INTERNATIONAL CAPITAL MARKETS

Law and Institutions

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INTRODUCTION

1.01 Money moves, and always has. International capital markets are not a new phenomenon; in various forms, they have been around for centuries. Capital has been flowing through empires, across oceans and continents, following trade routes, migration, wars, nation building, and imperial expansion. These markets have largely operated beyond the bounds of local institutions and markets. There have always been rules, express or implied, explicit or implicit, but not necessarily formal regulation as understood in modern times.

1.02 The global financial crisis, however, shone a strong light on the workings of international capital markets. They had, unmistakably, been purveyors of systemic risk and seemingly attracted little by way of oversight or regulation. There were calls for an international regulatory body[1] and greater coordination among national regulators and institutions. Certain market participants, reckless investment bankers and credit rating agencies, in particular, certain products, such as asset back securities, perhaps unfairly, were singled out for censure, public opprobrium, and regulatory action at various levels.[2] But formal regulation emanates from a national (or perhaps subnational) authority and operates locally. So, how have *international* capital markets been regulated and what lies on the regulatory horizon?

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1. Securities Regulation as a Model for the World

1.03 Until relatively recently, there has not existed a tidy package of 'securities regulation' in most places in the world. 'Securities regulation', the term most often ascribed to a distinct body of formal regulation applicable to primary and secondary markets in financial instruments and their intermediaries, originated in the United States as 1930s depression era legislation, the Securities Act of 1933[3] (the US 1933 Act), and the Securities Exchange Act of 1934[4] (the US 1934 Act). Both Acts continue in force to this day, and in the case of the US 1933 Act, more so than the US 1934 Act, with remarkably few fundamental changes.[5] A vast infrastructure of regulation constructed by the regulator charged with administration of these acts, the

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[1] See Eric C Chaffee, 'A Moment of Opportunity: Reimagining International Securities Regulation in the Shadow of Financial Crisis' (2010) 15 *Nexus* 29, 40.

[2] China, for example, banned asset backed securities across the board in 2009 and just re-opened the market in late 2012: Simon Rabonovitch, 'China Lifts Bar on Securitisation Sales', *Financial Times* (5 September 2012).

[3] Securities Act of 1933, 15 USC §§ 77a–77mm (2006).

[4] Securities Exchange Act of 1934, 15 USC §§ 78a–77kk (2006).

[5] Arguably, the Jumpstart Our Business Startups Act of 2012 (JOBS Act), Pub L No 112-106, 126 Stat 306 (2012), may be one of the first major shocks to the US 1933 Act. The US 1934 Act, on the other hand, has served as a repository for US federal legislative initiatives over the years and so covers a much broader range of issues.

Securities and Exchange Commission (SEC), supports this legislation, hence the terminology, securities regulation.

1.04 But terminology is tricky. Although references to securities regulation (and the legislative framework itself in many cases) now appear all over the world,[6] the term encompasses different aspects of financial markets in different places. In the United States, the focus of securities regulation has been the capital raising process and, to a lesser degree, the intermediaries in the markets, including the big equity exchanges. In the United Kingdom and Europe, the concept of securities regulation is quite new, but generally refers to regulation of the intermediaries and the markets, not the capital raising process or even necessarily investor protection, the traditional regulatory objective in the United States.[7]

1.05 Although securities regulation, as a distinct body of regulation, is rooted in US history and legislation, this does not mean that comparable 'regulation', or at least formal mechanisms designed to achieve similar purposes, did not exist elsewhere. They did, but in a more diffuse fashion. Investor protection, in the form of shareholder protection,[8] found itself embedded in English companies law for the most part; the empire, and then the Commonwealth, followed suit. In fact, unlike US corporation law,[9] modern English companies law had its origins strongly coloured by considerations of investor protection, with the 1844 and following registration statutes in the United Kingdom.[10] It was to this larger body of companies law that the United States turned in fashioning a subset of rules, what is known as 'securities legislation', in the 1930s. It is no coincidence that US securities law refers to 'registration' statements and 'prospectuses', terminology derived from nineteenth-century English companies law.

