . . exponential advances in computer technology and telecommunications have all but eliminated the remaining physical barriers to market access. Today, almost any business, or any trader, can pick up a phone, or just press the "Enter" key on her computer, and effect significant transactions half a world away'.

[24] *The Rise of the Network Society* (n 21) 412.

[25] ibid 412.

[26] ibid 470.

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A. *Basic Characteristics of the Regulatory Space*

While widespread transformations (ie deregulation) within the regulatory space have contributed to facilitate movements of flows, the regulatory space remains fundamentally a *divided* space. At the most obvious level, these divisions run along national lines. The first observation regarding the regulatory space is accordingly that it can be described as a 'space-of-places'. Secondly, within the regulatory space thus divided, the territorial principle is important as a basis of jurisdiction—that is, as a principle for claiming prescriptive (and enforcement) jurisdiction. It is a basic principle (or presumption) that laws should be applied territorially.[27] Regulatory law, as an instrument of public authority, is exercised over the territorial space which States occupy.[28] Cross-border operations typically create points of contact in the territory of different States. Each time that these contacts trigger the application of national law, the territorial principle is given expression or meaning. The language used to describe points of contact (or linking points)[29] varies: physical or legal location, solicitations/offers, activities, conduct or operations taking place in the national territory and so on. Indeed, the territorial principle is given more or less meaning depending on the type of contact which triggers the application of national laws. For instance, a State may seek to exercise jurisdiction on the basis that activities, which have taken place abroad, have had effects in the national territory. In such a case the link with the territory is weak. Thus, it is common to talk about the extraterritorial application of national law.[30]

The type of contact which is sufficient to trigger the application of national law may be specified by the national legislature or may have to be discovered by way of judicial interpretation. In the UK, for example, the Financial Services and Markets Act (hereafter, FSMA) lays down, together with its implementing legislation and the FSA Handbook, most of the regulatory framework which applies to financial market actors. Section 19 of FSMA sets out the so-called general prohibition. It provides that no person can exercise a 'regulated activity in the United Kingdom' unless authorized or

[27] eg W Patterson, 'Defining the Reach of the Securities Exchange Act: Extraterritorial Application of the Antifraud Provisions' (2005) 74 Fordham Law Review 213, 221; W Haseltine, 'International Regulation of Securities Markets: Interaction between the United States and Foreign Laws' (1987) 36 International and Comparative Law Quarterly 307, 317–8; F Mann 'Statutes and the Conflict of Laws' in The Royal Institute of International Affairs *The British Year Book Of International Law* 1972–1973 (OUP London 1975) 117, 127.

[28] The territorial principle is firmly established in international law as a basis of jurisdiction. Jurisdictional claims can also be made on the basis of nationality. But the latter is used less frequently. See V Lowe, 'Jurisdiction' in M Evans (ed), *International Law* (2nd edn, OUP 2006) 335, 345. Other principles, of lesser importance for the present purposes, are the universal principle or the protective principle. For a proposal to change the US approach to issuer disclosure to a nationality-based approach, see M Fox, 'The Political Economy of Statutory Reach: U.S. Disclosure Rules in a Globalizing Market for Securities' (1998) 97 Michigan Law Review 696.

[29] Admittedly, from the perspective of international law, territoriality, as a basis of jurisdiction, is itself a linking point for the exercise of jurisdiction. See 'Jurisdiction' (n 28) 336.

[30] See below 'B. Reflections on the Regulatory Space'.

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exempt.[31] 'Regulated activity' is a legally defined and specified concept.[32] The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, as amended (hereafter, the RAO) details the type of activities that are considered to be regulated activities under the provisions of FSMA. For activities which are caught by the RAO provisions, a person must either be authorized or exempt. Exchange activities are not a distinct regulated activity under the RAO.[33] Depending on their precise nature, they may be caught by the activity of dealing in investments (if exchanges provide central counterparty services) or by the activity of arranging deals in investments.[34] Communication flows—in the form of financial promotion, for instance—may also trigger the application of UK financial markets legislation. Section 21 of FSMA provides that an unauthorized person is not allowed to communicate in the course of business an 'invitation or inducement to engage in investment activity', unless the content of the communication has been approved by an authorised person or unless an exemption applies.[35]

The territorial principle is also a basic principle underpinning US securities regulation. Under the more detailed US federal securities laws, the type of act that amounts to a sufficient contact with the national territory has been given a generous meaning.[36] A broker-dealer that makes 'use of the mails or any

[31] See also FSMA s 418 which extends the scope of FSMA to five cases in which a person, not otherwise regarded as carrying on an activity in the UK, will be so regarded (eg in the case of a UK-based firm which is carrying on a regulated activity in another EEA State and is entitled to exercise rights under an EC Single Market Directive).

[32] See FSMA s 22(1) for further details.

[33] Note, however, that following the implementation of Mifid, the RAO now includes a new Art 25D which deals with the specified activity of operating a MTF.

[34] W Blair et al, *Banking and Financial Services Regulation* (Butterworths Lexis Nexis 2002) 116. Under the RAO, 'arranging deals in investments' is divided into 'making arrangements for another person (whether as principal or agent) to buy, sell, subscribe for or underwrite a particular investment . . .' (RAO Art 25(1)) and 'making arrangements with a view to a person who participates in the arrangements buying selling, subscribing for or underwriting investments . . .' (RAO 25(2)). The FSA has issued guidance in order to further clarify the meaning of these provisions. In relation to the former, it notes that it is aimed at 'arrangements that would have the direct effect that a particular transaction is concluded (that is, arrangements that bring it about)'. In relation to latter, the FSA states that it is aimed at cases 'where it may be said that the transaction is 'brought about' directly by the parties. This is where this happens in a context set up by a third party specifically with a view to the conclusion by others of transactions through the use of that third party's facilities. This will catch the activities of persons such as exchanges, clearing houses and service companies (for example, persons who provide communication facilities for the routing of orders or the negotiation of transactions). A person may be carrying on this regulated activity even if he is only providing part of the facilities necessary before a transaction is brought about'. See FSA Handbook PERG 2.7.7B. <http://fsahandbook.info/FSA/html/handbook/PERG> visited 12 January 2008. See also the RAO itself, which in Art 26 excludes arrangements that do not bring about the transaction in question.

[35] FSMA s 21(2) and (5). The FSA has provided guidance on the content and scope of FSMA s 21 in its Perimeter Guidance Manuel (PERG 8) <http://fsahandbook.info/FSA/html/handbook/PERG> visited 12 January 2008.

[36] J Ramsay 'Rule 15a-6 and the International Marketplace: Time for a New Idea?' (2002) 33 Law and Policy in International Business 507, 511 (in relation to 'solicitation'). Ramsey notes further that, while business conducted 'outside the jurisdiction of the United States' is generally

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means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security . . .' is subject to registration with the SEC.[37] Interstate commerce is given a broad meaning under the Securities Exchange Act 1934, thus potentially offering a broad basis for claiming jurisdiction.[38] After consideration, the SEC adopted, as a general policy principle, a territorial approach to international activities of broker-dealers.[39] Thus, broker-dealers physically operating within the US that effect, induce or attempt to induce securities transactions are subject to SEC registration, even if their activities are only directed to foreign investors which are located outside the US.[40] Moreover, foreign broker-dealers located outside the US, but which from outside the US induce or seek to induce trades by a person in the US, would generally be subject to registration too.[41] Registration requires compliance with an extensive set of rules and regulations. The dire state of affairs was smoothened by Rule 15a-6 which provides for a number of exemptions from registration (eg for *unsolicited* transactions with US investors).[42]

The SEC has also, as a matter of policy, adopted a territorial approach in relation to securities registration obligations under section 5 of the Securities Act of 1933.[43] Regulation S, which also includes a number of safe harbours, provides that section 5 shall not be deemed to apply to offers/sales of securities that occur outside the US.[44] But foreign securities that are intended to be offered directly to investors in the US must be registered with the SEC first. More recently, the question of the territorial scope of US securities laws was raised as a result of the merger proposal of the NYSE and Euronext. Section 5

excluded from the scope of the Securities Exchange Act of 1934 under section 30(b), 'the construction of this term by the courts and the [SEC] has been so limited so as to deprive it of any independent significance' (ibid 510).

[37] Securities Exchange Act 1934 § 15(a)(1) (15 U.S.C § 78o(a)(1)).

[38] Given the wording of section 15(a)(1) of the 1934 Act (15 U.S.C § 78o(a)(1)) and in particular the broad definition of 'interstate commerce' referred to therein, the SEC noted that 'virtually any transaction-oriented contact between a foreign broker-dealer and the US securities markets or a US investor in the United States involves interstate commerce and could provide the jurisdictional basis for broker-dealer registration' (see Registration Requirements for Foreign Broker-Dealers, Exchange Act Release No. 27017 (11 July 1989) 54 Fed. Reg. 30013, 30015). 15 USC § 78c(a)(17) defines interstate commerce as meaning 'trade, commerce, transportation, or communication among the several States, or between any foreign country and any State, or between any State and any place or ship outside thereof. . . .'.

[39] Registration Requirements for Foreign Broker-Dealers (n 38) 30016. The territorial approach is complemented by an 'entity approach' for registered broker-dealers. That is to say, 'if a foreign broker-dealer physically operates a branch in the United States, and thus becomes subject to US registration requirements, the registration requirements and the regulatory system governing US broker-dealers would apply to the entire foreign broker-dealer entity. If the foreign broker-dealer establishes an affiliate in the United States, however, only the affiliate must be registered as a broker-dealer: the foreign broker-dealer parent would not be required to register'. See ibid 30017.

[40] ibid 30016.

[41] ibid 30017.

[42] 17 CFR § 240.15a-6. Foreign-broker dealers may nevertheless be put off by the fear of U.S. liability attaching to them ('A Blueprint for Cross-Border Access to U.S. Investors' (n 4) 48).

[43] 15 USC § 77(e).

