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**Cover Page Footnote**
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# The Convergence of Securities Laws and Implications for Developing Securities Markets

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## I. Introduction

Securities markets have become increasingly globalized in recent years.[1] Investors, particularly institutional investors, are diversifying on an international basis and using new techniques for hedging and arbitrage in international markets.[2] The scope for this diversification is increasing with newly developing securities markets in countries such as Russia and China. Other countries, such as Vietnam, hope to develop securities markets to attract foreign capital, thereby encouraging economic development.

These developments have led to concerns about the differences in securities laws among various countries. This has resulted in pressure to harmonize securities laws, or at least to make them compatible.[3] In spite of these concerns there is, at least at a general level, a substantial degree of similarity in the securities laws of many countries. It becomes apparent upon a perusal of securities regulation in different countries that securities laws are

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[1] The amount of internationalization is documented extensively. *See, e.g.*, Joseph A. Grundfest, *Internationalization of the World's Securities Markets: Economic Causes and Regulatory Consequences*, 4 J. FIN. SERVICES RES. 349 (1990); Kellye Y. Testy, *Comity and Cooperation: Securities Regulation in a Global Marketplace*, 45 ALA. L. REV. 927 (1994); Josh Futterman, Note, *Evasion and Flowback in the Regulation S Era: Strengthening U.S. Investor Protection While Promoting U.S. Corporate Offshore Offerings*, 18 FORDHAM INT'L L.J. 806 (1995); Harvey Lazar et al., *Global Competition and Canadian Federalism: The Financial Sector*, 20 CAN. BUS. L.J. 1 (1992) (summarizing the effects of internationalization on the Canadian securities market).

[2] *See, e.g.*, Grundfest, *supra* note 1, at 361-64.

[3] The globalization of securities markets has been a factor in the development of the International Organization of Securities Organizations (IOSCO). *See* David Zaring, *International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations*, 33 TEX. INT'L L.J. 281, 283 (1998). The globalization of securities markets may have been a factor in the harmonization of insider trading laws through, for instance, the European Insider Trading Directive of 1989. *See* 1989 O.J. (L 334) 30. It may have also been a factor in the reciprocal recognition of securities laws such as in the Canadian Securities Administrators National Policy Statement and corresponding SEC rules in Securities Exchange Act. *See* Canadian Securities Administrator National Policy Statement No. 45, National Policy Statements ¶ 470-045 (July 1, 1991, amended through Dec. 31, 1993); Securities Exchange Act Release No. 6902, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,812 (June 21, 1991).

often copied, at least in form, if not verbatim.[4] It also appears that the copying comes from a limited number of sources.[5]

Why do different countries promulgate similar securities laws? Why does the copying appear to be from a very limited number of sources? What influences the source of borrowing? Why do significant differences in the details remain? Answers to these questions may inform the strategies to be adopted in formulating securities laws for newly developing securities markets.

In response to these questions, this Article notes reasons for the convergence of securities laws and factors that may contribute to differences in securities regulations. It then considers some of the implications these factors may have on strategies to be adopted in formulating securities laws for newly developing securities markets. Part II briefly notes general similarities of securities laws in different countries as well as the presence of differences in the specific details.[6] Part III sets out some reasons for the tendency towards convergence and notes factors that contribute to remaining differences.[7] Part IV discusses some implications for devising laws in newly developing securities markets.[8]

## II. The Convergence of Securities Laws

There is a substantial degree of similarity in the securities laws of different jurisdictions. Securities laws typically have mandatory disclosure requirements on the distribution of securities to the public.[9] They also typically have ongoing mandatory disclosure requirements to provide information in support of the post-distribution trading of securities.[10] Insider trading and market

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[4] *See infra* notes 9-24 and accompanying text.

[5] *See infra* notes 15-24 and accompanying text.

[6] *See infra* notes 9-29 and accompanying text.

[7] *See infra* notes 30-93 and accompanying text.

[8] *See infra* note 94 and accompanying text.

[9] *See, e.g.*, Scott D. Cohen, Comment, *Survey of Registration and Disclosure Requirements in International Securities Markets*, 9 MICH. Y.B. INT'L LEGAL STUD. 243 (1988).

[10] Such requirements include disclosure of financial statements, proxy circulars, insider trading reports, and ongoing reporting of significant events concerning the issuer. *See, e.g.*, MARK R. GILLEN, SECURITIES REGULATION IN CANADA 147-71 (1992);

manipulation techniques are usually prohibited in some manner.[11] Takeover bids are usually subject to rules governing the manner in which bids are made, the period over which bids must be kept open, and the information that must be provided to offeree shareholders.[12] Securities market services are usually subject to record keeping requirements, duties to clients, minimum competency standards, and minimum capital requirements that are enforced, in part, through licensing requirements.[13] In many

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*see also* THOMAS LEE HAZEN, 1 TREATISE ON THE LAW OF SECURITIES REGULATION §§ 9.2-9.3, at 514-24 (3d ed. 1995) (discussing mandatory disclosure requirements in the United States). In Malaysia, see the Companies Act, Act 125 of 1965, § 165 (Golden's Federal Statutes (Laws of Malaysia) 1996); Companies Act, Act 125 of 1965, sched. 8 (Golden's Federal Statutes (Laws of Malaysia) 1996). In Singapore, see the Companies Act, Act 42 of 1967, ch. 50, § 197 (1988 ed., revised ed. 1990); Companies Act, Act 42 of 1967, ch. 50, sched. 8 (1988 ed., revised ed. 1990). In the case of Japan, see, e.g., Ken Tsunematsu & Shuji Yanase, *Japan*, in 3(2) INTERNATIONAL SECURITIES REGULATION 1, at 50-58 (Robert C. Rosen ed., 1997).

[11] *See, e.g.*, Helen Lee, *An International Perspective on Market Manipulation, in* THE REGULATION OF FINANCIAL AND CAPITAL MARKETS 201, 201-04 (1992); *see also, e.g.*, Mary J. Houle, Comment, *Survey of National Legislation Regulating Insider Trading*, 9 MICH. Y.B. INT'L LEGAL STUD. 209 (1988) (surveying insider trading regulations in various countries).

[12] *See, e.g.*, GILLEN, *supra* note 10, at 312-21; 2 HAZEN, *supra* note 10, §§ 11.10 and 11.14, at 266-73, 290-99. In Japan, see the Securities and Exchange Law, Law No. 25 of 1948, art. 27-2 to 27-12 (as amended through Apr. 1, 1995) (*in* Tsunematsu & Yanase, *supra* note 10, 48-58) and the Japanese Takeover Ordinance. In Singapore, see the Companies Act, Act 42 of 1967, ch. 50, §§ 213 and 214 (1988 ed., revised ed. 1990); Companies Act, Act 42 of 1967, sched. 10 (1988 ed., revised ed. 1990); Code on Take-Overs and Mergers. In Malaysia, see the Securities Commission Act, Act 498 of 1993, § 33-33E (Golden's Federal Statutes (Laws of Malaysia) 1996). Both the Malaysian and Singaporean Codes on Take-Overs are virtually identical to the London City Code on Take-Overs and Mergers. The Panel on Take-Overs and Mergers, which administers the London City Code on Take-Overs and Mergers, was created in 1968 by the London Stock Exchange, the Bank of England, and other British financial institutions "to deal with perceived abuses in corporate takeovers." Deborah A. DeMott, *Comparative Dimensions of Takeover Regulation*, 65 WASH. U. L.Q. 69, 71 (1987). Although the broad thrusts of these takeover regulations are similar, there are, of course, considerable variations in detail. *See infra* note 28 and accompanying text.