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[6] For example, Niamh Moloney in 2002 entitled her text *EC Securities Regulation* (Oxford University Press). The primary international organization in the area is called the International Organization of Securities Commissions, and its first set of international principles, the IOSCO Objectives and Principles of Securities Regulation (1998).

[7] Even in the United States, the terminology is misleading. For historical reasons, the range of financial instruments encompassed by the term 'securities', and thus subject to securities regulation and the jurisdiction of the SEC, is arbitrarily circumscribed. Many types of financial instruments have always fallen outside the ambit of securities regulation in the United States, and with the increase in financial innovation, the list is growing longer. In this text, reference is often made to securities regulation, as it is the regularly used terminology, but increasingly 'capital markets regulation', a less specifically delineated, more broadly understood, term is supplanting 'securities regulation'. Hence, the title of this book.

[8] The original US 1933 Act was enacted very much with the retail equity investor in mind, moms and pops buying shares in the public markets for investment purposes.

[9] American business corporations are descendants of the chartered corporation. After the American revolution, incorporation in the United States involved obtaining a charter from the relevant state legislature. In fact, one of the first 'general' incorporation acts in the common law world was enacted in New York state in 1811. The rejection of monarchial authority to grant charters was taken to imply equality of rights to incorporation. Modern English registered companies, however, are not simply chartered corporations created in another manner. Instead, they are the descendants of the unincorporated joint stock company, an association possessing some of the attributes of a large partnership, but with features from the chartered corporation also added to the joint stock company. On contrasts between British and American corporation law, see LCB Gower, 'Some Contrasts Between British and American Corporation Law' (1956) 69 *Harvard Law Review* 1369.

[10] The Joint Stock Companies Registration and Regulation Act 1844 (UK) is the legislative ancestor of modern corporation law. It took over the deed-of-settlement company and made it a statutory incorporated body. The Limited Liability Act 1855 (UK) gave corporators the option of forming a company on the principle that the liability of the members would be limited to what they agreed to contribute to the company. English company law was later consolidated into the Companies Act 1862 (UK), the descendent of which today is the Companies Act 2006 (UK).

1.06 Equally, corporate debt holders found comfort in the provisions of nineteenth-century English companies law requiring the registration of charges and corporate debentures;[11] these provisions continue to populate older-style Commonwealth legislation around the world.[12] Together with the deference accorded self-regulation of professionals and the exchanges, there was little impetus for a stand-alone regulatory apparatus in the United Kingdom, or continental Europe for that matter (for somewhat different reasons).[13] Until recently, much of what would be characterized as securities regulation has in Europe taken the form of companies law directives, inspired primarily by Germany, and forming a regulatory supra-structure on a pan-European basis. For a time, exchanges in many parts of Europe were treated as regulated utilities, and since there was little interest by retail investors in equity products, little call for US-style investor protection in the form of a separate body of securities regulation.

1.07 Once the United Kingdom joined what is now the European Union in 1972, a new dynamic emerged. The United Kingdom was forced to embark on the daunting project of conforming its unruly legislative framework to European Commission directives and other legislative instruments. On the other hand, the United Kingdom pushed for implementation of English approaches to financial markets on a pan-European basis. This dynamic continues to inform regulatory choices.

1.08 However, by distilling rules associated with public capital raising and the regulation of intermediaries into an identifiable body of law known as 'securities regulation', the United States gained a tactical advantage in terms of the regulatory hegemony of its system.[14] An accident of history (the breakup of the Soviet Union in 1991) unleashed geopolitical forces which brought US securities regulation to large swathes of Eastern Europe. The aftermath of conflict (ie the War in the Pacific, for example) had already left imprints of US regulation in parts of Asia. Other accidents of history, the Asian financial crisis, and the rise of capitalism with Chinese characteristics, also brought US securities regulation (as well as insolvency legislation) to much of modern Asia.

