

**OUTLINE AND ANNOTATED BIBLIOGRAPHY:
CROSS-BORDER MERGERS OF SECURITIES EXCHANGES, REGULATION OF
FOREIGN BROKERS AND DEALERS, AND RELATED REFORMS**

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Summary:

- Mergers are thought to be correlated with or even caused by exchange demutualization and strengthening global competition.
- Technological advances are discussed in the scholarly literature as part of stock exchange mergers along with diversification of products (such as adding derivatives to regular equity trading operations) and trading platforms (e.g., electronic in addition to the traditional floor trading).
- Correspondingly, most authors reviewed the benefits of mergers as part of the general evolution of demutualized exchanges. The advantages include the economies of scale, integration of trading platforms, competitive product diversification and benefits related to raising capital. There are no empirical data measuring the actual benefits of cross border mergers. Some authors argue that the benefits of international mergers will accrue only when regulatory systems become unified or mutually recognized. Others see the current holding company structure as the only feasible, although unstable, solution in the medium term.
- To date, the merged stock exchanges are under the umbrella of their own national regulators, such as, e.g., the SEC and the College of Regulators.
- Many authors see exchange consolidation as a response to the growing international competition. Correspondingly, a case in point is why the US capital market has become less attractive to foreign issuers in terms of IPOs and cross-listing of securities.
- The discussion of future regulatory changes generally focuses on cross-border trading transactions through foreign exchanges and broker-dealers. The SEC repeatedly emphasizes the mutual recognition issues, the IFRS/GAAP reconciliation, and the substituted compliance regime. Currently, the proposed frameworks cover the regulation of foreign broker-dealers and foreign stock exchanges trading in *foreign* securities in the U.S. Many scholars express doubts about the mutual recognition regime and offer alternative ways to amend current regulations.
- The SEC seems to believe that the mutual recognition regime and amendments to Rules

15a-6 and 12h-6 correspond to the dual goal of assuring investor protection while decreasing transaction costs related to international securities trade.

- The Europeans pioneer in demutualization, mergers of exchanges, analysis of mutual recognition and international cooperation. There are solid analytical reports on the European mergers. Some authors also emphasize that Regulation NMS is less efficient than MiFD.
- A problem in the American scholarly literature is the lack of primary data. In addition, possibly due to the crisis, the focus of scholars has shifted towards other issues. Similarly, with respect to mutual recognition, there are a number of problems. Namely, even though a number of memoranda of understanding (hereinafter “MOU”) in this area have been signed, the regulatory “comparability assessments” are not fully disclosed and the actual impact of the latest MOU with Australia is uncertain due to the dearth of research in this area.

I. Analysis of Merger Documents and Ex Post Financial Statements

A. NASDAQ-OMX Merger

1. Deal Structure and Background Information:

a. The merger negotiations were continuing for two years with the assistance of several financial advisors, such as JPMorgan, Morgan Stanley & Co and Credit Suisse Securities (Europe) (NASDAQ OMX Group, Inc., Definitive Proxy Statement, DEFM14A for NASDAQ STOCK MARKET INC, 11/19/2007, (CIK - 1120193 /SIC - 6200) (hereinafter “Proxy Statement” or “PS”), 45, available at <http://www.sec.gov/cgi-bin/browse-edgar?action=getcompany&CIK=0001120193&type=DEFM14A&dateb=&owner=exclude&count=40>)

b. As a result, a joint offer was made by NASDAQ and Borse Dubai with cross-investments by Borse Dubai in NASDAQ.

c. Due to the complexity of compliance with multijurisdictional securities regulations, the parties utilized the Borse Dubai Option Agreements allowing Borse to become a minority shareholder in NASDAQ. The same number of shares that would have been issued to OMX

shareholders, was issued to Borse and the Trust, thus, assuring that the shares are held for the economic benefit of Borse and that its investment was non-controlling. After the sale of their holdings of the LSE shares, parties entered into a number of OMX Transaction Agreements and the DIFX Transaction Agreements, which were subsequently approved by the NASDAQ's Board (Proxy Statement, at 45-51).

d. The actual combination was completed on February 27, 2008 with NASDAQ as the legal acquirer in the combination. On January 29, 2009 the combined company filed a shelf registration statement with the SEC (See Form S-3, Jan 29, 2009).

2. NASDAQ's Reasons for the Transactions:

a. The Board, traditionally, did not quantify or "otherwise assign relative weights to the specific factors that it considered in reaching its determination." (PS, at 51). Instead, the standard language was used and all combination information was deemed forward-looking statements.

b. The general benefits of the transactions were that the combined company would:

i. Have strategic and technological benefits, such as:

a) Creating the world's largest companies listed on their respective marketplaces;

b) Having a leading market share of listings in such industries as technology, software, *etc.*

c) Providing increased access to global equity capital through greater liquidity pools, advanced speed of execution and integrated cross-border trading capabilities;

d) Combining the capabilities of OMX, which is an integrated cross-border stock market with a customer base of equity, debt and derivatives, with the NASDAQ's fastest U.S. trading platforms;

e) Benefiting from new technologies and combined electronic trading platforms;

f) Using its combined data vendors to enhance market transparency;

g) Combining technology businesses and assuring new growth opportunities;

h) Helping investors benefit from higher trading volumes, a common IT interface and positive portfolio diversification.

ii. Enhance product diversification and expand the Company's networks, including:

- Being highly competitive in derivatives market. In part, it was suggested since the Nordic Exchange was Europe's third largest marketplace for trading and clearing derivatives. Hence, the combined company would capture the high growth potential in global derivatives;

- Developing innovative data products and combined indices for stocks and derivatives, and increasing geographic and sector diversification;
- Extending the OMX's Nordic distribution network through an international network with cooperating exchanges.

Comment: An important question is where similar contractual cooperation could be possible between NASDAQ and OMX. It appears that the Boards did not consider that option.

- Providing better data business with improved global distribution and value-added services to market participants.

Comment: Among the most important factors, the Statements indicate the demand for multi-asset class trading platforms.

iii. Realize high synergy potential by 2010, namely, \$150 million of annual pre-tax synergies, including \$100 million cost synergies from rationalization of the IT-systems and data centers, reduced capital and procurement expenditures; and \$50 million of revenue synergies from deeper liquidity pools, increased cross-border trading and international listings.

Comment: There is no comprehensive quantitative study providing monetary evaluation of the "synergies" and whether they have been partially achieved since the merger. Some analysts argue that "NYSE Euronext nearly doubled its software and technology services revenue in the first half of 2008, to \$226 million. At the same time, NASDAQ OMX increased market technology revenue 22 percent, to \$69.8 million." The NYSE CEO Duncan Niederauer, CEO, NYSE Euronext; and Robert Greifeld, CEO, NASDAQ OMX Group, both emphasized the role of technology and product diversification. (Institutional Investor, Online Finance 30, Oct. 2008, available at http://www.iimagazine.com/InstitutionalInvestor/Articles/2029558/Online_Finance_30.html). It is not clear if the revenues derived from additional investments in software in the previous fiscal year or from the cost synergies resulting from the mergers.

iv. Have better managerial cooperation. The OMX Transaction Agreement (PS, at 87) indicates that Directors and managers of the combined entity will consist of 16 directors, including 9 from NASDAQ, four from OMX and two from Borse Dubai. Three directors from OMX and both from Borse must be independent.

3. In addition to the common merger-related risks, the Statement emphasized the following:

a. NASDAQ recurrently stated that the main reason for the transaction was competitive risks, including price competition, products and technology.

b. Also, the NYSE's mergers strengthened the competition by making the NYSE Euronext more competitive in attracting new listings and providing better electronic capabilities (PS, at 7).

c. The risks associated with MiFID were uncertain, as the European-wide requirement for best execution and creation of a unified European financial services market would not only enable greater transparency, but also increase competition for quotations and trade execution (PS, at 10). Similarly, risks of Reg NMS were unclear.

4. *See also* Offer by OMX AB (publ) to the Shareholders of Copenhagen Stock Exchange A/S and Listing Particulars (15 Dec. 2004), *available at* <http://www.NASDAQomx.com/digitalAssets/1/1635 OMX-CSE English.pdf> (providing generally analogous reasons for the merger, *see* the discussed above Prospectuses).

B. NYSE-Euronext Merger

1. Deal Structure and Background Information:

a. The NYSE merger was a common business combination where the Euronext shareholders under the mix-and-match provisions received cash and 0.98 of a share in the new holding company in exchange for their Euronext shares. Prior to the combination, in 2006, the Euronext was also discussing potential business combination options with the LSE and Deutsche Borse. Citigroup, Morgan Stanley and ABN AMRO acted as financial advisors for the parties (NYSE Euronext, Inc. Form S-4 Registration Statement and Prospectus, *available at* <http://www.integration.euronext.com/editorial/wide/editorial-7703-EN.html>, at 73-79 (hereinafter "Form S-4 and Prospectus"))).

2. NYSE's Considerations:

- a. The general benefits of the transactions were that the combined company would:
- i. Produce strategic benefits, such as:
 - Creating the first global exchange group with the presence in major markets and large capitalization of listed issuers;

- Having the common intercompany vision of a business model that does not include the clearing and settlement as a key driver of revenues;
- Effectively competing for non-U.S. listings outside of the U.S. and offering liquidity in Europe as an alternative for those who want to avoid the U.S. regulatory regime;

Comment: Since it seems to be an attempt to tap into regulatory arbitrage, it is questionable whether the exchanges welcome amendments to Rule 15a-6 and Reg NMS or the mutual recognition efforts. Some authors argued, however, that the full benefits of the mergers will be achieved only when a mutual recognition regime is created. (See Eric J. Pan, Single Stock Futures and Cross-Border Access for U.S. Investors, 14 Stan. J.L. Bus. & Fin. 221 (2008), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/stabf14&div=9&id=&page=>)

- Mitigating the uncertainties associated with strategic alternatives of the NYSE, including technological and regulatory challenges;
- The application of both US and European regulatory requirements separately.

Comment: See Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information Related to Market Oversight (Jan. 25, 2007). See also SEC, Euronext Regulators Sign Regulatory Cooperation Arrangement, SEC Press Release 2007-8 (Jan. 25, 2007), available at <http://www.sec.gov/news/press/2007/2007-8.htm>.

ii. Bring about product diversification, including:

- Cash equities, listings, derivatives, equity options and futures, bonds, market data and technology;
- Offering investor outreach and other programs in Europe.

Comment: From October 1, 2008, the NYSE began offering a global pricing rebate to its European customers who exceeded certain volume thresholds on each of Euronext, NYSE and NYSE Arca trading platforms. (NYSE Euronext, Form 10-Q, Nov. 6, 2009, available at <http://www.sec.gov/Archives/edgar/data/1368007/000119312509227514/d10q.htm>.

iii. Have significant cost savings and revenue synergies, including \$ 275 million of annual cost savings by the end of 2009, *i.e.*, within three years, and \$100 million of annual incremental revenue.

iv. Have a joint Board of Directors with 11 US domiciliaries and 9 European domiciliaries. Initially, the CEO of the NYSE became the CEO of the combined company, while the CEO of the Euronext became a deputy CEO. Chairmen of the respective Boards also remained with the Euronext Chairman as the Chairman of the joint Board (Form S-4 and Prospectus, at 81).

3. The Euronext's Considerations:

a. Strategic Considerations [not covered in the NYSE's analysis above] (Prospectus, at 84) were:

- i. To lower trading costs and increase liquidity via combining and harmonizing technology;
- ii. To cope with the competition and actively merging rivals;
- iii. To create a combined leader in a number of businesses, including equities, listings, derivatives, equity options, futures, bonds, market data and technology;
- iv. To provide a freer flow of capital across the Atlantic for European investors and to enhance diversity of investment products;
- v. To preserve federal and horizontal business model;

Comment: This is done in part through regulatory supervision of the Holding by the SEC and the Euronext College of Regulators. Many studies regarding the efficiency of horizontal and vertical stock exchange holdings have not produced conclusive results. (See the discussion in Chapter IV. See also Maurizio Polato & Josanco Floreani, Cross Border Mergers and Value Creation in the Exchange Industry: the Case of Diversified Conglomerate Exchanges (2009), available at <http://host.uniroma3.it/eventi/wolpertinger2009/19.pdf>).

vi. To compete for non-US listings outside of the US with no US regulatory risks for the European markets;

vii. To remain exempt from mandatory compliance with US securities laws.

Comment: U.S. regulations are perceived as an important risk factor throughout the Prospectus. Based on the history of the transactions, the parties seem to be satisfied with the regulatory status quo.

b. Product diversification, including new transatlantic indices, products leveraging the NYSE brand name and equity derivatives.

Comment: In 2008, the combined company created the Global Index Group and by 2009 the Group enriched the index portfolio to more than 300 indexes in total. See NYSE Euronext,

NYSE Euronext to Launch 12 New Strategy Indices, Feb. 04, 2009 available at http://www.euronext.com/news/press_release/press_release-1731-EN.html?docid=654457)

c. Cost and revenue synergies [described above]. Specifically, the projected synergies were as follows:

- i. The company expected to realize the annual cost savings of \$30, \$100 and \$250 million from 2007 to 2009. The savings were to accrue from the consolidation of the three cash trading platforms (NSC, Hybrid, NYSE Arca) and the three derivative platforms (LIFFE Connect, NYSE Arca Options, PCX+) into global trading platforms. The project included consolidation of ten data centers into four global centers.
- ii. The forecasted non-IT savings were expected to reach \$75 million due to the integration of support functions and marketing expenses.
- iii. \$49 million in savings were attributed to the revenue synergies from derivatives trading, including shared cross-border customer base, the extension of the European wholesale OTC derivative service, ABC, in the U.S., and launching new products. The revenue synergies from cash trading were expected to reach \$35 million by means of meeting the European demand for US blue chip companies, structured products, ETFs, and extended trading hours. \$20 million were to accrue from listings, which would derive from GDRs, the capture of overseas listings, a deeper global liquidity pool, etc. (Prospectus 90-92).

C. Analysis of the Most Recent 10-Q Forms

1. Form 10 Q, filed Nov 6, 2009, The NASDAQ OMX Group, Inc.

(The NASDAQ OMX Group, Inc., Form 10 Q, No. 6, 2009, available at <http://www.sec.gov/Archives/edgar/data/1120193/000119312509226871/d10q.htm>)

a. Consolidated Statements of Income (in millions):

- i. Within the 9-month period, merger expenses decreased from \$9 in the same period in 2008 (\$16 million total) to \$5 million.

b. Consolidated Balance Sheets (in millions):

- i. There is a \$410 million decrease in total assets from Dec 31, 2008 to Sep 30, 2009. Current assets diminished due to the \$63 million decrease in cash and cash

equivalents, in market value, and outstanding derivative positions by about \$600 million.

- ii. Probably because of the merger, the value of property and equipment decreased from \$183 to \$165 million, while goodwill and intangible assets grew by almost \$600 million.

Comment: Some research forecasted au contraire and argued that exchanges would continue writing off good will (Sebastian Bock, Specialized Finance – Securities and Commodity Exchanges, Henry Fund Research, the University of Iowa School of Management, Feb. 13, 2009, available at <http://tippie.uiowa.edu/henry/reports09/Exchanges.pdf>).

c. Selected Notes to Condensed Consolidated Financial Statements:

- i. The newly created Global Index Group develops branded indexes, associated derivatives and financial products. In addition to generating licensing fees, the indices and other products, particularly mutual funds and ETFs, entail increased investments in the NASDAQ listed companies. Other global products include licensing cash-settled options, futures and options on futures on indexes.
- ii. The Market Technology segment provides technology solutions for trading, clearing and settlement, facility management integration and advisory services to 70 exchanges in 50 countries. The global acquisitions of OMX AB and 33% of the equity in the DIFX were an indelible part of the technological expansion.

2. Form 10 Q, filed Nov 6, 2009, NYSE Euronext

(NYSE Euronext, Form 10-Q, Nov. 6, 2009, available at <http://www.sec.gov/Archives/edgar/data/1368007/000119312509227514/d10q.htm>):

a) Consolidated Statements of Operation (in millions):

- i. The total revenues increased in ninth months of 2009 compared to the same period in 2008 due to some slight increase in listing, cash trading, activity assessment, and software and technology services.

b) Consolidated Statements of Financial Condition:

- i. The total current assets decreased from December 2008 by approximately \$600 million due to decreases in financial investments (from \$236 to \$69), cash and cash equivalents, and accounts receivable.

- ii. Goodwill and intangible assets went up by slightly less than \$400 million, thus leading to a \$200 million increase in total assets.
- c) Discussing its Sources of Revenue, the Statements describe U.S. and European businesses separately, although some interconnected platforms are mentioned. The NASDAQ's descriptions are more consolidated in this sense.
 - i. For instance, activity assessment fees are mentioned for the U.S. (due to different regulatory policies of the SEC and European regulators); cash revenues are described separately with a note that the new MiFID might affect the revenues and that the revenues depend on the number of shares traded on "the U.S. securities exchanges and, the number of executed orders executed on Euronext for equities trading".
 - ii. The listing fees differ across the exchanges in the Group.
 - iii. The same difference is characteristic for the market data business: the NYSE Euronext offers *NYSE Realtime Reference Prices*, while Euronext's real-time market data services seem to be separate.