[44] 17 CFR §§ 230.901–905.

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of the Securities Exchange Act of 1934 provides that, unless an exchange is registered with the SEC or exempted under the limited volume exemption, it is unlawful for exchanges (and any broker dealer):

> 'to make use of the mails or any means or instrumentality of interstate commerce 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 . . .'[45]

Amidst growing anxieties about the reach of section 5 (and more specifically, the precise meaning of 'within or subject to the jurisdiction of the United States'), the SEC issued a 'fact sheet' on cross-border stock exchange consolidation in which it sought to address the question of the jurisdictional scope of the US registration requirements.[46] The fact sheet is brief. The SEC first noted that many forms of integration would not lead to SEC registration of a non-US exchange. According to the SEC '[w]hether a non-U.S. exchange, and thereby its listed companies, would be subject to U.S. registration depends upon a careful analysis of the activities of the non-U.S. exchange in the United States'.[47] Thus, '[t]he non-U.S. exchange would only become subject to U.S. securities laws if that exchange is operating within the U.S., not merely because it is affiliated with a U.S. exchange'.[48] Of course, the SEC's statements beg a question. When precisely is an exchange deemed to 'operate' in the US? The issue is significant not only for exchanges, but also for exchange members and issuers which would have to register with the SEC and comply with US securities law requirements,[49] including the Sarbanes-Oxley Act (hereafter, SOX) which would apply to issuers (unless they benefit of an exemption).[50] The SEC fact sheet does not give further details on the meaning of 'operating'. The fact is, however, that the SEC has long adopted a restrictive approach to market access and prohibited foreign exchanges to set up direct trading facilities in the US without registering with the SEC first. It is well known that it has opposed the installation by foreign exchanges of remote trading screens.[51] Admittedly, in 1999 the SEC exempted Tradepoint, a UK Recognised

[45] 15 USC § 78e. 'Facility of an exchange' is defined generously in 15 USC § 78c(a)(2) as including the exchange's 'premises, tangible or intangible property whether on the premises or not, any right to the use of such premises or property or any service thereof for the purpose of effecting or reporting a transaction on an exchange (including, among other things, any system of communication to or from the exchange, by ticker or otherwise, maintained by or with the consent of the exchange), and any right of the exchange to the use of any property or service'.

[46] SEC Office of International Affairs and Divisions of Market Regulation and Corporation Finance 'Fact Sheet on Potential Cross-Border Exchange Mergers' (16 June 2006) <http://www.sec.gov/news/press/2006/2006-96.htm> visited 10 December 2007.

[47] ibid.

[48] ibid.

[49] 15 USC § 78c(a)(3)(A), 15 USC § 78f(c)(1), 15 USC § 78l(a).

[50] R Aggarwal, A Ferrell, J Katz, 'U.S. Securities Regulation in a World of Global Exchanges' (John M. Olin Discussion Paper No. 569 12/2006) 21–3 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=950530> visited 12 December 2007.

[51] For details, see H Jackson, A Fleckner and M Gurevich, 'Foreign Trading Screens in the United States' (2006) 1 Capital Markets Law Journal 54.

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Investment Exchange which became Virt-x and is now SWX Europe, from registration as a national securities exchange.[52] The SEC based its decision on the limited volume exemption under section 5 of the 1934 Act.[53] It added rigorous conditions. Tradepoint remains the only foreign exchange which has benefited from this exemption. Likewise, the SEC has in the past set strict conditions on other types of contacts between foreign exchanges and US markets or US investors, for example in the case of foreign option exchanges seeking to familiarise certain US actors (US registered brokers-dealers or certain US institutional investors) with their markets or products.[54]

B. *Reflections on the Regulatory Space*

So far, it has been observed that the notion of territory is increasingly meaningless, as an organizing unit, within the market space while the territorial principle is a common basis for claiming jurisdiction within a divided regulatory space. Physical or legal location, activities, operations, investment solicitations or conduct taking place in the national territory create jurisdictional links. As a result, simple cross-border flows of information—in the form of an investment solicitation, for instance—can lead to the application of national law. Flows of capital, data or information are hence not outside regulation as Castells notes. Furthermore, while Castells' dichotomy between a space-of-flows and a space-of-places is useful for presenting the mismatch between the market and the regulatory space in metaphorical language, it does not capture the complex jurisdictional problems which cross-border operations create. For instance, how much 'contact' with the national territory is required before a State may impose its laws? A person may still be caught by the general prohibition of FSMA section 19 if only parts of the elements of a regulated activity are in the UK. This position was taken by the FSA,[55] but also by the Court of Appeal in *FSA v Fradley*.[56] According to the Court, FSMA does not require 'that the entirety of a business activity be carried on in the United Kingdom'.[57] Indeed, taking another view might lead to 'obvious abuse'.[58] In the age of the information society, cross-border flows of information raise

[52] As provided for under section 6 of the Securities Exchange Act of 1934 (15 USC § 78(f)).

[53] 15 USC § 78(e).

[54] For an example where the SEC granted a UK Recognised Investment Exchange (ie Liffe which is now Euronext.liffe) a no-action letter, subject to various requirements and conditions, see SEC no-action letter 'Trading of Flex style options on the London International Financial Futures and Options Exchange ("LIFFE")' (6 March 1996) <http://www.lexisnexis.co.uk> visited 10 January 2008. Note in this context that the SEC has recently proposed to amend Rule 15a-6 by enacting an exemption which will (inter alia) allow a foreign option exchange to engage in limited activities aimed at familiarizing certain US actors that are reasonably believed to be 'U.S. qualified investors', with the exchange itself and the products being traded. See also 'B. Recent Developments' below.

[55] FSA Handbook PERG 2.4.2.

[56] *Financial Services Authority v Fradley* [2005] EWCA Civ 1183, [2005] All ER (D) 314 (Nov) (in relation to the operation of a collective investment scheme).

[57] ibid [52].

[58] ibid.

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particular jurisdictional problems. As previously noted, section 21(1) of FSMA prohibits persons from communicating an 'invitation or inducement to engage in investment activity', unless the person is authorized, or the content of the communication was approved by an authorized person, or an exemption applies (under the Financial Promotion Order).[59] But what if the communication originates outside the UK while having an impact on markets or investors in the UK? Section 21(3) states that if a communication, which originated overseas, is 'capable of having an effect in the United Kingdom', the financial promotion restriction applies. It is irrelevant whether the communication has an actual effect.[60] What matters is that it is *capable* of having such an effect.[61] It follows that section 21 could potentially be interpreted as having a very wide jurisdictional scope.[62]

A fortiori, the effects doctrine, as applied by US courts, raises questions about the proper jurisdictional reach of national securities laws. As noted earlier, the scope of statutes is generally territorial. Thus, US courts have held that in the absence of congressional intent to the contrary, there is a general presumption against the extraterritorial application of a statute.[63] But they have also admitted that this canon of construction can be overcome, leading in practice to, what has been described, as a 'perceived tendency of U.S. law . . . to be applied across national borders'.[64] More specifically, the courts have given, by way of statutory interpretation, 'extra-territorial' scope to the

[59] FSMA s 21(1) (setting out the restriction), s 21(2) and (5).

[60] FSA Handbook PERG 8.8.1.

[61] ibid.

[62] FSA Handbook PERG 8.8.2. However, note that the Financial Promotion Order (Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (SI 2005/1529)) made by the Treasury specifies the scope of FSMA section 21 further. According to Art 12(1) of the Financial Promotion Order, the restriction on financial promotion does not apply if the communication, which originates overseas or within the UK, is made to a person 'who receives the communication outside the United Kingdom' or if it is directed 'only at persons outside the United Kingdom'. As a result, section 21(1) does not apply to a communication which originated overseas but which is not directed at a person in the UK. Note that in respect of an 'unsolicited real time communication', the communication must originate from outside the United Kingdom and be made for the purposes of a business which is entirely carried on outside the UK for the Article 12(1) exemption to apply (see also FSA Handbook PERG 8.12.4.). The directive on electronic commerce (Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market [2000] OJ L178/1) also affects Art 12(1). Thus under Art 12(7) of the Order, the exemption will not apply to an electronic commerce communication which is made from an establishment in the UK to a person in another EEA State. Likewise, the country of origin principle of the directive affects the jurisdictional scope of FSMA s 21. Art 20B(1) of the Financial Promotion Order provides that the financial promotion restriction in s 21 does not apply to 'incoming electronic commerce communications' which are electronic commerce communications 'made from an establishment in an EEA State other than the United Kingdom' (Financial Promotion Order Art 6(g)) to a person which is a user of an electronic commerce activity (FSA Handbook PERG 8.12.38). See also Art 20(B)(2) for communications to which Art 20B(1) does not apply.

[63] *EEOC v Arabian Am Oil Co* 499 U.S. 244 (1991).

[64] T Edmonds 'Investment Exchanges & Clearing Houses Bill' (Research Paper 06/58 House of Commons Library 23 November 2006) 7 <http://www.parliament.uk/commons/lib/research/rp2006/rp06-058.pdf> visited 3 August 2007.