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[11] Section 43 of the Companies Act 1862 (UK) required a company to keep a register of mortgages and charges but this register was only open for the inspection of persons who had already become creditors of the company. Recognizing the inadequacy that this did not allow for inspection by those thinking of providing credit, the UK Parliament amended the Companies Act 1900 in 1908 to provide for a public register at Somerset House of all mortgages and charges of certain specified classes. A new section in the Companies Act 2006 (section 741) requires companies to register an allotment of debentures with the Registrar of Companies, so that the existence of debentures is public knowledge. Similar provisions have been implemented through the Personal Property Securities Acts and have been enacted by all common law provinces and territories of Canada (beginning in 1976), in New Zealand (1999), and at the Commonwealth level in Australia (effective only in 2012).

[12] For example, the United States' Trust Indenture Act of 1939, 15 USC §§ 77aaa–bbbb (2006) (TIA). The TIA governs the public offer and sale of debt securities such as debentures. The SEC administers the TIA which mandates the appointment of a trustee to take care of the interests of the holders of debt securities or bonds of the issuer.

[13] There is no substantive body of law which constitutes European company law, however a host of minimum standards are applicable to companies throughout the European Union (EU). Since the formation of the European Community in 1967, a series of directives have been issued (first by the Council of the European Communities, now by the European Parliament and the Council of the European Union) to create these minimum standards. Under the European Company Statute, businesses meeting certain conditions may incorporate as a 'Societas Europaea' (SE).

[14] Edward F Greene, Daniel A Braverman, and Sebastian R Sperber, 'Hegemony or Deference: U.S. Disclosure Requirements in the International Capital Markets' (1995) 50 *The Business Lawyer* 413.

1.09 At this point, US securities regulation formally transformed itself into international standards, the IOSCO Objectives and Principles of Securities Regulation (1998). By 2001, the Lamfalussy Report (the official title of which was the *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets*[15]) sent up a call to arms; Europe had to have securities regulation, and that meant US-style securities regulation.[16]

1.10 There quickly followed the Prospectus Directive,[17] the Market Abuse Directive,[18] the Transparency Directive,[19] among others: US securities regulation filtered through European regulatory sensibilities. Needless to say, there was some UK consternation at this turn of events. On the other hand, domestic commentators in the United States urged on efforts to propagate US securities regulation around the world through participation in international dialogue and other fora such as IOSCO.[20] The SEC set up training sessions to introduce regulators from around the world to the US model.[21] These were heady days, pre-Enron, pre-Sarbanes-Oxley, pre-global financial crisis, pre-Dodd-Frank.

1.11 And so it came to be that US securities regulation set the standard and became the model. On the part of most US practitioners and regulators, this was all as it should be. At the beginning of this century, there was an unshakeable conviction on their part that the US model was the best.[22] The decade that followed sorely tested this conviction, beginning with the corporate governance failures of Enron and Worldcom and culminating only a few years later with the near collapse of the US, and world, financial system.

1.12 Nevertheless, by then the seeds had been sown, and US-style securities regulation had sprouted around the world. As legal systems demonstrate persistence and path dependency, where US-style securities regulation has taken root, it is unlikely to be replaced, at least not in the near future.

1.13 For this reason, many of the current regulatory techniques that dominate capital markets regulation at the domestic level inevitably derive from US regulation, disclosure based regulation being first among them. For better or worse, the reliance on information, and

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[15] No political correctness there.

[16] For Europe looking to US securities law, see Edward F Greene and Linda C Quinn, 'Building on the International Convergence of the Global Markets: A Model for Securities Reform' (Paper presented at A Major Issues Conference: Securities Regulation in the Global Internet Economy, Washington DC, 14–15 November 2001). For the necessity of action on securities regulation, see European Union, Initial Report of the Committee of the Wise Men on the Regulation of European Securities Markets (9 November 2000) <http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/initial-report-wise-men_en.pdf> accessed 24 December 2013.