II. The SEC's Position on Cross-Border Trading

A. Discussion on Mutual Recognition:

1. *Written Statement of the U.S. Securities and Exchange Commission, A Global View: Examining Cross-Border Exchange Mergers*, Before the Subcommittee on Securities, Insurance, and Investment of the U.S. Senate Committee on Banking, Housing, and Urban Affairs, July 12, 2007, available at <http://www.sec.gov/news/testimony/2007/ts071207sec.htm>:

- a. The Commission believes that the cross-border consolidation will continue and that the existing conglomerates will seek further operational integration.
- b. The mergers, such as the NYSE-Euronext, were prompted by the demutualization of exchanges, the demand for global exchanges, foreign securities and global mutual funds, and technological developments.
- c. Since the merged exchanges preserve a holding company structure, the SEC did not face significant regulatory challenges. Potential future trends, however, will involve placing

trading screens in different jurisdictions, consolidation of platforms and common liquidity pools.

d. The SEC, within its mandate of investor protection and for the purposes of fostering capital formation, can amend the existing regulations of exchanges and foreign broker-dealers without jeopardizing U.S. investors.

e. One way is the mutual recognition regime that would, *e.g.*, include placing trading screens with US broker-dealers without registration, eliminating the need to have US intermediaries, *etc.* Exemptions, *e.g.*, could be limited to transactions with sophisticated investors only.

f. Mutual comparability assessments are complicated and may call for international reciprocal arrangements.

2. Erik R. Sirri, *A Global View: Examining Cross-Border Financial Services*, Whistler, BC, Canada, August 18, 2007, available at <http://www.sec.gov/news/speech/2007/spch081807ers.htm> :

a. The author gives some statistics on the increasing holdings of foreign securities by U.S. and non-US investors from 2001 to 2005, and discusses the trends mentioned in the Statement above. The core issue faced by the SEC in this globalizing market will be to assure adequate disclosure and regulatory oversight for U.S. investors.

b. The National Securities Markets Improvement Act of 1996 granted the SEC broad authority to exempt any person from the Securities Exchange Act (hereinafter “SEA”) requirements and impose conditions on their operations. In combination with the NMS, such provisions allow the SEC to respond to the global competition.

c. The mutual recognition is one way to do that. It, *e.g.*, may include abridged registration system for broker-dealers based on the comparability of regulatory oversight in other jurisdictions, direct access to US investors, placing trading screens with U.S. brokers, *etc.*

d. This approach, however, will not address greater custodial and settlement costs existing in foreign markets.

e. Detailed comparability assessments are required. In the beginning, the regime may be limited to trades with sophisticated investors only or trading solely in foreign securities, *etc.*

3. *SEC Related Materials*, submitted by Abigail Arms et al., 1640 PLI/CORP 15 (2008)

(summarizing many of the foregoing proposals).

4. Ethiopis Tafara, *Trading Places: Mobility and the New International Financial Regulation*, Rendez-Vous With the AMF, Montreal, Quebec, October 15, 2007, available at <http://www.sec.gov/news/speech/2007/spch101507et.htm> :

- a. The SEC reacts to the global market changes via new rules on transparency, order handling, and competition. US foreign investments increased by 30% from 2000 to 2005. From 30 to 50% of European stocks are held by foreign investors. Both technology and regulations strengthened competitiveness of the US stock exchanges via the best order-execution services. The logic of the market further dictates a rapid expansion of capital market networks, alliances across borders and mergers. All these pose challenges to the SEC's mandate to protect investors.
- b. Among the problems are fraud and differences in the degree of protection offered by various countries, different regulatory systems applied to merger partners, inefficiency associated with overlapping regulations and others. A tempting, but inefficient option is "to just give up" and invoke caveat emptor. In case of the SEC, this option is also impossible as the Commission pursues three overarching goals: protecting investors, assuring market fairness and efficiency, and promoting capital formation.
- c. Securities regulations are local, although many countries have similar regulations, which allow for substituted compliance, "comparability assessments" and selective mutual recognition. Mergers raise unique regulatory concerns and involve application of different regulatory systems to merger partners.

Comment: No particular regulatory regime for consolidated cross-border stock exchanges have been offered to date by either E. Tafara or other SEC officials.

5. Paul S. Atkins, *The SEC's Role in Globalization of the Capital Markets* (2007), available at <http://www.sec.gov/news/speech/2007/spch101607psa.htm> (The concept of mutual recognition of foreign broker-dealers and exchanges is still debated at the SEC. Rule 15a-6 needs to be modernized as it increases costs for brokers and investors alike.).
6. Christopher Cox, *Keynote Address to the 2007 US-EU Corporate Governance Conference* (2007), available at <http://www.sec.gov/news/speech/2007/spch100907cc.htm> (The Chairman raised a

number of international enforcement concerns, but no solutions were proposed.).

7. John W. White, *Corporation Finance in 2007 -- An Interim Report* (2007), available at <http://www.sec.gov/news/speech/2007/spch081407jww.htm> (The new Exchange Act Rule 12h-6 permits a qualifying foreign issuer to deregister a class of equity securities if the average daily trading volume in the U.S. is less than five percent of the average daily trading volume of that class of securities, measured on a worldwide basis for 12 months. On the technology side, the SEC focused on the Business Reporting Language, or XBRL.).
8. Ethiopis Tafara, *Tchaikovsky's Fourth or Monk's Mood: Improvisation and Harmony in Cross-Border Regulation*, 2007, available at <http://www.sec.gov/news/speech/2007/spch061507et.htm> (The SEC in cooperation with foreign counterparts work on the the global acceptance of the International Financial Reporting Standards. The new cooperative bilateral and multilateral international infrastructure facilitates regulating the global securities market.).
9. Ethiopis Tafara, *Shared Responsibilities In Global Capital Markets*, British-American Business Inc.'s Financial Services Forum, London, England, May 8, 2007, available at <http://www.sec.gov/news/speech/2007/spch050807et.htm> :
 - a. The SEC and the UK have an enforcement information-sharing MOU. Serious insider trading, market manipulation and financial fraud cases in both countries have been prosecuted successfully based on coordinated investigations and information-sharing. Evidence, remedies and sanctions were coordinated. Such information-sharing has become a keystone of multilateral cooperation.
 - b. "In 2002, the International Organization of Securities Commissions created a multilateral information-sharing MOU under which all signatories pledge not just to share enforcement information with each other and cooperate with the others' investigations, but also demonstrate to the organization that they have the legal authority to live up to the MOU's provisions." The Multilateral MOU is a condition for the membership.
10. Ethiopis Tafara, *A Few Observations Based on International Regulatory Conversations, Before the CESR Conference "Preparing for the Future: Where to Now for the Regulation in the Field of Securities"*, Paris, France, February 23, 2009, available at <http://www.sec.gov/news/speech/2009/spch022309et.htm> .

i. “The four characteristics of the modern market are:

- its global nature and the resulting mobility of capital;
- the significantly increased competition among financial service providers;
- the elimination of differences between historically separate financial products, sectors, and actors; and
- the development of a large and relatively liquid unregulated institutional financial market paralleling the regulated markets.

First, of course, the new regulatory framework must address the issue of increased systemic risk, while not suppressing risk-taking *per se*. This is crucial if we are to address problems, yet not undermine economic innovation. To sustain the economic innovation needed to drive the economy, financial capital must be able to take risks... [*Comment: The Europeans are also concerned about financial innovations in the absence of unified regulatory policies within the EU. See the Lamfalussy Report (The European Commission, Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, Feb. 15, 2001, available at http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf)].*

Fourth, the regulatory framework needs to account for the fungibility of financial products, actors and markets...

Fifth, the regulatory framework of the future must be responsive to the fact that capital is mobile, markets are interconnected, and technology makes the movement of capital irrepressible.”.

11. Ethiopis Tafara & Robert J. Peterson, *A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 1669 PLI/CORP 387 (2008), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/hilj48&div=10&id=&page=>.

- a. Investor wealth and better information (including information issued by companies on their own, analytical reports and formalized corporate filings) have created the demand for international capital markets, while technology has made globalized markets feasible. At the same time, technology poses regulatory risks and requires changes in the oversight of cross-border market activities by the SEC. For instance, information processing errors can entail serious ramifications,

which augments the importance of “gatekeepers”. Those are, however, prone to the “moral hazard” problems. Also, cross-border fraud is another emerging issue.

- b. The Blueprint that seems to have been accepted by the SEC proposed a system of substituted compliance with the SEC regulations instead of registration with the SEC. While assuring an appropriate level of investor protection, the SEC needs to provide a better regime where financial intermediaries can access overseas securities markets.
- c. Laws resulting out of corporate scandals (such as the Sarbanes-Oxley Act, hereinafter “SOX”) proved to be controversial and “delved more deeply into corporate governance, auditor oversight, and other matters bearing directly on overseeing the quality of the disclosures issuers make.” Among the effects of the Act were numerous international issues. Specifically, “if securities regulation were limited only to disclosure requirements, cross-border regulatory conflicts would be relatively few and dealt with easily.” However, corporate governance, auditor oversight requirements, and prudential regulatory approaches, vary among jurisdictions and raise the costs of compliance for international financial institutions.
- d. Under the current regulations, few distinctions in terms of registration with the SEC are drawn between foreign and domestic market participants. Correspondingly, unregistered foreign stock exchanges are prohibited from placing trading screens with U.S. brokerage firms or institutional clients. Also, foreign broker-dealers may execute orders by U.S. investors, but cannot offer foreign securities to U.S. investors or offer additional services. Among the reasons for the approach was protecting investors against unknown risks and cross-border fraud.
- e. Recently, the SEC is cooperating with IOSCO in developing international disclosure standards and prospectuses, with addenda required by national regulations, and has permitted the reconciliation of the GAAP and IFRS. The developing mutual recognition efforts also call for regulatory convergence in order to prevent unhealthy regulatory arbitrage.
- f. The authors also proposed the substituted compliance approach. The major focus would be on lessening repetitive obligations of foreign exchanges and broker-

dealers, which ultimately increase transaction costs for U.S. investors. Later, the approach can be expanded to ECNs, mutual funds and ATSS. A foreign entity would not be allowed to offer U.S.-registered securities, but only foreign securities.

- g. The author mentions that US investors, offered foreign securities through exchange screens located in the U.S., may be unaware that thus purchased securities are regulated by a foreign legal system. Hence, the two prongs of the Tafara's approach are the new *exemption requirements* and *regulatory preconditions*, including exchange oversight; broker-dealer oversight; issuer requirements; general legal and enforcement comparability; reciprocity; appropriate supervisory and enforcement MOUs.
- h. The benefits of selected substituted compliance "include:
 - Increased competition in financial services in the United States, to the benefit of both retail and institutional investors;
 - Reduced transaction costs to U.S. investors interested in buying or selling foreign securities; and,
 - By limiting direct access to foreign screens and broker-dealers only from selected jurisdictions with high-quality regulatory oversight and highly liquid markets, U.S. retail investors would be protected by well-developed price discovery mechanisms in these foreign markets, even if the legal level of investor protection is different from that in the United States."

12. Brandon Becker & Christie Farris Oberg, *A Model in Transition?: The SEC's Approach to the Regulation of Cross-Border Trading*, 1669 PLI/CORP 555 (2008).

- i. The authors discussed that the national treatment model should be changed under the pressure of globalized markets, including cross-border exchanges. The MOU between the SEC and the Euronext College of Regulators, for example, states that the authorities will share information and engage in cooperative regulatory efforts across the Atlantic.
- ii. The authors also highlight that despite the fact that the securities laws were developed when the U.S. markets dominated securities trading, the SEC's mandate and mission have not changed and include investor protection, facilitation of capital formation and maintenance of fair, efficient and orderly

markets (U.S. Securities and Exchange Commission 2004-2009 Strategic Plan, at 4).

- iii. The authors also describe the current regulations of foreign broker-dealers, including electronic databases, registration of exchanges, the limited volume exception (based on the dollar volume and home country market share tests), trading disclosure, recordkeeping rules, *etc.*
 - iv. Finally, the article gives an overview of the Tafara-Peterson's proposal and its public comments and criticism. The authors mention that if implemented, the Proposal would require a principle-based approach, which would allow for easier comparative assessments of regulations, as opposed to the current rule-based approach.
 - v. Also, the U.S. SIFMA and the Investment Industry Association of Canada addressed G7 with a request to initiate a pilot project for global firms dealing with institutional investors. The project called for strengthened international regulatory and enforcement cooperation as opposed to comparability assessments (Developing Global Framework for Capital Markets Transactions Can Be Taken in Steps: SIFMA and IIAC Urge G7 to Support Facilitation of Cross-Border Business, SIFMA Press Release (Oct. 18, 2007)).
 - vi. Some commentators doubted the feasibility of comparability assessments in the area of investor protection, argued that retail investors are ill-equipped to properly assess related risks, proposed to grant a cause of action to U.S. investors to enforce "mutually recognized" foreign law in US courts, and made other suggestions. Some also criticized the proposals as limited and offered to extend them to issuers, mutual funds, investment advisers, and other financial institutions.
 - vii. Under the leadership of Chairman Cox, the mutual recognition regime seemed to be a priority. Officials like Eric Sirri stated that it might be limited to foreign securities and institutional investors. Commissioner Nazareth expressed concerns about such dangers of mutual recognition as regulatory arbitrage.
13. Edward F. Greene & Omer S. Oztan, *Global Capital Markets & the U.S. Securities Laws 2010: Strategies for the Changing Regulatory Environment*, 1807 PLI/CORP 51 (2010).
- a. The authors consider the effect of globalization on capital markets and analyze a

number of strategies the SEC has been pursuing in the past several years. In a nutshell, the analysis covers the amendments to Rule 15a-6 and the mutual recognition efforts, namely, the Australian MOU [*discussed infra*], and the ongoing negotiations with Canadian and the EU authorities. The recognition approach raises a number of problems with respect to the jurisdictional issues within Canadian provinces and 27 countries comprising the EU.

- b. The authors point out that the SEC continues to exclude even sophisticated investors from being eligible to participate in non-U.S. primary offerings (under Rule 144A). The current regime covers QIBs only. In the secondary market, investors are always given notice informing that a non-U.S. transaction is subject to securities laws of another jurisdiction. The authors argue that the current policy “has created a situation where there is a disconnect in approach, potentially resulting in reduced investor protection” (*id.* at 57).
- c. They also analyze the differences between exemption and recognition policies. The first one (under Rule 15a-6, *e.g.*) is narrower and focuses on specific aspects of foreign securities law, *e.g.*, registration of broker-dealers. Recognition, in contrast, has a broader scope, including comparable investor protection in the foreign country and cross-border trade through exchanges or market intermediaries. Also, the recognition regime can be applied either on a unilateral or mutual basis. The authors describe the national approach to broker-dealer registration under Section 14(a) of the SEA and Rule 15a-6.
- d. The authors particularly focus on the Australian MOU and access to the US and Australian markets by national exchanges and broker-dealers, disclosure requirements and related statements to investors, and two supplementary memoranda, including the Enhanced Enforcement Memorandum of Understanding and Supervisory Memorandum of Understanding.
- e. Such issues as regulatory arbitrage, the need for a more coherent framework, expansion of recognition policies with respect to non-U.S. issuers, better enforcement policies and others are also reviewed. The authors draw some conclusions based on the proposals of industry associations, such as the October 2007 Framework submitted to IOSCO by the International Institute of Finance and SIFMA. The proposal focuses on the global framework for cross-border

reforms. Finally, the authors suggest that a part of the unified regulatory approach could be to include sophisticated investors to participate in both non-U.S. primary offerings and secondary market transactions while simultaneously providing them with disclosure statements, monitoring that a foreign country has robust disclosure policies, and implementing closer enforcement cooperation with foreign jurisdictions.

B. MOU between the SEC and Australian Authorities

1. SEC Chairman Cox, Prime Minister Rudd Meet Amid U.S.-Australia Mutual Recognition Talks, Press Release, 2008-52m, available at <http://www.sec.gov/news/press/2008/2008-52.htm> (announcing the arrangement).

2. SEC, Australian Authorities Sign Mutual Recognition Agreement, Press Release, 2008-182, Aug. 25, 2008, available at <http://www.sec.gov/news/press/2008/2008-182.htm>.

3. 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, Aug. 25, 2008, available at http://www.sec.gov/about/offices/oia/oia_mutual_recognition/australia/framework_arrangement.pdf.

a. In the prefatory note, the parties recognized the potential benefits of globalized markets, the need to enable investors to realize benefits from cross-border trading, maintaining appropriate standards of investor protection, and limitations of duplicative costs and regulatory compliance.

b. The scope of the Arrangement covers markets and broker-dealers.

c. In short, Australian/U.S. markets doing business with U.S./Australian investors through Australian/U.S. broker-dealers are subject to Australian and U.S. laws respectively and have to provide investors, through Australian/U.S. dealers, with risk disclosure statements indicating that they are subject to the oversight by their national authorities.

d. Australian/U.S. broker-dealers dealing with qualified investors (U.S.) or wholesale clients (Australia) will be subject to their national laws, with the exception of antifraud regulations (U.S.) and misconduct provisions (Australia), and have to provide

investors with appropriate risk disclosure statements. Exemptive relief is granted based on the assessments and under such terms and conditions as each national authority deems appropriate. Also, Australian broker-dealers are able to do business with a broader range of entities than other foreign dealers.