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US Securities Acts' anti-fraud provisions.[65] That is to say, US courts have looked for conduct occurring within the United States,[66] but also for effects[67]—that is, fraudulent activities occurring abroad but having substantial effects on US markets or US investors. Questions regarding the extraterritorial reach of the provisions of US securities laws have also been raised in relation to the securities registration requirements of the Securities Act of 1933.[68] More recently, SOX has given rise to speculations and interrogations regarding the extraterritorial application of its provisions. SOX sought to improve financial reporting and auditing. It includes provisions which are explicitly applicable to foreign actors. Section 106, for example, extends the provisions of the Act to any foreign accounting firm 'that prepares or furnishes an audit report with respect to any issuer' (as defined in the Act).[69] The promoters of the NYSE Euronext merger and their advisers put a great deal of effort into calming fears over extraterritorial application of SOX to Euronext issuers by stressing that, by its terms, the Act only applied to companies which were registered or which were reporting to the SEC.[70] US courts have not yet had much opportunity to decide on the extraterritorial reach of SOX's provisions. One example is *Carnero v Boston Scientific Corporation*,[71] which concerned a 'whistleblower' provision found in section 806.[72] After reviewing the legislative history, the Court of Appeal for the First Circuit found that US Congress did not intend to give the provision extra-territorial effect.[73]

The above examples illustrate the type of problems which cross-border operations raise in a divided regulatory space. Yet, at the same time, the

[65] eg K Chang, 'Multinational Enforcement of U.S. Securities Laws: The Need for the Clear and Restrained Scope of Extraterritorial Subject Matter Jurisdiction' (2003) 9 Fordham Journal of Corporate and Financial Law 89; D Langevoort, '"Schoenbaum" Revisited: Limiting the Scope of Antifraud Protection in an Internationalized Securities Marketplace' (1992) 55 Law and Contemporary Problems 241. Note that the closest parallel to the U.S. anti-fraud provisions can be found in FSMA s 397 which has a very wide jurisdictional reach.

[66] eg Leasco Data Processing Equipment Corp. v. Maxwell 468 F.2d 1326 (2d Circuit 1972).

[67] eg Schoenbaum v. Firstbrook 405 F.2d 200 (2d Circuit 1968). Note that the conduct and effects tests have not been applied in a consistent manner by the Courts.

[68] Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London, Paribas Global Bond Futures Fund, Paribas Asset Management Ltd. and John Arida 147 F.3d 118 (2d Circuit 1998) (adapting the conduct and effects tests after examination of Regulation S, but finding that there was insufficient conduct or effect in the U.S.).

[69] 15 USC § 7216(a). The definition of issuer is found in 15 USC § 7201(7).

[70] eg Clearly Gottlieb Steen & Hamilton LLP 'Summary of certain U.S. legal aspects of the proposed combination between Euronext and NYSE Group Inc' (6 December 2006) <http://www.euronext.com/fic/000/010/901/109019.pdf> visited 13 January 2008.

[71] 433 F.3d 1 (1st Circuit 2006).

[72] 18 U.S.C. § 1514A.

[73] An even more recent case that addressed the question of the potential extra-territorial reach of section 806 is *O'Mahony v Accenture* (07 Civ. 7916). The defendant claimed that section 806 did not have extra-territorial reach. The District Court of the Southern District of New York distinguished *Carnero v Boston Scientific Corporation* on its facts and, after examination, found that it had subject-matter jurisdiction over the defendant in this case 'because the alleged wrongful conduct and other material acts occurred in the United States by persons located in the United States . . .'. As a result, the district judge considered that the resolution of the dispute would not implicate an extra-territorial application of U.S. law.

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organization of the regulatory space is increasingly being affected by a contrasting trend. That is to say, the regulatory space is increasingly subject to processes of change. Regulation, as an emanation of the nation-State, is to some extent being replaced by a supra-national layer of regulation which emanates from international organizations or from a type of polity such as the European Union. There is a growing re-scaling of regulatory activity. Supranational regulation spans the jurisdictional boundaries dividing the regulatory space among horizontally arrayed States. As will be shown later, this supranational layer of regulation affects the territorial jurisdiction of States and contributes to resolving jurisdictional problems. Thus, within the EU, the home country control principle, which is enacted in many Directives and Regulations, contributes to resolving problems of prescriptive and enforcement jurisdiction. The EC legislature defines at the outset criteria for allocating competence between different Member States (eg the Member State in which the registered office of a company is located or its head office, or the Member State in which a public offer is being made). These criteria create the necessary jurisdictional link for Member State regulators to assert competence. The home country principle is typically the corollary of the principle of mutual recognition which facilitates market access. In a sense, mutual recognition is also a form of extraterritoriality.[74] A host State recognises on its territory persons or products which comply with the regulatory standards of the home state. As a result, activities which take place in the host State are effectively being governed by the laws of another State. Note, however, that mutual recognition is a type of consensual extra-territoriality as Member States *agree* on the scope and form of mutual recognition;[75] admittedly, not without first setting conditions to the operation of mutual recognition which may, in turn, significantly limit its effectiveness.

IV. TRANSATLANTIC STOCK EXCHANGE CONSOLIDATION AND THE LACK OF FIT BETWEEN THE MARKET AND THE REGULATORY SPACE

In Part I, the principles underpinning the organization of the market space and the regulatory space were discussed. It was shown that territoriality is increasingly meaningless, as an organizing unit, for exchange and market actors who seek to look beyond territorial boundaries in search for business and investment activities. In the regulatory space, however, the territorial principle is a basic principle of jurisdiction. This part discusses the problems which the mismatch of the market and the regulatory space create. To this end, it examines first existing methods and arrangements which aim at facilitating cross-border market access and identifies their limitations (A). Next, it turns to

[74] K Nicolaidis and G Shaffer 'Transnational Mutual Recognition Regimes: Governance Without Global Government' (2005) 68 Law and Contemporary Problems 263, 267.

[75] ibid.

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the merger of the NYSE and Euronext and looks at the problems in a practical context (B).

A. Problems Raised by the Lack of Fit between the Market and the Regulatory Space

The fundamental problem which stock exchanges face when seeking to consolidate on a transatlantic or global scale can be put as follows: from the purely *technological* point of view, there are few difficulties in setting up a single trading system which provides unrestricted access to markets located in various jurisdictions and to securities listed and traded on all of them, thus bringing together liquidity from previously separate markets and creating one single liquidity pool. The expected benefits of technological integration in the exchange sector plead arguably for full integration: a single trading system, a single order book, a single list and common membership. However, in a divided regulatory space, market access, which is determined according to the principles/criteria discussed in the previous section, triggers the application of national regulatory law. Recall that what is at issue is the *unilateral* application of securities regulation or other 'public law' provisions to cross-border operations. Absent adequate bilateral or multilateral regulatory arrangements, transatlantic stock exchange consolidation thus remains prone to regulatory asymmetries. Asymmetries take the form of overregulation, rule spillover or rule conflict. Overregulation arises when economic actors must comply with two (or three, or four . . .) sets of rules. Rule spillover is the result of an extraterritorial application of laws. Rule conflict is linked to the problem of overregulation, but refers more specifically to a situation in which an economic actor must comply with conflicting or contradictory national regulatory requirements. Regulatory asymmetries potentially affect various constituencies, including exchanges, their members and issuers. Identifying asymmetries necessitates in practice a detailed and extensive legal and factual analysis. Both the combination arrangements and the exchange's activities need careful examination. The latter may include promotional activities, information and news dissemination and, of course, listing and execution services. In particular, considering that technological integration proves to be an important impetus for transatlantic exchange consolidation, the prospect of regulatory asymmetries depends importantly on the scope and level of technological integration.

In Europe, the combination of mutual recognition and harmonization has facilitated cross-border movements. By the same token, EC law has reduced the prospect of regulatory asymmetries (See IV A.2 below). The market integration logic which underpins the adoption of EC law has long been different from the logic which underpins US securities regulation. To be sure, the SEC has recently signed a first 'pilot' mutual recognition framework agreement with Australian authorities which represents the first stage towards

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implementing mutual recognition for eligible US and Australian exchanges and broker-dealers. Moreover, it has also proposed new rules which promise improved access to a generally wider category of US investors for foreign broker-dealers. These are noteworthy developments which drive the point home that there is a felt need to adapt more closely the regulatory space to the spatial logic of the market space. I will return to them later.[76] For now, I will concentrate on those arrangements that are in force and operational in the US.

1. The US

It is common to discuss questions regarding the application of US securities laws by noting that the US approach is one of 'national treatment'.[77] National treatment means that foreign actors, who seek access to US markets (or US investors), must generally comply with the same regulatory requirements than US actors. Thus, once it is established that US laws apply, the SEC's registration requirements pertaining to exchanges, broker-dealers and issuers apply to foreign actors, as well as the substantive law provisions to which SEC registered exchanges, issuers and broker-dealers are subject. Because these requirements are extensive, cross-border access to US markets is generally seen as costly and burdensome. At the same time, US investors—especially US retail investors—who seek to access foreign (ie non-US) markets have also faced difficulties. Tafara and Peterson thus describe a relatively cumbersome process for US retail investors.[78] In particular, they highlight two factors which affect retail investors' access to foreign markets.[79] The first factor concerns the transaction costs associated with having to pass through a US registered broker-dealer. The second factor—the most significant one according to the authors—concerns the absence of information about foreign investment opportunities. This absence is explained by restrictions which US securities laws set on who can contact US retail investors and what they can offer them.[80] Admittedly, the US approach to foreign actors is not one of absolute national treatment. Exemptions and arrangements which seek to

[76] See below 'B. Recent Developments'.

[77] eg E Greene 'Resolving regulatory conflicts between the capital markets of the United States and Europe' (2007) 2 Capital Markets Law Journal 5, 7; 'The Once and Future New York Stock Exchange' (n 7) 359. See also E Greene, D Braverman and J Schneck 'Concepts of Regulation—The U.S. Model' in F Oditah (ed) *The Future for the Global Securities Market—Legal and Regulatory Aspects* (Clarendon Press Oxford 1996) 157.

[78] 'A Blueprint for Cross-Border Access to U.S. Investors' (n 4) 48 (noting that '[g]enerally speaking, American retail investors interested in these foreign investment opportunities trade non-U.S. registered securities listed on a foreign exchange through registered U.S. brokers. But the U.S. brokers typically funnel the trade order through their foreign affiliates—a process that tends to involve somewhat higher transaction costs (and may take more time) than if the U.S. investors had conducted the transactions directly with the foreign affiliates or foreign brokers').

[79] ibid.

