Chapter 6

The Regulation of Global Securities Trading

Global trading in securities runs into complex problems and unnecessary risks because of the differences among national regulatory policies and structures. There is no international mechanism for regulating transborder activities, nor any way for a nation to enforce its own regulations beyond its sovereign reach, except insofar as there are cooperative agreements between nations.[1] The risks, discussed in chapters 3 and 5, include both unrecognized risk for investors who make decisions based on unrealistic expectations of fairness or institutional integrity, and wider systemic risks that might result, for example, from the failure of a major firm with heavy commitments in several countries. At best, there are many complex problems that result merely from differences among nations in market structures and procedures, in the relationships between securities markets and the banking system, and especially in the regulations that govern these activities.

COMPETITION AND REGULATION

Many market participants in many countries argue that these differences in regulatory regimes are best resolved through deregulation in those countries with the more regulated markets. Advocates of 'free markets," generally opposed to regulation, use the threat of international competition to counter any consideration of regulatory action. They are quick to argue that additional U.S. regulation or taxation, or even the maintenance of existing levels of regulation, will "drive the markets overseas." This argument may or may not be correct, but it is initially suspect because for many of those who make it, it is obviously self-serving. The argument should therefore be closely examined.

Free market advocates assume that trading will inexorably shift to the least regulated market because it is the least expensive to use, or the "most efficient." Regulation can significantly add to the cost of doing business. Mandated costs appear to have caused trading to shift at some times in the past. For example, the Eurobond market developed in London after a U.S. "interest equalization" tax in 1964 discouraged the issuance of debt in the United States by foreign borrowers. A significant amount of trading in German government bonds is said to have moved to London to avoid tax in Germany. However, many examples of movement off-shore offered by free market advocates cannot confidently be attributed to a single simple cause.

The concept of the pull of less regulated markets is probably too simple for several reasons. First, active markets have some natural protections. There is a strong tendency for securities to trade in the most liquid market, nearly always in the country of origin. Attempts by a second exchange to compete for volume trading in an existing heavily traded product nearly always fail. As noted several times in this report, this situation may change, especially when the product is offered in a different time zone. But for trading to shift to another place, the attracting market would have to begin with ample depth, i.e., enough participants at all times to provide liquidity to those wishing to trade.

The more dubious assumption is that the least regulated market is necessarily the most efficient market, or the most attractive market to investors. It seems likely that some degree of regulation is desired or even demanded by participants for their own protection. Beyond this is the question of how much systemic risk modern industrial nations are prepared to assume as the price of participation in world financial markets. Policy concerning financial institutions and markets has been, in nearly all countries and at all times, "protectionist," because of the concern of national governments about monetary control, savings, capital formation, and financial systems. The policy issues related to globalization of securities trading center on how much less or how much more protectionist financial regulatory policy should be in response to techno-

[1] GATT has in the past covered goods, not services. Service industries are included for the first time in the most current round of GATT negotiations, but once a general agreement is reached on trade practices in the international services sector, it will still have to be translated into specific agreements for different types of services.

logical change and the increasing global mobility of capital.[2]

TWO KINDS OF REGULATION

It is important to recognize that there are two quite different kinds of securities markets regulation.[3] The first, which can be called access regulation, is aimed at protecting domestic markets and their participants from outsiders; i.e., restricting access to the market to maintain the privileges and benefits of "membership in the club." In recent years major market nations have reduced these barriers; this has been a primary thrust of deregulation in the United Kingdom and France, for example, and even in Japan greater access has been opened for foreigners, although more slowly.[4]

The second kind of regulation may be called "prudential regulation" and is aimed at assuring investors of fair and equal treatment, by regulating trading practices, abolishing fixed commissions, making sure that investors are informed about risks, and requiring the availability of information about prices, fees, commissions, and factors influencing prices. Most governments consider it in the public interest to maintain markets that are fair and have the confidence of the public. However, some countries put much greater emphasis than others do, on assuring investors of fair and equal treatment. In the United States, broad participation in securities markets and stock ownership has been valued as a way of democratizing the economy, and investor protection is emphasized. In some countries, there have never been many "small investors" or household investors, and most market participants are large institutions, assumed to be able to look after themselves.