[13] *See, e.g.*, GILLEN, *supra* note 10, at 368-90; 2 HAZEN, *supra* note 10, §§ 10.2, 10.2.2-10.2.3, 10.6-10.7, at 10-27, 33-47, 91-102. *See generally* Malaysian Securities Industry Act, Act 280 of 1983 (Golden's Federal Statutes (Laws of Malaysia) 1996) (promulgating security market services regulations); Singaporean Securities Industry Act, Act 15 of 1986, ch. 289 (1986) (concerning the licensing of dealers, advisors and fund managers, while subjecting licensees to requirements such as record keeping and minimum capital requirements).

countries, there has also been a gradual shift towards a greater degree of public regulation.[14]

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[14] In the United Kingdom, the United States, and Canada, securities trading, at one time, was largely regulated by stock exchanges against the backdrop of the common law of contract. *See, e.g.*, ARTHUR P. POLEY & F.H. CARRUTHERS GOULD, THE HISTORY, LAW, AND PRACTICE OF THE STOCK EXCHANGE (1907); RUDOLPH E. MELSHEIMER & WALTER LAURENCE, THE LAW AND CUSTOMS OF THE LONDON STOCK EXCHANGE (1879) (discussing the law relating to stock exchanges). Stock exchanges and trading in company shares existed in the United States and Canada long before the adoption of specific securities laws. There is evidence of organized securities trading in the United States as early as 1792. *See* FRANCIS L. EAMES, THE NEW YORK STOCK EXCHANGE 13-17 (1968). In addition, there was the so-called "curb market" in New York City where securities could be traded at least as early as the 1870s, and which served as the precursor to the American Stock Exchange. *See* ROBERT SOBEL, AMEX: A HISTORY OF THE AMERICAN STOCK EXCHANGE, 1921-1971 xiii-xxi, 1-21 (1972). The first statute directly regulating securities sales in the United States was a Kansas statute, adopted in 1911. *See* 1911 Kan. Sess. Laws 133. The first major federal statutes to regulate securities sales in the United States were the Securities Act of 1933 and the Securities Exchange Act of 1934. In Canada, the Toronto Stock Exchange was first established in 1852 "as an association of businessmen who met in each other's office for approximately one half-hour each day to exchange holdings of securities." G.V. SAWIAK, THE TORONTO STOCK EXCHANGE: A PROCEDURAL GUIDE FOR COMPANIES AND THEIR PROFESSIONAL ADVISERS 1 (1986). The exchange was incorporated in 1878. *See id.* The first Canadian statute directly regulating the sale of securities was the Manitoba Sale of Shares Act of 1912, which was modeled on the Kansas statute. *See* Sale of Shares Act, ch. 75, 1912 M. Gaz. (Can.). Stock exchanges regulated securities issuers through listing agreements and regulated brokers through membership rules. *See, e.g.*, R.H. CODE HOLLAND & JOHN N. WERRY, POLEY'S LAW AND PRACTICE OF THE STOCK EXCHANGE 38-58, 89-113, 135-43, 153-56, 345-53, 409-18 (1932). Issuers agreed to requirements for the quotation of securities. *See id.* at 419-23. Brokers complied with membership rules for the right to execute trades through the exchange. *See id.* at 343-53.

Although early forms of regulation made use of administrators, they did not require the same types of administrative agencies that have been promulgated by modern securities legislation. For instance, instead of creating a securities commission or agency, the Manitoba Sale of Shares Act required a license for the sale of shares from the Public Utility Commission. *See* Sale of Shares Act, ch. 75, § 2, 1912 M. Gaz. (Can.). The first securities commission in Canada was created in Ontario in 1945 under the Ontario Securities Act, ch. 22, 1945 S.O. (Can.). In the United States, the federal Securities Exchange Commission (SEC) came into existence with the passage of the Securities Exchange Act of 1934. *See* 15 U.S.C. § 78d (West 1998).

While securities trading has been going on in Malaysia and Singapore since around the turn of the century, *see* TAN PHENG THENG, SECURITIES REGULATION IN SINGAPORE AND MALAYSIA: A PRIMER ON THE LAWS OF THE STOCK MARKET WITH CASES AND MATERIALS 1-3 (1978), Malaysia has only very recently created a securities commission, *see* Securities Commission Act, Act 498 of 1993, § 3 (Golden's Federal Statutes (Laws of Malaysia) 1996) and Singapore has yet to do so. Until the creation of

In many cases there are more than just similarities in the securities laws. Often securities regulations are clearly borrowed. For example, aspects of Malaysian and Singaporean securities laws dealing with both disclosure and continuous disclosure requirements were borrowed from the Australian uniform companies acts,[15] which were similar in many respects to the

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a securities commission in Malaysia, such matters as the vetting of prospectuses and administrative decisions with respect to takeovers were handled by a Capital Issues Committee (See the Securities Industry Act, Act 280 of 1983, §§ 5-6 (Golden's Federal Statutes (Laws of Malaysia) 1996), prior to their repeal by the Securities Commission Act, Act 498 of 1993, § 45 (Golden's Federal Statutes (Laws of Malaysia) 1996) and a Panel on Take-Overs and Mergers (See the Companies Act, Act 125 of 1965, § 179 (Golden's Federal Statutes (Laws of Malaysia) 1996), prior to its repeal by the Securities Commission Act, Act 498 of 1993, § 45 (Golden's Federal Statutes (Laws of Malaysia) 1996)) which were both part of the Kuala Lumpur Stock Exchange. See the Rules of Kuala Lumpur Stock Exchange prior to the enactment of the Securities Commission Act of 1993.

[15] *See* H.A.J. FORD, PRINCIPLES OF COMPANY LAW 15 (4th ed. 1986). The Australian uniform companies acts, containing virtually identical provisions, were enacted in 1961 and 1962. *See* New South Wales Companies Act, 1961, 10 Eliz. 2, No. 71, §§ 37-47, §§ 76-89 (Austl.); Victoria Companies Act, 1961, 10 Eliz. 2, No. 6839, §§ 37-47, §§ 76-89 (Austl.); South Australia Companies Act, 1962, No. 56, §§ 37-47, §§ 76-89 (Austl.); Queensland Companies Act, 1961, 10 Eliz. 2, No. 55, §§ 37-47, §§ 76-89 (Austl.); Western Australia Companies Act, 1961, 10 Eliz. 2, No. 82, §§ 37-47, §§ 76-89 (Austl.); Tasmania Companies Act, 1962, No. 66, §§ 37-47, §§ 76-89 (Austl.).

For example, the provision dealing with civil liability for misrepresentations in a prospectus in the Western Australia Companies Act (and in the identically worded provisions in the other Australian companies acts cited above) is as follows:

> Subject to this section, each of the following persons is liable to pay compensation to all persons who subscribe for or purchase any shares or debentures on the faith of a prospectus for any loss or damage sustained by reason of any untrue statement therein, or by reason of the wilful non-disclosure therein of any matter of which he had knowledge and which he knew to be material, that is to say every person who-
>
> (a) is a director of the corporation at the time of the issue of the prospectus;
>
> (b) authorised or caused himself to be named and is named in the prospectus as a director or as having agreed to become a director either immediately or after an interval of time;
>
> (c) is a promoter of the corporation; or
>
> (d) authorised or caused the issue of the prospectus.

Companies Act, 1961, 10 Eliz. 2, No. 82, § 46(1) (Austl.). The corresponding provision in the Malaysian Companies Act 1965 reads:

> Subject to this section, each of the following persons shall be liable to pay compensation to all persons who subscribe for or purchase any shares or debentures

United Kingdom's Companies Act 1948.[16] The Malaysian Securities Industry Act 1983[17] and the Singapore Securities

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> on the faith of a prospectus for any loss or damage sustained by reason of any untrue statement therein, or by reason of the wilful non-disclosure therein of any matter of which he had knowledge and which he knew to be material, that is to say every person who-
>
> (a) is a director of the corporation at the time of the issue of the prospectus;
>
> (b) authorized or caused himself to be named and is named in the prospectus as a director or as having agreed to become a director either immediately or after an interval of time;
>
> (c) is a promoter of the corporation; or
>
> (d) authorized or caused the issue of the prospectus.

Companies Act, Act 125 of 1965, § 46(1) (Golden's Federal Statutes (Laws of Malaysia) 1996); *see also* the Singaporean Companies Act, Act 42 of 1967, ch. 50, § 55(1) (1988 ed., revised ed. 1990) (containing a civil liability provision for misrepresentations in a prospectus which is a copy of the corresponding provision in the Malaysian statute).