[80] ibid. More specifically, the authors note that the lack of information is due to the fact that foreign actors which are not registered with the SEC are not allowed to solicit U.S. retail investor directly. Moreover, US registered broker-dealers cannot provide US investors with research or

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facilitate cross-border transactions, are in place.[81] Rule 15a-6, which provides conditional exemptions from SEC registration for foreign broker-dealers and which the SEC is now proposing to amend in recognition of the fact that it no longer adequately responds to the growing internationalization of markets, was already mentioned earlier.[82] The multijurisdictional disclosure system or MJDS allows Canadian issuers which comply with Canadian disclosure standards and wish to access US markets to rely on the disclosure documents filed with the Canadian authorities for SEC registration and periodic reporting purposes. The MJDS is only available to Canadian issuers. Yet even for these issuers, the effectiveness of the MJDS has been questioned.[83] Houston and Jones, for instance, report that the MJDS does not provide significant benefits.[84] American Depositary Receipts (hereafter, ADRs) are a more widely available and a more common method for US investors to hold foreign securities.[85] ADRs represent an ownership interest in foreign securities. The foreign security will be held by a US bank which will act as depositary and issue the ADR which will be freely negotiable. Finally, Rule 144A, which applies to both US and foreign issuers, exempts re-sales of securities which are made to so-called qualified institutional investors (QIBs) from the registration requirement of the Securities Act of 1933.[86] The existence of these rules and arrangements testifies to the fact that there are means and ways of facilitating cross-border operations. Thus, the problem for most financial market actors is rather one of added cost in the absence of more direct access arrangements. Unsurprisingly, there has been a demand for greater and cheaper cross-border access. Currently effective cross-border market access is mostly available to large institutional investors only. US institutional investors have thus already the capacity to access foreign securities markets in a reasonably effective manner.[87] Among the possible routes are so-called 'pass-through' linkages which allow institutional investors in the US to access EU securities markets through US broker-dealers' internal systems, instead of

information on foreign investment opportunities unless they are directly requested to do so by the investor.

[81] See generally H Scott and P Wellons *International Finance—Transactions, Policy, and Regulation* (Foundation Press New York 2007) 68–94; J Board, C Sutcliffe and S Wells 'Distortion or Distraction: U.S. restrictions on EU Exchange Trading Screens' (London School of Economics and Corporation of London, City Research Series Number Three, November 2004) 25–33 <http://www.cityoflondon.gov.uk/NR/rdonlyres/0C234A1F-022B-48E0-9128-1994192B4973/0/BC_RS_distortion_0411_ES.pdf> visited 12 December 2007.

[82] On the proposed amendments, see below 'B. Recent Developments'.

[83] 'Distortion or Distraction' (n 81) 22.

[84] C Olson Houston and R Ann Jones 'The Multijurisdictional Disclosure System: Model for Future Cooperation?' (1999) Journal of International Financial Management and Accounting 227, 228, cited in 'Distortion or Distraction' (n 81) 22.

[85] *International Finance—Transactions, Policy, and Regulation* (n 81) 79.

[86] 17 CFR § 230.144A.

[87] 'Distortion or Distraction' (n 81); SEC 'Unofficial Transcript of Roundtable Discussion on Mutual Recognition' (12 June 2007) <http://www.sec.gov/news/openmeetings/2007/openmtg_trans061207.pdf> visited 13 January 2008.

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relying on remote exchange trading screens which would require the foreign exchange to register with the SEC.[88] Note that according to Board et al these pass-through linkages have never been explicitly authorised by the SEC.[89] Moreover, smaller US investment banks do not benefit from the same facilities.[90]

As far as stock exchanges are concerned, a potentially promising route for facilitating cross-border access appeared to take shape in the 1980s when a number of US stock exchanges sought to link up directly with foreign stock exchanges. The SEC did indeed approve a few of these cross-border trading linkages.[91] The first one was approved in 1984 and linked the Boston Stock Exchange with the Montreal Stock Exchange. The second linked the Toronto Stock Exchange and the American Stock Exchange, and the third one connected the Toronto Stock Exchange to the Midwest Stock Exchange (which is now the Chicago Stock Exchange).[92] The SEC approved the linkages after making sure that adequate arrangements were in place (for instance, giving foreign exchanges the power to discipline members) and that the rules and regulations applying to each of the foreign stock exchanges were comparable to US requirements.[93] In each case, it was of crucial importance to the SEC that adequate information sharing arrangements were in place in order to ensure oversight and enforcement.[94] However, trading was limited in each case to dually listed securities. These linkages also do not appear to have proved successful. Loss and Seligman describe them as still in an 'incipient phase'.[95]

2. *The EU*

In Europe, regulatory arrangements, in the form of harmonization, mutual recognition and home country control, have facilitated cross-border market access between EC Member States and, by extension, member countries of the European Economic Area (EEA). Mutual recognition is a basic principle

[88] SEC Release 'Regulation of Exchanges' No. 34-38672 (1997). According to the SEC '[t]he market member [typically, the investor's broker-dealer] provides a direct, automated link between the customer and the foreign market by connecting the customer's computer system directly to its own, which is also connected with the foreign market. . . . The member's systems will then automatically distribute market information to the U.S. investor and route the investor's orders directly to the market. Through these types of "pass-through" linkages, the non-member customer can enjoy electronic trading capabilities that are equivalent to the trading privileges of a member of the foreign market'.

[89] 'Distortion or Distraction' (n 81) 31.

[90] 'Roundtable Discussion on Mutual Recognition' (n 87).

[91] eg R Bernard 'International linkages between securities markets: "A ring of dinosaurs joining hands and dancing together"?' (1987) 2 Columbia Business Law Review 321, L Loss and J Seligman *Fundamentals of Securities Regulation* (Aspen Publishers New York 2005) 750–1.

[92] Further details can be found in SEC 'Internationalization of the Securities Markets' (Report of the Staff of the SEC to the Senate Committee on Banking, Housing and Urban Affairs, and the House Committee on Energy and Commerce, July 1987) V-49–V-55 <http://www.sechistorical.org/collection/papers/1980/1987_IntSecMarketsRep/> visited 15 February 2008.

[93] ibid V-57.

[94] ibid V-56.

[95] *Fundamentals of Securities Regulation* (n 91) 750.

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underpinning the market integration logic of EC regulation. Thus, EC/EEA issuers that wish to make cross-border public offers or seek admission to trading of securities on a regulated market situated or operating in a different Member State, can take advantage of the mutual recognition provision of the Prospectus Directive (the PD).[96] The mutual recognition provision, which is also known as the passport system, allows an issuer to use its securities prospectus in any Member State, once it has been approved by the regulatory authority of the issuer's 'home Member State'. In comparison to the mutual recognition provisions of the PD's predecessors, the PD's mutual recognition system is more aggressive in terms of facilitating market access. Host Member States are, by and large, barred from managing the passport system via a set of residual powers (eg by asking for additional information or a full translation of the prospectus which affected the effectiveness of the mutual recognition provisions of the PD's predecessors). In order to make mutual recognition work, the PD lays down different criteria for designating the home and host Member State. These criteria create the necessary links for claiming jurisdiction. Thus, for issuers of non-equity securities whose securities have a denomination per unit of at least €1000 (as well as issuers of certain types of hybrid or derivative securities), Article 2(1)(m)(ii) provides that the home Member State is either (i) the Member State where the issuer's registered office is located; (ii) the Member State where the regulated market on which the issuer's securities are to be admitted to trading is located; or (iii) the Member State on the territory of which the issuer's securities are offered to the public, *at the choice of the issuer*. For issuers of all other types of securities—that is, mainly equity securities—the home State is the Member State in which the issuer's registered office is located.[97] The Transparency Directive (hereafter, the TD), which deals with ongoing disclosure requirements, includes similar provisions.[98]

One particularity of the PD is that third-country issuers, such as US issuers, can also benefit from the passport provisions of the directive once their prospectus, which has been drawn up in accordance with the provisions of the Directive, has been approved. To this end, the PD also lays down specific rules for designating the third-country issuer's 'home Member State'. The latter is determined in accordance with either Article 2(1)(m)(ii) which was examined above, or Article 2(1)(m)(iii).[99] Thus, a US issuer seeking admission of its

[96] Directive (EC) 2003/71 of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC [2003] OJ L345/64.

[97] PD Art 2(1)(m)(i).

[98] Art 2(1)(i) Directive (EC) 2004/109 of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC [2004] L390/38.

[99] PD Art 2(1)(m)(iii) states that 'for all issuers of securities incorporated in a third country, which are not mentioned in [Art 2(1)(m)(ii)]' the home Member State is the Member State 'where

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securities on Euronext Paris and whose prospectus has been approved by the regulatory authority of its designated home Member State—for example, the UKLA which is part of the UK FSA—will not need to have its prospectus approved by the French Autorité des marchés financiers. But the PD goes further. It includes a specific provision on the recognition of prospectuses which have been drawn up in accordance with the laws of a third country. Pursuant to Article 20, the national authority of the designated home Member State of the third-country issuer may approve such a prospectus as long as the prospectus is drawn up in accordance with sanctioned international standards and the information requirements are considered 'equivalent' to the requirements of the Directive (including the level-2 Commission Regulation). An approved prospectus may subsequently benefit of the passport provision. Likewise, the TD envisages the situation of third-country issuers for the purposes of the operation of the home country control system. These provisions build upon those found in the PD.[100]

Arguably the most significant piece of legislation for exchanges and investment firms under the European Commission's Financial Services Action Plan is Mifid.[101] Mifid lays down authorization requirements and operating/organizational conditions for investment firms and regulated markets.[102] It also includes mutual recognition provisions. Like the PD, Mifid is based on the home country control principle. The home Member State is determined according to the criteria laid down in Article 4(20). For investment firms, which are either natural persons or which do not have a registered office under national law, the home Member State is the Member State in which the firm's head office is located.[103] For investment firms with a registered office, it is the

the securities are intended to be offered to the public for the first time after the date of entry into force of this Directive or where the first application for admission to trading on a regulated market is made, at the choice of the issuer, the offeror or the person asking for admission, as the case may be, subject to a subsequent election by issuers incorporated in a third country if the home Member State was not determined by their choice'.

