MARKETS AS REGULATORS: A SURVEY

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ABSTRACT

Stock exchanges around the world have recently discarded their traditional mutual membership structure in favor of a for-profit corporate format. This development increased fears of conflicts of interest, as for-profit exchanges are more sensitive to pressures from their constituents and more likely to abuse their regulatory powers. In this Article, we explore the allocation of regulatory responsibilities to market infrastructure institutions, administrative agencies, and central government entities in the eight most influential jurisdictions for securities regulation in the world. Examining how different jurisdictions answer this question is particularly pressing given the December 2006 transatlantic stock exchange merger activity. After discussing the role of self-regulatory organizations in the oversight of modern stock exchanges, we report the results of a survey of the allocation of regulatory powers in a sample of eight key jurisdictions. In that survey, we examine the allocation of such powers at three levels: rulemaking, monitoring of compliance with these rules, and enforcement of rules violations. Based on our findings, we categorize these jurisdictions in three distinct models of allocation of regulatory powers: a Government-led Model that preserves significant

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authority for central government control over securities markets regulation, albeit with a relatively limited enforcement apparatus (France, Germany, and Japan); a Flexibility Model that grants significant leeway to market participants in performing their regulatory obligations, but relies on government agencies to set general policies and maintain some enforcement capacity (United Kingdom, Hong Kong, and Australia); and a Cooperation Model that assigns a broad range of power to market participants in almost all aspects of securities regulation, but also maintains strong and overlapping oversight of market activity through well-endowed governmental agencies with more robust enforcement traditions (United States and Canada).

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I. INTRODUCTION

The first transatlantic stock exchange is now a reality. In late December 2006, the New York Stock Exchange ("NYSE") agreed to merge with Euronext, which operates stock exchanges in Paris, Amsterdam,

Brussels, and Lisbon, as well as a derivatives market in London. The successful completion of this merger was by no means predetermined. Deutsche Börse, the Frankfurt Stock Exchange operator, had submitted a rival hostile bid for Euronext. Leading French[1] and German politicians[2] supported Deutsche Börse's bid, advocating for a "European solution"[3] in stock exchange consolidation. In addition, the French business world, at least initially, was highly skeptical of a New York partnership.[4] After months of heated debate, however, NYSE and Euronext shareholders approved the merger.[5]

In parallel with the NYSE-Euronext merger, another effort to create a major transatlantic stock exchange was unfolding. In the course of 2006, Nasdaq, the second largest U.S. exchange, acquired 28.75% of the London Stock Exchange ("LSE").[6] In mid-December 2006, Nasdaq launched a hostile bid for the majority of LSE's shares.[7] Although this bid failed, speculation about Nasdaq's future plans continues as it remains the primary LSE shareholder.[8] The drive toward consolidation is not limited to the largest international stock exchanges. Smaller bourses in Milan, Vienna, and Johannesburg are also prospective takeover targets.[9] The message is clear: the stock exchanges of the world are uniting.

Regulatory concerns are at the center of these merger efforts. Stock exchanges play a decisive role in capital allocation and provide key infrastructure for a country's markets. Thus, each country has established a

1. *See* Alistair MacDonald & Edward Taylor, *Chirac Frowns on NYSE-Euronext: Deutsche Börse Takes Heart from French Leader's Call for Franco-German Alliance*, WALL ST. J., June 7, 2006, at C4.

2. *See* Norma Cohen et al., *Deutsche Börse Prepares to Withdraw Euronext Bid*, FIN. TIMES (London), Nov. 15, 2006, at 1. *See also* James Kanter, *Deutsche Börse Drops Bid to Buy Euronext*, INT'L HERALD TRIB. (Paris), Nov. 15, 2006, *available at* http://www.iht.com/articles/2006/11/15/business/exchange.php?page=1.

3. *German Bid for Euronext Ditched*, BBC NEWS, Nov. 15, 2006, *available at* http://news.bbc.co.uk/2/hi/business/6149626.stm.

4. *See* Martin Arnold, *French Relent on NYSE Bid*, FIN. TIMES (London), Dec. 16, 2006, at 21.

5. *See* Gaston F. Ceron, *NYSE Group's Shareholders Approve Takeover of Euronext–Support Is Overwhelming for Transatlantic Deal: More Consolidation Seen*, WALL ST. J., Dec. 21, 2006, at C3; Aaron Lucchetti & Alistair MacDonald, *Euronext Holders Approve Deal for Historic Merger with NYSE: U.S. Exchange Will Vote on Market Tie-Up Today as Nasdaq, LSE Wrangle*, WALL ST. J., Dec. 20, 2006, at C3.

6. *See* Norma Cohen, *Nasdaq Sets Clock Ticking on LSE Offer*, FIN. TIMES (London), Dec. 13, 2006, at 17.

7. *Id.*

8. *See* Norma Cohen, *LSE Set to See Off Bid from Nasdaq*, FIN. TIMES (London), Feb. 10, 2007, at 1.

9. *See* Alistair MacDonald, *Smaller Exchanges Aim to Join Consolidation Race*, WALL ST. J., June 5, 2006, at C3.

strict regulatory framework to safeguard the operation of its stock market. The NYSE-Euronext markets are direetly regulated by the administrative agencies of six different jurisdictions, with varying powers, regulatory philosophies, and degrees of independence from central governments. During the merger negotiations, Americans discovered that officials under direct political control and electoral pressure, such as government ministers, had to approve the deal.[10] Although NYSE-Euronext is a multinational private corporation, various local authorities demanded a limited but special "say" in the appointment of its management.[11] A key motivation for the merger was European markets' success in attracting issuers seeking to avoid onerous U.S. laws, in particular the Sarbanes-Oxley Act requirements.[12] Nonetheless, Europeans feared that they would lose this advantage if U.S. regulators sought to apply unduly strict U.S. laws on companies listed on the European markets of the merged entity.[13] In response to these concerns, the U.S. and European markets of the merged company will operate independently of one another.[14] The corporate structure of the new entity permits the unraveling of the merger if regulators on either side of the Atlantic overextend their jurisdictional reach.

These regulatory hurdles brought to light significant differences between various jurisdictions regarding the allocation of regulatory authority over securities markets. Ultimately, who should be responsible for regulating securities markets? What role should central governments play? What powers should administrative agencies have, and what issues

10. *See* Martin Arnold, *Breton Sets Out Terms for Any Euronext Merger*, FIN. TIMES (London), May 23, 2006, at 23 (pointing out that French finance minister Thierry Breton detailed the terms under which the French government would accept a Euronext merger); Digby Larner, *NYSE-Euronext Deal Clears Hurdle: Dutch Minister Withdraws Veto Threat as Concerns Over Regulations Are Eased*, WALL ST. J., Dec. 19, 2006, at C3 (pointing out that Dutch Finance Minister Gerrit Zalm had at one point threatened to veto the merger of Euronext and NYSE Groups Inc.).

11. *See* Norma Cohen, *Veto Hurdle for Euronext Deal: Regulators Want Say in Board Appointment: Concerns Remain Over Merger of Exchanges*, FIN. TIMES (London), Dec. 1, 2006, at 13. Michel Prada, chairman of the AMF, the French regulator, said: "We want to have a say in the appointment of the board. . . .We want to have a global vision. . . . [We want] to have a say in the way governance is made and the way management is organised." The goal of this authority is to ensure that a board member is 'fit' for this role. NYSE and Euronext accepted these conditions. *See* Alistair MacDonald & Aaron Lucchetti, *Moving the Market: NYSE-Euronext Steams Ahead As EU Regulators Back Merger*, WALL ST. J., Dec. 6, 2006, at C3.

12. *See* Larner, *supra* note 10.

13. *See* Jeremy Grant, *Cox Hails US-EU "Ground Rules,"* FIN. TIMES (London), Sept. 26, 2006, at 29. *See also* Alistair MacDonald, *U.K. Frets Over LSE Takeover: Government to Shield Exchange from U.S.-Style Regulations*, WALL ST. J., Sept. 14, 2006, at C12.

14. *See* Aaron Lucchetti, *NYSE-Euronext: One, But Two*, WALL ST. J., Sept. 22, 2006, at C4 (outlining the mechanics of the deal).

are better left to the stock exchanges themselves? As transatlantic stock exchanges seek to integrate their operations, these differences grow in importance. Little doubt remains that greater cooperation among regulators from various jurisdictions is necessary.[15] Proposals from influential policymakers call for substituting Securities and Exchange Commission ("SEC") oversight of foreign exchanges with proof of compliance with home regulatory regimes, provided that such regimes' rules and enforcement philosophies are comparable to those of the U.S. regime.[16] Identifying similarities and differences between various jurisdictions is a critical step in determining comparability.

Changes in the ownership structure of stock exchanges have compelled regulators around the world to reexamine the allocation of regulatory authority. Traditionally run as mutual membership organizations, stock exchanges had developed rules for their members, listed companies, and trading processes. Most states had established systems of public oversight that took advantage of the benefits of self-regulation while mitigating the inherent conflicts of interest. In the last decade, most stock exchanges "demutualized": they abandoned their traditional nonprofit mutual membership structure in favor of a for-profit corporate format. Some privatized stock exchanges took the additional step of listing their shares on their own markets. These developments gave rise to new puzzles for regulators. Are institutions that are designed to maximize shareholder value well-suited to regulate their own markets? Does demutualization result in new conflicts of interest that call for greater regulatory intervention? In most leading jurisdictions, policymakers introduced reforms in securities markets supervision to respond to these concerns.

In this Article, we present a survey of the allocation of regulatory responsibilities over securities markets, seeking to understand how countries divide authority among government ministries, independent agencies, and stock exchanges themselves. We identify three key similarities in all the jurisdictions we survey. First, the scope of market oversight is comparable. Second, at least with regard to their own trading rules, stock exchanges in all eight jurisdictions maintain certain self-regulatory powers. Third, all jurisdictions use a multifaceted regulatory

15. SEC Chairman Christopher Cox stated that the problem was "beyond the ability of any individual regulator. We have no choice but to eo-operate." *See* Jeremy Grant, *Capital, Traders and Fraudsters Are All Completely Mobile*, FIN. TIMES (London), Nov. 28, 2006, at 3.

16. *See* Ethiopis Tafara & Robert J. Peterson, *A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 31, 32 (2007). Ethiopis Tafara is the director of the SEC Office of International Affairs. *Id.* at 31.

structure, where a variety of public bodies have oversight powers. The allocation of regulatory responsibilities within the eight jurisdictions of our survey, however, is substantially different. The mechanisms of oversight and cooperation between self-regulatory organizations ("SROs") and government agencies, moreover, vary significantly.

Our research suggests that there are three distinct models for the division of regulatory responsibility over securities markets. These three models shaped the direction of post-demutualization reforms in each jurisdiction; countries in each cluster responded similarly to the challenges of stock exchange transformation. More specifically, countries in the "Government-led Model" (France, Germany, and Japan) provide central governments with direct channels of influence over securities markets regulation. These jurisdictions reacted to stock exchange demutualization by enhancing the efficiency of government supervision: they reshuffled the organization of their administrative agencies and increased their already strong regulatory powers. The "Flexibility Model" countries (the United Kingdom, Hong Kong, and Australia) traditionally relied more heavily on market participants and granted them significant leeway in regulating many aspects of their activity. "For-profit" stock exchanges pose greater challenges for these jurisdictions. In response to demutualization, Flexibility Model countries curtailed the powers of SROs and enhanced oversight by administrative agencies. Yet, administrative agencies in these jurisdictions maintain a regulatory philosophy of cooperation with market participants, and typically issue guidance rather than mandatory rules. In the "Cooperation Model" countries (the United States and Canada), the regulatory powers of stock exchanges extend over most issues, but are exercised under close supervision by government agencies. Instead of substantially limiting self-regulation, governments in the Cooperation Model developed mechanisms to insulate stock exchange regulatory activity from the operation of the markets. Thus, under government influence, stock exchanges segregated their regulatory functions in a separate, independently-run subsidiary.

Part II below begins our analysis with a review of the role of exchanges as SROs, touching on both the history of regulation by exchanges and the traditional arguments for and against self-regulation in capital markets. We then turn our attention to recent developments in the organization of stock exchanges around the world, focusing on the wave of demutualizations that have occurred in the past decade. We next summarize the academic debate that these demutualizations have stimulated so as to provide a perspective on the current thinking of scholars and public policy

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analysts on the appropriate regulatory function of exchanges and other SROs in the context of a modern and competitive global capital market, populated with numerous for-profit exchanges and a variety of alternative trading mechanisms.

In Part III, we turn from the academic world to the real world and present a survey of the kinds of regulatory accommodations that have evolved around the world to deal with the allocation of regulatory authority over exchanges and their activities. While these practices do not map easily onto academic prescriptions, they do provide a range of approaches to regulatory responsibilities in which government bodies exert different degrees of control over exchanges and their activities. As of yet, no single model has emerged as dominant. Indeed, the three largest stock exchanges in the world—those of the United States, the United Kingdom, and Japan—all follow different approaches.

II. SELF-REGULATION IN THE MODERN STOCK EXCHANGE

A. THE REGULATORY ROLE OF STOCK EXCHANGES

1. Organizing a Market and Setting Its Rules

Stock exchanges predate government agencies as regulators of equity trading markets;[17] in fact, regulating the trading process was the primary goal behind the establishment of organized stock markets. Exchanges constituted an attempt by a group of brokers to take control of trading in certain equities so as to offer more streamlined trading conditions through increased liquidity in exchange for a fee.[18] As a result, setting out rules that define the operation of the market was inherent in the notion of an exchange. Similarly, the nature of exchanges dictated the ultimate sanction available to them for disciplining purposes: expulsion from the exchange hub. To set up the market, exchanges sought to control the trading members, the stocks to be traded among them, and the rules under which trading would take place. Below we look at each one in turn.

The aim of member regulation was to ensure that all market participants would be reliable trading partners. Thus, exchanges sought first

17. *See* Joel Seligman, *Cautious Evolution or Perennial Irresolution: Stock Market Self-Regulation During the First Seventy Years of the Securities and Exchange Commission*, 59 BUS. LAW. 1347, 1349 (2004).

18. *See* Jonathan R. Macey & David D. Haddock, *Shirking at the SEC: The Failure of the National Market System*, 1985 U. ILL. L. REV. 315, 317 (1985). Liquidity, of course, did not come for free. For example, brokers charged increased commissions for the privilege of offering access to the exchange to their clients.

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to establish certain eligibility criteria.[19] Continuous oversight after the admission stage, however, was necessary to maintain high-quality standards for trading participants. Exchanges set qualification standards for brokers' personnel, capital adequacy requirements, and best practice principles.[20] As trading participants are interested in safeguarding the quality of order execution, they have an interest in removing from the exchange potentially deceitful counterparties.[21] Moreover, exchanges required brokers and other market professionals to maintain the infrastructure necessary for conducting exchange transactions, and, more recently, to obtain certain technological capabilities.[22]

To maintain a high-quality marketplace, exchanges also focused on establishing criteria to determine which stocks they were going to admit and ensuring that investors received appropriate information as to the characteristics of each stock. Thus, exchanges put in place a signaling function: a stock's admission to listing indicates to investors that the stock is worth its investment.[23] To enhance this perception beyond the initial listing stage, exchanges gradually required listed companies to offer ongoing disclosures on their business activities, their investments, their obligations, and their future plans. Moreover, seeking to ensure investors that they are protected against abuses of corporate power, stock exchanges even adopted corporate governance standards for their listed firms.[24] To complement the mandatory disclosure and corporate governance regimes, as well as further strengthen their integrity credentials, exchanges developed an enforcement mechanism.[25]

Finally, exchanges set their own rules determining how the trading

19. *See* INT'L ORG. OF SEC. COMM'NS, TECH. COMM., CONSULTATION REPORT: REGULATORY ISSUES ARISING FROM EXCHANGE EVOLUTION 6–7 (2006) [hereinafter CONSULTATION REPORT].

20. *See id.* at 7.

21. *See* Onnig H. Dombalagian, Demythologizing the Stock Exchange: Reconciling Self-Regulation and the National Market System 40 (Aug. 19, 2004) (unpublished manuscript), *available at* http://ssrn.com/abstract=579261.

22. *See* CONSULTATION REPORT, *supra* note 19, at 7.

23. *See* Jonathan R. Macey & Hideki Kanda, *The Stock Exchange As a Firm: The Emergence of Close Substitutes for the New York and Tokyo Stock Exchanges*, 75 CORNELL L. REV. 1007, 1009 (1990). In a separate article, Macey argues that by denying listing to firms that their members did not trust, some exchanges, like the NYSE, "effectively pooled the information of all [their] members . . . ." *See* Macey & Haddock, *supra* note 18, at 318.

24. *See generally* Roberta S. Karmel, *The Future of Corporate Governance Listing Requirements*, 54 SMU L. REV. 325 (2001) [hereinafter Karmel, *Listing Requirements*].

25. *See* A.C. Pritchard, *Markets as Monitors: A Proposal to Replace Class Actions with Exchanges as Securities Fraud Enforcers*, 85 VA. L. REV. 925, 967 (1999) (arguing that exchanges will be more efficient enforcers of securities antifraud rules because the value of their members' seats will vary depending on the trading volume such exchanges attract, which in turn depends on the level of fraud in the exchange markets).

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process was going to be conducted, offering standardized-format trading contracts to brokers and investors.[26] As different trading systems confer different advantages to trading participants and investors, designing an efficient trading process has been a key concern for exchanges throughout their existence. Often, exchanges promulgated rules relating to clearing and settlement of transactions executed through their facilities. In addition, exchanges often undertook a policing role over their markets, monitoring compliance with trading rules, supervising day-to-day trading to identify instances of potential fraudulent or abusive behavior, and often undertaking enforcement actions against their members.[27]

As stock exchange regulatory power was, at least initially, based on contract, the exchanges' sanctioning abilities were structured in a contract-like manner. As such, discontinuation of the contract often constituted the harshest measure over the regulated entity, which was either a trading member or a listed firm. Consequently, the exchange had the power to devise less strict measures that addressed the particular concerns associated with the behavior in question.[28]

These rulemaking, monitoring, and enforcement efforts allowed stock exchanges to develop a "brand"; listing on the NYSE, for example, confirmed that an issuer was able to meet some of the highest corporate standards on a global scale. The exchange offered to listed companies a "panoply of rules" to govern their activities.[29] The importance of a brand for an exchange lies in the brand's ability to attract revenue. The NYSE and Nasdaq, for example, have traditionally intensely competed with one another for listing fees. Such competition has recently expanded to competition for trading fees and fees from the sale of market trading information.[30]

2. A Public Interest Role for Exchanges

While rulemaking for members, listed companies, and trading

26. *See* Macey & Kanda, *supra* note 23, at 1009.

27. *See* CONSULTATION REPORT, *supra* note 19, at 7.

28. Paul Mahoncy characterizes the weave of contractual relationships surrounding stock exchange transfers in the period that preceded the enactment of federal securities laws as a "private body of contract law." *See* Paul G. Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453, 1460 (1997). For example, pre-1933 NYSE rules threatened with suspension members who failed to comply with their client contracts; later, the NYSE established rules segregating client and proprietary trading. *See id.* at 1461.

29. Jonathan R. Macey & Maureen O'Hara, *Regulating Exchanges and Alternative Trading Systems: A Law and Economics Perspective*, 28 J. LEGAL STUD. 17, 22 (1999).

30. *See* James D. Cox, *Brands v. Generics: Self-Regulation by Competitors*, 2000 COLUM. BUS. L. REV. 15, 16–17 (2000).

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processes has been a key feature of an organized marketplace, the central role exchanges play in the economy has lent an important public interest perspective to their regulatory function.[31] Exchanges are the main gateway through which corporate issuers access public financing, and thus their interest in maintaining a high-quality marketplace coincides with the public goal of more efficient allocation of resources.[32] Exchanges provide liquid secondary markets, which are a precondition for effective primary markets.[33] In addition, exchanges offer other functions that are also beneficial to the wider investing public. For example, by requiring ongoing disclosure about a firm's activities, exchanges reduce information costs for the wider public and contribute to the efficiency of the markets in assessing the true value of that firm's stock.[34] Furthermore, by maintaining orderly markets, exchanges decrease the likelihood of serious market disruptions that could impose negative externalities on the larger economy.

The public interest objective of ensuring an efficient allocation of resources, coupled with exchanges' more concretely self-beneficial motivations to ensure market quality, formed the basis for the extensive use of self-regulation as a regulatory technique in the securities markets. In other words, policymakers noted the significant interests of exchanges in effectively organizing their markets and opted to take advantage of this dynamic to achieve the overarching goal of maintaining fair and orderly markets for investors and promoting market integrity. Where these objectives conflict reveals the limits of the public interest role for exchanges: exchanges will pursue the overarching public interest goals only so far as it is in their interests to do so. Some commentators, especially in the United States, often portray the adoption of a self-regulatory scheme for the securities exchanges as a "historical anachronism,"[35] or, at best, a "historical accident."[36] According to this account, it was convenient for Congress to assign regulatory powers to exchanges, as they already had significant regulatory infrastructure in

31. Jennifer Elliott, *Demutualization of Securities Exchanges: A Regulatory Perspective* 17 (Int'l Monetary Fund, Working Paper No. 02/119, 2002), *available at* http://ssrn.com/abstract=879869.

32. For a discussion of the policy repercussions of efficiency as a goal for regulatory policy in securities law, see Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, 95 MICH. L. REV. 2498 (1997).

33. *See* John W. Carson, *Conflicts of Interest in Self-Regulation: Can Demutualized Exchanges Successfully Manage Them?* 1–2 (World Bank Policy Research, Working Paper No. 3183, 2003), *available at* http://ssrn.com/abstract=636602.

34. *See* Macey & Haddock, *supra* note 18, at 319.

35. *See* Morris Mendelson & Junius W. Peake, *Intermediaries' or Investors': Whose Market Is It Anyway?*, 19 J. CORP. L. 443, 444 (1994).

36. *See* Dombalagian, *supra* note 21, at 38.

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place. Reconciling this argument with the almost universal appeal of the self-regulatory model around the world, however, is difficult.

B. SELF-REGULATION: ADVANTAGES AND CONCERNS

Stock exchanges had strong incentives to provide a regulatory framework for the operation of an organized market, and government authorities similarly had strong interests in sound regulation for the securities industry. While these parallel motivations, at least in part, show a potentially mutual regulatory goal, they fall short of explaining why governments around the world chose to regulate securities markets by assigning a wide array of regulatory powers to primarily private organizations. Yet, legislatures in many jurisdictions granted to market infrastructure institutions (such as a stock exchange or a clearing system) the power to regulate their members and their markets under the supervision of a government agency; while the scope of powers granted in each case varies, the two-layered pattern of stock exchange powers and agency supervision is consistent across borders. An allocation of roles between a regulator and a regulated entity hardly seems a straightforward solution, and has understandably generated a major debate in the academic community. Why is such a system preferable to consolidating all regulatory powers to a government agency, or to eliminating any government oversight, leaving stock exchanges as the sole regulators of their markets?

1. Why Grant Regulatory Powers to Stock Exchanges?

The technical expertise that SROs possess concerning the operation of the market is arguably unrivaled: the market flows through their facilities, the traders follow their rules, and their regulatory staff is engaged exclusively with overseeing their systems. Indeed, in a market where trading volumes are ever-increasing, the day-to-day task of supervising transaction activity seems so intensive and complicated that it might be better left to the same entity to conduct.[37] The strength of this argument is prevalent as to aspects of stock exchange-regulated activities that are highly technical in nature; however, as stock exchange regulatory powers expand to issues of wider interest, such as review of the accuracy of financial statements or corporate governance requirements, the advantages of stock exchanges over other regulatory bodies become unclear.

To legislators reluctant to spend taxpayers' money to finance

37. *See* David A. Lipton, *The SEC or the Exchanges: Who Should Do What and When? A Proposal to Allocate Regulatory Responsibilities for Securities Markets*, 16 U.C. DAVIS L. REV. 527, 545 (1983).

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ambitious regulatory plans, self-regulation presents an attractive solution: SROs are financed directly by the industries they regulate.[38] The resources of these organizations are independent of the government budget and the political considerations that surround them, effectively ensuring that significant resources will be utilized for supervising the securities industry. Having enlisted financial support from the industry, the government can then focus on its own priorities and direct resources to issues where its intervention is most needed.[39]

Self-regulation is also often praised for its ability to establish regulatory standards in an industry through a largely consensual process.[40] Trading members, in particular, are more willing to conform their behavior to rules promulgated by their representative bodies.[41] Moreover, exchanges and other SROs constitute a useful counterpart for negotiations for a government seeking to introduce regulatory initiatives, as they concentrate the industry's interest and simultaneously have the ability to enforce negotiation outcomes.[42] For that reason, exchanges are thought to be able to induce industry compliance with standards higher than or beyond those technically required under the law.[43] Thus, self-regulation may also constitute an efficient way to strike the right balance between overregulation and underregulation of the stock exchange industry, as self-regulation is more flexible than government-imposed rules and is driven by the needs of the industry. For some, the stock exchanges' responsiveness to the pulse of the market and to the requirements of investors is the key justification for the self-regulatory model.[44]

Exchanges are also free of the limitations that constrain government action in many respects. First, from a substantive point of view, stock exchanges' powers are not limited by any specific mandate, as regulators' powers often are.[45] Thus, exchange-originating rules may reach areas and

38. *See* JOHN C. COFFEE, JR. & JOEL SELIGMAN, SECURITIES REGULATION 673 (9th ed. 2003).

39. *See* Sam Scott Miller, *Self-Regulation of the Securities Markets: A Critical Examination*, 42 WASH. & LEE L. REV. 853, 855 (1985).

40. *See* Dombalagian, *supra* note 21, at 45.

41. *See id.*

42. *Id.* at 48.

43. *See* Paul G. Mahoney, *The Exchange As Regulator*, 83 VA. L. REV. 1453, 1458 (1997).

44. *Id.*

45. *See generally* Bus. Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990) (noting that the SEC had adopted a rule prohibiting stock exchanges and national securities associations from listing stock of a corporation that does not abide by the one share/one vote principle). The court, however, found that the SEC's power to approve SRO rules was limited by the purposes of the 1934 Exchange Act, which focused on providing adequate disclosure to investors. Thus, the SEC's regulatory powers did not extend to issues relating to the distribution of voting powers among shareholders.

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utilize regulatory tools that may not be available to government regulators. The scope of self-regulation is wider than government regulation with respect to the character of the rules promulgated: self-regulation extends beyond enforcing legal standards to establishing ethical standards and best practice principles.[46] Second, from a procedural point of view, exchanges are not subject to the same due process requirements and other procedural restrictions that render government enforcement actions inflexible and often unsuitable for the fast-changing and highly competitive environment of the financial markets.

Finally, the quality of an exchange's regulatory environment contributes to its reputation as a listing location. Exchanges developed a regulatory apparatus to safeguard their business and to ensure that they attract high-quality issuers. The integrity of their regulatory environment, therefore, is a significant component of their value as a "brand name."[47] Exchange members, whose business depends upon the trading interest listed issuers generate, would not jeopardize the reputation of the exchange by abusing its regulatory powers to achieve limited short-term benefits. Similarly, an issuer that decides to list on a high-quality exchange subscribes to a set of regulatory standards that increases investors' confidence in its stock and thereby reduces its own transaction costs.[48] As legal commentator Paul Mahoney points out, exchanges have often imposed upon the entities they regulate stricter standards than those required by the federal securities laws.[49] Competition, moreover, will lead different exchanges to develop different regulatory standards and trading models, thus catering to varying needs of the investing public. For a market economy to flourish, exchanges should be able to shape the services they offer to their customers, while investors should be free to choose the bundle of services that match their preferences.[50]

2. What Are the Concerns Traditionally Associated with Self-regulation?

Arguments against self-regulation have sought to outline the limitations of the self-regulatory mechanism as proposed by its advocates, and to disclose the complications caused by what is seen as the major

46. *See Self-Regulatory Organizations: Hearing Before the Subcomm. on Banking, Housing and Urban Affairs*, 109th Cong. (2006) [hereinafter *Self-Regulatory Organizations*] (testimony of Robert Glauber, Chairman and CEO, National Association of Securities Dealers), *available at* http://www.finra.org/PressRoom/SpeechesTestimony/ RobertR.Glauber/p016123.

47. *See* Carson, *supra* note 33, at 7–11.

48. *See* Macey & O'Hara, *supra* note 29, at 20.

49. *See* Mahoney, *supra* note 43, at 1458.

50. *See* Maeey & O'Hara, *supra* note 29, at 22.

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weakness of the self-regulatory model: its potential for conflicts of interest. We will discuss these arguments in turn.

Traditional justifications for self-regulation remain strong with respect to core areas of stock exchange activity, but grow weaker as the scope of regulatory powers granted to exchanges expands beyond the core aspects of their activity. There are strong arguments in favor of permitting exchanges to set their own trading rules, as they possess higher expertise and are better placed to understand the demands of the market.[51] Still, aspects of trading regulation, such as the intervention of specialists to stabilize trading activity or the widening of bid-ask spreads in the Nasdaq markets of the 1990s, have triggered accusations for regulatory capture. Moreover, while technical expertise is arguably helpful in trading model design, it is less apparent why corporate governance rules should be set by stock exchanges.[52] Seeking to increase the number of listed companies, stock exchanges may adopt corporate governance rules that promote management interests, as the decision for the listing location is a responsibility of the management. Management interests, however, may not necessarily align with the goal of profit maximization.[53]

The limitations inherent in the stock exchanges' enforcement mechanism also present challenges for self-regulation in this area. While exchanges arguably have a clear picture of trading activity in their markets, they often lack the investigative powers that government entities usually possess.[54] Moreover, the sanctions available to them are limited, as they are often exhausted after expulsion from the exchange.[55] Thus, the enforcement apparatus of the self-regulatory model has many imperfections.