16 1948, 11 & 12 Geo. 6, ch. 38 (Eng.); *see generally* FORD, *supra* note 15, at 13-15 (discussing the history of the Australian company laws). *Compare* Companies Act, 1948, 11 & 12 Geo. 6, ch. 38, §§ 37-46 (Eng.), *with* Western Australia Companies Act, 1961, 10 Eliz. 2, No. 82, §§ 37-47 (Austl.), *and* Tasmania Companies Act, 1962, No. 66, §§ 37-47. The provisions are generally similar. The provision on civil liability for misrepresentations in a prospectus is based on the U.K. Directors' Liability Act, 1890, 53 & 54 Vict., ch. 64 (Eng.), which, in the 1948 U.K. Companies Act, reads as follows:

> Subject to the provisions of this section, where a prospectus invites persons to subscribe for shares in or debentures of a company, the following persons shall be liable to pay compensation to all persons who subscribe for any shares or debentures on the faith of the prospectus for the loss or damage they may have sustained by reason of any untrue statement included therein, that is to say-
>
> (a) every person who is a director of the company at the time of the issue of the prospectus;
>
> (b) every person who has authorised himself to be named and is named in the prospectus as a director or as having agreed to become a director either immediately or after an interval of time;
>
> (c) every person being a promoter of the company; and
>
> (d) every person who has authorised the issue of the prospectus: . . . .

Companies Act, 1948, 11 & 12 Geo. 6, ch. 38, § 43(1) (Eng.). Compare this with the corresponding provisions in the Companies Act, 1961, 10 Eliz. 2, No. 82, § 46(1) (Austl.) and the Malaysian Companies Act, Act 125 of 1965, § 46(1) (Golden's Federal Statutes (Laws of Malaysia) 1996). Also, compare these provisions to Section 11 of the U.S. Securities Act of 1933 (codified as 15 U.S.C. § 77k(a) (West 1998)).

17 Securities Industry Act, Act 280 of 1983 (Golden's Federal Statutes (Laws of Malaysia) 1996).

Industry Act[18] are also very similar to corresponding Australian laws.[19] The takeover bid provisions in Malaysia and Singapore are based primarily on the London City Code on Takeovers and Mergers.[20] In addition, Rule 10b-5 in the United States has been copied in both Singapore and Malaysia.[21]

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[18] Securities Industry Act, Act 15 of 1986, ch. 289 (1986).

[19] *Compare* Malaysian Securities Industry Act, Act 280 of 1983 (Golden's Federal Statutes (Laws of Malaysia) 1996), *and* Singaporean Securities Industry Act, Act 15 of 1986, ch. 289 (1986), *with* New South Wales Securities Industry Act, 1975, No. 3 (Austl.), *and* Commonwealth Corporations Act, 1989, No. 109, ch. 7 (Eng.). Certain amendments to Australian securities industry acts have been adopted in subsequent amendments to Singaporean and Malaysian securities industry acts. *See, e.g.*, Khaw Lake Tee, *The Securities Industry Act 1983*, 11 J. MALAYS. COMP. L. 93 (1984).

Singaporean legislation on the regulation of the securities industry and market manipulation was developed at the same time similar legislation was being developed in Australia. Discussions were held between Singapore and Australian state authorities who were facing similar concerns about their respective securities markets. Singapore delayed passage of its legislation in order to coordinate its introduction with almost identically worded Malaysian legislation. *See* TAN PHENG THENG, *supra* note 14, at 31-33. Although the general thrust of these securities acts was similar to that of the U.S. Securities Exchange Act of 1934, the approach in Singapore and Malaysia at the time was to avoid the creation of a commission similar to the SEC and to rely more heavily on a self-regulatory approach to the securities industry. *See id.*

[20] *See* DeMott, *supra* note 12.

[21] U.S. Rule 10b-5 provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of any mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

17 C.F.R. § 240 (West 1998).

The corresponding provisions in the Malaysian Securities Industry Act provide that:

> It shall be unlawful for any person directly or indirectly in connection with the purchase or sale of any securities -
>
> (a) to use any device, scheme or artifice to defraud;
>
> (b) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person; or

Japan is another example of borrowed securities laws. The occupation forces in Japan permitted the reopening of Japanese stock exchanges after World War II when Japan adopted securities laws modeled on the U.S. Securities Act of 1933 and the Securities Exchange Act of 1934.[22] Japanese securities laws include an insider short-swing profit rule similar to that contained in § 16 of the U.S. Securities Exchange Act of 1934,[23] and an anti-fraud rule which is clearly based on U.S. Rule 10b-5.[24]

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> (c) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made in the light of the circumstances under which they were made, not misleading.

Malaysian Securities Industry Act, Act 280 of 1983, § 87A (Golden's Federal Statutes (Laws of Malaysia) 1996); *see also* Singaporean Securities Industry Act, Act 15 of 1986, ch. 289, § 102 (1986) (promulgating a similar restriction on fraudulent transfers of securities).

22 *See* Shen-Shin Lu, *Are the 1988 Amendments to Japanese Securities Regulation Law Effective Deterrents to Insider Trading?*, 1991 COLUM. BUS. L. REV. 179, 181.

23 The Japanese Securities and Exchange Law provides that:

> For the purpose of preventing the unfair use of secret information of a listed corporation, etc. which may have been obtained by an officer or principal shareholder of such corporation by reason of his office or position in the corporation, if such person realizes any profit by a purchase within six months after sale, or sale within six months after purchase, on his own account, of specified securities, etc. of the corporation, the corporation may required him to tender such profit to the corporation.

Securities and Exchange Law, Law No. 25 of 1948, art. 164 (as amended through Apr. 1, 1995) (*in* Tsunematsu & Yanase, *supra* note 10, 138). Section 16(b) of the U.S. Securities Exchange Act of 1934 provides that:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months.

15 U.S.C. § 78p(b) (West 1998); *see also* Lu, *supra* note 22, at 185 (discussing how the Securities Exchange Act of 1934 served as a model for corresponding Japanese legislation).

24 The Japanese Securities and Exchange Law states that:

> No person shall commit any act set forth in the following Items:

In spite of similarities between the securities laws of different countries, differences of varying degrees of significance remain. For instance, although a prospectus requirement and other forms of mandatory disclosure are common, the specific information that must be disclosed varies in terms of the type, quantity, and form.[25] In many countries, the regulation of insider trading is a much more recent phenomenon than it has been in other countries.[26] In some

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(1) To employ any fraudulent device, scheme or artifice with respect to buying, selling or other transactions of securities or with respect to securities index futures tradings, etc., securities options tradings, etc. or foreign market securities futures tradings, etc.;

(2) To obtain money or other property by using documents or any other representation which contains an untrue statement of a material fact or omits to state a material fact necessary to make the statements therein not misleading with respect to buying, selling or other transactions of securities or with respect to securities index futures tradings, etc., securities options tradings, etc. or foreign market securities futures tradings, etc.; and

(3) To make use of any false quotation for the purpose of soliciting buying, selling or other transactions of securities or securities index futures tradings, etc., securities options tradings, etc. or foreign market securities futures tradings, etc.

Securities and Exchange Law, Law No. 25 of 1948, art. 157 (as amended through Apr. 1, 1995) (*in* Tsunematsu & Yanase, *supra* note 10, at 134). Compare this to U.S. Rule 10b-5. *See supra* note 21. Although Japan has formally borrowed Rule 10b-5, its application in Japan has been different from its use in the United States. For instance, though Rule 10b-5 has been used widely in insider trading cases in the United States, it has never been used in an insider trading case in Japan. *See* Lu, *supra* note 22, at 185-86; Winifred Swan, *The 1988 Japanese Insider Trading Amendments: Will Japan See Results From These Tougher Laws?*, 12 U. PA. J. INT'L BUS. L. 275, 276-77 (1991).

[25] *Compare* R.R.O. Reg. 1015 (1990), *amended by* O. Reg. 638, 1993, § 1 (Can.) (containing Ontario Form 12 in the area of prospectuses for industrial issuers), *with* 17 C.F.R. § 239.11 (West 1998) (describing Form S-1). *Compare* R.R.O. Reg. 1015, (1990), *amended by* O. Reg. 638, 1993, § 1 (Can.), *and* 17 C.F.R. § 239.11, *with* Malaysian Companies Act, Act 125 of 1965, sched. 5 (Golden's Federal Statutes (Laws of Malaysia) 1996), *and* Singaporean Companies Act, Act 42 of 1967, ch. 50, sched. 5 (1988 ed., revised ed. 1990).