[100] TD Art 2(1)(i). See also TD Art 23 which exempts third-country issuers from complying with certain provisions of the TD.

[101] Parts of Mifid also apply to credit institutions which provide investment services or perform investment activities (Art 1(2)). These credit institutions benefit, *inter alia*, of Arts 31(1) and 32(1) which are examined hereafter.

[102] For the definition of 'regulated market', see (n 12). An investment firm is defined in Mifid Art 4(1)(1) as 'any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis'. Investment services and activities are listed in Section A of Annex I. These are the reception and transmission of orders in relation to one or more financial instruments, the execution of orders on behalf of clients, dealing on own account, investment advice, the underwriting of financial instruments and/or the placing of financial instruments on a firm commitment basis, the placing of financial instruments without a firm commitment basis and the operation of MTFs (for the definition of 'MTF', see (n 12)). A market operator is a person 'who manages and/or operates the business of a regulated market. The market operator may be the regulated market itself' (Art 4(1)(13)). Note also that a MTF may either be operated by an investment firm or a market operator (Art 4(1)(15)).

[103] Mifid Art 4(1)(20)(a)(i) and (iii).

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Member State in which the latter is located.[104] Similar rules govern the determination of the home and host Member State of regulated markets. Thus, the home Member State is the State in which the regulated market is registered.[105] If the regulated market has no registered office under national law (that is, the law of the Member State in which it is registered), the home Member State is the Member State in which the head office is located.[106] Investments firms which are authorized and supervized in accordance with the provisions of the Directive benefit from a number of cross-border rights. Article 31(1) allows them to 'freely perform' investment services and activities on a cross-border basis (by making telephone calls or by using the internet, for instance), provided that they notify the regulatory authority of their home Member State.[107] For matters which are within the scope of the Directive, host Member States are accordingly prevented from setting additional requirements. Furthermore, Article 32(1) allows investment firms to set up branches in other Member States in order to provide investment services and activities. An obligation to notify the home Member State applies.[108] The home country control principle is more diluted in this case. This is because the regulatory authority of the host Member State continues to exercise competence for certain matters.[109] Mifid also facilitates membership of, and access to, regulated markets. Article 33(1) provides that investment firms, which are authorized to execute client orders or to deal on their own account in their home Member State, have a right of membership or a right to access regulated markets established in the territory of other Member States either (directly) by establishing branches in the latter Member States, or by becoming remote members or having remote access. For matters which are covered by the Directive, Member States are, in each case, prohibited from imposing additional regulatory or administrative requirements.[110] Finally, Mifid provides that regulated markets shall be allowed to provide 'appropriate arrangements' in other Member States in order to facilitate access to and trading by remote members or participants.[111] A notification obligation applies. The regulated market must let its home Member State know in which Member State it intends to provide these arrangements.[112] But other Member States cannot impose 'further legal or administrative requirements'.[113]

[104] Mifid Art 4(1)(20)(a)(ii).

[105] Mifid Art 4(1)(20)(b).

[106] ibid.

[107] For details on the content of the information which they must provide to the home state regulator, see Art 31(2). See also HM Treasury 'UK Implementation of the EU Markets in Financial Instruments Directive (Directive 2004/39/EC)' (Consultation Document December 2005) 15 <http://www.hm-treasury.gov.uk/media/6/8/ukimplementationeumarkets151205.pdf> visited 12 December 2007.

[108] Mifid Art 32(2).

[109] See Mifid Art 32(7) which refers to the matters governed by Art 19 (conduct of business obligations), Art 21 (best execution), Art 22 (client order handling rules), Art 25 (transaction reporting/record keeping), Art 27 (pre-trade transparency) and Art 28 (post-trade transparency).

[110] Mifid Art 33(2).

[111] Mifid Art 42(6).

[112] Mifid Art 42(6) para 2.

[113] Mifid Art 42(6).

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Investment firms or market operators which operate MTFs also benefit from such rights under Article 31(5).[114]

We have seen that Mifid, the PD and the TD are based on the home-country control principle which is also essential to the operation of mutual recognition. Mifid's provisions have important consequences for the territorial competence of Member States. Thus, a market operator who operates a regulated market in a Member State is allowed to make arrangements in, let us say, the UK, in order for UK members to have remote access to its market, without the UK being able to impose further legal requirements.[115] The market operator will benefit from 'exempt person status'—that is, he will be exempt from the general prohibition in section 19 of FSMA as respects any regulatory activity carried on in the UK as part of the operation of the regulated market.[116] On the other hand, a UK-based firm, which would not otherwise be regarded as carrying on a regulated activity in the UK, may be so regarded as a result of Mifid. In accordance with Article 4(1)(20) of Mifid, a UK-based firm is a firm which has its registered office or, in the absence of a registered office, its head office in the UK. If such a firm carries on its activities *overseas* and thereby exercises its cross-border rights under Mifid, it may be considered as carrying on a regulated activity in the UK as a result of the application of the 'home country control' principle.[117]

It is obvious that Mifid's cross-border provisions reduce the prospect of regulatory asymmetries. However, unlike the PD or the TD, Mifid does not include provisions which allow designating, a 'home Member State' for third-country investment firms or exchanges. Also, third-country nationals do not benefit of the rights which Community actors (and EEA actors) enjoy under Mifid.[118] Member States are free to adopt differing approaches with regard to third-country nationals.[119] Some Member States have adopted a more open

[114] The notification obligation is found in Mifid Art 31(6).

[115] FSMA s 312A(1) (implementing Mifid Arts 31(5) and 42(6)). Operators of MTFs benefit of the same rights.

[116] FSMA s 312A(2).

[117] FSMA s 418(1) and (2).

[118] European Commission 'Your questions on MiFID' (Question no. 41.2—Update 21 February 2008) (in relation to third-country investment firms) <http://ec.europa.eu/internal_market/securities/docs/isd/questions/questions_en.pdf> visited 26 February 2008. See also EC Treaty Art 49 which lays down the right for a service provider to provide services on a cross-border basis. Service providers are nationals of a Member State who provide services in a state other than the one in which they are established. Article 49 para 2. envisages the situation of third country nationals. It provides that the Council can extend the rights to third country nationals on a proposal by the Commission. There is no indication that Mifid sought to extend the cross-border service rights to third country nationals. On the contrary, recital (28) explicitly states that branches of investment firms authorised in third countries 'should not enjoy the freedom to provide services under the second paragraph of Article 49 of the Treaty or the right of establishment in Member States other than those in which they are established'.

[119] In relation to branches of third-country investment firms, Art 5 of the Investment Services Directive—the predecessor of Mifid—provided that Member States should not treat them more favourably than branches of Community firms. Mifid no longer includes this provision (but see recital (28)). The Commission considers that the ISD principle continues to apply under Mifid. See 'Your questions on MiFID' (n 118). See also Financial Services Authority 'Reforming

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policy. The UK is a good example. In relation to foreign exchanges which qualify as recognized overseas investment exchanges (hereafter, ROIEs), FSMA lays down a 'relatively benign regime'.[120] ROIEs are exchanges that have neither their head office nor their registered office in the UK and that meet a number of criteria laid down in section 292(3) of FSMA. ROIEs are granted 'exempt person status' and are, as such, exempt from the general prohibition of section 19. For the regulation and supervision of ROIEs, the FSA relies on the regulatory authority of the state in which the overseas exchange's head office is located.[121] Before granting ROIE status, the FSA will, inter alia, verify that investors benefit from adequate protection.[122] It will assess the relevant laws and practices of the overseas country as well as the rules and practices of the overseas exchange itself.[123] It will also make sure that the overseas applicant is willing to co-operate with the FSA and that adequate cooperative arrangements are in place between itself and the overseas authority.[124] Overseas exchanges that wish to place trading screens in the UK most often apply for ROIE status. ROIEs cannot, however, operate regulated markets and it would seem that ROIEs cannot maintain a physical presence in the UK either.[125]

B. NYSE Euronext

The prospect of regulatory asymmetries is an important factor for explaining differences in the level of integration between stock exchanges. Euronext exchanges, which have, directly or indirectly, benefited from harmonization efforts at EC level, have thus, to a lesser extent, been plagued by regulatory asymmetries. As a result, Euronext could take the integration logic a good step forward. Euronext exchanges share a single trading platform—NSC on the cash side and LIFFE Connect on the derivative side—and benefit from a single order book. The integration of Euronext's trading platforms was facilitated by harmonized rules.[126] Membership could be extended across Euronext exchanges on the basis of the passport provisions of the Investment Services Directive (ISD) which has now been replaced by Mifid. Moreover,

Conduct of Business Regulation' (Consultation Paper 06/19 October 2006) 7 <http://www.fsa.gov.uk/pubs/cp/cp06_19.pdf> (adopting the same position).

[120] R Finney, R Pretorius and M Philipp 'Regulating Exchanges Internationally in a Competitive Age—the NYMEX Europe Example: Part I' (2006) 8 Journal of International Banking Law and Regulation 456, 458.

[121] FSA Handbook REC 6.1.2.

[122] FSMA s 292(3).

[123] FSMA s 292(4).

[124] FSMA s 292(3).

[125] 'Regulating Exchanges Internationally in a Competitive Age' (n 120) 458 (noting further that [t]his is, in broad terms, the interpretation of the FSA, except to allow an ROIE to maintain local representation and operational support'.

[126] Euronext's Rulebook I includes harmonized listing and trading rules, rules relating to membership, conduct and enforcement. Rulebook II sets out those rules which are not (yet) harmonized or which relate to particular non-regulated markets.

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the national authorities regulating and supervising Euronext—that is, the Belgium Commission Bancaire, Financière et des Assurances, the French Autorité des marchés financiers, the Dutch Autoriteit Financiële Markten, the Portuguese Comissão do Mercado de Valores Mobiliários and the UK Financial Services Authority—sought to play an active part by committing themselves to facilitate convergence in different Memoranda of Understanding and, perhaps more remarkably, by putting in place a 'proxy passport' for persons which could not benefit from the ISD passport.

