The Past Decade of Regulatory Change in the U.S. and EU Capital Market Regimes: An Evolution from National Interests toward International Harmonization with Emerging G-20 Leadership

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INTRODUCTION

The worldwide impact of the economic crisis on capital markets has caused United States (U.S.) and European Union (EU) regulators and policymakers to adjust their role in the context of a more interconnected global arena. The decade from 1999-2009 illustrates the changes that the U.S. has endured in its evolution from U.S.-centric attitudes, reflected in its laws and regulations affecting capital markets, to a more integrated approach. During this period, an internal evolution also took place within the EU, as its sovereign Member States moved toward an increasingly integrated approach demonstrated by the ratification of the Lisbon Treaty in 2009, which created a more centralized EU entity.1 The downturn in the global economy and its negative effect on capital markets has made it apparent that nations cannot act independently without regard to the impact of their actions on businesses and markets around the world.2

The U.S. has found it difficult to adjust its internal financial policies to the global arena because of its own geography, as well as its U.S.-centric attitudes as reflected in its interactions with interconnected capital markets. On the other hand, a global role is more familiar to Europe because of its geography and the colonization previously engaged in by many of its Member States. While the individual Member States in the EU have a clearer recognition of their external global role, they have not yet settled the nagging historical tensions that persist among them.3 These cross-border issues have resulted in Members' resistance to a centralized EU political structure, which in turn has made it difficult for the EU to internally harmonize its capital market regime with global policies.

The years between 1999 and 2009 provide a pertinent time span to examine the developments in international capital markets in light of global economic pressures4 and significant political events in the U.S.5 and the EU.6 The effect of

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2. The U.S. embarkation on a new era of global consciousness was reflected in a speech given in February 2009 by Mary L. Schapiro – Chairperson of the U.S. Securities and Exchange Commission (SEC or Commission) – in which she remarked that, as a result of the recent economic challenges facing the U.S., we must "move with great urgency to... modernize our country's regulatory system to match the realities of today's global, interdependent markets." Mary L. Schapiro, Chairperson, U.S. Securities and Exchange Commission, Address to Practising Law Institute's “SEC Speaks in 2009” Program, Washington, D.C. (Feb. 6, 2009), available at http://www.sec.gov/news/speech/2009/spch020609mls.htm. The same tone appeared in an earlier statement from the Department of Treasury that "the increasing interconnectedness of the global capital markets poses new challenges: an event in one jurisdiction may ripple through to other jurisdictions." U.S. DEPT. OF TREASURY, BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE 26 (March 2008), http://www.treas.gov/press/releases/reports/Blueprint.pdf [hereinafter DEPT. OF TREASURY BLUEPRINT REPORT].
4. Markets around the world became destabilized in Fall 2008. Capital markets started freezing up in succession: the interbank lending market, money market funds, and the commercial
the economic crisis on capital markets worldwide has caused U.S. and EU policymakers to rethink their role in a more interconnected global arena. There is an emerging recognition that national interests can no longer dominate; rather, these interests must be harmonized with the global environment in which other regions, like Asia and South America, are becoming increasingly important economically.

Analyzing the legislation, regulation, and policy during 1999 through 2009, the U.S. evolution from a nationalistic to an enhanced international consciousness occurred in four stages:

**STAGE I**: Reinforcing U.S. National Interests through a U.S.-centric Approach to Laws and Regulations;

**STAGE II**: America's Global Wake-up Call: U.S. Faces Increased Competition and International Pressures in the Intertwined Capital Marketplace;

5. Important changes to the U.S. political climate occurred between 1999 and 2009 that impacted the financial markets including: the end of Democratic President Bill Clinton's second term in which major legislation was passed deregulating critical aspects of the financial marketplace; eight years of a free-market era under Republican President George W. Bush, which incorporated the attack on the World Trade Center and the start of the controversial war in Iraq; and the first year of Democratic President Obama's term in which a more globally inclusive tone has been implemented. See Obama's Speech to the United Nations General Assembly (Text), N.Y. TIMES, Sept. 24, 2009, http://www.nytimes.com/2009/09/24/us/politics/24prexy.text.html.


Although the four designated stages are set against a U.S. backdrop, the events that occurred and the policies that are developed within each stage are interwoven with the global environment in which they took place. Particular attention is given to the EU, which combined with the U.S., "make[s] up 70% of the world's capital market."7

This paper analyzes the factors within each stage as they have been shaped by the global economic events and crises, as well as by increased international pressures that have served as a catalyst for the U.S. and EU to move more rapidly toward international cooperation and harmonization of regulations, standards, and policies.

In Part I, this paper examines the stage during which the U.S. continued to focus on reinforcing national economic interests without considering their external impact. Pivotal examples include the deregulation trend reflected by the 1999 repeal of the Glass-Steagall Act8 and the enactment of the 2000 Commodities Futures Modernization Act (CFMA),9 which played a role in creating the environment for the worldwide financial crisis a few years later. The rules-based Sarbanes Oxley Act (SOX)10 followed in 2002. It was widely criticized for Section 404, which has a focus on the establishment of internal

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control systems designed to detect financial fraud, and the expensive audit of those internal control systems. Corporations complained that Section 404 rules, and the burdens imposed on businesses by the SOX-created Public Companies Accounting Oversight Board (PCAOB), created oppressive financial and procedural burdens for domestic issuers, foreign issuers within and outside U.S. borders, and independent auditors.  

Parts II and III address the period prior to the financial crisis during which the U.S. received its wake-up call to the expanded viability of global securities markets. These Parts examine the U.S. reaction through Securities and Exchange Commission (SEC) initiatives related to SOX and through other steps taken by the SEC, the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) toward convergence of the International Financial Reporting Standards (IFRS) and the U.S. Generally Accepted Accounting Principles (GAAP). In addition, this paper discusses other external factors, such as the rapid growth in emerging nations and the stock exchange consolidation and harmonization that increased the pressure for changes in U.S. financial market regulation.

In Part IV, this paper analyzes the reform efforts of the newly formalized G-20\textsuperscript{12} and of other international groups. Driven by the onset of the worldwide financial turmoil, these groups developed a strategy for making necessary adjustments in capital market regimes. This paper will also evaluate the legislative actions on financial reform taken by the U.S. and EU, which reflected the recommendations of the G-20 to inject a comprehensive harmonization of national interests with global and multilateral policies. This paper will conclude by delineating recommendations for the G-20 in setting guidelines for establishing the necessary institutional structures and by addressing questions posed by former Soviet leader Mikhail Gorbachev\textsuperscript{13} with regard to the role and function of the G-20. The recommendations are presented in the context of the progress and challenges ahead in the new world order in which harmonization is beginning to replace introspective national interests.

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I.

STAGE ONE: REINFORCING U.S. NATIONAL INTERESTS THROUGH A U.S.-
CENTRIC APPROACH TO LAWS AND REGULATIONS

The repeal of the Glass-Steagall Act in 1999 and the passage of the Commodities Futures Modernization Act of 2000 (CFMA) set the U.S. backdrop for what ultimately precipitated the financial crisis of 2009: the risky financial instruments created by Wall Street and invested in worldwide. These legislative actions were followed by the enactment of SOX in 2002. It was passed in quick reaction to the accounting fraud scandals. SOX is applicable to every publicly traded company, both domestic and foreign, along with their officers and directors. A methodical analysis of the underlying problems that developed externally as a result of the legislators' U.S.-centric approach requires an examination of the requirements of SOX Section 404 and a review of the way in which the PCAOB, which SOX created, operates.

A. Important U.S. Statutes Deregulating Functions within Financial
Institutions and Clarifying the Legitimacy of Derivative Instruments

In 1999, Congress repealed the depression-era Glass-Steagall Act, which had separated commercial banking from investment banks; the repeal was included as a small part of the Financial Modernization Act ("Gramm-Leach-Bliley"). The repeal had a significant impact on the way banks and Wall Street investment companies interacted. For more than 60 years, Glass-Steagall had prevented commercial banks from engaging in the business of underwriting corporate securities, but after its repeal the floodgates were then opened for banks to "re-enact the same kinds of structural conflicts of interest that were endemic in the 1920s." The newly created interrelationship allowed banks to

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get deeply into underwriting mortgage-backed securities and issuing exotic derivatives that were at the very heart of the credit crisis.20

Furthermore, in retrospect, the Commodities Futures Modernization Act of 2000 provided a boost toward a greater deregulated financial environment. 21 It was passed in December 1999, the last month of President Clinton’s second term in office. The thrust of the CFMA was the specific exclusion from regulation of over-the-counter (OTC) derivatives - such as credit default swaps,22 as long as the parties trading were large institutions or wealthy individuals. This specific exclusion encouraged the extensive use of innovative derivatives; the high risk, exotic financial instruments that created a fertile environment for the later worldwide economic upheaval.

B. Passage of the Sarbanes-Oxley Act

The passage of the rules-based23 Sarbanes-Oxley Act (SOX) in 2002 arose from Congressional attempts to restore investor confidence in the securities markets in response to the devastating damage suffered from massive accounting frauds.24 President George W. Bush characterized SOX as “the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt.”25 It also had a profound effect on domestic public issuers, as


23. According to one author, “a rule generally entails an advance determination of what conduct is permissible leaving only factual issues to be determined by the frontline regulator. . .” while “a principle may entail leaving both specification of what conduct is permissible and factual issues to the frontline regulator.” Cristie L. Ford, New Governance, Compliance, and Principles-Based Securities Regulation, 45 AM. BUS. L.J. 1 (2008).

24. Serious acts of accounting fraud, misconduct, and erosion of ethical standards were exposed in high-profile cases like Enron, WorldCom, Tyco, and Adelphia. See JERRY W. MARKHAM, A FINANCIAL HISTORY OF MODERN U.S. CORPORATE SCANDALS FROM ENRON TO REFORM 13 (2006) (briefly explaining the legal problems arising in these cases).

25. President Bush Signs Corporate Corruption Bill, THE FEDERALIST SOCIETY, July 30,
well as a significant impact abroad. In the rush to pass SOX in 2002, Congress failed to fully recognize the ramifications that some of its stringent provisions might have beyond U.S. borders. This myopic vision resulted in complaints from foreign businesses and auditors about the negative extraterritorial effect and complaints from EU officials that Congress had failed to confer with them.

There were two sections that were particularly burdensome to U.S. and non-U.S. public issuers: (1) the internal control reporting requirements for all public companies in Section 404 and (2) the establishment of the Public Company Accounting Oversight Board (PCAOB) and its original Auditing Standard No. 2 (AS2).

1. Rules of SOX Section 404 Creating Burdens on Domestic and Foreign Businesses

One of the primary reasons for the SOX legislation was to protect investors from accounting fraud by mandating processes that would produce more reliable financial information. To accomplish this, Congress included stringent rules, later implemented by the SEC, that require public companies to maintain an adequate internal control system, require an assessment of the effectiveness of the system, and require outside auditors to evaluate the internal control assessment, as well as a certification by the CEOs and CFOs that the reports are accurate. Unfortunately, the legislation was passed with such haste that there was no solicitation of cooperation from other countries that would be affected by its cross-border application.


26. Section 404 of SOX and the PCAOB former Auditing Standard 2 (AS2) were criticized because they created oppressive financial and procedural burdens for non-U.S. issuers and independent auditors trying to comply with the rules. Id. Public Company Accounting Oversight Board, Auditing Standard No. 2: An Audit of Internal Control over Financial Reporting Performed in Conjunction With an Audit of Financial Statements (superseded by Auditing Standard No. 5) (March 9, 2004), available at http://www.pcaobus.org/Standards/Standards and_Related_Rules/Auditing_Standard_No.2.aspx [hereinafter PCAOB Auditing Standard No. 2].

27. David Wright, Director of Financial Services Policy and Financial Markets (2000-2007) of the European Commission complained that SOX was "passed without the slightest regard to third world countries and with no consultation." See Timon Molloy, Half-Time and a Pause for Breath, 16 COMPLIANCE MONITOR 1 (June 2004).


32. Molloy, supra note 27 (referring to the complaint by a European commissioner that there had been no consultation).
Section 404 is the most problematic of the mandates in SOX because the implementation of the internal control provisions proved to be very difficult, expensive, and time consuming for both domestic and foreign issuers, particularly for small public companies.\(^{33}\) The purported benefits of Section 404, such as an end to many fraudulent accounting practices and the increased confidence of compliance, are difficult to measure, while the costs of compliance are immediate and easy to identify.\(^{34}\) SOX critics were bolstered by former Treasury Secretary Henry Paulson’s public stance that endorsed the broader approach of “whether U.S. corporate governance and listing requirements strike the right ‘regulatory balance’ between protecting investors and imposing undue restraints and cost on business.”\(^{35}\)

2. Establishment of the PCAOB in SOX Creating Burdens on Domestic and Foreign Businesses

The PCAOB is a private sector, non-profit corporation created in the SOX legislation to oversee the auditors of public companies, i.e., to audit the auditors.\(^{36}\) The SEC is vested with the authority to appoint Board members, as well as oversight and enforcement authority. No rule of the Board becomes effective without prior approval of the SEC.\(^{37}\) The Board’s authority to inspect extends only to registered accounting firms, but the authority to inspect does not extend to public companies themselves.\(^{38}\)

Congress established the PCAOB in Section101 of SOX for the purpose of engaging in a compulsory, independent oversight of auditors “in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports.”\(^{39}\) Auditors lost their right to self-regulation after it was demonstrated that they failed in their duty as gatekeepers when their role in the accounting scandals with Enron, WorldCom


\(^{34}\) See Clyde Stoltenberg, Kathleen Lacey, Barbara Crutchfield George & Mike Cuthbert, A Comparative Analysis of Post-Sarbanes-Oxley Corporate Governance Developments in the U.S. and European Union: The Impact of Tensions Created by Extraterritorial Application of Section 404, 43 AM. J. COMP. L. 457, 462 (2006).

\(^{35}\) Krishna Guha & Jeremy Grant, Paulson to Call for Rethink on US Rules, FIN. TIMES, Nov. 20, 2006, at 1. As former Goldman Sachs chairman, Mr. Paulson had a broad business-oriented perspective. He understood the global competitive challenge to the U.S. capital markets if the U.S. persisted in its rules-based financial regulatory system. Id.

\(^{36}\) Sarbanes-Oxley Act §101; see also Sarbanes-Oxley at Four: Protecting Investors and Strengthening Markets Hearing before the House Committee on Financial Services, 109th Cong. (2006) (statement of Christopher Cox, SEC Chairman).

\(^{37}\) Sarbanes-Oxley Act §108.


\(^{39}\) Sarbanes-Oxley Act §101.
and others was revealed. However, the creation of the PCAOB caused so much irritation in the business community that in 2007, a Nevada-based accounting firm and a number of groups, including the conservative Free Enterprise Fund, brought a lawsuit attacking the constitutionality of the Board. If the lawsuit had been successful, it would have invalidated SOX.

a. Problems Related to Foreign Audit Firms Inspections

SOX authorizes the PCAOB to inspect U.S. and non-U.S. registered firms “for the purpose of assessing compliance with certain laws, rules, and professional standards in connection with a firm’s audit work for clients that are ‘issuers’ as that term is defined in the [Securities and Exchange] Act.” Section 106 of SOX includes a subsection titled “Inspections of Foreign Registered Public Accounting Firms”, which was implemented through rules issued by the

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43. See Inspected Firms, PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD, http://pcaobus.org/Inspections/Pages/InspectedFirms.aspx (last viewed Aug. 22, 2010).
Thus, any non-U.S. public accounting firm that prepares or furnishes an audit report with respect to any U.S.-listed public company, whether domestic or foreign, is subject to SOX and the rules of PCAOB. The extraterritorial application included in that section was a source of frustration in Europe.

b. Early Problems Related to the PCAOB’s Original Auditing Standard No. 2 (AS2)

SOX Section 103 provides that the PCAOB should establish rules governing auditing, quality control, and ethics standards. As directed, the PCAOB developed Auditing Standard No. 2 “to provide for an integrated audit of both internal control over financial reporting and the financial statements themselves.” There were bitter complaints about the vague and unnecessarily complex rules in AS2 during the four years of its application, before being substantially improved and replaced with AS5 in 2007.

During the period of AS2 applicability, the PCAOB came under intense criticism from domestic and foreign companies and auditing firms in two areas. First, the lack of clarity in AS2 (a document over 180-pages) prompted auditors to require excessive internal control checks. Businesses and audit firms argued these checks were both unnecessary and costly and were the cause for overkill by auditors in their quest to meet compliance requirements. Second, inspections of domestic and foreign registered public accounting firms were viewed as intrusive as they “audit[ed] the auditors.” The argument was that AS2’s lack of clarity prompted auditing firms to overreact and require excessive checks to ensure compliance. The Institute of Management Accountants blamed the SEC for not providing sufficient guidance on the scope of management’s

44. Sarbanes-Oxley Act §106(a); PCAOB Rule 4012.
46. Board to Consider Proposing a Revised Auditing Standard on Internal Control over Financial Reporting, PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD (Dec. 5, 2006), http://www.pcaobus.org/News and Events/News/3006/12-05.aspx. The SEC approved the original A2 standard and it “serves as a companion to the SEC’s rule implementing Section 404(a) of the Act, which requires companies annually to provide their managements’ assessments of the effectiveness of internal control.” Id.
48. Id. It is interesting to note that public accounting firms that were targets of SOX ironically have ended up profiting from Section 404 by offering costly compliance services for internal controls. See Ernst & Young Internal Controls, ERNST & YOUNG, http://www.ey.com/US/en/Services/Advisory/Risk/Internal-Controls (last viewed May 1, 2010).
49. Ernst & Young Internal Controls, supra note 48.
50. Id.
internal control compliance checks, leaving the void to be inadequately filled by the PCAOB.\textsuperscript{51}

As discussed later in this paper, most of the criticisms of AS2 have been addressed in the principles-based approach used in the PCAOB’s adoption of AS5 as the replacement for AS2.