The greater risk associated with self-regulation, repeatedly underlined by some of its most vocal opponents, relates to the potential for conflicts of interest inherent in a grant of regulatory powers to an organization

51. *See, e.g., supra* Part II.B.1.

52. *See* Dombalagian, *supra* note 21, at 40 (suggesting that "there does not appear to be any nexus between corporate governance standards . . . and the operations of particular exchanges"). This analysis echoes the predictions of the modern economic theory of regulation, which suggests that the industry will request the intervention of its regulators when it faces intense competition by newcomers. *See* Macey & Haddock, *supra* note 18, at 319.

53. *See* Marcel Kahan, *Some Problems with Stock Exchange-Based Securities Regulation*, 83 VA. L. REV. 1509, 1511 (1997) (mentioning the ability of stock exchange rules affecting corporate governance to alter the balances in the market for corporate control in favor of managers).

54. SROs in the United States, for example, do not possess power to subpoena entities or individuals. *See* Ernest E. Badway & Jonathan M. Busch, *Ending Securities Industry Self-Regulation as We Know It*, 57 RUTGERS L. REV. 1351, 1355 (2005).

55. *See* Dombalagian, *supra* note 21, at 80. *See also* Kahan, *supra* note 53, at 1517.

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representing, essentially, the regulated entities themselves.[56] The concept of self-regulation is premised upon an exchange's ability to use its market power for regulatory purposes, mainly by threatening individual members and listed issuers with termination of their contractual arrangements in case of noncompliance with the rules of the "club." [57] Using the same power to achieve less public-minded goals is simply the other side of the same coin; while the potential for abuse is disquieting, self-regulation would not be successful without the stick of dominant stock exchange power.

Commentators have often interpreted rulemaking or enforcement initiatives by stock exchanges as indications of anticompetitive behavior seeking to exclude or limit the influence of potential competitors in their markets. These scholars view stock exchanges as entities controlled by their members, apt to use their regulatory powers to promote their members' interests.[58] In the United States, there has been a long history of controversies over perceived anticompetitive practices, whereby major exchanges, particularly the NYSE, exploited their market power to extract monopoly rents.[59] More recently, academics have attributed the lack of modernization in U.S. exchanges to the SEC's decision to enlist the NYSE and Amex to design the national market system.[60] According to this view, the two major self-regulatory market operators in the United States at the time opted for a design that continued fragmentation of the markets and stalled innovation so as to suppress competition. As commentator Joel Seligman has argued, the NMS forced orders to the NYSE floor by allowing the possibility for price improvement.[61] Moreover, Stavros Gadinis has argued that, by limiting competition within the marketplace to solely price, the NMS rules (including the SEC's 2005 Regulation NMS) have consistently favored the NYSE over its competitors for trades in NYSE-listed stocks.[62] In addition, the ability of the stock exchange to design its trading rules may allow certain interest groups within the exchange to push regulation that is favorable to them but detrimental to investors.[63] According to some scholars, the central part that specialists

56. *See* COFFEE & SELIGMAN, *supra* note 38, at 675; Lipton, *supra* note 37, at 545.

57. Others have preferred the term "cartels." *See* Mendelson & Peake, *supra* note 35, at 452.

58. *See* Dombalagian, *supra* note 21, at 8.

59. *See, e.g.*, Gordon v. NYSE, Inc., 422 U.S. 659 (1975); Silver v. NYSE, Inc., 373 U.S. 341 (1963).

60. *See, e.g.*, Mendelson & Peake, *supra* note 35, at 447.

61. *See* Seligman, *supra* note 17, at 1347.

62. *See* Stavros Gkantinis, Regulation and Innovation: Comparing U.S. and European Equity Trading Markets (Feb. 16, 2006) (unpublished manuscript), *available at* http://ssrn.com/abstract=887645.

63. *See* Miller, *supra* note 39, at 865–66.

have maintained on the floor of the NYSE illustrates the following scenario: specialists, which have managed to survive by virtue of the NYSE mutual ownership structure that allows specialists to control NYSE management, are part of an outdated institution surpassed by modern trading designs.[64] To sum up, self-regulation acts as a shield "insulating" the industry it purports to regulate from government intervention that enhances investor protection, albeit at a cost to industry members.

The severe repercussions of conflicts of interest for prospective regulators are even more evident in the case of enforcement. How vigorously will an exchange undertake enforcement actions against its own members? Enforcement actions by exchanges against their trading members often result in punishing no more than "a few bad apples" and often fail to reveal weaknesses or prosecute wide-spread practices in the underlying system that, although harmful to investors, are financially beneficial to members. Furthermore, enforcement actions by exchanges often fail to trigger regulatory reforms.[65] On the other hand, exchanges may be willing to use the full panoply of their regulatory powers to silence criticism against their rules or practices by the individual firms that they regulate.[66] If exchanges show leniency toward their members, they must be even less vigilant with respect to their customers, the listed firms.[67] As the numbers of listing venues multiply, exchanges will be less willing to displease the issuers they fought hard to attract. Thus, exchanges might be tempted to relax their corporate governance enforcement efforts.[68]

Although self-regulation has the advantage of tapping additional financial resources for regulatory purposes, industry financing may also divert regulatory efforts from their intended goal. At the very least, allowing the industry to hold the "power of the purse" may provide it with a say on crucial issues, either dictating the content of regulatory measures or leading to compromises. For example, in order to avoid losing trading participants or listed firms, a stock exchange may be willing to lower its

64. *See generally* Dale Arthur Oesterle et al., *The New York Stock Exchange and Its Out Moded Specialist System: Can the Exchange Innovate to Survive?*, 17 J. CORP. L. 223 (1992).

65. *See* Kahan, *supra* note 53, at 1517. The failure of SROs to tackle industry-wide abusive practices is evident in the examples listed *infra*, drawing from the U.S. and the U.K. experiences.

66. *See* Mendelson & Peake, *supra* note 35, at 463.

67. In some instances, such as in the United States, national laws require trading firms to be part of an SRO, thereby increasing the leverage SROs have toward their members. *See, e.g.*, Maloney Act, Pub. L. No. 75-719, 52 Stat. 1070 (1938) (codified as amended at 15 U.S.C. §§ 78–83 (2006)). Corporations, however, have the option to either issue securities to the public markets, or seek alternative ways of financing.

68. *See* Dombalagian, *supra* note 21, at 71.

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regulatory standards.[69] Moreover, while self-regulation may serve the government's budgetary interests, it is arguably more expensive for investors as a whole, as it often entails duplication of regulatory efforts and is plagued by lack of coordination among different self-regulatory bodies with overlapping spheres of competence.[70]

According to the theory of the self-regulation model, the role of the administrative agency overseeing the SROs is to alleviate some of the concerns outlined above. In practice, however, the ability of such agencies to guide the SROs toward the direction that public interest dictates is limited. As market infrastructure institutions, SROs are crucial to the undisrupted operation of the market. While agencies can threaten fines and require regulatory reforms, they are ultimately constrained from imposing measures that would jeopardize the continuous operation of the market.

Over the years, opponents of the current self-regulatory model have been able to point to a number of instances where SROs failed to respond efficiently to their supervisory mission. Especially in the U.S. markets, where the self-regulatory system has a long history, such examples are plentiful. Perhaps the most impressive cases are the most recent ones—cases involving Nasdaq bid-ask spreads and NYSE specialists—which helped to reinforce voices requesting the curtailment of the self-regulatory model.[71] But earlier examples exist, too: the October 1987 crash was attributed by some to trading by NYSE specialists in a manner inconsistent with public interest.[72] Similarly, in the United Kingdom, industry-wide practices regarding the selling of personal pensions, which was in violation of the rules of the SROs overseeing the market, led to a massive "clean up exercise" by the authorities and an enormous compensation to misled investors.[73] In the late 1990s, the U.K. government felt that the SRO system generated such complexity and inefficiency that it decided to transfer SRO regulatory powers to the Federal Securities Administration (the "FSA").[74]

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69. *See id.* at 39, 42.

70. *See* Miller, *supra* note 39, at 860.

71. *See* Badway & Busch, *supra* note 54, at 1357.

72. *See* Macey & O'Hara, *supra* note 29, at 39.

73. Howard Davies, Dir., London Sch. of Econ. & Pol. Sci., Address in Hong Kong, What's Left for. Self-Regulation, (Mar. 26, 2004), *available at* http://www.lse.ac.uk/collections/meetthedirector/articlesReviewsAndLectures.htm.

74. *See* Howell E. Jackson, *An American Perspective on the UK Financial Services Authority: Politics, Goals, and Regulatory Intensity*, *in* REGULATORY REFORMS IN THE AGE OF FINANCIAL CONSOLIDATION: THE EMERGING MARKET ECONOMY AND ADVANCED COUNTRIES 39 (Lee-Jay Cho & Joon-Kyung Kim eds., 2006). *See also* Eilis Ferran, *Examining the United Kingdom's Experience in Adopting the Single Financial Regulator Model*, 28 BROOK. J. INT'L L. 257, 265 (2003).

C. DEMUTUALIZATION AND ITS IMPACT ON ACADEMIC DEBATES OVER THE REGULATION OF EXCHANGES AND OTHER SELF-REGULATORY ORGANIZATIONS

The 1990s witnessed a transformation in the organizational structure of stock exchanges. One after the other, stock exchanges abandoned the typical mutual membership format they had adopted since their inception to become private corporations under general corporate law. The first exchange to adopt the private corporation format, or "demutualize," was the Stockholm Stock Exchange in 1993.[75] Others followed suit and, after the grant of exchange status to Nasdaq and the completion of the NYSE-ArcaEx merger in 2006, most major stock exchanges of the world have now demutualized. Table 1 below provides some additional information on the major milestones in the demutualization process for the most important stock exchanges in the jurisdictions included in our study.

TABLE 1. Demutualization of Major Stock Exchanges

Stock Exchange	For-profit Structure	Listing
Euronext	1997	2001
Australian Stock Exchange	1998	1998
London Stock Exchange	1999	2001
Deutsche Börse	2000	2001
Hong Kong Exchanges	2000	2000
Tokyo Stock Exchange	2001	–
TSX Group	2002	2002
Nasdaq[76]	2000	2000 (2006)
NYSE	2006	2006

Most exchanges justified their move to a for-profit structure on the basis of their need to raise capital to finance their infrastructure expenses. The introduction of electronic trading heightened competition among

75. *See* Amir N. Licht, *Stock Exchange Mobility, Unilateral Recognition, and the Privatization of Securities Regulation*, 41 VA. J. INT'L L. 583, 589 (2001).

76. Nasdaq was founded in 1971 as a wholly-owned subsidiary of the National Association of Securities Dealers, Inc. ("NASD"). In 2000, NASD initiated a restructuring in Nasdaq through a two-phase private placement of its securities which were offered to all NASD members, some issuers listed on the Nasdaq Stock Market, and investment companies. On January 13, 2006, the SEC granted Nasdaq's application to operate as a national securities exchange. *See* NASDAQ, 2005 ANNUAL REPORT (2006), *available at* http://files.shareholder.com/downloads/NDAQ/52812485x0x36919/4926252F-A3F3-446A-85D0-AEA84A42CB82/NASDAQ_2005AnnualReport.pdf.

Nasdaq became operational as a national securities exchange on August 1, 2006. *See* Press Release, NASDAQ, NASDAQ Becomes Operational as a National Securities Exchange (Aug. 1, 2006), *available at* http://ir.nasdaq.com/relcasedetail.cfm?ReleaseID=205921.

exchanges, both within their national borders and internationally, and allowed the emergence of alternative, low-cost trade execution venues. Thus, most exchanges invested heavily in technical infrastructure to offer cheaper and more efficient trading services.[77] Introduction of electronic trading systems, however, was not always popular with stock exchange members, who saw a threat to their privileges over trading activity.[78] The transition from a mutually-held organization to a corporation liberated stock exchange managers from their subservience to members' demands. Stock exchanges then were able to implement trading structures relying less on the involvement of intermediaries and to enter into alliances or mergers with other exchanges.[79]

I. How Does Demutualization Affect the Traditional Model of Self-regulation?

As a result of demutualization, the orientation of the exchange operation changes from catering to the interests of its members to catering to the interests of its shareholders. While exchanges were traditionally accused of harboring a "clubby" perspective in terms of protecting the interests of their members, they are now oriented toward maximizing profits for their shareholders. The traditional model of self-regulation found its justification in the alignment of interests between the investing public and member firms. In the post-demutualization world, self-regulators must establish that they share the interests of their shareholders and their corporate managers. The potential for conflict between the exchange's business goals and regulatory mission is apparent.[80]

Competition among exchanges, as well as between exchanges and alternative venues of trade execution, has increased dramatically in recent years. First, technological developments have allowed alternative trading platforms and large brokerage houses to slash trading costs and threaten traditional exchanges.[81] These venues are attractive mostly to institutional

77. European exchanges, which updated their technological infrastructure faster than major U.S. markets, sought to expand in the United States by establishing remote trading screens. The SEC, however, largely prohibited the operation of foreign trading screens in the United States without compliance with U.S. regulatory requirements for exchange operation. *See generally* Howell E. Jackson et al., *Foreign Trading Screens in the United States*, 1 CAP. MKTS. L.J. 54 (2006).

78. *See* Gkantinis, *supra* note 62, at 15.

79. *See* Benn Steil, *Changes in the Ownership and Governance of Securities Exchanges: Causes and Consequences* 8 (Brookings-Wharton Papers on Fin. Servs., Working Paper No. 02-15, 2002), *available at* http://fic.wharton.upenn.edu/fic/papers/02/0215.pdf.

80. *See* Carson, *supra* note 33, at 11.

81. According to Macey and O'Hara, "[m]ore than 140 broker-dealer firms have informed the SEC that they operate some kind of [alternative trading system]. Some of these systems are run

investors, whose participation in the market has increased over the years. Finally, the emergence of large international financial centers, such as London and, most recently, Hong Kong, has also diverted liquidity away from more traditional exchanges.[82] Many commentators have urged regulators to "maintain a watchful eye" for anticompetitive behavior by the incumbent exchanges through their self-regulatory powers.[83] Demutualization further intensifies competition between marketplaces by enshrining profit maximization as the top priority of modern exchanges. The concern is that, following demutualization, exchanges would institutionally be either more inclined to misuse their regulatory powers to achieve their goals, or less efficient in enforcing securities laws and their own rules.[84] The possibility for abuse of regulatory powers is greater in cases where the exchange is responsible for regulating some of its competitors, such as large brokerage houses or firms operating alternative trading systems.[85] Exchanges may be tempted to utilize their regulatory powers in order to disadvantage alternative trading systems operators, with whom they are directly competing.

Demutualization has also resulted in strengthening the ability of two particular groups to affect stock exchange decision making. First, for-profit exchanges place higher emphasis on the revenue that regulated entities bring to the exchange in the form of listing fees, trading fees, or other charges. In comparison to a threatened diminution of an exchange's reputation, which is much harder to quantify and may not even eventually materialize, the loss of a source of revenue has much more immediate and tangible consequences for the exchange and its profit-maximizing management. Thus, for-profit exchanges are more sensitive to the needs of these customers. Membership organizations could afford to ignore these customers because their priorities lay elsewhere. Expecting stock exchanges to rigorously enforce their rules against their much sought-after customers may prove misguided.[86] Second, stock exchange shareholders

completely in-house, while others are available for customers or for market participants generally." They attribute the alternative trading system's success in attracting order flow to its ability to reduce market impact costs for large traders. Macey & O'Hara, *supra* note 29, at 46.

82. *See* Gkantinis, *supra* note 62, at 22–25.

83. *See* Cox, *supra* note 30, at 16.

84. *See* U.S. GEN. ACCT. OFFICE, REPORT TO CONG. COMM., SEC. MKTS.: COMPETITION AND MULTIPLE REGULATORS HEIGHTEN CONCERNS ABOUT SELF-REGULATION 2 (2002) [hereinafter U.S. GAO REPORT], *available at* http://www.gao.gov/new.items/d02362.pdf.

85. *See* Roberta S. Karmel, *Turning Seats Into Shares: Causes and Implications of Demutualization of Stock and Futures Exchanges*, 53 HASTINGS L. J. 367, 401 (2002) [hereinafter Karmel, *Turning Seats Into Shares*].

86. *See* Carson, *supra* note 33, at 13.

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have more leverage over an exchange they own than exchange members have traditionally had. Active secondary markets in the stock allow shareholders to exit the exchange immediately if they disagree with the firm's business strategy. In the pre-demutualization world, the powers of members who owned the exchange were limited, as their future was tied with the future of the exchange. As a result, exchanges were less prepared to succumb to requests by listed or member firms than a private firm, whose primary goal was profit maximization.

For these reasons, increasing competition may gradually erode the dominant power of exchanges, which was a critical assumption underlying the old self-regulatory model. The new alternative venues for listing, while performing functions identical or very similar to those of the exchanges, often lack the financial resources and the market power to build an adequate regulatory apparatus.[87] At the same time, continuing to demand existing exchanges to invest in their regulatory efforts puts them at a grave disadvantage against newcomers.[88] Some commentators have seen the emergence of these low-cost competitors as signaling a move away from an exchange-centered marketplace,[89] which would jeopardize the future of the self-regulatory model. As large brokerage houses and alternative trading systems have made their presence felt in the market for trading services, the functional borders that the self-regulatory model envisioned are becoming blurred and the rationale for granting regulatory powers to some marketplaces rather than others is not consistent with underlying realities.[90]

While enlisting exchanges as front-line regulators relieves the government budget from regulatory costs, exchanges themselves need to devote significant resources to fulfill their respective obligations. These expenses place stock exchanges at a disadvantage vis-à-vis competitors that are not subject to the same regulatory responsibilities.[91] Arguably, high-quality regulation contributes to an exchange's "brand name" and thus justifies, at least partly, the costs of the exchange's regulatory apparatus. Still, in periods of financial hardship, a private corporation seeking to minimize its expenses may look into cutting its regulatory budget, possibly right at the moment that market conditions would justify a high-level intervention more than ever.

87. *See* Dombalagian, *supra* note 21, at 92.

88. Mendelson & Peake, *supra* note 35, at 462 (citing the NYSE comment letter on the SEC Market 2000 Study).

89. *See* Dombalagian, *supra* note 21, at 117.

90. *See* Maureen O'Hara, *Searching for a New Center: U.S. Securities Markets in Transition*, FED. RES. BANK ATL. ECON. REV., Fourth Quarter 2004, at 37.

91. *See* Cox, *supra* note 30, at 18.

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For-profit exchanges, especially following a public offering or listing of their shares, are also open to foreign investors. Many exchanges have attempted or completed cross-border mergers or entered into international alliances of market infrastructure institutions.[92] These exchange formations are less tied to the interests of a single national market, jurisdiction, or government than membership exchanges operating in a monopolistic or oligopolistic national market. The central place exchanges enjoy in a country's financial infrastructure may (1) lead national governments to oppose such mergers or alliances; or (2) diminish the self-regulatory powers of exchanges so that such governments may affect exchanges' policy decisions.[93] Another concern associated with exchanges operating as public companies relates to the conflicts of interest that arise when responsibility for reviewing the application for listing and, more generally, overseeing the listed exchange, falls upon the exchange itself.[94] Andreas Fleckner, for example, has questioned whether an exchange can perform its role as guarantor of the quality of listed firms and as a link for the transmission of accurate information to investors when the financial interests of the exchange's shareholders may be in conflict.[95]

2. Academic Perspectives on the Regulatory Implications of Demutualization

Stock exchange demutualization has rekindled a long-standing debate among academics, policymakers, and industry representatives regarding the regulatory role of SROs. One segment of this debate focuses on whether efficient post-demutualization market oversight requires greater regulatory intervention or whether the highly competitive modern environment calls for reduced government regulation. Another line of inquiry examines the appropriate regulatory structure to deal with the conflicts of interest inherent in the post-demutualization world.

Academics have long been concerned that regulators tend to neglect issues of market structure. Back in the mid-1980s, Walter Werner argued that the SEC's scrutiny of proposed SRO rules was inadequate and proposed to assign SRO oversight to a specialized administrative agency that would not grow indifferent to its major task.[96] Joel Seligman has criticized SEC regulation of market structure as a product of crisis reaction

92. *See* Licht, *supra* note 75, at 589.

93. *See* Elliott, *supra* note 31, at 17.

94. *See* Andreas M. Fleckner, *Stock Exchanges at the Crossroads*, 74 FORDHAM L. REV. 2541 (2006). *See also* Karmel, *Turning Seats Into Shares*, *supra* note 85, at 422.

95. *See generally* Fleekner, *supra* note 94.

96. *See* Walter Werner, *The SEC as a Market Regulator*, 70 VA. L. REV. 755, 783 (1984).

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that lacks a vision for the market.[97] More recently, Robert Ahdieh identifies a "cueing" function for law in relation to market structure, suggesting that law and its primary enforcers, the regulators, should seek to coordinate regulatory efforts of separate bodies, push market participants to cooperate in industry-wide technical schemes, and shape market developments toward the direction most beneficial to the investing public as a whole.[98] For some commentators and industry observers, new regulation will be necessary to resolve the conflicts of interest resulting from demutualization, at least in some respects. Even the Securities Industry Association ("SIA") suggested more regulatory attention to SRO funding as a potential channel of influence to SRO rulemaking.[99] The U.S. General Accounting Office ("GAO"), in its 2002 Report on self-regulation, noted that market participants were not in favor of fundamental changes in the regulatory framework and recommended that the SEC institute a formal mechanism to identify material regulatory inefficiencies caused by differing interpretations of the rules among various SROs.[100] Seligman argues that a restructuring of the SRO oversight framework should provide more safeguards of SRO independence from industry interests by increasing SEC powers over SRO board member selection and budgeting.[101]

The emergence of numerous competitors for exchanges has led advocates of less regulation to argue that new conditions in the market can alleviate many of the concerns associated with demutualization. Maureen O'Hara argues that we need to reorient the direction of capital markets regulation to take account of today's more competitive environment, in which greater competition reduces the need for regulation in some respects, such as pricing and access.[102] The power of the stock exchange to oversee individual member firms, however, has collapsed. Regulators, therefore, need to explore other solutions in this regard. Others, like Roberta Karmel, note that the invasion of modern technology and new competitors in the market for trading services is also likely to lead to less regulation.[103] On the other hand, as Karmel points out, the expansion of the marketplace beyond

97. *See* Seligman, *supra* note 17, at 1348.

98. *See* Robert B. Ahdieh, *Law's Signal: A Cueing Theory of Law in Market Transition*, 77 S. CAL. L. REV. 215, 246–48 (2004).

99. *See* Letter from Marc E. Lackritz, President, Sec. Indus. Ass'n, to Jonathan Katz, Sec'y, SEC (Mar. 9, 2005) [hereinafter SIA Letter] (on file with authors).

100. *See* U.S. GAO REPORT, *supra* note 84, at 3.

101. *See generally* Seligman, *supra* note 17.

102. *See* O'Hara, *supra* note 90, at 51–52.

103. *See* Karmel, *Turning Seats Into Shares*, *supra* note 85, at 369.

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national borders may justify the survival of the self-regulation model.[104]

In general, while commentators may dispute whether the overall level of regulatory intervention in the market should increase or decrease, such commentators nonetheless agree that there are areas where regulators should step up their efforts and areas where new, highly competitive conditions remove the need for strict regulatory oversight. Identifying these areas and assigning respective regulatory powers to the most appropriate entity, either a government agency or an SRO offering higher safeguards of independence, has led to a new debate on restructuring securities markets' regulatory framework, to which we now turn.

The conflicts of interest inherent in self-regulation have led many academic commentators and policymakers to propose a restructuring of the securities markets regulatory framework; for example, to strengthen the powers assigned to some regulatory bodies, to create new regulatory bodies, or to change regulatory processes to achieve greater transparency and accountability. From the late 1990s onward, stock exchange demutualization has reinforced voices calling for restructuring. Below, we will discuss some characteristic proposals before turning to the regulatory framework currently in place in the eight jurisdictions we study.[105] While the solutions each proposal favors are very different, they all share a common underlying rationale: to alleviate conflicts of interest by segregating market operation from market regulation.[106]

A straightforward method to achieve greater independence of market regulation from market operation would be to vest regulatory powers in a separate subsidiary of the exchange operator. This approach predates the demutualization era as it resulted directly from an SRO regulatory failure in the mid-1990s. A series of academic papers suggests that Nasdaq market-makers engaged in market-wide collusion by avoiding quotes in odd-eighths to artificially inflate spreads.[107] As a result of the SEC enforcement action, the National Association of Securities Dealers ("NASD"), which operated the Nasdaq market, undertook to separate its regulatory operations from any interest in an exchange through the establishment of an independent regulatory corporate subsidiary, NASD Regulation, Inc.[108]

104. *Id.* at 370.

105. *See* discussion *infra* Part V.

106. Mendelson and Peake captured the essence of this aim long before demutualization became a concern for regulators. *See* Mendelson & Peake, *supra* note 35, at 462.

107. *See generally* William G. Christie & Paul H. Schultz, *Why Do NASDAQ Market Makers Avoid Odd-Eighth Quotes?*, 49 J. FIN. 1813 (1994).

108. Following the grant of the Nasdaq application to be recognized as an exchange, the NASD entered a process of selling its financial interest on Nasdaq, which it hoped to eomplete by the end of

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Arguably, the twin corporate structure of the model will help bring some separation between the two functions, as the two entities will have separate personnel, separate culture, and a clearer division of missions between the two arms. Both entities, however, will still be under common management and will be receiving funding by common sources. In addition, this approach maintains the complexities associated with the existence of multiple SROs in a single jurisdiction.[109]

To minimize any conflicts of interest still persisting despite the allocation of the regulatory function to a separate entity, SROs could establish governance measures that provide additional guarantees of independence. Seligman examines the governance framework of the Public Company Accounting Oversight Board ("PCAOB"), the newly formed regulator of the audit profession,[110] and argues that it presents clear advantages to the current governance structure of SROs in the United States. For example, the PCAOB's board includes a majority of independent directors that the SEC appoints, and has the power to set its own budget, which remains subject to SEC approval but shielded from industry pressure. In Seligman's view, the PCAOB governance framework successfully addresses two of the major sources of interest group influence over an SRO's regulatory output.[111]

In its 2004 SRO Concept Release, the SEC suggested that it would consider the establishment of a separate SRO that would be responsible for broker-dealer regulation both from a financial stability perspective and from an investor protection perspective.[112] Pursuant to the proposal, market operators would still maintain their regulatory powers, but only with respect to matters related to the operation of their markets. This structure would achieve the parallel goals of ensuring greater independence for member regulation and avoiding duplicative and expensive regulatory measures. It would also remove any concerns associated with potentially anticompetitive behavior by current SROs with some of their members who offer alternative trading services. This structure, however, would not eliminate all channels of member influence, as this SRO would still be

2006. *See Self-Regulatory Organizations*, *supra* note 46.

109. Concept Release Concerning Self-Regulation, 69 Fed. Reg. 71,255, 71,277 (Dec. 8, 2004) (to be codified at 17 C.F.R. pt. 240) [hereinafter SRO Release]. When some SROs are responsible for market oversight, while others supervise brokcr-dealers, conflicts may arisc regarding the boundaries of each organization's powers.

110. The PCAOB was established in 2002 stemming from the Sarbanes-Oxley Act. *See* Seligman, *supra* note 17, at 1348.

111. *See id.* at 1380–81.

112. *See* SRO Release, *supra* note 109, at 71,278.

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funded by broker-dealers, and it would still require exchanges to finance regulatory services without imposing similar burdens on its competitors. The broker-dealer community supported the idea of separating SROs by function. In its response to the SEC's Concept Release, the SIA endorsed this proposal, noting, however, that it would require increased SEC involvement in coordinating the various SROs.[113] Moreover, the SIA suggested that direct membership participation in the single SRO board, even in a minority position, would be necessary to channel market expertise in the single SRO's management.[114]

A more radical approach would be to consolidate all SROs into a single organization, so as to avoid coordination inefficiencies between multiple regulatory bodies and impose proportionate financial obligations on the trading venues regulated, regardless of their history or trading system. Some jurisdictions, such as Canada, have followed a variant of this approach: they have allowed the establishment of a separate entity to which SROs may outsource their regulatory operations.[115] Arguably, this system offers a more effective shield from the influence of special interest groups, as it is a collective venture that promulgates rules of general applicability. The risk, however, as the SEC pointed out in its 2004 SRO Concept Release, is that the SRO would be detached from the markets and thus be lacking in trading expertise.[116] Canada has attempted a compromise to this dilemma through SRO governance measures: half the directors in the SRO board are independent, while the remaining directors represent the market operators and the broker-dealer industry association.[117] The Canadian independent SRO, both from a market manipulation perspective and from a customer care perspective, performs day-to-day surveillance of trade activity in the markets it oversees and has the power to bring enforcement proceedings against violators.[118]

As this brief account of the major solutions to the concerns associated with self-regulation demonstrates, eliminating or limiting the effects of the conflicts of interest inherent in the self-regulatory model is a grueling task

113. *See* SIA Letter, *supra* note 99.

114. *Id.*

115. The most characteristic example is Canada, where the Toronto Stock Exchange and the Investment Dealers Association have formed a joint venture in the form of a not-for-profit SROs funded through a user-pay-fee structure. *See* MKT. REGULATION SERVS., INC., 2003 ANNUAL REPORT 2 (2003), *available at* http://docs.rs.ea/ArticleFile.asp?Instance=100&ID=6C7BBE67ED6043298B14BB1EC4870D2F.

116. *See* SRO Release, *supra* note 109, at 71,280.

117. SRO ownership is shared between the market operator and the broker-dealer industry association. *See* MKT. REGULATION SERVS., INC., *supra* note 115.