On the other hand, the integration strategy of NYSE Euronext is facing greater obstacles. NYSE Euronext is based on Euronext's 'federal' model. Like Euronext, NYSE Euronext is not *one* exchange. NYSE Euronext is an exchange network formed as a result of a merger at holding company level. It is a combination of different exchanges under a holding structure—called, NYSE Euronext—which is located in the US state of Delaware. Euronext exchanges continue operating under a separate holding structure, but are integrated within the overall holding structure of NYSE Euronext. While the holding structure has tax advantages, this decentralized or federal structure also allows each of the exchanges to continue operating under distinct exchange licences. Furthermore, in comparison with Euronext, NYSE Euronext's integration strategy is more limited. While the merger should allow cost savings because of synergies in the technical and technological areas, NYSE Euronext does not offer common membership, that is, on a transatlantic scale. Nor does it offer a common list.[127] Indeed, Euronext cannot offer direct trading facilities in the US (save for Euronext.liffe on the derivative side). While NYSE Euronext may ultimately share the same technology, access to securities listed and traded on NYSE and Euronext, respectively, will have to be restricted to those members which comply with the relevant national regulatory requirements. Hence, NYSE and Euronext also continue to have separate liquidity pools.

Because of the corporate and organizational structure of NYSE Euronext, the merger did not have any significant regulatory implications in terms of exchange registration, broker-dealer registration or issuer registration. Each exchange continues to be accountable to its national regulator. Likewise, members of NYSE and the Euronext exchanges continue to be regulated by their respective national regulatory authorities. Issuers listed on Euronext exchanges did not have to register their securities with the SEC. Nor did NYSE issuers fall under the jurisdiction of European regulators. Spillover effects could be ruled out. The provisions of SOX did not become applicable to

[127] Note that, in an effort to facilitate listings of SEC registered companies on Euronext, NYSE Euronext has recently announced that it will offer secondary 'technical' listings on Euronext exchanges for which certain SEC filings can be used (following the decision of Euronext regulators to accept these filings). The scheme takes advantage of PD Art 20. See J Grant, 'NYSE set to challenge LSE in Europe' (FT 14 April 2008).

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Euronext listed issuers as a result of the merger. Finally, the creation of the holding company did not create substantial regulatory problems either.[128] Yet, the weaknesses of the NYSE Euronext model are obvious. While it allows the management of problems of overregulation and spillover, the downside is that the potential benefits of transatlantic stock exchange integration cannot currently be realised. Considering these difficulties, coordinated regulatory action is of prime importance.

V. REFORMING THE REGULATORY SPACE

One question, which is currently occupying the minds of policy actors and regulators alike, is how to respond to transatlantic stock exchange consolidation. All seem to concur that within the regulatory space the unilateral application of national securities laws is unsatisfactory and that policy coordination is necessary if transatlantic exchange consolidation is to deliver its full benefits. Policy coordination describes here cooperative arrangements, but also regulatory arrangements in the form of mutual recognition or harmonization.

In this section, I resist adding new normative proposals to the already existing ones.[129] Rather I examine recent developments that have taken place in the regulatory space and evaluate processes of change which are ongoing within this space (B). I proceed on the premise that, before we evaluate solutions to the regulation of a transatlantic stock exchange, we ought to understand and discuss the type of considerations which are likely to enter the calculus of policy actors and exchange/market actors (A). My assumption is that the future regulation of transatlantic exchange consolidation is likely to take account of a number of considerations—that is, (i) for exchange and market actors that bear, inter alia, cost and risk, but arguably may also benefit from the non-coordinated application of national regulatory requirements; and (ii) for regulatory authorities which must satisfy the broad regulatory objectives which they have been entrusted with, but which may not be immune to self-interest and private interest interferences either. These considerations may factor in the assessment of the underlying regulatory problems/issues or contribute to shaping the preferences of regulators for a particular policy response. This section is deliberately open-ended. No attempt is made to be exhaustive. It offers these considerations mainly for discussion purposes and in order to better understand the issues at stake and the forces at work.

[128] SEC, 'Written Statement of the U.S. Securities and Exchange Commission—A Global View: Examining Cross-Border Exchange Mergers' (Subcommittee on Securities, Insurance, and Investment of the U.S. Senate Committee on Banking, Housing, and Urban Affairs 12 July 2007) <http://www.sec.gov/news/testimony/2007/ts071207sec.htm> visited 20 December 2007.

[129] eg 'A Blueprint for Cross-Border Access to U.S. Investors' (n 4).

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A. Strategic Considerations

1. Regulation as Cost, Risk . . . or Opportunity?

Part IV examined different types of regulatory asymmetries. They were described as the result of the application of national regulatory laws in an uncoordinated fashion. These asymmetries can be assumed to affect the matrix of opportunities and constraints which exchange and market actors face. As noted earlier, multilateral regulation respecting territorial frontiers has obvious drawbacks. If exchange and market actors have to comply with two (or three, or four . . .) sets of rules, cross-border activities will increase the burden of regulation. This increased burden translates into cost for actors. The uncoordinated application of national laws also creates risk. Evaluating the regulatory position of a transatlantic or global exchange is a complex task. Laws may be unclear. Case law may not be settled and interpretations may change. The precise regulatory implications of consolidation may be uncertain. All of these uncertainties create unnecessary risk. They create regulatory risk, that is, the risk that regulatory law operates or is found to operate in a way which was not foreseen or anticipated. Regulatory risk is a type of legal risk which parties will seek to evaluate and mitigate.[130] In the case of NYSE Euronext, the parties to the merger sought to mitigate cost and risk by setting limits to the level of integration and by establishing a trust/*stichting* structure in order to deal with the future risk of an extra-territorial application of national law which could adversely affect NYSE Euronext. However, it is apparent that such a strategy is not a satisfactory response if the full benefits of exchange integration are to be realized.

On the other hand, the uncoordinated application of national laws may also present stock exchanges and market actors with regulatory opportunities. Cross-border consolidation may a priori serve as a vehicle for taking advantage of such opportunities. Stock exchanges may seek to benefit from differences between regulatory regimes by merging with exchanges located in jurisdictions in which the regulatory environment is more favourable.[131] A ‘global’ exchange may, for example, offer listings with ‘subsidiary’ exchanges located in jurisdictions in which issuers are subject to local regulatory requirements. This scenario is, by no means, hypothetical. One of the stated reasons for the NYSE Euronext merger was NYSE’s intention to gain a share of the listing of companies which did not wish to be subject to US regulatory requirements—SOX, in particular. Shortly after the merger was completed, NYSE Euronext started to improve the profile of Paris as a place for listings of European and Asian companies, especially Chinese and Indian companies.[132]

[130] See generally R McCormick, *Legal Risk in the Financial Markets* (OUP, Oxford, 2006).

[131] eg H Scott and G Dallas, ‘End of American Dominance in Capital Markets’ (FT 19 July 2006).

[132] A Gangahar, R Beales and G Tett, ‘NYSE on the move as deal with Euronext is completed’ (FT 4 April 2007); A Gangahar, ‘Exchanges step up the march east’ (FT 12 April 2007).

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2. Strategic and Institutional Considerations for Regulators

Regulators also face a number of stark choices. Regulatory authorities are typically entrusted with a number of institutional objectives or goals. Commonly these objectives reflect a set of values or norms such as ensuring investor protection, market integrity or promoting market efficiency. These objectives formalize the purpose for which authorities are created and which they subsequently serve. They are worth highlighting because they contribute to guiding an authority's evaluation of different courses of action and, as such, may contribute to shaping preferences for different regulatory responses. For instance, the activities of the FSA are guided by a number of objectives and principles. Besides four core regulatory objectives—which are, (a) market confidence; (b) public awareness; (c) the protection of consumers; and (d) the reduction of financial crime[133]—the FSA must take account of a number of secondary principles. More precisely, when exercising its functions it must have regard to, inter alia, the cost of regulation, the desirability of facilitating innovation, the possible adverse effects which its activities might have on competition, as well as the desirability of facilitating competition.[134] Indeed, the FSA must also have regard to the international character of the UK financial markets and the 'desirability of maintaining the competitive position of the United Kingdom'.[135] Moreover, section 5(2) of FSMA sets out the principle that consumers should take responsibility for the decisions that they take. This section enacts the so-called 'caveat emptor' principle which is characteristic of the FSA's approach to regulation. The SEC's activities are also informed by a set of objectives. Retail investor protection is commonly associated with the SEC's primary policy objective. Admittedly, it is not the SEC's sole objective.[136] Other goals such as facilitating capital formation or promoting competition are also relevant. Typically, it is a matter of balancing different objectives against each other, a process which is, in itself, loose and open-ended. Yet, protecting investors remains a key consideration for the SEC. It has been described as the SEC's very '*raison d'être*'.[137] Indeed, the SEC has in the past highlighted investor protection as the reason for restricting

[133] FSMA s 2(2).

[134] FSMA s 2(3) states that '[i]n discharging its general functions the Authority must have regard to (a) the need to use its resources in the most efficient and economic way; (b) the responsibilities of those who manage the affairs of authorised persons; (c) the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction; (d) the desirability of facilitating innovation in connection with regulated activities; (e) the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom; (f) the need to minimise the adverse effects on competition that may arise from anything done in the discharge of those functions; (g) the desirability of facilitating competition between those who are subject to any form of regulation by the Authority'.

[135] ibid.

[136] 'Foreign Trading Screens in the United States' (n 7).

[137] 'A Blueprint for Cross-Border Access to U.S. Investors' (n 4) 44.