II.

\textit{STAGE TWO: AMERICA’S GLOBAL WAKE-UP CALL: U.S. FACES INCREASED COMPETITION AND INTERNATIONAL PRESSURES IN THE INTERTWINED CAPITAL MARKETPLACE}

A. \textit{Period of Transition (from Stage One into Stage Two)}

The U.S. received a firestorm of criticism from issuers mandated to meet SOX requirements, particularly small companies and the foreign issuers subject to the Act’s extraterritorial application of Sarbanes-Oxley.\textsuperscript{52} Significant negative press on SOX emanated from evidence that the largest international Initial Public Offerings (IPOs) were now taking place outside of the U.S. Foreign issuers complained that there was not enough time for them to comply with the SOX Section 404 management assessment requirement. Along with the vociferous criticisms about the flaws in Section 404, listed companies blamed the vague and confusing rules in the PCAOB guidelines in AS2 (which were used as a default framework to the SEC rule for preparation of audits) for the nitpicking and the unnecessary, expensive work by their independent auditors.\textsuperscript{53}

The negative reaction from both foreign and domestic issuers jolted U.S. financial policymakers into recognizing that they had inadvertently ignored the way in which the financial world was changing. Policymakers began to realize that their actions had created stronger competition for Wall Street and caused the loss of a significant number of IPOs, as issuers turned to non-U.S. public markets that had grown stronger in the new global economy. It became clear that if some remedial action was not taken, the United States would no longer play the commanding role it did during the second half of the twentieth century as a source of global capital. While U.S. capital markets remained “the largest, most liquid, and efficient in the world, ... in recent years ... more companies have turned to overseas markets to raise capital.”\textsuperscript{54}

\begin{itemize}
\item \textsuperscript{51} \textit{Id.}
\item \textsuperscript{52} Stoltenberg, et al., \textit{supra} note 34.
\item \textsuperscript{53} In a survey of senior executives at 334 companies based in the U.S., U.K., Germany, France, India, China, and Japan, the Financial Services Forum found that the most important factor in a firm’s decision to delist from a U.S. exchange was not availability of capital, but rather accounting standards, SOX, or the litigation environment in the United States. \textit{The Financial Services Forum, 2007 Global Capital Markets Survey} (Dec. 11, 2007).
\item \textsuperscript{54} \textit{Id.} In 2006, more capital was raised through initial public offerings on the Hong Kong
Not only has the share of capital raised through IPOs and secondary offerings on global public markets fallen since 2002, but more U.S. companies are choosing to list shares overseas than on U.S. capital markets. Larger overseas capital markets make it “easier for foreign companies to raise investment capital closer to home,” but even “when companies do decide to list outside their home country, they are increasingly looking to non-U.S. markets.”

Professor Luigi Zingales, the distinguished University of Chicago economist, argues that most of the U.S. losses have nothing to do with regulation, but simply result from the fact that other capital markets are becoming better. He asserts that Americans are good at playing the game the American way, but there is a need to recognize that the U.S. can no longer cling to the narrow perception that it has “the most competitive team in the world.”

Thus, it can be argued that the two major sources of increased competition involve a combination of rising economic power and wealth in other markets, and negative perceptions regarding the burden of market regulation in the U.S.

B. Factors Involved in Declining U.S. Competitiveness Against Foreign Rivals

1. Opinions Regarding Reasons for the Decline

A number of varying opinions were expressed about the reasons for the declining competitiveness of U.S. capital markets. New York Mayor Michael Bloomberg and Senator Charles Schumer released a report in January 2007, citing problems posed by the threat of securities litigation and overly complex regulation as the main causes of the decline. Others, however, suggested that the trend toward listing in London and Hong Kong “reflect[ed] the development of those markets, as well as advancements in technology.”

Still others...
hypothesized that New York’s comparative decline of market share in the global economy was “probably in large part a simple reflection of the growth of the rest of the world.”61 Furthermore, the weakening dollar could be seen as aggravating the apparent shift.62 The shift toward Europe, in particular, could be attributed in part to the expansion of the “Eurozone”, thereby increasing the appeal of the currency.63 From a broader perspective, it has been suggested that “the fact that economies that were closed to outside investment a generation ago are now creating systems of market capitalism should be seen as a victory for the United States, not a defeat.”64

2. U.S. Strict Regulatory Environment Cited as a Factor in Declining Competitiveness

a. The Impact of Regulation on Listings

Following the mid-term elections in 2006, Treasury Secretary Henry Paulson acknowledged in a speech to the Economic Club of New York that the requirements of SOX and the revamped accounting rules might discourage foreign companies from listing in the United States financial markets. He attributed the decline in foreign listings to “a complex and confusing regulatory structure and enforcement environment... and new accounting and governance rules which, while necessary, are being implemented in a way that may be creating unnecessary costs and introducing new risks to our economy.”65 While acknowledging that post-Enron legal and regulatory changes had improved transparency and accountability at companies and restored investor confidence, he also observed that lawmakers and regulators had gone too far and that it was time for a reassessment.66 Contemporaneously, the accounting profession also issued reports calling both for relaxed standards of liability67 and for

62. “Even adjusting for the differential power of currencies in their home markets, growth in the United States has lagged global growth over the last 10 years.” Id.
63. Id.
64. According to Jim O’Neill, head of global economic research in the London office of Goldman Sachs, “Many of the countries that are doing well are mimicking the best of what America has stood for—globalization and the export of the American capital markets culture. There’s nothing that New York and U.S. policies can do about it unless they want to roll back globalization.” Id.
66. Id.
67. The report, issued by the heads of the six largest auditing firms in the world, “did not offer
replacement of static quarterly financial statements with real-time, internet-based reporting encompassing a wider range of performance measures. 68

Commentators suggested that events were confirming the initial concerns. The number of foreign companies listing on the New York Stock Exchange fell to an average of eighteen per year between 2003 and 2005 from an average of forty-eight per year between 2000 and 2002. 69 As a result, "exchanges in Brazil and India are attracting a healthier proportion of their domestic issues." 70 Furthermore, exchanges "perceived to have a lighter regulatory touch . . . are winning foreign listings that would traditionally have gone to New York. For [London], these have included notable Russian listings. For Hong Kong it is Chinese companies." 71 The chairman of the Cato Institute at the time noted, "the average 'listing premium'—the benefit that companies receive by listing their stocks on American exchanges—has declined by 19 percentage points since 2002." 72 He claimed that "[t]his explains why the percentage of worldwide initial public offerings on our exchanges dropped to 5 percent [in 2006], from 50 percent in 2000." 73

b. Recommendations of the Committee on Capital Markets Regulation on SOX (2007)

In September 2006, a group of high-profile investment banking executives, hedge fund managers, corporate chiefs and professors formed a new independent committee ("The Committee on Capital Markets Regulation") to


68. Barney Jopson, Accountancy Firms Map Out New World, FIN. TIMES, Nov. 8, 2006, at 19.
70. Id.
71. Id.
73. And the Chairman of the Cato Institute suggested that other costs associated with SOX might be even more important: "For example, more stringent financial regulations and increased penalties for accounting errors may make senior managers too risk-averse. Most chief executives are not accountants, so the requirement that they personally affirm tax reports — at the risk of jail time should anything be amiss — may make them reluctant to partake in perfectly legitimate activities." Id. With respect to venture-capital-backed companies, the National Venture Capital Association issued a report which included the finding that "57 percent of 200 investors surveyed say there will be a growing propensity in the industry to take American companies public in overseas markets in 2007." Matt Richtel, Looking for Best Place to Take a Company Public, Some Look Overseas, N.Y. TIMES, December 22, 2006, available at http://www.nytimes.com/2006/12/22/business/worldbusiness/ 22venture.html?ref=business.
evaluate "whether U.S. capital markets regulations [were] making American companies less competitive than their foreign rivals." At the time, it was noted that European merger and acquisition activity was outpacing that of the U.S., and that the Asia Pacific region excluding Japan had also hit record levels, while the U.S. market was showing only modest growth. Treasury Secretary Paulson endorsed the committee's mission, noting, "this issue is important to the future of the U.S. economy and a priority for me." Similarly, John Thain, the then New York Stock Exchange (NYSE) Chief Executive, echoed the concern about the flight of capital markets activities to foreign shores as the U.S. equity market limped along.

At the end of November 2006, the Committee on Capital Markets Regulation issued its interim report, calling for a sweeping overhaul of securities market regulations. It recommended raising the standard for indictments brought by the government or suits brought by private lawyers against companies, and urged the creation of policies to keep the SEC from adopting rules that impose high costs on business. The report contained thirty-two recommendations over four major categories: shareholder rights; the regulatory process; public and private enforcement; and the effect of SOX.

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75. Id.

76. Press Release, Committee on Capital Markets Regulation New Independent Non-Partisan Committee to Study Capital Markets Regulation and Make Recommendations to Key Policy Makers (Sept. 12, 2006), http://www.capmktsreg.org/pastpress_releases.html#9_12; see also id.


81. "[T]he committee endorsed a move to regulation based on principles rather than specific laws, as favored by the UK's Financial Services Authority . . . and the importance of cooperation among federal regulators and state-specific efforts." Id.

82. "[T]he committee . . . pushed for reform of the tort system, which governs class-action law suits against companies." It also recommended "criminal enforcement against companies should be a last resort, reserved for companies that have become criminal enterprises from top to bottom. We should not hold outside directors responsible for corporate malfeasance that they cannot possibly detect." Id.
C. International Pressures Impacting Position of the U.S. in the Intertwined Capital Marketplace

1. Relatively Rapid Growth in Emerging Nations

While the emerging economies (such as Brazil, Russia, India and, China—collectively referred to as the BRIC countries—and the ASEAN countries) account for less than fifteen percent of global stock market capitalization, they produce over forty percent of global exports, contribute fifty percent of global GDP adjusted for purchasing power parity, and hold seventy percent of the world's foreign exchange reserves. Their export growth and comparatively high savings rates have helped produce their high foreign exchange reserves, giving them a newfound level of economic power among the nations of the world. Emerging economies' critical position in global dispersed manufacturing and developed-country supply chains has given them leverage to go along with their power. Like Japan in the 1980s, China's rising prominence in the international monetary and financial system could be "linked to its sudden emergence as a major creditor country." It has "suddenly emerged as a public authority with considerable clout in the international financial system because of its influence over very large international assets.'

With the BRIC economies growing and becoming more open, it is no wonder that they are becoming bigger players in the global economy and providing alternatives to the traditional Triad (Europe, North America, and Japan) markets as sources of capital. While economic reform in the big emerging economies can "improve global welfare, particularly if [the countries] are incorporated into multilateral institutions and are induced to play by their rules," it is also true that "more efficient nations become stronger economic competitors."

In addition to their growing economic power and leverage, some of the big emerging economies' other traits are also important to the global competitive

83. MIKE W. PENG, GLOBAL BUSINESS 5 (2009).
China became a net creditor only in 2003, but its net foreign assets have accumulated very rapidly since then, totaling US$1.022 trillion by the end of 2007. The most dramatic symbol of China's growing creditor position has been its foreign exchange reserves, which rose to a total of US$1.7 trillion by mid-2008. China's creditor status has emerged alongside the country's rapidly growing current account surplus, which is presently the largest in the world (and valued at approximately 11 percent of China's GNP).

Id.
85. Id. at 89.
dimension. In the case of emerging economies transitioning from a centralized planning process toward more market-oriented practices, it was widely assumed by the late 1990s that “private markets [had] triumphed over the state,” and “countries that wanted to succeed had to embrace the policies favored by private capital.” However, more recent developments challenge the notion that private markets have completely triumphed over the interventionist state. In what one commentator has characterized as a “neo-Westphalian” global market, two key developments have emerged: “First, large states are again key actors in financial markets,” and “second, national governments have more financial firepower than do the multilateral institutions.”

The increased economic power and leverage of the emerging economies combined with the role of the state in some of them led to a “theory of decoupling centered on the belief that emerging markets had broken away from their western peers and so would be unaffected in the event of a downturn in the more developed economies, such as the U.S. and Europe.” Even as late as 2007, proponents of the decoupling theory “argued that emerging markets would separate from the U.S. and Europe and come out of the credit crisis stronger than developed economies.” Although the U.S. was the source of the 2008 financial crisis, its impact on developed and emerging economies belies the claim of

88. Today’s global economic system is marked both by increased trade—including greater trade in financial assets—and by a far larger state role in the financial markets. Martin Wolf, the Financial Times’ influential columnist, recently wrote, “Globalization was supposed to mean the worldwide triumph of the market economy. Yet some of the most influential players are turning out to be states, not private actors.” The reassertion of the state in the marketplace has come not from an expansion of the state’s regulatory role, but rather from the growing role governments—particularly governments in the emerging world—play in key global markets. Global financial order once again depends heavily on the financial decisions of large states, not just on swings in private market flows. Id. at 17-18.
89. Id. at 18. While the total stock of privately held financial assets in the United States, Europe and Japan remains large relative to the stock of financial assets in government hands, the foreign assets of key emerging market governments are growing far faster than those of private intermediaries. The foreign portfolios of large emerging market states now exceed the foreign assets of even the largest private financial institutions.
90. Id. “While the IMF’s lending capacity is $250 billion, by mid-2008, China held US$1800 billion at its central bank, with another US$500 billion or so in the hands of the state banks and in China’s new sovereign wealth fund. . . . Through the increase in the dollar holdings of their central banks and sovereign funds, emerging market governments [were] likely to provide $1 trillion in financing to the United States in 2008. This dwarfs IMF lending to the emerging world in the 1990s. The largest IMF program topped out at around $30 billion. The Group of Seven (G-7) countries generally preferred to lend to troubled emerging economies in concert, often through the IMF. By contrast, today’s emerging powers have financed the United States through a series of uncoordinated national decisions. No multilateral institutions that advocate for coordination on a level comparable to that of the G-7—let alone of the IMF—exist among today’s new financial powers.” Id.
92. Id.
decoupling. That is not to say, however, that the emerging economies’ role has not become stronger. It is the G-20, not the G-6 or G-7, that has been at the forefront of articulating a more coordinated response to the crisis. And it is the emerging economies that are driving the current recovery and, some argue, leading innovation and developing the new business models of the future.

2. Stock Exchange Consolidation and Harmonization

The financial press provided considerable coverage of proposed link-ups between the New York Stock Exchange (NYSE) and Euronext (a pan-European operator running exchanges in Amsterdam, Brussels, Lisbon, Paris, and the futures market in Britain), which was consummated, and between NASDAQ and the London Stock Exchange (LSE), which failed. Yet these two high-profile negotiations were merely part of a larger scenario involving a dozen exchanges on three continents. At the end of 2006, one commentator wrote, “untangling the prospects for global exchange consolidation this year has been like trying to understand the plot of a Mexican soap opera. A dozen protagonists on three continents flirted, rejected and accepted advances, but there was little consummation.” From a U.S. perspective, the urgency reflected concern “about declining competitiveness of U.S. capital markets in the face of greater competition from capital markets in Europe and Asia.”


94. All the elements of modern business, from supply-chain management to recruitment and retention, are being rejigged or reinvented in one emerging market or another. The World Turned Upside Down: A Special Report on Innovation in Emerging Markets. ECONOMIST, Apr. 17, 2010, at 1.


96. Greg Ip, Is a U.S. Listing Worth the Effort?, WALL ST. J., Nov. 28, 2006, at Cl. Of particular interest was empirical research demonstrating a reduction in the premium investors were willing to pay for shares of foreign companies listed in the U.S. A study by University of Chicago finance professor Luigi Zingales showed that the premium for listing on both U.S. and foreign exchanges, which had averaged 51 percentage points from 1997 to 2001, dropped to 31 percentage points between 2002 and 2005. Id. On the other hand, a study completed by University of Chicago accounting professor Christian Leuz suggested that the credibility gained when non-U.S. companies comply with U.S. corporate governance laws outweighs the resultant costs. His study indicated that foreign firms save money when they have shares traded both on U.S. and native country exchanges: “[r]esearch done by others shows that the market valuation of foreign firms goes up between 10 percent and 30 percent when their shares are listed in multiple countries.” Andrzej Zwaniecki, Benefits Often Outweigh Costs of Compliance With Sarbanes-Oxley Act, U.S. STATE DEPT. WASH. FILE, July 19, 2006, http://usinfo.state.gov/xarchives/display.html?p=washfile-english&y=2006&m=July&x=2006071917232. Another contemporaneous study completed by Mazars, a Paris-based accounting firm, found that “more than 72 percent of Asian and 81 percent of Latin American firms surveyed said they believe the benefits will exceed the costs of compliance with Sarbanes-Oxley and none would consider delisting.” Id. The same study, however, found that “only 43 percent of European companies think the law’s benefits will outweigh its costs, and 17
a. Acquisition Efforts

Whatever the underlying reasons, U.S. stock exchanges recognized the trend and undertook their acquisition efforts as a result. There were, however, many twists and turns along the way. Even though the NYSE and Euronext solidified their relationship, there were efforts within Europe to avoid that result. Most notably, the German stock exchange made a competing effort to buy Euronext.97 "Another factor . . . was that the proposed deal with Euronext likely faced the prospect of a lengthy review of the deal by European competition authorities in Brussels."98 The collapse of negotiations between the German exchange and Borsa Italiana, which some viewed as an attempt to place pressure on Euronext to consider a three-way European merger instead of joining forces with the NYSE, also undercut the German exchange's Euronext strategy.99

A major concern that the NYSE overcame in its successful pursuit of Euronext was the fear by Euronext corporate users of being subject to SOX regulation. Euronext agreed, "to create an independent foundation for the tie-up, which could be dissolved in the case of regulatory overspill."100 Declarations from both the SEC and Treasury Secretary Paulson vouching against regulatory spillover of SOX rules into Europe provided additional assurance.101 To overcome fears that the U.S. exchange would be favored, the NYSE also agreed with Euronext to change the planned board composition so that each exchange would be equally represented.102 Spillover regulatory issues were also an aspect of the NASDAQ-LSE negotiation, but it confronted additional issues that led to its perception in Europe as essentially a hostile takeover bid.103

percent would consider delisting from U.S. stock exchanges." Id.