The exposure of stock market fraud over the last 3 years in several countries-the United States, Japan, France, West Germany, and Canada-has given rise to demands for new or more seriously enforced prudential regulation or deregulation.[5] West Germany, Belgium, Spain, Italy, and Ireland have passed or are considering new laws forbidding insider trading or providing stiffer penalties. In Japan, insider training was against the law, but until recently it was not considered a serious offense. When detected, offenders might be reprimanded, but usually not publicly.[6] A stricter law has been passed since the scandals last year, but enforcement is weak.

In the United States, some people who favor deregulation have suggested that investor protections should now be relaxed because institutional investors, guided by professional money managers, need less protection than the traditional small investor. On the other side, some say that more regulation may be needed to protect the growing number of participants in mutual and pension funds against abuse and mismanagement by fiduciary agents; and some suggest that deregulation in the United States has begun to threaten essential investor protections, by subtly shifting to emphasize not the "small investor" but the "informed investor," implying a philosophy of "caveat emptor," or let the buyer beware.[7]

Prudential regulation of markets still differs widely from country to country.[8] Regulatory agencies in some countries approve nearly any new trading products, such as index futures contracts, that are proposed by the financial community; other

[2] This formulation borrows from a formulation by David D. Hale, Kemper Financial Services Inc., in "How European Economic Integration and Japanese Capital Power Will Produce Managed Trade in American Financial Services During the 1990' s," an address to the Athens College Alumni Association Fourth International Economic Conference, 1989. However, Mr. Hale is not responsible for the permutations of his question used in this chapter.

[3] Much of the material in this section draws on Manning Gilbert Warren III, "SecuritiesRegulation in the European Communities,' a contractor report to the Office of Technology Assessment, Aug. 1, 1989.

[4] There are no barriers to foreign membership on U.S. exchanges other than the requirement that members have an office in the United States. In 1977 the NYSE further broadened access to trading by providing for (in addition to the traditional purchase of a "seat") leasing of seats, electronic access memberships, and a few physical access memberships with limited participation on the trading floor without other attributes of membership. The National Association of Securities Dealers has never had barriers to foreign membership. Information provided by the NYSE and NASD.

[5] For a brief summary of insider trading rules prior to recent changes see Andrew N. Grass, Jr., "Internationalization of the Securities Trading Markets," *Houston Journal of International Law, vol. 9, No.* 1, Autumn 1986, pp. 44-49.

[6] Arturo Weiner and Edward Knight, "The Stock Market in Japan: An Overview and Analysis," Congressional ResearchService ReportforCongress, Mar. 15, 1988.

[7] OTA workshop on "The Small Investor," May 1, 1990.

[8] This section draws heavily on "Arrangements for the Regulation and Supervision of Securities Markets in OECD Countries," in OECD: *Financial Market Trends 41,* November 1988. Most of the summary statements below apply therefore to OECD countries, which includes all major markets.

countries are more restrictive, on the grounds that some forms of trading are basically speculative and may lead to excessive volatility or undermine confidence in the financial system. Some major market countries heavily regulate securities underwriters and investment advisers; others require only that there be disclosure of basic information..

Countries also differ in the degree to which competition among financial institutions is restricted--e.g., whether banks can engage in securities underwriting and related activities. Several countries have recently removed regulatory barriers that formerly separated banks, thrifts, securities houses, and other financial companies. In other countries, chiefly the United States and Japan, there are still some legal restrictions that may affect the participation of banks in international securities activities.

These differences result in part from historical circumstance-the way in which national banking and payment systems evolved, and when and under what conditions the existence and importance of securities markets were first recognized. In part, they result from differing perspectives on the distinction between private and public sectors (i.e., how capitalistic or how socialistic an economy is). A third factor is the constitutional structure of the government: in federal systems regulatory responsibility may belong either to provincial or central government, or be dispersed.