[17] Directive 2003/71/EC of the European Parliament and of the Council of 4 November, on the Prospectus to be Published When Securities are Offered to the Public or Admitted to Trading and Amending Directive 2001/34/EC, OJ L 345 (2003).

[18] Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003, on Insider Dealing and Market Manipulation (Market Abuse), OJ L 96 (2003).

[19] Directive 2004/109/EC 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, OJ L 390 (2004).

[20] Greene and Quinn (n 16).

[21] The US Securities and Exchange Commission conducts training of foreign regulators through its International Technical Assistance Program run by the SEC's Office of International Affairs. This International Technical Assistance Program has been operating since 1989. See <http://www.sec.gov/news/press/2010/2010-68-factsheet.htm> accessed 24 December 2013.

[22] The fact that it was virtually the only model reinforced this conviction.

the process by which it is disclosed, now permeates capital markets regulation everywhere. Originally, at the time the regulatory system was taking shape in the United States of the 1930s, a combination of ideology and pragmatism likely led to disclosure based regulation taking precedence over what was then called 'merit based regulation'.[23] Great faith was placed at the time in the good sense of those stalwart retail investors who formed the majority of participants in US equity markets.[24]

1.14 Later though, in a rather circular fashion, the development of the efficient market hypothesis (EMH) by Chicago School economists[25] reinforced the legitimacy of disclosure based regulation. US equity markets operated in a disclosure based regulatory environment; US equity markets were efficient in absorbing information which was reflected in the price of publicly traded shares; information produced self-correcting markets; securities regulation should be disclosure based. It is hard to overestimate the influence and importance of the FMH on US regulators and policymakers; it operates implicitly and explicitly in the cornerstone US 1933 Act.[26] Arguably, blind faith in the EMH accounts for the actions of and the near fatal delays by the US administration in addressing the financial meltdown of September 2008. The market had to self-correct; but it didn't.

1.15 The failure of Enron and Worldcom, however, prompted new academic thinking in the United States in terms of regulation of securities markets. Disclosure based regulation did not detect or deter fraud. The focus shifted to 'gatekeepers', those professionals, the accountants and the lawyers, charged with sifting through the masses of information produced by the disclosure based system.[27] The tensions between a disclosure based model and prescriptive rules (as well as acknowledgement of the role of gatekeepers) appears in the legislative response to Enron and Worldcom, the Sarbanes-Oxley Act of 2002. Much of the statute addresses the accounting and auditing profession, as well as, but to a lesser degree, the legal profession. A strong form of fiduciary duties (which persists in the United Kingdom) having been hollowed out by the courts and state legislatures in the United States, the obligations of corporate executives as gatekeepers had to be explicitly spelled out in Sarbanes-Oxley.

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[23] Merit-based regulation would ultimately impose on the regulator the onus of making an investment decision with respect to a particular transaction and financial product. A form of merit-based regulation does exist at state level in the United States but is eclipsed by federal legislation.

[24] Other familiar US aphorisms come to mind, such as 'You can fool some of the people some of the time, but not all of the people all of the time'.

[25] Efficient market hypothesis (EMH) was first developed by Professor Eugene Fama, now a Nobel Laureate in Economics, at the University of Chicago in the early 1960s. EMH asserts that financial markets are 'informationally efficient' which therefore results in the inability to consistently achieve returns in excess of average market returns on a risk-adjusted basis. This is due to the information available at the time the investment is made. There are three main variants of EMH: (1) 'Weak' EMH claims that prices on traded assets already reflect all past publicly available information; (2) 'Semi-strong' EMH holds that prices reflect all public available information and that prices also instantly change to reflect new public information; (3) 'Strong' EMH additionally asserts that asset prices instantly reflect even hidden or insider information.