Comment: Discussions on a similar arrangement between the US and Canadian authorities were to begin in mid-June 2008. See Schedule Announced for Completion of U.S.–Canadian Mutual Recognition Process Agreement, Release 2008-98, May 29, 2008, available at <http://www.sec.gov/news/press/2008/2008-98.htm>

C. Rule 15a-6: Current Regulations and Proposals

1. Current Rule 15a-6 (17 CFR 240.15a-6) (available at <http://www.sec.gov/divisions/marketreg/rule15a-6.htm>):
 - a) Exemption is granted if a foreign broker-dealer
 - i. does not solicit transactions;
 - ii. provides research reports to major institutional investors (*i.e.*, institutional investors or registered investment advisers that have/manage total assets in excess of \$100 million; in contrast, an “institutional investor” is any registered investment company, bank and S&L) that do not recommend the use of this dealer;
 - iii. does not follow up on the research report or induce institutional investors to purchase/sell securities;
 - iv. enters into transactions discussed in the research reports only through a registered broker-dealer;
 - v. induces transactions with major institutional and institutional investors only through a registered broker-dealer;
 - vi. provides the SEC with any documents in possession that the SEC requests (the SEC may withdraw the exemption if foreign laws prohibit a foreign broker-dealer to provide such information);
 - vii. visits U.S. institutional investors within the U.S. only if “chaperoned” by an associated person of a registered broker-dealer who accepts responsibility for the communications; and subsequently effects any transactions through the

broker-dealer, who issues a confirmation to the U.S. institutional investor and is responsible for the extension of any credit to the investor, maintaining books and records and safeguarding funds. The registered broker-dealer should have obtained from the foreign broker-dealer information under Rule 17a-3(a) (which requires a broker-dealer to make records relating to associated persons, including information about the associated person's employment and disciplinary history) (17 C.F.R. 240.17a-3) and a consent to service of process;

viii. is not subject to a statutory disqualification and has not made any false statements pursuant to Section 3;

ix. effects transactions with registered broker-dealers, Asian Development Bank, African Development Bank, IADB, IBRD, IMF, foreign persons present in the U.S., U.S. physical or legal personae resident outside the US.

- b) The reasons for the enactment of the Rule were to provide compliance guidelines to foreign broker-dealers and to facilitate access to foreign markets by US institutional investors. (Sec.Exch. Act Rel.No. 34-27017 [1988-1989 Transfer Binder] Fed.Sec.L.Rep. (CCH) 84,428 (July 11, 1989), *available at* <http://www.sec.gov/rules/final/34-27017.pdf> . See Aaron C. Ball & Thomas R. Rus, *Rule 15a-6 and Beyond: Are U.S. Rules for Non-U.S. Broker-Dealers Workable in Today's Global Marketplace?*, 29 U. BALT. L. REV. 175 (2000), *available at* http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/ubl_r29&div=11&id=&page=).

2. References:

- a) SEC Release No. 58047, 93 S.E.C. Docket 1663, 2008 QL [Exemption of Certain Foreign Brokers or Dealers], *available at* <http://www.sec.gov/rules/proposed/2008/34-58047.pdf>.
- b) Thomas Lee Hazen, *Treatise on the Law of Securities Regulation*, 5 Law Sec. Reg. § 14.5 (6th ed. 2009)
- i. In addition to the overview of the Rule, the author notes that the SEC has not exercised the full limits of its authority to require registration of foreign broker-dealers (Sec. Exch. Act Rel. No. 34-27,018, 43 SEC Docket 2110 (1989).Sec. Exch. Act Rel. No. 34-27,017, 43 SEC Docket 2079 (1989)).

- ii. Similarly, the official position is that securities purchased in the US cannot be sold by an unregistered broker-dealer to US investors abroad (Cleary, Gottlieb, Steen & Hamilton, [1996–1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) 77,210 (SEC No Action Letter Jan. 30, 1996). *See generally* Sam S. Miller & Andrew Farber, Regulation of Foreign Broker–Dealers in the United States, 34 N.Y.L.SCH.L.REV. 395 (1989), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/nyls34&div=21&id=&page=>).
- iii. Purchases of mutual fund shares in the U.S. for sale abroad do not trigger the registration requirement so long as shares are sold to foreign nationals. Traditionally, sales of mutual fund shares to U.S. nationals abroad called for the registration. (Guidelines Concerning Applicability of Federal Securities Laws to Offer and Sale Outside the U.S. of Shares of Registered Open–End Investment Companies, Sec. Act Release No. 33–5068, Sec. Exch. Act Rel. No. 34–8907, Inv. Co. Act Rel. No. IC—6082, Release No. IS–75, 1970 WL 5618, [1969–1970 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 77,828 (SEC June 23, 1970).). The position was overruled by the 1989 Rule (Applicability of the Federal Securities Laws to the Offer and Sale Outside the United States, Exchange Act Release No. 34–8907, [1969–1970 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 77,828 (June 23, 1970) (Registration required of foreign seller to U.S. national “no matter where” located.)).
- c) Harold S. Bloomenthal & Samuel Wolff, *International Capital Markets and Securities Regulation*, 10B Int’l Cap. Markets & Sec. Reg. §§ 34:3; 34:46; 34:48; 34:49; 34:50.
 - i. Regulation S follows a territorial approach and redefines the term “U.S. person” in a way that the registration provisions of the SEA are not applicable to U.S. citizens residing abroad or foreign affiliates of institutional investors, even if created for the purposes of buying foreign securities outside the U.S.
 - ii. Under Rule 15a-6, exempted broker-dealers do not have to comply with substantive provisions of the SEA.

- iii. The SEC's position is that extraterritorial application of Section 15(a) is determined by the Statute, judicial construction, the Release, the Rule and no-action letters that were not specifically withdrawn ("Registration Requirements for Foreign Broker-Dealers," Exch. Act Release No. 27017 (July 11, 1989), Fed. Sec. L. Rep. (CCH) ¶84,428, at 80,241. An example of such a withdrawal is set forth in footnote 43 of the Adopting Release. *Id.* at 80,237 n.43.).
 - iv. The terms "solicitation" and "solicited" transaction are not defined in the Rule, but in the Adopting Release (solicitation is any affirmative effort inducing transactional business). The Commission's position is that in such a case an investor contacts an exempted broker, whose exemption is unaffected by the proposed transaction. ("Registration Requirements for Foreign Broker-Dealers," Exch. Act Release No. 27017 (July 11, 1989), Fed. Sec. L. Rep. (CCH) ¶84,428, at 80,238.).
 - v. Distribution of foreign broker-dealers' quotations by foreign exchanges or private vendors is generally permitted. What constitutes "solicitation" is subject to interpretation.
 - vi. Distribution of research may qualify as "solicitation" ("Registration Requirements for Foreign Broker-Dealers," Exch. Act Release No. 27017 (July 11, 1989), Fed. Sec. L. Rep. (CCH) ¶84,428, at 80,244.). The SEC exempts some research reports distributed to major institutional investors and by registered broker-dealers, with the exception of soft dollar arrangements. ("Registration Requirements for Foreign Broker-Dealers," Exch. Act Release No. 27017 (July 11, 1989), Fed. Sec. L. Rep. (CCH) ¶84,428, at 80,246–80,247).
 - vii. The Rule imposes substantial obligations on registered broker-dealers. Yet it does not determine some issues, including, *e.g.*, how they are to make a determination that a foreign associated person is not subject to substantially equivalent foreign disqualification.
- d) Robert J. Haft & Peter M. Fass, *Investment Limited Partnerships and Other Pass-Through Vehicles* CB SEC4 App. B2 (1994):

- i. Limited activities directed at one prospective investor may be deemed solicitation for the purposes of the Rule, although they do not constitute directed selling efforts.
 - ii. Quotations by third-party systems-exchanges are not considered directed selling efforts if transactions are not executed through the systems and there are no solicitation efforts on the part of brokers. By contrast, using, *e.g.*, private quotation systems and other direct dissemination of quotations to U.S. residents is an offer and a directed selling effort.
- e) §§ 9:01-9.04 *E-Commerce Financial Products and Services* (Andrew J. Morris & Brian Smith eds., 2001) (the book is partially available at http://books.google.com/books?hl=en&lr=&id=r_sRvQGfD4C&oi=fnd&pg=PR7&dq=%22E-Commerce+Financial+Products+and+Services+%22&ots=JDmlHrZXwd&sig=Q_0H77f0GGnzS0yetzCwDWMqBS0#v=onepage&q&f=false).
 - i. Publication of research on a web-page of an unregistered foreign broker dealer in the US also violates the Rule, unless it is published through a registered broker-dealer who adopts the research as its own.
 - ii. IOSCO has established an Internet Task Force, including regulatory jurisdictions of the US, the US and Germany. IOSCO also proposed a set of rules on broker-dealers' use of the Web.
 - iii. The use of web-sites by foreign broker-dealers is not prohibited so long as there are no solicited transactions.
- f) Robert J. Half & Michele H. Hudson, *Analysis of Key SEC No-Action Letters* §§ 9:13; 9:15 (2009).
 - i. The SEC applies the “territorial approach” to registration (*e.g.*, an entity located in the US and directing its activity toward foreign investors outside the U.S. is not exempt from registration) and the “entity approach” to registered broker-dealers (any foreign broker-dealer operating a branch in the U.S. is subject to the U.S. registration and regulatory requirements as an entity, although the parent firm is not required to register).
 - ii. Over the years, the no-action relieves were granted regarding engaging in various securities activities under the Rule.

iii. Discussing an Order exempting foreign securities subsidiaries of Citicorp, Citibank, from registration under section 15(a) as consistent with the 1989 Rule (Citicorp, Aug. 1986, 1986 WL 67172). In a nutshell, Citibank acquired a registered broker-dealer, Vickers, which engaged in riskless principal market making trading in foreign securities. Under the arrangement, Vickers did not receive a market maker spread, but was compensated as an agent for its clients, foreign securities dealers and institutional clients.

3. SEC, June 2008 Proposals: Release No. 34-58047, 93 S.E.C. Docket 1663, 2008 WL 2566725 (Jun 27, 2008), *available at* <http://www.sec.gov/rules/proposed/2008/34-58047.pdf>.

- a) The new exemptions would apply to both the registration and reporting requirements under the SEA, with the exception of antifraud rules.
- b) The Proposals extend the ability of foreign broker-dealers to provide research and execute transactions with U.S. investors. Also, the prohibition of “solicitation” is modified. Namely, direct “visits” and other communications with qualified investors by foreign broker-dealers are permitted. In addition, distribution of foreign broker-dealers’ quotations by third-party systems or the dealers are not viewed as “solicitation” if the systems do not allow securities transactions between U.S. residents and the foreign dealers.
- c) Under certain circumstances, foreign broker-dealers will be allowed to maintain custody of investors’ funds and assets, while registered broker-dealers will not be responsible for arranging extension of credit, issuing confirmations, complying with the net capital rule, delivering funds, maintaining accounts for customers, and complying with the related SEC customer protection rules. Although a registered broker-dealer is required to maintain copies of all books and records, including a confirmation and statements issued by foreign parties to investors, it may be done in the form required by a foreign securities regulator.
- d) The categories “major institutional investor” and “institutional investor” are replaced with “qualified investors”, including registered investment companies, issuers whose securities are held by qualified purchasers, banks and S&Ls, employee benefit plans,

- financial contracts companies, foreign banks, bank trusts, legal and physical personae with at least \$25 million in investments.
- e) Broker-dealers, which meet the foreign business test [namely, at least 85% of the aggregate value of securities must be foreign] may provide full-service brokerage services;
 - f) The chaperoning requirement is cancelled.
 - g) Transactions with U.S. resident fiduciaries for the accounts of foreign resident clients (entities not organized under U.S. law, non-resident natural persons, entities organized under US law with at least 85% of voting shares owned by non-residents) are exempted.
 - h) Foreign options exchanges may provide information to qualified investors without registration with the SEC. Non-U.S. clearing agency regulations will be inapplicable to foreign clearing organizations for foreign options exchanges.
 - i) OTC options processing service may be used by foreign broker-dealers to transact in foreign listed options for qualified investors.
 - j) A foreign broker-dealer must maintain information on professional qualifications of its associated persons.

4. Additional Related References:

- a) George H. White III, *Expansion of Exemptions from Registration for Non-U.S. Broker-Dealers*, 1712 PLI/CORP 81 (2009). The review describes the Proposing Release, the history of the original 1989 Rule, the introduction of the territorial approach to broker-dealer registration, the details of the proposed Rule, the applicability of U.S. securities law, and other issues. In addition to his analysis of the substantive amendments to the Rule, the author mentions the following open-ended questions:
 - i. The category “qualified investors” is general and includes investors with sophistication in investing in foreign markets, although it could exclude persons covered by the current definition of a US institutional investor. For example, a trust with \$5 million in assets and directed by a sophisticated natural or legal person is an institutional investor, “while a trust whose investments are directed by a sophisticated person is a qualified investor without reference to a minimum asset threshold, but only if its purchases of securities are directed by specified

institutions” (*id.* at 87). The SEC sought comments on the definition and categories of qualified investors.

- ii. The use of Exemptions (A)(1) (under which a foreign broker-dealer can maintain the custody of funds and records of investors and is subject to the foreign business test) and (A)(2) (where a registered US broker-dealers should maintain custody of investor’s funds and records) is complicated, particularly with respect to the calculation on a rolling two-year basis of the amount of foreign business by a dealer.
 - iii. The language of the exemptions is not clear as to the cases where intermediation by a US registered broker-dealer is required. U.S. securities laws would apply to almost all transactions in U.S. securities with the exception of certain OTC transactions not executed through a U.S. registered broker-dealer.
 - iv. The limited exemption of non-U.S. options exchanges would allow them to communicate with qualified investors, including the matters regarding non-U.S. securities options, OTC options processing services (*i.e.*, a mechanism for submission of an option to a foreign options exchange for replacement with an option contract listed on the foreign exchange). Foreign clearing organizations will be exempted from the registration requirements and if the foreign options exchange does not have a “public offering” and falls under the Section 4(2) exception from registration, its communications could be limited to QIBs only.
- b) *U.S. Regulation of the International Securities and Derivatives Markets* §10.03(3) (Edward Greene et al. eds., 9th ed. 2005):
- i. The Treatise describes in detail the current Rule, its history, application, related no-action letters, the correlation with Reg S (*e.g.*, US advisers acting on behalf of foreign persons are exempted under Reg S, but not under Rule 15a-6, although there are related no-action letters granting exemption to transactions effected by fiduciaries for offshore clients), the understanding of major institutions and institutional clients, the interposition of U.S. registered broker-dealers in, *e.g.*, providing research reports to other U.S. investors, the chaperoning requirement and the concept “qualifying broker-dealer”, government securities activities (*see* Treas. Reg. § 401.9, similar to Rule 15a-6), the liability issues, *etc.*

- ii. The 1997 Cleary Letter substantially expanded the scope of the Rule by extending the types of investors and limiting the chaperoning requirement. However, registered and foreign broker-dealers continued requesting to relax the Rule.
 - iii. The authors mentioned, among the currently granted exemptions, the establishment of the NASDAQ International Service and the pertinent permission granted to non-registered UK broker-dealers affiliated with registered broker-dealers to execute transactions for their U.S. affiliates.
 - iv. The authors find that the Rule was increasingly relied upon in recent years, despite its limited scope, discrepancies between the Rule and Rule 144A and the use of registered affiliates in the US instead of the exemptions
 - v. The authors mention that the 1994 NAFTA Agreement may potentially challenge the SEC requirements imposed solely on non-resident broker-dealers, although the challenges may be defeated under the “prudential carve-out” provision and reservations to Chapter 14.
 - vi. The 1990s and the beginning of the century were characterized by various MOUs with other securities regulatory authorities, such as the MOUs on enforcement with the FSA, Japan and Switzerland, and the 2003 IOSCO Multilateral MOU Concerning Consultation and Cooperation and the Exchange of Information.
 - vii. In 1997, the SEC issued a concept release requesting public comments on the rules regarding foreign broker-dealers who provide US persons the means to trade directly on foreign markets. The SEC was deliberating on the regulations specifically tailored to the access provider activities of such broker-dealers.
 - viii. In 1999, the SEC granted exemptive relief to Tradepoint Financial Networks, a UK investment exchange, and permitted it to place trading terminals in the US.
 - ix. Importantly, there were early attempts by the SEC to introduce a quasi-mutual recognition exemptive regime. Namely, the 1989 Concept Release proposed granting exemptions to broker-dealers from limited jurisdictions with comparable regulations and if there was an MOU between the SEC and a foreign regulatory authority. Public comments were generally negative.
- c) Steven Gatti, *Cross-Border Trading Reform Loses Momentum*, US Regulatory & White Collar Update, Clifford Chance, Feb. 25 2009 (a copy is available at <http://www.lexology.com/library/detail.aspx?g=3ed56b42-e49a-4d77-83bc-0702dd34e770>).