98. Id.


103. First, as the NASDAQ bid evolved (NASDAQ already had a 29.35% stake in the LSE), it came to appear more like a hostile takeover. Although the LSE had eluded a number of takeover bids since its first public offering in 2001, commentators gave NASDAQ's offer a reasonable chance of success. With trading costs in Europe as much as 80% higher than in the U.S., the LSE was under considerable pressure to reduce costs to avoid possible defection of key customers. Stanley Reed, Up Against the Wall in the City, BUS. WK. ONLINE, Dec. 4, 2006, http://www.businessweek.com/print/
b. Competitive Pressures

Both the NYSE-Euronext and NASDAQ-LSE negotiations were proceeding against the backdrop of yet another competitive development in Europe, which saw seven of the biggest banks (Morgan Stanley, Goldman Sachs, Citigroup, Credit Suisse, Merrill Lynch, UBS, and Deutsche Bank) unveil plans to build a share-trading platform in Europe that would rival other European stock markets. Although earlier bids to build alternative exchanges in Europe had failed, the banks felt that the situation had changed enough to make it worth another attempt.104

The NYSE also added competitive pressures on the NASDAQ by entering into a "broad, non-exclusive agreement" with the Tokyo Stock Exchange to "cooperate on joint developments such as financial products, mutual listings and technology."105 For the NYSE, the alliance brought access to Asia’s largest market amidst "rebounding stock and asset prices as Japan’s economy finally recover[ed] from a long slump in the 1990s."106 Furthering its Asian market

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104. First, an EU directive had been promulgated that permitted the creation of new trading platforms. Second, the technology for setting up an exchange had become readily available from Sweden’s OMX bourse and elsewhere. The banks felt that their proposed integrated trading platform “would allow equities to be traded more cost effectively and allow users to obtain ‘significant liquidity with greater efficiency.’” Kanter, supra note 97; SEC, Euronext Regulators Sign Regulatory Cooperation Arrangement, Press Release, SEC, Euronext Regulators Sign Cooperation Arrangement (Jan. 25, 2007), available at www.sec.gov/news/press/2007/2007-8.htm [hereinafter SEC, Euronext Regulators Sign Cooperation Arrangement].


106. Id.
penetration goals, the NYSE also purchased a five percent stake in India’s Mumbai-based National Stock Exchange.\textsuperscript{107}

c. Evolving Harmonization Process

John Thain, then head of the NYSE, aptly summarized the situation of exchange consolidation as follows: “Globalization is both good and inevitable. In some ways we’re lagging behind what has already happened in the marketplaces themselves. The marketplaces are already global.”\textsuperscript{108} The regulatory dimension of this phenomenon was aptly summarized by Benn Steil, senior fellow at the Council on Foreign Relations, when he observed, “Stock exchanges were always national institutions and were usually local institutions. The idea of an international stock exchange is quite revolutionary.”\textsuperscript{109}

The process of harmonization—represented most prominently in this context by the multilateral process of developing international accounting standards and their growing acceptability and utilization—provides at least some elements of a model for moving forward.\textsuperscript{110} SEC Commissioner Annette Nazareth specifically addressed the issue of conflicts in international regulatory standards relative to transatlantic financial market consolidation in her keynote speech to the UCLA Law Third Annual Institute on Corporate Aspects of Mergers and Acquisitions in New York in October 2006:

Consummation [of the NYSE/Euronext merger] would not necessarily mean that foreign companies listed on Euronext would become subject to U.S. law. The structure of the merger... would be such that non U.S. markets would not become U.S. registered exchanges, nor would Euronext offer its products directly in the United States. As a result, the merger would not result in the mandatory registration of the non U.S. markets’ listed companies in the U.S., nor would our federal securities laws necessarily apply to the non U.S. exchanges.\textsuperscript{111}

A review of NYSE Euronext’s first year as a transatlantic exchange provides an overview of the opportunities and pitfalls of exchange consolidation

\textsuperscript{107} That stake was the maximum allowed and, although it did not give the NYSE a chance to share directly in the earnings gains of the Indian exchange, it was viewed as a “strategic investment” that might enhance Indian company listings on the NYSE. Joseph Weber, \textit{NYSE Group Buys into India Market}, \textit{Bus. Wk.COM}, Jan. 10, 2007, \url{http://www.businessweek.com/print/globalbiz/conten/jan2007/gb20070110_143431.htm}.


\textsuperscript{109} \textit{Id.}

\textsuperscript{110} Stoltenberg et al., \textit{supra} note 34, at 488-89.

\textsuperscript{111} She referred to a meeting between then SEC Chairman Cox and the Chairman’s Committee of the Euronext regulators at which the regulators affirmed that “joint ownership or affiliation of markets alone would not lead to regulation from one jurisdiction becoming applicable in the other.” They also “affirmed their shared belief in the importance of local regulation of local markets.” Annette Nazareth, Commissioner, SEC, Remarks before the UCLA Law Third Annual Institute on Corporate Aspects of Mergers and Acquisitions (Oct. 23, 2006), \url{available at http://www.sec.gov/news/speech/2006/spch102306aln.htm}. 
in the current environment. After the merger, it "[grew] its trading businesses, . . . launched products and forged market links."  

Although both U.S. and European equity trading volumes were up in 2007, the exchange worked to reduce its reliance on equity trading while expanding into derivatives. The group’s U.S. equities trading franchise faced pressure from both new electronic trading systems and NASDAQ, which continued to take market share from the NYSE in 2007. The NYSE’s own electronic exchange, Arca, continued to grow and, by the middle of 2008, appeared set to surpass activity on the main exchange. Promised cost cuts resulting from the merger were slower to materialize than anticipated. Regulatory barriers also undercut some of the benefits of U.S. exchanges’ efforts to form overseas ties, increasing pressure on the SEC to accelerate its mutual recognition concept. With increased “pressure from other exchanges as well as alternative trading systems, and even broker-dealers, . . . market conditions [made] listings more difficult.” This, combined with increased competition on the execution side of the business and a lot of regulatory changes in process, promised continued pressure on exchanges. Among other things, exchanges responded by "branching out into new businesses, including the supply of trading systems to potential rivals." In the process, they were evolving into organizations somewhat different from those for which governing regulation was designed.


113. Id.


115. "[T]he main challenge . . . has been delivering to users $275 [million] of cost savings, $250 [million] from the technology side, by the first quarter of 2010, a promise made before the merger." Id.

116. While “NASDAQ, OMX, NYSE Euronext, Eurex International Securities Exchange and CME Group have all been buying, building or taking shares in non-US destinations . . . in anticipation of an opening of the borders between countries that would allow cash equities and options to be freely traded . . . the volume is going one way—into the US. This is blamed on antiquated US regulation that prevents US institutions from trading directly in foreign markets.” Melanie Wold, US Exchanges Stumble In Rush To Form Overseas Ties, FIN. NEWS ONLINE US, Apr. 14, 2008, http://www.financialnews-us.com/?page=ushome&contentid=235036031.

117. Id.

118. Id.


120. Current NYSE Euronext chief executive Duncan Niederauer aptly characterizes the current situation as follows: We’re no longer just a stock exchange. We’re an exchange. We need to embrace technology to the fullest. A common technology platform is the enabler to get places like Asia, the Middle East, Latin America and Africa on our network. Some of our recent acquisitions are really technology acquisitions, not exchange acquisitions.
3. Attempts To Converge U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) Due to an Increased Global Emphasis on IFRS

It sounds like a reasonable and logical concept to converge the FASB’s rules-based Generally Accepted Accounting Principles (GAAP) with the International Accounting Standard Board’s (IASB’s) principles-based International Financial Reporting Standards (IFRS) so that all public corporations and their investors, regardless of geographic location, would function under the same set of global accounting principles. However, convergence is a daunting task. It involves compromises, adjustments, and intensive work by multiple public and private entities, made more difficult because of intervening political overtones produced by the financial crisis.

a. Developments at the SEC

i. SEC Rule on Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with IFRS Without Reconciliation to U.S. GAAP (December 21, 2007)

A significant achievement for the SEC was the adoption of its Final Rule allowing foreign issuers to utilize IFRS without reconciliation to GAAP.122 The effective date was March 4, 2008, and it was applicable to statements for financial years ending after Nov. 15, 2007. A commentator noted the essential role of this rule in the movement from GAAP to IFRS, describing it as the ‘watershed’ event that fueled the creation of the SEC’s IFRS roadmap – “the proposal to move U.S. companies to IFRS by 2014.”124

121. The IFRS have been characterized as principles-based because they do not include the detailed guidance for accountants as to how to apply the standards to specific business transactions. See Sir David Tweedie, Chairman, Int’l Acct. Standards Board, Remarks at the Empire Club of Canada, Toronto, Canada (Apr. 21, 2008) [hereinafter Tweedie Remarks]. In its effort to keep the American markets competitive, the SEC has increasingly directed its attention toward the European model of a more principles-based approach to securities regulation. Ford, supra note 23. While a broad set of concept statements underlie GAAP, the individual standards include more specific guidance and examples about how to apply the rules.


ii. SEC Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with IFRS (August 2007)\textsuperscript{125}

In August 2007, the SEC issued a Concept Release regarding the possibility of allowing U.S. issuers to prepare financial statements in accordance with IFRS should they choose to do so.\textsuperscript{126} This Concept Release ultimately resulted in the SEC Proposed Rule for a Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers.\textsuperscript{127} This was a pivotal SEC Concept Release, but the voluntary use of IFRS by U.S. issuers must be distinguished from mandatory use. The mandatory use of IFRS standards by all U.S. issuers is pending in the proposed rule or “roadmap” discussed below.


In November 2008, the SEC proposed its Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers (“The Roadmap”). This would cover the potential use of financial statements prepared in accordance with International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board, by U.S. issuers for purposes of their filings with the Commission.\textsuperscript{128} The Roadmap outlines the modified role that the FASB would have in the future with respect to the development of accounting standards. The SEC envisioned the future role of FASB as follows:

This release does not address the method the SEC would use to mandate IFRS for U.S. issuers. One option would be for the Financial Accounting Standards Board (“FASB”) to continue to be the designated standard setter for purposes of establishing the financial reporting standards in issuer filings with the Commission. In this option our presumption would be that the FASB would incorporate all provisions under IFRS, all future changes to IFRS, directly into generally accepted accounting principles as used in the United States (“U.S. GAAP”). This type of approach has been adopted by a significant number of other jurisdictions when they adopted IFRS as the basis of financial reporting in


their capital markets.\textsuperscript{129}

The Roadmap sets forth several milestones that, if achieved, could lead to the mandatory use of IFRS by U.S. issuers in 2015 should the Commission believe it to be in the public's interest and for the protection of investors.

The first step would be the SEC proposed amendments to the rules that would allow certain U.S. issuers that meet specific criteria to file financial statements in accordance with IFRS as issued by the IASB, rather than U.S. GAAP, for use in their annual and other reports.\textsuperscript{130} As a step along this Roadmap, this release then describes proposed amendments that would permit a U.S. issuer that is among the largest companies worldwide within its industry, and whose industry uses IFRS as the basis of financial reporting more than any other set of standards, to elect to use IFRS beginning with filings for fiscal years ending on or after December 15, 2009. Permitting some U.S. issuers to report under IFRS may provide assistance in a transition to mandatory financial reporting in accordance with IFRS by creating additional, but manageable, demand for IFRS-related services at this time. Provisionally, under the transition, the Roadmap has a progression of mandatory compliance dates for IFRS filings that would begin for large accelerated filers for fiscal years ending on or after December 15, 2014.\textsuperscript{131} Accelerated filers would begin IFRS filings for years ending on or after December 15, 2015 and in 2016 for all others. Non-accelerated filers, including smaller reporting companies, would begin IFRS filings for years ending on or after December 15, 2016.\textsuperscript{132}

The SEC noted that "this Roadmap leans towards the mandatory, rather than elective, use of IFRS for U.S. issuers in order to promote fully a single set of high-quality globally accepted accounting standards to improve the comparability of financial information prepared by U.S. public companies and foreign companies."\textsuperscript{133} This is a significant statement in the Roadmap, as the particular goal embodied in it has also been incorporated into the G-20 Action Plan covered later in this article.

The SEC established a February 2009 deadline for affected constituencies to submit comments on the proposed Roadmap to the SEC for evaluation. However, the change in presidential administrations in January 2009 and the credit crisis delayed evaluation and implementation.\textsuperscript{134}

\begin{footnotesize}
\begin{itemize}
  \item \textsuperscript{130} 17 C.F.R. §§ 210, 229, 230, 244 & 249; Exchange Act Release Nos. 33-8982; 34-58960 (Nov. 2008).
  \item \textsuperscript{131} \textit{Id.}
  \item \textsuperscript{132} \textit{Id.}
  \item \textsuperscript{133} \textit{Id.}
  \item \textsuperscript{134} Wayne Carnall, Chief Accountant, Div. of Corp. Fin., Presentation at the American Accounting Association Annual Meeting (Aug. 3, 2009); see also Jeff Ellis, SEC IFRS Roadmap Clear Roads or Delays Ahead?, HURON CONSULTING GROUP,
\end{itemize}
\end{footnotesize}
b. Developments at the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) in the Attempt to Converge GAAP and IFRS

The IASB is an independent standard-setting body of the International Accounting Standards Committee Foundation, while the FASB is the U.S. accounting standards-setting body that derives its authority from the SEC. The SEC has historically delegated its authority for developing accounting rules to the FASB, focusing instead on enforcing them. The FASB authored much of the current U.S. GAAP. The SEC has designated the FASB as a private sector standard setter since 1973, and reaffirmed this status in 2003, with the SEC providing regulatory oversight of the standard setting process. A critical part of the “sea change” in the U.S. regulatory structure has been the shift in power from the FASB to the SEC.

i. Steps Toward Convergence

The FASB and the IASB began working together to achieve the best standards. One of the earlier steps toward collaboration was the Norwalk Agreement of 2005, which memorialized the agreement between the FASB and the IASB to work together to create one set of accounting standards. A

http://www.huronconsultinggroup.com (last visited April 6, 2011).

135. The International Accounting Standards Board is the independent standard-setting body of the International Accounting Standards Committee Foundation (IASC Foundation). Facts About Us, IASB, http://www.iasb.org/About+Us/International+Accounting+Standards+Board+About+Us.htm (last visited Aug. 2, 2010); see also Rachel Sanderson, Push For Accounting Convergence Threatened By EU Reform Drive, FIN. TIMES, April 5, 2010, at 15 (indicating that the new EU Commissioner of Internal Markets, Michel Barnier has signaled that EU funding for the IASB may be dependent upon more direct control over the Board).

136. The FASB is composed of a panel of five accounting experts that has written much of the current U.S. GAAP. Members usually are appointed for five-year terms. A board of trustees serving in the public interest governs it. The Board has a mandate to “evaluate, in adopting accounting principles, the need to keep standards current in order to reflect changes in the business environment, the extent to which international convergence on high quality accounting standards is necessary, or appropriate in the public interest and to protect investors.” Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, Release Nos. 33-8221; 34-47743; IC-26028; FR-70 (Apr. 25, 2003); Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, Release Nos. 33-8221; 34-47743; IC-26028; FR-70 (Apr. 25, 2003).


138. Id.

139. See Ford, supra note 23.

memorandum of understanding between the FASB and the IASB in 2006 followed this agreement.

Part of the effort included a work program to create a converged Conceptual Framework. Instead of trying to eliminate the myriad differences between the GAAP and the IFRS, the agencies sought to develop a conceptual framework that would be the foundation of "something better than either U.S. GAAP or IFRS alone." The Conceptual Framework states that such a framework is essential "to fulfilling the Board's goal of developing standards that are principles-based, internally consistent and internationally converged, and that lead to financial reporting that provides the information capital providers need to make decisions." In order to harmonize GAAP and IFRS, the FASB and IASB undertook a multi-year (three to five year) agenda whereby they would seek public comment on existing standards, replace out-of-date standards, and achieve consensus on disparate rules.

To advance the move toward convergence, the FASB held an open public forum on June 16, 2008 with two goals: (1) initiating dialogue with all affected stakeholders about whether and how to move the U.S. financial reporting system to IFRS; and (2) defining the next steps. The forum was well attended and produced a plethora of comments and concerns from constituencies including U.S. companies, the accounting and finance professions, and educators. The FASB has since directed its attention to topics such as lease-accounting, financial statement presentation, and revenue recognition.

In October 2008, the IASB and the FASB announced the creation of a global advisory group comprising of regulators, preparers, auditors, investors,

141. Id.
142. Leone, supra note 124.
144. Id.
145. Id.
146. Id.
147. Many concerns remain. One concern is the greater latitude in reporting earnings that would be permitted if American companies shift to the international rules. Stephen Labaton, Accounting Plan Would Allow Use of Foreign Rules, N.Y. TIMES, July 5, 2008, http://www.nytimes.com/2008/07/05/business/05sec.html. Some accounting experts have argued, "Companies that have used both domestic and overseas rules have, on average, been able to report revenues and earnings that were 6 percent to 8 percent higher under the international standards." Id. Some have pointed out that the shift would allow companies to "provide fewer details about mortgage-backed securities, derivatives and other financial instruments at the center of today's housing crisis and that have troubled many Wall Street firms." Id. It has also been suggested that "the shift to international standards could . . . wind up eliminating the conflict-of-interest rules, adopted after the collapse of Arthur Andersen and Enron, that have limited auditors from performing both accounting work and consulting for the same client." Id.
and other users of financial statements. This advisory group will help to ensure that reporting issues arising from the global economic crisis will be considered in an internationally coordinated manner.