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foreign securities exchanges from having direct access to US investors.[138] Tafara and Peterson note that the SEC's institutional values or goals 'have created the lens through which the SEC sees the world'.[139] Their importance must not be exaggerated however. While they can be thought of as entering the decision-making calculus of regulatory authorities, institutional objectives will not necessarily prescribe one particular course of action. In practice, national regulators might have divergent regulatory 'philosophies', but adopt broadly similar rules. Broad and open-ended objectives such as ensuring investor protection also allow for broad discretion. Factors other than institutionalized norms and values may enter policy judgments. National legislatures and, in the EC context, the EC legislature, are likely to be involved in substantial reform proposals. As a result, the impact of institutional and organizational goals might be substantially diluted by actors who do not act under the same decision-making premises. Furthermore, regulators have self-interest as well.[140] They are not immune from interest group and governmental interferences. Interest group and governmental pressures are hence likely to bear importantly on decision-making premises.

B. Recent Developments

Broad access to US markets for stock exchanges, intermediaries and issuers is still currently an *ex post* hypothesis. Having said this, progress has undoubtedly been made. In relation to accounting standards, for example, the SEC announced that it would no longer require reconciliation and accept financial statements from foreign issuers in the US which are drawn up in accordance with the International Financial Reporting Standards.[141] Reconciliation described the process by which foreign issuers reconciled their financial statements with the US Generally Accepted Accounting Principles (Gaap). This process was costly, but it was thought necessary because of differences in national accounting standards. Likewise, the SEC has facilitated deregistration for foreign issuers and has sought to accommodate foreign firms with respect to certain provisions of SOX. Recent months have seen two new developments that positively affect market access. First, the SEC has proposed amendments to Rule 15a-6 which has since 1989 provided limited and

[138] 'Resolving regulatory conflicts between the capital markets of the United States and Europe' (n 77) 21. See also 'A Blueprint for Cross-Border Access to U.S. Investors' (n 4) 48 (noting that investor protection was also the reason for limiting U.S. investors' access to foreign investment opportunities).

[139] ibid 42.

[140] See generally G Majone, 'International regulatory cooperation: a neo-institutionalist approach' in G Bermann, M Herdegen and P Lindseth (eds), *Transatlantic Regulatory Cooperation—Legal Problems and Political Prospects* (OUP Oxford 2000) 119.

[141] SEC, 'SEC Takes Action to Improve Consistency of Disclosure to U.S. Investors in Foreign Companies' (Press Release 2007/235, 15 November 2007) <http://www.sec.gov/news/press/2007/2007-235.htm> visited 10 January 2007.

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conditional exemptions from SEC registration for foreign broker-dealers.[142] A detailed assessment of these amendments is beyond the scope of this paper. In essence, however, the proposed changes aim at improving access for certain US investors to foreign broker-dealers and foreign markets whilst not triggering SEC registration requirements for the foreign actors. For this purpose, the SEC proposes first to allow foreign broker-dealers to interact with generally a wider category of experienced and sophisticated US investors by introducing a new definition of 'qualified investors' (as currently found in section 3(a)(54) of the Exchange Act)[143] into Rule 15a-6.[144] Next, it offers to reduce the role that US broker-dealers will have to play in connection with transactions between foreign broker-dealers and US qualified investors.[145] Notably, the SEC proposes to abandon the so-called 'chaperoning requirements' under which contacts by a foreign broker-dealer with US institutions have to be chaperoned by a US broker-dealer. Other amendments include a new exemption under which foreign option exchanges will, inter alia, be allowed to engage in limited activities aimed at familiarizing US actors, that they reasonably believe to be US qualified investors, with the exchange itself and the products which are traded. In addition, the SEC would allow foreign broker-dealers to effect *unsolicited* transactions in options on foreign securities on the foreign option exchange for US qualified investors[146] and allow the exchange's OTC options processing service being made available to US qualified investors without triggering SEC registration requirements for the foreign option exchange.[147]

The second noteworthy development concerns the signing of a first framework mutual recognition agreement between the SEC, the Australian Securities and Investments Commission and the Australian Minister for Superannuation and Corporate Law in August 2008 (the MR Agreement).[148] By signing the MR agreement, the SEC appears to engage on a promising new regulatory route which might, one could imagine, lead to a future mutual recognition agreement between US and European authorities that might

[142] Exemption of Certain Foreign Brokers or Dealers; Proposed Rules, Exchange Act Release No 58047 (8 July 2008) 73 Fed. Reg. 39182.

[143] 15 USC § 78c(a)(54).

[144] In particular, the new definition allows covering interactions with institutional investors that own and invest on a discretionary basis $25 million or more in investments and individuals who own and invest on a discretionary basis $25 million or more in investments. 'Exemption of Certain Foreign Brokers or Dealers' (n 142) 39185–6.

[145] ibid 39188–96.

[146] ibid 39197.

[147] An 'OTC options processing service' is defined as 'a mechanism for submitting an options contract on a foreign security that has been negotiated and completed in an over-the-counter transaction to a foreign options exchange so that the foreign options exchange may replace that contract with an equivalent standardized options contract that is listed on the foreign options exchange and that has the same terms and conditions as the over-the-counter options' (ibid 39197). The SEC considered that whilst the OTC options processing service might be regarded as a 'facility of an exchange' (see n 45), the service 'would not effect any transaction in a security or report any such transaction'. Hence, it concluded that the registration requirements of section 6 of the Exchange Act would not be triggered (ibid 39198).

[148] (n 6).

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possibly also help to overcome some of the limitations which the integration strategy of transatlantic exchanges is currently facing—for example, by allowing mutual access through the operation of remote trading screens. Having said that, for the time being, it is prudent to somewhat dampen one's enthusiasm. First, the actual MR agreement between the SEC and the Australian authorities is in essence a framework agreement. It does not, by itself, create any rights to mutual recognition for market participants. It expresses the signing parties' commitment to 'further the mutual recognition program'.[149] More specifically, under the agreement, the parties commit themselves to 'consider' applications for exemption by eligible market participants of each other's jurisdiction subject 'to such terms and conditions as each Authority may find appropriate'.[150] In other words, each authority will thus be expected to ultimately allow eligible market participants access to investors in its jurisdiction by granting them exemptions from otherwise applicable national regulatory requirements on the basis that the eligible actor is regulated and overseen by its 'home' authority. In the case of the SEC, this will be done by way of exemptive orders. Eligible market participants are for the time being (i) SEC registered national securities exchanges ('US market(s)') and (ii) SEC registered broker-dealers ('US broker-dealer(s)').[151] For Australia, are eligible (iii) Australian licensed financial markets ('Australian market(s)') and financial services license holders that are participants of an Australian market ('Australian broker-dealer(s)').[152] Secondly, the agreement's arrangements are for now carefully limited to four specific cases: (i) US markets which want to do business with Australian investors, via an Australian broker-dealer, in US equity or debt securities that are listed on a US market and subject to relevant US legislative and regulatory provisions and market rules; (ii) US broker-dealers which want to do business with Australian wholesale clients in US equity or debt securities that are listed on a US market and subject to relevant US legislative and regulatory provisions and market rules; (iii) Australian markets that want to do business with US investors, via a US broker-dealer, in Australian equity or debt securities that are listed on an Australian market and subject to relevant Australian legislative and regulatory provisions and market rules; (iv) Australian broker-dealers that want to do business with US qualified investors in Australian equity or debt securities that are listed on an Australian market and subject to relevant Australian legislative and regulatory provisions and market rules.[153] Thirdly,

[149] MR Agreement Rec (8).

[150] MR Agreement Item Two.

[151] MR Agreement Item One, paras 7 and 8.

[152] ibid.

[153] MR Agreement Item Four, para 17(a), (b), (f) and (g). Note that, for the time being, references to 'Australian markets' in Item Four are meant to be references to Australian markets which are operated by the Australian Securities Exchange (ASX) (Item Four, para 17(a)(i)). Applications for exemptive relief can also therefore be made only for ASX-operated financial markets. Moreover, US markets which want to do business with Australian investors will, for the time being, need to do so via an Australian broker-dealer which is a participant of ASX (Item Four, para 17(b)(i)).

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an important point for the success of mutual recognition are going to be the terms and conditions which each authority is allowed to impose when considering applications for exemptive relief. Admittedly, by signing the MR agreement, the SEC and Australian authorities implicitly expressed their views of shared interests, similar regulatory systems and philosophies. But the MR agreement leaves authorities with full discretion on the question of the terms and conditions. For the moment, the only certitude is that US anti-fraud and Australian misconduct provisions will continue applying to exempted entities.[154]

So what about the prospect of a future mutual recognition agreement between the SEC and European authorities? SEC Commissioners have at various times highlighted the need for policy coordination in relation to transatlantic exchange consolidation.[155] The European Commission, which will want to be involved in any initiative on transatlantic mutual recognition, has made clear that discussions on transatlantic mutual recognition must respect five core principles or 'red-lines'.[156] First, the adoption of mutual recognition must be a gradual process. The Commission favours an incremental process which should start with professional markets. Secondly, a multilateral approach should be preferred to bilateral arrangements between the US and individual Member States. Thirdly, US and European actors should use the same assessment criteria when examining how equivalent or comparable the regulatory systems are. Fourthly, specific European jurisdictions should not be excluded on arbitrary grounds. Finally, there can be no extra-territoriality: '[b]usiness conducted within the territory of the European Union should only be subject to the laws of the EU and the Member-States'.[157]

Arguably, transatlantic stock exchange consolidation is a strong impetus for reform. In the longer term, it may also contribute to a process of regulatory convergence between national regulatory regimes. In the meantime, however, it already contributes to two more subtle processes. First, it contributes to strengthening an ongoing process of rapprochement and interdependence between regulators. Thus, in the case of NYSE Euronext, the most significant transatlantic stock exchange merger so far, the regulators' first line of response was to strengthen their cooperative arrangements. No national regulatory authority has the competence or the resources to monitor on its own the 'space-of-flows'. Because the regulatory space is divided, regulators will have

[154] MR Agreement Item Five, para 20(b).