118. *See id.*

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with uncertain outcomes. It is perhaps no surprise that policymakers around the world are questioning its continuing benefits.[119] The most impressive sweep of self-regulatory powers in favor of a government agency, arguably, was the establishment of the Financial Services Authority ("FSA") in the United Kingdom, which replaced a number of SROs and undertook many powers that the LSE previously monopolized, including the power to decide on listing applications for the stock exchange's markets. Still, the advantages of self-regulation, especially the additional resources it brings to market surveillance, its ability to establish new rules through a consensual process with its regulated entities, and its high expertise, are not easily ignored. As our analysis demonstrates, the FSA's approach to regulation is different from that of other regulators and seeks to induce best practices to industry members, while also permitting such members significant leeway in framing their behavior. The correlation between the FSA's broad authority over the financial services industry and its gentler regulatory approach may reveal some of the limitations of a government-agency-dominated system.

III. SURVEY AND ANALYSIS: THREE MODELS FOR ALLOCATING REGULATORY POWER

Our account of the academic literature on self-regulation and of representative policymakers' studies has illustrated the emerging consensus regarding the regulatory response to demutualization. In particular, there is agreement on two points: first, there remains some merit to self-regulation, at least in particular areas of regulatory oversight, and thus complete abandonment of the self-regulatory model would have substantial costs. Second, demutualization of stock market ownership does introduce new and potentially significant conflicts of interest that may warrant a greater degree of separation of regulatory oversight from market operation. Each of these two propositions, however, leaves ample space for variation among different jurisdictions. Do states agree as to the areas in which the contribution of the self-regulatory model is most beneficial? What methods can states use to achieve greater separation of regulatory oversight from market operation? Is there a universal approach to the challenges demutualization poses for self-regulation?

The purpose of our survey is to examine how the regulatory framework of various influential jurisdictions has addressed these questions in the post-demutualization era. In particular, we seek to explore whether

119. In its SRO Release, for example, the SEC considers the alternative of resorting to SEC-only regulation. *See* SRO Release, *supra* note 109, at 71,281.

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the legal treatment of SROs around the world reflects the emerging consensus of academic thinkers and policymakers described above. We then consider how these jurisdictions have allocated regulatory responsibilities among market infrastructure institutions as self-regulatory bodies, administrative agencies, and government ministries. As SROs represent just one tier of the regulatory hierarchy in securities markets, a study of SRO powers would be incomplete without considering how SROs interact with the government agencies that supervise them. Moreover, we seek to identify the mechanisms states have used to segregate market operation from market regulation. The tools available to policymakers range from enhancing procedural safeguards imposed on market institutions, to transferring regulatory functions from exchanges to government bodies, to recasting the balance of powers among government agencies and SROs in various other ways. Furthermore, enhanced corporate governance mechanisms may serve an additional protective role, insulating the regulatory function from market operation. While our study explores the powers of regulators over stock exchange governance, it does not cover measures that stock exchanges have voluntarily adopted to deal with these concerns. Such concerns remain the subject of another study in this volume.

We begin this section with an overview of our research methodology. We then summarize our findings, outlining three general approaches to the allocation of regulatory responsibility that emerged from our surveys. We then discuss each of these models in detail. Summaries of individual country case studies appear in Appendix A. In Appendix B, we reproduce a copy of the survey form used to collect the data upon which our analysis is based.

A. OVERVIEW OF SURVEY DESIGN

We examine the regulatory framework of eight influential jurisdictions for capital markets regulation: the United States, Japan, the United Kingdom, France, Canada, Germany, Hong Kong, and Australia. These jurisdictions include the three largest stock exchanges by market capitalization in three large regions (North America, Europe, and Asia-Pacific) and cover 74% of the world's aggregate stock exchange capitalization.[120] We have asked stock exchanges and local lawyers to respond to a common questionnaire seeking to outline the allocation of regulatory powers to administrative agencies and market infrastructure

120. *See* WORLD FED'N OF EXCHS., 2005 ANNUAL REPORT AND STATISTICS 66 (2005), *available at* http://www.world-exchanges.org/publications/WFE%202005%20Annual%20Report.pdf.

institutions in their local jurisdiction.[121] Our conclusions in this Article are based on the responses we received to our survey questionnaires, which shaped our assessment of each jurisdiction's regulatory structure. While we complemented our understanding of these foreign countries' laws with independent research, we did not seek additional local law evidence for each individual point in our questionnaires beyond the information provided in the survey responses themselves. Delineating the various nuances of local laws in the context of a single article is unworkable; instead, our goal is to present each country's regulatory framework in comparison with regulatory trends and solutions in other jurisdictions.

To identify the areas in which different jurisdictions have opted for the self-regulatory model, we have adopted a *functional* perspective. Our questionnaire has analyzed securities markets regulatory oversight in forty-five distinct regulatory functions, divided into six greater areas: (1) Authorizing and Supervising the Public Offer Process; (2) Issuer Regulation Following Public Offer/Listing; (3) Regulation of the Trading Process; (4) Regulation of Marketplaces; (5) Supervision of the Financial Intermediation Process; and (6) Supervision of Clearing and Settlement. In each of the forty-five functions, we have asked our respondents to indicate separately the regulatory body responsible for rulemaking, monitoring, and enforcing local laws. Thus, responses to our questionnaire yield a detailed breakdown of 135 different regulatory powers for each jurisdiction.

The functional approach of our survey and the detail in the responses allow us to understand the extent of real powers each institution has over the markets it runs or oversees. In this way, we attempt to avoid confusion caused by open-ended jurisdictional assignments as well as ambiguities resulting from legal provisions that have not been fully implemented. Through our surveys, we have attempted to obtain a full map of the allocation of regulatory powers in each jurisdiction by outlining each institution's powers against another's, and by identifying areas of activity that remain unregulated or that fall within the sphere of competence of other regulatory bodies. From an analytical standpoint, a functional methodology facilitates comparisons across jurisdictions and among regulatory entities. Overall, our functional methodology explores the first prong of our research question by setting out the areas where states have permitted market infrastructure institutions to retain regulatory powers in a post-demutualization world.

121. A copy of that survey appears in Appendix B *infra* Part VI. All responses to the questionnaires are on file with the authors.

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Our questionnaire also explores mechanisms to separate market operation from market regulation by inquiring into the capacity of governmental authorities to oversee market infrastructure institutions or capital markets in general. The role of an institution in a regulatory framework is defined not only by its own powers, but also by the powers of other institutions to dictate, limit the scope of, or overturn the institution's actions. Thus, looking solely at powers that SROs have would not accurately depict their overall role in the regulatory framework of each jurisdiction.

Increased regulation of market infrastructure institutions could range from greater government intervention in SRO governance to limiting the decision-making flexibility of SROs. Our survey reflects the interplay between market infrastructure institutions and state authorities in three main ways. First, we distinguish among the different types of state authorities, such as central government bodies (for example, ministries), regulators (agencies or specialized authorities), and courts, that may become involved in the regulatory process. Second, we seek to identify varying degrees of interaction among these authorities by separating cases where an institution acts alone and cases where approval by another institution is required. Third, we report the role of different levels of government authorities (federal or state) where relevant.

B. SUMMARY OF SURVEY RESULTS

As our individual country case studies illustrate,[122] our results confirm the consensus we identified among academic thinkers and policymakers regarding the role of market institutions in the regulatory structure of modern capital markets. While some jurisdictions reacted immediately and with great force to stock exchange demutualization, no jurisdiction has considered it necessary to remove all regulatory powers from stock exchanges and other market institutions. Although trends to concentrate supervisory powers in a single regulatory body have emerged across borders, all jurisdictions in our study have designed a multifaceted regulatory apparatus for their markets. Their regulatory structures seek to utilize, within a single nation, a wide variety of regulatory bodies (both public and private) and an equally wide variety of regulatory approaches, more or less interventionist, to address different concerns. The purpose of our study is to illuminate these differences and reveal diverging policy rationales; however, we find the overarching fractionalization of regulatory authority noteworthy. Modern regulatory regimes have reached a

122. *See infra* Part V.

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remarkable degree of sophistication and completeness. Despite an extensive questionnaire of separate regulatory functions, we rarely encountered blank responses, indicating that most jurisdictions rarely leave these functions unregulated. Indeed, the jurisdictions participating in our survey sought to provide an affirmative response to demutualization by adopting measures that separate market regulation from market operation.

Nonetheless, differences among the jurisdictions we examined are plentiful. As we expected, there is no consensus regarding which areas are better served by regulation through market institutions or through government bodies. Jurisdictions have followed different approaches to separating market operation from market regulation, ranging from divesting market institutions of regulatory powers to simply imposing additional governance measures. How vast are these differences? Are there any preferred responses to demutualization that proved popular across borders? Has demutualization resulted in scaling down the regulatory powers of market institutions?

Our results indicate that among jurisdictions there are three distinct patterns of allocation of regulatory powers to market institutions and government agencies. In France, Germany, and Japan, central governments have shaped the regulatory framework to ensure that regardless of a specialized administrative agency, such governments maintain control over certain key aspects of securities regulation. We characterize this pattern of regulatory power allocation as the "Government-led Model." In contrast, the United Kingdom, Hong Kong, and to a lesser degree, Australia, have sought to grant as much leeway as possible to market participants in structuring their activities while also fulfilling their regulatory obligations. We characterize this pattern of regulatory power allocation as the "Flexibility Model." Finally, the U.S. and Canadian regulatory frameworks grant a much wider regulatory role to market infrastructure institutions, while also strengthening the oversight that government agencies exercise over market institutions in respect of their regulatory tasks. We characterize this pattern of regulatory power allocation as the "Cooperation Model." The lines between jurisdictional responsibilities in countries following the Cooperation Model tend to be blurred, and both administrative agencies and SROs tend to have strong and independent enforcement traditions. The regulatory reforms introduced in these jurisdictions in the wake of stock exchange demutualizations vary depending on the model each jurisdiction follows. Government-led Model jurisdictions seek to create more efficient government oversight mechanisms for their financial markets, primarily by reorganizing administrative agencies and secondarily by increasing their

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already strong regulatory powers. Flexibility Model jurisdictions seek to curtail the role of market infrastructure institutions in the post-demutualization world and enhance the powers of administrative agencies; the regulatory approach they employ, however, still seeks to maintain flexibility for issuers, investors, and other market players. Finally, Cooperation Model jurisdictions could hardly afford to abolish the regulatory functions of market infrastructure institutions, given the important role that these institutions have historically played in these jurisdictions. As an alternative, Cooperation Model jurisdictions delegate those regulatory functions to an independent subsidiary of the market operator. Below, we depict in further detail the characteristics of each model.

C. GOVERNMENT-LED MODEL

1. Overview

The allocation of regulatory powers in Government-led Model jurisdictions favors administrative agencies and central government officials over market infrastructure institutions. Laws in these jurisdictions tend to require greater involvement of central governments in certain key actions and regulatory measures than is required under other models. The regulatory powers of market institutions are specific, carefully defined, and relate to areas, such as the regulation of the trading process, where the involvement of market institutions is strictly necessary. Even in these limited areas, the exercise of regulatory powers by market institutions is often subject to approval by an administrative agency. At the enforcement stage, however, these jurisdictions devote substantially less efforts than Flexibility Model or Cooperation Model jurisdictions.

2. How Do Agencies and Market Institutions Divide Areas of Regulatory Responsibility?

In the Government-led Model, the allocation of areas of regulatory responsibility between administrative agencies and market infrastructure institutions is *issue-specific*: statutes direct market institutions' regulatory efforts to precisely delineated areas of activity and regulatory responsibility, assigning them specific tasks and granting them specialized powers. Thus, market institutions derive their regulatory powers from a complex set of different provisions, each one aiming to provide regulatory solutions to a particular concern. As a result, their regulatory role comes together in a piecemeal fashion, rather than through a general authorization

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to uphold securities laws and formulate rules for their implementation.[123] A further consequence in these jurisdictions of the issue-specific approach to the allocation of regulatory powers is that the government agency is the default regulator for the securities markets. When a power has not been expressly assigned to a market institution, it resides with the government.

In addition to adhering to an issue-specific method of allocating regulatory responsibilities, jurisdictions in the Government-led Model are distinctive with respect to the specific areas in which they have preserved market institutions' regulatory powers. Thus, market institutions in these jurisdictions appear on the regulatory map in the following areas: determining prospectus disclosure requirements, establishing listing requirements and ongoing disclosure obligations, setting the trading rules according to which transactions are effected in the stock exchange, and setting out clearing and settlement procedures.[124] In other words, stock exchanges have a role in controlling whether issuers can obtain access to their markets and how trading will take place, while clearing and settlement institutions are responsible for designing the clearing and settlement process.

This allocation of powers in Government-led Model jurisdictions is consistent with the view that stock exchanges may be more effective in regulating certain aspects of the securities markets. It also signals an effort to restrain market institutions' regulatory role to the bare minimum; that is, to areas where their involvement is either strictly necessary or immensely beneficial for the smooth operation of the market.[125] The limited rulemaking and review authority granted to exchanges regarding initial and ongoing issuer disclosure requirements constitutes a channel through which the exchange familiarizes itself with a new issuer. Especially as ongoing disclosure takes place through bulletins and exchanges' other methods of disseminating information, the argument that exchanges should retain some regulatory powers over issuer disclosure requirements is particularly strong. Similarly, the exchange trading system is one of the core aspects of an exchange's activity in which market institutions' daily involvement guarantees a high level of expertise. Thus, it is not surprising that

123. Compare this structure with the approach followed in the Cooperation Model. *See infra* Part III.E.2.

124. *See infra* Tables 2, 3, and 4 (summarizing the allocation of regulatory powers for France, Japan, and Germany, respectively).

125. Of all the market infrastructure institutions included in our survey, the only one whose regulatory powers cover less area than the four areas covered in the Government-led Model is the LSE. The philosophy that underpins the U.K. regulatory framework, however, is fundamentally different. *See infra* Part V.D.

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regulation of the exchange trading process is one of the few areas where all the jurisdictions in our survey, including those of the Government-led Model, coincide in granting significant regulatory powers to exchanges. Given the complicated technical questions associated with market microstructure, most jurisdictions leave wide discretion to exchanges and limit themselves in setting high-level principles by which a trading system must abide.[126] An analogous argument holds for clearing and settlement regulation, where government agencies focus on financial stability and infrastructure adequacy, leaving the design of the highly technical clearing and settlement systems to the institutions operating them.

The degree of discretion market institutions enjoy in these areas varies. Government intervention, for example, is stronger in rulemaking that determines which issuers will have access to public financing, as statutes and agency rulemaking usually prescribe the conditions that trigger the prospectus requirements and outline a prospectus's required contents. On the other hand, central governments are usually less interested in specifying rules that determine market microstructure issues, leaving trading technicalities for exchanges to determine.[127] In the areas where market infrastructure institutions enjoy regulatory responsibilities, in most cases their powers are not exclusive, as regulators will also bear some authority in these same areas. Often, the law will subject the market institution's discretion in the exercise of its powers to government agency oversight. The discussion below examines in further detail the interaction between market institutions and regulators in the Government-led Model; its focus, however, centers on the all-encompassing scope of agency authority.[128] These jurisdictions have avoided entrusting the sole authority to regulate a group of functions identified in our questionnaire to a market institution. The presence of parallel government powers was deemed necessary to achieve related regulatory goals.

The tables that follow demonstrate the similarities in the pattern of allocation of regulatory responsibilities among the countries in the

126. Perhaps the most prescriptive rules in the jurisdictions we study with respect to exchanges' trading models are found in France. The AMF General Regulation enshrines the principles of price priority and time priority that in effeet point to a central limit order book model very close to that employed by Euronext.

127. In the public debate in the United States surrounding the SEC's adoption of Regulation NMS, NYSE CEO John Thain warned the SEC that it should avoid turning the U.S. market into an immense central limit order book. *See* John Thain, *The Quest for the Right Balance*, WALL ST. J., Dec. 21, 2004, at A18. A year later, the NYSE entered into a merger agreement with Euronext, which, although not providing a trading platform at the moment, is generally expected to lead to a unified trading platform in the future.

128. *See infra* Part III.C.3.

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Government-led Model. For the purposes of facilitating graphic representation in a concise manner, we have reduced the forty-five functions included in our survey into ten major categories. The areas marked in light grey illustrate government or administrative agency authority, while the areas left white indicate market institution authority. Similarities in the color pattern among the three jurisdictions are apparent.

TABLE 2. Overview of the Regulatory Framework in France

	RULEMAKING		MONITORING		ENFORCEMENT	
Prospectus Disclosure	AMF	E	AMF	E	AMF	E
Securities Distribution	AMF		AMF		AMF	
Listing – Ongoing Disclosure	AMF	E	AMF	E	AMF	E
Issuer Corporate Governance	AMF		AMF		AMF	
Market Abuse	Ministry/AMF		Ministry/AMF		AMF	
Trading Rules	AMF	E	AMF	E	AMF	E
Marketplace Oversight	Ministry/AMF		Ministry/AMF		AMF	
Brokers – Investment Firms	CECEI/ CB	E	CECEI/ CB	E	CECEI/ CB	E
Clearing & Settlement	AMF	LCH	AMF	LCH	AMF	LCH

KEY

AMF: Autorité des Marchés Financiers

E: Euronext Paris

LCH: LCH.Clearnet

CB: Commission Bancaire

CECEI: Comité des établissements de crédit et des entreprises d'investissement

TABLE 3. Overview of the Regulatory Framework in Japan

	RULEMAKING		MONITORING		ENFORCEMENT	
Prospectus Disclosure	JFSA	TSE	JFSA	TSE	JFSA	TSE
Securities Distribution	JFSA		JFSA		JFSA	
Listing – Ongoing Disclosure	JFSA	TSE	JFSA	TSE	JFSA	TSE
Issuer Corporate Governance	JFSA		JFSA		JFSA	
Market Abuse	JFSA		JFSA		JFSA	
Trading Rules	JFSA	TSE	JFSA	TSE	JFSA	TSE
Marketplace Oversight	JFSA		JFSA		JFSA	
Brokers – Investment Firms	JFSA/JSDA		JFSA/JSDA		JFSA/JSDA	
Clearing & Settlement	Ministry	JSCC	Ministry	JSCC	JSCC	

KEY

JFSA: Japanese Financial Services Agency

TSE: Tokyo Stock Exchange

JSCC: Japan Securities Clearing Corp.

JSDA: Japan Securities Dealers Association

Ministry: Ministry of Finance

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TABLE 4. Overview of the Regulatory Framework in Germany

	RULEMAKING	MONITORING	ENFORCEMENT
Prospectus Disclosure	BaFin	BaFin	BaFin
Securities Distribution	BaFin	BaFin	BaFin
Listing – Ongoing Disclosure	BaFin / DB	BaFin / DB	BaFin / DB
Issuer Corporate Governance	BaFin	BaFin	BaFin
Market Abuse	BaFin	BaFin	BaFin
Trading Rules	DB	HÜSt / DB	Länder / DB
Marketplace Oversight	Länder/ BaFin	Länder/ BaFin	Länder/ BaFin
Brokers – Investment Firms	BaFin	BaFin	BaFin
Clearing & Settlement	BaFin / DB	BaFin / DB	BaFin / DB

KEY

BaFin: Bundesanstalt für Finanzdienstleistungsaufsicht

DB: Deutsche Börse

HÜSt: Market Surveillance Office

Ministry: Ministry of Finance

The administrative agencies currently dominating the regulatory scene in the Government-led Model jurisdictions sprung out of a series of regulatory reforms in these countries at the turn of the decade. In France, the Autorité des Marchés Financiers ("AMF") succeeded a number of smaller agencies specializing in securities markets oversight. In Japan, the Japanese Financial Services Agency ("JFSA") emerged as a high-level supervisory body for agencies regulating the banking and securities

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markets. And in Germany, BaFin[129] is an amalgamation of the administrative agencies previously responsible for the German insurance, banking, and securities industries. Reformers justified these extensive reorganizations as necessary to respond to increasing complications and constant innovations in modern financial markets. Stock exchange demutualizations, occurring simultaneously with these reforms, evidenced the belief that the outlook of financial markets was rapidly changing. Although the introduction of these new agencies was not meant to disturb the allocation of authority in the regulatory structure, subsequent measures have increased such agencies' powers at the expense of stock exchange autonomy. Thus, the Government-led Model jurisdictions' response to the changing environment of modern finance has created a more efficient mechanism for stronger government supervision of the securities markets.

3. What Rules Define the Interaction Between Market Infrastructure Institutions and Administrative Agencies?

As already demonstrated above, the regulatory powers of market infrastructure institutions generally coexist with powers afforded to the administrative agencies active in securities markets regulation. Given this overlap, the risk of clash between these bodies' actions is almost inevitable. Government-led Model jurisdictions have employed a number of solutions to counter this problem, most of which grant precedence to agency powers over stock exchange or clearinghouse powers. First, stock exchange rules often require agency approval to be effectual; although a similar requirement also exists in other models,[130] the dynamics in the Government-led Model are unique because the market institution's power is more narrowly prescribed in the first place, given its issue-specific character. As a result, the rulemaking space reserved to market institutions is much narrower in comparison to the discretion these institutions have, for example, under the Cooperation Model. Moreover, the law often grants agencies the ability to direct market institutions to adopt certain measures in areas where they also enjoy the power of prior approval of market institution rulemaking. Second, agencies are often granted the power to reverse decisions by market infrastructure institutions; for example, the AMF in France has the power to object to Euronext's decision to admit a security for listing or to delist an issuer. Finally, the character of SROs' rulemaking and enforcement actions in the Government-led Model is

129. BaFin is an abbreviation for "Bundesanstalt für Finanzdienstleistungsaufsicht," the German Financial Supervisory Authority. *See* BaFin, *at* http://www.bafin.de/cgi-bin/bafin.pl (last visited Sept. 1, 2007).

130. *See* discussion concerning the Cooperation Model *infra* Part III.E.3.

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secondary to agency initiatives. On the rulemaking side, SRO rules, rather than define new regulatory objectives, often seek to concretely implement agency directives. On the enforcement side, SROs often exercise their powers in support of agency initiatives, such as by expelling from the exchange issuers whose fraudulent activities have already been the target of agency investigations.[131] In sum, the regulatory mission of market institutions in the Government-led Model largely consists of supplementing agency regulatory actions, rather than bringing concrete regulatory initiatives to the fore.

4. What Is the Role of Central Government in the Securities Markets Regulatory Framework?

In all the Government-led Model jurisdictions, the central government has shaped the securities regulatory framework to maintain important channels of influence in the operation of market institutions. Sometimes, these channels of influence are direct, as powers to approve the establishment of a stock exchange or a clearinghouse rest with a central government official, such as a Minister.[132] Often, these channels are indirect, expressed through a tight relationship between the central government and the administrative agency responsible for the regulatory oversight of the securities markets. For example, JFSA is positioned under the Prime Minister's Cabinet in the Japanese regulatory hierarchy, and some of its rules require the Prime Minister's approval before implementation.[133] In France, all AMF rules require the approval of the Ministry of Finance before implementation. Moreover, the Ministry can influence the AMF deliberation process through its directly appointed representative on the AMF board.[134] In this way, central governments in these jurisdictions maintain a strong grip over the regulation of securities markets.

5. How Vigorously Are Securities Laws Enforced in These Jurisdictions?

We focus primarily on data on securities law enforcement by public authorities, as they present a central aspect of the relationship between government agencies and market institutions.[135] We base our conclusions

131. Japan is a good example. *See infra* Part V.B.

132. This is the case in France. *See infra* Part V.A.

133. *See infra* Part V.B.

134. *See infra* Part V.A.

135. Although we refer to the availability of private enforcement routes where relevant, we have not included data on private enforcement in this Article. For our assessment of enforcement intensity in each jurisdiction, we have focused on public enforcement and have largely drawn from an article authored by Howell E. Jackson. *See* Howell E. Jackson, *Variation in the Intensity of Financial*

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on the responses we have received from market institutions to our questionnaires, as well as data Howell E. Jackson has collected and presented in the past.

The Government-led Model jurisdictions present the lowest levels of enforcement intensity among the jurisdictions in our survey. Our research regarding Japan, for example, indicates that while local regulators and market institutions are aware of this weakness and are taking measures to step up regulatory efforts, actual enforcement levels remain low.[136] Past research by Howell E. Jackson suggests that, although probably higher than Japan, enforcement intensity in Germany also remains at low levels overall. Examining data on the number of actions brought by BaFin between 2000 and 2002 (which, however, does not reflect the level of monetary sanctions BaFin has imposed),[137] Jackson concludes that such actions amount to about only one fifth of the actions brought in the U.S., even after controlling for market size.[138] Similarly, Government-led Model jurisdictions devote significantly less budgetary resources to securities markets regulation than Flexibility Model and Cooperation Model jurisdictions, as Jackson has pointed out.[139]

D. FLEXIBILITY MODEL

1. Overview

Whereas the Government-led Model seeks to preserve inroads for central government influence in securities markets regulation, the philosophy of the Flexibility Model is to grant as much leeway as possible to market participants in structuring their activities while also fulfilling their regulatory obligations. This does not necessarily entail lack of clarity or rigorousness in setting out firm objectives for securities markets regulation, nor does it signal laxity in enforcement. On the contrary,

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Regulation: Preliminary Evidence and Potential Implications, 24 YALE J. ON REG. 253 (2007) [hereinafter Jackson, *Variation in Intensity*]. Reeent work shows that publie enforcement is at least as important as private enforeement in explaining financial market outcomes around the world. *See* Howell E. Jackson & Mark J. Roe, Public Enforeement of Securities Laws: Preliminary Evidence (Aug. 8, 2007) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1000086.

136. It is interesting that enforcement efforts with regard to the management of the stock exchange, such as conduct of its officials and staff, internal organization, and control, are extremely low. *See* Tokyo Stock Exchange Responses to Questionnaire (on file with authors).

137. *See* Jackson, *Variation in Intensity*, *supra* note 135, at 282.

138. With regard to enforcement actions brought by public authorities in Germany, we do not account for actions relating to the exercise of voting rights, which would be a matter for state eorporate law in the United States. *See id.*

139. *Id.* at 275–76.

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regulatory objectives remain clear and enforcement efforts in these jurisdictions are often stronger than in the Government-led Model. In considering how to implement these objectives, however, regulated entities often have the ability to shape their own solutions, either through reaching an understanding with the regulators directly, or through channeling their preferences as the clientele of a market infrastructure institution which enjoys regulatory powers. Ultimately, these jurisdictions achieve flexibility by channeling agency rulemaking in the form of guidance, rather than, or in addition to, prescribing rules, and by limiting central government involvement in the monitoring and enforcement stages.

Among the Flexibility Model jurisdictions, the United Kingdom stands apart not only for its particular role as a global financial center but also for its decision to create a single regulator—the FSA—for the banking, securities, and insurance industries. On the surface, the FSA seems like a particularly strong regulator with an extremely wide scope of powers. Indeed, at the time the FSA was being created, many industry participants were lobbying the U.K. government in an effort to tone down its sweeping powers.[140] A closer look at the FSA and its relationship with the U.K. Treasury, however, reveals that its true character is different from the government-dominated agencies of the Government-led Model. As detailed in the U.K. Country Study, the FSA is a hybrid regulator, operating in the form of a corporation whose board is appointed by the government. Historically, the FSA resulted from a merger of a series of self-regulatory institutions.[141] Its regulatory approach is nonintrusive, largely reflecting the regulatory approaches followed in the other Flexibility jurisdictions.

2. How Do Agencies and Market Institutions Divide Areas of Regulatory Responsibility?

Similar to the Government-led Model, the allocation of regulatory powers in the Flexibility Model is *issue-specific*: government entities,

140. *See* Ferran, *supra* note 74, at 296.

141. Until the mid-1980s, financial markets supervision in London was informal, clubby, and opaque. After repeated market collapses, a series of reforms in 1986 known as the "Big Bang" hoped to preserve the London tradition of mutual professional trust by creating a number of SROs, as well as a hybrid body, the Securities Investment Board ("SIB"). The SIB consistcd of both government officials and industry representatives and did not possess any enforcement authority. Nine of these self-regulatory bodies, including the SIB, merged to create the FSA. *See* Jerry W. Markham, *Super Regulator: A Comparative Analysis of Securities and Derivatives Regulation in the United States, the United Kingdom, and Japan*, 28 BROOK. J. INT'L L. 319, 374–78 (2003). The FSA government website lists thosc once self-regulatory institutions that eventually merged to become the FSA. See Fin. Servs. Auth., About the FSA, History, *at* http://www.fsa.gov.uk/Pages/about/who/History/index.shtml (last visited Sept. 1, 2007).

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regulators, and market infrastructure institutions have distinct responsibilities for regulatory oversight. This does not necessarily mean that there are no risks of overlap or clash in the fringes. Rather, the core powers each entity has are designed as distinct (although, in some cases, they are complementary). In contrast to the Government-led Model, where the central government maintains powers to intervene directly in the day-to-day oversight of capital markets, the Flexibility Model favors allowing market- or industry-led initiatives to shape regulatory policy and enforcement. In the Australian and Hong Kong regimes, market infrastructure institutions enjoy greater responsibilities, and the United Kingdom reaches roughly the same result through the regulatory approach employed by the FSA. The paragraphs that follow outline the similarities and differences in the pattern of allocation of regulatory responsibilities in the jurisdictions of the Flexibility Model, and the following section discusses the regulatory approaches these jurisdictions have adopted.