[26] A European Community directive in 1989 led to the introduction of insider trading laws in several European countries. *See* 1989 O.J. (L 334) 30. In Germany, this type of legislation was not adopted until 1994. *See* Georg F. Thoma & Jonathan S. Berck, *Germany*, *in* INSIDER TRADING: THE LAWS OF EUROPE, THE UNITED STATES AND JAPAN 79 (Emmanuel Gaillard ed., 1992) (discussing insider trading in Germany prior to 1994); *see also* Tony Hickinbotham & Christoph Vaupel, *Germany*, *in* INTERNATIONAL INSIDER DEALING 129 (Mark Stamp & Carson Welsh eds., 1996) (concerning the regulation of insider trading after 1994).

countries, short selling is prohibited, while in others it is allowed.[27] Takeover bid rules, while similar in many respects, have significant variations in takeover bid periods, withdrawal right periods, and the kind of information that must be disclosed.[28] While similar techniques are typically used to regulate securities market participants, the specific requirements can vary considerably.[29]

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[27] *See* Malaysian Securities Industry Act, Act 280 of 1983, § 41 (Golden's Federal Statutes (Laws of Malaysia) 1996 (as amended Mar. 19, 1998). This section has its origins in very similarly worded provisions of the Australian uniform securities acts (New South Wales Securities Industry Act, 1975, No. 3, § 54 (Austl.); Victoria Securities Industry Act, 1975, No. 8788, § 54 (Austl.); Queensland Securities Industry Act, 1975, No. 78, § 54; Western Australia Securities Industry Act, 1975, No. 99, § 54 (Austl.)), which were carried forward into the uniform federal Corporations Act. *See* Corporations Act, 1989, Act 109, § 846 (Austl.). An early version of a short selling provision appeared in the Queensland Securities Industry Act of 1971, although that section only required that the seller disclose to the dealer that he or she had no currently exercisable interest in a security that he or she proposed to sell. *See* Queensland Securities Industry Act, 1971, No. 2, § 41 (Austl.). Curiously, Singapore has no short selling restriction even though the Singapore Securities Industry Act was drafted in conjunction with and drew extensively from Australian securities industry acts.

Section 41(1) of the Malaysian Securities Industry Act provides:

> Subject to this section and any regulations that may be made, a person shall not sell securities unless, at the time when he sells them-
>
> (a) he has or, where he is selling as agent, his principal has; or
>
> (b) he believes on reasonable grounds that he has, or where he is selling as agent, his principal has,
>
> a presently exercisable and unconditional right to vest the securities in a purchaser of the securities.

Securities Industry Act, Act 280 of 1983, § 41(1) (Golden's Federal Statutes (Laws of Malaysia) 1996) (as amended Mar. 19, 1998). Section 846(1) of the Australian federal Corporations Act reads as follows:

> Subject to this section and the regulations, a person shall not sell eligible securities to a buyer unless, at the time of the sale:
>
> (a) the person has or, where the person is selling as agent, the person's principal has; or
>
> (b) the person believes on reasonable grounds that the person has, or where the person is selling as agent, the person's principal has;
>
> a presently exercisable and unconditional right to vest the securities in the buyer.

Corporations Act, 1989, Act 109, § 846(1) (Austl.).

[28] *See, e.g.*, DeMott, *supra* note 12, at 84-116.

[29] *See supra* note 13 and accompanying text.

## III. Reasons for Similarities and Differences in Securities Laws

This Part notes various reasons for similarities in securities laws and factors contributing to differences in securities laws. Subpart A notes reasons for similarities while subpart B highlights factors contributing to those differences.

### *A. Why Are There Similarities in Securities Laws?*

There may be many reasons for similarities in securities laws. Perhaps the laws move towards similar solutions because these are the only practical solutions. Perhaps similar interest groups arise in securities markets wherever they develop, resulting in political pressures that lead to similar laws. The similarities may be the result of competitive pressures associated with attracting investment capital. Such competition may have become more pronounced because of the increasing internationalization of securities markets.[30] Other factors that may cause securities laws to converge are pressures from American regulators to have U.S. style securities laws adopted in other countries, the geographical proximity of countries, the sharing of a common language, or close business or educational contacts. The important roles played by particular persons in the development of securities laws may also be a factor. Similarities in securities laws could also develop because of simple coincidences that lead to the following of one country's laws over those of another. These factors are briefly noted below.

#### *1. Convergence Towards Optimal Solutions*

Securities laws may have a tendency to converge because securities markets develop similar problems for which there are optimal solutions towards which markets gravitate. Each jurisdiction thus works its way to these optimal solutions as their securities markets develop. While the details of the laws may differ from one jurisdiction to another, the broad thrust of the laws will be similar. For instance, mandatory disclosure may be the

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[30] *See supra* note 1 (noting the amount of internationalization and the effects therefrom).

best solution to problems of asymmetrical information and potential frauds on the public distribution of securities,[31] or it may provide a more comparable standard of disclosure that might not be produced in the private market.[32]

Such inevitable solutions are, at best, only part of an explanation for the similarities in securities laws. First, doubt has been expressed as to whether the solutions securities laws typically provide are in the public interest. For instance, it has been suggested that the costs of mandatory disclosure may outweigh the benefits,[33] and the evidence on the effect of mandatory disclosure suggests that it brought little, if any, benefit.[34] The benefit of regulating insider trading or takeover bids has also been questioned.[35] There is empirical evidence suggesting that takeover bids that result in net gains in wealth are not wholly due to pure wealth transfers,[36] and that takeover bid regulation deters these

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[31] *See infra* notes 54-58 and accompanying text.

[32] *See infra* note 59 and accompanying text.

[33] *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 707-14 (1984).

[34] *See, e.g.*, George J. Stigler, *Public Regulation of Securities Markets*, 37 J. BUS. L. 117 (1964); Gregg A. Jarrell, *The Economic Effects of Federal Regulation of the Market for New Security Issues*, 24 J.L. & ECON. 613 (1981); Carol J. Simon, *The Effects of the 1933 Securities Act on Investor Information and the Performance of New Issues*, 79 AM. ECON. REV. 295 (1989); George J. Benston, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934*, 63 AM. ECON. REV. 132 (1973) (discussing tests of the effects of the U.S. Securities Act of 1933 and the U.S. Securities Exchange Act of 1934).

35 *See, e.g.*, HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET (1966); Henry G. Manne, *Insider Trading and the Law Professors*, 23 VAND. L. REV. 547 (1970); Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857 (1983); Daniel R. Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 Tex. L. Rev. 1 (1978); Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Alan Schwartz, *Search Theory and the Tender Offer Auction*, 2 J.L. ECON. & ORG. 229 (1986) (regarding takeover bid regulation).

[36] This has generally been the conclusion of reviews of the considerable empirical literature on the effects of takeovers. *See, e.g.*, Gregg A. Jarrell et al., *The Market for Corporate Control: The Empirical Evidence Since 1980*, 2(1) J. ECON. PERSP. 49, 54-58, 66 (1988); Roberta Romano, *A Guide to Takeovers: Theory, Evidence and Regulation*, 9 YALE J. ON REG. 119, 122-55 (1992) (finding evidence in support of value

socially beneficial takeovers.[37]

Second, there are conceivable alternatives to the types of securities laws that are most prevalent. The concern for asymmetrical information and potential frauds, for instance, has been addressed in a variety of ways at different times. Initially, there was very little of what one would recognize as modern day securities regulation.[38] Markets and implicit market forces served to limit the extent of the problem.[39] The early response in England was to expand the scope of civil sanctions for misrepresentations by issuers.[40] Another approach has been to provide a mechanism to facilitate the investigation of frauds backed up by civil, administrative or penal sanctions.[41] Yet another approach has been to require the disclosure of certain information to a private or public administrative body that will assess the merits of investment in the securities and will only allow the distribution if investment in the securities met some minimum quality standard.[42]

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maximizing explanations for takeovers and only weak evidence of non-value maximizing explanations of takeovers that cannot fully account for the overall gains from takeovers); Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control: the Scientific Evidence*, 11 J. FIN. ECON. 5, 23-27 (1983).