BANKING AND SECURITIES MARKETS[9]

In most countries, banks are major participants in securities markets and securities-related activities. In the United States and Japan, the policy has been to protect the banking system from security market risks. Banking and securities activities are separated. People making bank deposits are assumed to be trying to safeguard their assets, and are thus given more protection; their deposits are guaranteed up to a certain limit by government insurance, and the types of liabilities that banks may incur are limited. Those investing in securities knowingly and by choice assume risks, in return for the opportunity to profit; they are nevertheless protected to the extent of seriously enforced laws against fraud and manipulation, requirements that the investors' risk be disclosed to them, and insurance protection against the failure of a securities firm. Separation of banking and securities activities tends to result in large independent securities houses such as those in the United States, Canada, and Japan. OECD analysts conclude that in such systems there may be greater acceptance of innovative products than there is in universal banking countries.[10]

A universal bank system is more common; countries with universal banking (which include Austria, Denmark, Finland, West Germany, Luxembourg, The Netherlands, Norway, Sweden, and Switzerland) allow banks to engage in the full range of financial activities.[11] These countries assume that the risk of financial failure in any one activity is reduced by the bank engaging in a broad range of activities-a form of diversification.

A third system allows either banks or brokers to receive customer orders for securities transactions, but requires the trading to take place through independent intermediaries. The activity of dealing for a proprietary account is separated from the activity of trading as an agent for customers. This may constrain the range of services that stockbrokers offer. This system is used in Belgium, France, Greece, Ireland, Italy, Portugal, and Spain.

These differences in the securities-related powers of banks result at the international level in the issue of national treatment v. reciprocity .12 "National treatment' means that a country applies the same set of requirements and regulations to both domestic institutions and foreign institutions operating within its boundaries. In most regards this should provide a "level playing field' and promote competition. But in the United States, where national laws

[9]Material in this section is drawn in part from OECD, op. cit., footnote 8. See also OECD, "International Trade in Services: Securities," *Financial Market Trends 37*, May 1987; and OECD, *International Trade in Services: Banking* (Paris, *1988);* Bank for International Settlements, *RecentInnovations in International Banking,* April 1986; and *Banking and Payment Services,* materials for an International Symposium sponsored by the Board of Governors of the Federal Reserve System, Washington DC, May 1989.

[10]OECD, op. cit., footnote 8, pp. 19-20.

[11]In West Germany and Austria anyone engaging insecurities trading must obtain a banking license. In the other countries, some financial firms which do not accept deposits maybe licensed to engage in securities activities without banking licenses.

[12]See OECD, *International Trade* i,, *Services:* Banking, pp. 15-20. See also An&w T. Hook and M. Alberto Alvarez, "Competition From Foreign Banks," Chapter 10 of Federal Reserve Bank of New York, NY, *Recent Trends in Commercial Bank Profitability,* A Staff Study, September 1986.

separate banking and securities activities, the banks of universal-banking countries are prevented from engaging insecurities-related activities because they are officially banks. European countries whose banks are officially excluded in this way could in theory demand "reciprocity," or access to U.S. markets as a condition for allowing U.S. institutions to participate in their markets. The official U.S. position[13] is that:

> The United States considers reciprocity in financial services to be inconsistent with the internationally accepted principles of national treatment and non-discrimination . . . The national treatment approach used by the U.S. Government in financial services seeks to ensure that foreign firms in the United States and U.S. firms in foreign countries are given "equality of competitive opportunity" with domestic firms.

The European Community has as one goal of its "1992 initiative" the establishment of a single European market in banking and securities activities. The 1992 Initiative originally included a policy of reciprocity, which has recently been modified.

REGULATORY INSTITUTIONS[14]

The institutional structures for regulating securities markets differ widely. In universal banking countries, one regulatory or supervisory agency may cover all financial activities[15]; in the United States, securities markets, futures markets, bond markets, and banks have different regulators. In some countries, primary supervision over securities trading is generally carried out by self-regulatory bodies, such as stock exchanges, under the oversight of a regulatory agency. This is the case in the United States, and it is also the case in Finland, West Germany, and Switzerland, where securities and banking supervisory functions are not separated. In countries with a federal structure, primary responsibility for supervising markets may be assigned either to the national government, as it is in the United States, or to provincial or state governments, as it is in Australia, Canada, and West Germany. In the United States and the United Kingdom, any entity offering securities or investment services to the public is regulated, but in some countries such as Italy and Switzerland, some parties-e. g., over-the-counter dealers-are not covered.