A brief look at Tables 5 and 6 below confirms that market infrastructure institutions in Flexibility Model jurisdictions enjoy a wide scope of regulatory powers. These powers cover areas in the regulatory spectrum as diverse as primary markets' disclosure rules and regulation of stock exchange member firms, and even extend to the regulatory oversight of the marketplaces themselves. A comparison between Tables 5 and 6 in the Flexibility Model and Tables 2, 3, and 4 in the Government-led Model reveals telling differences between the two models. First, Flexibility Model jurisdictions have entrusted market infrastructure institutions with substantially more powers than Government-led Model jurisdictions. Second, in the areas where the market institutions of the Government-led Model have regulatory powers, market institutions of the Flexibility Model also have regulatory powers. In other words, there is a core set of areas, namely, Prospectus Disclosure Rules, Listing–Ongoing Disclosure Rules, Trading Rules, and Clearing and Settlement Rules, where both Flexibility Model jurisdictions and Government-led Model jurisdictions have trusted market institutions with regulatory powers. The U.K. example notwithstanding, these powers constitute the "bare minimum" regulatory role for market institutions; in both Government-led Model and Flexibility Model jurisdictions, market institutions' powers extend at least to these four areas. Jurisdictions in the Flexibility Model have then expanded the powers of their market institutions by incrementally adding to this set of minimum powers. Finally, there are many areas in the Flexibility Model where market infrastructure institutions are the exclusive regulators, without significant powers residing with government entities or administrative agencies. This is a stark characteristic of the Flexibility

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Model that sets it apart both from the Government-led Model and the Cooperation Model, neither of which allow such leeway to market institutions. These three attributes of the regulatory role of market institutions in Flexibility Model regimes—the volume of regulatory powers, the allocation of powers beyond the "bare minimum," and the exclusivity market institutions enjoy in some areas—illustrate the greater flexibility these regimes allow to market participants.

As the traditional role of market institutions in the regulatory structure of Flexibility Model jurisdictions was more important, developments such as demutualization had a profound impact on their regimes. The decision of the U.K. government to strip the LSE of its Listing Authority powers and to assign this role to the FSA is perhaps the most celebrated government response to a stock exchange demutualization, but policymakers in the other Flexibility Model jurisdictions also reacted to similar developments in their markets. The Hong Kong government, for example, although fully supportive of the stock exchange's demutualization, resolved to strengthen the powers of the regulator in the post-demutualization regime.[142] Australia maintained an important regulatory role for the Australian Stock Exchange ("ASX"), but established an enhanced governance regime over the stock exchange: ASX Supervisory Review ("ASXSR"), a wholly-owned subsidiary of ASX, was created to function as an independent internal auditor to ASX regarding the performance of its supervisory functions.[143] In addition, ASX entered into a special memorandum of understanding with the Australian Securities and Investment Commission ("ASIC") regarding its supervision as a listed entity[144] that enhanced ASIC's supervisory role. Overall, Flexibility Model jurisdictions responded to stock exchange demutualization by strengthening the position of regulators toward stock exchanges and implementing additional governance measures where necessary. To avoid sacrificing flexibility for investors in the name of combating conflicts of interest through stronger government agencies, these jurisdictions have employed a more market-friendly regulatory

142. *See* Laura Cha, Address at The Commonwealth Club of California: Securities Markets Reform: The Hong Kong Experience (June 6, 2000), *available at* http://www.sfc.hk/sfc/doc/EN/speeches/public/others/speechbook/chapter23.pdf.

143. *See* Press Release, Australian Stock Exchange, ASX Reinvigorates Market Supervision, Provides More Resources to Strengthen Investigation and Enforcement: New Supervisory Structure Is Demonstrably More Independent (Dec. 15, 2005) (on file with authors). *See also infra* Part V.E. In 2006, ASX delegated its operational supervisory functions to a wholly-owned subsidiary, ASX Market Supervision Pty Limited ("ASXSM"). As an independent auditor was no longer deemed necessary, ASXSR was disbanded. *See infra* Part V.E.

144. *See* Aus. Stock Exch., History of ASX, *at* http://www.asx.com.au/research/market_info/history/history_ASX.htm (last visited Sept. 1, 2007).

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approach, illustrated by their preference for guidance over rules and the preservation of significant powers in the hands of market institutions.

TABLE 5. Overview of the Regulatory Framework in Australia

	RULEMAKING		MONITORING		ENFORCEMENT	
Prospectus Disclosure	Treasury	ASX	ASIC	ASX	ASIC	ASX
Securities Distribution	Treasury		ASIC		ASIC	
Listing – Ongoing Disclosure	ASX		ASX		ASX	
Issuer Corporate Governance	Government		ASIC		ASIC	
Market Abuse	Government		ASIC		ASIC	
Trading Rules	ASX		ASX		ASX	
Marketplace Oversight	Treasury	ASX	ASIC	ASX	ASIC	ASX
Brokers – Investment Firms	Treasury	ASX	ASIC	ASX	ASIC	ASX
Clearing & Settlement	Treasury	ASX	RBA	ASX	ASIC	ASX

KEY

ASX: Australian Stock Exchange

RBA: Reserve Bank of Australia

ASIC: Australian Securities and Investments Commission

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TABLE 6. Overview of the Regulatory Framework in Hong Kong

	RULEMAKING		MONITORING		ENFORCEMENT	
Prospectus Disclosure	SFC	HKEx	SFC	HKEx	SFC	HKEx
Securities Distribution	HKEx		HKEx		HKEx	
Listing – Ongoing Disclosure	HKEx		HKEx		HKEx	
Issuer Corporate Governance	HKEx		HKEx		HKEx	
Market Abuse	SFC	HKEx	SFC	HKEx	SFC	HKEx
Trading Rules	HKEx		HKEx		HKEx	
Marketplace Oversight	SFC	HKEx	SFC	HKEx	SFC	HKEx
Brokers – Investment Firms	SFC	HKEx	SFC	HKEx	SFC	HKEx
Clearing & Settlement	SFC	HKEx	SFC	HKEx	SFC	HKEx

KEY

HKEx: Hong Kong Exchanges and Clearing Ltd.

SFC: Securities and Futures Commission

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TABLE 7. Overview of the Regulatory Framework in the United Kingdom

	RULEMAKING	MONITORING	ENFORCEMENT
Prospectus Disclosure	Treasury	FSA	FSA
Securities Distribution	Treasury	FSA	FSA
Listing – Ongoing Disclosure	Treasury	FSA	FSA
Issuer Corporate Governance	FSA/Panel	FSA	FSA
Market Abuse	Treasury/FSA	FSA	FSA
Trading Rules	LSE	LSE	LSE
Marketplace Oversight	Treasury/FSA	FSA	FSA
Brokers – Investment Firms	Treasury/FSA	FSA	FSA
Clearing & Settlement	Treasury/FSA	FSA	FSA

KEY

FSA: Financial Services Authority

LSE: London Stock Exchange

Panel: Panel for Takeovers and Mergers

3. What Rules Define the Interaction Between Market Infrastructure Institutions and Administrative Agencies?

In the Flexibility Model, the administrative process constraints agencies impose on market infrastructure institutions are limited. In Australia and the United Kingdom, the approval of the local agency is

generally not required for a stock exchange rule to enter into force.[145] Given that the allocation of regulatory responsibilities is issue-specific, as outlined above, the absence of a prior approval requirement effectively grants market infrastructure institutions wide flexibility in the exercise of their rulemaking authority over the areas they regulate. In Hong Kong, the Hong Kong Exchanges and Clearing Ltd. ("HKEx") must still obtain the Securities and Futures Commission's ("SFC") prior approval before its rules can enter into force. The areas over which HKEx cnjoys exclusive regulatory powers, however, are numerous, whilc in all remaining areas HKEx shares regulatory powers with the SFC. This structure considerably strengthens the presence of HKEx as a market regulator in Hong Kong.

A central characteristic of the regulatory process in the Flexibility Model lies in the nonintrusive approach these jurisdictions employ as to capital markets regulation, in general, and rulemaking, in particular. As in all jurisdictions in this study, the laws passed by the legislature require implementation by second-tier legislative measures that deal with the practical details of enforcement. Unlike other jurisdictions, however, the task of implementation often falls in the hands of a central government entity, such as the treasury, that is authorized by law to issue the necessary legislative instruments with which government agencies and market infrastructure institutions must comply and ensure compliance. In practice, central governments rely heavily on their specialized agencies for suggestions and advice on formulating the implementing legislative instruments. Sometimes, these governments seek input from the wider public. Often, these second-tier measures may contain general principles that do not lend themselves in practice to direct implementation in the same way that rules of a day-to-day regulator do. Thus, these measures may require further elaboration by the agency or markct institutions under whose sphere of competence their subject-matter falls and that are asked to add "teeth" to the law. Moreover, the issuing government entities are often reluctant to revisit their rules and view such revisits as "one-off" obligations that the law imposes. In many cases, administrative agencies are further authorized to issue implementing regulations; administrative agencies in the Flexibility Model jurisdictions, however, have also developed the practice of issuing to regulated entities "guidance" illustrating their approach implementing a specific legal requirement. Guidance resembles rulemaking in that it is phrased in terms of general

145. In Australia, the Department of Treasury maintains the right to disallow certain ASX rules changes that refer to the regulation of the marketplace itself. *See* Australian Stock Exchange Responses to Questionnaire (on file with authors).

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applicability and is not addressed to a specific entity.[147] Language in guidance, however, is not prescriptive and is often phrased in "best practice" terms rather than firm regulatory obligations.[148] In many cases of noncompliance with guidance, agencies do not threaten sanctions against regulated entities, but instead ask them to disclose noncompliance to the public and explain the reasons that led to it, leaving it to the market to appreciate their validity.[149] Overall, these jurisdictions take less of a hard-line approach in determining compliance with their rules and are ready to recognize that adherence to general principles may require different actions from different entities.

4. What Is the Role of Central Government in the Securities Markets Regulatory Framework?

The nonintrusive character of capital markets regulation in Flexibility Model jurisdictions stems also from the relationship between the central government, on one hand, and the administrative agencies and market institutions that form the backbone of the regulatory framework, on the other hand. Agencies in the Flexibility Model enjoy greater independence from central government and greater flexibility in monitoring and enforcing securities laws. Below, we illustrate the Flexibility Model institutional arrangements by drawing a comparison with similar arrangements under the Government-led Model.

In the Government-led Model, central governments seek to influence securities markets regulation through their sway over administrative agencies that dominate the full spectrum of regulatory responsibilities (rulemaking, monitoring, and enforcement).[150] In the Flexibility Model, central governments have provided more independence to administrative agencies and market infrastructure institutions, maintaining only limited power to affect their day-to-day operation and decision making process. In

147. In this respect, guidance is different than no-action letters issued by other agencies, such as the SEC. Moreover, guidance, as opposed to no-action letters, represents the official view of the agency.

148. The preference for guidance over mandatory rules is particularly evident in the United Kingdom's FSA rulebook. *See infra* Part V.D. For a more detailed discussion of FSA choices between rules and guidance, see Iain MacNeil, *The Future for Financial Regulation: The Financial Services and Markets Bill*, 62 MODERN L. REV. 725, 733–34 (1999).

149. The FSA follows this approach when reviewing compliance with takeover rules. The ASX follows the same approach when reviewing compliance with Corporate Governance Council rules.

150. *See supra* Part III.C.4.

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most Flexibility Model jurisdictions, the main direct power central governments maintain over securities markets operation consists in their power to approve the agency decision for the establishment of a new stock exchange or clearinghouse.[151] Although central governments, through the appointment of agency officials, may indirectly influence the operation of the agencies, such governments do not have other means of influencing a particular agency decision.[152]

In return, central governments in the Flexibility Model have retained significant rulemaking powers, often empowering a central government entity to issue implementing legislation that, in Government-led Model jurisdictions, would have been issued by an administrative agency.[153] As Tables 5, 6, and 7 above illustrate, the presence of central government entities in the rulemaking column is strong; as discussed above, however, the legal instruments these entities produce often require further elaboration by agencies before they can be implemented. As agencies are exclusively responsible for monitoring and enforcing implementing legislation, their interpretations of these rules in the form of guidance dominates the oversight process. Given the nonprescriptive character of guidance, there is room for negotiation with the agency and for arguing before a court in favor of a regulatory approach the agency dislikes. Often, agencies themselves follow a "comply or disclose" approach with regard to substance of their guidance. As a result, although central governments are the promulgators of the initial rule, agencies still possess significant tools to frame their implementations in practice.

5. How Vigorously Are Securities Laws Enforced in These Jurisdictions?

In general, Flexibility Model jurisdictions seek to extend their nonintrusive approach to securities markets regulation in their enforcement strategy, while also ensuring that market participants do not abuse the freedom allowed by law. Their enforcement efforts often consist of selected investigations of securities laws violations, yet the budgetary and staff resources they devote to enforcement are significant in comparison to Government-led Model jurisdictions. This picture may suggest that, in their view, more intensive enforcement efforts are a necessary corollary of the greater flexibility they allow to market participants and a guarantee for fulfilling their regulatory role. While greater enforcement intensity is an

151. *See* Australian Stock Exchange Responses to Questionnaire and U.K. Responses to Questionnaire (on file with authors).

152. For example, this is the case in France. *See infra* Part V.A.

153. In Government-led Model jurisdictions, however, agencies will also have to obtain the approval of a central government entity before their rules enter into force. *See supra* Part III.C.3.

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overall characteristic of Flexibility Model jurisdictions in comparison to Government-led Model jurisdictions, the United Kingdom, Australia, and Hong Kong do differ significantly in their approaches to enforcement. Below, we discuss each jurisdiction's approach to enforcement more specifically.[154]

John Tiner, the former FSA Chief Executive, has successfully summarized the regulatory philosophy of the United Kingdom by stating that the FSA is not primarily an enforcement agency.[155] Thus, the FSA's enforcement philosophy is largely preventive: the agency conducts investigations on a sample basis and the primary purpose is to deter potential violators rather than to unveil every instance of potential misbehavior in the industry.[156] Still, the United Kingdom devotes significant resources to enforcement, in comparison with Government-led Model jurisdictions such as Germany. Howell Jackson has shown that the United Kingdom's regulatory costs, per billion dollars of stock market capitalization, are fifteen times higher than Germany's; similarly, Hong Kong spends eight times more than Germany and Australia spends thirty-one times more than Germany on regulatory supervision (per billion dollars of stock market capitalization).[157] Comparing data on actions brought in the United Kingdom and Germany between 2002 and 2004, Jackson notes that, although the number of actions in the two jurisdictions is roughly equivalent, anecdotal evidence suggests that the level of sanctions in the United Kingdom is much higher.[158]

The responses we have received in our questionnaire indicate that enforcement intensity in Australia and Hong Kong is also higher than in the Government-led Model,[159] as representatives of these jurisdictions consider the levels of enforcement in their jurisdictions as medium or higher. In Australia, enforcement efforts are a top priority for ASIC, amounting to almost half of its budgetary expenses, as John Coffee reports.[160] As noted above, Hong Kong also devotes significant resources to enforcement,

154. *See infra* Parts V.D and V.F.

155. *See* John Tiner, Chief Exec., Fin. Servs. Auth., Keynote Address at the Enforcement Law Conference (June 16, 2006) ("[W]e are emphatically not an enforcement-led regulator."), *available at* http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2006/0616_jt.shtml.

156. *Id.*

157. *See* Jackson, *Variation in Intensity*, *supra* note 135.

158. *Id.* (working paper at 28–29).

159. *See* Hong Kong Stock Exchange Responses to Questionnaire and Australian Stock Exchange Responses to Questionnaire (on file with authors).

160. See John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement* 48 (Columbia Law & Econ., Working Paper No. 304, 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=967482.

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although calls to improve the supervisory framework post-demutualization have recently surfaced.[161]

E. COOPERATION MODEL

1. Overview

The main characteristic that distinguishes the Cooperation Model from the Flexibility Model is the pervasiveness of the self-regulatory structure, which provides market institutions with wide powers as well as extensive responsibilities for the fair and efficient operation of securities markets. In the Cooperation Model, market institutions have a role in almost all aspects of securities markets regulation, devote significant resources to assist and support agencies' efforts, and undertake their own independent regulatory initiatives. Thus, their role in the securities markets regulatory framework is pervasive. The involvement of market institutions is also strong at the enforcement stage, to which self-regulatory bodies in these jurisdictions devote significant effort and resources. While central governments in jurisdictions following the Cooperation Model have a very limited role in regulatory oversight, specialized agencies are actively involved in market oversight responsibilities, often sharing jurisdictions with self-regulatory agencies and pursuing independent enforcement actions. But rather than delegating specific and limited powers to market institutions (as is the case under the Government-led Model) or granting broad latitude to these entities (as is the case in the Flexibility Model), administrative agencies operating under the Cooperation Model tend to engage in continuous dialog with market structure institutions, under which the boundaries of regulatory responsibility and even the content of regulatory requirements remain in a constant state of flux.

2. How Do Agencies and Market Institutions Divide Areas of Regulatory Responsibility?

The Cooperation Model tends to avoid the issue-specificity of the Government-led and Flexibility Models in favor of a structure where the regulatory powers of market institutions are pervasive, extending in almost all areas of the regulatory spectrum. Statutes in the Cooperation Model jurisdictions do not attempt to draw clear lines between the authority of the government agencies and the authority of market institutions, nor do they seek to avoid jurisdictional overlaps and create separate spheres of competence. Instead, they call on administrative agencies and market

161. *See infra* Part V.F.

institutions to cooperate in almost all aspects of securities markets activities in order to better achieve the high-level objectives, such as investor protection and fair and efficient operation of the markets, that the law sets. While the law sets out certain obligations for administrative agencies and market institutions and sketches out the basic framework of securities markets operation, agencies and market institutions maintain significant leeway regarding the functions they choose to regulate, the manner in which they choose to regulate, and the sanctions they may threaten to violators.

This regulatory philosophy constitutes a stark departure from the approach of other jurisdictions. Although Flexibility Model and Government-led Model jurisdictions exhibit a similar allocation of regulatory powers to agencies and market institutions in certain isolated areas, only in the Cooperation jurisdictions has this approach become the dominant regulatory technique. Inspired by the self-regulatory tradition of common law jurisdictions,[162] this regulatory approach was a political choice that sprung out of a New Deal compromise in the United States and sought to maintain market institutions as the front line regulators under the vigilant eye of a public-interest-minded agency. The benefits of self-regulation,[163] including the enhanced expertise and the de facto supervision of market operation by market institutions, justified the attempt to channel input from market participants to regulation through the market institutions that encompassed them. The pervasive character of the Cooperation Model, although clear in the exercise of rulemaking authority, extends also to monitoring and enforcement authority. Under the Cooperation Model, market institutions are not responsible for monitoring and enforcing compliance with solely their own rules, but are also responsible for ensuring compliance with securities laws in general.

Although it is clear how this approach differs from the Government-led Model, where agencies dominate the pattern of allocation of regulatory powers, it is perhaps less clear how it differs from the Flexibility Model, which, after all, also seeks to achieve regulatory efficiency by combining market initiatives with government power. From the perspective of regulatory power allocation, the main difference lies in the type of powers agencies and market institutions in both jurisdictions exercise. Flexibility Model agencies, often opting to issue guidance to regulated entities to assist them in implementing central government rules, hardly ever exercise

162. *See* Paul G. Mahoney, *The Political Economy of the Securities Act of 1933*, 30 J. LEGAL STUD. 1 (2001).

163. *See* discussion *supra* Part I.B.

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direct rulemaking powers. By contrast, agencies in Cooperation Model jurisdictions are active rule makers, often dominating the securities markets regulatory universe. Moreover, agencies and market institutions often share enforcement responsibilities, with parallel enforcement proceedings conducted in both to investigate the same alleged violations.

For market professionals in Cooperation Model jurisdictions, participation in SROs is mandatory. Most SROs are associated with a market institution, or have historically originated under the auspices of such institutions. Mandatory membership in SROs illustrates both the central role these organizations play in the regulatory structure as well as the pervasive sharing of responsibilities between SROs and government agencies.

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TABLE 8. Overview of the Regulatory Framework in the United States.

	RULEMAKING		MONITORING		ENFORCEMENT	
Prospectus Disclosure	SEC		SEC		SEC	
Securities Distribution	SEC	SROs	SEC	SROs	SEC	SROs
Listing – Ongoing Disclosure	SEC	SROs	SEC	SROs	SEC	SROs
Issuer Corporate Governance	SEC	SROs	SEC	SROs	SEC	SROs
Market Abuse	SEC	SROs	SEC	SROs	SEC	SROs
Trading Rules	SEC	SROs	SEC	SROs	SEC	SROs
Marketplace Oversight	SEC	SROs	SEC	SROs	SEC	SROs
Brokers – Investment Firms	SEC	SROs	SEC	SROs	SEC	SROs
Clearing & Settlement	SEC	SROs	SEC	SROs	SEC	SROs

KEY

SEC: Securities and Exchange Commission

SROs: Self-regulatory Organizations

TABLE 9. Overview of the Regulatory Framework in Canada

	RULEMAKING		MONITORING		ENFORCEMENT	
Prospectus Disclosure	OSC	TSX	OSC	TSX	OSC	TSX
Securities Distribution	OSC		OSC		OSC	
Listing – Ongoing Disclosure	OSC	TSX	OSC	TSX	OSC	TSX
Issuer Corporate Governance	OSC	TSX	OSC	TSX	OSC	TSX
Market Abuse	OSC	TSX	OSC	TSX	OSC	TSX
Trading Rules	OSC	TSX	OSC	TSX	OSC	TSX
Marketplace Oversight	OSC	TSX	OSC	TSX	OSC	TSX
Brokers – Investment Firms	OSC	TSX	OSC	TSX	OSC	TSX
Clearing & Settlement	OSC	TSX	OSC	TSX	OSC	TSX

KEY

OSC: Ontario Securities Commission

TSX: Toronto Stoek Exchange

One interesting feature of the regulatory structure in jurisdictions following the Cooperation Model is the prevalence of efforts to segregate the regulatory functions of exchanges and other SROs from other activities. In the United States, the incorporation of a separate subsidiary—NASD Regulation, Inc.—of the NASD in 1996 is a good illustration of this phenomenon.[164] The development of a separate NYSE Regulation division

164. In response to market maker abuses, the NASD reorganized its operations into two separate subsidiaries in 1996: one unit undertook NASD's regulatory functions, while the other was responsible for running the Nasdaq Stock Market. *See* Notice of Filing and Order Granting Temporary Accelerated

evidences a similar effect.[165] In Canada, one sees similar efforts, with the creation of Market Regulation Services Inc. ("RS") as a separate oversight body to which the major Canadian exchanges and even the Investment Dealers Association ("IDA") have delegated supervisory responsibilities. Arguably, it is no coincidence that Cooperation Model jurisdictions have been the countries most apt to experiment with segregated regulatory units within larger SROs. A defining characteristic of the Cooperation Model is the delegation of robust regulatory functions and enforcement powers to SROs. When scandals (such as the Nasdaq price fixing investigation of the 1990s in the United States) reveal weakness in SRO oversight of market practices, dramatic changes in SRO oversight responsibilities—conceivable in those operating under a Government-led Model—are difficult to accomplish in Cooperation Model jurisdictions. Hence, segregation of regulatory function emerges as a viable alternative. With Cooperation Model jurisdictions, similar responses are likely to occur in the face of the regulatory challenges posed by stock market demutualizations; for example, the proposal within the United States to spin off the NYSE's regulatory activities to another SRO, but not to an administrative agency, in the wake of its recent public stock offering.

3. What Rules Define the Interaction Between Market Infrastructure Institutions and Administrative Agencies?

The essence of the Cooperation Model lies in the ways government agencies and SROs work together to regulate securities markets effectively. The Cooperation approach is a result of certain key features of the regulatory regime, as well as several distinctive characteristics of the national securities markets in these jurisdictions. The Cooperation Model's regulatory regime requires SRO rules to obtain the approval of the government agency prior to implementation. Although the requirement for agency approval in SRO rulemaking seems to steer the Cooperation Model in the direction of the Government-led Model, a number of countervailing features differentiate the two models. First, Cooperation Model jurisdictions are home to multiple and diverse SROs that are often in competition with each other. For them, rulemaking is another method of attracting members and gaining business from their competitors. Second,

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Approval of Proposed Rule Change, Release No. 34-37107, 61 Fed. Reg. 16,948-01 (Apr. 11, 1996). For additional information regarding the NASD restructuring, see Jeffrey Taylor & Deborah Lohse, *SEC Seeks Settlement with NASD*, WALL. ST. J., June 18, 1996, at C1; Power William, *NASD Members Back Reorganization; SEC Investigation May Be Near End*, WALL. ST. J., Jan. 12, 1996, at B6.

165. In July 2007, the NASD merged with the member regulation functions of NYSE Regulation to create a new SRO, the Financial Industry Regulatory Authority ("FINRA"). *See infra* Part V.G.1.

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the law grants government agencies the power to intervene by rulemaking when it deems necessary. As a result, SROs, to avoid loss of powers and more intrusive regulation for their members, are constantly seeking to convince agencies that their rules successfully achieve the objectives set out in the law. In other words, SROs compete not only among themselves, but also against agencies. As a result, SRO rulemaking under the Cooperation Model is different than rulemaking by the same organizations under the Government-led Model, where the requirement for prior approval of SRO rules by agencies also prevails. In the Cooperation Model, SROs are not limited to the role of a second-tier regulator whose mission is to implement agency rulemaking. On the contrary, such SROs take their own initiatives and develop their own regulatory programs.

4. What Is the Role of Central Government in the Securities Markets Regulatory Framework?

Central governments in the Cooperation Model maintain a high-level oversight of the securities markets, expressed mainly through their lawmaking powers and their influence over government agencies. As the Cooperation Model assigns SROs with the power to undertake regulatory initiatives, lawmakers must consider the successes and failures of the SRO- and agency-promulgated regulatory framework before they decide to act. Moreover, while SRO rules require prior agency approval, agency rules do not require prior government approval in the Cooperation Model. Thus, the entities that constitute the main actors in the Cooperation Model—market institutions and agencies—perform their day-to-day rulemaking tasks without direct interference from the central government. Once lawmakers establish the need to intervene in securities markets regulation, however—often in response to a crisis—they may establish rules that hold agencies and SROs to higher standards than in the past. Thus, governments constitute the final institutional layer that guarantees protection to investors, intervening when there is a perceived agency failure, often in addition to an SRO failure.

While the Cooperation Model does not provide for direct channels of government intervention in securities markets regulation, some indirect channels of intervention still persist. Most importantly, governments maintain the power to appoint agency officials. Local law, however, in comparison with other jurisdictions, often limits the level of influence central governments are able to exercise through indirect channels, allowing agency officials to set their own political goals independent of the

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central government.[166] In the two jurisdictions that we study here—the United States and Canada—the federal structure of the government also introduces limitations on the combined influence central government entities exercise over securities markets. Finally, the presence of SROs with strong regulatory powers and agencies that possess highly regarded market expertise ensures that any high-level changes in securities markets regulation will be the subject of much debate and criticism, thus increasing the political cost a central government must pay in the event it decides to intervene. Consequently, central governments may exercise only limited influence over securities markets regulation indirectly.

5. How Vigorously Are Securities Laws Enforced in These Jurisdictions?

Enforcement intensity in Cooperation Model jurisdictions is on average higher than in any other model discussed here. Howell Jackson notes that the number of annual public securities law enforcement actions brought in the United States is almost double that of the United Kingdom and almost five times that of Germany, while the level of enforcement sanctions imposed in the United States is dramatically higher than in the United Kingdom.[167] Academic commentators have repeatedly portrayed the SEC as primarily an enforcement agency and have often complained about its policymaking efforts.[168] In addition to public enforcement actions, market infrastructure institutions often undertake parallel enforcement initiatives, while the wide use of private actions by individuals complements the regulatory framework for enforcement in these jurisdictions. The Canadian regulatory structure is roughly equivalent to the U.S. system in terms of budget and staffing levels. Private enforcement in the United States is much more widespread than in Canada. Although public enforcement in Canada used to be less intensive than in the United States, Canadian regulators and SROs have recently stepped up their

166. U.S. administrative law, for example, restricts the president from dismissing an independent agency chairman merely on the grounds of disagreement with the agency chairman's policies. *See, e.g.*, Humphrey's Ex'r v. United States, 295 U.S. 602, 628–29 (1935) (noting that independent administrative agencies are created by Congress to carry on a legislative policy and to perform duties not only of an executive character, but also of a legislative and a judicial character). Thus, the president's power to remove officials serving in these agencies is limited to the removal causes expressly provided in each agency's authorizing statute.

167. *See* Jackson, *Variation in Intensity*, *supra* note 135, at 281–86. According to Coffee, Australia has reached, if not exceeded, U.S. levels of enforcement intensity. *See* Coffee, *supra* note 160, at 48. As the U.S. market is much larger, enforcement vigorousness in the United States is still impressive.

168. *See* Macey & Haddock, *supra* note 18, at 319–20. *See also* Werner, *supra* note 96, at 783.

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enforcement efforts significantly.[169]

The data discussed above in relation to enforcement intensity in these three models suggest that, as market institutions' participation in the regulatory structure increases, enforcement efforts intensify. Indeed, enforcement intensity was low in the Government-led Model jurisdictions, higher in Flexibility Model jurisdictions, which assigned a greater role to market institutions, and even higher in the Cooperation Model jurisdictions, where market institutions have a wide presence in the regulatory system. At this stage, we do not possess any data that would suggest a causal relationship between the two trends or point to the direction of the causality.

IV. CONCLUSION

Self-regulation has significant benefits for the oversight of securities markets. In comparison to government agencies, stock exchanges have superior technical expertise regarding market operation, provide a consensual process for disciplining their members and listed companies, and transfer the cost of regulation from the taxpayer to the industry. While stock exchanges have incentives to offer high-quality regulation for their markets, they also face significant conflicts of interest. Critics of self-regulation point to rulemaking that shows preference for entrenched interest groups and laxity in enforcement that can lead to severe scandals.

During the last decade, stock exchanges worldwide underwent the most dramatic transformation since their creation: they abandoned their manual trading floors for electronic facilities, discarded their mutual membership organizational structure for a for-profit corporate format, are responding to increasing competition from alternative electronic trading venues, and are expanding their operations across national borders through mergers or alliances with other exchanges. These developments raise concerns as to stock exchanges' continuing ability to perform their self-regulatory functions. For-profit exchanges are more sensitive to pressures from their constituents and more likely to abusively exercise their regulatory powers against their competitors. Eliminating the regulatory powers of stock-exchanges, however, would deprive the market of the benefits of self-regulation.