- i. The Comment described the Australia MOU and the Proposing Release regarding Rule 15a-6.
 - ii. In their analysis, the authors mention that the mutual recognition regime is currently limited to bilateral agreements, such as the Australian one, while extension of Rule 15a-6 would be applicable to a wider range of foreign entities.
 - iii. Potentially, the new Rule will entail restructuring of the existing inter-affiliate relationships and reducing the costs of servicing U.S. clients. Also, the new amendments left open such questions as financial liability, net capital and others.
- d) Mark Holland & Polly Snyder, *Foreign-Cubed Securities Class Actions: The Second Circuit Leaves the Door Open, but with a High Threshold*, US Regulatory & White Collar Update, Clifford Chance, Feb. 2009 (discussing that securities laws do not specify their extraterritorial reach, which is defined by courts through the conduct test and the effects test; and assessing the recent developments in this area).
- e) Margaret R. Blake & Nicole M. Crum, *Mutual Recognition of Broker-Dealers—The Great Unknown*, INSIGHTS: THE CORP. & SEC. LAW ADVISOR (Oct. 2007).
- i. The article mentions, *inter alia*, the principal differences in the reforms proposed by Eric Sirri (amending the Rule to allow sales to qualified institutional buyers only, see Speech by SEC Staff: A Global View: Examining Cross-Border Financial Services by Erik R. Sirri, Whistler, BC, Canada, August 18, 2007, available at <http://www.sec.gov/news/speech/2007/spch081807ers.htm>) and Ethiopis Tafara (permitting sales of foreign securities by foreign broker-dealers to both institutional and retail investors).
 - ii. The SEC held a roundtable on mutual recognition in June 2007. Participants mostly agreed that better enforcement regimes are needed in foreign jurisdictions.
- f) SIFMA, *Summary of Securities Exchange Act Rule 15a-6 and Mutual Recognition*, 2008, available at <http://www.sifma.org/legislative/international/pdf/15a-6-mutual-recognition.pdf> .
- i. Mutual Recognition is a long-term process, while amendments to the Rule can be accomplished in the short-term.
 - ii. The Rule grants an exemption that is similar to, *e.g.*, the UK Rule (under which foreign broker-dealers are exempted from the local licensing requirements if they

provide services to sophisticated investors, to unsolicited investors and through a UK-licensed firm).

- iii. In a nutshell, SIFMA suggests decreasing the threshold for eligible major institutional investors, and cancelling the chaperoning and intermediation requirements (*i.e.*, allowing foreign broker dealers effect transactions while U.S. broker-dealers could assume responsibility for performance of regulatory requirements)
- g) EU-US Coalition Response to SEC Proposed Amendments to Rule 15a-6 (File No. S7-16-08), Sep 11, 2008, *available at* <http://www.sec.gov/comments/s7-16-08/s71608-39.pdf>
- i. The Coalition welcomes all proposed changes, including, in particular, the introduction of the definition of a “qualified investor”, which should include physical persons as well as institutions, codification of all no-action letters on fiduciary regulations and cancellation of the chaperoning requirement.
 - ii. The Coalition also indicated potential problems regarding unitary regulations of the “universal” banking system in Europe, the need to modify the proposed “foreign business” test, which is not applied to U.S. broker-dealers in Europe, and the problem with the application of the definition “foreign security” to derivatives.
- h) Christopher Cox, *Statement at Open Meeting on Amendments to Rule 15a-6*, U.S. Securities and Exchange Commission, Washington, D.C., June 25, 2008, *available at* http://www.sec.gov/news/speech/2008/spch062508cc_foreign.htm .
- i. Currently, any person who induces or attempts to induce the purchase or sale of a security using the mails or other means of interstate commerce should register with the SEC as a broker-dealer.
 - ii. The original Rule 15a-6 of the 1980s was enacted in response to the increased interest in foreign investments. Today, the demand is over \$7.5 trillion and more than 2/3 of American investors own foreign securities. Although the no-action letters and the Rule acted as “a key safety valve” for years, the regulations are cumbersome.
 - iii. The new proposals include raising the threshold for interactions with institutional investors to at least \$25 million in assets/investments (currently, the threshold is \$100 million) and *natural persons*; cancellation of the chaperoning requirement;

maintaining the custody of funds directly by foreign broker-dealers; providing direct research services; accommodation of institutional trading such as basket trades by allowing foreign dealers offer US securities to US investors.

- i) Nicolas Grabar, *The SEC's International Agenda in the Cox Years*, 1743 PLI/Corp 507 (2009)
 - i. 2007-2008 brought about the following changes:
 - a. Foreign private issuer deregistration (namely, Rule 12h-6 and amendments to Rule 12g3-2(b) changing registration and the market for sponsored and unsponsored ADRs and what information a broker-dealer must have before providing quotations);
 - b. Amendments to Form 20-F accepting IFRS statements without reconciliation;
 - c. Changes to the rules on cross-border M&A purported to encourage inclusion of U.S. investors in cross-border business combinations and minimize regulatory conflicts.
 - ii. In 2008, the following initiatives were proposed and remained unfinished:
 - a. Amendments to Rule 15a-6, which were generally supported by public comments. Also, FINRA, *e.g.*, argued that the SEC should narrow the class of investors and limit intermediation to foreign securities.
 - b. The mutual recognition reforms. The 2006-2007 idea that the U.S. markets were not competitive prompted the discussion on mutual recognition. Australia was the only bilateral mutual recognition arrangement in 2008. The regime, if adopted, would change accounting principles, registration of offers and sales of securities, reporting and M&A rules.
 - c. The IFRS proposals on adopting IFRS for U.S. issuers.
 - d. Foreign private issuers deregistration amendments, including termination of reporting obligations, deregistration based on low levels of U.S. trading volume for shares.
- j) SEC Announces Next Steps for Implementation of Mutual Recognition Concept, Release 2008-49, Washington, D.C., March 24, 2008, *available at* <http://www.sec.gov/news/press/2008/2008-49.htm> (the proposals included developing a

formal framework for mutual recognition negotiations, exploring initial agreements with selected counterparts, developing mutual recognition discussions, and reforming of Rule 15a-6).

III. Academic and Professional Articles

1. James D. Cox & Edward F. Greene, *Financial Regulation in a Global Market Place: Report of the Duke Global Capital Markets Roundtable*, 18 DUKE J. COMP. & INT'L L. 239 (2007), available *at* <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/djcil18&div=9&id=&page=> .

Due to improvements in foreign markets, foreign issuers have alternatives to U.S. capital markets, which face more competition. Weaknesses of the U.S. regulatory system and the multiplicity of regulators place national financial markets at a disadvantage, which concerns, *inter alia*, converging complex financial products, transfers of some products offshore and thereby depriving the U.S. investors of the diversification benefits of holding global portfolios. The future regulatory system must make markets more efficient, maintain high standards of investor protection, be more sensitive to the differences in risks faced by institutional and retail investors, *etc.* Further, the report emphasized:

- the importance of converging financial products and the need for modifications of the statutory mandate of the SEC;
- the differences between the U.S. and London markets, such as the focus on retail investors in the U.S. regulatory system, the opposite regulatory trend towards an institutional or wholesale market in London. Among the features that make the U.S. regulations and markets less attractive vis-a-vis London are “a robust securities class action regime, a burdensome auditor attest function called for by section 404 of Sarbanes Oxley, weaker shareholder governance rights than exist in the United Kingdom, limited work visa availability, burdensome anti-money laundering requirements, multiple regulators as contrasted with the single administrator in the United Kingdom, and a regulatory posture that is more enforcement oriented than that of the British FSA.”

The report argued for prudential rule-based regulations as opposed to principles-based regulations. With respect to the dangers of private litigation, the report suggested that it appeared

attractive to develop “meaningful safe harbors for various groups, such as underwriters or outside directors with respect to their due diligence exposure in public offerings, or provid[e] other protections via the SEC's exemptive and rulemaking authority in other provisions of the securities laws.”

The report discussed problems related to mutual recognition and the persistence of separate enforcement regimes. Outside the enforcement area, “there is de facto informal mutual recognition in the case of the easy access of U.S.-based institutional investors to foreign 144A offerings. The question for the U.S. regulators is whether the freedom enjoyed by institutional investors should be extended to retail investors.” “Also, there is cause to believe that the degree and content of mutual recognition should vary with the actor, so that the contours of mutual recognition for issuers will not be the same as for the regulation of brokers or investment advisors. Similarly, the characteristics of classes of investors will be an important factor in decisions to engage in mutual recognition.” In addition, important variables emphasized by the Forum participants were the durability of new regulations in light of the developing electronic markets and the demand for predictability of regulatory actions and rules. Finally, the report reviewed changes in the attitude of the SEC towards the IFRS and GAAP, and the need for independence of the U.S. auditors and the Big Four.

2. Andreas M. Fleckner, *Stock Exchanges at the Crossroads*, 74 *FORDHAM L. REV.* 2541 (2006), *available* *at* <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/flr74&div=85&id=&page=> .

Comment: Many authors connect demutualization of stock exchanges with the recent wave of mergers. This article focuses on demutualization and competitive advantages of consolidated stock exchanges.

Deregulation, technological advances and globalization have caused increased competition and organizational modifications of stock exchanges, including their demutualization [the author makes references to U.S. Gen. Accounting Office, *Securities Markets: Competition and Multiple Regulators Heighten Concerns About Self-Regulation* (2002); Int'l Org. of Sec. Comm'ns, *Issues Paper on Exchange Demutualization* (2001); Int'l Org. of Sec. Comm'ns, *Discussion Paper on Stock Exchange Demutualization* (2000)].

Stock exchanges perform several functions, including acting as market organizers by providing a marketplace for trading in securities; information distributors facilitating the price

discovery processes; market regulators; setters of corporate governance standards, such as the NYSE Listed Company Manual “aiming not at bettering the quality of trading but at increasing the quality of the traded products”; and business enterprises. The author reviews the age of pure self-regulation, the creation of the SEC (that did not change the self-regulatory system as such), Reg NMS, and more recent developments, such as the international demutualization, some failed attempts to demutualize in the United States and the current tendencies.

The previous failures to demutualize could be attributed to the SEC’s attitude toward the traditional membership structure and the limitation of exchange participation to registered broker-dealers [Regulation of Exchanges, Exchange Act Release No. 34-38672, International Series Release No. IS-1085, 62 Fed. Reg. 30,485, 30,487 (June 4, 1997)], and, in part, to the judicial doctrines [Silver v. N.Y. Stock Exch., 373 U.S. 341, 350 (1963) (“The exchanges are by their nature bodies with a limited number of members, each of which plays a certain role in the carrying out of an exchange's activities.”; Bd. of Trade v. SEC, 923 F.2d 1270, 1272 (7th Cir. 1991) (stating that “the statute requires that an exchange be controlled by its participants, who must in turn be registered brokers or individuals associated with such brokers”)]. This position changed in 1998 (Regulation of Exchanges and Alternative Trading Systems, Exchange Act Release No. 34-40760, 63 Fed. Reg. 70,844, 70,848 (Dec. 22, 1998)). The first demutualizations in the U.S. took place in 1999, while mergers occurred in the 21st century.

The author compared organizational structures of foreign and domestic stock exchanges and their market value (as of February 17, 2005), concluding that even after mergers, the U.S. stock exchanges had lower market value than European exchanges.

The reason for both demutualizations and mergers was competition spurred by deregulation, technological advances and globalization. Among those three variables, communication and information technologies were the primary driving forces behind the changes. Correspondingly, through mergers, old stock exchanges like the NYSE attempted to create a hybrid market and tap into the electronic trading technologies. [“Declining trading fees allow more frequent trades; more trades lead to huge economies of scale (once you have built your trading system, it requires few if any additional funds to handle more orders), which in turn lead to further fee cuts and once again to more trades.”]

At the same time, due to communication technologies, foreign marketplaces attract investors from the U.S. [for an overview, see S. Eric Wang, *Investing Abroad: Regulation S and U.S. Retail Investment in Foreign Securities*, 10 U. MIAMI BUS. L. REV. 329 (2002), available at

<http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/umblr10&div=16&id=&page=>, and Howell E. Jackson, Mark Gurevich & Andreas M. Fleckner, *The Controversy over the Placement of Remote Trading Screens from Foreign Exchanges in the U.S.* (Nov. 2005)]. The author reviews related statistical data. In 2006, 452 foreign issuers were listed on the NYSE, down from a peak of 473 in 2002. The European offerings dropped since 2001, the number of Latin American issuers listed on the NYSE also decreased. Explanations could be the Sarbanes-Oxley Act and the fact that issuers need not be listed in the United States for reaching U.S. investors. As a result, exchanges are forced to move into new areas, including trading other products such as derivatives, bonds, and exchange-traded funds.

Demutualization brought about several competitive advantages, such as capital raising opportunities, different decision-making rules and new avenues for consolidation. A stock exchange is a best example of economies of scale, since once an exchange has been established, there are almost no further costs, “regardless of the number of transactions performed at the exchange.” Merges diminish fixed expenses related to updating trading systems and corporate governance rules. Many exchanges saw consolidation and demutualization as interconnected [*Comment: the author refers to a number of speeches by representatives of exchanges, who unfortunately did not explain in detail the benefits of mergers*].

3. Amir N. Licht, *Stock Exchange Mobility, Unilateral Recognition, and the Privatization of Securities Regulation*, 41 VA. J. INT’L L. 583 (2001), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/vajint41&div=28&id=&page=> .

Competition has reached the levels when even the largest stock exchanges are exposed to threats to their existence and have to transform into international demutualized entities. Foreign listings and cross border trading *via* chains of broker-dealers or ADRs and GDRs ceased to be the main international vehicles due to alliances and mergers of stock markets. The trend was first characteristic to the European market and, lately, to the U.S. (*based on the statistics referred to by other articles*). Correspondingly, consolidated exchanges acquire substantial bargaining power *vis-à-vis* national securities regulators who lag behind modern technological and financial developments.

European Directives establish a mutual recognition regime facilitating exchange integration. Although the author emphasizes that several integration initiatives of European exchanges failed in the past, most mergers of the 1990s were successful. A concomitant trend

was demutualization, including the NYSE and the LSE. Furthermore, “[a]ccording to the International Federation of Stock Exchanges (FIBV), in late 1999, demutualization was under consideration by forty-four of FIBV's fifty-two members--with several also considering public stock offering.” This phenomenon has exposed exchanges to hostile takeover bids, particularly within the EU (such as the OM Gruppen bid for the LSE, which prevented the vote of the LSE shareholders on the merger with Deutsche Boerse). The author gives examples of multiple mergers and alliances of exchanges. Similar to several speakers at the Conference, the author mentions such contentious issues in the regulatory integration as the transparency of trading, antifraud rule, insider trading and other factors affecting price formation and discovery, which are subject to diverse regulatory regimes.

An example of the European regulatory integration was the iX project, a pan-European market for blue chip stocks and high-growth market. The LSE and Deutsche Boerse divided the regulatory issues: “trading on the blue chip market would have been subject to UK regulation, supervised by the LSE from London, and trading on the high-growth market would have been subject to German regulation, supervised by the Frankfurt Stock Exchange.” [iX-international Exchanges Plc, Information Document in Respect of the Merger of London Stock Exchange and Deutsche Boerse Newco 4 (2000). This regulatory project was harshly criticized and iX was called off. *Comment: Today, however, the integration proceeds and a similar approach is pursued by the MIFiD.*].

The author noted that outside of the EU, the mutual recognition regime is less feasible. For instance, self-regulatory principles may differ among stock exchanges, including additional disclosure, governance requirements, and trading. The author also proposed to make dual listings less cumbersome as compared to public offerings. As examples, the author considered relatively similar disclosure and liability principles of the NYSE and the LSE; and the Multi-Jurisdictional Disclosure System between the SEC and Canadian authorities.

Also, the author considers differences between public and private law. In particular, despite the public nature of securities law, issuers may opt in a certain regime by choosing a listing jurisdiction. The global equity market is in contrast to the national territorial application of securities law.

Stock exchanges are the agents of change and primary lobbying institutions (an example is the NYSE's attempts to reduce disclosure duties imposed on foreign issuers). The current mobility of stock exchanges, acting as wholesale agents, and opportunities for regulatory

arbitrage add new variables and pressure on regulators. If in the past, protection of investors was a primary regulatory purpose, today, it is promotion of economic interests of the financial sector. Also, competition may prompt exchanges into developing their own corporate governance regimes that are disconnected from national laws.

Denationalization correlates with demutualization of stock exchanges [*Comment: some authors claim that there is a direct causation, see the next article*]. Defining nationality of a company depends on incorporation in common law countries, while in civil law jurisdictions it is predicated upon the real seat or a combination of factors, such as domicile of shareholders, business operations, *etc.* When physical trading floors have disappeared and clearance is outsourced, exchanges function as market frameworks engaged in price discovery and should be protected by disclosure, anti-manipulation and antifraud rules. How can then securities regulators assert jurisdiction over such markets? The author mentions such variables as the location of the trading systems, the nationality of listed issuers, the domicile of broker-dealers and end-investors. Also, the author sees increased regulatory cooperation as a placebo, not a real remedy, while creation of a global regulator is not feasible.

4. Eric J. Pan, *Single Stock Futures and Cross-Border Access for U.S. Investors*, 14 STAN. J.L. BUS. & FIN. 221 (2008), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/stabf14&div=9&id=&page=> .

The mutual recognition regime is seen by many commentators and the SEC itself as a long-term project. Hence, some financial products are offered as immediate alternatives to the extended mutual recognition. Single stock futures (SSFs) are an example. Also, the author analyzes various reasons for stock exchange mergers.