[26] The SEC's introduction of the integrated disclosure system in 1982 coordinated required disclosures under the US 1933 Act and the US 1934 Act, in light of an assumption of EMH that information effectively disseminated to the public will be rapidly reflected in share prices regardless of the source of the data. See Joel Seligman, 'Götterdämmerung for the Securities Act?' (1997) 75 *Washington University Law Quarterly* 887. More explicitly, 'efficiency' was explicitly added to considerations which rule making had to address (§ (b) of US 1933 Act).

[27] John C Coffee, *Gatekeepers: The Role of the Professions in Corporate Governance* (Oxford University Press, 2006).

1.16 Securities regulation in the United States is deeply rooted in the equity culture and public capital markets which dominated much of the twentieth century there. So it is no accident that the innovation so characteristic of the last 25 years has flourished in the unregulated interstices of this regulated world. Securitization or structured finance usually took the form of a less regulated financial product: debt. With the securitized products, the lawyers[28] and accountants were still gatekeepers, at least in theory, but now largely unregulated, private sector, profit driven, credit rating agencies played (or misplayed) the main role.

1.17 Equally, large institutional investors and intermediaries sought the unlit, unregulated corners of the market, the exempt markets. Information was still key, but undisclosed information: no level playing field here. Dark pools, with their sinister connotations, are aptly named and now, estimated conservatively, comprise some 13.3 per cent of the trading market.[29]

1.18 But the seismic shock, and biggest challenge, to disclosure based regulation has been its collision with information technology. Information has run amok; it can no longer be regulated and controlled. The fundamental distinction between public (regulated) and private (unregulated) markets based on the concept of a general solicitation or offer to the public fell victim to election year politics and the JOBS Act of 2012[30] in the United States. Equally, and controversially, the JOBS Act has recognized new, technology driven forms of capital raising through 'crowdfunding', investor protection be damned.[31] It is this same technology that has created modern international capital markets.

1.19 Self-regulation of market participants forms another pillar of the securities regulatory landscape, predating the disclosure based regulation of the 1930s. Self-regulation harkens back centuries, to the medieval guilds, and is inextricably entwined with the history of the City of London, long an autonomous and international financial marketplace.[32] Self-regulation has

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[28] Although Lee Buchheit maintains that lawyers failed miserably in this respect. See Lee Buchheit, 'Did We Make Things Too Complicated?' (2008) 27(3) *International Financial Law Review* 24, 26: 'Why do some contracts, tantamount to crimes against humanity, not occasion more expressions of outrage from bankers, analysts, rating agencies, investors and regulators? (They do sometimes incur the wrath of the judiciary.) These people often meekly accept a turgid, incestuous, redundant, disorganised and arthritic contract without even a bleat of protest.'

[29] 'Dark pools of liquidity' refers to trading volume or liquidity that is not openly accessible to the public. The majority of these dark pools represent large trades by financial institutions that are offered outside of public exchanges so that such trades are anonymous. According to the US broker Rosenblatt Securities from their regular *Let There Be Light Report*, dark pools accounted for 13.3% of all US equity trading in 2012. See <http://www.tradersmagazine.com/news/dark-pool-volume-down-share-up-2012-110790-1.html> accessed 24 December 2013.

[30] JOBS Act, Pub L No 112-106, 126 Stat 306 (2012). There exists general consensus that the JOBS Act requires the SEC to lift the ban on general solicitation and advertizing of private offerings so long as issuers take reasonable steps to ensure that they sell only to so-called accredited investors. Securities law scholars, state regulators, Democrats in Congress and in the SEC's own Investor Advisory Committee all argue, however, that removing the marketing ban fundamentally alters the nature of private offerings and therefore increases the risk of fraud. They are therefore calling on the SEC to incorporate sensible safeguards when lifting the ban on general solicitation. On the other hand, securities industry representatives and Congressional Republicans are urging the SEC to approve lifting the general solicitation ban without additional investor protections. See <http://www.huffingtonpost.com/barbara-roper/jobs-act-rule-poses-early_b_2389134.html> accessed 24 December 2013.