[37] *See* Jarrell, *supra* note 36, at 53-54; Romano, *supra* note 36, at 155-60; Jensen & Ruback, *supra* note 36, at 28-29; *see also, e.g.*, Fischel, *supra* note 35; Easterbrook & Fischel, *supra* note 35; Schwartz, *supra* note 35 (arguing that takeover bid regulation does in fact deter beneficial takeovers).

[38] *See supra* note 14 (noting that the trading of securities pre-dated by many years the development of modern-day securities regulation).

[39] Reliance on market forces to deal with problems of assymetrical information may be a reasonable approach given the evidence on the effectiveness of mandatory disclosure and arguments on the cost of mandatory disclosure relative to its benefits. *See supra* notes 33-34 and accompanying text (presenting a cost benefit analysis of mandatory disclosure). Reliance on market forces may also be a reasonable approach to insider trading and takeover bid regulation given the doubts that have been raised with respect to the benefits of insider trading regulation and takeover bid regulation. *See supra* notes 35-37 and accompanying text (noting the presence of empirical evidence suggesting that takeover bid regulation may not be beneficial).

[40] *See, e.g.*, Directors' Liability Act, 1890, 53 & 54 Vict., ch. 64 (Eng.).

[41] *See, e.g.*, The Securities Fraud Prevention Act, ch. 34, 1928 S.O. (Can.).

[42] This was the approach of early state "blue sky" legislation in the United States, first enacted in the state of Kansas. *See* 1911 Kan. Sess. Laws 133. This legislation was later adopted in several states and in other jurisdictions. For a review of the development of state blue sky laws, see Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347 (1991); *see also* the Sale of Shares Act, ch.

Some scholars argue that many aspects of securities regulation served the particular rent-seeking interests of various participants in securities markets[43] or responded to the bureaucratic pressures present in securities regulatory organizations.[44] In responding to such interests and pressures, various aspects of securities regulation may not, in fact, be consistent with the broader public interest.

Thus, while similarities in securities regulation can be explained, in part, as a gradual movement towards optimal solutions to common problems, other factors may also play an important role in the convergence of securities laws. Given the plausible alternatives to the most prevalent types of securities laws, it's not clear that the most common types of securities regulations are optimal. Further, securities laws arguably serve interests other than a broad public interest.

### 2. *Political Pressures Leading to Similar Securities Laws*

An alternative explanation for the convergence of securities laws is that similar political pressures may exist in different

75, 1912 M. Gaz. (Can.) (promulgating a blue sky law in the province of Manitoba).

[43] On public choice theories, see, e.g., SUSAN M. PHILLIPS & J. RICHARD ZECHER, THE SEC AND THE PUBLIC INTEREST (1981) (arguing that the securities laws in the United States amount to a substantial subsidy to securities analysts and institutional investors); Henry G. Manne, *Economic Aspects of Required Disclosure Under Federal Securities Laws*, *in* WALL STREET IN TRANSITION, at 21 (Henry G. Manne & Ezra Solomon eds., 1974) (arguing that securities regulation in the United States worked to the advantage of larger issuers of securities by imposing much more substantial burdens on smaller issuers than on larger issuers); Macey & Miller, *supra* note 42 (arguing that smaller local banks, local industries, and farmers lobbied for state blue sky regulation at the expense of large Wall Street banks, investment banking firms, and major issuers of securities in manufacturing, railroad, and public utility companies); David D. Haddock & Jonathan R. Macey, *Regulation on Demand: A Private Interest Model, with an Application to Insider Trading Regulation*, 30 J.L. & ECON. 311 (1987) (arguing the interests of professional traders and insiders coalesced to bring about the particular pattern of insider trading regulation).

[44] *See, e.g.*, Donald C. Langevoort, *The SEC as a Bureaucracy: Public Choice, Institutional Rhetoric, and the Process of Policy Formulation*, 47 WASH. & LEE L. REV. 527 (1990) (arguing that goals of individuals in the SEC influence its institutional behavior and create a tendency towards complex and arcane regulation); Nicholas Wolfson, *A Critique of the Securities and Exchange Commission*, 30 EMORY L.J. 119 (1981) (noting the influences on SEC staff that encourage a continuing expansion of federal securities regulation).

countries where securities markets develop.[45] First, similar political pressures may arise in different jurisdictions quite independently of competitive pressures that evolve in securities markets due to international competition. Second, competition for capital in international securities markets may also affect the shape of domestic securities laws. Third, foreign interests may attempt to influence domestic securities laws to protect economic rents in existing markets against competition and to secure similar economic rents in the host jurisdiction.

*(a) Similarities in Developing Securities Markets Leading to Similar Political Pressures*

Similar political pressures may arise due to common features in the development of securities markets that lead to similar interest groups applying political pressure in search of economic rents.

*(i) Similar Securities Market Participants*

Forms of organization involving multiple investors are likely to develop in response to economic pressures to capture economies of scale by producing on a large scale or otherwise to engage in enterprises that require very large capital outlays. The benefits of liquidity tend to encourage forms of investment that can be freely traded.[46] An industry with expertise in the trading of these investments is likely to develop.[47] Consequently, many different countries are likely to end up with securities markets that have broadly similar structural characteristics. There will be promoters, investors, brokers, dealers, underwriters, portfolio managers, and investment advisers. To manage risk, capture the benefits of

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[45] *See supra* notes 43-44 and accompanying text (discussing public choice theories of securities regulation). These explanations of securities regulation might apply in other countries if similar political pressures exist in those countries.

[46] On the benefits of limited liability in the form of increased liquidity, see, e.g., Paul Halpern et al., *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. TORONTO L.J. 117 (1980); Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability in the Corporation*, 52 U. CHI. L. REV. 89 (1985).

[47] Stories of the development of stock exchanges and other markets are often quite similar. *See, e.g.*, FERNAND BRAUDEL, 2 CIVILIZATION AND CAPITALISM, 15TH-18TH CENTURY: THE WHEELS OF COMMERCE 97-114 (1982).

diversification, and connect providers of funds with users of funds, various forms of financial intermediation will likely develop.[48] Exchanges are likely to be formed as brokers find that they can increase their business by facilitating trading through an exchange.[49] Accountants, who become involved as issuers of securities, attempt to signal the quality of their investments to investors by calling upon other accountants to put their reputational capital at stake in lending their seals of approval to the issuer's financial statements.[50] Other experts may be called upon in a similar fashion to put their reputations at stake in approving the claims made by issuers of securities.[51] Lawyers will become involved both in developing the contractual framework within which securities trading takes place and in the process of settling the legal disputes that frequent securities trades are bound to create.

*(ii) Common Investor Protection Interests*

These various market participants may have a common interest in protecting investors. Investor protection that increases the expected values of securities encourages capital formation through the issuance of securities, thereby increasing business for

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[48] *See, e.g.*, H.H. BINHAMMER, MONEY, BANKING AND THE CANADIAN FINANCIAL SYSTEM 99-103 (5th ed. 1988) (describing the services that financial intermediaries provide); TAN CHWEE HUAT, FINANCIAL MARKETS AND INSTITUTIONS IN SINGAPORE 23-170 (7th ed. 1992) (describing financial institutions in Singapore that provide financial intermediation services).

[49] Stock exchanges often developed when brokers met in a given place and inquired whether their fellow brokers had clients interested in buying what their clients were interested in selling. *See* BRAUDEL, *supra* note 47, at 99. *See generally*, TAN PHENG THENG, *supra* note 14, at 1-4 (describing the development of the Singapore and Kuala Lumpur Stock Exchanges).

[50] *See, e.g.*, Ross L. Watts & Jerold L. Zimmerman, *Agency Problems, Auditing, and the Theory of the Firm: Some Evidence*, 26 J.L. & ECON. 613 (1983); Easterbrook & Fischel, *supra* note 33, at 687-89 (regarding the use of accountants as a signal of accuracy of financial statements).