The author argues that through SSFs investors gain exposure to a potentially unlimited number of foreign securities on a single U.S. exchange, handled by U.S. brokers, through contracts governed by U.S. law, and where clearance and settlement occur in the U.S. SSFs are successfully used elsewhere. The current regulatory regime places U.S. investors at a competitive disadvantage. Correspondingly, the SEC should reconsider its opposition to SSF, particularly in light of the complexity of the substituted compliance system [*Comment: the author discussed the Tafara-Peterson proposal among others*] and the mutual recognition regime [*although there are undergoing projects on MOUs with Canada, the EU and Australia*].

SSFs represent a simpler regulatory option. Their utility involves allowing U.S. investors speculate on the value of shares of foreign companies, trading on U.S. regulated futures exchanges, through US-regulated brokers, where transactions are cleared and settled in the U.S. Yet the SEC continuously restricts the types of securities offered through SSFs, imposes unfavorable margin requirements (similar to options), transaction fees and taxes, overall preventing SSFs markets to build up trading volume.

Although investors are increasingly mobile, chiefly due to advances in technology, issuers are restricted by Rule 114A and Regulation S, and cannot reach U.S. retail investors. Despite regulatory problems, trading activity in foreign securities grew steadily over the past 10 years, while ownership of ADRs dropped.

Today, the consolidation of exchanges puts pressure on the SEC to lessen restrictions on foreign broker-dealers and exchanges. Mutual recognition efforts are inhibited by the problems with determining whether foreign regulations are “substantively comparable” and foreign regulators have “substantively similar” enforcement and regulatory powers. The recent U.S.-Australia Mutual Recognition Arrangements does not offer comprehensive information on the comparability assessment made by the national regulators.

SSFs represent a simpler option to grant the U.S. investors access to global markets. Many foreign markets, such as Euroenext.Liffe (“universal stock futures”), Eurex and others have embraced SSFs in the past several years. By contrast to the 2000 CFMA, the EU III Directives made derivative instruments trade easier within the EU.

In the U.S., a number of factors, including the current option listing requirements, regulations prohibiting SSFs that are based on securities not registered under Section 12 (including foreign securities), the fact that the SEC does not usually use its power to grant exemptions to foreign securities, regulation of margin requirements, the dual regulation of securities futures products and others, hamper the use of SSFs.

The author believes that demutualization *resulted* in consolidation of stock exchanges, investments in ETNs and cross-ownership of securities and derivative exchanges within the global financial markets. The mutual recognition is designed to forestall this trend placing the new exchanges within the jurisdiction of the SEC. That would require regulatory convergence, harmonization of rules on broker-dealers, *etc.*

The author also analyzes why exchanges rushed to demutualize and merge with foreign counterparties in order to take advantage of the increased mobility of issuers and investors. Such

consolidation calls for granting foreign broker-dealers and exchanges greater direct access to U.S. investors.

The reasons for mergers of stock exchanges were capturing order flow, liquidity, faster and lower execution costs, united trading platforms and technology, as well as reduced overheads. However, the major benefits will be achieved only when investors *and* issuers are granted full access to combined exchange markets, which is not the case today (e.g., the NYSE and Euronext).

Comment: The SEC and European securities regulators repeatedly stated that the joint ownership of the US and European exchanges does not intermix regulatory standards (Press Release, Autorité des marchés financiers, SEC Chairman, Euronext Regulators Meet to Discuss Cooperation in the Event of the NYSE Euronext Combination (Sept. 27, 2006), available at http://www.amf-france.org/documents/general/7342_1.pdf ; Letter from the Chairman's Committee of the Euronext Regulators to Jean-François Théodore, Chairman and CEO of Euronext N.V. (Dec. 5, 2006), available at http://www.amf-france.org/documents/general/7509_1.pdf). *Instead, the exchanges Prospectus provides for the material adverse change of law triggering the mitigation mechanism based on the Delaware trust and a Dutch Fund.*

5. European Trends:

In the past several years, there was a productive discussion on the need to unite capital markets through integration of stock exchanges in Europe as part of the European Monetary Union Initiative. (Eddy Wymeersch, *The Harmonisation of Securities Regulation in Europe in the New Trading Environment* 1 (Fin. Law Inst., Universiteit Gent, Working Paper No. WP 2000-16, 2000), available at <http://www.law.ugent.be/fli/WP/WP2000-pdf/wp2000-16.pdf> ; and Emiliós Avgouleas, *A Critical Evaluation of the New EC Financial-Market Regulation: Peaks, Troughs, and the Road Ahead*, 18 TRANSNAT'L LAW 179, 224-29 (2005), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/tranl18&div=25&id=&page=> .

At the same time, the Treaty Establishing the European Community (Consolidated Versions of the Treaty on the European Union and the Treaty Establishing the European Community, Dec. 24, 2002, 2002 O.J. (C 325) 33, available at

http://europa.eu/abc/treaties/index_en.htm) did not grant the EU the powers to “unite” the securities market.

The Investment Services Directive and the current Markets in Financial Instruments Directive (Council Directive 2004/39, arts. 2-3, 2004 O.J. (L 145) 1 (EC), *available at* http://ec.europa.eu/internal_market/securities/isd/index_en.htm) both, to some extent, spoke of the integration through a legal framework encompassing “the full range of investor-oriented activities”.

The Lamfalussy Report was the most comprehensive political statement on the united capital markets. The Committee of Wise Men on the Regulation of European Securities Markets indentified that a problem of the EC law was that there was no approach to facilitating innovations in the EU securities markets and its unification. On the market side, the Euronext and other exchanges facilitated cooperation with securities regulators, the mutual recognition regime and harmonization of listing requirements (*see, e.g.,* European Commission, *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets* (Feb. 15, 2001), *available at* http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf)

Based on its Annual Reports and MOUs, Euronext links different member states and cooperates with securities regulators, an example of which is the College of Regulators, Rulebooks on listing, disclosure and reporting requirements, *etc.* (Euronext N.V., 2005 Registration Document and Annual Report 18-19 (2006), *available at* http://www.euronext.com/file/view/0,4245,1626_53424_824839144,00.pdf ; Memorandum of Understanding on Supervision, Regulation, and Oversight of the Euronext Group, Mar. 22, 2001, *available at* http://www.amf-france.org/documents/general/3622_1.pdf).

The Euronext College is not an EU institution, but an entity uniting national supervisors (for a good review of primary sources, *see* Bryan Thomas Shipp, *Filling Gaps in European Union Securities Law: Contractually Organized Supervision & College of Euronext Regulators*, 23 Am. U. Int'l L. Rev. 387 (2008)).

Euronext N.V., Prospectus of NYSE Euronext, Inc., 349-51 (Euronext, N.V., Nov. 27, 2006) at A-15, *available at* http://www.euronext.com/file/view/0,4245,1626_53424_979643772,00.pdf) defines the College of Euronext Regulators. Euronext must submit many decisions and actions for preliminary review by the Euronext College, which acts as a freestanding regulatory body.

For an analysis of London and European regulations and their interdependence and globalization, see *A Review of the Structure of the Listing Regime*, submitted by Nicolas Grabar, Cleary Gottlieb Steen & Hamilton LLP, 1669 PLI/CORP 105 (2008) (discussing how the UK has recently increased its share of the global IPO market, the primary and secondary listing standards, listing of GDRs, etc.).

There are also several case studies regarding European exchanges (e.g., James Faulconbridge *et al.*, *Analysing The Changing Landscape of European Financial Centres: The Role of Financial Products and the Case of Amsterdam*, GROWTH AND CHANGE, Vol. 38, Issue No. 2 (2007), 279-303, mentioning that there were no systematic attempts to analyze mergers within Europe and discussing factors affecting competitiveness of financial centers).

See also Nis Jul Clausen & Karsten Engsig Sorensen, *Stock exchange Mergers – The New Driver in the Harmonisation of Securities Market Regulation?* ECFR 2009, 29-70, available at <http://www.reference-global.com/doi/abs/10.1515/ECFR.2009.29> . The study is focused on the Euronext and OMX mergers and their rule harmonization efforts within integrated markets. The EU countries have comparable securities laws and some incorporated Level 3 of the Lamfalussy procedure. However, not all countries in Europe implement coordinated efforts or wish to support integrated exchanges. Also, the delegation of self-regulatory power to exchanges (like in the U.S. system) is improbable and complicated. SROs cannot ensure legally binding effect of their rules. In some cases, issuers and traders, as major stakeholders in stock exchanges, have a veto power with respect to harmonization efforts. See also Eddy Wymeersch, *The Harmonisation of Securities Regulation in Europe in the New Trading Environment*, Fin. Law Inst., Universiteit Gent, Working Paper No. WP 2000-16, 2000, available at <http://www.law.ugent.be/fli/wps/showwps.php?wpsid=19> Comment: The discussed below World Bank report also mentions the weakness of European SROs as compared to the US exchanges.

6. Wachtell Lipton made several practical comments related to placing limitations on cross-border application of the U.S. regulations. See *Global Capital Markets & the U.S. Securities Laws 2009: Strategies for the Changing Regulatory Environment*, submitted by David A. Katz, Wachtell, Lipton, Rosen & Katz, 1743 PLI/Corp 1277 (2009). The authors argued that concepts, such as “U.S. holders” of securities or “predominantly foreign” classification of securities are no longer clear and acceptable. Also, U.S. persons may be excluded from foreign transactions due to

the overreaching and intrusive nature of the U.S. regulation. Placing limitations on the applicability of the U.S. regulation to non-U.S. transactions will benefit both investors and fund managers. Among the proposed measures are the adoption of a relative trading volume test in place of a beneficial ownership test (“many U.S. investors and fund managers have opted to forego U.S. capital markets in whole or in part, investing directly in non-U.S. companies by trading on non-U.S. exchanges. Their trading on non-U.S. exchanges should not operate to divest non-U.S. companies from otherwise applicable exemptions.”); exemptive relief from 13D filing obligation, which should be expanded to include exemption from the filing requirements of Section 13(d) as the Tier I-style exemption from tender offer regulation; and elimination of “unconventional tender offer” analysis in cross-border transactions.

7. Eric Pan, *The New Internationalization of US Securities Regulation: Improving the Prospects for a Trans-Atlantic Marketplace*, 1669 PLI/CORP 365 (2008) (a version of the paper is available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1089491).

The willingness of the SEC to admit that some legal requirements are unnecessary in light of the growth of international capital markets and cooperation with foreign regulators is remarkable. Globalization produces a number of ramifications, among which is a shift of capital and investment activity away from the U.S. market. Also, many “foreign issuers are bypassing US regulation by structuring their offerings to take advantage of certain registration exemptions to sell only to US institutional investors, pursuant to Rule 144A, or to investors located outside of the United States, pursuant to Regulation S.” Financial services providers facilitate this outflow.

Another trend is the cross-border exchange consolidation. Its key purpose is to concentrate trading on a single platform. Yet, while “the NYSE and Euronext can enjoy the savings of reduced overhead and shared trading systems, the primary benefit of the merger will be achieved only when investors and issuers are granted full access to all markets operated by the combined entity.”

The current SEC’s reforms, such as the elimination of the GAAP reconciliation requirement and the availability of deregistration, will have limited implications; and there “remain several other aspects of the US regulatory system that will continue to deter foreign issuers including the tough liability regime, perception of overly aggressive state and federal enforcement, fear of private class action suits, the Foreign Corrupt Practices Act, and unique securities distribution requirements.”

In the future, the primary beneficiaries of the mutual recognition regime will be the EU, although it is premature to speak of a transatlantic market.

8. During the 2007 Conference on Cross Border Mergers of Stock Exchanges, Columbia Law School, panelists discussed, *inter alia*, potential administrative reforms. On the current regulatory proposals, *see, e.g.*, Jill E. Fisch, *Top Cop of Regulatory Flop? The SEC at 75*, 95 VA. L. REV. 785 (2009), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/valr95&div=26&id=&page=> (analyzing an article by Coffee and Sale who argued based on the analysis of the current market failures that the SEC is “ill-suited” to regulate the major investment banks; and concluding that although the future of the SEC financial regulation is unclear, it was the most effective enforcer and, with “modest improvements”, such as increased intermediary oversight and better market data analysis, it will remain the key regulator); Joel Seligman, *The SEC in a Time of Discontinuity*, 95 VA. L. REV. 667 (2009), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/valr95&div=23&id=&page=> (emphasizing a need for comprehensive capital market reforms, preservation of some regulatory fragmentation and stating that “electing to have a single crisis manager is quite different from choosing to have one agency alone address all aspects of financial regulation”); *Davis Polk – A New Foundation for Financial Regulation?*, submitted by Alan L. Beller, Cleary Gottlieb Steen & Hamilton LLP et al., 1773 PLI/CORP 317 (2009) (analyzing the Obama Administration's White Paper on Financial Regulatory Reform, including the Fed as a systemic risk regulator, SEC’s supervision programs, regulations of money market funds, insurance companies, GSEs, futures and securities markets, etc.)

9. Howell E. Jackson, *Toward a New Regulatory Paradigm for the Trans-Atlantic Financial Market and Beyond: Legal and Economic Perspectives*, 1743 PLI/CORP 1203 (2009).

The author discusses the problems of regulatory coordination, and the redundancy and counter-productiveness of local oversight. A short analysis of banking v. capital markets regulations reveals that in response to the Herstatt risk and the BCCI failure, the principles of the “qualified home country” oversight became a norm for cross-border banking. In contrast, recognition of this principle in capital market regulations is less well recognized. Instead, the SEC applies a modified national standard to foreign firms, although Rule 144A and Regulation S

lessened the national requirements with respect to structuring offerings outside the U.S. and sales to large institutional investors. Yet U.S. law is a formidable factor affecting listing decisions. The SOX is an example.

The national treatment approach is outdated since investors have become more mobile and the importance of the US capital markets has declined over the past two decades. Similarly, the quality and the role of the US financial market oversight declined and is substituted for regulations similar to the US, ISOCO and the EU. Political considerations, including the shifts in the positions of the now global NYSE and NASDAQ, puts additional pressure on the SEC, which has proposed the selective substituted compliance regime and mutual recognition, accepted the IFRS, and started reconsidering its opposition to the placement of remote trading screens by foreign exchanges. Europeans have traditionally deemed the SEC's stance on the matter as protectionist.

Proposed modifications of Rule 15a-6 further narrow the national treatment approach as applied to foreign firms. A problem is that it is done without consideration of the quality of supervision in foreign jurisdictions. Hence, it seems that the substituted compliance proposals and modifications of the Rule contradict each other.

Namely, there is concern that the Rule exposes qualifying retail investors to unregulated foreign broker-dealers through unregulated transactions and, thus, imposes the principle of caveat emptor. The Tafara's Proposal, instead, is focused on international diversification of securities offered to retail investors. Also, the Proposal will motivate pertinent amendments in foreign regulations affected by the framework. Thus, the Proposal envisions a better integrated global capital market. Among the limitations of the substituted compliance regime are the limits on the exportation of supervisory services, regional confederations, such as the EU, problems with private litigation, enforcement and political factors.

The article also analyzes regulatory intensity through budgets and staffing of foreign securities regulators, including such jurisdictions as Australia, the U.S., Germany and the UK. Additional enforcement mechanisms, such as BaFin in Germany, Financial Ombudsman Service and the Financial Reporting Council in the UK are also mentioned as auxiliary variables in assessing enforcement.

Finally, the article highlights that due to misdirection of regulatory resources, inadequate granularity of staff dedicated to enforcement activity and other factors, comparisons of enforcement activities are complicated. Similarly, the mechanisms of enforcement and related

litigation are often incomparable. Also, globalization is factored in national enforcement. For example, Canadian securities markets free-ride on U.S. regulations due to cross-listings on the U.S. stock exchanges. A closer look at the manipulation in stock prices, bid-ask spreads, price synchronicity and similarities in probative values of cross-listed companies is needed.

10. Henry Klehm III, *Current Issues in Broker-Dealer Regulation in the Post-Credit Crisis Environment*, 1701 PLI/CORP 801 (2008).

The author discussed the recent anti-crisis measures and proposals, including the temporary Primary Dealer Credit Facility introduced in the wake of the Bear Stearns crisis, the recommendations of the President's Working Group on Financial Markets, The Financial Stability Forum, Basel Guidance, *etc.* The articles gives an overview of the proposed changes to the regulation of credit rating agencies (Rules 17g-2 and 17g-5), of short sales (Regulation SHO), mutual recognition initiatives, and Rule 15a-6.

11. Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. 1025 (2009), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/valr95&div=32&id=&page=> .

The article discusses the effect of the combined trends of institutionalization and globalization of stock exchanges. Most markets for corporate securities in the U.S. are not retail. The SEC, therefore, has to change its approach to investor protection. The emergence of the British "light touch" model of securities industry regulation, the policies of the "antifraud only" and the expansion of research on consumer and investor behavior and behavioral economics are disorienting the SEC.

The other two trends are that foreign issuers can seek out U.S. investors without triggering some national regulations and that retails investors participate in global investments through institutions more than in the domestic market. The recent SEC proposals on mutual recognition are, on balance, positive, especially for institutional investors, although there are some caveats.