[31] Steven M Davidoff, 'Trepidation and Restrictions Leave Crowdfunding Rules Weak', *The New York Times* (29 October 2013) <http://dealbook.nytimes.com/2013/10/29/trepidation-and-restrictions-leave-crowdfunding-rules-weak/?_r=0> accessed 24 December 2013.

[32] See Gillian Tett, 'This guilded life', *Financial Times* (3 November 2013) <http://www.ft.com/intl/cms/s/2/41776c74-41bd-11e3-b064-00144feabdc0.html#axzz2jeX5oOyS> accessed 24 December 2013.

much to commend it; it is cheap and can be reasonably effective. However, it usually demands a communality of understanding as to the limits of acceptable behaviour (or alternatively, an elastic view of what is acceptable). As groups of actors become more open and heterogeneous, as with London in the 1980s, self-regulatory mechanisms can break down.

1.20 Nevertheless, self-regulation has been remarkably resilient in the United States, in defiance of the institutional difficulties associated with it. Cynics might argue this is a triumph of powerful lobby groups, self-interest and the arcane, closed nature of the trading world. However, in the United States, regulatory oversight to self-regulation provides a counterweight to rampant self-interest. Unlike the United States, self-regulation suffered an abrupt near demise in the United Kingdom in 2000 with the Financial Services and Markets Act and operations of a new regulator, the Financial Services Authority.[33] But with forces as powerful as the denizens of the City of London at work, self-regulation continued to motor away, under the guise of 'light touch' regulation, for another decade.

1.21 For the United Kingdom, however, 2012 could be known as the year of 'Scandal and the City'. Much criticized financial failures in the banking sector, collateral damage in the disaster of the global financial crisis, were followed by revelations of private sector manipulation of LIBOR and other benchmarks as well as examples of outrageous risk-taking by investment bankers, such as the 'London Whale'.[34] Calls in the United Kingdom went up for 'heads on stakes', very well-coifed heads. The formal regulatory impulses of the European Union appeared, at least in the short term, vindicated.

1.22 Exchanges, as old institutions, have been naturally self-regulatory. Over time, exchanges experienced growing regulatory encroachment due to recognition of their 'public utility' function, and more recently, their role in the transmission of systemic risk. Demutualization was a major turning point, when the resulting conflicts of interest prompted many exchanges to cede certain aspects of traditional self-regulatory authority.

As important as exchanges are in the United States, arguably they have traditionally been a more significant engine of market regulation in Europe and the United Kingdom.[35] Generally

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[33] The Financial Services Authority was an independent non-government body, which changed its name from the Securities and Investment Board in 1997 and was given statutory powers by the Financial Services and Markets Act 2000 (UK). After a series of financial scandals during the 1990s, culminating in the collapse of Barings Bank, there was a move to end the long-time self-regulation of the financial services industry in the United Kingdom and to consolidate regulation responsibilities which were previously split among multiple financial regulators. As of 1 April 2013, the Financial Services Act 2012 (UK) entered into force, abolishing the Financial Services Authority and replacing it with three successor bodies: (1) the Prudential Regulation Authority (PRA) is responsible for ensuring the stability of financial firms (including banks, investment banks, building societies and insurance companies) and is part of the Bank of England; (2) the Financial Conduct Authority (FCA) is now responsible for the regulation of financial firms providing services to consumers and maintains the integrity of the United Kingdom's financial markets; (3) the Bank of England's powerful Financial Policy Committee has also gained a direct supervisory role for the whole banking system and can instruct both the PRA and FCA.

[34] Further scandals have emerged, for example in currency markets; London is the premier market for currency trading in the world. Scandal is not new to the City, as noted by the 'City of London Corporation Inquiry' [1853] *Law Review & Quarterly Journal of British & Foreign Jurisprudence* 389, 426–7: 'The present members of the Corporation of London . . . seem to have imbibed the notion that in order to divert a reform of the present system, and the substitution of one which should really serve the purposes of a Metropolitan municipality, it would suffice to urge that there is no ground for the imputation of "moral turpitude or personal corruption".' This situation was in contradistinction to their predecessors in the eighteenth century where '[h]eavy tavern expenses were allowed, the cause of charity and education was neglected, and publicity avoided'.