4. Impact of Private Equity and Sovereign Wealth Funds

Private equity transactions have assumed a higher profile as the U.S. regulatory environment imposed additional demands and economic power began to shift to the rapidly developing emerging economies. The most cited reasons for the proliferation of private equity investing include an abundance of cheap debt financing and companies with publicly traded securities seeking to escape the burdens of SOX.

There are two main categories of private equity buyers: (1) private equity sponsors, which "seek to acquire companies that they can grow or improve (or both) with a view toward eventual sale or public offering"; and (2) strategic buyers, which are "companies that are already in the target company's industry or in a similar industry" that may seek to integrate the target into their own operations. With more than $2 trillion of resources to buy companies, private equity funds' impact on the markets is significant. The credit crunch of late 2007 and early 2008 slowed private equity transactions significantly, and by mid-2008 signs about a pick-up in the volume of private equity activity remained mixed.

The other significant development has been the increasing power of sovereign wealth funds. Indeed, the credit crunch has enhanced these funds' impact, as the amount invested by them in U.S. and European banks in the first two months of 2008 nearly matched half of the 2007 total. While Middle

150. Id. IASB and FASB created an advisory group to review reporting issues related to credit crisis on October 16, 2008.
152. Id.
156. Credit Squeeze Accelerates Sovereign Fund Investments, FINANCIAL NEWS ONLINE (Mar.
Eastern and Asian sovereign wealth fund investments have come under increasing scrutiny for their lack of transparency and regulation, they represent an enormous pool of assets providing significant liquidity during a credit crunch. Sovereign funds can process deals faster because they are "subject to fewer regulations and have a streamlined internal decision-making process." The rapid growth in the assets under management of sovereign wealth funds coupled with their emergence as players in the global mergers and acquisitions market have thrust them centre stage and invited the attentions of regulators, politicians and investments banks.

III.

STAGE THREE: THE U.S. RECOGNIZES, REACTS, AND RESPONDS TO GLOBAL CHALLENGES: SHORING UP THE GLOBAL COMPETITIVENESS OF U.S. FINANCIAL MARKETS PRIOR TO THE ECONOMIC MELTDOWN

In the mid-2000s, the U.S. began to recognize that it was no longer alone as a front-line competitor in the financial markets. Therefore, the U.S. undertook a number of initiatives to ensure that it remained in a competitive position. These initiatives involved the active participation of the SEC in replacing AS2 with a more palatable AS5 and other steps to remedy the deteriorating competitiveness created by Section 404. Under the direction of then Secretary Paulson, the U.S. Department of the Treasury developed and released its Blueprint, which sets forth a series of short, intermediate, and long-term recommendations for reform of the U.S. regulatory structure. The important private group previously discussed, the Committee on Capital Markets Regulation, also made specific recommendations on the way in which small companies and foreign companies listed on U.S. exchanges could be relieved of some of the burdens of Section 404.

24, 2008), http://www.efinancialnews.com/usedition/index/content/2450141122.
160. Rothnie, supra note 158.

Sovereign wealth funds more than doubled their spending spree [in 2007] with acquisitions or companies and minority stakes of more than $60 billion. [In 2008] they are again expected to increase significantly their investments as their assets under management continue to grow from current estimates of up to $3 trillion.

A. SEC Responses to Criticisms by Domestic and Foreign Issuers

The SEC responded to the intense pressure from critical constituencies by implementing a three-step plan of review mechanisms to assess ongoing impact. In addition to (1) obtaining public comment, the SEC included in its three-step plan, (2) the issuance of guidance rules, and (3) working with the PCAOB on revising Auditing Standard No. 2.¹⁶¹

1. SEC-PCAOB Cooperation on Revising Auditing Standard No. 2 (AS2)

a. Replacement of AS2 with AS5

As described above, the SEC took the criticisms seriously and steps were taken to make Section 404 more efficient, cost-effective, and scaled to the size and complexity of each company. Not only did the SEC propose its own guidance rules; it also worked with the PCAOB to replace AS2 with standards more in sync with the guidance rules.¹⁶²

Specifically, then SEC Chairman Christopher Cox announced at the end of November 2006 that he was seeking ways “to lighten the burden of [SOX] on smaller companies by addressing the focus and cost of audits of internal controls.”¹⁶³ He said that his goal was to smooth the way for PCAOB to propose a new auditing standard in the area, and for the SEC to approve it¹⁶⁴ by spring 2007.¹⁶⁵ In an effort to meet Chairman Cox’s announced goal, the PCAOB voted in December 2006 to have public comment on a proposed new standard for auditing internal control over financial reporting (referred to as AS5) to replace AS2.¹⁶⁶


¹⁶⁴. SOX Section 107 gives the SEC oversight and enforcement authority over the PCAOB. Thus, no rule of the Board becomes effective without prior approval of the SEC.

¹⁶⁵. Norris, supra note 163.

¹⁶⁶. Board Proposes Revised Auditing Standard on Internal Control over Financial Reporting,
The new standard called on auditors “to use a ‘top-down’ approach and identify the areas where fraud or errors are most likely.” The PCAOB’s chief auditor claimed that adoption would “provide the auditor with flexibility to avoid unnecessary testing” by virtue of adopting a “risk-based” auditing approach. The new AS5, in addition to the SEC’s proposed guidance, made it easier and cheaper for companies to comply with Section 404. Its text reduced the length of AS2 by a third.

Under AS5, the PCAOB uses a more principles-and-risk-based approach to audits to point the auditor toward the most important matters, “increasing the likelihood that material weaknesses will be found before they cause material misstatement of the financial statements.” Compared to AS2, AS5 (PCAOB Rule 3525, which became effective for integrated audits conducted for fiscal years ending on or after November 15, 2007) is:

- Less prescriptive;
- Makes the audit scalable – so it can change to fit the size and complexity of any company;
- Directs auditors to focus on what matters most, such as risk of fraud or misstatements – and eliminates unnecessary procedures from the audit;
- Includes a principles-based approach to determining when and to what extent the auditor can use the work of others.

The tension over AS2 subsided with the adoption of AS5 as its replacement.

2. Responding to Section 404 Problems

As noted earlier, Section 404 requires that public companies annually assess, and their auditors attest to, the effectiveness of internal control over financial reporting. The provisions of Section 404 of Sarbanes-Oxley and their implementation by the PCAOB and the SEC have been blamed as one of...
the major reasons for the U.S. having lost its first-place position among public equity capital markets in the world. In order to shore up the competitive position of the U.S., it became necessary to change some previously adhered to insular policies, and for the SEC to take action to remedy some of the Section 404-related costs and burdens on domestic issuers and foreign issuers trading their securities on U.S. exchanges.

a. Fine-Tuning Section 404 for Predominantly Domestic Issuers

In order to gain information to address the number of domestic issuers’ complaints in regard to the expense and burden of compliance with Section 404, the SEC engaged in information gathering through two Section 404 Roundtables.174 These Roundtables were composed of fifty participants each and solicited feedback from the public, including issuers, auditors, and investors.175 When processed, the Roundtable of May 2006 highlighted both benefits and continuing concerns regarding Section 404. Benefits included “management’s renewed sense of ownership of controls, newfound ways to make controls more efficient, and better financial reporting and the detection of problems before they become more serious.”176 The SEC focused on the burdens, expense, and compliance difficulties expressed by various entities, especially smaller domestic companies and foreign issuers. In addition, many participants in the May 2006 Roundtable expressed the need for greater guidance from management on how best to comply with Section 404.177

As a result of the May 2006 Roundtable, the SEC issued a press release announcing its intended strategy and guidance for Section 404.178 This included a planned Concept Release Concerning Section 404, with the intention to issue interpretive guidance to those subject to that section.179 A subsequent Concept Release Concerning Management’s Reports on Internal Control over Financial

174. Id.


176. Id. SEC Commissioner Annette L. Nazareth noted a Lord and Benoit report indicating that stock performance of corporations complying with Section 404 was significantly better than it was for non-compliant companies. One possible explanation is that investors feel more confident in the financial statements released by compliant companies.

177. Id.


179. The SEC, to provide additional guidance from the Committee of Sponsoring Organizations (Treadway Commission), to revise Auditing Standard No. 2 with the PCAOB, and to extend compliance dates for small companies (non-accelerated filers) until December 15, 2007. Recently, the SEC further extended the compliance date for these non-accelerated filers until June 15, 2010
Reporting was issued in July 2006.180 This Concept Release addressed critical issues related to the developing SEC guidance for management, such as assessing risks, identifying controls, evaluating the operating effectiveness of internal controls, and documenting assessment.

On December 13, 2006, the SEC voted to propose interpretive guidance for management to improve Section 404 implementation.181 The SEC guidance described itself as principles-based, contrasted with the rules-based approach traditionally thought to guide U.S. accounting standards. The underlying principles are that “management should evaluate the design of the controls” and “should gather and analyze evidence about the operation of the controls being evaluated based on its assessment of the risk associated with those controls.”182

b. Responding to Objections from Foreign Issuers

i. Issuance of SEC Releases Extending Section 404 Compliance Dates for Foreign Companies

On June 5, 2003, the SEC adopted rules in preparation for implementing Section 404 that became effective for most U.S. companies on November 15, 2004, and for foreign issuers on July 15, 2005. After an extraordinary number of complaints, the date for accelerated foreign issuers to comply with Section 404’s management assessment requirement was moved forward to their first fiscal year ending on or after July 15, 2006.183 These companies, however, did not have to prepare an auditor’s attestation report until December 15, 2007.184 For domestic and foreign non-accelerated filers the SEC postponed the compliance date for the first required management’s assessment under Section 404 until their first fiscal year ending on or after Dec. 15, 2007.185 The SEC also excused


182. Id. The guidance clarified four particular areas: (1) Identification of risks to reliable financial reporting and the related controls that management has implemented to address those risks; (2) Evaluation of the operating effectiveness of internal controls; (3) Reporting the overall results of management’s evaluation; and (4) Documentation to support management’s assessment.


these entities from complying with the more expensive auditor attestation requirements until December 2009.186 Both of these concessions reflected the slowly-evolving approach of the SEC to compromise and coordinate with foreign issuers trading their securities on U.S. exchanges.

ii. Deregistration for Foreign Companies

The SEC announced a new deregistration proposal for foreign companies in December 2006. The key component of the proposal would allow delisting for foreign companies if their average daily U.S. trading volume was five percent or less than the average daily trading volume on its primary trading market.187 In addition, the foreign issuer must (1) have been both registered with the SEC and listed on a foreign exchange as its primary trading market for at least one year, (2) have made all its required SEC filings on time, (3) not have made any SEC-registered public offerings in the United States for one year, (4) not have terminated its ADR program within the previous twelve months, and (5) post copies of home country reports in English on its website.188

In March 2007, the SEC approved new rules making it easier and faster for companies to withdraw their stocks from the U.S. markets, based on the December 2006 proposal.189 In implementing the rule, the SEC refined its 2006 proposal in three respects:

1. The 5 percent threshold would be calculated by comparing a company’s U.S. trading volume to its worldwide trading volume, rather than comparing it to

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186. 17 C.F.R. §§ 210, 228, 229 & 249. The SEC adopted amendments to temporary rules that were published on December 21, 2006, in Release No. 33-8760 [71 FR 76380]. Those temporary rules require companies that are non-accelerated filers to include in their annual reports, pursuant to rules implementing Section 404(b) of the Sarbanes-Oxley Act of 2002, an attestation report of their independent auditors on internal control over financial reporting for fiscal years ending on or after December 15, 2008. Under the amendments, a non-accelerated filer will be required to file the auditor’s attestation report on internal control over financial reporting when it files an annual report for a fiscal year ending on or after December 15, 2009. The SEC noted that their data indicates that out of the approximately 1240 foreign private issuers that are subject to the Exchange Act reporting requirements, about 39% of these are large accelerated filers, 23% are accelerated filers, and the remaining 38% are non-accelerated filers. The estimated percentages of foreign private issuers within each accelerated filer category are based on market capitalization data from Datastream as of December 31, 2005. Christopher Cox, Chairman, SEC, Address Before the 34th Annual Securities Regulation Institute: Re-thinking Regulation in the Era of Global Securities Markets (Jan. 24, 2007), available at www.sec.gov/news/speech/2007/spch012407cc.htm [hereinafter Cox Address].


trading volume in the company’s one or two primary markets; (2) Off-market trading would be counted worldwide, and not only in the U.S., so long as the information source was reliable and not duplicative of exchange-reported trading; and (3) convertible and other equity-linked securities would no longer be counted in the threshold calculation.190

While twenty-nine percent of the approximately 1,200 foreign companies registered with the SEC qualified to leave under the new rules,191 it remained to be seen just how many foreign issuers might use the new rules. “Many of the biggest European issuers... informally indicated that they intend[ed] to stay registered, at least for the time being.”192 Commentators suggested that they would likely “wait to see whether the SEC eliminate[d] the U.S. GAAP reconciliation of IFRS financial statements (targeted for 2009), a change that would substantially reduce the costs of a US listing.”193

3. Reduction by the SEC of the Financial Statement Disclosure Requirements for Foreign Issuers

a. Amendment Streamlining Filing Requirements

The SEC also took additional steps to reduce the disclosure burden on U.S.-listed foreign issuers by streamlining their filing requirements. In February 2008, the Commission “unanimously voted to propose amendments to modernize its disclosure requirements for foreign companies, including eliminating all requirements for paper submissions.”194 SEC Chairman Cox characterized the proposed amendments as bringing “our foreign company

190. “The rule also retains a number of other provisions from the December 2006 proposal, including a requirement that a deregistering company be listed in one or two foreign markets that together represent at least 55% of its worldwide trading for a year before deregistration; that it have at least a one-year SEC reporting history at the time of deregistration; and that it not have sold securities in an SEC-registered offering for a year before deregistration. Companies that deregister are automatically eligible for the registration exemption of Rule 12g3-2(b), meaning that their deregistration will be permanent so long as they publish English versions of their home country reports and financial statements on their web sites.” Id.


192. SEC Liberalizes Foreign Issuer Deregistration, supra note 189.

193. Id. Andrew Bernstein, capital markets partner at Cleary Gottlieb in Paris, thought that “the most significant practical impact could come from a provision in the new rules that allows companies that use their shares to acquire foreign SEC registrants to avoid registering themselves as successor issuers... This provision could facilitate cross-border M&A transactions that previously would have been blocked by the successor registration requirement.” Id.

194. Lianna Brinded & Tara Loader Wilkinson, SEC Unburdens Foreign Issuers, FINANCIAL NEWS ONLINE US, Feb. 14, 2008, http://www.financialnews-us.com/?page=ushome&contentid=2449810824. Currently, such firms must “provide a written submission to the SEC, including a list of its non-US disclosure obligations, information concerning US shareholders and paper copies of its non-US disclosure documents published since the beginning of the most recent fiscal year.”
THE PAST DECADE OF REGULATORY CHANGE

The past decade of regulatory change has shifted disclosure requirements into the 21st Century by eliminating any requirement for paper, and by giving investors access to foreign company disclosure documents electronically, in English, on the Internet.\textsuperscript{195} The proposed amendments coincided with implementation of U.S. Regulations, which relaxed restrictions on U.S. investors in U.S. companies listed on London’s junior market Aim.\textsuperscript{196}

\textbf{b. Exemptions for Non-U.S. Broker-Dealers and Exchanges}

Consistent with mutual recognition, the SEC also began exploring proposals to exempt non-U.S. broker dealers and exchanges from registration. Under this approach, “a foreign exchange would be allowed to install a trading facility on the desk of a U.S. broker, provided that the exchanges’ home-country regulators’ rules were deemed ‘comparable’ to the SEC’s.”\textsuperscript{197} “Restrictions on the ability of foreign brokers to solicit U.S. investors could also be removed.”\textsuperscript{198} An SEC proposal to accelerate the reporting deadline for annual reports from foreign issuers, however, could discourage foreign company listings in the U.S.\textsuperscript{199}

\textbf{B. Treasury Department Blueprint for a Modernized Financial Regulatory Structure}

In its response to the continuing problem of maintaining the competitiveness of U.S. capital markets, the U.S. Department of Treasury convened a conference addressing that issue in March 2007.\textsuperscript{200} The Conference identified an outdated regulatory structure as an obstacle to global competitiveness. In June 2007, then Treasury Secretary Paulson announced “the next steps of his capital markets competitiveness action plan,” which included,\textit{ inter alia}, the development by the Department of the Treasury of a blueprint for reforms to affect a modernized regulatory structure.