A major trend in the EU is that it is better suited to establishing a disclosure regime for issuers based on institutional ownership with much less enforcement actions and informal sources of suasion by regulators. The mutual recognition regime in the U.S. could question the comparability of this antifraud-only approach.

Hence, mutual recognition can increase the risks of retail investors, although it would bring more foreign stocks to U.S. investors' attention. The political results will benefit the financial

services industry in the major U.S. cities. The author suggests that disclosure regulation and enforcement should be based on the issuer's home place of business, not the locus where securities are traded. Overall, there is a trend for greater institutionalization, which calls for changes in the retail investor-driven regulation.

12. Roberta S. Karmel, *The EU Challenge to the SEC*, 31 FORDHAM INT'L L. J. 1692 (2008), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/frdint31&div=61&id=&page=> .

The article discusses the general US regulatory picture for domestic and foreign issuers and notes that the concept of mutual recognition was the European invention embedded into the Prospectus Directive and the Transparency Directive. The Directives sought to promote the "maximum harmonization" initiative and incorporation by reference of information already disclosed by an issuer, supported the IFRS and prescribed the contents of the annual financial reports.

The process of reconciliation of GAAP and IFRS was slow in the U.S. Until 2008, only the documents of Canadian issuers could be used as SEC disclosure filings and mutual recognition existed with respect to tender offers and rights offers. The article also discusses Tafara's proposals.

Among the major problems in the globalization efforts is granting foreign exchanges access to the U.S. markets. First, it is questionable how to fit them into Reg NMS. ECNs and ATSs, *e.g.*, are regulated within the NMS framework through Reg ATS. Secondly, non-registered securities will become tradable in the U.S. Therefore, the SEC could limit cross-border trading by foreign exchanges to transactions effected through US broker-dealers or ECNs or to transactions with sophisticated U.S. investors.

The author believes that the EU and the SEC have been mutually influencing each other over the past years. Ultimately, however, it is the investors and financial intermediaries, not authorities, who promote changes in the market. The merger of the NYSE-Euronext was a signal that further regulatory convergence is required. Finally, the threat from other emerging capital markets should incentivize the EU and the SEC to combine forces and strengthen securities regulations.

13. Edward F. Green, *Resolving Regulatory Conflicts Between the Capital Markets of the United States and Europe*, 1643 PLI/CORP 391 (2008) (a version of the paper is available at <http://intl-cmlj.oxfordjournals.org/cgi/content/extract/2/1/5>)

Transatlantic markets are close to a harmonized regulatory model of non-financial disclosure in securities offerings. The disclosure standards of the IOSCO were adopted by both the U.S. and the EU. Mutual recognition and regulatory convergence with respect to securities intermediaries and exchanges is more complicated. The MiFID is an example of a pan-European regulatory framework, which allows member states to implement more robust regulations of, e.g., broker-dealers, comparable to those of the SEC. MiFID addresses some concerns of the SEC, including those of Rule 15a-6, about granting direct access to European securities exchanges through trading screens and broker-dealers. The Market Abuse Directive (MAD) and the Stabilization Implementation Regulation restrict market manipulation and are comparable to the SEC's requirements, Regulation M and Section 9 of the SEA.

In 2005, the Corporation of London and industry associations published a report recommending further convergence in the area of securities intermediaries regulation. The transatlantic securities market can be improved through defining such terms as “customer” and “solicitation”, defining a common approach to investor protection and “know your customer” rules, and developing examination and registration requirements. In 2005, SROs in the U.S. (the NASD, NYSE and the U.S.'s Securities and Investment Institute) simplified registration and testing requirements for cross Atlantic professionals, based on a single qualification exam.

After the mergers of securities exchanges in the US and the EU, the respective regulators created a joint working group to address potential regulatory issues from cross-border mergers. Overall, due to increasing international market competition, the U.S. regulators have to be more proactive. Among the practical steps towards transatlantic regulatory harmonization can be resolution of the overlapping requirements of the MAD, the Stabilization Implementation Regulation and the US law; allowing companies like WKSIs to access cross-border markets using disclosure and prospectuses from home countries, and coordination of enforcement.

14. *Conferences:*

a. Robert A. Schwartz et al., *The New NASDAQ Marketplace* (2007), available at <http://www.springerlink.com/content/xqwh486043244471/> .

That roundtable discussed primarily national market mergers. Some practitioners thought that mergers in the national financial industry helped redefine and strengthen both the listed

marketplaces and OTC. Also, many mentioned that mergers enhanced liquidity and were beneficial for corporate issuers (*id.* at 16). Practitioners also mentioned that (a) the actual and potential results of a merger represent “the unknown” for a period of time and (b) that mergers have the liquidity enhancing potential (*id.* at 80). Many expressed concerns about the current fragmentation of the markets. Robert Schwarz mentioned that it could be overcome through consolidation, although not necessarily, as there might be other types of connectivity in the markets.

Comment: Cross-border mergers were not the primary subject of the discussion.

b. Robert A. Schwartz et al., *Competition in a Consolidating Environment* (2008) (the book is partially available at http://books.google.com/books?hl=en&lr=&id=S5S_2-370TwC&oi=fnd&pg=PR7&dq=%22Competition+in+a+Consolidating+Environment%22&ots=LyYHZGFiw&sig=H6P80x1KJo-od3S3ROAhD8O_dwU#v=onepage&q&f=false)

Practitioners-panelists could not precisely identify the exact benefits of mergers (*id.* at 4-5). Some mentioned such benefits as operational and cost synergies resulting from writing off one system and keeping another. Some saw synergies from multi-product listings, which became a global business (*id.* at 49). Also, others thought consolidation of data centers across the Atlantic was improbable in the short term, as opposed to inter-European consolidation (*id.* at 12). Another concern was the regulatory differences on the both sides of the Atlantic (*id.* at 11).

15. Importantly, excessive integration of securities/derivatives exchanges is perceived as suspicious. *See Deal Digest*, 26 Int'l Fin. L. Rev. 8 (2007). The DOJ did clear the merger of CBOT and CME, but later on expressed concerns about inhibition of competition in the financial exchange industry (the issue was also discussed by journalists, *see* Ben Steverman, *Exchange Mergers Hit Roadblocks*, *BusinessWeek*, Feb. 2008, available at http://www.businessweek.com/investor/content/feb2008/pi2008025_208000.htm).

16. Gerald Adolph et al., *Merge Ahead: Mastering the Five Enduring Trends of Artful M&A* (2009) (partially available at <http://books.google.com/books?hl=en&lr=&id=IVcfL6grkAYC&oi=fnd&pg=PA17&dq=Merge+Ahead:+Mastering+the+Five+Enduring+Trends+of+Artful+M%26A&ots=Z6NA8JmqL2&sig=IIYSwg8zGLw5yEnLzLwHXK3LH5k#v=onepage&q&f=false>).

Comment: It is a non-academic book written by practitioners. They note that the NYSE-Euronext merger, first and foremost, helped the conglomerate to develop the market reach (*id.* at 41) and that NYSE closed several trading rooms after the merger, which was, in part, also due to new technologies (*id.* at 50). A problem of structuring every merger deal is the “snapshot” view and capturing short-term gains of post-merger activities (*id.* at 162-189). The long-term benefits are rarely factored in merger plans.

17. Tanja Boskovic et al., *Comparing European and U.S. Securities Regulations: MiFID versus Corresponding U.S. Regulations*, WB Working Paper No. 1 8 4 (2010), available at http://siteresources.worldbank.org/ECAEXT/Resources/258598-1256842123621/6525333-1263245503321/European_US_SecuritiesRegulations.pdf

The paper compares the substantive provisions and philosophy underlying Regulation NMS and MiFID, but does not draw any conclusions regarding their respective effectiveness. The paper analyzes the similarities among the authorities’ response to the crisis and future regulatory changes.

Among the differences between the regulatory regimes in question are the scope of regulations (*e.g.*, MiFID does not apply to dark pools as opposed to Reg NMS), greater discretion of EU regulators in authorizing investment firms, broader organizational requirements for exchanges in the US, capital requirements that are risk-based in the EU and liquidity-based in the U.S., the components of best execution, better data consolidation on equity trades in the US, etc.

Consolidation of exchanges coupled with the increasing use of dark pools, as well as fragmentation of exchanges in Europe are mentioned among the major trends of the current markets. In this respect, the authors suggest that the post-MiFID situation is similar to the pre-NMS market in the U.S. with greater fragmentation and liquidity moving away from exchanges. The study does not make any merger-related conclusions. The study is remarkable for its side-by-side comparison of the two systems.

18. Thomas O. Miller & Michael S. Pagano, *Who Wants to Dance? Some Possible Exchange Partners*, THE JOURNAL OF TRADING, Spring 2007, 63-72, available at <http://www.ijournals.com/doi/abs/10.3905/jot.2007.682140>.

The authors analyze risk-return relationships for 17 major securities exchanges that demutualized and/or merged starting from 2001 to 2006. The authors did not analyze potential

merger synergies. Their analysis is applicable to mergers where combined exchanges operate under the umbrella of holding companies.

The authors mention that little research was done in the area of cross-border exchange mergers. Their analysis of the literature uncovers that risk-reduction and product diversification are the primary rationale of mergers. However, mergers of financial service companies do not unequivocally guarantee such results. Risk-reduction is contingent upon the nature of assets. Earlier research also indicates that weaker performance of American companies has prompted cross-Atlantic acquisitions.

The authors statistically analyzed daily returns of exchanges and possible diversification benefits of mergers' daily returns, and created the Global Exchange Markets index. The authors then paired various merger candidates based on their return-to-risk ratios. A conclusion was that NYSE-Euronext offered a comparatively good return-to-risk ratio, while a hypothetical merger of the NASDAQ and the LSE or Deutsche Boerse was a lower return-to-risk combination.

19. A.J. Padilla & M. Pagano, *Efficiency Gains from the Integration of Stock Exchanges: Lessons from the Euronext “Natural Experiment”*, Report for Euronext, May 2005, available at http://www.competition-commission.org.uk/inquiries/ref2005/lse/main_submission_received_euronext_nv_lecg_2.pdf.

The study has found that, statistically, the integration of stock exchanges under the umbrella of Euronext had brought about significant efficiency gains and lower fees. The integration reduced trading fees, lowered brokerage fees and eliminated the duplication of infrastructure costs. The users benefited from the access to a single trading platform, savings on IT and human capital monitoring a single platform, trading diversified portfolios and cross-border liquidity, including lower bid-ask spreads and potential price concessions.

The study's timeframe was September 2000 – November 2003. The study took into account the causal interpretation of the external policy decision regarding the merger and the accrual of the aforesaid benefits.

It was found that cost savings included rationalization of operations through a single trading platform and the reduction of operating costs. The total annual costs fell primarily due to IT cost savings resulting from consolidation of the infrastructure and elimination of the duplication of IT investments and staff costs, particularly, in cash trading platforms.

Notably, the authors believe that any other form of alliance would not have achieved similar benefits. First, it could produce a limited form of platform integration with lower cost efficiencies. Alternatively, a contractual alliance would be accompanied by the difficulty of coordination in investment decisions and a greater level of duplication of similar expenses.

The study analyzed the quantitative evidence using the standard regression technique and found that trading fees fell in Paris (15%), Amsterdam (31%) and Brussels as a result of the integration.

The merger provided the members with direct access to different markets avoiding multiple exchange memberships or operating in several locations; expanded the range of securities, particularly tradable cash securities; avoided intermediation costs; provided clients with a better trading opportunities; and reduced operating costs.

The merger increased liquidity of the exchanges due to:

- Lower bid-ask spreads, which, *e.g.*, fell by 40-48% in Paris, 23-30% in Brussels and 4-11.5% in Amsterdam (although the merger effect there was statistically significant and material only under certain specifications of the model). The increase in spreads in Lisbon was generally statistically insignificant.
- Increases in trading volume by about 40%.
- Reduction in volatility of large-cap securities by 9% to 18%.

20. Reena Aggarwal et al., *U.S. Securities Regulation in a World of Global Exchanges, Exchanges: Challenges and Implications*, Euromoney, 2007, Harvard Law and Economics Discussion Paper No. 569, ECGI - Finance Working Paper No. 146/2007, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=950530

The article, first, analyzes examples of demutualization of securities exchanges, the incentives and interests of the new owners, and the emergence of global exchanges resulting from cross-border M&A transactions. Second, ECNs, ATs, advancements in technology, elimination of SRO trading rules prohibiting members to trade on other platforms, Reg NMS, Reg 144A and Reg S enhanced global competition. Stock exchanges respond by demutualization, multiple trading platforms and acquisitions of new trading facilities. Third, the authors consider the self-regulatory functions of exchanges *vis-à-vis* the new for-profit structure, separation of market operations and commercial interests from the regulatory arm, corporate

governance principles, such as limitations on ownership and voting by broker-dealers, and the proposed Reg AL related to safeguards applied to listings of affiliated securities.

Finally, the article argues that demutualization was “undertaken with an eye toward future mergers” (*id.* at 19). Also, for example, the NYSE itself saw the cross-border merger as a solution to the outflow of new listings from New York to, *e.g.*, the LSE. The article also gives an overview of the organizational structure of NYSE-Euronext.

In terms of pre-merger polemics, it mentions that the Europeans were concerned about potential applicability of U.S. securities law, SRO requirements, Reg NMS and the SOX to either the Euronext or companies listed on it. The SEC assured that the merger will not automatically bring the Euronext under its jurisdiction as a “non-US exchange would only become subject to US securities laws if that exchange is operating within the US, not merely because it is affiliated with a US exchange” (*id.* at 22) based on joint ownership.

Rule 12g3-2 also provides an exemption from the registration requirements of the SEA. Within this regulatory framework, the merger could only be structured as a holding company without a single trading platform. Having such a platform could make some substantial percentage of securities deemed traded in the U.S. Hence, the NYSE-Euronext would have to register with the SEC. Therefore, under the current regulations, it is not possible to fully realize potential cost savings and maximize liquidity. The inter-European mergers resulting in the Euronext stand in contrast to the NYSE-Euronext example.

Interestingly, there is a specific break-up provision in the merger documents that is triggered if a substantial number non-U.S. firms listed on the Euronext become subject to US securities law. The authors also point out at potential regulatory concerns, such as the regulation of the LIFFE market by the FSA and the potential interference by the CFTC, which has permitted foreign markets to place trading terminals in the U.S.

21. Reena Aggarwal & Sandeep Dahiya, *Demutualization and Public Offerings of Financial Exchanges*, Working Paper (Nov. 2006), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=859305.

The authors analyze the examples and implications of demutualization of exchanges. Among the reasons are the increasing deregulation of exchanges, which not only fosters competition, but also results in growing conflicts of interest between existing owners. The process is accompanied by the rise of ATS and the advancements in technology. The authors also analyze performance of demutualized exchanges, including stock market performance (and

found that most exchanges continued to “generate substantial excess returns”) and operating performance (the results suggest that most exchanges perform well). The authors foresee a major wave of consolidations in the financial exchanges industry, including M&As across product lines, such as equities and derivatives exchanges. The authors believe that one or two large exchanges are to emerge in Europe.

22. Baris Serifsoy, *Stock Exchange Business Models and Their Operative Performance - Empirical Evidence*, Journal of Banking & Finance Vol. 31, Issue No. 10, Oct. 2007, 2978-3012, available at http://www.sciencedirect.com/science?_ob=ArticleURL&_udi=B6VCY-4NF4F42-1&_user=10&_coverDate=10%2F31%2F2007&_rdoc=1&_fmt=high&_orig=search&_sort=d&_docanchor=&_view=c&_searchStrId=1377031902&_rerunOrigin=scholar.google&_acct=C000050221&_version=1&_urlVersion=0&_userid=10&md5=80f4748dee4cd06fe3c0752204572b28 (see also Department of Finance, Goethe University Frankfurt am Main, Working Paper Series: Finance and Accounting, No. 158 (2007), available at <http://ideas.repec.org/p/fra/franaf/158.html>)

Evidence supports increasing diversifications of operations of now profit-oriented exchanges into derivatives, software and post-trading services. The author analyzes the economic and “social” efficiency of such integration of activities based on technical efficiency and factor productivity of different business models of exchanges. The research relies on the data from 28 stock exchanges. The timeframe of the research was from 1999 to 2003. Among the findings are that non-diversified cash trading exchanges are more efficient, that available evidence does not support the claim that vertically integrated exchanges are more efficient than others, that they, nonetheless, have better potential productivity growth, that theoretically the operational complexity of diversified business models leads to technical inefficiency and is not set off by synergetic benefits.

23. Ben Maiden, *NYSE Merger will Force Regulatory Harmony*, 25 INT’L FIN. L. REV. 37 (2006), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/intfinr25&div=155&id=&page=> .

To succeed, the NYSE, Euronext and regulators have to reevaluate domestic regulations, their potentially international application and consolidation.

The merger was criticized by European politicians, who advocated local alternatives to the NYSE's bid. A major concern was the extension of the reach of the SOX and other US securities regulations to European issuers and exchanges. The SEC's representatives, however, assured the parties that the merger should be driven by market forces, not regulatory imperatives, and that if an exchange did not operate in the US, it would not be subject to the US laws because of its affiliation with a US exchange.

The author interviewed a number of practitioners, who expressed concerns whether the existing arrangement between the NYSE and Euronext could be permanent. Practitioners and analysts are divided whether the holding structure with separate regulatory regimes is durable and optimal in the medium term or the long term for a truly transatlantic exchange.