Academic thinkers and policymakers alike explore mechanisms that

169. *See generally* HOWELL E. JACKSON, REGULATORY INTENSITY IN THE REGULATION OF CAPITAL MARKETS: A PRELIMINARY COMPARISON OF CANADIAN AND U.S. APPROACHES (2006), *available at* http://www.tfmsl.ca/docs/V6(2)%20Jackson.pdf.

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can alleviate heightened fears of conflicts of interest while preserving the self-regulatory model, at least in part. For some, self-regulation is appropriate only for limited areas of oversight. Curtailing the responsibilities of stock exchanges, therefore, is a necessary step. Others argue for more efficient filters to separate market regulation from market operation. Most jurisdictions reformed their regulatory framework in response to stock exchange demutualization, using a combination of these techniques.

Our survey sheds light on the debate regarding the appropriate role of SROs in the post-demutualization era by mapping the allocation of powers to central governments, administrative agencies, and stock exchanges in eight leading jurisdictions. We find that, although some jurisdictions significantly reduced the scope of stock exchanges' powers, none has considered it necessary to completely eliminate self-regulation. Moreover, most jurisdictions utilize a multifaceted regulatory structure, where a variety of public bodies have oversight powers. Despite these similarities, considerable differences remain in the responses of these jurisdictions to stock exchange demutualization.

Overall, we suggest that there are three distinct models of allocation of regulatory powers to market institutions and government agencies. We also showed that these three models entail distinct regulatory responses to stock exchange demutualization. In the Government-led Model jurisdictions (France, Germany, and Japan), central governments maintain a close grip over securities markets regulation, despite the existence of a specialized administrative agency. In the wake of demutualizations, these jurisdictions restructured the government oversight of financial markets, primarily by reorganizing administrative agencies and secondarily by increasing their already strong regulatory powers. The regulatory framework of the Flexibility Model jurisdictions (the United Kingdom, Australia, and Hong Kong) allows great latitude to market participants, provided they fulfill some core regulatory obligations. The heightened risk of post-demutualization conflicts of interest was a more important threat for these countries. Consequently, they reduced the scope of stock exchanges' powers and strengthened their administrative agencies. Despite dramatic realignments of authority in some of these jurisdictions, their regulatory philosophy of issuing guidance instead of prescriptive rules and pursuing cooperation with market participants still maintains significant flexibility for market players. Finally, in the Cooperation Model jurisdictions (the United States and Canada), stock exchanges' self-regulatory powers extend to a much wider set of issues than in any other model. Instead of curtailing

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the role of SROs, governments in these countries exert pressure on stock exchanges to assign their regulatory functions to an independent subsidiary.

This taxonomy has significant implications for policymakers seeking to design a regulatory regime for integrated transatlantic exchanges. While the current debate focuses on the number of regulators overseeing an integrated transatlantic market, the key challenges arise from differences in the regulatory structures. First, jurisdictions have reserved for government bodies varying degrees of control over different aspects of securities regulation. What stock exchanges can easily decide for themselves in some jurisdictions, therefore, may require government authorization in others. Second, rulemaking and enforcement capacities of stock exchanges differ widely. It will be problematic for an integrated transatlantic stock exchange to perform certain regulatory functions for one jurisdiction and not for another. Integrated transatlantic exchanges seeking to establish a reputation of uniform quality will face significant challenges in overcoming such differences. Third, the bargaining power of administrative agencies vis-à-vis their foreign counterparts may also depend on the scope of each agency's authority. The distinct responses to demutualization in each model highlight that regulatory convergence on common problems is not easily achieved. Overseeing integrated transatlantic exchanges will involve many common problems. Regulators will have to examine and assess the efficacy of different solutions.

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V. APPENDIX A: INDIVIDUAL COUNTRY CASE STUDIES

This Appendix presents a brief overview of the regulatory structure in each jurisdiction we surveyed. By outlining each jurisdiction's regime in a few paragraphs, we hope to inform readers about the broad allocation of authority among central governments, administrative bodies, and market infrastructure institutions. A full treatise on each jurisdiction's legal and administrative framework would provide insights and reveal details that these paragraphs could not possibly accommodate. Our objective here is to briefly sketch the main elements of each country's regulatory system to facilitate comparisons among them.

To assist readers in finding more information about each jurisdiction below, we have included in our footnotes references to scholarly work, foreign laws and regulations, and internet materials. Our primary source for the paragraphs below, however, consists of the various institutions' responses to our survey questionnaire. While we sought to confirm the questionnaire responses with independent research, our survey may still reflect the views of each participant. Moreover, given that our survey was addressed to market infrastructure institutions, our results may tend to reflect the views of that type of market actor, as opposed to the views of government officials or academic observers.

A. FRANCE

1. Overview

One of the most characteristic elements of the French regulatory structure is the existence of multiple regulatory bodies and the range of powers directly maintained by the central government over the securities industry. In an effort to consolidate the exercise of regulatory oversight of the French financial services sector, three prominent regulators merged in 2003 to create the Autorité des Marchés Financiers ("AMF").[170] Although the AMF has the status of an "independent public authority," which allows it to levy fees and receive revenue directly,[171] a government representative

170. The AMF was created on November 24, 2003. *See* AUTORITÉ DES MARCHÉS FINANCIERS, CREATION OF THE AUTORITÉ DES MARCHÉS FINANCIERS 1 [hereinafter AMF, CREATION OF AMF], *available at* http://www.amf-france.org/documents/general/5541_1.pdf (last visited Sept. 1, 2007). For an overview of the AMF's organizational structure, see AUTORITÉ DES MARCHÉS FINANCIERS, INTRODUCTION TO THE AMF AND OVERVIEW OF OPERATIONS IN 2004, *available at* http://www.amf-france.org/documents/general/ 6393_1.pdf (last visited Sept. 1, 2007).

171. *See* AUTORITÉ DES MARCHÉS FINANCIERS, CREATION OF THE AUTORITÉ DES MARCHÉS FINANCIERS, *supra* note 170, at 2.

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attends and can intervene in all deliberations.[172] In addition to influencing the AMF, the Ministry of Finance maintains significant direct powers, especially in rulemaking: AMF must obtain the prior approval of the Minister of Finance to implement its rules.[173] Beyond the AMF, a number of separate commissions, whose operating infrastructure is provided by the Banque de France and whose members are appointed by the Minister of Finance, have been entrusted with significant regulatory powers in this area.[174]

The most important stock exchange in France is operated by a private company, Euronext Paris SA, a wholly owned subsidiary of Euronext N.V., a holding company incorporated in the Netherlands and formed following a merger of the Amsterdam, Brussels, and Paris bourses in 2000. The Euronext group now includes the Lisbon stock exchange and London's International Financial Futures and Options Exchange ("LIFFE").[175] Despite the clear tendency in the French regulatory structure to maintain powers at the central government level, the stock exchange has retained responsibility for promulgating rules and monitoring compliance and enforcement in a number of significant areas. While some of its rules require prior approval by the AMF before implementation, others may enter into force immediately upon adoption by the exchange.

2. Authorizing and Supervising the Public Offer Process

The AMF and the stock exchange share parallel competencies regarding the conduct of a public offering of securities and an admission to listing, with the AMF powers prevailing over the exchange's powers in case of disagreement. In particular, the AMF is responsible for reviewing and approving an issuer's prospectus,[176] drafted according to the AMF rules approved by the Minister of Finance.[177] In addition to obtaining the AMF's authorization, the issuer must also have its listing application approved by the stock exchange, which, independent of the AMF and of

172. *See id.* at 4. The government representative does not vote, but can request a second deliberation on all issues except sanctions. *Id.*

173. *See id.*

174. *See id.* at 4–5.

175. Euronext N.V. has now merged with the New York Stock Exchange. *See supra* notes 1–5 and accompanying text.

176. HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION § 38:20 (2007).

177. These rules are contained in GENERAL REGULATION OF AUTORITÉ DES MARCHÉS FINANCIERS, bk. II, tit. I (2007) [hereinafter AMF GENERAL REGULATION], *available at* http://www.amf-france.org/affiche_plan.asp?IdSec=4&IdRub=96&IdPlan=159&Id_Tab=0&lang=en (unofficial translation).

any government approval, has the power to set its own prospectus disclosure and listing requirements.[178] The AMF, however, has the power to object to the decision of the Board of Directors of Euronext Paris as to the listing or delisting of a certain security.[179] Apart from prospectus disclosure, the AMF regulations govern the remaining aspects of the public offer process. The AMF is also principally responsible for monitoring and enforcing the law in this area, while the stock exchange also maintains some monitoring obligations coupled with the ability to impose certain enforcement measures, such as the expulsion of an issuer from the exchange.[180]

3. Issuer Regulation Following Public Offer/Listing

Regulating issuers' obligations after admission to listing falls mainly under the AMF's powers, with the exchange maintaining a secondary, complementary role to the AMF. Thus, the AMF sets out obligations for periodic filings and reports, ad hoc disclosure of important developments, the process for tender offers, and merger activity approvals.[181] The exchange's rulemaking, monitoring, and enforcement powers as to periodic and ad hoc disclosure requirements supplement the AMF's requirements.[182] The exchange, however, is exclusively responsible for setting out obligations regarding investor relations for listed companies.[183]

4. Regulation of the Trading Process

Rulemaking powers in this area are split between the central government, which sets out rules on market manipulation and insider trading,[184] and the AMF, which regulates issues such as order and execution priority as well as best execution requirements.[185] Surprisingly, the exchange retains limited room for flexibility; although the exchange makes the final decision for the format of the trading mechanism, its options are limited by AMF rules. In particular, the AMF General Regulation sets limits on the trading structure a stock exchange can adopt,

178. For the Euronext listing and delisting rules, see EURONEXT, EURONEXT RULES bk. I, ch. 6 (2005), *available at* http://isis.ku.dk/kurser/blob.aspx?feltid=72798.

179. *See* AMF GENERAL REGULATION, *supra* note 177, bk. II, tit. I, ch. IV.

180. *See* EURONEXT RULES, *supra* note 178, at 61.

181. *See* AMF GENERAL REGULATION, *supra* note 177, bk. II, tits. II, III & IV.

182. *See* EURONEXT RULES, *supra* note 178, at 62–65.

183. *See id.* at 63.

184. The central government is principally responsible for setting the insider trading laws that form part of the French commercial code. *See* BLOOMENTHAL & WOLFF, *supra* note 176, § 38:32–33.

185. *See* AMF GENERAL REGULATION, *supra* note 177, bk. V, tit. I, ch. V. *See also id.* arts. 515-7 to 515-9.

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requiring that, in general, order matching must be continuous or through call auctions, and that any order matching departing from that trading structure is limited and subject to specific rules, especially as to price deviation. In addition, the General Regulation enshrines the principles of price- and time-priority, to which stock exchanges must adhere, and requires that post-trade disclosure of prices and quantities is immediate.[186] Stock exchange rules govern issues such as halting of trades, deviation from the trading structure for a limited number of trades, cancellation of trades, and the continuous disclosure of trade prices and quantities. In any case, stock exchange rules require the AMF's prior approval.[187] The AMF is also principally responsible for overseeing compliance with the trading process; the exchange is required to immediately furnish information on trading activity to the AMF.[188] Similarly, at the enforcement level, the exchange has limited sanctioning powers, as contemplated in the contractual arrangements with its member firms, while the AMF carries on the bulk of enforcement responsibilities.[189]

5. Regulation of Marketplaces

The tendency to concentrate significant powers at the central government level is particularly evident in the oversight of the exchanges themselves. The power to authorize the establishment of a stock exchange and to withdraw this authorization rests with the Minister of Economic Affairs, operating upon a proposal by the AMF.[190] The AMF is principally responsible for regulating the remaining aspects of exchange activity, such as appointment and conduct of stock exchange management and staff, internal organization and control rules, and ownership restrictions. Monitoring and enforcement powers also rest generally with the AMF.[191] Moreover, the AMF is also responsible for regulating firms that operate alternative trading systems.

6. Supervision of the Financial Intermediation Process

France is unique among the jurisdictions in this study in assigning oversight of the financial intermediation process to more regulators, as well as maintaining a part for the stock exchange. Yet, the central government

186. *Id.*

187. *See id.* bk. V, tit. I, ch. I. *See also id.* at arts. 511-2, 511-4.

188. *See id.* bk. V, tit. I, ch. V. *See also id.* at art. 515-8.

189. For an overview of the sanctioning powers of AMF over securities law violations, see BLOOMENTHAL & WOLFF, *supra* note 176, § 38:39.

190. *See* AMF GENERAL REGULATION, *supra* note 177, bk. V, tit. I, ch. I. *See also id.* at art. 511-7.

191. *See id.* at bk. V, tit. I, ch. I.

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has delegated only limited rulemaking powers to agencies, retaining the authority to set the framework for the provision of investment services. As far as licensing, authorizing, and monitoring powers are concerned, the AMF is responsible for authorizing investment firms that intend to offer portfolio management services.[192] All investment firms wishing to offer other types of investment services[193] and all firms wishing to operate as credit institutions must obtain their authorization from the Comité des établissements de crédit et des entreprises d'investissement ("CECEI"),[194] although the AMF's consultation as to the operation plan of the firm must still be sought. The capital adequacy and position risk supervision of investment firms falls within the competence of the Commission Bancaire ("CB"), which also supervises the financial position of credit institutions.[195] In order to conduct trading on a stock exchange, an authorized investment firm must become a member of that stock exchange and comply with the rules of that market. The application for membership is a separate process, and access to membership is granted by the market operator itself (that is, Euronext Paris).[196] Issues considered by Euronext Paris in connection with the membership application refer to professional qualifications, informational technology resources, and staff organization. Similarly, enforcement powers are divided among these regulators along the lines of their monitoring responsibilities.

7. Supervision of Clearing and Settlement Functions

In the past, the law required clearinghouses to have the status of credit institutions, that is, to become authorized as banks, which obtain their authorization from the Ministry of Finance. Although no such requirement is in effect any longer, LCH.Clearnet, the designated clearinghouse for Euronext Paris, has been established under this regime and still operates as

192. *See id.* bk. III, tit. II, ch. II.

193. Investment services in France are categorized into core and ancillary activities. The core activities consist of receiving, transmitting, and/or executing orders on the account of third parties, dealing on own account, managing client portfolios, underwriting on a firm commitment basis, and placing securities on a "best efforts" basis. In order to supply any of these services (or more than one), a firm must be authorized as an investment firm or a credit institution (that is, a bank). *See* LEGIFRANCE, MONETARY AND FINANCIAL CODE arts. L321-1, L321-2 & L321-3 (2004), *availabe at* http://www.legifrance.gouv.fr/html/codes_traduits/moncang.htm#p11.

194. The CECEI is chaired by the Governor of the Banque de France. Banque de France, Banking Regulation and Supervision, Banking Licenses and Authorisations, CECEI, *at* http://www.banque-france.fr/gb/supervi/agrement/page1.htm (last visited Sept. 1, 2007).

195. *See* AMF, CREATION OF AMF, *supra* note 170, at 2.

196. *See* EURONEXT RULES, *supra* note 178, at 18–22.

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a credit institution.[197] Clearinghouses operate under the supervision of the AMF, which is responsible for setting general operation requirements, approving their rules, monitoring compliance with these rules, and bringing enforcement actions in case of violation.[198] Thus, although clearinghouses maintain significant self-regulatory powers, their exercise is subject to important constraints. Thus, the AMF General Regulation requires a clearinghouse to establish internal regulations and conduct of business rules for its staff, which is subject to professional secrecy and honesty obligations. Clearinghouses are required to appoint officials responsible for supervising clearing, for supervising clearinghouse members, and for ensuring compliance. Clearinghouses provide these appointed officials with independent decision making power and resources necessary to perform their tasks. These officials, whose appointment is subject to approval by the AMF, are then required to file with the AMF annual reports regarding their activity. The conditions for membership in the clearinghouse are set out in the rules of the clearinghouse which, in turn, are subject to AMF approval.

B. JAPAN

1. Overview

On the surface, Japan's two-tiered institutional structure for securities markets regulation bears a remarkable resemblance to the U.S. regime. For example, SROs in Japan include not only stock exchanges, such as the Tokyo Stock Exchange ("TSE"), but also a professional association largely responsible for the oversight of broker-dealers, the Japan Securities Dealers Association[199] ("JSDA"). Moreover, the Japan Securities Clearing Corporation[200] ("JSCC"), an SRO that operates the Japanese clearing and settlement systems, has extensive regulatory capabilities in the area of its activity. These SROs operate under the supervision of a government agency, the Japan Financial Services Agency ("JFSA").[201]

Despite these similarities, a closer look at the Japanese system reveals that its institutional dynamics, ties to central government, and traditionally

197. For an overview of the history of the LCH.Clearnet Group, see LCH.Clearnet, About LCH.Clearnet Group, *at* http://www.lchclearnet.com/about_lchclearnet_group/our_history.asp (last visited Sept. 1, 2007).

198. *See* AMF GENERAL REGULATION, *supra* note 177, bk. V, tit. III, ch. I.

199. *See* Japan Sec. Dealers Ass'n, About Us, *at* http://www.jsda.or.jp/html/eigo/ about_pro.html (last visited Sept. 1, 2007).

200. *See* Japan Sec. Clearing Corp., About Us, *at* http://www.jscc.co.jp/english/about/ index.html (last visited Sept. 1, 2007).

201. *See* FIN. SERVS. AGENCY, JFSA PAMPHLET 3 (2006) [hereinafter JFSA PAMPHLET], *available at* http://www.fsa.go.jp/en/ about/pamphlet.pdf (last visited Sept. 1, 2007).

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low intensity of enforcement make for a regulatory philosophy fundamentally different from that of the United States. For example, the JFSA supervises the banking industry and the insurance market as well as public auditors and accountants.[202] In addition, as the JFSA's position in the Japanese government structure is under the Prime Minister's Cabinet, some of its rules take the form of an Ordinance of the Cabinet Office, which requires the Prime Minister's approval.[203] By and large, the regulatory powers of Japanese SROs run parallel to JFSA authority to regulate markets. In some areas, usually the most crucial ones, SRO rules require the approval of the JFSA to be implemented,[204] while in other areas SROs are unrestricted to pass their own rules. For cases where the JFSA does have approval powers, it also has the authority, should it decide that market developments demand a new regulatory solution, to direct the SROs to amend their rules.

On the regulatory authorities' side, enforcement of securities laws is the responsibility of the Securities and Exchange Surveillance Commission ("SESC"),[205] a separate government agency which is subject to the JFSA and chaired by a JFSA Commissioner. SESC carries out most of the day-to-day market surveillance and enforcement tasks,[206] and may suggest rulemaking or enforcement actions to the JFSA.[207] Traditionally, enforcement in Japan was considered lax, although recently there are efforts to increase enforcement intensity.[208] In some areas, such as broker-

202. *Id.*

203. In practice, the Prime Minister has very rarely, if ever, exercised any powers to intervene in the regulation of the securities markets. Telephone interview with Mr. Masahiro Takada, Deputy Gen. Manager, Tokyo Stock Exch. N.Y. Representative Office, in Wash., D.C., (July 23, 2006). The availability of a direct channel for government intervention at the highest level, however, may prove influential in its own right under certain circumstances.

204. Some SROs, and in particular the Tokyo Stock Exchange, have established a working relationship with the JFSA over the years, which allows them to gauge the JFSA's intentions with respect to a proposed rule before it becomes approved by their board of directors. Due to this informal consultation process, rulemaking at the SRO level takes place with the JFSA's cooperation.

205. In addition to securities markets, the SESC also supervises financial futures markets.

206. Since April 2005, the SESC has also administered a civil money penalty system. *See* SEC. & EXCH. SURVEILLANCE COMM'N, ANNUAL REPORT 2004/2005 8, 20 (2005) [hereinafter SESC 2004/2005 ANNUAL REPORT], *available at* http://www.fsa.go.jp/sesc/english/reports/re2004pamph/all.pdf.

207. *See* JFSA PAMPHLET, *supra* note 201, at 13.

208. For example, Japan introduced civil penalties, in addition to already existing criminal penalties, for violation of securities laws. *See* Sadakazu Osaki, *Civil Fines Under the Securities and Exchange Law Take Hold*, 10 NOMURA CAP. MKT. REV. 14 (2008). In addition, Japan is trying to improve the technology infrastructure in its markets and increase the reliability of financial administration. *See* Tatsuya Ito, Minister of State for Fin. Servs., Gov't of Japan, Presentation at the Japan Society, New York: The New Forward-Looking Phase of Japan's Financial System: Japan's

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dealer supervision, government powers are relatively limited, leaving supervisory efforts largely in private hands[209] and thus voiding any threats of agency intervention in case of material wrongdoing by market participants or substantial SRO failure. Even in areas where the law provides administrative authorities with all necessary powers, however, the volume of enforcement actions brought is unimpressive.[210] SRO enforcement efforts are often secondary and supplementary to government enforcement efforts, and often consist of reporting to the SESC facts indicating potential violations.[211] Thus, most SRO enforcement powers coexist with agencies' authority to impose sanctions on securities law violators. Japanese law, however, has provided significant enforcement powers and policy independence to stock exchanges by granting them the exclusive power to enforce their listing and membership requirements.

2. Authorizing and Supervising the Public Offer Process

Perhaps due to strong public policy considerations arising when granting access to public financing, rulemaking in this area is dominated by the central government and the administrative agencies. SROs' rulemaking powers are limited to issues relating to misstatement liability in issuers' disclosures, for which the stock exchanges also maintain the power to impose enforcement sanctions. As far as monitoring is concerned, both administrative agencies[212] and SROs are responsible for reviewing prospectuses and ensuring adherence to rules regarding promoting securities to the public. Thus, TSE's Listing Department reviews issuers' prospectuses and may require additional disclosures.[213] SRO review in this

Challenge: Moving Toward a Financial Services Nation (May 2, 2005), *available at* http://www.fsa.go.jp/en/announce/state/20050502.pdf.

209. Traditionally, SESC's supervision of broker-dealers was limited to a fair-trading perspective. Since July 2005, the JFSA has delegated to the SESC further power to supervise broker-dealers from a financial solvency perspective. *See* SESC ANNUAL REPORT 2004/2005, *supra* note 206, at 21. This shift of powers from the JFSA to the SESC, however, does not significantly impact our assessment of the overall involvement of governmental agencies in broker-dealer regulation.

210. *See* Tokyo Stock Exchange Responses to Questionnaire (on file with authors).

211. The Tokyo Stock Exchange cooperates closely with the SESC in broker-dealer supervision. *See* TOKYO STOCK EXCH., TSE COMPLIANCE REPORT, *available at* http://www.tse.or.jp/english/sr/compliance/comp_report/report.pdf (last visited Sept. 1, 2007). TSE submits to the SESC its semiannual inspection plan, along with analysis of its achievements in the past six months and its priorities for the future. For each inspection it conducts, TSE sends a separate report to the SESC.

212. For an overview of the SESC's prospectus review functions, see SESC, SESC OCTOBER 2006 PAMPHLET 9 (2006), *available at* http://www.fsa.go.jp/sesc/english/aboutsesc/all.pdf.

213. *See* TSE COMPLIANCE REPORT, *supra* note 211, at 2(ii).

sphere, however, is secondary to SESC reviewers who take the lead in assessing issuers' disclosures.[214]

3. Issuer Regulation Following Public Offer Listing

Contrary to the regulatory pattern at the prelisting stage, regulatory oversight at the listing and postlisting stages relies heavily upon the stock exchanges. First, stock exchanges are primarily responsible for setting their own listing requirements, provided they obtain the JFSA's approval.[215] Moreover, stock exchange decisions to list or delist a company, as well as any other related sanctions, are not subject to agency approval or appeal, and thus a firm has very limited leeway against the exchange.[216] On all other aspects of issuer regulation after listing (such as periodic filings or reports, ad hoc disclosure of important developments, etc.),[217] both government agencies and stock exchanges share significant powers with regard to rulemaking, monitoring, and enforcement, although stock exchange rulemaking initiatives generally require the JFSA's approval.[218]

4. Regulation of the Trading Process

Stock exchanges are granted the power, subject to agency approval, to set, monitor, and enforce their own trading rules.[219] On issues central to the smooth operation of the market, such as market manipulation, insider trading, and order priority rules, primary enforcement obligations belong to the SESC.[220] Stock exchanges, however, retain significant rulemaking,

214. Telephone Interview with Masahiro Takada, *supra* note 203.

215. The Tokyo Stock Exchange is currently implementing a plan to improve its listing system. For an overview of the implementation plan, see TOKYO STOCK EXCH., COMPREHENSIVE IMPROVEMENT PROGRAM FOR LISTING SYSTEM (2007), *available at* http://www.tse.or.jp/rules/seibi/2007programjokyo-e.pdf.

216. For a brief overview of TSE's listing and delisting requirements regarding Japanese stocks, see TOKYO STOCK EXCH., CRITERIA FOR LISTING, FORMAL REQUIREMENTS (DOMESTIC STOCKS) (2006), *at* http://www.tse.or.jp/english/rules/listcriteria/index.html.

217. *See* TOKYO STOCK EXCH., ACTION PROGRAM FOR QUARTERLY FINANCIAL DISCLOSURE (2002), *available at* http://www.tse.or.jp/english/rules/quarter/action_program.pdf.

218. In recent years, the TSE has taken measures to improve investor information about corporate governance in listed firms. Since June 2006, TSE requires listed firms to issue a report on their corporate governance arrangements and provides continuous guidance on preparing this report. *See* TOKYO STOCK EXCH., TSE-LISTED COMPANIES: WHITE PAPER OF CORPORATE GOVERNANCE (2007), *available at* http://www.tse.or.jp/english/rules/cg/white_paper.pdf.

219. *See* TOKYO STOCK EXCH., BUSINESS REGULATIONS OF THE TOKYO STOCK EXCHANGE, INC. (2005), *available at* http://www.tse.or.jp/english/rules/regulations/businessregulations.pdf. For a brief overview of TSE's trading rules for Japanese stocks, see the Tokyo Stock Exchange Group, Inc., *at* http://www.tse.or.jp/english/rules/equities/dstocks/index.html.

220. *See* SESC OCTOBER 2006 PAMPHLET, *supra* note 212, at 5–6. In its annual report, the SESC provides additional information about its investigations and market surveillance operations. *See* SEC. &

monitoring, and enforcement authority in all these areas that run parallel to JFSA and SESC powers. Often, SROs' duties consist of identifying a potential violation and forwarding the case to the SESC for further investigation.[221] In addition, the SESC supervises SROs to ensure their effectiveness in carrying out their market surveillance and member compliance duties. On the other hand, the JSDA sets, monitors, and enforces best execution requirements, also operating in parallel with the central government and/or regulatory agency framework.[222]

5. Regulation of Marketplaces

Central government and regulatory agencies in Japan intervene in the regulation of marketplaces in both a direct and indirect way. First, rulemaking and monitoring powers with respect to stock exchange establishment and ownership restrictions rest with the JFSA, which thus maintains a tight grip over the exchange.[223] Second, while stock exchanges are almost unconstrained in setting their own internal organization and control rules, most of these rules are part of the facts considered by the JFSA in the context of its approval for the establishment of the exchange, and the continuous assessment of its operations, thus involving the JFSA indirectly as the stock exchanges amend their rules in these areas.[224] Although the central government and regulatory agencies retain some limited monitoring powers in this respect, enforcement was traditionally considered lax. Recently, however, the government adopted a series of reforms to ensure the independence of the exchanges' performance of their self-regulatory tasks. According to these measures, an exchange that seeks to list on its own market must outsource its regulatory functions to a self-regulatory committee with a majority of outside directors.[225] As far as alternative trading systems and OTC markets are concerned, the JSDA plays a prominent role in regulating alternative marketplaces, presumably

EXCH. SURVEILLANCE COMM'N, ANNUAL REPORT 2005/2006 (2006) [hereinafter SESC ANNUAL REPORT 2005/2006], *available at* http://www.fsa.go.jp/sesc/english/reports/re2005.pdf.

221. *Id.*

222. *See* JAPAN SEC. DEALERS ASS'N, REGULATIONS CONCERNING SOLICITATION FOR INVESTMENTS AND MANAGEMENT OF CUSTOMERS, ETC., BY ASSOCIATION MEMBERS (1975), *available at* http://www.jsda.or.jp/html/pdf/ekisoku/b-0100.pdf.

223. The JFSA has authorized SESC to conduct inspections on SROs to ensure compliance with their regulatory obligations and proper operation of their member supervision and enforcement systems. *See* SESC OCTOBER 2006 PAMPHLET, *supra* note 212, at 4.

224. *Id.*

225. The JFSA Newsletter includes a useful summary of the reforms. *See FSA Newsletter* (Fin. Servs. Agency, Tokyo, Japan) Nov. 2006, *available at* http://www.fsa.go.jp/en/newsletter/2006/11a.html.

operated by broker-dealers that are JSDA members, along with the central government and regulatory agencies.

6. Supervision of the Financial Intermediation Process

In the Japanese regulatory system, stock exchanges retain significant powers to regulate their members, especially with respect to fiduciary duties, conduct of business rules, and capital adequacy, where they share rulemaking, monitoring, and enforcement powers with agencies and industry associations.[226] Stock exchanges have significant leverage vis-à-vis their members due to their exclusive power (that is, without the approval of regulatory authorities being required) to set the requirements for stock exchange membership, monitor ongoing compliance with these requirements, and decide to disqualify a broker-dealer from membership. Central government and regulatory agencies, however, have the exclusive power to grant, suspend, or revoke the license of a broker-dealer. On the other hand, significant rulemaking, monitoring, and enforcement powers regarding security analysts, investment advisers, and collective investment schemes are shared between the JSDA and the central government and/or regulatory agency.[227] Enforcement in these areas is remarkably lax.