On March 31, 2008, the Treasury Department released its Blueprint for modernization containing a series of short, intermediate, and long-term recommendations for reform of the U.S. regulatory structure.\textsuperscript{201} In his remarks

\begin{itemize}
  \item \textsuperscript{195} Id.
  \item \textsuperscript{196} Id.
  \item \textsuperscript{198} Id.
\end{itemize}
announcing the release of the Blueprint, Secretary Paulson referred to both the global impetus for such reform, as well as hinting at his preference for an “objectives-based” or “principles-based” regulatory approach:

We could and can have a structure that is designed for the world we live in, one that is more flexible, one that can better adapt to change ... The challenge is to evolve to a more flexible, efficient and effective regulatory framework — and that is the purpose of this Blueprint." 202

C. Specific Recommendations of the Committee on Capital Market Regulation on the Regulatory Implementation of Section 404

The CCMR issued its interim report in 2006,203 which was followed with a formal report, Competitive Position of the Public Equity Market, in late 2007.204 Among its recommendations205 in the interim report was a suggestion that “federal regulators and Congress should consider changing the [SOX] requirements for small companies, who are less able to afford the cost of keeping up with [SOX] and [should] periodically test existing rules to ensure they still meet reasonable cost/benefit standards.”206 While the SEC’s Office of Economic Analysis conducts some cost/benefit analysis, the committee proposed making that process more formal by establishing “an internal staff group of qualified economists and business analysts to perform a systematic cost-benefit analysis as a regular part of the rule-writing process.”207

The CCMR report specifically addressed foreign companies listed on U.S. exchanges, suggesting that they be exempt from Section 404 “if they have something similar in their home markets.”208 For American companies, the SEC and PCAOB “should provide guidance to make application of [Section 404] less


203. CCMR Interim Report 2006, supra note 78.


205. As might be expected, some (including Financial Executive International, a 15,000-member group of chief financial officers and other finance executives, and the National venture Capital Association) felt the report did not go far enough. Moore, supra note 80. On the other hand, Columbia law professor Harver Goldshmid, a former member and general counsel of the SEC, said that adopting the report’s recommendations would replace “the recent drive for accountability and deterrence” with a “world in which almost everything goes.” Floyd Norris & Stephen Labaton, Panel to Urge Rewriting Rules to Aid Companies, N.Y. TIMES, Nov. 30, 2006, http://www.nytimes.com/2006/11/30/business/30regs.html.

206. CCMR Interim Report 2006, supra note 78.

207. Norris & Labaton, supra note 205.

208. Id.
costly." The other suggestions regarding Section 404 addressed in the report were the issue of deregistration and the impact of the current requirement that a company cannot delist unless the number of American shareholders falls below 300. The Committee suggested making it easier to delist companies by “omitting institutional shareholders from the count, on the theory that it is individual investors who most need protection.” And for foreign companies not now registered in the United States, the report suggested that the SEC “abandon most restrictions on leaving, so long as American investors are warned before they invest that such a departure is possible.”

IV. STAGE FOUR: EFFORTS TO HARMONIZE NATIONAL INTERESTS WITH GLOBAL AND MULTILATERAL POLICIES: AN INTEGRATIVE INTERNATIONAL APPROACH TO CAPITAL MARKETS INITIATED BY THE ONSET OF WORLDWIDE FINANCIAL TURMOIL

The final stage of analysis covers the last months of the Bush administration in 2008 and into the first year of the Obama administration. During this period, both administrations took significant steps to develop an international and coordinated response to the economic crisis. There were numerous pending proposals to be considered and action items marked for implementation, as well as the creation of new measures for internal regulatory restructuring as legislative bodies struggled to find ways to protect investors against future fiscal disasters.

A. Period of Transition (from Stage Three into Stage Four)

In 2007, there was a marked shift in the SEC’s approach to interaction with foreign issuers and global regulators that potentially signaled a new era in the history of U.S. securities regulation and the focus of the SEC. As briefly mentioned earlier, several cooperative efforts emerged between the SEC and global regulators.

1. Mutual Recognition Concept

Generally, the U.S. is moving in the direction of removing barriers to cross-border access between U.S. and foreign markets in response to investor demands for wider market opportunities. In an attempt to reduce the burdens of regulatory
duplication, SEC Chairman Cox and Charlie McCreevy, the EU Commissioner for the Internal Market and Services, met in 2007 to discuss facilitating a mutual recognition policy based on substituted compliance.\textsuperscript{213} They agreed that if a foreign regulator was found to be a "high-quality regulatory regime" the SEC, on a country-by-country basis, would grant "substituted compliance" status to foreign exchanges and broker-dealers.\textsuperscript{214} This would give them access to the U.S. market without meeting the SEC registration requirements.\textsuperscript{215} A determination of whether the foreign regulator met the standard of being a high-quality regulatory regime was to be based upon a comparability assessment by the SEC and by the foreign authority of one another’s regulatory regimes.\textsuperscript{216} Subsequently, the SEC began to implement the concept of mutual recognition.\textsuperscript{217}

\begin{footnotesize}
\begin{itemize}
  \item \textsuperscript{213} Lianna Brinded, \textit{EU and SEC Start Official Talks on Exchange Plans}, \textsc{FIN. NEWS ONLINE US}, Feb. 4, 2008, \texttt{http://www.financialnews-us.com/?page=ustradingtechnology&contentid=2449722100}. In its statement summarizing the outcome of their meeting, the SEC said “[a]n EU-US mutual recognition arrangement for securities would have the potential to facilitate access of EU and US investors to a broader and deeper transatlantic trading and transaction costs and increase oversight coordination among regulators.” \textit{See also} John C. Coffee, Jr., \textit{SEC Diplomacy}, \textsc{Nat. L. J.}, June 16, 2008, at 13.
  \item \textsuperscript{214} \textit{See SEC Mulls 'Mutual Recognition' For Transatlantic Trading}, \textsc{FIN. NEWS ONLINE US}, June 19, 2007, \texttt{http://www.financialnews-us.com/?page=usspressdigest&contentid=2348064803}. Under such a system, the SEC would allow foreign broker-dealers to provide products and services to US investors without having to register with the SEC. It would also allow foreign exchanges to place trading screens on the desks of US-based brokers without such registration. In both cases, the home country regulator’s standards would have to be “substantively comparable” with that of the SEC. \textit{Id}.
  \item \textsuperscript{215} Jeremy Grant, \textit{SEC Eyes Cross-Border Shake-Up}, \textsc{WALL ST. J.}, Jan. 3, 2008, at 1. The foreign exchanges have traditionally assiduously avoided SEC registration because of the extra burden of dual regulation with their home country. \textit{See} Coffee, Jr., \textit{supra} note 213. The problem is that foreign issuers with more than 500 shareholders worldwide (of which at least 300 are U.S. investors) and $10 million in assets are required to register their equity securities with the SEC and, therefore, must make meet its disclosure rules by submission of annual and periodic reports. Exchange Act §12(b), (g), 15 U.S.C. §78(b), (g) (Supp IV 2004); Exchange Act § 13, 15 U.S.C. §78m (Supp II 2002); Exchange Act § 15(d), 15 U.S.C.S. §78o(d). Even though foreign issuers “can file for an exemption from such registration, they are required to file in their home jurisdiction in English translation, their securities cannot then [actively] trade on an exchange, but only on the pink sheets bulletin board.” \textit{See} Rule 12g3-2(b), 17 C.F.R. §240.12g3-2(b) (2007); \textit{see also} Roberta S. Karmel, \textit{The Once and Future New York Stock Exchange: The Regulation of Global Exchanges}, 1 \textsc{BROOK. J. CORP. FIN. & COM. L.} 355 (2007).
  \item \textsuperscript{217} \textit{See} Coffee, Jr., \textit{supra} note 213. The problem is that foreign issuers with more than 500 shareholders worldwide (of which at least 300 are U.S. investors) and $10 million in assets are required to register their equity securities with the SEC and, therefore, must make meet its disclosure rules by submission of annual and periodic reports. Exchange Act §12(b), (g), 15 U.S.C. §78(b), (g) (Supp IV 2004); Exchange Act § 13, 15 U.S.C. §78m (Supp II 2002); Exchange Act § 15(d), 15 U.S.C.S. §78o(d). Even though foreign issuers “can file for an exemption from such registration, they are required to file in their home jurisdiction in English translation, their securities cannot then
Market participants welcomed the new approach, but also raised questions about how cost effective it would be in reality and to which exchanges the mutual recognition framework would relate.\textsuperscript{218} U.S. political forces also tried to put the brakes on any rapid move toward mutual recognition.\textsuperscript{219} To keep the process of mutual recognition moving ahead, the Commission began exploring the idea specifically with counterparts in Australia, which reached fruition in August 2008. The agreement allowed U.S. and Australian securities regulators to brokers and exchanges to do business in each country while being regulated only by their home countries.\textsuperscript{220}

At an earlier meeting of the Federation of European Securities Exchanges in Brussels, SEC Director of International Affairs Ethiopis Tafara had called for faster mutual recognition between U.S. and foreign regulators.\textsuperscript{221} The specific actions taken by the SEC were consistent with the agreement made by the G-7 finance ministers at their February 2007 meeting to shed overlapping financial regulations and standards that burden companies doing business globally.\textsuperscript{222} The goal, embodied in their official statement, was “to explore within the G-7 free trades in securities based on mutual recognition of regulatory regimes.”\textsuperscript{223}
Treasury Secretary Paulson noted that "many countries have strong regulatory regimes and it should be possible for nations to recognize one another's rules and standards." At the same time, though, he recognized that it is "something that will take a long time given that many countries . . . have multiple regulators and overseers."

2. Framework for Advancing Transatlantic Economic Integration between the U.S. and EU: Transatlantic Economic Council (TEC)

a. Establishment of the Transatlantic Economic Council

Another important effort, particularly significant because it involves international cooperation at the powerful government-to-government level, occurred in April 2007 when leaders at the EU-U.S. Summit established the Transatlantic Economic Council (TEC) in the Framework for Advancing Transatlantic Economic Integration between the United States of America and the European Union ("Framework"). The emphasis in the Framework was on a goal of transatlantic economic integration. To accelerate progress towards this goal, the TEC was established as a joint political-level body, co-chaired by representatives from the U.S. and the EU, to oversee the efforts outlined in the Framework. One of the charges to the TEC included in Section IV of the Framework provides for support from expert advisers through the convening of "a group of individuals experienced in transatlantic issues" to provide "input and guidance" from existing transatlantic dialogues – the Transatlantic Legislators Dialogue (TLD), Trans Atlantic Consumer Dialogue (TACD), and Trans Atlantic Business Dialogue (TABD).
b. The Work of the Transatlantic Economic Council

The agenda given to the TEC by the EU-U.S. summit leaders includes a number of areas (e.g., Intellectual Property Rights Enforcement), but among the more relevant areas are investments, accounting standards, and securities regulatory regimes.\textsuperscript{230} The Framework requires the TEC to meet at least once a year, but in 2008 an additional meeting was held in response to the financial crisis and "to help provide momentum and secure the continuity of the TEC after changes in leadership in both the United States and the European Union in 2009."\textsuperscript{231}

The work of the TEC became more pressing with the need for a coordinated global response to the global financial crisis. As James Quigley, Co-Chair of the TABD, asserted, "[w]hat we do know is that this crisis has highlighted the high degree of transatlantic economic interdependence – and the marked need for coordinated responses.\textsuperscript{232} The TEC has exerted an extra effort towards crafting responses to the worldwide fiscal crisis.\textsuperscript{233} A report from the 2009 meeting indicated that there was a discussion of the ongoing financial regulatory cooperation with an emphasis on the importance of compatible approaches and the avoidance of financial mercantilism between the EU and the U.S.\textsuperscript{234}

Generally, the reaction to the organization has been favorable. \textsuperscript{235} The

\begin{itemize}
\item \textsuperscript{231} Id.
\item \textsuperscript{232} Press Release, TransAtlantic Business Dialogue, TABD Co-Chairs James Quigley and Jurgen Thumann urge TEC to enhance political ambition and avoid over-regulation in the face of the global financial and economic crisis (Dec. 12, 2008), http://www.tabd.com/storage/tabd/documents/tabd_tec_press_release_12_12_08.pdf. Co-Chair Quigley further commented that "[t]he TEC presents a unique opportunity for the US and EU to inspire confidence in the transatlantic marketplace and build on the collective resolve of the G-20 Leaders to maintain open investment and trade policies globally."
\item \textsuperscript{235} Although the TEC does not have an extensive history because its first meeting was in late 2007, both the EU and U.S. have deemed each meeting successful. TEC Vice-President, Günter Verheugen's comments on the second meeting in May 2008 reflect this view from his European perspective:
\end{itemize}

The European Union and the United States have already committed themselves to reach the common objective of economic integration and a barrier free economic area. The Transatlantic Economic Council (TEC) is of key importance to achieve this objective. Within a short time the TEC has delivered steady progress towards
status conferred on the TEC in the Framework as a government-to-government body places it in a unique position to advance the integration of capital markets and help to maintain a strong and stable transatlantic commercial and business relationship.

3. Movement Toward the Middle: Increased Use of European Principles-Based Approach to Regulation

One major difference between Europe and the U.S. is that Europe has primarily followed a general principles-based approach, focused on achieving desired policy goals or outcomes, while the traditional U.S. approach to regulation has been rules-based, with an emphasis on specifically prescribed requirements that must be met. The U.K. Financial Services Authority, the regulatory body comparable to the SEC in the U.K., adopted a principles-based approach in 2003. The U.K.'s shift to a principles-based approach provided a strong impetus for its adoption in the U.S., given Treasury Secretary Paulson's complaint that the U.S.'s rules-based regulatory system was prescriptive, and led to a greater focus on compliance with specific rules. Treasury Secretary Paulson pointed out the advantages of moving "toward a structure that gives regulators more flexibility to work with entities on compliance within the spirit of regulatory principles."  

a better regulatory environment and has dealt with issues of concern of both sides. Mutual confidence and trust in each others' commitment to remove barriers remains crucial for succeeding in the transatlantic economic cooperation.


236. Perhaps because of its geographic location, Europe has been better than the U.S. at taking a more global perspective. It has been quick to acknowledge the growing strength of markets on other continents and its adoption of an approach to regulation based on broad principles rather than specific rules has allowed an easier transition into the world marketplace. See Ford, supra note 23.

237. Several reasons given for U.S. bias towards the rules-based system of financial regulation are that:

This bias has developed in response to our complex regulatory structure, an ever-growing body of national and state laws and implementing regulations that address financial activities and practices in great detail, and the felt need for certainty in the face of an ever present risk of litigation and enforcement actions.


238. A simple example that has been given to differentiate between a principles based approach and a rules based approach is that a rule will say, "Do not drive faster than 55 mph" where a principle will say, "Do not drive faster than is reasonable and prudent in all circumstances." See Ford, supra note 23.

The rules-based approach is demonstrated in SOX and the regulatory actions taken by the SEC to enforce SOX. The PCAOB’s AS2 exemplified a rules-based approach with its complex and detailed regulations.240 The Financial Services Roundtable241 expressed its preference for a more principles-based or “top-down” approach to the SEC implementation of SOX in “The Blueprint for U.S. Financial Competitiveness”:

Regulatory burden could have been ameliorated by more principles-based requirements that emphasized the use of a “top-down” approach, and afforded both management and auditors the discretion to concentrate on the most significant aspects of a company’s internal control framework.242

Not surprisingly, when AS2 was replaced in 2007 with AS5, it was heralded as a principles-based approach that “allows auditors to apply professional judgment in determining the extent to which they’ll use the work of others.”243 Both the Commission’s new standards for conducting audits and its new SOX management guidance for complying with the internal control requirements have been described as principles-based.244 Also, as discussed earlier, U.S. movement toward reconciling its GAAP with the IFRS is a tangible example of adjusting its rules-based GAAP to a more principles-based IFRS.245

While there is movement by the U.S. towards accepting, and even encouraging, a more principles-based regulatory system, the result will likely be a hybrid model that combines the two systems.246 The U.S. has moved in the direction of the principles-based approach “to ensure that U.S. financial services firms are competitive, consumers of financial services are protected, and financial markets are stable and secure.”247 However, substantial differences exist between the U.S. and Europe in their regulatory and legal structures which preclude outright U.S. adoption of a primarily principles-approach. The U.S.’s complex system of multiple national and state regulators and our reliance on private litigation, with remedies such as class actions, are all reasons why the

240. See Johnson, supra, note 47.

241. The Financial Services Roundtable is to provide legislative and regulatory advocacy. Its predecessor group was comprised of bankers, but in 1999 the mission was broadened to represent integrated financial service providers and accepted members from the securities, investment and insurance sectors. See History of the Roundtable, THE FINANCIAL SERVICES ROUNDTABLE, http://www.fsround.org/about/index.htm (last visited April 6, 2011).