[51] These other experts might include ratings organizations, engineers, geologists, or lawyers rendering legal opinions. For a discussion on the use of "informational intermediaries," see Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 603-05 (1984).

promoters, underwriters, accountants, and lawyers.[52] The increased capitalization of the market tends to prompt more trading and thus more business for brokers and exchanges. Increased investment and trading is also likely to lead to more business for portfolio managers and investment advisers. Participants in securities markets at the time of an expansion in investment through investor protection will gain temporary economic rents until a competitive response restores normal profits.[53]

The various market participants can use market mechanisms to address problems of asymmetric information that cause investors

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[52] Suppose investors require a return of 10% per annum on an investment of a given risk. Suppose that there is a project of the given risk requiring $1,000,000 of capital, and which will yield $110,000 of profit per annum (or 11%). At a 10% required rate of return, this project seems worthwhile. However, if investors are concerned that the facts upon which the potential returns are based may be the result of a fraud or misrepresentation, they may adjust their estimate of the potential returns accordingly. If they adjust their expectations of the returns down to $90,000 per annum, the project will not be worthwhile to investors, and project promoters will not proceed with it. Investors are expecting only $90,000 on an investment of $1,000,000, or a 9% return, which is less than the required 10%. If one were to sell shares on such a project, and the market was reasonably efficient, the most one could expect to raise (no matter what the number of shares sold) would be $900,000.

If investors were more confident that the facts on which the $110,000 per annum return was based were accurate, they would be willing to pay up to $1,100,000 on the financial instruments sold to raise the required capital investment funds. The project promoters would be able to proceed with the project. In other words, if investor confidence in the accuracy of information concerning investment projects could be increased through investor protection, then more investment projects would proceed with more securities being sold to raise the capital thus creating more business for securities industry participants.

[53] Economic rent has been described as follows,

> The amount that a factor must earn in its present use to prevent it from moving (i.e., transferring) to another use is called its **transfer earnings**. Any excess it earns over this amount is called its **economic rent**.

RICHARD G. LIPSEY ET AL., ECONOMICS 336 (6th ed. 1988). Normal profits are "the imputed returns to capital and risk taking just necessary to prevent the owners from withdrawing from the industry." *Id.* at 180.

In other words, normal profits are the profits that are just enough to keep persons in an industry from pursuing other ventures that would yield approximately the same profits. Economic rent accrues when the resources used in the business earn more than the amount that is just sufficient to prevent the owners of those resources from transferring them to other uses.

to discount the value of securities.[54] Indeed, various participants in securities markets may have come into existence largely to address these concerns. For instance, as noted above, issuers of securities may engage underwriters, accountants, and other experts in an attempt to provide a signal to investors of the quality of their securities.[55] By subjecting issuers to various requirements in exchange for listing privileges, securities exchanges can also protect investors with the result that listings on exchanges come to serve as signals of the investment quality of securities listed on them.[56] There may, however, be limitations to these market mechanisms.[57] The general reluctance of societies to allow private parties to impose punitive sanctions limits the capacity of markets to enforce mechanisms designed to reduce asymmetric information.[58] Thus, market participants may seek the assistance of public forms of enforcement.

Public enforcement may also serve a common investor protection interest in providing a more comparable standard of

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[54] There is an asymmetry in information in that issuers of securities have more information about the value of their securities than investors have. Investors and issuers can attempt to reduce the asymmetry. Issuers can try to provide investors with information, and investors can try to gather and assess information. However, these activities involve costs. At some point, the cost of further reductions in the asymmetry in information will outweigh the benefits. Investors will be left with a residual inability to distinguish between better quality and poorer quality securities. They will adjust for the uncertain quality by an across the board discount in the prices of securities. This will tend to drive the higher quality securities out of the market. The seminal paper on this "adverse selection" process is George A. Akerlof, *The Market for 'Lemons': Qualitative Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970). For an application of this process to securities markets, see, e.g., Easterbrook & Fischel, *supra* note 33, 673-74.

[55] *See supra* notes 50-51 and accompanying text.

[56] *See, e.g.*, Easterbrook & Fischel, *supra* note 33, at 689-90; FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 294-95 (1991).

[57] *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 300-03 (1991).

[58] Imprisonment of individuals under private agreements is generally not allowed, and courts are reluctant to enforce liquidated damages provisions in private agreements that are punitive in nature. *See, e.g.*, S.M. WADDAMS, THE LAW OF CONTRACTS 301-08 (3d ed. 1993); G.H. TREITEL, THE LAW OF CONTRACT 898-902 (9th ed., Sweet & Maxwell 1995); SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 776, at 667-79 (Walter H.E. Jaeger ed., 3d ed., Baker, Voorhis 1961).

disclosure than one produced in the private market.[59] Investors, issuers and persons in the securities business may benefit from the development of a standard form for the presentation of information. However, an individual issuer, because she could not capture the benefits that other issuers would derive from their adoption of a standard form of disclosure, may not have an incentive to adopt a standard form of disclosure to its optimal extent. This might be addressed through a mechanism, such as membership in a stock exchange, which would require compliance with a standard disclosure format. Limits on allowable methods of private enforcement, however, may justify some public involvement in this area.

*(iii) Anti-Investor Protection Rent Seeking Activities*

The various participants are also likely to promote regulation that provide them with economic rents.[60] However, this may not be conducive to maximizing the values of securities.[61] For instance, securities industry participants may seek regulation that controls entry into their particular businesses. Licensing regimes for various types of market participants, such as brokers, underwriters, portfolio managers, and investment advisers, might, in part, be interpreted as attempts to control entry into these businesses. It has been suggested that mandatory disclosure gives larger issuers a competitive advantage over smaller issuers because the costs of compliance with disclosure requirements are, to a large extent, fixed.[62] Thus, the costs of compliance for larger issuers would be a smaller percentage of the value of their

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[59] *See* Easterbrook & Fischel, *supra* note 33, at 686-87.

[60] *See* PHILLIPS & ZECHER, *supra* note 43, at 21-24; *supra* note 43 (citing articles that contend securities regulation has arisen as a result of rent-seeking activities by securities participants or as a consequence of bureaucratic pressures within regulatory organizations).

[61] *See id.*; *supra* notes 33-37 (outlining the costs and benefits of both mandatory disclosure and takeover bids).

[62] *See* Manne, *supra* note 43, at 28-36; PHILLIPS & ZECHER, *supra* note 43, at 46-49, 114.

outstanding securities than would be the case for smaller issuers.[63] It has also been suggested that financial analysts benefit from having information gathered and formatted under mandatory disclosure laws,[64] while underwriters, accountants, lawyers, and other experts gain from their involvement in complying with mandatory disclosure laws without corresponding benefits to investors.[65]

Other interests that are less directly involved in securities markets, but instead offer competing modes of raising capital, may also play an important role in the regulation of securities markets. For instance, it has been argued that state banks, which stood to lose loan business from an increased use of stocks and bonds in capital formation, were a significant source of pressure for the adoption of so-called "blue sky laws" in the United States. These blue sky laws required a regulatory review of the investment merits of securities before they could be sold.[66]

*(iv) Summary*

Different countries, in adopting securities laws, may be subjected to the same kinds of political pressures because each developing securities market will have broadly similar groups participating in it and will have similar forms of competing interests shaping it. Since similar political pressures affect the securities markets of different countries, laws taking broadly similar approaches to the regulation of securities markets may occur quite independently. The securities regulation that results from these political pressures may or may not be in the public interest.

*(b) Competition for Capital and the Internationalization of Securities Markets*

While different countries may independently develop quite

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63 *See* PHILLIPS & ZECHER, *supra* note 43, at 46-49, 114.

64 *See id.* at 22-23, 37, 44, 51.

65 *See id.* at 44, 114.

66 *See generally* Macey & Miller, *supra* note 42 (reviewing development of state "blue sky" laws).

similar political pressures leading to the adoption of similar securities laws, there are also pressures in the international context that have probably contributed to a trend toward similarity in securities laws. International competition for capital is a potential source of political pressure that has probably increased in recent years with the globalization of securities markets.