7. Supervision of Clearing and Settlement Functions

While the central government and regulatory agencies retain the power to license, impose, and monitor restrictions as to a clearinghouse's ownership interests and membership and access policies, the core aspects of the clearing and settlement function, such as operating rules and procedures, are regulated by the JSCC.[228]

226. For an overview of SESC supervision powers with regard to financial intermediaries, see SESC OCTOBER 2006 PAMPHLET, *supra* note 212, at 10. For additional information on SESC supervisory activity in this area, see SESC ANNUAL REPORT 2005/2006, *supra* note 220, at 13–25. For an overview of TSE enforcement efforts toward its members, see TSE COMPLIANCE REPORT, *supra* note 211, at 5–15.

227. TSE and JSDA cooperate closely to select broker-dealers they will target in their inspections. *See* TSE COMPLIANCE REPORT, *supra* note 211, at 5.

228. JSCC is a private company whose majority shareholder is the TSE and whose minority shareholders include other Japanese securities exchanges. JSCC issues its Business Rules, which set out the settlement and clearing rules it employs. For an overview of JSCC's clearing and settlement system, sce Japan Sec. Clearing Corp., Basic Structure of Clearing & Settlement System, *at* http://www.jscc.co.jp/english/system/index.html (last visited Sept. 1, 2007).

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C. GERMANY

1. Overview

The German regulatory structure is unique among the jurisdictions in our study for the parallel existence of federal and state powers in the oversight of securities markets. State powers are especially preeminent in the regulation of the stock exchanges, and marketplaces more generally. Although Germany is home to eight stock exchanges, the largest and most important one is the Frankfurt Stock Exchange, located in the state of Hesse.[229] Deutsche Börse, the operator of the Frankfurt Stock Exchange, is a private company licensed as an investment firm by the Hessian authorities.[230] The federal government undertook a serious initiative with respect to financial services supervision with the establishment of BaFin,[231] an administrative agency responsible for regulating the banking, insurance, and securities industries. BaFin is independent of the federal budget as its revenues consist of fees and charges to the industries it supervises.[232] BaFin's Administrative Council, its highest internal collective organ also responsible for setting its budget, however, comprises a majority of government appointees[233] and a minority of industry representatives.[234] In addition, the Administrative Council appoints BaFin's president. The states ("Länder") may advise BaFin with respect to securities markets issues through the Securities Council, one of BaFin's advisory committees that consists solely of states' representatives.[235] Although federal supervision of the securities markets dates only from 1994, and BaFin was created as recently as 2002, the federal arm has gradually come to dominate the regulatory structure at the expense of both state powers and stock exchange powers.

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229. The Frankfurt Stock Exchange is a self-governing public law body that does not have a separate legal personality; its activities are carried out by its operator, Deutsche Börse. *See* Hendrik Haag & David Brownwood, *Inside the Biggest German IPO of 2001: Deutsche Börse*, INT'L FIN. L. REV., July 2001, at 11, 12.

230. *Id.*

231. *See supra* note 129.

232. *See* BaFin, About Us, *at* http://www.bafin.de/cgi-bin/bafin.pl?verz=0101010000&sprache=1&filter=&ntick=0 (last visited Sept. 1, 2007).

233. The similarities with the organizational structure of the AMF are apparent. *See supra* Part V.A.

234. The Administrative Council's twenty-one members include four representatives of the Federal Ministry of Finance (including the Chairman), one representative of the Ministry of Economics and Labor, one representative of the Ministry of Justice, five Members of the German Bundestag (Lower House of Parliament), and ten representatives of the banks, investment companies, and insurance companies. *See* BAFIN, 2002 ANNUAL REPORT 199 (2002), *available at* http://www.bafin.de/jahresbericht/jb02_e_TeilA.pdf.

235. *See id.* at 178.

2. Authorizing and Supervising the Public Offer Process

Since its inception, BaFin was responsible for overseeing the public offer process, promulgating rules regarding the requirement to issue a prospectus, and ensuring issuer compliance with the rules regarding the procedural steps to offer securities to the public.[236] As a result of the implementation of the recent European Union Prospectus Directive in Germany, BaFin obtained the sole authority for reviewing the contents of prospectuses for accuracy and completeness, a power which previously resided with the stock exchange.[237] BaFin powers have been expanded in similar fashion on the rulemaking, monitoring-authorizing, and enforcement side. Recent laws have also facilitated enforcement against fraudulent statements in disclosure documents in the case of actions brought by a wide number of investors (similar to class actions under U.S. law). Court judgments resulting from such actions are binding on future courts faced with an action brought by other defendants against the same issuer.

3. Issuer Regulation Following Public Offering/Listing

The stock exchanges, under the supervision of state authorities, are responsible for setting the listing requirements in the markets they operate.[238] The federal government has promulgated rules regarding the postlisting obligations of the issuer, setting mandatory disclosure and periodic filling requirements as well as external auditors' requirements.[239] These rules do not prohibit stock exchanges from imposing additional obligations to issuers in order to ensure higher transparency for their markets, although stock exchange rules may not contravene federal government rules. The stock exchange has made use of this power to enhance issuer disclosure to the market.[240] The federal government,

236. *See id.* at 166–68.

237. *See* BAFIN, 2005 ANNUAL REPORT 140–42 (2005), *available at* http://www.bafin.de/jahresbericht/2005/kapitel_VI_en.pdf.

238. For the listing rules of the Frankfurt Stock Exchange, see DEUTSCHE BÖRSE GROUP, FRANKFURTER WERTPAPIERBÖRSE RULES AND REGULATIONS (2006), *available at* http://www1.deutsche-boerse.com/INTERNET/EXCHANGE/zpd.nsf/KIR+Wcb+Publikationen/HAMN-52FBA9/$FILE/Fwb00e_060126.pdf?OpenElement [hereinafter FWB EXCHANGE RULES FOR THE FRANKFURT STOCK EXCHANGE].

239. For example, the federal laws require listed companies to immediately disclose new developments or facts that may impact their stock price. *See* 2002 ANNUAL REPORT, *supra* note 234, at 157.

240. For example, the stock exchange rules require issuers to publish corporate action timetables and hold at least one annual meeting with analysts. *See* FWB EXCHANGE RULES FOR THE FRANKFURT STOCK EXCHANGE, *supra* note 238, §§ 64–65.

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however, dominates regulation of an issuer's corporate behavior following listing, and in particular takeovers, tender offers, and mandatory bids.[241]

4. Regulation of the Trading Process

The stock exchange has the power to set its own trading rules, design its trading model, and set the principles for order interaction in its markets. The federal authorities, on the other hand, are responsible for clarifying and implementing laws aiming to maintain the integrity of the markets, such as rules regarding market manipulation and insider trading.[242] While authority on the rulemaking side is divided between the stock exchange and BaFin, their cooperation is necessary in order to monitor compliance with these rules, as the stock exchange has immediate oversight of trading activity in its markets. The German regulatory framework is unique in establishing a special authority, HüSt, with the exclusive mission of supervising the trading process. Although HüSt is technically the Market Surveillance division of the Frankfurt Stock Exchange, the law protects it with unusual safeguards of independence (such as special rules regarding the hiring and dismissal of its staff).[243]

5. Regulation of Marketplaces

State authorities in Germany are primarily responsible for the regulatory regime governing stock exchanges.[244] The federal government, however, has recently adopted laws that directly affect the regulation of the stock exchanges, such as related European directives.[245] The federal

241. The Federal Securities Acquisition and Takeover Act of 2002 established, for the first time, a binding legal framework for takeovers in Germany, monitored by BaFin. *See* 2002 ANNUAL REPORT, *supra* note 234, at 169.

242. *See id.* at 150–51.

243. Deutsche Börse describes the interplay of regulatory authority between BaFin, HüSt, and the Hessian Exchange Supervisory Authority as follows: (1) HüSt supervises trading activity and analyzes irregularity patterns; (2) the Hessian Exchange Supervisory Authority initiates sanctions at the state level; and (3) BaFin imposes sanctions for market abuse. *See* Deutsche Börse Group, The Proper Conduct of Trading Within the Exchanges is Monitored by Market Surveillance, *at* http://deutsche-boerse.com/dbag/dispatch/en/kir/gdb_navigation/about_us/20_FWB_Frankfurt_Stock_Exchange/40_Supervisory_Bodies (last visited Sept. 1, 2007).

244. The state authority responsible for the oversight of the Frankfurt Stock Exchange is the Hessian Exchange Supervisory Authority, a division of the Hessian Ministry for Economic Affairs, Transport and Regional Development. *See id.*

245. For example, the Investment Services Directive included specific standards for designating a stock exchange as a "regulated market" capable of being recognized across EU member states. Council Directive 93/22, art. 1, 1993 O.J. (L14) 27 (EC), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31993L0022:EN:HTML (last visited Sept. 1, 2007). The organization of Deutsche Börse reflects these requirements—for example, Deutsche Börse offers listing either at the Official or Regulated Market, or at the Unofficial or Open Market. For an overview of these options, see Deutsche Börse Group, Market Segments by German Law, *at* http://deutsche-boerse.com/

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government has a greater role in the regulation of alternative trading venues, requiring them to register with BaFin as providers of investment services, in addition to their registration as operators of marketplaces with state authorities.

6. Supervision of the Financial Intermediation Process

The main regulator responsible for the oversight of investment firms is BaFin.[246] Its rulemaking, monitoring, and enforcement powers cover the whole spectrum of investment firm activity, such as licensing requirements, fiduciary duties, conduct of business, and capital adequacy.[247] The stock exchange, however, continues to play an important role regarding member regulation. First, it sets, monitors, and enforces membership requirements.[248] Moreover, it often complements BaFin rules with additional requirements its members must fulfill, focusing largely on issues relating to adequate performance of members' professional obligations, such as members' behavior toward other members in the context of trading or their ability to meet the financial obligations they incur toward their counterparties.[249]

D. UNITED KINGDOM

1. Overview

For many commentators, the existence of a single regulator for the financial services industry, whose powers expand into banking and insurance, sets the U.K. regulatory approach apart from other jurisdictions.[250] To delineate the allocation of powers among business, this study focuses on a different question: how do the powers allocated to the FSA in the area of capital markets regulation compare with the powers of regulators in other jurisdictions possessed in the same area? We find that,

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dbag/dispatch/en/kir/gdb_navigation/trading_members/25_Market_ structure/60_Marktsegmente (last visited Sept. 1, 2007). The FWB rules set out the terms of operation of these segments in further detail. *See* FWB EXCHANGE RULES FOR THE FRANKFURT STOCK EXCHANGE, *supra* note 238, §§ 68–73, 89.

246. According to the "universal banking" tradition in Germany, banks may also offer securities trading services. BaFin is the supervisory authority responsible for the oversight of both banks and financial services firms. *See* 2002 ANNUAL REPORT, *supra* note 234, at 81–84.

247. *Id.*

248. *See* FWB EXCHANGE RULES FOR THE FRANKFURT STOCK EXCHANGE, *supra* note 238, §§ 14–20.

249. For example, the stock exchange board may require members to provide sufficient security to ensure that they can meet their financial obligations toward their counterparties. *Id.* § 13.

250. *See generally* Joseph J. Norton, *Global Financial Sector Reform: The Single Financial Regulator Model Based on the United Kingdom FSA Experience—A Critical Reevaluation*, 39 INT'L LAW. 15 (2005).

in terms of sheer scope, FSA powers are sweeping.[251] Indeed, the regulatory role of the London Stock Exchange ("LSE") is practically limited to setting its own trading rules and providing the FSA with information on trading activity; other powers retained by the exchange are only secondary and complementary to FSA rules. We observe, however, that exercise of rulemaking power by the FSA is substantially different than what other legal systems prescribe. First, a series of secondary legislative instruments implementing the Financial Services and Markets Act of 2000 ("FSMA") are issued by H.M. Treasury. Second, with respect to some crucial aspects of securities regulation, such as regulation of exchanges and clearinghouses, the FSA has often opted, instead of promulgating specific rules binding investors as well as itself, for issuing nonbinding guidance on the implementation of the provisions it is charged with overseeing.[252]

Given the preeminence of London as an international financial center and the competition it provides to U.S. markets, comparisons between the U.S. and the U.K. regulatory frameworks are plentiful in academic literature.[253] In considering differences and similarities between the SEC and the FSA in particular, commentators often point to the wide range of powers afforded to the FSA and the variety of objectives of the FSA mandate, in contrast with the SEC's focus on investor protection.[254] While these differences in scope are important, the difference in regulatory technique between the two agencies is, in our view, more profound. The SEC is primarily an enforcement agency, pursuing a large number of individual cases each year.[255] By contrast, the FSA initiates only a limited amount of enforcement actions against the entities it oversees, resting

251. During the public consultation stage that preceded the creation of the FSA, many feared that its powers "to make rules [appeared] to be virtually untrammeled." *See* SIMON GLEESON, FINANCIAL SERVICES REGULATION: THE NEW REGIME 22 (1999).

252. The FSA Handbook, a daily-updated, codified version of FSA rulemaking, contains a significant number of codified FSA guidance rules prescribed by the FSA as nonmandatory. *See* FIN. SERVS. AUTH., FSA HANDBOOK (2007), *available at* http://fsahandbook.info/FSA/html/handbook. The mandatory status of the Handbook provisions is best explained within FSA's introductory guide to the Handbook. *See* FIN. SERVS. AUTH., READER'S GUIDE: AN INTRODUCTION TO THE HANDBOOK 22 (2007), *available at* http://fsahandbook.info/FSA/pdf/rguide.pdf.

253. *See generally* Markham, *supra* note 141; Hiren B. Mistry, *Battle of the Regulators: Is the U.S. System of Securities Regulation Better Provided For Than That Which Operates in the United Kingdom*, J. INT'L FIN. MKT. 2002 4(4), at 137; Heidi Mandanis Schooner & Michael Taylor, *United Kingdom and United States Responses to the Regulatory Challenges of Modern Financial Markets*, 38 TEX. INT'L L. J. 317 (2003).

254. *See* Schooner & Taylor, *supra* note 253, at 331. Joseph Norton notes that the FSA operates under statutorily mandated principles of good regulation that require it to take into account considerations beyond consumer—that is, investor—protection, such as the competitiveness of London's financial industry globally. *See* Norton, *supra* note 250, at 29.

255. *See* Jackson, *Variation in Intensity*, *supra* note 135, at 278–81.

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instead on other tools to ensure compliance with its rules.[256] Furthermore, SEC rulemaking is more detailed and more prescriptive, while FSA operates largely through issuing nonbinding guidance, allowing significant flexibility to the application of its rules. In contrast with most other statutory regulators, the FSA's organizational structure offers greater administrational and managerial flexibility; the FSA is an independent nongovernmental body organized in the form of a company limited by guarantee.[257] The financial industry finances the operation of the FSA, but the Treasury appoints the FSA board.

2. Authorizing and Supervising the Public Offer Process

Traditionally, U.K. law designated the LSE as the U.K. Listing Authority, vesting it with the power to approve disclosure documents necessary prior to obtaining a U.K. listing, and thus allowing it to shape U.K. disclosure requirements. Following the LSE's decision to demutualize in 1999, H.M. Treasury assigned the role of U.K. Listing Authority to the FSA, stripping the LSE of any regulatory powers in this area.[258] As a result, rulemaking authority with regard to the public offer process is now divided between the central government and the FSA. In particular, H.M. Treasury has issued key legislative instruments in this area, such as the Prospectus Regulations 2005.[259] The monitoring and enforcement powers, on the other hand, have passed exclusively to the FSA, while the law threatens criminal sanctions in certain cases.

3. Issuer Regulation Following Public Offer/Listing

H.M. Treasury has set the regulatory framework in this area, delegating, however, detailed rulemaking powers to the FSA. For example, the Treasury has drafted the regulations necessary to implement the Market Abuse Directive in the United Kingdom,[260] but the FSA provides the detailed provisions issuers must eventually follow in the FSA Handbook

256. *See* Tiner, *supra* note 155.

257. *See* Fin. Servs. Authority, About Us, *at* http://www.fsa.gov.uk/Pages/About/Who/index.shtml (last visited Sept. 1, 2007).

258. *See* Andrew Rosling, *FSA Takes Over LSE Responsibility as UK Listing Authority*, 19 INT'L FIN. L. REV. 13, 13 (2000).

259. Prospectus Regulations, 2005, S.I. 2005/1433 (U.K.), *available at* http://www.opsi.gov.uk/si/si2005/uksi_20051433_en.pdf.

260. *See* Financial Services and Markets Act 2000 (Market Abuse) Regulations, 2005, S.I. 2005/381 (U.K.), *available at* http://www.opsi.gov.uk/SI/si2005/20050381.htm.

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(Disclosure Rules).[261] The Treasury has followed a similar pattern with the implementation of the recently completed Transparency Directive.[262] The FSA Handbook also contains significant guidance for the implementation of these rules. The Department of Trade and Industry, responsible for the regulation of companies in the United Kingdom, has designated the Panel on Takeovers and Mergers, an independent industry body, as the supervisory authority to implement certain regulatory functions relating to takeovers pursuant to the Takeover Directive.[263] The primary responsibility of the panel is to issue and administer the City Code on Takeovers and Mergers.[264]

4. Regulation of the Trading Process

This is the single area in U.K. securities regulation where the LSE still maintains significant regulatory powers. In particular, the exchange sets out its own trading and order priority rules and monitors and enforces compliance with these rules.[265] While the central government sets out the framework of market manipulation and insider trading law, the FSA promulgates implementing regulations that provide detailed rules in these areas.[266] Best execution aspects, on the other hand, are set out exclusively by the FSA.[267] As supervision of compliance with the market, market abuse, and best execution regimes requires keeping a close eye on activity

261. Disclosure rules are part of the FSA Handbook. *See* FIN. SERVS. AUTH., FSA HANDBOOK, DISCLOSURE AND TRANSPARENCY RULES (2007), *available at* http://fsahandbook.info/FSA/html/handbook/ DTR/1.

262. The Treasury and FSA undertook parallel procedures to implement the Transparency Directive. For more information about the Treasury's activities, see H.M. Treasury, Transparency Directive, *at* http://www.hm-treasury.gov.uk/consultations_and_legislation/transparency_directive/transparency_directive.cfm (last visited Sept. 1, 2007). *See also* Fin. Servs. Auth., Implementation of the Transparency Directive/Investment Entities Listing Review, *available at* http://www.fsa.gov.uk/Pages/Library/Policy/CP/2006/06_04.shtml (last visited Sept. 1, 2007).

263. In addition, the FSA requires issuers to comply with the Panel, or otherwise disclose noncompliance with its rules. *See* FIN. SERVS. AUTH., FSA HANDBOOK, MARKET CONDUCT 4.3.: SUPPORT OF THE TAKEOVER PANEL'S FUNCTIONS (2007), *available at* http://fsahandbook.info/FSA/html/handbook/MAR/4/3.

264. For more information on the Takeover Panel, see The Takeover Panel, *at* http://www.thetakeoverpanel.org.uk/new/ (last visited Sept. 1, 2007).

265. The rules of the LSE specify procedural steps for effecting transactions in each of its segments, establish membership qualifications, and impose compliance and enforcement measures on its members. *See* LONDON STOCK EXCH., RULES OF THE LONDON STOCK EXCHANGE (2007), *available at* http://www.londonstockexchange.com/NR/rdonlyres/8B4BA38B-9676-4C72-8809-AC16BE1B3D38/0/RuleBook180607v2.pdf.

266. *See* FIN. SERVS. AUTH., FSA HANDBOOK, MARKET CONDUCT 1: THE CODE OF MARKET CONDUCT (2007), *available at* http://fsahandbook.info/FSA/html/handbook/MAR/1.

267. Best execution rules are included in the FSA Handbook. *See* FIN. SERVS. AUTH., FSA HANDBOOK, CONDUCT OF BUSINESS (2007), *available at* http://fsahandbook.info/FSA/html/handbook/COB.

in the trading market, the LSE has the obligation to cooperate closely with the FSA to this end.

5. Regulation of Marketplaces

The regulatory framework for marketplaces constitutes perhaps the clearest example of the noninterventionist approach to regulation that the FSMA seeks to establish and the FSA embodies. Exchanges that seek to operate as regulated markets[268] must obtain an authorization from the FSA, provided that it meets the standards set out in the Recognition Requirements for Investment Exchanges and Clearing Houses Regulations, promulgated by the Treasury.[269] While these Regulations require the FSA, when granting its authorization, to consider specific aspects of an exchange operation, such as the suitability of its management, the adequacy of its financial resources, or the sufficiency of its internal control and governance system, they do not prescribe specific thresholds that an exchange must meet, leaving the task of specifying the standard itself to the FSA. The FSA has addressed these questions through guidance included in its Handbook, again providing wide flexibility to regulated entities, both through careful shaping of individual standards and by virtue of the nonbinding nature of this guidance.[270] To sum up, while the FSA possesses the power to mandate certain measures from the exchanges and the alternative trading systems it regulates, should it wish to do so, it also has the flexibility to strike an individual deal with each marketplace. Despite the uncertainty this framework introduces, the FSA's independence seeks to offer to exchanges and other trading platforms a "level playing field."

6. Supervision of the Financial Intermediation Process

Similar to its regulation of the public offer/listing and trading processes, as well as its regulation of marketplaces, the U.K. regime has ensured that the involvement of the stock exchanges in the supervision of the financial intermediation process is limited to the bare minimum. In essence, the only leeway the stock exchange is allowed refers to its ability

268. The EU Investment Services Directive introdueed the term "regulated market" to identify markets that fulfilled eertain criteria that allowed them to operate cross-border. *See* Council Directive 93/22, art. I, 1993 O.J. (L14) 27 (EC), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31993L0022:EN:HTML (last visited Sept. 1, 2007).

269. *See* Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations, 2001, S.I. 2001 (U.K.), *available at* http://www.hm-treasury.gov.uk/media/C/0/127.pdf.

270. *See* FIN. SERVS. AUTH., FSA HANDBOOK, RECOGNISED INVESTMENT EXCHANGES AND RECOGNISED CLEARING HOUSES (2007), *available at* http://fsahandbook.info/FSA/html/handbook/REC.

to set its own membership requirements;[271] the FSA, however, still has the power to ensure the objectivity of these requirements. In all other material respects, regulatory oversight of the financial intermediation process is at the hands of the FSA. In the context of the statutory instruments it has issued to implement the FSMA, the Treasury has promulgated the Regulated Activities Order, which specifies the activities for which registration as an investment firm is required.[272] While the law sets out general rules on investment firm activities, such as fiduciary duties and conduct of business, FSA guidance allows regulated entities to understand its perspective on what constitutes compliance with the law.[273]

7. Supervision of Clearing and Settlement Functions

The regulatory framework for clearinghouses bears many similarities to the regime governing the operation of exchanges. Thus, the Treasury has promulgated the rules prescribing specific requirements for clearinghouse establishment and setting out ownership restrictions while the task of supervising these entities belongs to the FSA.[274] Establishment of a clearinghouse requires, in addition to FSA authorization, however, the prior approval of the Treasury. Otherwise, the FSA provides some rules and also guidance to assist regulated entities in complying with their obligations, oversees the operation of the clearinghouses, and is mainly responsible for pursuing enforcement actions in case of violations.

E. AUSTRALIA

1. Overview

The most important market infrastructure institutions in Australia are the Australian Stock Exchange ("ASX") and its subsidiaries, the Australian Clearing House and the Australian Settlement and Transfer Corporation. Significant aspects of securities markets regulation remain at the hands of these institutions. The main government body responsible for the regulatory oversight of these institutions and the markets they operate is the Australian Securities and Investments Commission ("ASIC"); other government entities such as the Reserve Bank of Australia ("RBA") and the Department of Treasury, however, also enjoy some powers over

271. *See* RULES OF THE LONDON STOCK EXCHANGE, *supra* note 265, Rs. 1000-1700.

272. *See* Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, S.I. 2001 (U.K.), *available at* http://www.hm-treasury.gov.uk/media/0/E/regulation.pdf.

273. *See* FIN. SERVS. AUTH., FSA HANDBOOK, AUTHORISATION (2007), *available at* http://fsahandbook.info/FSA/html/handbook/AUTH.

274. *See supra* notes 252 and 269.

specialized aspects of the Australian securities markets.[275] Thus, securities regulation in Australia takes place at the federal level.

The defining feature of the Australian regime is the extensive regulatory powers that market infrastructure institutions, and in particular ASX, possess. The bulk of regulatory powers, especially as to rulemaking, but also as to monitoring and enforcement, belong to stock exchanges, and especially ASX. To ensure fair operation of its markets, ASX has placed its operational supervisory functions in a wholly-owned subsidiary, ASX Market Supervision Pty Limited ("ASXSM"), which operates under safeguards of independence.[276] ASXSM monitors compliance with ASX listing requirements, ASX rules as to broker participation in its markets, and ASX clearing and settlement rules.[277] ASX is under an obligation to notify ASIC of its rules. Despite the emphasis Australia places on self-regulation, no industry association participates in its regulatory structure.

ASIC's institutional focus lies in market supervision, and its enforcement efforts are particularly intensive.[278] ASIC's formal rulemaking authority is, at a first glance, quite limited: the agency possesses few direct rulemaking powers, and its involvement consists in overseeing rules promulgated by market infrastructure institutions. Often, it exercises policymaking through issuing guidance in the form of policy papers,[279] or by issuing class orders, an enforcement tool, the scope of which simultaneously extends to a wider number of regulated entities.[280] ASIC's

275. For an overview of the powers of the Treasurer, see ROBERT BAXT ET AL., SECURITIES AND FINANCIAL SERVICES LAW 11 (6th ed. 2003).

276. *See* Australian Sec. Exch., Supervision Subsidiary—ASX Markets Supervision, *at* http://www.asx.com.au/supervision/approach/supervision_subsidiary.htm (last visited Sept. 1, 2007). The head of ASXSM does not report to the CEO of ASX, but instead reports to the Board of ASXSM. *Id.*

277. Following the establishment of ASXSM, ASX decided to cease the operations of another subsidiary it maintained, the ASX Supervisory Review Pty Limited ("ASXSR"). ASXSR embodied a unique experiment among regulatory responses to the conflicts of interest facing self-regulation following the demutualization and listing of ASX in 1998. In contrast to exchange subsidiaries or spin-offs in the United States and Canada, ASXSR did not itself exercise the regulatory powers granted by law to ASX; rather, ASXSR acted as an independent auditor that reviewed ASX's own performance of its regulatory functions. With the transfer of direct regulatory powers to ASXSM, the continued operation of ASXSR was not deemed necessary. *See* Media Release, Australian Sec. Exch., ASX Markets Supervision Assumes Responsibility for ASX Supervisory Review (Oct. 9, 2006), *available at* http://www.asx.com.au/about/pdf/mr20061009_asx_sr.pdf.

278. According to John Coffee, ASIC's enforcement efforts, after adjusting for relative market capitalization, seem to exceed even those of the SEC. *See* Coffee, *supra* note 160, at 48.

279. ASIC states its policy preferences in various documents such as Policy Statements, Practice Notes, and No-action letters. *See* BAXT ET AL., *supra* note 275, at 17.

280. *See* AUSTL. SEC. & INVS. COMM'N, BETTER REGULATION: ASIC INITIATIVES 8–9 (2006), *available at*, http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Better_regulation.pdf/$file/Better_regulation.pdf.

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monitoring and enforcement powers, however, provide it with undoubted leverage in the policymaking arena. For example, in the context of its duty to assess how well a licensed market operator is complying with its obligations as a holder of a markets license, ASIC considers ASX's broader approach to regulation and supervision and suggests methods to improve its performance as a market supervisor.[281] Many changes in ASX's regulatory and supervisory functions result from related ASIC recommendations.[282] In addition, ASIC considers part of its mission to advise the central government on rule changes and report to it on market supervisory arrangements. The central government often follows ASIC's policy suggestions when it has formally retained decision making power. Thus, the analysis of central government powers in the paragraphs below should be read in this light.

2. Authorizing and Supervising the Public Offer Process

Rulemaking powers in this area belong almost exclusively to the central government, although government policy is often formulated through formal or informal ASIC recommendations.[283] ASX maintains some powers to set the requirements to submit a prospectus. ASIC, however, is responsible for authorizing the issuance of a prospectus and reviewing its contents, as well as monitoring issuer compliance with rules regarding the process of promoting securities to the public. In addition to exclusive monitoring powers, ASIC also has exclusive sanctioning powers for violations in this area.

3. Issuer Regulation Following Public Offer/Listing

Rulemaking powers in this area are split between the ASX and the central government. Thus, the stock exchange sets out listing requirements,[284] rules on periodic filings and reports, and disclosure of important developments, while the central government focuses on external audit requirements and the tender offer and merger and acquisition process.[285] Corporate governance rulemaking takes place under a special

281. *See* SEC. & INVS. COMM'N, ANNUAL ASSESSMENT (S794C) REPORT (2005) [hereinafter SIC ANNUAL ASSESSMENT REPORT], *available at* http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASX_report_June_2005.pdf/$file/ASX_report_June_2005.pdf.

282. *See id.* at 8–9.

283. For a quick overview of the requirements for regulated securities offers and the provisions governing each procedural step, see BAXT ET AL., *supra* note 275, at 75.

284. For the ASX Listing Rules, see ASX, *at* http://www.asx.com.au/supervision/rules_guidance/listing_rules1.htm (last visited Sept. 1, 2007).