242. Id.

243. Id.

244. Id.

245. Tweedie Remarks, supra note 121.


U.S. could not replicate the 2003 shift in the U.K. by the Financial Services Authority to a principles-based regime.\textsuperscript{248}


In the wake of the financial crisis, the CCMR observed, “the U.S. employs more financial regulators and expends a higher percentage of its gross domestic product on financial oversight than any other major country.”\textsuperscript{249} Noting that recent events suggested “the far larger staffs and greater funding in the U.S. have not resulted in a correspondingly higher quality of supervision,” the CCMR saw the financial crisis as an “opportunity to bring U.S. financial regulatory structure into the 21st century, ensuring our role as a global leader in financial markets.”\textsuperscript{250}

Following its January 2009 recommendations, the CCMR issued its May 2009 report titled The Global Financial Crisis: A Plan for Regulatory Reform.\textsuperscript{251} In this report, the CCMR identified four critical objectives for improving the U.S. financial system: (1) reduced systemic risk through more sensible and effective regulation;\textsuperscript{252} (2) increased disclosure to protect investors and stabilize the market;\textsuperscript{253} (3) a unified regulatory system where lines of accountability are clear and transparency is improved;\textsuperscript{254} and (4) international regulatory harmonization and cooperation.\textsuperscript{255} The two factors common to all the CCMR’s fifty-seven recommendations were the importance of (1) “principles-based regulation focused on effectiveness”;\textsuperscript{256} and (2) a “coordinated

\begin{itemize}
\item \textsuperscript{248} \textit{Id.}; see also Ford supra note 23.
\item \textsuperscript{249} Press Release, Committee on Capital Markets Regulation, Committee on Capital Markets Regulation Releases Recommendations for Reorganizing U.S. Regulatory Structure (Jan. 14, 2009). There are approximately 38,700 financial regulatory staff in the U.S., versus some 3,100 in the United Kingdom. Meanwhile, financial regulatory costs in the U.S. total $497,984 per billion dollars of GDP versus $276, 655 in the United Kingdom.
\item \textsuperscript{250} \textit{Id.}
\item \textsuperscript{251} The CCMR opined that reform done properly could “restore market confidence, increase consumer and investor protection, improve regulatory quality, stimulate capital formation, enhance our ability to manage systemic risk and facilitate global policy coordination.” \textit{Id.}
\item \textsuperscript{253} Recommendations under this category included: 1) revision of capital requirements; 2) resolution procedures; 3) regulation of non-bank financial institutions; and 4) clearinghouses and exchanges for derivatives. \textit{Id.} at ii-iv.
\item \textsuperscript{254} \textit{Id.} at v.
\item \textsuperscript{255} \textit{Id.} at vi.
\item \textsuperscript{256} \textit{Id.} at i (emphasis added).
\end{itemize}
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international approach . . . in all areas of reform.”257

B. Updates on International Pressures Impacting the U.S. Financial Market Regulation

1. Financial Crisis Impact on Emerging Nations

While the global impact of the financial crisis undercut notions that emerging economies had decoupled from the developed economies, former World Bank economist Uri Dadush said that “any recovery in growth must emerge in countries outside the epicenter of the financial crisis.”258 In this connection, he noted, “roughly two-thirds of the world’s $50 trillion gross domestic product is produced in countries such as Brazil and South Korea, which did not have highflying banks but are suffering from the downturn in global trade.”259 Analysts have suggested that while the U.S. economy has previously led the world back to growth after bruising global downturns, “developing countries could be the engine that powers the next recovery.”260

Despite fears just months ago that they would be among the biggest victims of the financial crisis, emerging giants like China, India and Brazil are set to rebound strongly next year . . . as Europe, the United States and Japan lag . . . The divergence between the emerging and the developed countries suggests that the once-popular theory of decoupling—the notion that the emerging markets could be moving independently of the developed economies—may make a comeback . . . “Decoupling is back as a thesis,” said Adam Posen, deputy director of the Peterson Institute for International Economics in Washington. “And we should recognize how different the current situation is from past crises.” . . . [W]ith China and other emerging countries seemingly leading the way, the idea that countries like China, India and Brazil are going to play a far bigger role in global economic expansion is coming back in vogue.261

Decoupling could have both positive and negative implications for

257. Id. at vi (emphasis added).

A global financial system demands globally coordinated rules . . . . Failures of international coordination can lead to the duplication of requirements and set the stage for regulatory arbitrage. . . . Additionally, there obviously needs to be coordination and convergence between U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) as we contemplate a single standard. While the world is not yet ready for a global regulator, the time has come to ensure greater global coordination.

Id.


259. Id.


261. Id.
developed economy countries. On the positive side, there is the possibility that “growing wealth in China and India could, in theory, increase demand for goods made in recession-battered countries like Japan, Germany and the United States.” However, “emerging market-centered growth could spur higher interest rates in the West and Japan, and push up prices for oil and other commodities when the developed world could least afford it. Another potential downside of decoupling could be a tsunami of capital from developed markets washing over emerging economies and inflating values.”

The first half of 2009 witnessed two fundamental changes in the architecture of the international financial system: First, based on a concern about systemic risk, detailed proposals in the April 2008 Financial Stability Forum Report for more intensive, systemic, international regulatory cooperation have been adopted by the G-20. Second, there has been a shift in power from the G-7 to a broader group of countries, the G-20, which includes Argentina, Brazil, China, India, Indonesia, Mexico, and South Africa. Given the likelihood that “this new international regulatory framework and shift in power will outlast the present crisis,” the question then becomes: “after the storm has subsided, what will be the impact on capital markets and international finance of these two fundamental changes?”

Two responses emerge: “First, the new framework confirms that regulatory arbitrage, seeking the least regulated, most favorable jurisdiction, is not systemically healthy. This will encourage international cooperation on several financial law issues that were not directly related to the crisis, but which could benefit from cross-border cooperation.” “Second, and more important, the shift in power to a broader group of countries will bring into question the west’s hegemony on regulation.”

One commentator articulated the shift in power as follows:

Owning up to the geopolitical implications will be as painful for the rich nations as paying the domestic price for the profligacy. When American and European diplomats talk about the rising powers becoming responsible stakeholders in the global system, what they really mean is that China, India and the rest must not be allowed to challenge the existing standards and norms. Yet the big lesson is that the west can no longer assume the global order will be remade in its own

262. Id.
263. Id.
265. Id.
266. This would include issues such as insolvency, corporate law and corporate governance, securities regulation, commodities regulation, codes of conduct for multinational companies, money laundering and illicit financial flows including corruption. “At present they do not seem to be a high priority, but they will receive close attention in the future. Finance and trade have become globalize, and the new international regulatory framework will permit regulatory cooperation to catch up. Id.
267. “If the US, UK and international financial organizations . . . could not prevent the crisis, why should they determine the response?” Id.
Events during the second half of 2009 supported the notion of a significant shift in power toward Asia, with the Hong Kong Stock Exchange predicted to finish 2009 as the world’s largest IPO market and Chinese banks dominating IPO rankings for the first time. While stock markets around the world essentially fell and rose together during 2008-09 may refute the notion of decoupling, the fact that the best performances were turned in by emerging markets indicates some shift of relative power.

2. Evolving Status of Exchange Consolidation

The year 2008 has been described as the “end of the honeymoon” period for merged exchanges. NYSE Euronext took charges of $1.6 billion for reduction in goodwill and other intangible assets related to their merger due to falls in equity markets in 2008. The London Stock Exchange, facing competition from its new alternative trading rivals (Chi-X Europe, and, more as many as 100 IPOs are believed to be in the pipeline, among them several multi-billion-dollar deals. Even in the slower months earlier this year, activity has been quietly simmering at the Hong Kong Stock Exchange. Total market capitalization rose 36.37% in the first half of 2009. Capital-raised initial share stakes alone amounted to US $2.3 billion. While this was 65% lower than a year earlier, it still amounted to the lion’s share for the region. According to data compiled by Bloomberg, companies in Asia, excluding Japan, raised a total of $US 3.59 billion through IPOs in the same period.

Id.

273. Id.

274. Tom Fairless & Shanny Basar, NYSE Euronext Loses $738 Million On European Writedown, Fin. News Online US, Feb. 9, 2009, http://www.efinancialnews.com/usedition/content/1053283656/25481. After stripping out costs associated with the Euronext merger, NYSE Euronext said gross revenues rose 19% for the year to $4.5 billion, as volatility following the collapse of Lehman Brothers boosted trading volumes across the company’s US stock and derivative exchanges. However, profits fell as the higher volumes resulted in increased rebates to customers following the introduction of new pricing structures to attract high frequency traders.

Id.
recently, Turquoise, Bats Trading, and, to a lesser extent, NASDAQ OMX Europe), "reported a 13% fall in trading revenue for the last three months of 2008 following a 38% slump in trading value.\textsuperscript{275} "Shares in exchanges around the world plunged by around two-thirds [in 2008], as optimism generated by a wave of mergers gave way to fears over failing hedge funds, tumbling equity markets and the threat of competition from new trading systems."\textsuperscript{276} The "magnitude of the write-down and the value destruction implicit in the lower share prices" caused some to question "whether the mergers were a good idea in the first place."\textsuperscript{277}

These results had an immediate impact on stock market operations. The NYSE temporarily lowered its market capitalization requirement for listed companies because of "difficult market conditions."\textsuperscript{278} NYSE Euronext implemented a worldwide salary freeze and reduced incentives for 2009.\textsuperscript{279} NYSE Euronext also slowed its Middle East push following "an increase of the involvement of Western exchanges in the Middle East in recent years."\textsuperscript{280}

A thoughtful analysis of exchange consolidation in light of the financial crisis considered results relative to the four key considerations that drove the mergers. The first consideration focused on efficiency.\textsuperscript{281} On this component, "the ability of NYSE Euronext, NASDAQ, OMX, and the LSE to achieve [their] goals has varied."\textsuperscript{282} The second consideration involved the goal of diversifying
their businesses, "either geographically or by branching into new products such as clearing." There were successful examples of such diversification for all three exchanges. Third, exchanges hoped their deeper liquidity pools would attract investors. "At least two academic studies indicate that mergers improve exchanges' liquidity and attract market share." Fourth, exchanges hoped that their great presence would encourage companies to list on their markets. The ability to attract capital is an important consideration, and commentators suggested that a fresh wave of consolidation might be approaching. However, they predicted that, "mergers will have a different flavour this time," and urged that exchanges "consider ways of partnering with one another that do not involve acquisitions." In any event, with some recovery in sight, signs began to emerge (e.g., LSE’s talks to acquire Turquoise) that the exchanges’ acquisitive streak might not be entirely a thing of the past.

3. Private Equity and Sovereign Wealth Funds

While the private equity market may have seemed invincible during the years before the current financial crisis, the upheaval in the financial markets changed the assumptions underlying such strength. No longer could it be assumed that "values would forever increase, investors would always clamor to get a piece of a fund, and investors would never default on future commitments." Private equity returns fell throughout 2008 "after the first two quarters showed a consecutive decline for the first time in more than five years." When leaders of the industry met in Berlin in February 2009 to assess NYSE Euronext achieved only $120 million of the $250 million in planned technology savings by the end of 2008. NASDAQ OMX and LSE beat their cost-saving targets. Id. at 26-27.

283. Id.

284. "The LSE . . . reduced its exposure to cash equities and acquired derivatives and clearing businesses through its tie-up with Borsa Italiana . . . NYSE's acquisition enabled it to move into several large European markets, a feat that would have been difficult to accomplish alone . . . NASDAQ's motives in the OMX deal were centered on diversification . . . First was to establish a strong presence in Europe in order to grow [the] combined business through a streamlined infrastructure in the Nordics and pan-European initiative. Second was to gain a global footprint, operation and exchange relationships through OMX's highly successful global technology business." Id.

285. Arnold et al.'s study in 1999, which analyzed the effect of three US regional mergers on liquidity and market share, found that merged exchanges provided narrower bid-ask spreads and drew market share from rivals. Another study, by Padilla and Pagano in 2005, which looked at the harmonization of clearing systems in the Euronext exchanges, found that liquidity among the largest 100 stocks rose substantially. Id.

286. Id.


the situation, Henry Kravis, founding partner of Kohlberg Kravis Roberts, urged private equity firms to “adapt to the new realities of the global recession or become irrelevant.”290 David Rubenstein, co-founder of the Carlyle Group, predicated that 2009 “would see relatively few completed buyouts, a higher percentage of non-control investments, a lower number of funds raised and the collapse of some major investments made at the market’s peak.”291

Nonetheless, there were also reasons to be optimistic about the role of private equity. Rubenstein identified “15 reasons why the industry would benefit from the economic turmoil.”292 Other commentators also noted positive characteristics of the industry.293 The CCMR May 2009 report concurred that private equity firms “have several important advantages relative to their public (or non-private equity) competitors”294 and saw no need for further regulation of the industry.

As part of the industry’s effort to improve its image, the Private Equity Council, a Washington-based organization created in 2007 by thirteen of the world’s largest buyout firms, embraced the United Nations Principles for

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291. Id.

292. Id. The fifteen reasons are as follows: 1) the need for private equity is greater than ever; 2) lower prices improve returns; 3) many deals now do not need new debt, or even any debt; 4) resumption of normal patterns affords time to improve companies; 5) pressure on banks to lend will mean by late 2009 or 2010 there will be more leverage available; 6) co-investment opportunities will be greater than before; 7) debt will be on tougher terms; 8) less pressure to invest quickly; 9) the number of less-disciplined buyers will be reduced; 10) governments will see private equity as a solution to problems; 11) there will be an enhanced recognition that private equity caused neither systemic risk nor the economic decline; 12) the expectations of what private equity can achieve will return to more normal levels; 13) firms will stabilize, then grow; 14) the industry’s image will improve; and 15) private equity will become the preferred alternative investment. Id.


294. First, Moody’s Investors Service has found that troubled firms “backed by private equity have access to capital sources unavailable to strategic operators facing similar market constraints.” Second, recent research completed by the World Economic Forum found that during periods of acute financial stress, productivity growth at PE-sponsored companies was 13.5 percentage points higher than productivity growth at comparable non-PE businesses. PE-owned companies also have flexibility provided by heavily involved boards that can act decisively to avoid a crisis. Finally, it is important to recognize that the failure of a portfolio company is unlikely to have knock-on effects to the larger financial system. Portfolio companies are broadly diversified across industries and neither PE funds nor portfolio companies are cross-collateralized. These factors, taken as a whole, demonstrate that PE firms pose little in the way of systemic risk. The Global Financial Crisis: A Plan for Regulatory Reform, Committee on Capital Markets Regulation, May 2009, at ES-14, http://www.capmktsreg.org [hereinafter The Global Financial Crisis].
Responsible Investment, which cover environmental, health, safety, labor, governance, and social issues. The industry group composing a code of conduct for European private equity decided against adopting the UN Principles, but said that it would acknowledge them in the process of drawing up a voluntary code.

C. The New Integrative Role of the Group of Twenty (G-20): 2008 and 2009

Summits Tackling the Financial Crisis

The G-20 is uniquely qualified to play a significant role in formulating an international plan for tackling the emergency situation created by the worldwide economic breakdown. Almost a decade since its inception, it has now emerged as the designated premier forum in attacking the root causes of the crisis and giving direction to the member countries, particularly with regard to its Declaration and Action Plan, and the Communiqué issued at its London meeting in 2009. The emerging importance of the G-20


297. The G-20 members include Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, United Kingdom, United States, and the EU. See About G-20, supra note 12. It was initially founded in 1999 as a roundtable of the finance ministers from the major economies, and from the major international development banks. It serves as an opportunity for those ministers to cooperate and consult and “bring together major advanced and emerging economies to stabilize the global financial market and,” to achieve a sustainable economic growth and development. See About G-20, www.g20.org (last visited Mar. 20, 2011). The structure is a revolving one (to prevent domination by any one country) and consists of a three-member management group from the past, present and future chairs, known as the Troika. See id.

298. “The G-20’s economic weight and broad membership gives it a high degree of legitimacy and influence over the management of the global economy and financial system.” Id.


and the necessity for cooperation among the Leaders of its member nations is self evident: collectively the twenty members represent around ninety percent of the global gross national product, eighty percent of world trade, and two-thirds of the world’s population. In an acknowledgment of the need to have a broad body of both developed and developing nations to deal with the global economic crisis, the G-20 was formalized as the “premier forum for international economic cooperation” at the 2009 meeting in Pittsburgh. The emergence of a formal G-20 body represents an expansion of vision beyond that of the powerful industrialized countries of the G-7 and G-8.


At the meeting in Washington D.C., the G-20 Leaders published a Declaration of the Summit on Financial Markets and the World Economy (Washington Declaration) in which it expressed a determination “to enhance our cooperation and work together to restore global growth and achieve needed reforms in the world’s financial systems.”

a. Common Principles for Reform of Financial Markets

The Washington Declaration includes a list of Common Principles for Reform of Financial Markets (Common Principles) that contains conceptual objectives for stabilizing markets. Their goal was to “implement reforms that will strengthen financial markets and regulatory regimes so as to avoid future crises.” The separate responses from the U.S. and the EU in regard to the call for an implementation of financial reforms are discussed in later sections of this paper. The Common Principles consist of: 1) strengthening transparency and accountability; 2) enhancing sound regulation; 3) promoting integrity in financial markets; 4) reinforcing international cooperation; and 5) reforming international financial institutions. The principles were founded on the notion that international cooperation and coordination among regulators was essential

304. See About G-20, supra note 12. “The G-20’s economic weight and broad membership gives it a high degree of legitimacy and influence over the management of the global economy and financial system.” Id.

305. G-20, Leaders’ Statement, supra note 299. The G-8 started as the G-6 in 1975, initially only including the wealthy nations of France, Germany, Italy, Japan, United Kingdom and the United States, but later expanded to include Canada in 1996 (G-7), and Russia in 1997 (G-8). See Glen Levy, A Brief History of The G-8, TIME, Jul. 8, 2009, http://www.time.com/time/world/article/0,8599,1909008,00.html; see also About G-20, supra note 12.


308. Id.
for successful and consistent implementation for reform of financial markets.309

b. Action Plan

Using the Common Principles as a basis, the G-20 Leaders created a very specific Action Plan outlining mutually agreed upon goals and including some target dates.310 The Action Plan included immediate, medium, and long-term goals under each of the five Common Principles. Progress on implementation of the immediate goals was expected to occur by the time of the London summit in April 2009.311 The G-20 Leaders emphasized the need for intensified international cooperation among regulators and strengthening of international standards with consistent implementation.312 Therefore, integrated throughout the Action Plan are actions to be taken by the International Monetary Fund (IMF), the expanded Financial Stability Board (FSB), World Bank, and other multilateral development banks (MDBs),313 a recommendation that there should be work by key global accounting standards bodies toward the objective of creating a single high-quality accounting standard,314 and concerns with the governance of the international accounting standard setting body (IASB).315 The Action Plan also underscored the need to comprehensively reform the Bretton Woods institutions and to support emerging market economies and developing countries.316 In a press release following the meeting, European Commission President José Manuel Barroso made two very relevant points: there is no national road out of the financial crisis and there is a need to adjust global economic institutions and rules.317

309. Washington Declaration, supra note 300, ¶ 8.
310. Action Plan, supra note 301.
311. Id. See Washington Declaration, supra note 300.
312. Washington Declaration, supra note 300, ¶ 8.
315. Id.
316. Washington Declaration, supra note 300, ¶ 9, Reforming International Financial Institutions. The international monetary system was established by the International Monetary Fund and World Bank in 1944 at Bretton Woods, New Hampshire to provide stable and adjustable exchange rates.