### *(i) Securities Laws and the Competition for Capital*

Capital directed to investment promotes economic growth and development.[67] The capital necessary for investment can come from either of two sources: channeling the savings of the country's residents into investment or encouraging foreign investment. Countries compete for the scarce funds of investors in the international marketplace. Funds tend to move to the country that is perceived to provide the best return on investment for a given level of non-diversifiable risk.[68] This places pressure on policymakers, with the influence of local entrepreneurs, to provide conditions that will encourage investment by both residents and foreigners by maximizing return on investment and minimizing non-diversifiable risk.

A country's legal infrastructure is among the factors that affect the country's investment climate.[69] A country's securities laws are part of that legal infrastructure. This provides an incentive for countries to gravitate towards securities laws that appear most

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[67] Investment is necessary for economic growth. *See, e.g.*, LIPSEY ET AL., *supra* note 53, at 828. The resulting capital formation can result in increases in labor productivity. *See, e.g.*, ROBERT V. CHERNEFF, MACROECONOMICS 332, 336-38 (1993).

[68] Risk and return are the two essential elements of assessing the value of an investment. An efficient portfolio of investments consists of investments that produce the greatest return for a given level of risk. *See, e.g.*, J. FRED WESTON & THOMAS E. COPELAND, MANAGERIAL FINANCE 357-92 (9th ed. 1992) (discussing the effect of risk and return on investment decisions).

[69] *See, e.g.*, Michael J. Trebilcock, *What Makes Poor Countries Poor?: The Role of Institutional Capital in Economic Development*, *in* THE LAW AND ECONOMICS OF DEVELOPMENT, at 15, 40-44 (Edgardo Buscaglia et al. eds., 1997). On the importance of a legal infrastructure to economic prosperity, see also DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 54-60 (1990).

inclined to attract investment.[70]

*(ii) Increasing International Competition*

With the significant trend toward the "globalization" of securities markets in recent years,[71] issuers of securities frequently float issues in countries other than their home countries,[72] and investors invest increasing amounts in foreign markets.[73] This trend has been encouraged by numerous factors. For instance, advances in communications technology and the development of computer technology in the processing of transactions facilitates the trading of securities and the settlement of securities transactions in remote markets.[74] Developments in finance theory

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[70] This is similar to the argument that competition in corporate chartering would cause different jurisdictions to gravitate to similar corporate laws in what might be called a "race to the bottom" (the seminal article for which is William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974)) or a "race to the top" (the seminal article for which is Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977)). For a general discussion of corporate chartering competition, *see, e.g.*, ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 14-51 (1993). Similar arguments have been made with respect to securities regulation. *See, e.g.*, EASTERBROOK & FISCHEL, *supra* note 56, at 295-96, 300-02.

[71] *See supra* note 1 (noting the amount of internationalization in recent years).

[72] North American issuers have sought increasing amounts of capital overseas. For instance, in the first nine months of 1986, private issuers in the United States offered U.S.$35.1 billion in debt securities in the Eurobond market. *See* Leslie Wayne, *Finance Officers' Wider Role*, N.Y. Times, Oct. 20, 1986, at D1. International bond issues by U.S. issuers expanded from U.S.$40 billion in 1980 to over U.S.$250 billion in 1989, and international equity issues by U.S. issuers increased from almost nothing in 1984 to over U.S.$18 billion in 1987. *See* Futterman, *supra* note 1, at 806 n.2. In Canada, the sales of new issues of securities to non-residents increased from Can.$6.5 billion in 1978 to Can.$22.3 billion in 1989. *See* Lazar et al., *supra* note 1, at 5.

[73] For instance, in Canada, sales of outstanding issues to non-residents grew from Can.$2.6 billion in 1978 to Can.$107.9 billion in 1989, and purchases of outstanding issues from non-residents grew from Can.$3.0 billion in 1978 to Can.$95.4 billion in 1989. *See* Lazar et al., *supra* note 1, at 5. United States investors acquired and sold a record high U.S.$270.9 billion of foreign equities in global markets in 1992, with total equity holdings by U.S. investors at U.S.$210 billion in 1993. *See* Testy, *supra* note 1, at 930. In the first half of 1993, U.S. investors bought U.S.$27.3 billion of foreign bonds compared to U.S.$21.9 billion for all of 1990. *See id.*

[74] *See, e.g.*, Jeffrey G. MacIntosh, International Securities Regulation: Of Competition, Cooperation, Convergence, and Cartelization 2 (Oct. 20-21, 1995) (paper presented at the Consumer and Commercial Law Workshop).

favor increased international portfolio diversification.[75] Such developments also favor the introduction of new types of securities, such as derivative securities, which can be used to achieve the benefits of international diversification while circumventing local restrictions on foreign ownership with smaller levels of investment.[76] The growth of institutional investment increases the number of investors that spread the information and transaction costs of international diversification across a large dollar value portfolio.[77] Deregulation in areas such as foreign exchange controls and reduced restrictions on participation by investors in foreign securities markets also serve to facilitate the internationalization of securities markets.[78]

This internationalization of securities markets increases the availability of funds from foreign investors, and facilitates the flight of funds from local markets.[79] This tends to increase competition between countries for investment funds. Such increased competition for investment funds tends to place additional pressure on countries to adopt securities laws that are perceived to be the most likely to attract investment funds.

Securities law developments in the United States and Canada provide evidence consistent with this competition for investment funds and securities business. The potential flight of funds and securities business from the United States and Canada to other less heavily regulated jurisdictions was a significant factor in the development of shelf registration, Regulation S, and Rule 144A in the United States,[80] and the development in Canada of prompt and

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[75] *See id.* at 3.

[76] *See id.*

[77] *See id.* at 3-4.

[78] *See id.* at 4.

[79] *See supra* notes 72-73 (noting increased international competition).

[80] *See* MacIntosh, *supra* note 74, at 17; Futterman, *supra* note 1, at 806-07. Regulation S protects U.S. issuer securities offerings or resales of such securities outside the territorial boundaries of the United States. *See* Testy, *supra* note 1, at 937-55; Futterman, *supra* note 1, at 807-08, 825-40; 1 HAZEN, *supra* note 10, § 4.28.1, 308-13; 3 HAZEN, *supra* note 10, § 14.2, at 72-73. Rule 144A authorizes unlimited resales of securities which haven't been registered under the Securities Act of 1933 as long as such sales are made to a particular group of large institutional investors. *See* 1 HAZEN, *supra* note 10, § 4.26.1, at 301-03; 3 HAZEN, *supra* note 10, § 14.2, 74-75.

shelf offerings[81] and the multijurisdictional disclosure system.[82]

*(c) Foreign Interests Protecting Economic Rents from International Competition*

The development of a country's securities laws may also be affected by political pressure from a foreign country that has well-developed securities markets and securities regulations. The securities laws in the foreign country may provide market participants in that country with economic rents that could be lost in the face of foreign competition. It may then behoove the foreign country's market participants to exert political pressure for the adoption of similar securities regulations in other developing securities markets so that the economic rents they earn in the domestic market are not subject to dilution through competition. In the context of the internationalization of securities markets, such political pressure may also be brought to bear in order to secure similar economic rents for operations carried on in developing securities markets.

In recent years, there has been diplomatic pressure from the

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[81] In the Canadian context, see Robert Steen & Ross McKee, *The Prompt Offering Qualification System* at 1626, 1628-30 (Ontario Securities Commission Bulletin, Mar. 21, 1986). Prompt offerings in Canada allow for a quicker vetting of prospectuses by securities commissions by reducing the prospectus to information primarily on the rights associated with the particular securities being offered and having other information about the issuer incorporated by reference from continuous disclosure documents. *See* GILLEN, *supra* note 10, at 223-32. Shelf offerings allow an issuer to pre-clear the issuance of securities of a particular type over an ensuing two-year period. The issuer can then issue securities of that type virtually instantaneously over the two-year period without having to wait while Canadian securities commissions clear a prospectus for the particular issue. *See id.* at 232-41.