Other differences relate to collective investments such as mutual funds; there are different prudential requirements about corporate structure, fees, and management compensation. The United States has rigorous prudential requirements; many European countries are just beginning to develop tougher requirements after major losses by investors. There have been some efforts to harmonize standards. The European Community has just adopted common standards for mutual funds its member countries.

The differences in accounting practices and standards, and in capital adequacy requirements for various kinds of financial institutions and market participants are very important and very difficult to resolve. Some of these differences were discussed in chapter 5, on clearing and settlement.

ENFORCEMENT OF SECURITIES REGULATIONS

As securities trading is further globalized, regulators responsible for investor protection face the difficulty of supervising activities that flow through electronic systems and networks across national boundaries. Currently, the U.S. market regulatory agencies (the SEC and the CFTC) have limited authority to assist foreign authorities with investigations of violations of foreign laws from a U.S. location. When a foreign government needs U.S. assistance with market investigations, it must ask for a court order to compel testimony or evidence. But it is often undesirable to have a public hearing while an undercover investigation is in progress. A bill now before Congress, the International Securities Enforcement Act (H.R. 1396), would strengthen SEC authority for cooperative enforcement by increasing its ability to punish brokers, dealers, and investment advisors for overseas violations, giving the agency greater discretion over the release of information, and allowing the agency to accept reimbursement from foreign securities authorities for costs of investigations that SEC would conduct for them.

13 An issue paper from the U.S. Department of the Treasury entitled "EC Single Market: Banking and Securities" provided by the International Trade Administration, U.S. Department of Commerce, Aug. 1, 1989.

14 Much of the material in this section, not otherwise cited, is drawn from OECD, op. cit., footnote 8.

15 This includes: Austria, Belgium, Denmark, Finland, West Germany, Luxembourg, Norway, Portugal, Sweden, and Switzerland.

In cases where U.S. markets are abused or manipulated from overseas, the SEC's investigative power is limited when the evidence is located elsewhere. When the SEC seeks help from a foreign government, it must make a formal request under the terms of the Hague Convention or exert pressure on U.S. branches of overseas financial institutions. The SEC has been required to go through long negotiations or court proceedings to obtain information about transactions through foreign banks or securities houses. As Charles Cox, a former SEC commissioner, explained:

> All nations with securities markets may face the dilemma of deciding whether to protect their markets from foreign-based fraud, or to live with markets where some participants can defraud others with impunity. . . . The acceptable alternative is to develop ways of sharing surveillance and investigative information, and to formalize these arrangements in bilateral or multilateral understandings.[16]

Formal agreements have not been completely effective. In spite of the Hague Evidence Convention some nations refuse to disclose information, and the legal mechanism of letters rogatory have been inadequate for gathering evidence for litigation.[17] While the United States accepts the idea of government access to financial data for the purpose of enforcing securities laws, some nations view this as a violation of confidentiality and may have secrecy or blocking statutes that forbid the release of such information.[18] Secrecy laws recognize confidentiality as a fundamental right and forbid any disclosure of a customer's financial information, including business records and accounts, without personal permission. Blocking laws protect national rather than individual interests, and are intended to prevent the disclosure of information by citizens as parties to foreign litigation, or to prevent any foreign government from conducting investigations and imposing its policies within their borders, as an invasion of sovereignty.[19]

In 1985, the SEC proposed the idea of "a waiver by conduct," meaning that anyone who traded in U.S. markets would be held legally to have waived the right to prevent the SEC from investigating. But the concept was widely viewed as politically unacceptable because it infringed on the sovereignty of foreign governments and created tension with friendly nations.

To encourage cooperation from other nations, the SEC is seeking legislation to authorize it to issue subpoenas and take dispositions in this country on behalf of foreign securities regulators or law enforcers.[20] It also wants the power to bar from U.S. securities markets people who have been convicted in foreign courts of certain financial abuses. This, however, raises questions of legal rights or justice, because foreign governments may lack safeguards which are considered essential in the United States for those accused of crimes, or may have very different standards of proof.