On April 2, 2009 the Leaders of the G-20 met in London. They were fully aware of the extent of the financial crisis and the resulting economic chaos, so a great deal of time was spent trying to reach consensus on an appropriate response to the crisis. The most important outcome of the London Summit was the Global Plan for Recovery and Reform: the Communiqué from the London Summit (Communiqué). In addition to the Communiqué, the Leaders issued a detailed forty-seven-item Progress Report on the Washington Action Plan goals (Progress Report).

a. The London Summit Communiqué

The Communiqué outlined a system of international financial regulation in recognition that the fundamental causes of the crisis were major failures in the financial sector and in financial regulation and supervision. In line with their commitment to international cooperation and adoption of a more global perspective, the G-20 Leaders agreed, in rather broad language, “to build a stronger, more globally consistent supervisory and regulatory framework for the future financial sector, which will support sustainable growth and serve the needs of business and citizens,” and will integrate its financial policy and regulation with the EU and the rapidly evolving financial systems.

The G-20 initiatives and agenda within the scope of this article were directed toward harmonization of member capital markets in a swiftly changing global economy, particularly those items related to strengthening transparency and accountability and promoting integrity in the global financial marketplace. Attention was given in the Communiqué to goals related to international cooperation, prudential regulation, and the scope of regulation of hedge funds. It called on the credit derivatives industry to develop an action plan on

320. See Communiqué, supra note 302.
322. See Communiqué, supra note 302.
323. Id. ¶ 13.
324. The London Communiqué pledged to accomplish six goals: 1) restore confidence, growth and jobs; 2) repair the financial system to restore lending; 3) strengthen financial regulation to rebuild trust; 4) fund and reform international financial institutions to overcome this crisis and prevent future ones; 5) promote global trade and investment and reject protectionism, to underpin prosperity; and 6) build an inclusive, green and sustainable recovery, Id. at ¶ 4.
standardization and establishment of central clearing counterparties subject to effective regulation and supervision.326 The Communiqué also outlined reforms to be undertaken relevant to executive compensation, tax havens, non-cooperative jurisdictions, and credit rating agencies.327

The G-20 Leaders agreed that national accounting standard setters should improve standards for the valuation of financial instruments, and make significant progress towards a single set of high quality global accounting standards.328 In regard to strengthening financial regulation, the Communiqué pledged that the Leaders would implement the Action Plan through specific actions, and issued a Declaration, Strengthening the Financial System (London Declaration).329 Some provisions of the agreement refer to international commitments to establish a new Financial Stability Board (replacing the former Financial Stability Forum), including all G-20 countries, and to reinforce the stability of, and collaborate with, the IMF in order to provide early notification of macroeconomic and financial risks, and the actions necessary to resolve them.330


It was at the Pittsburgh Summit that the G-20, rather than the G-7 or G-8, became designated as the premier forum for international economic cooperation.332 With governments and international organizations hard at work on alternative investments


326. Communiqué, supra note 302, ¶ 15.

327. Id. ¶ 15.


330. Id. at 1.


332. G-20, Leaders’ Statement, supra note 299, pmbl. ¶ 19. Edmund L. Andrews, Global Economic Forum to Expand Permanently, N.Y. TIMES, Sept. 24, 2009, http://www.nytimes.com/2009/09/25/world/25summit.html?_r=1 (giving information about President Obama’s announcement that the G-7 and G-8 will be replaced formally with the G-20 – having the effect of reducing the status of the global forum of rich industrial nations known as the G-7 and G-8 through the introduction of a much broader-based body that now includes countries like China, Brazil, and India); Leader’s Statement: The Pittsburgh Summit (Sept. 24-25, 2009), available at http://www.whitehouse.gov/the_press_office/Statement-by-the-President-on-G-20-Summit-in-Pittsburgh [hereinafter Leaders’ Statement: Pittsburgh G-20 Summit]. In his “Statement by the President on G-20 Summit in Pittsburgh” President Obama noted, “to avoid being trapped in the cycle of bubble and bust, we must set a path for sustainable growth while steering clear of the imbalances of the past. That will be a key part of the G20 agenda going forward and the Pittsburgh
to meet the objectives set out at the Washington and London Summits, a top agenda item in Pittsburgh was to make the Leaders accountable by a review of the progress made since the prior two summits and a discussion of further actions to assure a sound and sustainable recovery from the global financial and economic crisis.\textsuperscript{333} The Leaders committed to the swift implementation of financial market reform, considering the improvement of financial markets' functioning as essential to avoiding a repetition of the fiscal crisis.\textsuperscript{334} Specifically there was an agreement that all major G-20 centers must adopt the Basel II Capital Framework, as strengthened by the Basel Committee (the organization responsible for establishing international banking standards) by 2011.\textsuperscript{335}


\textit{a. Regulatory and Accounting Standard-Setting Changes}

The G-20's call for convergence of the relevant accounting standard-setters to "achieve a single set of high quality global accounting standards, within the context of their independent standard setting process, and complete their convergence by 2011" is a powerful mandate. As the G-20 Leaders pledge to fulfill obligations to dramatically revise the international securities marketplace and achieve the goal of a single set of global accounting standards, the U.S. standard-setting agents include the SEC and the FASB. Both entities participate in the regulatory and standard-setting process in the U.S.

\footnotesize{Summit can be an important milestone in our efforts." Statement by the President on G-20 Summit in Pittsburgh, www.pittsburgh.gov/press/129285.htm (last visited Sept. 10, 2010).}

\textsuperscript{333} G-20, Leaders' Statement, supra note 299, pmbl. \textsuperscript{¶} 7.

\textsuperscript{334} \textit{Id.}


\textsuperscript{336} G-20 Leaders' Statement, supra note 299, pmbl. \textsuperscript{¶} 14. As long as the EU follows the IFRS and the U.S. applies the GAAP standards, the comparison of capital requirements between EU and U.S. banks are not comparable for the purposes of the Basel II capital adequacy rules. The commitment by the G-20 Leaders at their 2009 Pittsburgh Summit that they would implement the Basel II Capital Framework by 2011 has thus created an immense problem.
i. SEC Roadmap Update

There has been a delay in completing the SEC Roadmap project for achieving GAAP/IFRS convergence while the government is staving off the effects of the economic crisis. However, SEC Chief Accountant James Kroeker gave some encouragement in 2009 that, "turning back to the roadmap will be an important priority for us this fall." Kroeker mentioned that from the two hundred comment letters the SEC had received, it was "resoundingly clear" that the commentators agreed that there should be a single set of accounting standards; however, they disagreed on how to accomplish that goal. The SEC staff, Kroeker stated, would be working to establish the "pillars and milestones" to achieve convergence with IFRS, while attempting to avoid a "race to the bottom.") However, he assumed a cautionary tone when he addressed the issue of the timing of the SEC Roadmap in December 2009 at a conference on IFRS, and emphasized that the accounting standard-setting boards should not wait for the SEC to make its decision on the final Roadmap.

Current SEC Chairman Mary Schapiro previously seemed determined to move ahead with the Roadmap. In September 2009, she confirmed the SEC’s determination to complete the Roadmap and indicated her intent to again turn the SEC’s attention back to actively moving forward on it. Further support for this position was provided by a Commission vote to issue a statement making clear its continued belief in convergence and setting a due date of October 2010 for a status report from the SEC staff on the FASB and IASB convergence projects. Although the SEC has been pursuing the goals of

337. Defelice, supra note 336. More than 110 countries, including most of Europe and Asia, use the IFRS drawn up by the IASB while most U.S. companies use the GAAP standards drawn up by FASB. Sanderson, supra note 127.


339. Id.

340. Id.


342. SEC Chairman Mary Shapiro has been quoted from a speech at Georgetown University as saying, “I expect we will speak a little later this fall about what our expectations are with respect to IFRS.” See IFRS on Schapiro’s Agenda, AICPA, Sept. 18, 2009, http://www.ifrs.com; see also Emily Chasan, SEC to Refocus on IFRS roadmap-official, REUTERS, Sept. 17, 2009, http://www.reuters.com/article/ousivMolt/idSTRE58G4BJ20090917. Subsequently, however, “[i]n Feb. 2010, the SEC [changed position and] unanimously approved a timeline that envisions 2015 as the earliest possible date for the required use of IFRS by U.S. public companies. Alexandra Defelice & Matthew G. Lamoreaux, No IFRS Requirement Until 2015 or Later Under New SEC Timeline, J. ACCOUNTANCY, Feb. 24, 2010 http://www.journalofaccountancy.com/Web/20102656.htm. The SEC statement has been met with mixed reactions, ranging from supportive to disappointed.

343. Press Release, SEC, SEC Approves Statement on Global Accounting Standards (Feb. 24,
convergence in its Roadmap efforts, it has made no direct reference to the G-20 emphasis on creating a single set of high quality accounting standards.

ii. Progress between Financial Accounting Standards Board and International Accounting Standards Board on Convergence of Accounting Standards

The FASB and IASB also feel the pressure from the G-20 to proceed more rapidly on the convergence of accounting standards. As a result of the worldwide financial turmoil, the IASB and FASB created a Financial Crisis Advisory Group (FCAG) in the fall of 2008. The FCAG's mandate was to review financial reporting issues arising from the global crisis. Among the decisions of the FASB and the IASB, "partly in response to G-20 recommendations, and partly in response to other recommendations[,] such as those from the Financial Crisis Advisory Group," are proposals relating to financial instruments, fair value, financing receivables, and the allowance for credit losses. The two standard-setters are hosting three joint roundtables on financial instruments accounting. Additionally, the IASB recently released an updated table summarizing its response to G-20 recommendations.

The IASB and FASB have organized the three joint projects on which they are working simultaneously: 1) Financial Crisis related projects; 2) Memorandum of understanding projects; and 3) the Conceptual Framework.

Despite all these efforts, Sir David Tweedie, Chairman of the IASB, and an influential figure in both the EU and the world of international financial regulation, remains concerned with the U.S. advancement toward IFRS. In a speech to the American Accounting Association, he noted, "My view is that the U.S. needs to commit by 2011, one way or the other." Tweedie expressed his frustration by asking, "Where is the USA? That is a question that I am asked all...


345. Id.


348. Id.

349. Sir Tweedie's term of office expires in June 2011 and his replacement has not been announced. Sir Tweedie has been criticized for making a priority his effort "to get the U.S. to adopt international rules at the expense of European interests." Rachel Sanderson & Nikki Tait, Hunt for IASB Head Hits Hurdle, FIN. TIMES, Aug. 16, 2010, at 1.

over the world. . . . If you’re going to have global standards, we need the U.S.,
but it can’t go on indefinitely."351

Feeding into Sir Tweedie’s frustrations is the latest announcement from the
SEC that the commissioners unanimously approved a new timeline envisioning
2015 as the earliest possible date for the required use of IFRS by the
U.S.352 Although it may seem obvious to some that the U.S. should accept that
new, single, and quality accounting standards are essential to the interdependent
global economy, delays seem to be the order of the day, with an increasing risk
of the U.S. being bypassed by the world’s capital and financial markets.

b. Ongoing SEC Review of Section 404: The September 2009 Survey

In September 2009, the SEC issued its survey results on the ramifications
of its expensive internal control requirements, delineated in Section 404, for
foreign and domestic issuers.353 The survey was fueled by concerns that were
covered earlier in this article, such as the expense and burden of compliance and
the potential of de-listings (77 percent of small foreign firms considered
delisting from the U.S. exchanges, it turns out). Overall the “evidence from the
survey response data shows that the cost of Section 404 compliance decreased
following the Commission’s reforms introduced in 2007; this evidence may
prove useful in understanding the effects of the 2007 reforms as well as guiding
any subsequent regulatory efforts.”354 This quotation from the SEC survey,
emphasizing the U.S. response and reforms to Section 404 complaints from
foreign issuers, manifests awareness that the U.S. must consider its place in the
global securities marketplace when evaluating regulatory changes.

c. U.S. Developments in Statutory Implementation Related to G-20
Financial Recommendations

The U.S., as a key member of the G-20, is obligated to realign its
accounting standard-setting to converge with the international accounting
standards. Similarly, it needs to review regulation of hedge funds, derivatives,
and regulation of banks and other financial institutions to ensure that its
regulatory systems are consistent with those of the rest of the financial world.

In June 2009, President Obama unveiled a plan that would create a new
agency tentatively called the Consumer Financial Protection Agency and which
would “reshape the ways financial institutions do business in the United States

351. Id.
352. Defelice & Lamoreaux, supra note 342.
353. SEC, Office of Economic Analysis, Study of the Sarbanes-Oxley Act of 2002 Section 404
Internal Control over Financial Reporting Requirements (Sept. 2009),
354. Id. at 96-97.
and the way government supervises that business." The proposal immediately caused friction among regulators and criticism from a multitude of sources. It took Congress just about a year to finalize a bill, during the course of which the SEC sued Goldman, Sachs & Co. for fraud in the structuring and marketing of a collateralized debt obligation (CDO) tied to subprime mortgages, just as the U.S. housing market was beginning to falter. The litigation, which may have had some impact in moving the legislation along, was ultimately settled for $550 million. While the settlement ranked among the largest in the SEC's history, it was characterized as "only a small financial dent for Goldman, which reported $13.39 billion in profit last year."

The final legislation addressed key areas of limiting some of the riskiest activities of banks, regulating the multitrillion-dollar market in over-the-counter derivatives, giving federal regulators the tools to shut failing banks and financial firms instead of bailing them out, protecting consumers from abusive and predatory lending, and giving investors more power to influence corporate boards. While the bill received considerable criticism for not moving reform along enough, it did signal a shift on deregulation. The precise impact, however, will depend on how regulators exercise the considerable discretion the legislation grants them when drafting the detailed regulations for implementation.


5. EU Financial Reform in Line with G-20 Action Plan

a. EU Developments in Statutory Implementation Related to G-20 Financial Recommendations

The final ratification of the Lisbon Treaty has created a shift in the structure of the EU, but the new Treaty is unlikely to have any direct effect on the outcome of attempts at a centralized financial reform. Unlike the U.S., the EU had no central agency for securities regulation until 2009, with each of the twenty-seven Member States within the EU solely responsible for its own regulation and fiercely protective of national sovereignty. In the case of a

363. The final full ratification of the Lisbon Treaty resulted in some changes in the EU leadership at the end of 2009, although the revolving six months presidency of the European Council (formally the Council of Ministers made up of representatives from the Member States) was retained. Lisbon Treaty, supra note 1. The new positions of President of the European Council and High Representative of the Union for Foreign Affairs and Security (chief of foreign policy) were created. Herman Van Rompuy of Belgium was elected President of the European Council (and usually referred to as EU President, perhaps because of the central leadership role of the European Council within the EU structure) for a term of two and a half years (renewable once). Press Release, General Secretariat of the Council of the EU, Background, President of the European Council (Nov. 2009), available at www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/111298.pdf. Lady Catherine Ashton of Great Britain was elected head of foreign policy, Press Release, European Parliament, Summary of the hearing of Catherine Ashton-Foreign Affairs (Jan. 11, 2010), available at www.europarl.europa.eu/sides/getDoc.do?type=IM-PRESS&reference=201001081PR66978&language=EN. The position of President of the European Commission remained untouched by the Lisbon Treaty and Jose Barroso was reelected and he named Michael Barnier of France as the Commissioner of Internal Market and Services, replacing Charlie McCreevy. See also The Members of the Barroso Commission (2010-2014), EUROPEAN COMMISSION, http://ec.europa.eu/commission 2010-2014/index_en.htm (last visited April 6, 2011). Commissioner Barroso’s office within the EU speaks externally for the Member States in dealing with the fiscal crisis with international entities.


365. See Shelley Thompson, The Globalization of Securities Markets: Effects on Investor Protection, 41 Int’l LAWYER 1121 (2007). At the EU level, the existing situation is that there are three advisory committees in the financial services sector: These are: the Committee of European Banking Supervisors (CEB), the Committee of Insurance and Occupational Pensions Committee (CEIOPS) and the Committee of European Securities Regulators (CESR). These are referred to as the “Lamfalussy level 3 Committees” because of the “role they play in the EU framework for financial services legislation” created in a 2001 report by a group chaired by Alexandre Lamfalussy. See Financial Services Supervision and Committee Architecture, Overview, EUROPEAN COMMISSION, http://ec.europa.eu/internal_market/finances/committees/index_en.htm (last visited April 17, 2011).
global fiscal crisis, the EU central body is entirely dependent on its Commissioner of Internal Markets and Services and on the issuance of Directives by the European Commission, which are to be adopted by each Member State. The EU response was propelled by the severity of the worldwide economic downturn and the assault on the Eurozone by significant levels of debt in Greece, Portugal, and Spain.

i. Background

A bloc-wide regulatory regime is not a new idea for the EU. Early in the 2000s, the EU turned its attention to developing an approach to the general financial service industry regulations. In 2001, an EU advisory committee chaired by Alexandre Lamfalussy, a leading central banker and general manager of the Bank for International Settlements spearheaded this project, which came to be known as the “Lamfalussy process.” Lamfalussy’s aim was to allow the EU to respond rapidly and flexibly to developments in financial markets to achieve greater market integration and improve competitiveness.