[35] The role of Nomads (Nominated Advisors who advise on compliance with financial regulatory rules), for example in the AIM (Alternative Investment Market).There may be any number of factors contributing

speaking, both continental Europe and the United Kingdom focused more on prudential regulation of institutions and their actors, leaving the activities of market professionals among themselves alone. [36] There may be any number of factors contributing to this difference: the relative weakness of the equity culture in Europe making the exchanges themselves less significant sources of regulatory failure and of less interest to governmental authorities; universal banking focusing regulatory attention on the banks; London's determination to position itself as the premier international marketplace justifying 'light touch' regulation.

1.23 In addition to providing wide latitude for unregulated or self-regulated activities in the private or exempt professional markets, in the United Kingdom this approach placed a heavier responsibility on professionals to act in the best interests of their clients and to maintain high standards of professional conduct. Mixed results ensued, and as London had become the centre of the world for international capital markets, the reverberations were worldwide. The global financial crisis also sparked greater regulatory interest in the United States in the activities of the big professional actors. The failure of the New York investment bank, Lehman Brothers, in September 2008 shocked the US administration, the financial community, and regulators alike. This failure too reverberated around the world, nearly taking the US financial system with it. Once largely immune from intensive scrutiny by Congress, US legislators now took a close, and exhaustive, look at their capital market institutions and intermediaries.[37] The resulting Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 adopted aspects of European-style 'institutional' regulation, an approach which had not been characteristic of US securities regulation.

2. The Trajectory of International Capital Markets Regulation

1.24 In the recent past, the story of international capital markets regulation has been a US story; the imprint of US securities regulation is everywhere. On the other hand, markets around the world demonstrated surprising diversity and resistance to formal regulation. Until the global financial crisis, the forces of competition and convergence, transmitted along the Washington-New York-London-Brussels corridor, drove regulatory agendas and absorbed much of the attention. But the jolt of crisis has changed the trajectory of markets and their regulation, or at least perceptions of them. Despite the public face of the traditional stock

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to this: the relative weakness of the equity culture in Europe making the exchanges themselves less significant sources of regulatory failure and of less interest to governmental authorities; universal banking focused regulatory attention on the banks; London's determination to position itself as the premier international marketplace justified 'light touch' regulation, for example.

[36] For decades, a distinction was made in the regulatory approaches as between the United States and Europe, between transactional or functional regulation in the United States and institutional regulation in Europe.

[37] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub L No 111-203, 124 Stat 1376 (2010) (Dodd-Frank Act). US securities regulation adopted aspects of European-style 'institutional' regulation, not one of its hallmarks. Together with a greater emphasis on regulatory oversight of systemic risk in the capital markets, 'SIFIs', Systemically Important Financial Institutions, must be identified and subjected to greater scrutiny. The Dodd-Frank Act requires that SIFIs must submit resolution plans annually to the Federal Reserve and the Federal Deposit Insurance Corporation. Each plan (commonly known as a living will) must describe the SIFI's strategy for aid and orderly resolution under the US bankruptcy law in the event of significant financial distress or failure of the company. However, according to the Republican controlled House Financial Services Committee, 'the jury remains very much out on the question of whether Dodd-Frank has created a more stable banking system'—Financial Services Committee, United States House of Representatives, *One Year Later: The Consequences of the Dodd-Frank Act* (2011), 3.

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exchange, much of the world of finance has long been a fine and private place.[38] Crisis and scandal now cast a strong regulatory light into the corners of finance.[39] Masses of regulation are being churned out.