285. The rules governing takeovers are established in the Corporations Act 2001. *See generally* BAXT ET AL., *supra* note 275, at 210.

institutional structure: ASX has established an informal Corporate Governance Council which put together the "Principles of Good Corporate Governance and Best Practice Recommendations." These principles are not mandatory, but ASX requires issuers to explain any deviations from the Corporate Governance Council's recommendations.[286] The stock exchange is also responsible for monitoring and enforcing the rules it has competence to promulgate. On the other hand, ASIC is entrusted with monitoring and enforcing central government laws on tender offers and mergers and acquisitions.[287]

4. Regulation of the Trading Process

While the central government maintains the lawmaking initiative in this area, stock exchanges are granted wide powers to set rules in many core aspects of market activity, such as market manipulation, order priority, and trading rules. Stock exchanges also bear the main burden of monitoring compliance with these rules;[288] their authority runs parallel to ASIC's supervision of market manipulation rules. Interestingly, stock exchanges have no participation in the insider trading regime: the central government established insider trading laws and has assigned their supervision on administrative agencies exclusively. Similarly, ASIC is also exclusively responsible for enforcing the insider trading regime, while it shares enforcement powers with stock exchanges as to market manipulation. Criminal sanctions are in place for violations of both regimes. In contrast, stock exchanges have the exclusive power to enforce their trading and order priority rules.

5. Regulation of Marketplaces

This sphere of regulatory activity illustrates vividly the strength of the self-regulatory model in Australia. The central government has chosen to set out general requirements for stock exchange licensing and to impose on

286. These institutional arrangements are similar to the arrangement in the United Kingdom, where the FSA has incorporated in the listing rules a requirement for issuers to state whether they comply with the Combined Code on corporate governance issued by the Financial Reporting Council ("FRC"), or otherwise explain any deviations from that code.

287. Australian law has created a separate dispute-resolution body, the Takeovers Panel, to address disputes arising in the takeover process. Its members are appointed by the Governor General of Australia after nomination by the Treasury. For more information about the Takeovers Panel, see Takeovers Panel, About the Panel, *at* http://www.takeovers.gov.au/display.asp?ContentID=6 (last visited Sept. 1, 2007).

288. For an overview of ASX trade manipulation rules, see A.J. BLACK, ROLE OF AUSTRALIAN STOCK EXCHANGE LIMITED (forthcoming 2007) (manuscript at 73,214–216, on file with authors). For an overview of ASX supervisory and enforcement powers in this area, see *id.* (manuscript at 73,284).

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exchange licensees broad obligations, such as maintaining a fair and orderly market and maintaining financial resources to carry out their operations properly. As long as they comply with these obligations, licensees are free to determine almost all other remaining issues under the self-regulatory model.[289] Thus, stock exchanges are responsible for promulgating rules regarding appointment and conduct of stock exchange management and staff or internal organization and control, unrestrained by any requirement to have their rules approved by ASIC. ASIC's decision to license a new stock exchange requires approval by the central government. ASIC's remaining tasks consist of supervising compliance with the marketplace regime and in enforcing these rules (assisted, in some respects, by the market infrastructure institutions themselves).[290]

6. Supervision of the Financial Intermediation Process

Australia follows distinct approaches regarding broker-dealer firms' regulation and regulation of other market professionals, such as security analysts and investment advisers. Rulemaking powers for broker-dealers are divided between the central government, which sets out general licensing and capital adequacy requirements,[291] and the stock exchange, which sets out rules on fiduciary duties, conduct of business, and stock exchange membership.[292] In contrast, rulemaking authority over security analysts, investment advisers and collective investment schemes is held solely by the central government and ASIC. In accordance with the allocation of tasks in rulemaking, stock exchanges maintain monitoring and enforcement functions with respect to broker-dealer firms, operating, however, under ASIC's supervision.[293] ASIC is further responsible for monitoring and enforcing licensing obligations and rules on security analysts, investment advisers, and collective investment schemes.

7. Supervision of Clearing and Settlement Functions

The involvement of the Australian central government in clearing and settlement of equity trades is limited to legislation on Central Securities Depository ("CSD") establishment and ownership requirements. The core issues associated with the clearing and settlement function, such as membership and access to the CSD, CSD operation rules, and exclusivity arrangements, are determined by the stock exchange, which operates the

289. *See* BAXT ET AL., *supra* note 275, at 249, 251–52.
290. For more information, see SIC ANNUAL ASSESSMENT REPORT, *supra* note 281.
291. *See* BAXT ET AL., *supra* note 275, at 345–46.
292. *See* BLACK, *supra* note 288, at 73,103–104.
293. *See* BAXT ET AL., *supra* note 275, at 283.

clearing and settlement facility through a wholly-owned subsidiary.[294] Similarly, the stock exchange is responsible for monitoring and enforcing compliance with these rules. In line with the systemic risk considerations associated with the clearing and settlement function, RBA oversees compliance with CSD establishment requirements, cooperating with ASIC in this regard.

F. HONG KONG

1. Overview

Hong Kong Exchanges & Clearing Ltd. ("HKEx") manages the main market infrastructure institutions in Hong Kong. HKEx operates the Stock Exchange of Hong Kong Limited ("SEHK") and the Hong Kong Futures Exchange Limited, the only stock and derivatives exchanges, and their related clearinghouses Hong Kong Securities Clearing Company Limited ("HKSCC"), HK Clearing Corporation Limited ("HKCC") and the SEHK Options Clearing House Limited ("SEOCH").[295] HKEx is itself a recognized exchange controller under the Securities and Futures Ordinance ("SFO"). The principal government agency responsible for the oversight of Hong Kong's securities and futures markets is the Securities and Futures Commission ("SFC"), an independent statutory body established in 1989.[296]

The main characteristic of the Hong Kong securities regulatory model is the extensive powers vested with HKEx, which constitutes the front line regulator of the Hong Kong market. These powers are evident in two respects. First, the rulemaking process offers a number of important advantages to HKEx over the SFC, and second, the areas that HKEx is principally responsible for regulating—namely, the public offer process, the ongoing requirements for listed companies, and the trading process—constitute the main points of contact between the financial system and

294. *See* ASX, ASX Settlement & the Role of CHESS, *at* http://www.asx.com.au/investor/shares/how/how_settlement_works.htm (last visited Sept. 1, 2007).

295. *See generally* HKEX, HOW TO BECOME A CLEARING PARTICIPANT OF HKFE CLEARING CORPORATION LIMITED (2006), *available at* http://www.hkex.com.hk/expartadm/guide/hkcc.pdf.

296. The statutory instrument that established the SFC in 1989 is the Securities and Futures Commission Ordinance ("SFCO"). The SFCO and nine other securities- and futures-related ordinances were consolidated into the Securities and Futures Ordinance ("SFO"), which came into operation on April 1, 2003. *See* Sec. & Futures Comm'n, Regulatory Objectives, *at* http://www.sfc.hk/sfc/html/EN/aboutsfc/objectives/objectives.html (last visited Sept. 1, 2007). It is worth noting that the Hong Kong Chief Executive may, if satisfied that it is in the public interest to do so, give the Commission written directions as to the furtherance of any of its regulatory objectives or the performance of any of its functions. The SFC is required to comply with Chief Executive-written directions. Securities and Futures Ordinance, (2006) Cap. 571, § 11. (H.K.).

investors. In the rulemaking sphere in particular, HKEx enjoys a general rulemaking authority over issues subject to its competence,[297] constrained only by the requirement to obtain SFC approval for its rules.[298] SFC may use public enforcement powers to require listed companies to comply with HKEx rules. The SFC itself may promulgate its own rules with respect to certain aspects of securities activities, such as admission to listing or requirements for stock exchange membership for financial intermediaries.[299] Our research, however, indicates that SFC has not exercised its powers in this regard, and HKEx rules issued under the exchange's parallel powers continue to govern activity in these areas. Although SFC rules prevail over HKEx rules in the case of a conflict, the SFC must consult with the Financial Secretary and HKEx before finalizing its rule.[300] In addition, the SFC needs to consult with the Financial Secretary before requesting that HKEx itself promulgate a rule on a certain issue.[301] Although the government does not strictly control the HKEx board, because it appoints only six of its twelve directors, it follows developments within HKEx closely and would probably be able to intervene in a decisive manner, if necessary from its perspective.[302]

Hong Kong demutualized the HKEx and passed to the SFO in 2003 in order to offer a cutting-edge technical infrastructure and flexible regulatory environment to local and international investors, hoping to become the leading financial center in Asia. Yet, there are rising concerns that further regulatory reforms may be necessary to enhance the independence of supervisors, improve enforcement quality, and address the conflicts of interest arising from demutualization. Following a series of scandals in Hong Kong's financial services industry, the government commissioned an expert report to assess the overall capital markets framework in Hong Kong.[303] The report expressed concern about the quality of some corporations listing in HKEx, discussed failures among key financial intermediaries that participate in initial public offerings ("IPOs"), and

297. *See* Securities and Futures Ordinance, (2003) Cap. 571, § 23(1)–(2). (H.K.).

298. *See id.* § 24(1).

299. *See id.* § 36(1).

300. *See id.* § 36(2).

301. *See id.* § 23(4).

302. For an overview of HKEx's organizational and corporate governance structure, see HKEx, Corporate Governance Structure Chart, *at* http://www.hkex.com.hk/exchange/cg/CG%20Structure%20Chart.pdf (last visited Sept. 1, 2007).

303. *See* EXPERT GROUP TO REVIEW THE OPERATION OF THE SEC. & FUTURES MKT. REGULATORY STRUCTURE, REPORT BY THE EXPERT GROUP TO REVIEW THE OPERATION OF THE SECURITIES AND FUTURES MARKET REGULATORY STRUCTURE (2003), *available at* http://www.info.gov.hk/info/expert/expertreport-e.htm.

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identified conflicts of interest between HKEx's role as the listing authority and as the main beneficiary of listing fees. The report recommended the creation of a new listing authority in Hong Kong; so far, this recommendation has not materialized.

2. Authorizing and Supervising the Public Offer Process

HKEx regulation dominates access to public financing in Hong Kong, as the exchange possesses significant rulemaking, monitoring, and enforcement powers and is the primary point of contact for prospective issuers.[304] The SFC, however, has recently increased its role in this area through monitoring and enforcement functions. In particular, the 2003 SFO has established a "dual filing" regime, whereby a prospectus filed with HKEx is deemed to have been also filed with the SFC and is subject to its enforcement powers.[305]

3. Issuer Regulation Following Public Offering/Listing

HKEx plays the most important role as to the regulation of listed companies. Through its power to set listing requirements, it has recently taken a number of high-profile initiatives related to listed companies' corporate governance arrangements.[306] Following its dual filing arrangements, SFC's presence in this area has also increased. In addition, SFC administers the Takeovers and Mergers Code and the Share Repurchases Code.[307]

4. Regulation of the Trading Process

HKEx's powers as to regulating the trading process are extensive. HKEx promulgates the rules under which trading takes place and conducts day-to-day surveillance of the market. Thus, brokers who wish to trade in the exchange must obtain, in addition to their SFC license, a special trading

304. For example, the Exchange has the power to authorize a prospectus for registration with the Registrar of Companies. *See* HKEX, RULES GOVERNING THE LISTING OF SECURITIES ON THE STOCK EXCHANGE OF HONG KONG LIMITED, ch. 11A, § 11A.04 (2007), *available at* http://www.hkex.com.hk/rule/listrules/vol1_2.htm.

305. Interestingly, there are currently discussions in Hong Kong about enhancing the SFC's position by transferring some elements of the HKEx's present role to the SFC by codifying provisions into statutes that are currently solely in the listing rules. *See* HKEx Responses to Questionnaire (on file with authors).

306. HKEx's listing rules and guidelines can be found at HKEx, Regulatory Framework and Rules, *at* http://www.hkex.com.hk/rule/index/rulesandguidelines.htm (last visited Sept. 1, 2007).

307. The SFC has established two separate committees, the Takeovers Panel and the Takeovers Appeals Committee, to supervise the takeover and merger process. *See* SEC. & FUTURES COMM'N, CODES ON TAKEOVERS AND MERGERS AND SHARE REPURCHASES (2005), *available at* http://www.sfc.hk/sfcRegulatoryHandbook/EN/displayFileServlet?docno=H396.

right by the exchange and comply with its rules and regulations.[308] As far as enforcement is concerned, HKEx maintains the power to impose sanctions for violation of its rules, but will also refer any wrongdoing to the SFC. Following the transfer of the power to supervise trading participants from HKEx to the SFC,[309] HKEx tends to prefer referring enforcement matters to the SFC rather than imposing sanctions on a unilateral basis. The SFC is mainly responsible for monitoring compliance with rules prohibiting market manipulation and insider trading.[310]

5. Regulation of Marketplaces

While the HKEx maintains significant regulatory powers in many fields, supervision of the exchange itself by SFC has intensified post-demutualization. SFC has the power to revoke the stock exchange's license if it considers that it has failed to comply with its regulatory obligations.[311] The stock exchange still has the power to set its own rules as to internal organization and control, as well as the appointment and conduct of stock exchange management.[312] Government presence, especially in the HKEx management structure, however, is strong. Six out of twelve HKEx board members are appointed directly by the government, and acquiring a shareholding of 5% or higher requires SFC approval.[313] In addition, law has required HKEx to set up a risk management committee to address systemic risk concerns.[314] To avoid conflicts of interest, supervision of HKEx as a publicly listed company has passed to the SFC, which may impose additional conditions to address potential conflicts of interest.[315] Thus, the government has framed the exchange governance structure and set out its systemic stability obligations so as to countenance the wide grant of regulatory powers to the stock exchange.

308. *See* HKEX, PARTICIPANTSHIP AND TRADING RIGHTS GUIDE (2007), *available at* http://www.hkex.com.hk/expartadm/guide/guide.pdf.

309. *See* questionnaire on supervision of the financial intermediation process *infra* Part VI.B.6.

310. Enforcement of market integrity rules is a key responsibility of the SFC. *See* Sec. & Futures Comm'n, About the SFC, Enforcement Division, *at* http://www.sfc.hk/sfc/html/EN/aboutsfc/structure/enforcement/enforcement.html (last visited Sept. 1, 2007).

311. *See* Securities and Futures Ordinance, (2003) Cap. 571, § 28(1), (4)–(6). (H.K.).

312. *See* HKEX, RULES AND REGULATIONS ch. 2, *available at* http://www.hkex.com.hk/rule/exrule/chap-2_eng.pdf.

313. *See* Securities and Futures Ordinance, (2003) Cap. 571, § 61 (H.K.).

314. *See id.* § 65.

315. *See id.* § 74(1), (2).

6. Supervision of the Financial Intermediation Process

As a result of HKEx's demutualization in 2004, the bulk of regulatory powers over the broker-dealer profession passed from HKEx to the SFC.[316] The exchange continues to require that broker-dealers, in addition to their SFC license, obtain a right to trade in its facilities and comply with its rules and regulations. HKEx powers in the broker-dealer sphere include capital adequacy supervision as well as enforcing and implementing broker-dealer fiduciary duties and conduct of business rules.[317]

7. Supervision of Clearing and Settlement Functions

The SFC has obtained the power to regulate establishment of clearing and settlement infrastructure institutions, approve their ownership structure, and oversee their linkage and exclusivity arrangements with stock exchanges.[318] On the other hand, stock exchanges set out, monitor, and enforce rules, such as membership requirements or clearing and settlement process rules, relating to the operation of the clearinghouses.[319]

G. UNITED STATES

1. Overview

The current system of allocation of regulatory powers among administrative agencies and market infrastructure institutions in the United States has survived longer than any other regulatory framework discussed in this study. Although the merits of self-regulation, which underpins the U.S. system, have long been debated in both the academic and the business community, reforms introduced over the years were aimed at mending specific deficiencies of the system rather than causing a complete overhaul.

The Securities Exchange Act of 1934,[320] building upon the surveillance infrastructure stock exchanges had already constructed to supplement their business activities, officially assigned a regulatory role to stock exchanges, granting them powers to regulate both their member firms and the companies they listed. The 1938 Maloney Act completed the self-regulatory scheme of the U.S. markets by granting self-regulatory status to a broker-dealers industry association, renamed the National Association of

316. *See id.* §§ 114–215.

317. *See* HKEX, RULES AND REGULATIONS chs. 3–6 (2007), *available at* http://www.hkex.com.hk/rule/exrule/exrule.htm.

318. *See* Securities and Futures Ordinance, (2003) Cap. 571, § 37–44 (H.K.).

319. *See* HKEx, Rules and Regulations: Clearinghouse Rules, *available at* http://www.hkex.com.hk/rulc/clearinghouserules.htm (last visited Sept. 1, 2007).

320. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–mm (2006).

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Securities Dealers ("NASD").[321] Today, all broker-dealers in the United States are required to be members of an SRO.[322] The government agency responsible for the supervision of these SROs is the U.S. Securities and Exchange Commission ("SEC"). The SEC supervises SROs, seeking to ensure that they adequately perform their regulatory function and that they dedicate the effort and resources necessary to achieve their regulatory objectives. All SRO rules must be approved by the SEC before entering into force, and the SEC has the power to require SROs to amend their rules according to its discretion.[323] In some respects, however, SRO rulemaking powers are wider than the SEC's own.[324]

In contrast with most other jurisdictions,[325] where distinct areas of regulatory oversight fall under SROs' sphere of competence, while other such areas are regulated exclusively by government agencies, the U.S. system is characteristic for the coexistence of SRO and SEC powers throughout, with the exception of public offer regulation. As a result, the SEC appears to have wider powers than almost any other government agency among those discussed here. The SEC, however, often opts to exercise these powers through the SRO surveillance channel, rather than through direct rulemaking or enforcement. In this sense, the precise frontier in the allocation of powers between the agency and market infrastructure institutions is constantly changing, so as to adjust to market developments, SEC policies, and, often, SRO failures.

One of the most important changes in the U.S. self-regulatory structure over the past decade has been the attempts to separate the regulatory aspect of the SROs from such SROs' other functions. The creation of separate regulatory units is best exemplified by the creation of NASD Regulation, Inc. as a separate regulatory division of NASD. This separation was largely the result of regulatory lapses regarding the maintenance of excessively large bid-ask spreads by Nasdaq market-makers. The NASD gradually divested of its shareholding in the Nasdaq stock market,[326] which operates as a national securities exchange since 2006. When the NYSE became a public for-profit company, it also

321. Maloney Act, Pub. L. No. 75-719, 52 Stat. 1070 (1938) (codified as amended at 15 U.S.C. §§ 78–83 (2006)).

322. 15 U.S.C. § 78o (2006).

323. *Id.* § 78s.

324. *See generally* Bus. Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990).

325. Canada is an exception. *See infra* Part V.H.

326. For an overview of the process leading up to the separation of NASD from Nasdaq, see NASDAQ, 2006 ANNUAL REPORT 6 (2006), *available at* http://files.shareholder.com/downloads/NDAQ/166916063x0x91563/1b77ca58-33b4-489b-abc1-018c152e6039/NASDAQ_2006AnnualReport.pdf.

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reorganized its regulatory arm in a separate not-for-profit subsidiary which, although wholly owned by NYSE, is led by a majority-independent board of directors.[327]

In November 2006, NYSE and NASD announced a plan to merge the member regulation, enforcement and arbitration functions of the NYSE with the NASD, creating a new SRO, the Financial Industry Regulatory Authority ("FINRA").[328] In January 2007, the NYSE and the NASD approved the by-laws amendments necessary for the merger;[329] the two SROs requested the SEC's approval for the proposed consolidation in March 2007,[330] and the SEC granted its approval in late July 2007.[331] The new entity is known as FINRA starting from July 30, 2007. Following the merger, FINRA regulates nearly 5100 brokerage firms.[332] According to NYSE and NASD spokespersons, the merger has two main goals: to avoid duplicative and inconsistent regulation, and to reduce regulatory costs. Firms subject to both NASD and NYSE regulation were often required to deal with conflicting rules. Indeed, prior to the decision to merge, the NASD and the NYSE were already cooperating to harmonize their rules and rule interpretations; this process will continue after the merger.[333] Moreover, member firms were often burdened with multiple examinations and other redundant regulatory efforts by overlapping SROs. The merger hopes to reduce these inefficiencies and lower regulatory costs for the securities industry. NASD and NYSE emphasized the double goal of avoiding duplicative regulation and reducing costs in their official submissions to the SEC.[334] Moreover, the merger arrangements provide FINRA with a new internal governance structure, requiring half of

327. *See Consolidation of NASD and the Regulatory Functions of the NYSE: Working Towards Improved Regulation: Hearing Before the Subcomm. on Sec., Ins. and Inv. of the U.S. Senate Comm. on Banking, Housing and Urban Affairs*, 110th Cong. (2007) [hereinafter *Consolidation of NASD*] (testimony of Richard G. Ketchum, CEO, NYSE Regulation, Inc.).

328. *See* Randall Smith & Kara Scannell, *NASD, NYSE Agree to Merge Some Oversight; Supporters Foresee Streamlining in Market Regulation as Foes Fear Less Protection for Individuals*, WALL ST. J., Nov 29, 2006, at C1.

329. *See* News Release, NASD, NASD Member Firms Embrace Streamlined, More Efficient Regulation (Jan. 21, 2007), *available at* http://www.finra.org/PressRoom/NewsReleases/2007News Releases/P018334.

330. *See* Notice of Filing of Proposed Rule Change to Amend the By-laws of NASD, Release No. 34-55495, 72 Fed. Reg. 14,149-01 (Mar. 20, 2007) [hereinafter SEC Notice].

331. *See* Press Release, SEC, SEC Gives Regulatory Approval for NASD and NYSE Consolidation (July 26, 2007), *available at* http://www.sec.gov/news/press/2007/2007-151.htm.

332. *See* FINRA, About the Financial Industry Regulatory Authority, *at* http://www.finra.org/AboutFINRA/CorporateInformation/index.htm (last visited Sept. 1, 2007).

333. *See Consolidation of NASD*, *supra* note 327.

334. *See* SEC Notice, *supra* note 330.

FINRA's board members to be independent from the industry.[335] Increased board independence was a longstanding SEC policy goal for SRO governance and a main reason behind the SEC's support for the merger.[336]

2. Authorizing and Supervising the Public Offer Process

Regulating the distribution of securities to the public to ensure adequate disclosure of information to investors was the hallmark of the Securities Act of 1933. Thus, the presence of the SEC in regulating the primary portion of the securities market is strong. SEC rules determine requirements for, and exemptions from, registration under the Securities Act, and SEC No-action letters often provide guidance to issuers about the implementation of the 1933 Act provisions. Apart from the SEC, the NASD has also promulgated rules that govern the behavior of its members in securities distributions.[337] The SEC is primarily performing monitoring functions in this area, while the NASD is responsible for securing compliance with its rules. On the enforcement side, SEC efforts are complemented by the availability of private enforcement measures, primarily through class actions brought against issuers in courts.

3. Issuer Regulation Following Public Offer/Listing

Traditionally, the SEC focused most of its attention on disclosure requirements for public offerings. It was gradually becoming clear,

335. FINRA's board will ultimately consist of twenty-two members: eleven public governors, who must have no material business relationship with a broker-dealer or an SRO, ten industry governors, and the FINRA chief executive officer. Public governors will be appointed as follows: five by the NYSE, five by the NASD, and one jointly by the NYSE and the NASD. Industry governors will be representing different segments of the industry: three governors will be registered with firms that employ 500 persons or more, one governor will be registered with firms that employ between 499 and 151 persons, and three governors will be registered with firms that employ 150 persons or less. NYSE floor members, independent dealers and insurance affiliates, and investment company affiliates will each elect one governor. *See* Order Approving Proposed Rule Change to Amend the By-laws of NASD, Release No. 34-56145, 72 Fed. Reg. 42,169-01 (July 26, 2007).

336. SEC Commissioner Annette Nazareth stated that an SRO cannot be "dominated" by its members so much that the "regulatory mission suffers;" Mary Schapiro, former NASD chairman, warned member firms that, if the merger proposal does not go through, the securities industry may lose the privilege of self-regulation, such as the accounting industry has. *See* Randall Smith, *NASD's Chief Fights For United Regulators; Critics Challenge the Benefits Of Tie-Up With NYSE Unit; A Q&A Session Gets Heated*, WALL. ST. J., Dec 15, 2006, at C1. Two former SEC Chairmen, William Donaldson and Harvey Pitt, noted that the proposed merger "offers the industry an important, and perhaps its only, opportunity to shape its own future" and that "the SEC can't allow the current self-regulatory system to continue as is." *See* William H. Donaldson & Harvey L. Pitt, *Outdated and Inefficient*, WALL ST. J., Jan. 6, 2007, at A7.

337. NASD, MANUAL: CONDUCT RULES: SECURITIES DISTRIBUTIONS §§ 2710–2790 (2006), *available at* http://nasd.complinet.com/nasd/display/display_display.html?rbid=1189&element_id=1159000530.

however, that the investor protection rationale—one that demanded high quality of disclosures at the public offer stage—persisted. The SEC has increasingly concerned itself with continuous disclosure as well. In establishing the integrated disclosure system,[338] the SEC sought to align requirements at both stages. Moreover, the advent of the Sarbanes-Oxley Act, which raised the regulatory obligations of listed firms in response to Enron and other corporate scandals, especially as to internal audits, officer certifications, and audit committee independence requirements, entailed new rulemaking responsibilities for the SEC. Despite increased SEC responsibilities in this area, SROs have continued to impose additional, and sometimes stricter, disclosure obligations for listed firms. In some respects, SRO powers, especially in relation to corporate governance powers, are wider than SEC powers.[339]

4. Regulation of the Trading Process

SROs and the SEC share rulemaking powers in this area, with each of them taking the lead in different aspects of the trading process. In particular, responsibility for rulemaking on issues related to market abuse falls largely under SEC powers,[340] and SRO-imposed rules in this regard largely reinforce members' obligations to comply with federal laws. On the other hand, responsibility for designing trading models and setting order priority rules rests primarily with the exchanges that are, in principle, free to choose their trading model. By mandating the establishment of a national market system that connects all U.S. marketplaces,[341] however, Congress gave the SEC significant powers to intervene in trading microstructure and to set specific requirements to which all markets need adhere. The extent to which SEC powers in this field may intervene in the operation of the market was evident in the adoption of Regulation NMS, which some criticized as over-intrusive.[342] As a result, direct SEC rulemaking authority

338. The SEC adopted the integrated disclosure system in 1982. On the history of and the rationale behind the adoption of the integrated disclosure system, see generally Edward F. Greene et. al., *Hegemony or Deference: U.S. Disclosure Requirements in International Capital Markets*, 50 BUS. LAW. 413 (1995). *See also* Donald C. Langevoort, *Deconstructing Section 11: Public Offering Liability in a Continuous Disclosure Environment*, LAW & CONTEMP. PROBS., Summer 2000, at 45 (arguing, however, that SEC enforcement of the integrated disclosure system is less stringent than it should be).

339. *See generally* Bus. Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990).

340. The role played by courts in this area should not be underestimated: protection against insider trading has largely sprung out of the courts' interpretation of the SEC's Rule 10b-5.

341. 15 U.S.C. § 78k-1 (2006).

342. These critical voices included SEC Commissioners Cynthia Glassman and Paul Atkins, who dissented to the decision of the majority to adopt the rule. *See* Dissent of Commissioners Cynthia A. Glassman and Paul S. Atkins to the Adoption of Regulation NMS, *at* http://www.sec.gov/rules/final/34-51808-dissent.pdf (last visited Sept. 1, 2007).

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in this area goes deeper than in any other jurisdiction in our study.[343] With regard to enforcement of laws on trading processes, SROs, and exchanges in particular, are the front-line regulators in the United States due to their daily involvement in trading. Similarly, the SEC and the SROs share enforcement responsibilities in this area.

5. Regulation of Marketplaces

SEC powers to regulate the marketplaces constitute one of the foundations of the U.S. system of self-regulation, as these powers provide the SEC with the ability to ensure that SROs perform their tasks adequately and with the necessary leverage over powerful market institutions. Thus, SEC rulemaking powers cover most aspects of the regulation of marketplaces. In addition, the SEC took the initiative to address the concerns raised in connection with the regulatory treatment of alternative trading systems by introducing Regulation ATS in 1998.[344] Still, stock exchanges are responsible for setting rules on and monitoring the appointment and conduct of their management and staff.

6. Supervision of the Financial Intermediation Process

The regulatory framework for the oversight of broker-dealers in the United States illustrates how closely tied SRO powers are to SEC powers. All broker-dealers must be registered with the SEC and be members of an SRO, in most cases the NASD. In addition, broker-dealers are also subject to licensing requirements at the state level. Broker-dealers may also apply for membership to exchanges, which also have rulemaking and disciplinary powers over their member firms. The powers each regulatory body has are often overlapping, and concerns about the costs of duplicative regulation have been repeatedly raised.[345] Despite this overlap, it is natural to expect each regulatory body to focus on different aspects of broker-dealer operation. Thus, the exchanges are more likely to focus on compliance with market-specific trading rules and on technical infrastructure that allows them to communicate with their markets and conduct their trading activities seamlessly. NASD, especially following Nasdaq's spin-off, is more likely to focus on broker-dealer conduct of business and customer treatment rules. Similar patterns follow with regard to monitoring and enforcement powers.

343. It is true that agencies in other jurisdictions also have to approve the trading rules of the exchanges through their power to grant licenses to stock exchanges. Their review, however, is limited to the adequacy of the trading model and does not extend to mandating specific requirements for trading processes.

344. Regulation ATS, 17 C.F.R. § 242.301 (2006).

345. *See supra* text accompanying notes 107–08.

It is worth pointing out that recent years have been marked by large-scale SRO failure to adequately supervise their members' activity. In particular, academic research in the mid-1990s revealed market-wide collusion at Nasdaq, where members were avoiding quotes in odd-eights, thus artificially inflating market-maker spreads.[346] Moreover, the SEC successfully pursued charges against NYSE specialist firms for trading ahead of their clients.[347]

H. CANADA

1. Overview

Contrary to the United States, where securities laws operate at the federal level, Canadian securities regulation remains in the hands of its thirteen provinces and territories. As a result, these separate jurisdictions often differ in their approaches with regard to allocation of powers among market infrastructure institutions and government agencies. All provinces have established government agencies responsible for regulating local securities markets. In most provinces, the structure of the government agency is two-tiered, including an appointed commission and a lower-ranking director supported by the agency staff. To promote cooperation among provinces, local regulators have formed a collective representative body, the Canadian Securities Administrators ("CSA"). To avoid an overly complicated presentation of the position in Canada, we have chosen to focus our research on the regulatory framework in force in the province of Ontario, where the Toronto Stock Exchange ("TSX"), Canada's largest stock exchange, is located. Where regulatory structures apply across Canada, we will indicate this accordingly.