The article seems to believe that the Euronext experiment, *i.e.*, the creation of the College of Regulators who meets regularly to monitor the group, has laid the foundation for adding one more entity, the SEC, to the regulatory scheme. However, that does not mitigate the differences between the European principle-based and the U.S. rule-based approaches to securities regulations. Nor does it mitigate political discourse on the matter.

Globalization of capital markets is inevitable. In particular, through their attempts to merge with European partners, the NYSE and NASDAQ both have confirmed that the strengthening market and regulatory integration in Europe will create deep and liquid securities markets. The European and other foreign issuers can bypass the US market. Those who formerly held dual listings in both sides of the Atlantic may intend to deregister, while the SEC is improving the process of deregistration. A yet another trend is that issuers resort to Reg S.

Success of a transatlantic exchange depends on creating unified listings standards and selling shares across marketplaces. For this reason, a full cross-border merger of exchanges is required. Some scholars offered two solutions in this respect: a single regulator should govern the exchanges; and/or better regulatory cooperation is needed. Otherwise, stock markets would find "their own ways to unify". The SIA believed that the merger of the NYSA and Euronext would be a catalyst for developing new global regulations. Similar thoughts were expressed by the FSA and Chairman Cox. The merger was thought to influence the existing SRO debate and legal services on both sides of the Atlantic.

24. Christopher Osborne, *A Look at the Globalization of the Exchanges and Its Effects on the United States Market through an Analysis of the NYSE and Euronext Merger*, 1 J. BUS.

ENTREPRENEURSHIP & L. 447 (2008), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/jbelw1&div=23&id=&page=>

The author cites many cases of international cooperation among stock exchanges, including the NYSE-Euronext merger, and the Group's negotiations with Borsa Italiana, the National Stock Exchange of India, the Tokyo Stock Exchange and others. The factors preventing close integration of exchanges are not only domestic regulatory concerns, but also political issues and the notion that national exchanges need to be independent.

The article discusses the history of the NYSE and Euronext NV. The latter is organized as a holding company, is incorporated under Dutch law, has a single platform for cash products and one for derivatives, and has several subsidiaries in France, the Netherlands and Belgium. Although the regulatory and technical merger structure of the Euronext may be somewhat analogous to the NYSE-Euronext consolidation, the analogy is weakened by the pan-European EU legislation.

The article describes the merger negotiations and considerations. First, the Euronext seemed to have acknowledged that the U.S. exchanges, though losing their share of listings, had excellent investor base. Second, the Deutsche Borse's deal was structurally less attractive as a stock-for-stock merger as opposed to the combination of cash and shares of stock offered by the NYSE. Also, the dual management structure of the new holding company allowed the Euronext to preserve its business model. The author draws an analogy with NASDAQ. For example, the NASDAQ's increase of LSE ownership "put the LSE on the defensive", which is common for most stock exchanges valuing their independence. Finally, an all-European transaction could trigger antitrust concerns. Therefore, despite political lobbying by, *e.g.*, President Chirac and the head of the European Central Bank, the NYSE offer was deemed preferable. [*Comment, the author does not analyze any studies on the effects and benefits of the merger and simply refers to the relevant statements by the merger participants.*]

The article also discusses how and why the US exchanges became less attractive for foreign issuers, including Reg S, Rule 144A, the SOX (including the fact that the Act in some cases conflicted with domestic law of issuers), *etc.* In 2006, *e.g.*, there were 123 foreign IPOs on the LSE, 23 on NASDAQ and 18 on the NYSE. In addition, globalization of capital markets was "going to happen with or without" the US.

The discrepancies among national legal systems and the need to, *e.g.*, clear a merger with several regulators (such as the SEC, the Dutch Minister of Finance, the College of Regulators, including the Netherlands Authority for the Financial markets, the Belgian Banking, Finance and Insurance Commission, the Portuguese Securities Commission, the FSA and antitrust authorities in the UK and Portugal, in case of the NYSE-Euronext merger) complicate merger transactions. Yet international cooperation among stock exchanges is strengthening, including the formal alliance between the NYSE Group and the TSE, a potentially similar partnership agreement between NASDAQ and the TSE (which did not demutualize at the time, but was planning on going public in 2009), the NYSEs's statements regarding Borsa Italiana and entering China, the LSE's partnership with MICEX in Russia, *etc.* [*Notably, the author does not draw distinctions among various forms of merger agreements and other contractual arrangements, such as partnerships or strategic alliances*].

25. Donald C. Langevoort, *U.S. Securities Regulation and Global Competition*, 3 VA. L. & BUS. REV. 191 (2008), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/valbr3&div=10&id=&page=> .

U.S. securities regulators are in a bind because of their need to pursue two different objectives. On the one hand, the SEC has to react to the scandals like Enron and Worldcom (which led to the SOX), mutual fund late trading scandals, options back-dating and the mortgage securities crisis through tighter regulations. In the other hand, the SEC is faced with the diminishing competitiveness of the U.S. in the global marketplace. The U.S. has a unique political economy “driven by widespread retail investor participation in the securities markets”, which makes it prone to political overreaction to financial scandals. The upcoming reforms may cause a further outflow of transactions from the U.S.

The article assesses several studies of the U.S. regulations. The first one is the 2006 Interim Report of the Committee on Capital Markets Regulation headed by Hal Scott. The Report emphasized the shift in the IPOs from the U.S., greater reliance on private equity investments and some pertinent underlying motives, such as avoiding the antifraud provisions of the U.S. law.

By contrast, the author believes that the reduced competitiveness of the U.S. market should be explained by a number of other factors. Those, first and foremost, include the better quality of capital markets in other countries, such as the UK, which starting from the 1980s

started deliberately opening their financial markets and competing with the U.S. Secondly, the 1990s were the era of the technology stock boom, which attracted all sorts of issuers to the then vibrant U.S. markets. After the technology bubble, a number of oil producing regions, China and India became the centers of economic activity. A yet another explanation is that U.S. regulations deter the “lemons” and keep the “oranges” that welcome stronger investor-protection rules. Although the Wall Street may see fewer deals, investors might benefit from such natural selection. Finally, the loss of the market share by the U.S. may be irrelevant *per se*, since the U.S. does not possess the absolute competitive advantages in technology, talent and access to wealth.

The second study discussed is by Howell Jackson and Eric Pan. It evaluates capital raising transactions by European issuers and weakens the “issuer choice” arguments. Notably, capital raising transactions had more similarities than differences in the US and Europe. Also, Rule 144A emerged as a prominent capital raising vehicle of choice even prior to the SOX. The interviewees in the study mentioned that Rule 144A simply gave them better access to institutional investors. In addition, the reconciliation of the GAAP and IFRS was not perceived as problematic. The study is important for the mutual recognition discussion. For instance, substituted compliance will help foreigners to overcome the SOX-related problems. However, it will not affect private litigation in the U.S. The author reviews many statements in this respect, including alternative dispute resolution proposals, and argues that without a meaningful litigation reform the mutual recognition will not attract foreign issuers back to the U.S.

Third, the author also reviewed the accounting standards issues, suggesting that by eliminating the reconciliation requirement, the SEC “has made a strategic bet, and may be willing to let go of some disclosure quality to win it”. Finally, he analyzed the global market regulation study and suggested the MiFID is preferable to Reg MS along most dimensions. A relevant problem stems from different interests of retail and institutional investors. The latter are hampered by Reg NMS and resort to the use of dark pools.

Another issue is mergers of stock exchanges, which in this international environment and in terms of the mutual recognition reform emphasize the problems of Reg MS. Keeping the merged exchanges separate for the purposes of compliance is inefficient in the long run. Consequently, the author forecasts that Reg NMS is unstable. The SEC could soon “abandon exceptionalism in an effort to gain greater influence over market structure evolution” on the

global scale. Similarly, the notion of “listings” as a basis for jurisdiction will weaken with time. The future will bring new institutions creating world-wide standards for capital markets.

26. Maning Gilbert Warren III, *Global Harmonization of Securities Laws: The Achievements of the European Communities*, 31 HARV. INT’L L.J. 185 (1990), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/hilj31&iv=14&id=&page=> .

Comment: The article seems to support the Langevoort’s suggestions that the declining competitiveness of the U.S. exchanges is a natural consequence of the formation of stronger and better foreign markets in the last two decades of the 20th century.

The author indicates that the pace of market internationalization increased starting from the 1980s and gives some statistics on the matter. Internationalization is explained by the cancellation of the Bretton Woods system, new communication technologies, the reduction of risk through global diversification, stronger post-World War II economies of Europe and China and liberalization of regulatory controls.

The author delineates a conceptual framework for deregulation, including access deregulation (which started with the “Big Bang” permitting foreign firms to become members of the stock exchange, the French boom, new German laws on futures trading, *etc.*), prudential reregulation, regulatory arbitrage, regulatory harmonization through commonality of substantially equivalent or international rules in both Europe and the Americas (*e.g.*, cooperation among US and Canadian regulatory authorities, the NASSA, *etc.*) and other trends.

The most striking example of these processes, however, is Europe, which for centuries had weak securities laws with the exception of the UK and where most stock exchanges were self-regulating. Starting from the establishment of the common market in 1992 and the 1985 White Paper, several directives were enacted (Company Law Directives, merger regulations, the Listing Particulars Directive, the Public Offer Prospectus Directive, the Mutual Funds Directive, *etc.*). Such greater uniformity was supposed to bring better access to the integrated national markets for securities and to reduce market fragmentation across borders.

27. James M. Falvey & Andrew N. Kleit, *Commodity Exchanges and Antitrust*, 4 BERKELEY BUS. L.J. 123 (2007), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/berkbusj4&id=>

[iv=8&id=&page=](#) . The article focuses on mergers of derivatives exchanges and antitrust law theories, complaints filed with the CFTC and related lawsuits, such as U.S. Futures Exchange, L.L.C. v. Board of Trade of the City of Chicago and the Chicago Mercantile Exchange, NY Mercantile Exchange v. Intercontinental Exchange, Inc., a challenge by the London International Financial Futures Exchange brought before the CFTC, etc.

28. Sarah M. Saylor, *Are Securities Regulators Prepared for a Truly Transnational Exchange?*, 33 BROOK. J. INT'L L. 685 (2008), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/bjil33&iv=23&id=&page=> .

Comment: It is a student note presenting a good compilation of primary and secondary sources.

The note discusses the details of the NYSE-Euronext merger, argues that it would serve as a catalyst for the transatlantic unification of securities regulations, compares the US and the EU regulations, discusses the “fear” of the SOX in Europe, analyzes the issues related to self-regulation of the merging exchanges, reviews the existing regulatory organizations and cooperation, and looks into the possibility of a global quasi-regulator with the authority to issue binding regulations.

The note cites representatives of the NYSE and Euronext arguing, *e.g.*, that the merger manifests “further market consolidation, greater diversity of product offerings, and a much better ability to reach investors and issuers around the world” (quoting NYSE Group and Euronext Announce Merger, 13 NYSE Group Newsletter 3, June 2006).

29. Peter Kim, *Securities Exchange Merger Activity*, 26 ANN. REV. BANKING & FIN. L. 85 (2007). (*It is a student note*).

The article gives a step-by-step analysis of the NYSE-Euronext merger, starting with the strong European opposition to the merger, the concerns, *e.g.*, that the NYSE would dominate the French exchange, and the corresponding proposals by the NYSE to add more Europeans on the Board. Similar to politicians, European hedge funds also opposed the merger. At the same time, London feared losing the Liffe to Deutsche Borse and there were possible antitrust concerns regarding the “European solution”. The merger went through.

At about the same time, NASDAQ failed to acquire the LSE, despite the numerous arguments that the consolidation of the markets would continue and that NASDAQ wanted to list its shares in London and leave the LSE board independent.

The author describes how the NYSE's move forestalled similar efforts by CME and that, with the LIFFE, the NYSE was expecting to enter into the derivatives markets. In terms of regulatory issues, the SEC announced that the European subsidiary or the new holding company was outside the scope of U.S. regulations. However, it also stated that this matter depends on a careful analysis of activities of a foreign exchange in the U.S. The European regulators agreed to the merger under a condition that it would not change the existing market structure and that many Euronext's actions and appointments should be approved by the regulators. The SEC and the College of Regulators signed an MOU thereto.

30. Chris Brummer, *Stock Exchanges and the New Markets for Securities Law*, 75 U. CHI. L. REV. 1435 (2008), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/uclr75&div=53&id=&page=> .

The development of foreign exchanges into liquid markets with 90% of world's IPOs made the US exchanges consolidate and acquire European competitors. Yet there is no comprehensive analysis of these processes. Instead, scholars have been focused on various reforms of securities laws, thus, overlooking developments in corporate finance and the resulting competition among securities regulators. The U.S. regulators no longer have a *de facto* priority in providing securities laws, and new forms of regulatory competition emerge as a result of changes in the capital markets. First, there is a public market for securities laws prompted by the commoditization of exchanges. Second, cross-border mergers create a private market for securities laws by offering issuers jurisdictional alternatives.

Exchanges might in the future be able to choose governing regulatory regimes. Issuer choice reforms and issuer mobility are intertwined. In the future, issuers will be choosing markets primarily based on the liquidity of exchanges, which would decrease regulatory competition since regulators of large financial centers already have a comparative advantage in competing with small financial centers.

The author analyzes the often criticized principle of territorial governance of securities transactions, the choice-of-law reforms based on the "issuer choice", "portable reciprocity", "exchange-based choice of law" and "substituted compliance" reforms. Within this framework, reformers often ignore the issue of regulatory monopolies and focus on the direction of hypothetical regulations. Correspondingly, the author compares the economic theory and the fact that the state has the regulatory market power as an ability "to charge outsiders for use or access"

that depends on the presence of similar resources in other jurisdictions and the mobility of market participants. Today, advances in exchange microstructure and technology offer more listing options to issuers. In addition, the roles of exchanges evolve into facilitators of capital and law, as they regulate market they organize. In some cases, regulation provides tangible benefits to issuers signaling protection of investor rights and raising share prices. Yet the benefits may be theoretical. Thus, tougher regulatory standards will make issuers opt for other jurisdictions.

The author also analyzes such issues as commoditization of exchanges, liquidity, incumbent effect and switching costs, floor exchanges as an impediment to market entry, new electronic exchanges, their geographic reach, investor mobility, execution costs, etc. Another paradigmatic analysis focused on the causes of regulatory competition, such as domestic lobbies (at least 5 interest groups promote securities reforms in the US) and the political need to draw transactions to national jurisdictions.

The aforementioned private market for securities law emerged as a consequence of internationalization of exchanges. Such integration allows exchanges to expand regulatory options for issuers. There are several modes of exchange consolidation. First is investment in competitors, which has some critical limitations, such as the lack of operational control. Second, there are strategic alliances usually conducting limited joint ventures, reducing R&D costs, adopting common clearing and settlement technologies and offering listed firms broader access to investors. However, they do not provide deep integration, as exchanges' interests may be misaligned and the agreements may prove temporary.

The third way is cross-border mergers that allow mergers to diversify revenue sources, to align interests of managers and shareholders, to exploit best technologies firm-wide, to effectuate strategies faster and more effectively, to create common trading platforms, etc. The costs of developing trading technology are fixed, while the economies of scale are significant and there is potential for handling greater liquidity. Trading cross-border securities that comply with various national regulatory requirements and creating a global pool of investors are other advantages of mergers vis-à-vis other forms of alliances. Also, standardization of technology reduces switching costs.

With respect to regulatory differences, the author mentions that a cross-border holding company can offer issuers to list securities on a national subsidiary of their choice. This, again, emphasizes the function of exchanges as facilitators and sellers of law and increases issuer mobility, which in turn strengthens regulatory competition. Currently, transatlantic exchanges,

like the NYSE Group, should be under the pressure of unrealized economies of scale due to regulatory restrictions. Hence, they are motivated to increase lobbying for legal convergence. The author also considers the corresponding theories of exchange choice, substituted compliance and issuer choice, and states that empirical work regarding the correlation of new capital markets and securities law is needed.

31. Pierre Schammo, *Regulating Transatlantic Stock Exchanges*, INTERNATIONAL AND COMPARATIVE LAW QUARTERLY, Vol. 57, 827-862 (2008).

The author highlights misalignments between the current international market development and the adaptation of the regulatory space, which creates the “lack-of-fit” affecting transatlantic activities of merged exchanges. The two corresponding regulatory processes are a process of rapprochement and interdependence, and a process of learning. Both are triggered by exchange consolidation, which is also the engine of globalization of financial markets. While mutual recognition helps harmonization of regulations, rapprochement substantively improves regulations within the boundaries of territorial sovereignty. Regulators are essentially learning from each other, which allow them to adapt to new market developments. The author projects that the principles of national regulations and sovereignty of regulators will slowly yield to internationalization, although in the short-term domestic regulations will remain.

32. John C. Coffee, Jr, *Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Compensation on International Corporate Governance*, 102 COLUM. L. REV. 1757 (2008), available at <http://www.jstor.org/pss/1123661> .