HARMONIZATION

Many people argue that a worldwide securities regulatory body is needed, but others believe that a broadly multinational institution with strong authority is not feasible, at least at present. They look to a less drastic solution: "harmonizing" regulation by reducing the differences (or the effect of differences) in national regulatory regimes.

Harmonization is the process of reducing regulatory disparities among mutually accessible markets, through the development of common or mutually compatible regulatory regimes, standards, and practices.[21] Advocates hope that harmonization would lessen the threat of "regulatory arbitrage," or allowing competition among national securities markets to force prudential regulation down to the lowest common denominator. Critics fear that harmonization could raise the threat of "regulatory imperialism" in which less regulated markets are

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16 Charles Cox, "Transactions: Blocking the Success of Market Links," *Maryland Journal of International Labor and Trade, vol.* 11, 1987, p. 215.

17 Ibid., p. 217.

18 Brandon Becker and Thomas Etter (Securities and Exchange Commission), "International Clearance and Settlement," *16 Brooklyn J. 271,292-293, 1988.*

19 An SEC investigation of suspicious trades originating in foreign countries indicated that some U.S. and foreign investors avoid SEC surveillance by executing transactions through financial institutions in countries with secrecy and blocking laws. "Problems With the SEC's Enforcement of U.S. Securities Laws in Cases Involving Suspicious Trades Originating Abroad," House Report 100-1065, Oct. 6, 1988.

20 H.R. 13%, The International Securities Enforcement Act, now before the Senate.

21 Warren, op. cit., footnote 3. See also Miller, "Regulating Financial Services in the Unite dKingdom-AnAmerican Perspective," 44 *Business Law* 323, 1989; and Bernard, "The United Kingdom Financial Services Act 1985: A New Regulatory Framework," 21 *International Law 3431987.*

forced to become more regulated. Pessimists fear that the effort to achieve harmonization may itself become a form of regulatory arbitrage.

The term "harmonization" itself has in this way become controversial, and because it is controversial it has become difficult to define. Different stakeholders, or interest groups, tend to define the term in ways that imply different objectives as well as different approaches. It is necessary to recognize, at least, that harmonization allows for two approaches. The first, "commonality," means the development of uniform international rules, such as uniform disclosure requirements, enforced in all countries. The second, sometimes called "reciprocity" or "comparability,' calls only for substantially equivalent minimum standards.

The North American Securities Administrators Association (NASAA) recently urged the creation of global minimum standards of investor protection; this is a commonality approach to harmonization. The International Organization of Securities Commissions (IOSCO)[22] is attempting to develop disclosure requirements for multi-jurisdictional securities offerings. IOSCO is also working with the International Accounting Standards Committee to develop common accounting rules and standards. Other international securities organizations working toward commonality, or universal standards, are listed in box 6-A.

The SEC and Canadian provincial regulatory authorities have proposed reciprocal recognition of prospectuses in connection with certain types of offerings from specific kinds of issuers; the requirements for these perspectuses, although not identical in the several jurisdictions, show 'substantial equivalence." This is the comparability approach. The approach of the European Community, in attempting to harmonize securities market regulation among its members, has shifted pragmatically from commonality to comparability.

"Substantially equivalent rules" could be sought on a global basis either gradually through a multinational forum or program, or through a series of informal arrangements. Informal arrangements in the past have not been very effective. The International Association of Securities Commissions has an organized program for exchange of information, but the meetings have had little impact.[23] Bilateral agreements through non-binding memoranda of understanding (MOUs) have been somewhat more successful. They provide flexibility for regulators to work out techniques of securities enforcement in a reamer consistent with domestic law, taking account of differing legal systems and culture rather than demanding complete uniformity. They may reduce the need for case-by-case negotiation that can deplete regulatory resources and cause nearly endless delays, but they are a clumsy solution; each country could find itself with many MOUs that are different from one another. The SEC has MOUs with Canada, the United Kingdom, and Switzerland. The CFTC is party to MOUs with the United Kingdom and has arrangements with Australia, Canada, and Singapore for sharing information from monitoring and surveillance activities.