1.25 New forces are at work. Regulatory convergence appears less likely and more problematic outside the EU, while operating strongly within it.[40] Along the transatlantic corridor, the lines of regulatory communication now are always open; the tangible effects of coordination and cooperation are evident in the broad outlines of new regulatory institutions and initiatives. Yet, look more closely, and there are fundamental differences emerging. Both the United Kingdom and the European Union have new, as yet untested, capital markets regulators, with the regulatory balance of power as yet undetermined. Europe is moving away from the disclosure model, such as it was, exerting regulatory control over retail investment products and previously unregulated market participants such as hedge funds and credit rating agencies, in a decidely unAmerican way. On the other hand, ironically perhaps, the European Union is flexing regulatory muscle in a decidedly American and extraterritorial fashion.

1.26 The spectre of systemic risk is changing the nature and role of capital markets regulation, which now operates more strongly as a tool of macroeconomic policy. In the process, capital markets regulation has become more politicized, but not necessarily better. There are new forms of capitalism too, populated increasingly by the 'inadvertent' investor: individuals are more and more exposed to market risk through governmental investment activity, mandatory pension schemes, and sovereign wealth funds, which due to their size and appetite are inherently internationally diversified (and interconnected). New trading patterns, new trading platforms, new trading possibilities, new methods of capital raising are racing ahead of regulators. Roaring capitalism with Chinese characteristics is already reshaping the financial world,[41] while it is still an open question as to the impact of Islamic finance.[42] Overenthusiastic, but ultimately artificial, experiments in internationalism, like Dubai, have so far disappointed.

1.27 And then there are the international institutions, organizations, fora, industry associations, new and old, which have surged to prominence in the new interconnected world of modern finance. So far, the proliferation of many international financial standards has not produced lasting, or even intended, results.[43] Sceptics abound.[44] Nonetheless, to an already complex juxtaposition of regulation, rules, and practices, has been added another layer.

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[38] With apologies to John Donne (1572–1631).

[39] The term 'shadow banking' is not an idle metaphor.

[40] See Stéphane Rottier and Nicolas Véron, 'Not all financial regulation is global', Breugel Policy Brief 2010/07, August 2010 where they discuss the phenomenon of 'multipolarity' and re-regulation. Within the European Union there is now a dominant trend towards regulation (of immediate and direct applicability within member states) and maximum harmonization.

[41] Although the capital market as casino mentality appears to be subsiding, there is no evidence that the interventionist inclinations of the Chinese government regulator are.

[42] Islamic finance, with its potential market of some 1.6 billion adherents, is inherently international and growing rapidly. However, its innate diversity and resistance to commercial standardization, impedes its significance.

[43] For example, despite obtaining an almost perfect score on ratings involving the IOSCO Objectives and Principles of Securities Regulation (compared to very mixed results for the United States when measured against the same benchmarks), the Dubai International Financial Centre has so far failed to deliver. See Ch 9 in this book. See also Cally Jordan, 'How International Finance Really Works' (2013) 7 *Law and Financial Markets Review* 256.

[44] 'Admittedly, the G20 has entrusted the Financial Stability Board with the mission of monitoring the standard-setting activity and has mandated the Basel Committee, IOSCO, and the IAIS (among others) with

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1.28 There is no doubt that in a dozen years from now, the regulatory and institutional landscape of international capital markets will have been transformed. Adjustments to the shock of financial crisis are working their way through systems around the world. Demographics and geopolitical forces are shifting, changing with them investment patterns, institutional models, and long-held assumptions about market behaviour. Information technology has profoundly impacted information-based regulatory systems, outpacing regulatory responses. Traditional market institutions, such as exchanges, are scrambling to adapt. The private underbelly of finance is being exposed, at least to a limited extent. Theories of regulatory design are being challenged and rethought. Indeed, a new world of finance is already upon us.

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the task of developing new rules. However, this choice seems more a quick-fix than a sustainable strategy. It will neither preserve state unity on the international stage, nor solve the issues of circumvention of national and regional democratic processes.' Régis Bismuth, 'The Independence of Domestic Financial Regulators: An Underestimated Structural Issue in International Financial Governance' (2010) 2 *Goettingen Journal of Internaltional Law* 93, 108–9.