The article focuses on the phenomenon of cross-listing: issuers migrate to the U.S. to increase their market value by voluntarily opting for stronger disclosure and corporate governance standards and compensating for weak protection in their own national law. As a result, a new type of regulatory competition emerges, particularly as countries attempt to retain their national issuers by enhancing their own securities law. The author covers several important issues, including IPOs, post-listing behavior, the risk of litigation, self-selection, exchange demutualization, the SOX, examples of emerging markets, the ways stronger laws encourage economic development, etc.

In addition, the author notes that future consolidation of exchanges is an attempt to gain greater market share and is prompted by globalization and technology. At the same time, the article states that competition might not produce a “single winner”. The cross-border regulatory competition is a factor behind competition among national exchanges, which, in the end, may

create greater specialization and fragmentation among markets as opposed to uniformity. Namely, the regulatory rules of an exchange are premised on the structure of shareholder ownership of listed firms. Cross-listing is, therefore, described as a form of private action; and specialization of exchanges is inherently path-dependent.

33. Ugur Lel & Darius P. Miller, *International Cross-Listing, Firm Performance, and Top Management Turnover: A Test of the Bonding Hypothesis*, FRB International Finance Discussion Paper No. 877 (2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=926606 . The findings corroborate John Coffee's article on the motives for cross-listing: non-US cross-listed firms from jurisdictions not requiring strong investor protection tend to terminate poorly performing CEOs.

34. Mark H. Lang, *Discussion of Regulation and Bonding: The Sarbanes-Oxley Act and the Flow of International Listings*, JOURNAL OF ACCOUNTING RESEARCH, Vol. 46, Issue No. 2, 427-433 (2008).

The author reviews several studies explaining the sudden decrease of cross-listings on U.S. exchanges. Some of the studies suggest that relatively few firms delist because of the SOX and that those who do are generally smaller companies with weak corporate governance. Thus, the overall effect of the SOX may be positive (*similar to the discussion in Prof. Coffee's article discussed above*).

In fact, many factors influence listing decisions, including globalization, electronic trading, the AIM in London, intra- and international mergers of exchanges, *etc.* Alternatives to listing on major exchanges, such as Rule 144A, OTC, or electronic markets, are expanding. Some researchers believe that the valuation premium for firms cross-listed on U.S. markets is substantial, although it changes due to globalization. Correspondingly, the competitive landscape has changed. Moreover, there are analogous listing and delisting trends across the markets, including the U.S. and London; while listing activity decreased in general after 2000. Potentially, however, "gains by London unrelated to SOX are difficult to disentangle from losses by New York due to SOX."

35. Joseph D. Piotroski & Suraj Srinivasan, *Regulation and Bonding: The Sarbanes-Oxley Act and the Flow of International Listings*, Rock Center for Corporate Governance at Stanford University Working Paper No. 11, available at: <http://ssrn.com/abstract=956987>.

The study reviews large statistical datasets and analytical papers, and offers an exchange choice model that utilizes firm, industry, exchange, geographic and country-specific factors. It

recognizes that in making listing decisions managers choose among several foreign exchanges by, inter alia, weighing the costs and benefits of particular securities law standards and other benefits of listing, such as bonding.

In short, the authors find that it is not certain that in the post-SOX period the LSE has attracted foreign firms that would have listed in the US. The analysis takes into account additional independent variables, such as the development of viable non-US listing platforms, the growth of the AIM, corporate scandals in the US, financial reporting standards in the US and Europe, and the types of firms.

For the sample of larger firms, whose direct costs of SOX reporting are less significant compared to the “bonding related benefits”, SOX had no effect. Instead, the attributes of foreign firms changed. Even based on the pre-SOX data analysis, a decline in listings could be predicted. That is not the case for smaller, less profitable firms using lower quality auditors. Their listing decisions seem to be affected by the SOX.

36. Mahmood Bagheri & Chizu Nakajima, *Competition and Integration among Stock Exchanges: the Dilemma of Conflicting Regulatory Objectives and Strategies*, OXFORD JOURNAL OF LEGAL STUDIES, VOL. 24, NO. 1 (Spring, 2004), 69-97, available at <http://ojls.oxfordjournals.org/cgi/content/abstract/24/1/69> .

The authors analyze positive and normative aspects of competition. Consolidation is depicted as an outgrowth of competition, liberalization of securities markets and “de-monopolization” of national capital markets. At the same time, competition, simultaneously, defragments such markets. Better disclosure of information is central to competitive and stable financial market. Finally, the authors conclude that the norms of economic competition are not always applicable to capital markets and there is a tension between the principles of competition and the economies of scale.

37. Norman S. Poser, *The Stock Exchanges of the United States And Europe: Automation, Globalization, and Consolidation*, 22 U. PA. J. INT'L ECON. L. 497 (2001), available at <http://heinonline.org/HOL/LandingPage?collection=journals&handle=hein.journals/upjiel22&div=21&id=&page=> .

The article focuses on the growing M&A trend in Europe and the U.S. Notably, for several years, the NYSE and NASDAQ lagged behind the European markets rushing to demutualize and consolidate. At the same time, international investment banks and institutional

investors need global stock markets. The need of large firms and institutions to reduce transaction costs is driving consolidation.

The article mentions numerous examples of European mergers, whether failed or successful. The competitive environment has changed. For instance, ECNs represented direct competition to stock exchanges, although in Europe, they were not as well established as in the U.S. because European exchanges operated electronic trading markets, like, *e.g.*, Tradepoint in the UK. In the U.S., there were some regulatory proposals regarding establishing a national electronic system for trading U.S. stocks.

The article describes common functions performed by all exchanges, namely operating trading markets, clearing and settlement, representation of their members, regulation, collection and distribution of information, operation of the trading markets, whether call or continuous markets, quote-driven or order-driven, open-outcry or electronic, etc. The article also names the constituencies of the exchanges, such as, *e.g.*, NYSE specialists, and potential conflicts among present and future constituencies, such as, *e.g.*, shareholders.

Finally, the regulation of transnational markets is highlighted as an important issue. The author considers the role of the SEC (starting from the 1975 reforms) in shaping the national market *vis-à-vis* the EC. In general, regulatory agencies are unable to make adequate regulatory decisions for establishing an international securities market. Self-regulation is also not well-suited for this role due to conflicts of interest. However, self-regulation will, probably, become important for international electronic exchanges. Notably, creation of a world's stock market is not inevitable, in part, due to the differences between the European markets, on the one hand, and the NYSE and NASDAQ, on the other. At the same time, in spite of diverging regulatory systems, capital markets will continue to consolidate under the pressure of large investment banks and institutions.

38. Steven M. Davidoff, *Regulating Listing in a Global Market*, 86 N.C. L. REV. 89 (2007), available *at*
http://works.bepress.com/cgi/viewcontent.cgi?article=1003&context=steven_davidoff

The SEC should promote investment equality in order to tap into the global markets. In doing so, it needs to consider the demand side arguments and create a free-listing regime permitting foreign issuers listed in jurisdictions with equivalent regimes to list on U.S. securities markets without falling under substantive regulation of the SEC.

39. For an analysis of transaction costs, problems with optimizing financial structures, protection of minority shareholders, and synergies of the exchange mergers from the perspective of European regulators and markets, see Ioannis Kokkoris & Rodrigo Olivares-Caminal, *Lessons from the Recent Stock Exchange Merger Activity*, 4 J. COMPETITION L. & ECON. 837(2008), available at <http://jcle.oxfordjournals.org/cgi/content/abstract/nhn002> (also discussing the Report by London Economics for the European Commission on the integration of EU financial markets, arguing that “exchanges face strong competitive constraints from OTC trading”).

40. Other Related Research Papers and Articles:

- a. Ulf Nielsson, *Stock Exchange Merger and Liquidity: The Case of Euronext*, JOURNAL OF FINANCIAL MARKETS, Vol. 12, Issue No. 2, May 2009, 229-267, available at http://www.sciencedirect.com/science?_ob=ArticleURL&_udi=B6VHN-4T5CH0P-1&_user=10&_coverDate=05%2F31%2F2009&_rdoc=1&_fmt=high&_orig=search&_sort=d&_docanchor=&_view=c&_searchStrId=1377018492&_rerunOrigin=scholar.google&_acct=C000050221&_version=1&_urlVersion=0&_userid=10&_d5=004244d6a458268849ef5202ce3a65b6 .

The article focuses on the mergers of European exchanges under the umbrella of the Euronext and examines possible motives for mergers, the influence of market competition, the unification of clearing systems, *etc.* The article has a dataset of all listed firms for the period of 1996-2006. It analyzes the effect of consolidation on stock liquidity and finds asymmetric liquidity gains where positive gains are characteristic to larger firms or firms with foreign sales. The author tentatively explains the finding by the fact that such firms are more familiar to foreign investors who enter the market after a merger. The study has not found a negative effect on liquidity for any types of firms as a result of the Euronext mergers, which suggests Pareto improvement.

No pattern was found as to liquidity benefits among listing locations and industries. At the same time, the consolidation of the Euronext increased its market share *vis-à-vis* the LSE, and the trading activity drifted to the mainland Europe. Yet the Euronext did not attract new listings. The author mentions that the MiFID and other potential regulatory changes will affect the economic results of these mergers.

Comment: The NYSE-Euronext and the NASDAQ-OMX mergers are not discussed.

- b. Ted Oberhaus & Milton Ezrati, *Exchange Mergers*, THE JOURNAL OF TRADING, 17-19 (2006), available at <http://www.ijournals.com/doi/abs/10.3905/jot.2006.644084> .

The authors see exchange mergers as a well-established global trend, which is prompted by maneuvering around competitive exchanges. For example, the acquisition of the Euronext blocked similar CME's efforts and allowed the NYSE to expand its business into derivatives. Gaining options and futures capabilities is also a major reason behind mergers since margins in equity and bond trading are diminishing. Another reason is providing greater numbers of consumers with better product breadth and liquidity and improving information flow. Also, American exchanges want to offer their clients an opportunity to avoid the SOX and the NMS rules on trading with the "trade through" rule, which is disliked by institutions. The offsetting concern is the risk of monopoly.

- c. Maurizio Polato & Josanco Floreani, *Cross Border Mergers and Value Creation in the Exchange Industry: the Case of Diversified Conglomerate Exchanges* (2009), available at <http://host.uniroma3.it/eventi/wolpertinger2009/19.pdf> .

Demutualization and consolidation of exchanges modify exchange operations and global competition patterns. Liquidity is a main source of competitive advantages. Demutualization and consolidation, in turn, are primarily driven by technological advances in products and process innovations. Changes in "production diversification" are related to integrating data dissemination, activities such as screen-based platforms, services and business perimeter.

Within this general picture, revenue sources across the Atlantic differ. U.S. exchanges rely on cash trading revenues more than European exchanges, which historically have had more diversified business models, whether horizontally or vertically integrated.

The academic research on the efficiency of merged stock exchanges is insufficient. However, the NYSE-Euronext merger reduced the original number of trading platforms from six to three, adding to the general trend of creating a network of securities exchanges. The group's revenues from the U.S. operations are only 63% and fluctuations in the trading volumes across the Atlantic may offset each other when needed. The authors also compare the average volumes of major exchanges over the period of seven years, 2001-2008, and find that they positively correlate with cost efficiency and the reduction of average costs.

Data analysis of derivatives and cash markets suggests that, first, the valuation of exchanges is problematic, second, market values derivatives exchanges more than cash trading markets, and, third, that exchanges with diversified products have a greater potential for value generation. Correspondingly, it might be a part of the rationale behind the NYSE-Euronext merger. However, contrary to expectations, the share price of the combined entity declined starting at the end of 2007.

In theory, the economies of scale and of scope are the major incentives for mergers. The general market trend is the creation of fewer exchanges with more diversified business models, better cost efficiency, greater liquidity and exploitation of business complementarities. In contrast, increases in profits seem to be less important incentives. A yet another benefit of integration is that conglomerates are better adapted to geographical changes in market activities.

- d. Frederick H Harris, *Execution Costs and Market Design Worldwide: A Panel Discussion*, THE JOURNAL OF TRADING, 9-24 (2008), available at <http://www.ijjournals.com/doi/abs/10.3905/jot.2008.700222> .

The report discusses what constitutes an “optimal security market design”. The differences among various exchanges a vast: some have market makers, other do not; some preserve pre-trade anonymity, others, like the NYSE, fully reveal the complete LOB providing transparency to all participants; some have trading floors, other do not, *etc.* The Panel discussed statistical comparisons of various designs in order to determine whether the variety of designs is sustainable, why some designs reduce execution costs, but raise spreads, and the effects of the two transatlantic mergers.

The data compared (1) property rights, market mechanisms, call auctions, and market transparency for seven exchanges; (2) execution costs, as well as the floor effect as a function of execution cost and market capitalization; (3) relative spreads, share prices and order placement behavior; (4) market design effects, including the presence of a physical trading floor, the effect of market makers, non-disclosure of broker IDs, display of the full LOB to investors and brokers, the effect of 2002-2003 mutual association and automated NYSE circuit breakers, stamp duties, the combination of quote-driven dealers, order-driven electronic markets and hybrid market on the LSE.

With respect to the effect of the two major mergers of stock exchanges, the panelists emphasized the global diversification of technologies, sophisticated IT, peer-to-peer trading

and “triangular arbitrage”. Finally, the participants discussed the role of MiFID and problems with clearing and settlement in Europe.

- e. William O. Brown et al., *Competing with the New York Stock Exchange*, *The Quarterly Journal of Economics*, 2008, Vol. 123, Issue No. 4, 1679-1719, available at <http://ideas.repec.org/a/tpr/qjecon/v123y2008i4p1679-1719.html> . The article discusses the viability and effect of competition among stock exchanges. The authors ran a case study on the competition between the NYSE and the Consolidated Stock Exchange of NY in the early 20th century. The study found that bid-ask spreads fell when the Consolidated started trading NYSE securities and increased when the Consolidated stopped operating. Competition improves consumer welfare. Correspondingly, similar reasoning can be used in light of the present wave of M&As.
- f. Jin W. Choi, *An Examination into Rationality and Operational Efficiency of Exchange Mergers*, *THE JOURNAL OF ECONOMIC ASYMMETRIES*, Vol. 6, Issue No. 1, 89, JUNE 2009, available at <http://apforum.org/JEAV6N1.pdf#page=93> . The article discusses primarily the mergers of Asian exchanges, which were initiated by governments. The author mentions that, in general, intra- and inter-business mergers are purported to provide financial stability to their industries, to diversify product lines, to initiate preemptive measures for better technologies, and “to obey their government's implicit edicts for greater financial and operational efficiency”.
- g. Jack Clark Francis et al., *Exchange Mergers and Electronic Trading*, *The Journal of Trading*, Winter 2009, 4.1:35-43, available at <http://www.ijournals.com/doi/abs/10.3905/JOT.2009.4.1.035?journalCode=jot>

Comment: The article is descriptive and gives narratives of all major merger stories involving U.S. exchanges.

The article mentions synergistic effects of mergers, revenue enhancement, marketing gains, strategic benefits, competitive advantages, economies of vertical integration, technological integration, tax gains, unused debt capacity, reduced electronic trading technology, *etc.* It also notes that after the NYSE-ArcaEx merger, electronic technology replaced the NYSE's specialist system and diversified products to include options. Similarly, with the Euronext, the NYSE Group expanded its products to derivatives and diversified its market

internationally. A similar logic underlies the purchase of a stake in the NSE of India. Also, the current alliance with the Tokyo Stock Exchanges is a step towards an eventual merger of the two exchanges. Creating global and multi-asset trading platforms are believed to be the rationale underlying the NASDAQ merger activities.

- h.** Sebastian Bock, *Specialized Finance – Securities and Commodity Exchanges*, Henry Fund Research, the University of Iowa School of Management, Feb 13, 2009, available at <http://tippie.uiowa.edu/henry/reports09/Exchanges.pdf>

The research projects that electronic trading and ATS will increase competition and put more pressure on margins; that regulators will not develop a global regulatory system; that although excessive M&As resulted in large charge-offs in late 2008 and that exchanges (including the NYSE-Euronext) will continue writing off goodwill, consolidation will continue along with strategic partnership agreements.

Consolidation has brought about operating efficiencies and increased market share and product diversification of major exchanges. Today, e.g., NASDAQ-OMX Europe claims to provide order routing to major regional exchanges. Cross-border arrangements also geographically expanded listings.

Regulations played an important role in driving IPOs from the U.S. in the post-SOX period, although MiFID and Reg NMS themselves are comparable. Similarly, U.S. and EU regulations may prompt an increase in off-exchange trading.

- i.** Perrine Fiorina, *Global Securities Exchange Landscape*, The Journal of Trading, 25-28 (Winter 2008), available at <http://www.ijournals.com/doi/abs/10.3905/jot.2008.700221> .

Out of 12 major exchanges, only four are unlisted. The NYSE-Euronext group is the largest exchange based on the trading volume, turnover and revenue. The article breaks down the sources of revenue (cash trading, cash listing, derivatives trading, clearing and settlement, information products, systems and “other”) for 12 major stock exchanges in the U.S., Japan and Europe. Notably, the two European entities, which merged with the U.S. stock exchanges, the Euronext and OMX, are among major providers of IT services worldwide. The two major trends, demutualization and consolidation of stock exchanges, are explained by the goal to achieve revenue and cost synergies due to diversification of revenue sources, attracting more listings and expansion of trading.

IV. Jurisdictional Issues: Cross Border Fraud

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