The risk with a policy of reciprocity with substantial equivalence is that countries with the most stringent regulations will be led to interpret "substantial equivalence' too broadly. They may begin to interpret their own rules more loosely and enforce them more slackly, in order to attract or retain foreign investment in the face of competition from countries with less prudential regulation. Then domestic firms will demand regulatory parity in order to compete with foreign fins, and this becomes a form of prudential deregulation through leveling downward--i.e., another form of regulatory arbitrage.

Many market participants and many regulators, although eager to engage in international trading of securities and derivative products, are critical of the objective of harmonization. For example, in the United States, CommissionerAlbrecht, of the CFTC, recently told a public meeting that:[24]

> Unfortunately, harmonization is a word that those of us at the Commodity Futures Trading Commission, as well as many in the futures industry, have come to view with a great deal of suspicion. . . . At

[22] IOSCO includes securities regulators from more than 40 countries.

[23] Becker and Etter, op. cit., footnote 18; see Note (Needham), "Insider Trading Liability," 16 *Brooklyn J. 357,381-385, 1988.*

[24] William P. Albrecht, "Harmonizing International Regulation of Futures and Options Markets," a Speech to the Conference on Futures and Options Markets in the 1990's—Innovation, Regulation and Jurisdiction, co-sponsored by the Commodity Futures Trading Commission and the Futures Industry Institute, Washington DC, May 2, 1990.

Box 6-A--International Organizations Related to Coordination of Securities Regulation

The International Organization of Securities Commissions (IOSCO)

Membership: Securities Regulators from about 40 countries. (SEC is the principle U.S. representative with CFTC as an associate member.)

Aims: Coordination, exchange of information, mutual assistance related to standards and surveillance.

Mechanism: Technical committee and working groups on multinational equity offerings, accounting and auditing standards, capital requirements and financial 'data, enforcement information exchange, off-market trading, clearing and settlement, futures markets.

Federation Internationale Des Bourses de Valeurs (FIBV)

***Membership:* 33** stock exchanges.

Aims: To facilitate exchange of information. Recently concentrating on clearing and settlement, disclosure requirements, listing procedures.

Mechanism: voluntary information exchange.

Group of Thirty

Also called The Consultative Group on Economic and Monetary Affairs.

Membership: 30 individuals from world-class banks, multinational corporations, government agencies, and academia.

Aims: To increase policymakers understanding of international economic and financial issues and explore the international effects of public and private decisions.

Mechanism: Ad hoc committees.

Organization for Economic Cooperation and Development (OECD)

Membership: 24 developed nations. Representation by ambassadors and at selected meetings by cabinet-level officials.

Aims: Encouragement of economic growth, expansion of world trade. Looks at securities coordination in terms of international flow of travel.

Mechanism: Permanent research staff, participation of ministers with authority over securities and other financial institutions.

International Councils of Securities Dealers and Self-Regulatory Associations

Membership: Formed in 1988, membership includes four SROs (Canada, Japan, the United Kingdom, the United States) and three Securities Dealers Associations (Canada, Japan, the United States).

Aims: To aid and encourage the sound growth of the international securities markets by promoting and encouraging harmonization in the procedures and effective regulation of those markets, thereby facilitating international securities transactions and by promoting mutual understanding and the sharing of information among the members.

the international level, some calls for harmonization should also be viewed with suspicion.

Commissioner Albrecht called on governments to recognize the importance of relying on market forces, saying "Competition is the best harmonizer, the best regulator of market forces." Commissioner Albrecht said that with regard to cross-national trading, "the CFTC favors a policy combining national treatment with mutual recognition,' and he defined the two terms as follows: national treatment requires authorities in each country to treat operations of foreign firms as they would those carried out by domestic firms; mutual recognition means that a country would allow foreign entities to operate within its jurisdiction as long as they complied with the regulations of their country of origin and "as long as the rules of the firm's country of origin are comparable to our own. ' However, the CFTC participates in international discussions and negotiations related to harmonization.