Provincial governments in Canada recognize a number of SROs to which they assign regulatory functions alongside provincial government regulators. The SROs are recognized and overseen in virtually all cases by the provincial or territorial regulators, not by the provincial government itself. In Ontario, SROs that operate marketplaces include TSX and TSX Venture Exchange, a marketplace specializing in smaller and upstart companies. A publicly traded entity, TSX Group Inc., operates both these

346. *See* Christie & Schultz, *supra* note 107.

347. Eventually, specialist firms concluded a settlement with the SEC that reached the unprecedented amount of $240 million. *See* Press Release, SEC, Settlement Reached with Five Specialist Firms for Violating Federal Securities Laws and NYSE Regulations (Mar. 30, 2004), *available at* http://www.sec.gov/news/press/2004-42.htm.

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marketplaces.[348] In addition to marketplaces, the self-regulatory model extends to the broker-dealer industry, where the Investment Dealers Association ("IDA") of Canada is a major national SRO, divided further along provincial districts. Another SRO, the Mutual Fund Dealers Association, also provides supervisory oversight. The provincial securities administrator for Ontario is the Ontario Securities Commission ("OSC").

Similar to the U.S. regulatory model, the participation of SROs in the Canadian regulatory structure is pervasive, with SROs and government agencies retaining powers to regulate the same areas and possessing monitoring and enforcement capacities to ensure adherence to the same rules.[349] There are, however, two major differences between the Canadian and the U.S. regulatory framework. First, the rulemaking powers of the OSC, although wide in scope, are subject to approval of its rules by the Ontario Minister of Finance, thus allowing a direct channel for the provincial government to influence the regulation of securities markets.[350] Second, TSX Group and IDA have formed a joint venture to create an independent nonprofit SRO, Market Regulation Services Inc. (widely abbreviated as "RS"), which can undertake the performance of regulatory duties relating to market supervision on behalf of other SROs, and also regulates trading on marketplaces that are not SROs (that is, alternative trading systems) in return for a fee. From 2002 onward,[351] RS has regulated trading on all Canadian marketplaces for publicly-traded equity securities, including the TSX and TSX Venture Exchange, and CNQ exchange (another small-cap exchange). The IDA regulates fixed income trading, and the Montreal Exchange regulates derivatives trading on its own market. In April 2006, IDA and RS announced plans to merge their operations in the future.

2. Authorizing and Supervising the Public Offer Process

Regulation of the primary securities markets generally falls in the hands of the OSC, which has wide authority to promulgate rules with respect to the distribution process and the disclosures by issuers, subject to the framework set out in provincial government laws. OSC is also

348. For an overview of major steps in TSX's development, see TSX, TSX Group History at a Glance, http://www.tsx.com/en/pdf/TSXHistory.pdf (last visited Aug. 13, 2007).

349. For a detailed comparison between U.S. and Canadian enforcement efforts, see Howell E. Jackson, *Regulatory Intensity in the Regulation of Capital Markets: A Preliminary Comparison of Canadian and U.S. Approaches*, 48 HARV. INT'L L.J. (forthcoming Winter 2007), *available at* http://www.tfmsl.ca/docs/V6(2)%20Jackson.pdf.

350. *See* Securities Act, R.S.O., § 143(1), (2) (2007) (Can.).

351. *See* Market Regulation Services Inc., About RS, *at* http://www.rs.ca/en/about/index.asp?printVersion=no&loc1=about,%20for%20detailed%20information (last visited Sept. 1, 2007).

primarily responsible for reviewing disclosure in the prospectus and ensuring compliance with other rules on the distribution process. In addition to OSC regulation, the TSX also sets rules as to prospectus contents and performs a review of the prospectus if the issuer also seeks a listing there. As a result, enforcement of disclosure obligations takes place through penalties imposed by the OSC and sanctions by the TSX, as well as through private parties' initiatives, such as class actions in courts and individual complaints to the OSC.

3. Issuer Regulation Following Public Offer/Listing

Stock exchanges may set their own listing requirements, some of which are subject to agency approval, and may decide unconstrained on admission of an issuer for listing. In all other respects of postlisting issuer regulation, agency and stock exchange rulemaking, monitoring, and enforcement powers run parallel. Issuer regulation at the postlisting stage was traditionally dominated by stock exchange rules, while government regulators and state corporate laws maintained a less pronounced role. Following the Enron collapse and the other high-profile corporate scandals of the early 2000s, government agencies undertook a number of initiatives with regard to listed firms' corporate governance. As a result, the scope of their direct powers in this area is now wider. Stock exchanges, however, continue to maintain an important role in regulating the takeover and merger and acquisition processes, in conjunction with state corporate law requirements. Monitoring and enforcement authorities are divided among exchanges and the OSC along the lines suggested above, while the availability of private enforcement channels in this area is another characteristic of the Canadian regulatory framework.

4. Regulation of the Trading Process

The main focus of government rulemaking, supervision, and enforcement powers in this area is market abuse. Thus, OSC rules and the rules administered and enforced by RS in relation to public equity marketplaces govern issues such as insider trading or market manipulation. On the other hand, stock exchanges are primarily responsible for designing their own trading models and setting rules on order priority, while their own rules on market abuse are supplementary to those of the agency. The task of monitoring the market, both to protect investors against abusive practices and to ensure compliance with stock exchange trading rules, belongs to the stock exchanges as market operators and is delegated to RS. RS also monitors trading on alternative trading systems. RS has the power to impose sanctions and to refer violations of provincial securities laws to

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the OSC, although the OSC may also undertake investigations on its own initiative. Following the adoption of laws turning insider trading into a criminal offense, enforcement powers for such violations rest solely with the OSC and federal authorities. Criminal jurisdiction is now shared with the Royal Canadian Mounted Police as a result of recent amendments to the federal Criminal Code adding insider trading and tipping as criminal offenses.

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VI. APPENDIX B: SAMPLE QUESTIONNAIRE

THE REGULATION AND GOVERNANCE OF MARKET INFRASTRUCTURE INSTITUTIONS

QUESTIONNAIRE

A. INTRODUCTION

This questionnaire is part of a large research project being undertaken on the governance of market infrastructure institutions (exchanges, central-counterparties and central securities depositories). It explores how regulatory powers are allocated between governmental and nongovernmental bodies in securities and other financial markets.

The questionnaire and its analysis are being undertaken by Professor Howell E. Jackson, Andreas Fleckner, and Stavros Gadinis of Harvard Law School. Please address any questions you may have to Professor Howell E. Jackson at hjackson@law.harvard.edu.

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B. ALLOCATION OF POWERS AMONG MARKET INFRASTRUCTURE INSTITUTIONS

This section of the questionnaire seeks to examine how regulatory powers are allocated between governmental and nongovernmental bodies for seven broad areas in the securities markets:

1. Overview of Regulatory Structure;
2. Authorizing and Supervising the Public Offer Process;
3. Issuer Regulation Following Public Offer/Listing;
4. Regulation of the Trading Process;
5. Regulation of Marketplaces;
6. Supervision of the Financial Intermediation Process; and
7. Supervision of Clearing and Settlement.

For each of these areas, the questionnaire seeks to explore:

a. the allocation of rulemaking powers;
b. the allocation of licensing-authorizing and monitoring powers;
c. the sources and intensity of enforcement activity within the last three years; and
d. some general questions.

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Specific instructions as to how to fill in the tables that follow are included in the respective sections. If anything is unclear, however, please contact us.

Please identify yourself, your institution, and the type of your institution.

Name:	Institution:

Type of Institution:	
Stock Exchange	
Derivatives Exchange	
Central Counter Party	
Central Securities Depository	
Other:	

1. Overview of Institutional Framework in Your Jurisdiction

Please fill in the table below by indicating, in the boxes provided, the name and legal type of institutions that are allocated any regulatory powers (either rulemaking, licensing, monitoring-authorizing or cnforcement) in the respective fields in your jurisdiction (for example, for the U.S. SEC, you would indicate: "Securities and Exchange Commission—Independent Administrative Agency" in the "Administrative Agency" box). Please list all institutions that have any degree of regulatory power over the respective fields. If you are not clear as to which institutional pattern in the horizontal axis of the questionnaire corresponds to your jurisdiction, please feel free to check "Other" and specify further in the General Comments section. Questions about the precise scope of regulatory power and enforcement activities of these institutions appear below.

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	Authorizing and Supervising the Public Offer Process	Issuer Regulation Following Public Offer/Listing	Regulation of the Trading Process	Regulation of Marketplaces	Supervision of the Financial Intermediation Process	Supervision of Clearing and Settlement
Administrative Agency (State or Federal)						
Central Government (e.g. Ministry)						
Provincial Government (e.g. State Ministry)						
Stock Exchange (including stock exchange operating bodies or companies)						
Industry Association (only if accorded formal powers)						
Other						

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2. Authorizing and Supervising the Public Offer Process

In the tables below, the institutions to which powers may be allocated are on the horizontal axis, and the functions regulated are on the vertical axis. Please put an "X" in the box that corresponds to the institution entrusted with each of the powers specified in the vertical axis.

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a. Rulemaking Authority

	Central Government-Legislator	Provincial Government-Legislator	Administrative Agency (no Government Approval)	Administrative Agency with Government Approval	Stock Exchange (no Agency Approval)	Stock Exchange with Agency Approval	Industry Association	Other (please specify)
Requirement to Submit a Prospectus / Registration Statement								
Prospectus / Registration Statement Contents								
Process of Promoting Securities to the Public								
Misstatement Liability								

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b. Authorizing and Monitoring Authority

	Central Government	Provincial Government	Administrative Agency (no Government Approval)	Administrative Agency with Government Approval	Stock Exchange (no Agency Approval)	Stock Exchange with Agency Approval	Industry Association	Other (please specify)
Issue of Prospectus / Registration Statement								
Prospectus / Registration Statement Contents								
Process of Promoting Securities to the Public								

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c. Enforcement

Please assess the intensity of enforcement efforts actually occurring in your jurisdiction in the area of authorizing and supervising the public offer process in the last three years, taking into account considerations such as frequency of enforcement actions, severity of penalties actually imposed, and effectiveness of the overall enforcement scheme. Under the "Intensity" column, please put a grade from "0" to "5" ("0" corresponding to a situation where, to the best of your knowledge, no enforcement action has been taken in the last three years, and "5" corresponding to very intense enforcement). Please fill in the remaining columns regarding allocation of enforcement jurisdiction among market infrastructure institutions by putting an "X" in the appropriate box for any form of public or private enforcement which could be used to impose monetary or nonmonetary sanctions for violations of law in your jurisdiction. Please indicate the existence of enforcement jurisdiction, even if no enforcement actions were brought in the past three years.

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	Intensity (0-5)	PUBLIC ENFORCEMENT				PRIVATE ENFORCEMENT				Other
		Administrative Agency Sanctions	Stock Exchange Sanctions	Industry Association Sanctions	Criminal Sanctions	Arbitration	Individual Complaints to Agencies	Individual Complaints to Courts	Class Actions in Courts	
Prospectus/Registration Statement Contents										
Process of Promoting Securities to the Public										
Misstatement Liability										

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d. General Comments on Authorizing and Supervising the Public Offer Process

In your view, what are the main difficulties associated with the pattern of allocation of powers with regard to authorizing and supervising the public offer process? Are there areas where overlapping powers among regulatory institutions have led to confusic.; or have otherwise affected regulatory outcomes?
Plcase comment briefly on any recent changes and/or historical trends associated with the pattern of allocation of powers set out above.

3. Issuer Regulation Following Public Offer/Listing

In the tables below, the institutions to which powers may be allocated are on the horizontal axis, and the functions regulated are on the vertical axis. Please put an "X" in the box that corresponds to the institution entrusted with each of the powers specified in the vertical axis.

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a. Rulemaking Authority

	Central Government-Legislator	Provincial Government-Legislator	Administrative Agency (no Government Approval)	Administrative Agency with Government Approval	Stock Exchange (no Agency Approval)	Stock Exchange with Agency Approval	Industry Association	Other (please specify)
Listing Requirements								
Periodic Filings and Reports								
Ad hoc Disclosure of Important Developments								
External Auditors Requirements								
Corporate Governance Requirements for Listed Issuers								
Tender Offer Prospectus								
Tender Offer Process								
Mandatory Bid Requirements								
M&A Prospectus or other Circular to Shareholders (apart from Tender Offer)								
M&A Process								

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b. Authorizing and Monitoring Authority

	Central Government	Provincial Government	Administrative Agency (no Government Approval)	Administrative Agency with Government Approval	Stock Exchange (no Agency Approval)	Stock Exchange with Agency Approval	Industry Association	Other (please specify)
Admission to Listing								
Periodic Filings and Reports								
Ad hoc Disclosure of Important Developments								
External Auditors Requirements								
Corporate Governance Requirements for Listed Issuers								
Tender Offer Prospectus								
Tender Offer Process								
Mandatory Bid Requirements								
Prospectus or other Circular to Sharcholders for other M&A (apart from Tender Offer)								
M&A Process								

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c. Enforcement

Please assess the intensity of enforcement efforts actually occurring in your jurisdiction in the area of issuer regulation following public offer/listing in the last three years, taking into account considerations such as frequency of enforcement actions, severity of penalties actually imposed, and effectiveness of the overall enforcement scheme. Under the "Intensity" column, please put a grade from "0" to "5" ("0" corresponding to a situation where, to the best of your knowledge, no enforcement action has been taken in the last three years, and "5" corresponding to very intense enforcement). Please fill in the remaining columns regarding allocation of enforcement jurisdiction among market infrastructure institutions by putting an "X" in the appropriate box for any form of public or private enforcement which could be used to impose monetary or nonmonetary sanctions for violations of law in your jurisdiction. Please indicate the existence of enforcement jurisdiction, even if no enforcement actions were brought in the past three years.

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	Intensity	PUBLIC ENFORCEMENT				PRIVATE ENFORCEMENT				Other
	(0-5)	Administrative Agency Sanctions	Stock Exchange Sanctions	Industry Association Sanctions	Criminal Sanctions	Arbitration	Individual Complaints to Agencies	Individual Complaints to Courts	Class Actions in Courts	
Compliance with Listing Requirements										
Periodic Filings and Reports										
Ad hoc Disclosure of Important Developments										
External Auditors Requirements										
Corporate Governance Requirements for Listed Issuers										
Tender Offer Prospectus										
Tender Offer Process										
Mandatory Bid Requirements										
Prospectus or other Circular to Shareholders for other M&A (apart from Tender Offer)										
M&A Process										
Misstatement Liability										

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d. General Comments on Issuer Regulation following Public Offer/Listing

In your view, what are the main difficulties associated with the pattern of allocation of powers with regard to issuer regulation following public offer/listing? Are there areas where overlapping powers among regulatory institutions have led to confusion or have otherwise affected regulatory outcomes?
Please comment briefly on any recent changes and/or historical trends associated with the pattern of allocation of powers set out above.

4. Regulation of the Trading Process

a. Rulemaking Authority

	Central Government-Legislator	Provincial Government-Legislator	Administrative Agency (no Government Approval)	Administrative Agency with Government Approval	Stock Exchange (no Agency Approval)	Stock Exchange with Agency Approval	Industry Association	Other (please specify)
Market Manipulation Rules								
Insider Trading Rules								
Stock Exchange Trading Model Rules								
Order Priority Rules								
Best Execution Requirements								

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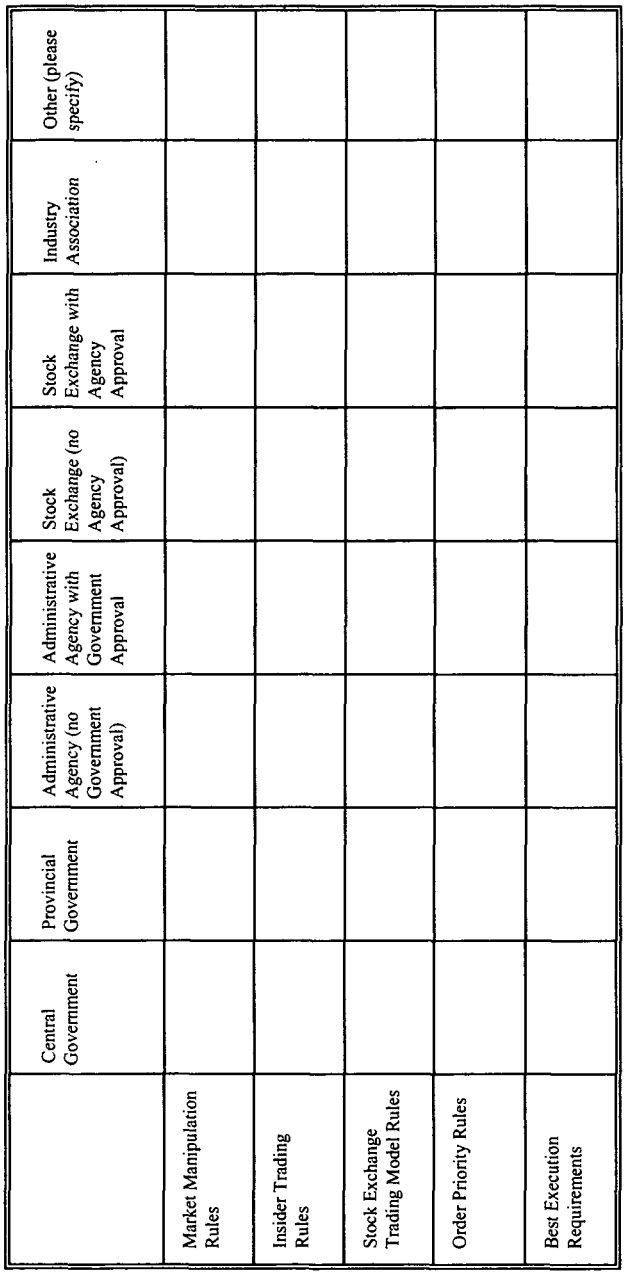
b. Monitoring Authority



	Central Government	Provincial Government	Administrative Agency (no Government Approval)	Administrative Agency with Government Approval	Stock Exchange (no Agency Approval)	Stock Exchange with Agency Approval	Industry Association	Other (please specify)
Market Manipulation Rules								
Insider Trading Rules								
Stock Exchange Trading Model Rules								
Order Priority Rules								
Best Execution Requirements								

c. Enforcement

Please assess the intensity of enforcement efforts actually occurring in your jurisdiction in the area of trading process regulation in the last three years, taking into account considerations such as frequency of enforcement actions, severity of penalties actually imposed, and effectiveness of the overall enforcement scheme. Under the "Intensity" column, please put a grade from "0" to "5" ("0" corresponding to a situation where, to the best of your knowledge, no enforcement action has been taken in the last three years, and "5" corresponding to very intense enforcement). Please fill in the remaining columns regarding allocation of enforcement jurisdiction among market infrastructure institutions by putting an "X" in the appropriate box for any form of public or private enforcement which could be used to impose monetary or nonmonetary sanctions for violations of law in your jurisdiction. Please indicate the existenee of enforcement jurisdiction, even if no enforcement actions were brought in the past three years.

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	Intensity	PUBLIC ENFORCEMENT					PRIVATE ENFORCEMENT				Other
	(0-5)	Administrative Agency Sanctions	Stock Exchange Sanctions	Industry Association Sanctions	Criminal Sanctions	Arbitration	Individual Complaints to Agencies	Individual Complaints to Courts	Class Actions in Courts		
Market Manipulation Rules											
Insider Trading Rules											
Stock Exchange Trading Model Rules											
Order Priority Rules											
Best Execution Requirements											

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d. General Comments on Regulation of the Trading Process

In your view, what are the main difficulties associated with the pattern of allocation of powers with regard to regulation of the trading process? Are there areas where overlapping powers among regulatory institutions have led to confusion or have otherwise affected regulatory outcomes?
Please comment briefly on any recent changes and/or historical trends associated with the pattern of allocation of powers set out above.

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5. Regulation of Marketplaces

a. Rulemaking Authority

	Central Government -Legislator	Provincial Government -Legislator	Administrative Agency (no Government Approval)	Administrative Agency with Government Approval	Stock Exchange (no Agency Approval)	Stock Exchange with Agency Approval	Industry Association	Other (please specify)
Stock Exchange Requirements								
Stock Exchange Trading Rules								
Appointment and Conduct of Stock Exchange Management								
Appointment and Conduct of Stock Exchange Staff								
Stock Exchange Internal Organization and Control Rules								
Stock Exchange Ownership Restrictions								
Alternative Trading System Establishment Requirements								
Alternative Trading System Trading Rules								
Alternative Trading System Aeeess Rules								
Alternative Trading System Internal Organization and Control Rules								
OTC Market Rules								

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b. Authorizing and Monitoring Authority

	Central Government	Provincial Government	Administrative Agency (no Government Approval)	Administrative Agency with Government Approval	Stock Exchange (no Agency Approval)	Stock Exchange with Agency Approval	Industry Association	Other (please specify)
Stock Exchange Requirements								
Stock Exchange Trading Rules								
Conduct of Stock Exchange Management								
Conduct of Stock Exchange Staff								
Stock Exchange Internal Organization and Control Rules								
Stock Exchange Ownership Restrictions								
Alternative Trading System Establishment (if different from Stock Exchange or Broker/Dealer)								
Alternative Trading System Trading Rules								
Alternative Trading System Access Rules								
Alternative Trading System Internal Organization and Control Rules								
OTC Market Rules								

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c. Enforcement

Please assess the intensity of enforcement efforts actually occurring in your jurisdiction in the area of marketplace regulation in the last three years, taking into account considerations such as frequency of enforcement actions, severity of penalties actually imposed, and effectiveness of the overall enforcement scheme. Under the "Intensity" column, please put a grade from "0" to "5" ("0" corresponding to a situation where, to the best of your knowledge, no enforcement action has been taken in the last three years, and "5" corresponding to very intense enforcement). Please fill in the remaining columns regarding allocation of enforcement jurisdiction among market infrastructure institutions by putting an "X" in the appropriate box for any form of public or private enforcement which could be used to impose monetary or nonmonetary sanctions for violations of law in your jurisdiction. Please indicate the existence of enforcement jurisdiction, even if no enforcement actions were brought in the past three years.

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	Intensity	PUBLIC ENFORCEMENT				PRIVATE ENFORCEMENT			Other
	(0-5)	Administrative Agency Sanctions	Stock Exchange Sanctions	Industry Association Sanctions	Criminal Sanctions	Arbitration	Individual Complaints to Agencies	Individual Complaints to Courts	Class Actions in Courts	
Stock Exchange License Suspension / Revocation										
Stock Exchange Trading										
Conduct of Stock Exchange Management										
Conduct of Stock Exchange Staff										
Stock Exchange Internal Organization and Control Rules										
Stock Exchange Ownership Restrictions										
Alternative Trading System (if not a Broker/Dealer or Stock Exchange)										
Alternative Trading System Trading Rules										
Alternative Trading System Access Rules										
Alternative Trading System Internal Organization										

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d. General Comments on Regulation of Marketplaces

In your view, what are the main difficulties associated with the pattern of allocation of powers with regard to regulation of marketplaces? Are there areas where overlapping powers among regulatory institutions have led to confusion or have otherwise affected regulatory outcomes?
Please comment briefly on any recent changes and/or historical trends associated with the pattern of allocation of powers set out above.

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6. Supervision of the Financial Intermediation Process

a. Rulemaking Authority

	Central Government -Legislator	Provincial Government -Legislator	Administrative Agency (no Government Approval)	Administrative Agency with Government Approval	Stock Exchange (no Agency Approval)	Stock Exchange with Agency Approval	Industry Association	Other (please specify)
Broker/Dealers *Establishment*								
Credit Institutions' Provision of Equity Trading Services								
Broker/Dealers Fiduciary Duties and Conduct of Business								
Broker/Dealers Capital Adequacy								
Stock Exchange Membership								
Securities Analysts								
Investment Advisers Establishment and Licensing/Registration								
Investment Advisors Fiduciary Duties and Conduct of Business								
Collective Investment Schemes Establishment								
Collection Investment Schemes Conduct of Business								

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b. Licensing, Authorizing, and Monitoring Authority

	Central Government -Legislator	Provincial Government -Legislator	Administrative Agency (no Government Approval)	Administrative Agency with Government Approval	Stock Exchange (no Agency Approval)	Stock Exchange with Agency Approval	Industry Association	Other (please specify)
Broker/Dealers Licensing								
Credit Institutions' Provision of Equity Trading Services								
Broker/Dealers Fiduciary Duties and Conduct of Business								
Broker/Dealers Capital Adequacy								
Stock Exchange Membership								
Securities Analysts								
Investment Advisers Establishment and Licensing/Registration								
Investment Advisors Fiduciary Duties and Conduct of Business								
Collective Investment Schemes Licensing and Establishment								
Collection Investment Schemes Conduct of Business								

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c. Enforcement

Please assess the intensity of enforcement efforts in your jurisdiction in the area of supervising the financial intermediation process in the last three years, taking into account considerations such as frequency of enforcement actions, severity of penalties actually imposed, and effectiveness of the overall enforcement scheme. In the "Intensity" column, please put a grade from "0" to "5" in the same manner as above. Please fill in the other columns regarding allocation of enforcement jurisdiction among market infrastructure institutions by putting an "X" in the appropriate box for any form of public or private enforcement which could be used to impose monetary or nonmonetary sanctions for violations of law in your jurisdiction. Please indicate the existence of enforcement jurisdiction, even if no enforcement actions have been brought.

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	Intensity	PUBLIC ENFORCEMENT				PRIVATE ENFORCEMENT				Other
	(0-5)	Administrative Agency Sanctions	Stock Exchange Sanctions	Industry Association Sanctions	Criminal Sanctions	Arbitration	Individual Complaints to Agencies	Individual Complaints to Courts	Class Actions in Courts	
Broker/Dealer License Suspension or Revocation										
Credit Institutions' Provision of Equity Trading Services										
Broker/Dealers Fiduciary Duties and Conduct of Business										
Broker/Dealers Capital Adequacy										
Stock Exchange Membership										
Securities Analysts										
Investment Advisers Establishment Licensing/Registration										
Investment Advisers Fiduciary Duties and Conduct of Business										
Collective Investment Schemes License Suspension / Revocation										
Collective Investment Schemes Conduct of Business										
Broker/Dealer License Suspension or Revocation										

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d. General Comments on Supervision of the Financial Intermediation Process

In your view, what are the main difficulties associated with the pattern of allocation of powers with regard to supervision of the financial intermediation process? Are there areas where overlapping powers among regulatory institutions have led to confusion or have otherwise affected regulatory outcomes?
Please comment briefly on any recent changes and/or historical trends associated with the pattern of allocation of powers set out above.

7. Supervision of Clearing and Settlement Functions

a. Rulemaking Authority

	Central Government-Legislator	Provincial Government-Legislator	Administrative Agency (no Government	Administrative Agency with Government	Stock Exchange (no Agency	Stock Exchange with Agency	Industry Association	Other (please specify)
Clearing House – Central Securities Depository (CSD) Establishment								
Clearing House – CSD Ownership Restrictions								
Clearing House – CSD Membership and Access								
Clearing House – CSD Operation Rules								
Exclusivity Arrangements for Clearing House – CSD Services to Local Stock Exchange								

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b. Licensing, Authorizing, and Monitoring Authority

	Central Government-Legislator	Provincial Government-Legislator	Administrative Agency (no Government Approval)	Administrative Agency with Government Approval	Stock Exchange (no Agency Approval)	Stock Exchange with Agency Approval	Industry Association	Other (please specify)
Clearing House – Central Securities Depository (CSD) Establishment								
Clearing House – CSD Ownership Restrictions								
Clearing House – CSD Membership and Access								
Clearing House – CSD Operation Rules								
Exclusivity Arrangements for Clearing House – CSD Services to Local Stock Exchange								

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c. Enforcement

Please assess thc intensity of enforcement efforts occurring in your jurisdiction in the area of supervision of clearing and settlement functions in the last three years, taking into account considerations such as frequency of enforcement actions, severity of penalties actually imposed, and effectiveness of the overall enforcement scheme. Under the "Intensity" column, please put a grade from "0" to "5" ("0" corresponding to a situation where, to the best of your knowledge, no enforcement action has been taken in the last three years, and "5" corresponding to very intense enforcement). Please fill in the remaining columns regarding allocation of enforcement jurisdiction among market infrastructure institutions by putting an "X" in the appropriate box for any form of public or private enforcement which could be used to impose monetary or nonmonetary sanctions for violations of law in your jurisdiction. Please indicate the existence of enforcement jurisdiction, even if no enforcement actions were brought.

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	Intensity	PUBLIC ENFORCEMENT					PRIVATE ENFORCEMENT				Other
	(0-5)	Administr-ative Agency Sanctions	Stock Exchange Sanctions	Industry Association Sanctions	Criminal Sanctions	Arbitration	Individual Complaints to Agencies	Individual Complaints to Courts	Class Actions in Courts	
Clearing House – CSD Licensing										
Clearing House – CSD Ownership Restrictions										
Clearing House – CSD Membership and Access										
Clearing House – CSD Operation Failures										
Exclusivity Arrangements for Clearing House – CSD Services to Local Stock Exchanges										

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d. General Comments on Supervision of Clearing and Settlement Functions

In your view, what are the main difficulties associated with the pattern of allocation of powers with regard to supervision of clearing and settlement functions? Are there areas where overlapping powers among regulatory institutions have led to confusion or have otherwise affected regulatory outcomes?
Please comment briefly on any recent changes and/or historical trends associated with the pattern of allocation of powers set out above.