366. When it becomes necessary to respond internally, for instance, to G-20 mandates for fiscal regulatory reform, this is handled mainly by the issuance of Directives (although sometimes by Regulations) that involve a harmonization process. A deadline is set by which each Member State must implement the Directive by either passing new national laws or by changing existing national legislation that does not comply. The Treaty section applicable to effect of Directives is carefully worded to preserve semi-autonomous Member States: “A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods.” Treaty Establishing the European Community, art. 249 (2), Nov. 10, 1997, 1997 O.J. (C 340) 03.

367. “Eurozone” is defined as the geographic and economic region that consists of, to date, 17 EU countries that have fully incorporated the euro as their national currency. See Eurozone, INVESTOPEDIA, http://www.investopedia.com/terms/e/eurozone.asp (last viewed May 6, 2010).


369. Alexandre Lamfalussy was also the first President of the European Monetary Institute and one of the main proponents for the single capital market within the European Union. The approach to the development of financial service industry regulations was named after Alexandre Lamfalussy, chair of the Committee of Wise Men, the EU advisory committee that created the process. See Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, Brussels (Feb. 15, 2001), http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf. The first aim of the Lamfalussy Report was to set up the adoption of EU financial services law. This approach consisted of four levels: Level 1 consists of framework Directives or Regulations; at Level 2, four regulatory Committees assist the Commission in adopting implementing measures, ensuring that technical provisions can be kept up to date with market developments; Committees of national supervisors are responsible for Level 3 measures, which aim to improve the implementation of Level 1 and 2 acts in the Member States and at Level 4, the Commission will strengthen the enforcement of EU law. Id.

ii. High-Level Group on Financial Supervision

In October 2008, European Commission President Barroso established The High-Level Group on Financial Supervision ("High Level Group" or "Group") in the EU, chaired by Jacques de Larosière, to give advice on the future of European financial regulation and supervision. The Group drew on the work contained in the Lamfalussy process.

In the report presented by the High-Level Group in February 2009, a distinction was made between financial regulation and financial supervision, but it was recognized that the two were intertwined. The High Level Group Report ("Report") pointed out Europe's special situation requiring bloc-wide attention, including the need for EU cohesiveness that could be achieved if there was a set of regulations and directives that would strive for maximum harmonization among the Member States.

Commissioner McCreevy to commend the Economic and Monetary Affairs Committee on the contents of its follow-up report on the Lamfalussy process pertaining to the future structure of [financial regulatory] supervision and to comment that "[i]t is heartening to see that so many of the issues you highlight are those that the Commission is also prioritizing." Press Release, Europa, Charlie McCreevy, European Commissioner for Internal Market and Services, Lamfalussy follow up: future structure of supervision, speech at the European Parliament Plenary Session, Brussels (Oct. 8, 2008), available at http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/513&format=HTML&aged=0&language=EN&guiLanguage=EN.


372. Report of The High-Level Group on Financial Supervision in the EU, Brussels (Feb. 25, 2009), http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf [hereinafter Larosière Report]. One of the problems identified in a list that appeared at the foreword to its Report: "Financial regulation and supervision have been too weak or have provided the wrong incentives. Global markets have fanned the contagion. Opacity, complexity have made things much worse." Id. at 3. The solution was to be a new framework of regulation to reduce risk and improve risk management, to provide stronger coordinated supervision and to build confidence among supervisors. Id. at 4.

373. The definition of "financial regulation" is the set of rules and standards that govern financial institutions; the main objective of "financial regulation" is to foster financial stability and to protect the customers of financial services. On the other hand, "financial supervision" is the process designed to oversee financial institutions in order to ensure that rules and standards are properly applied. Id. at 13. There needs to be a judgment at the EU level as well as in the Member States and a greater role for the European Central Bank (ECB). Id. at 42.

374. Id. at 27, 29, 39.

375. Id. at 29. The European Central Bank (ECB under the Larosière proposals would have a macro-prudential oversight but not a micro-prudential supervision which would remain with the individual Member State who would work towards a European System of Financial Supervision (ESFS). See id. at 46. The current Banking Supervision Committee (BSC) of the ECB would be replaced by the European Systemic Risk Council (ESRC) chaired by the President of the ECB. See id. at 44. The ESFS would be composed of existing national supervisors who would carry out day-to-day supervision. See id. at 47. However, the overall aim would be the creation of a European system of financial supervision. This would be achieved by the transformation of level three committees into three European Authorities: a European Banking Authority, a European Insurance Authority and a European Securities Authority. See id. at 49. The time span suggested by Larosière was a phased change so that immediate action would be taken to strengthen national supervisory
The High-Level Group Report indicated that it welcomed the work of the G-20 in promoting integrity in financial markets and reinforcing international cooperation. Also, it supported the continuing role of the newly renamed Financial Stability Board and the strengthening of the IMF.\textsuperscript{376} When the Report was presented on February 25, 2009, the European Commission readily accepted the recommendations.\textsuperscript{377}

### iii. Progress Toward Pan-European Financial Reform

The global credit crisis, the G-20 commitments, and the market turmoil triggered by the fallout from the Eurozone crisis are a few of the factors creating incentives for the EU to move more quickly towards a central, bloc-wide regulatory scheme. In September 2009, the European Commission put forward a regulation engineering a new pan-European financial supervision architecture.\textsuperscript{378} The focus fell on three regulatory proposals covering: 1) alternative investment funds, including hedge funds and equity funds;\textsuperscript{379} 2) capital requirements for banks and the bonuses these financial institutions pay out based on Basel-II, with similar objectives agreed to by leaders of the G-20 meeting in London;\textsuperscript{380} and 3) the supervision of the financial sector, both at the micro and the macro level.\textsuperscript{381} The last of the three proposals was the most

authorities with a view to upgrading the quality of supervision in the EU. See id. at 51.

\textsuperscript{376} Larosière Report, supra note 372 at 61, 64.

\textsuperscript{377} "...[S]wift decisions in Europe, based on the conclusions of the report which I asked the de Larosière group to present, can help us drive the global effort on supervision. The Commission will make detailed proposals to the June European Council. I am happy with the good overall reaction that was given to the de Larosière report." Press Conference, Remarks by President Barroso (Mar. 31, 2009), available at http://ec.europa.eu/cyprus/news/20090401_g20_barroso_en.htm.

\textsuperscript{378} Proposed Regulation on Financial Supervision Reforms, supra note 364; see also Commission Adopts Legislative Proposals, supra note 364.


controversial because it brought to the fore fears that the powers of national authorities will be eroded.382

It appeared that the European Commission sought to impose bloc-wide/pan-European regulatory bodies to supervise banks and detect systemic risks that threaten the financial system.383 The new legislation proposed the creation of a European Systemic Risk Board, 384 and a European System of Financial Supervisors385 consisting of a network of national financial supervisors working in tandem with three new European Supervisory Authorities: the European Banking Authority, the European Insurance and Occupational Pensions Authority, and the European Securities and Markets Authority. 386

The pending threat of bloc-wide regulation caused the Germans to argue that the Commission had overstepped its mandate by pushing for the creation of three new authorities with supra-national powers that would conflict with those of national bodies.387 The U.K. also viewed the pan-European regulatory scheme with great concern.388 There were complaints that what had been left to "local enforcers" would be centralized and "London could end up with stricter


383. Id. See also Proposed Regulation on Financial Supervision Reforms, supra note 364; Commission Adopts Legislative Proposals, supra note 364.

384. Id.

385. Id.

386. Id.; Directive on Powers of the Banking Authority, Insurance Authority and EMSA, supra note 381.


388. Lord Woolmer, who chaired the House of Lords Committee looking at 'The future of EU financial regulation and supervision', said: “But there are concerns. Financial services are a key, strategic industry for the UK. London operates in a global market place as well as in Europe. Many other EU member states do not share this perspective. The UK government must ensure these national interests are properly reflected in new regulations or in structural reforms. There are some worrying signs. The timing and pace of Commission proposals appeared dictated by the timetable of the European Parliament elections and the twilight days of the old Commission.” Press Release, House of Lords Committee, The Future of EU Financial Regulation and Supervision (June 17, 2009), available at http://www.publications.parliament.uk/pa/ld200809/ldselect/1deucom/106/10602.htm. A comment from French Finance Minister Christine Lagarde impacts the U.K. when she suggests that the EU should set up its own commodity futures trading commission similar to the U.S. Commodity derivatives are currently regulated by the relevant authorities in each European country. But with London as the primary European trading center, the UK’s Financial Services Authority (FSA) would absorb the bulk of the work. The FSA will view Finance Minister Lagarde’s comments as trespassing on its turf. The Lex Column, Derivatives Trading, FIN. TIMES, Apr. 15, 2010, at 12.
rules than New York and lose business to laxer jurisdictions." Other Member States worried that the EU was moving too fast and that this could change the way in which financial institutions operate. In sorting this conflict out, the specter of long-held underlying fears of EU Member States that the central European body will infringe on their carefully guarded national sovereignty has again been raised.

RECOMMENDATIONS AND CONCLUSIONS

The adverse reaction of capital markets worldwide to the fiscal crisis that started in the U.S. in 2008 persuasively suggests that the era of national containment of financial market problems has ended. Technology has ushered into the globalized economy and has initiated a financial era where securities markets are inextricably intertwined. As made clear in the Communiqué issued by the G-20 Leaders in London, "a global crisis requires a global solution."

After a slow evolution over a ten-year period, the U.S. has begun to shift to a more external perspective in its attitudes and governmental actions. During the same period, perhaps motivated by their background and experience in international relations, EU Member States have also begun to shift away from their historic internal tensions. They have instead moved in the direction of an understanding of the advantages of a unified approach to external issues.

In light of the preceding factors, recommendations based on G-20 initiatives for which the history of GATT/WTO provides a supporting framework are discussed below.


392. Id.

Recommendation #1: Utilize lessons from the institutional evolution of the GATT/WTO to strengthen the impact of the G-20.

As the G-20’s global leadership role is developing, the world is slowly entering a new era of international cooperation. On a broader scale, it may not be unreasonable to suggest that the emergence of the G-20 as the primary catalyst for global financial policy-making bears some resemblance to the establishment of the General Agreement on Tariffs and Trade (GATT) after World War II. Just as GATT recognized the need for a multilateral, reciprocal mechanism for reducing tariffs on manufactured goods, the G-20 creates a mechanism for coordinating and harmonizing financial, securities, and accounting regulation. Indeed, the depth and breadth of our recent global financial crisis and the steps we are taking to recover from it are akin to the significance of the Bretton Woods institutions, which was developed to restore a functioning global financial and trade framework after the ravages of the Great Depression and the conflagration of World War II.

Mikhail Gorbachev, no stranger to momentous institutional change, has characterized the emergence of the G-20 as a recognition that “the world has changed and that the old institutions have not kept pace with rapidly evolving needs.” Yet, he has pointed out that, “already there are questions about the substance and functioning of this new body—questions that need to be answered without delay.”

Recommendation #2: The G-20 must strategically focus on achievable targets by reaching closure in a timely manner on the most critical substantive securities and accounting regulatory reforms upon which agreement can be attained.

The first question Gorbachev articulates is “whether the decisions adopted in London can resolve the global financial and economic crises, setting the world economy on track to sustainable growth.” If the G-20’s role follows the GATT model, we can be hopeful about the substantive outcomes it may achieve. As noted above, the framework that the G-20 has developed to address key areas of financial, securities, and accounting regulatory reform has yielded impressive short- and long-term goals and a mechanism for assessing results. Similarly, GATT’s focus on achieving lower import duties globally on manufactured goods was achieved through a methodical, focused series of tariff reduction rounds. The Basel Committee on Banking Supervision, already linked to the

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394. PENG, supra note 83.
395. Id. at 190.
396. Gorbachev, supra note 13.
397. Id. No G-20 agency has been created with enforcement authority and moral suasion appears to be the primary tool for the member nations’ adoption of G-20 dictates.
398. Id.
399. PENG, supra note 83.
G-20, is providing another building block model.400

Recommendation #3: Where international agreement cannot be achieved in the short run, efforts should be made to at least reduce the incompatibility of domestic policies.

As we have pointed out, two recent developments are undercutting the consensus toward global financial integration. The first development concerns the undertaking by developed economies of “financial reregulation . . . guided by domestic political realities that make international consensus more elusive.”401 The second development is espoused by “financial institutions from emerging countries [which] are beginning to overtake their western peers” and are “increasingly resist[ing] standards proposed by members of the old north Atlantic consensus.”402 These forces require global leaders to prioritize their efforts: “A new principle of subsidiarity . . . in which only those policy aims that cannot be addressed locally should be tackled globally. This might seem like a step back from integration but, in truth, many reforms are not best pursued at the global level.”403 Again, the GATT experience is relevant. In 1947, essentially all that could be agreed upon (the “low-hanging fruit”) was the desirability of reducing tariffs on manufactured goods, so that is what the GATT focused on for its first several decades. Only when that goal was achieved did the GATT tackle new areas, such as trade in services and intellectual property issues.

Recommendation #4: The G-20 needs to develop a workable form of dispute resolution to achieve a realistic mechanism for enforcement and policy accommodation.

The second, and more difficult, question Gorbachev raises is regarding the “concerns the G-20’s place within the system of global institutions.”404 He suggested that the G-20 “could claim collective leadership in world affairs if it acts with due respect for the opinions of non-members.”405 In this regard, he describes “the presence in the G-20 of countries representing different geographic regions, different levels of development and different cultures” as a “hopeful sign.”406 However, he also notes that the G-20 is “an improvised affair,

402. Id.
403. Id. (emphasis added).
404. Gorbachev, supra note 13.
405. Id.
406. Id.
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put together under duress in the extreme conditions of an unexpected global upheaval.\(^{407}\) This suggests the difficulty of enforcing outcomes agreed upon by the G-20 in the future if members' interests are contrary or a lack of urgency results in reluctance to go to the effort of changing the status quo. Here, GATT provides another useful parallel. As originally adopted, and until the creation of the WTO, the GATT was a “provisional treaty served by an ad hoc secretariat.”\(^{408}\) It wasn’t until the WTO was created that adequate trade dispute settlement mechanisms were adopted, allowing the WTO to “adjudicate trade disputes among countries in a more effective and less time-consuming way.”\(^{409}\)

\[\text{\textit{A Context for Progress and the Challenges Ahead}}\]

U.S. and EU domestic adherence to existing and evolving G-20 proposals is a pivotal component for the successful implementation of the above recommendations. Therefore, the U.S. and EU must set aside their separate sets of sovereignty issues and recognize that the new order of globalization requires taking heed of the call of the G-20. This new order is referred to by EU Internal Market Commissioner Charlie McCreevy in a speech in May 2009 as the need “to take action to build a more globally consistent, regulatory and supervisory system for the future of financial services.”\(^{410}\) History teaches us that if we do not act now, when the threat of global economic collapse is still fresh in our minds,\(^{411}\) the underlying problems will remain to be dealt with later, perhaps in even less desirable circumstances.\(^{412}\)

\(^{407}\) Id.

\(^{408}\) PENG, supra note 83, at 211.

\(^{409}\) Id.


\(^{412}\) One might see a parallel in the inadequate armistice ending World War I (“The War to End All Wars”), which left the most serious underlying problems for later resolution by World War II. Much attention has been given recently to the 80\(^{8}\) anniversary of the Great Crash of 1929. As we have pointed out in our earlier work, although the October 1929 crash was traumatic to those affected by it, it “was hardly the first time in history that losses were incurred as the result of market abuses.” Kathleen Lacey, Barbara Crutchfield George & Clyde Stoltenberg, Assessing the Deterrent Effect of the Sarbanes-Oxley Act’s Certification Provisions: A Comparative Analysis Using the Foreign Corrupt Practices Act, 38 VANDERBILT J. TRANSNAT’L L. 405 (2005). Ralph deBedts’ cautionary observations based on history bear repeating now:

In the history of man’s attempts to preserve integrity in the realm of financial transactions, some continuity in the insurance of such honesty can be seen from century to century. The passage of laws and the accretion of custom have aided; occasionally government itself operated a medieval bank of exchange. However,
At this point the analogy to GATT again becomes pertinent. The evolution of the GATT into the WTO occurred over a period of some fifty years in what was, structurally, a relatively stable post-war global environment. Today's world is quite different. Joseph Stiglitz, Nobel Laureate in economic sciences, has pointed out how economic globalization continues to outpace both the political structures and the moral sensitivity required to ensure a just and sustainable world. As Yale law professor Amy Chua has pointed out, we now know that the combination of free markets and democracy alone is not transforming the world into a community of modern, peace-loving nations full of civic-minded citizens and consumers.

Competing forces are bringing the planet together and driving its pieces apart at the same time, and we are constantly surprised by the new world disorder. Increasing complexity and interdependence, in combination, make problem solving more difficult. We have also seen the difficulty, in both the U.S. and the EU, of overcoming national interests in times of broader financial distress, at the same time that the emerging world is rivaling rich countries for business innovation. Again, Stiglitz has articulated the need to think and act globally, even in the absence of a supporting institutional infrastructure. The world can best meet the challenges ahead with the existing structure of the G-20 serving as an interim framework for developing the institutions fundamental to achieving global financial stability and visionary regulation.

in that area of financial honesty concerned with protecting the unwary investor from the fraudulent activities of the dishonest stockbroker or issuer of securities, no faintest semblance of orderly progression can be found. The actions and experience of one century seemingly have no connection with the legislative flurries in a subsequent period, and the observer is acutely aware of an utter lack of continuity. Only one thing remains in common in several centuries of legislative efforts to regulate the exploiter of the investor. Inevitably such attempts come about only when the disastrous results are seen in retrospect. Calamity must befall those who have ventured their funds before protective measures may be launched.

413. JOSEPH E. STIGLITZ, GLOBALIZATION AND ITS DISCONTENTS (2002).
414. AMY CHUA, WORLD ON FIRE (2003).
417. Id.