The SEC has indicated a somewhat different approach, saying that an effective regulatory struc-

[25]Ibid.

ture for an international securities market must include:

- efficient structures for quotation, price, and volume information dissemination, order routing, order execution, clearance, settlement, and payment, as well as strong capital adequacy standards;
- sound disclosure systems, including accounting principles, auditing standards, etc.; and
- fair and honest markets, through investor protection legislation, surveillance, and enforcement cooperation.[26]

At the end of 1989, the SEC signaled its intention of encouraging international cooperation in regulatory affairs by creating an Office of International Affairs that will report directly to the chairman of the Commission. The office is to set up information-sharing agreements with other countries and direct cooperative enforcement efforts. The CFTC also actively participates in many international regulatory cooperative activities.

Many countries are now reviewing their regulatory frameworks in response to the internationalization of markets. According to OECD:

> There is increasing awareness that securities market activities involve risks that are comparable to the systemic risks inherent in banking, and that, accordingly, the basic question arises as to what extent existing regulatory and supervisory arrangements are adequate to deal with current market realities.[27]

The EC's 1992 initiative (see ch. 4) provides an example of how harmonization could be achieved among major market nations, given sufficient incentive and leadership. If successful, the EC initiative may stimulate further action toward broad multinational cooperation. The 1992 directives are aims, not yet achievements, but enough has been done toward integrating European markets to make it likely that the EC will become a significant factor in international securities trading.

AMERICAN LEADERSHIP

It seems reasonable to conclude that the United States now has, in the aggregate, the largest and most liquid securities market and futures market in the world, and possibly the most efficient, innovative, and fair markets in the world—although there are certainly challenges on several of these fronts. Assuming that Congress believes that it is in the public interest to maintain this position, what must be done to assure our competitive position, while safeguarding the interests of U.S. investors, financial institutions, and most importantly, the public at large?

A number of international cooperative efforts are underway to achieve harmonization of regulation. The problem for policymakers is how to be sure that the United States encourages this movement and provides leadership for it, without becoming a victim of "regulatory arbitrage" in which countries with much lower levels of prudential regulation set the norms. This calls for coherent and consistent policy positions that American negotiators can present and defend.

One need is to prevent the erosion of the framework of prudential regulation that Congress has erected since 1934, as an unintended byproduct of the effort to achieve harmonization. The second need is to clarify and reassert congressional guidance over the evolutionary development of securities markets as they face the challenge of global trading. There may be differences between the two U.S. regulatory agencies in their approaches to international regulatory harmonization that could confuse and hamper American leadership in defining a desirable regime for global securities trading. A statement of policy similar to that underlying the Securities Act Amendments of 1975 maybe needed.

This implies something of a dilemma for U.S. policymakers. A general trend toward deregulation and non-intervention has been apparent in the United States as well as in other countries, during the 1980s. On the other hand, the United States sees many of the advantages of its chief competitor, Japan, as resting on the close relationship between financial institutions, industry, and government, so that Japanese investment banks operate in a market guided and insured by the government. There is legitimate concern that unnecessary regulation might interfere with the ability of exchanges, over-the-

[26] "Regulation of International Securities Markets," Policy Statement of the United States Securities and Exchange Commission, Washington DC, November 1988.

[27] OECD, Op. cit., footnote 8, p. 31.

counter markets, and financial information systems developers to experiment and innovate. There is fear that excessive regulation might make markets less efficient and drive trading to overseas exchanges. There are also encouraging signs that some U.S. markets are prepared to take a lead in developing the technology and institutional mechanisms for global trading; in this regard the futures markets are far ahead of the stock exchanges.

Large institutional investors want greater transaction speed, mobility, and opportunities for diversification, and there are already strong indications that they will seek more freedom from the clock than the traditional exchange trading hours and floor mechanisms can accommodate. U.S. stock exchanges are so far slow to show any interest in adopting automated trading systems that bypass or compete with traditional dealer intermediaries or that operate around the clock.[28] U.S. regulators may need to actively encourage market officials to take a long-term view of market development, and U.S. regulators themselves may have to be encouraged to do so by the U.S. Congress.

[28] A forthcoming OTA report, *Electronic Bulls and Bears—Securities Markets and Information Technology*, discusses these issues.