[155] eg R Campos, 'The Current Role of Capital Market Regulation' (SEC Speech Rio de Janeiro 5 September 2006), A Nazareth 'Remarks Before the NYSE Regulation Second Annual Securities Conference' (SEC Speech 20 June 2006); SEC 'A Global View: Examining Cross-Border Exchange Mergers' (n 128) <http://www.sec.gov> visited 12 February 2008.

[156] C McCreevy, 'Security Markets Consolidation and its Implications' (Austrian Financial Markets Authority and Vienna Stock Exchange Conference 'Main Challenges for Supervisor & Exchanges in Central and Eastern Europe' 30 November 2007) available at <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/776&format=HTML&aged=0&language=en> visited 12 February 2008.

[157] ibid.

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to rely on significant information sharing arrangements in order to fulfil their institutional objectives. Cooperation is a non-coercive means to bridge divides. It is a well-trodden approach. The oversight of Euronext itself was based on the same cooperative principles.[158] The commitment to cooperation is typically formalised by the adoption of Memoranda of Understanding. Thus, a Memorandum of Understanding (hereafter, MOU) was signed in early 2007 between the SEC and the Euronext regulators.[159] The 2007 MOU complements already existing cooperative arrangements. But it concerns specifically the supervision of NYSE Euronext. In comparison with the Memoranda which were signed separately between Euronext regulators, the scope of the activities and arrangements provided for under the NYSE Euronext MOU is more limited. It formalizes the authorities' willingness to 'cooperate with each other in the interest of fulfilling their respective regulatory mandates, particularly in the areas of investor protection, fostering market integrity, and maintaining investor confidence and systemic stability'.[160] It also underlines the authorities' intention to 'consult, cooperate and exchange information in connection with oversight of NYSE Euronext and the Markets . . .'[161] At the same time, it also explicitly affirms the authorities' 'shared belief in the importance of local regulation of local markets'.[162] Hence, as long as the regulatory space is divided, guaranteeing comprehensive oversight means that regulators are 'condemned to cooperate'.[163] Or to put it otherwise, a network of regulators will have to match the network of markets in order to ensure comprehensive oversight. Admittedly, transatlantic cooperation is not a new theme for regulators and policy-makers. The transatlantic regulatory dialogue between the EU and the US has been in place for some time.[164] Indeed,

[158] For regulatory and oversight purposes, Euronext regulators—ie the Belgian, Dutch, French, Portuguese and UK regulatory authorities—meet within a college of Euronext regulators. Within the college, the activities and operations of Euronext are examined from a group perspective (ie from the perspective of the regulators as a group). Two Memoranda of Understanding underpin this approach.

[159] 'Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information Related to Market Oversight' (25 January 2007) <http://www.sec.gov/news/press/2007/2007-8_mou.pdf> visited 14 February 2008.

[160] MOU Opening Statement.

[161] MOU Art 2 para 6.

[162] MOU Art 2 para 13. Besides foreseeing changes in the corporate and governance structure of NYSE Euronext (Art 3 para 17), the MOU also foresees further integration and harmonisation steps (Art 3 paras 18 and 19). It specifically envisages the case in which NYSE Euronext would seek to harmonise trading rules (Art 3 para 18). The MOU provides that the signing authorities will work together in order to coordinate their approval processes and will seek to facilitate the development of consistent rules. Coordination efforts are also envisaged in relation to integration steps such as the restructuring and the creation or the closing of new exchanges/facilities.

[163] J Grant, 'Deal would pose new dilemma' (FT 16 March 2007) (citing Charlie McCreevy, EU Internal Market Commissioner).

[164] The regulatory dialogue also includes discussions between CESR and the SEC (and between CESR and the CFTC). Note that the transatlantic economic council, which was set up in 2007, is the latest body which was designed to promote closer transatlantic economic integration and cooperation <http://www.eurunion.org/partner/summit/Summit20070430/TransatlEcoIntegratFramew.pdf> visited 14 February 2008.

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international cooperation is not a new phenomenon. Interdependence and rapprochement is an *ongoing* process which accompanies greater economic integration between nation states.[165] Transatlantic exchange consolidation is the latest expression of this integration process. It lends added impetus to existing cooperative trends. But arguably transatlantic consolidation is likely to cause a *qualitative* increase in interdependence between regulators. This is because stock exchanges continue playing a central role in the economic life of nation-States. In addition, because stock exchanges set rules and standards for capital raising and corporate governance purposes, they are an essential part of the wider regulatory system. Any changes to their functions, activities or operations are likely to raise considerable attention among financial market actors and regulators. The enactment of the 'Balls Act' in the UK perhaps best illustrates this point.[166] Second, by implication, transatlantic stock exchange consolidation may also contribute to strengthening another ongoing process between regulators, which is a process of learning. This point ought to be made in the form of an assumption because regulatory learning is a process which is difficult to observe. However, the potential for such learning is real.[167] Both of these processes—increased interdependence and rapprochement on the one hand and regulatory learning on the other hand—will continue intensifying if a transatlantic mutual recognition system is agreed. Indeed, the 'pilot' MR agreement between US and Australian authorities is noteworthy for precisely these reasons. Its adoption was preceded by discussions between US and Australian authorities on the regulatory and supervisory systems and philosophies in each jurisdiction. The agreement itself provides for continuous consultation and cooperation. In addition, greater interdependence is fostered by the signing of two new

[165] Majone reminds us that network models are a feature of the regulatory landscape in many sectors of activities. See 'International regulatory cooperation: a neo-institutionalist approach' (n 140) 137–41.

[166] The Balls Act, also known as the Investment Exchanges & Clearing Houses Act 2006, was the response of the British government to the fears voiced in the City of London that, as a result of a takeover, a UK Recognised Investment Exchange (such as the London Stock Exchange) or a Recognised Clearing House could introduce rule changes which would adversely impact on the UK financial markets. The Balls Act, which amended FSMA, was thus described as the result of three developments: 'First the flotation of the London Stock Exchange (LSE) [which] opened up the possibility of it being taken over by, crucially, a foreign buyer. Secondly, the introduction of significantly more onerous audit and accounting regulations on companies listed in the United States regardless of where their main business areas are. Thirdly, the perceived tendency of U.S. law, especially business law, to be applied across national borders' (see 'Investment Exchanges & Clearing Houses Bill' (n 64) 7). The Balls Act essentially ensures that the FSA can exercise control over any future rule changes.

[167] The arrangements laid down in the NYSE Euronext MOU could provide a context for such learning. MOU Art 3 para 15 states that the SEC and the Chairmen's Committee of the College of Euronext Regulators, which is formed by the chairman of each of the Euronext regulatory authorities, will endeavor to meet on an annual basis in order to identify and debate issues of regulatory concern, as well examine the regulatory implications of any future integration steps taken by NYSE Euronext.

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Memoranda of Understanding on oversight and enforcement between authorities.[168]

VI. EPILOGUE: THE FUTURE OF SECURITIES MARKETS REGULATION

This article examined transatlantic stock exchange consolidation. It charted different processes: processes of change in the market space which call for processes of adaptation in the regulatory space. Castells' space-of-flows and space-of-places metaphor captured the differing organisational logic of the market and the regulatory space and helped diagnosing and conceptualising the lack-of-fit which is currently affecting efforts to merge stock exchanges on a transatlantic scale. To be sure, the space-of-flows and space-of-places language is not terribly precise. But it was helpful to compare and contrast the differing characteristics of both spaces and to represent the lack-of-fit pathology. Two additional processes were identified when examining recent developments in the regulatory space: (i) a process of rapprochement and interdependence between regulators; and (ii) more tentatively, a process of learning. It was argued that the consolidation trend in the exchange sector contributes to both of these ongoing processes.

Stock exchange consolidation is at the same time an expression of increasingly global financial markets and a driving force of this trend. The focus on exchange consolidation thus leads one to conclude by underlying the importance of continuing to adjust the regulatory space to the space-of-flows without compromising important policy objectives such as investor protection. Regulatory arrangements, such as mutual recognition, undoubtedly help to mimic the space-of-flows logic. But rapprochement between regulators is also a strategy for responding to global financial markets within existing boundaries of territorial sovereignty. Adapting the regulatory space to the market space calls for securities authorities which are close to their peers, which are knowledgeable of securities legislation in other jurisdictions, which are flexible and which can easily adapt to new market circumstances. The limited suggestion which is put forward here is thus to strengthen already ongoing processes of rapprochement, communication and learning between regulators. In short, regulatory authorities will need to be increasingly 'other-regarding' in the future. Thus, what national regulators have gained in independence from governmental authorities, they will lose in the future in terms of autonomy from other national regulatory authorities. It is the

[168] SEC and ASIC 'Memorandum of Understanding, Cooperation and the Exchange of Information related to Market Oversight and the Supervision of Financial Services Firms' (Washington 25 August 2008) <http://www.sec.gov/about/offices/oia/oia_mututal_recognition/australia/supervisory_mou.pdf> visited 28 August 2008; SEC and ASIC 'Memorandum of Understanding, Cooperation and the Exchange of Information related to the Enforcement of Securities Laws' (Washington 25 August 2008) <http://www.sec.gov/about/offices/oia/oia_mututal_recognition/australia/enhanced_enforcement_mou.pdf> visited 28 August 2008.

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transnational organization of the market space which creates the need for greater interdependence and rapprochement within the regulatory space.[169] But the nation-State will not disappear. For the foreseeable future, regulators will remain *national* creatures. Moreover, one should not understate the need for substantive regulatory reforms. Processes of learning and rapprochement are a necessary, but not a sufficient condition to prepare the regulatory space for the true global stock exchange of tomorrow.

[169] Staff exchange programs can *a priori* contribute to foster rapprochement and learning and should therefore be promoted. Similar suggestions were made by CESR in order to strengthen ties between European regulators. See Committee of European Securities Regulators 'The role of CESR at "Level 3" under the Lamfalussy Process—Action Plan for 2005' (October 2004) available at <http://www.cesr.eu/index.php?page=document_details&from_title=Documents&id=2550> visited 13 February 2008.

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