[82] *See* the Canadian Securities Administrators National Policy Statement No. 45, National Policy Statements ¶ 470-045 (July 1, 1991, amended through Dec. 31, 1993). For the corresponding U.S. provisions, see the Securities Exchange Act Release No. 6902 [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,812 (June 21, 1991). These provisions allow, in some situations, distributions of securities in Canada on the basis of compliance with U.S. disclosure laws, while also allowing distributions of securities in the United States on the basis of compliance with Canadian disclosure laws. It also permits takeover bids involving shareholders in the United States and Canada to proceed, in certain circumstances, on the basis of compliance with Canadian takeover bid requirements or, in certain circumstances, on the basis of compliance with U.S. takeover bid requirements. *See* 3 HAZEN, *supra* note 10, § 14.2, at 73-74; GILLEN, *supra* note 10, at 111-12.

United States to obtain assistance in the enforcement of U.S. securities laws and to encourage other countries to adopt securities regulations similar to those in the United States. This is perhaps most notable with respect to insider trading.[83] These diplomatic endeavors may be the result of political pressure brought to bear in the United States by those who earn economic rents brought about by U.S. securities laws.[84] The concern is that these rents will be dissipated with the flight of funds from the United States to countries with securities laws that impose fewer restraints on securities transactions.

The desire to protect economic rents obtained through American securities regulation may also account for the pressure to give U.S. securities laws an increasingly extraterritorial effect.[85] Following U.S. style securities laws may be a straightforward step for a country if American securities laws are effectively being applied there in any case. Enacting U.S. style securities regulations may, in part, be a means of protecting some degree of sovereignty in enforcement. The desire to protect economic rents from foreign competition may also be a factor in U.S. attempts to obtain a greater degree of harmonization of securities laws through the International Organization of Securities Organizations (IOSCO).[86]

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[83] *See, e.g.*, Gregory R. Raifman, *The Effect of the U.S.-Swiss Agreement on Swiss Banking Secrecy and Insider Trading*, 16 SEC. L. REV. 423 (1984); Mark S. Klock, *A Comparative Analysis of Recent Accords Which Facilitate Transnational SEC Investigations of Insider Trading*, 11 MD. J. INT'L L. & TRADE 243 (1987); John J. Ryan IV, *International Enforcement of Insider Trading: The Grand Jury Process, Court Compulsion and the United States-Switzerland Treaty on Mutual Assistance in Criminal Matters*, 26 AM. CRIM. L. REV. 247 (1988); Gerald A. Polcari, *A Comparative Analysis of Insider Trading Laws: The United States, the United Kingdom and Japan—The Current International Agreements on Securities Regulation*, 13 SUFFOLK TRANSNAT'L L.J. 167 (1989).

[84] For instance, a possible explanation for U.S. efforts to secure treaties dealing with insider trading is that this is a response to political pressure from members of the securities industry in the United States to protect economic rents, which they obtain through insider trading laws, from being dissipated by competition from foreign securities markets. *See* Haddock & Macey, *supra* note 43 (discussing the potential economic rents to securities industry participants from the regulation of insider trading).

[85] *See, e.g.*, 3 HAZEN, *supra* note 10, § 14.2, at 59-75.

[86] On the increasing U.S. influence in IOSCO, see MacIntosh, *supra* note 74, at 25-26; *U.S. SEC Forges New Global Role Within IOSCO; Breeden Chairs Strengthened*

### 3. *Transaction Costs, Information Costs, Uncertainty, and the Source of Borrowing*

As noted above, not only do securities laws tend to converge but there is also evidence that jurisdictions borrow substantial elements of securities laws from one another. While political pressures in both the domestic and international context may lead to a convergence of securities regulations, they do not explain this tendency to borrow securities laws. They also do not explain why countries generally borrow from a very limited set of existing securities laws.

#### *(a) Why Borrow?*

##### *(i) Avoids Cost of Political Compromise*

One could start from scratch by creating securities laws that respond to political pressures from local interest groups. However, this involves a potentially prolonged process of political compromise while various interest groups lobby for their particular interests. Instead, foreign laws might be invoked in the political dialogue, in part as a form of rhetoric and, in part as a starting point representing a compromise between similar interest groups in the foreign country. With the foreign compromise as a starting point, much of the prolonged process of political compromise might be avoided. This might then be modified by variations on the foreign laws that accommodate differences in the structure of local interest groups.

##### *(ii) Uncertainty Discourages Experimentation*

Another reason for borrowing laws may be the uncertain effect of creating unique laws. Borrowing allows one to get some sense of the effect the laws will have by looking to the effects of those laws in other jurisdictions. It may be nearly impossible to predict the effect of a newly created, unique set of laws, and the consequent uncertainty will tend to discourage the adoption of approaches that radically differ from those in other countries. This

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*Technical Committee*, 3(24) INT'L SEC. REG. REP. 1 (1990); *U.S. SEC Would Cut Futures Group From IOSCO Working Party Structure*, 3(16) INT'L. SEC. REG. REP. 1 (1990).

uncertainty, in the face of international competition for investment, is likely to be an important factor in the context of securities laws.

Even if a country were to accept the uncertainty associated with the effect of a radically different approach to securities laws, it would face the added costs of communicating the unique approach to investors and overcoming the uncertainty investors would have as to the effect of any radically different approach. Borrowed securities laws can reduce the costs of overcoming investor uncertainty where the borrowed laws are ones with which investors are already familiar or have developed a level of comfort from their dealings with them.

*(b) Information Costs and the Number of Sources of Borrowing*

In its approach to borrowing securities laws, a country could consider all of the existing securities laws in other jurisdictions. However, this is likely to be inordinately costly. While the costs of gathering securities laws, translating them into the local language, and even comparing them at some general level might be manageable, it would nonetheless be virtually impossible and exceedingly costly to assess the likely effect of the different securities laws if they were adopted. Thus, such a comprehensive approach can not realistically be undertaken. A choice must be made regarding which laws to consider.

*(c) Factors Affecting the Source of Borrowing*

The process of deciding which jurisdiction should be the source for a country's securities laws may be affected by several factors. These factors can be related to information costs involved in choosing the source of borrowing. They tend to encourage a relatively narrow focus in terms of the potential sources for a new securities market's regulations. The factors include such things as how well known and apparently successful a particular set of foreign securities laws is, educational links, language, the extent of inter-country commercial links, and possibly, the extent of parallel legal structures in the borrowing and source countries.

### *(i) Uncertainty and the First-Mover Advantage*

Uncertainty over the effect of different securities laws and the difficulty of overcoming investor uncertainty toward radically different securities regulations tend to discourage fundamental deviations from an existing set of securities laws. As a result of this uncertainty, countries focus on the set of securities laws that are widely known and perceived, correctly or incorrectly, to be most closely linked to success in attracting investment or earning economic rents for influential market participants. Adopting such laws reduces the uncertainty associated with unique securities laws and avoids the costly and virtually impossible task of attempting to assess the effects of a variety of other possible approaches while adopting what *ex ante* appear to be the laws most likely to achieve the desired effect. It is also likely to reduce the cost of communicating to investors the nature and likely effect of the laws by allowing one to simply point to the existing securities laws of a country with which investors are likely to have some familiarity. The success of the country that is the source of the securities laws is also likely to be an effective form of rhetoric for market participants who seek economic rents similar to those enjoyed by their counterparts in the source country. A country that is the first to develop an apparently successful set of securities laws can, thus, have a considerable edge in being the source country of choice, given the likely reluctance of countries to experiment with different approaches to securities laws.

The U.S. securities laws of the 1930s appear to fit the role of such a first-mover. Other countries adopting securities laws, daunted by the empirical task of assessing the effects of a wide variety of possible securities regulations, may have had a tendency to look to U.S. laws, noting the success of the U.S. economy. Also, the United States is an important source of investors. American investors may be generally familiar with U.S. securities laws and have some confidence in the protection they provide. They are likely to be more inclined to invest in countries having similar securities laws. Thus, this may be another important factor in the tendency to follow the approach of U.S. securities laws.[87]

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[87] Some evidence of this tendency to follow the approach of U.S. securities laws is

*(ii) Educational Links*

A country's choice for its source jurisdiction may also be affected by the educational backgrounds of the country's lawyers and policymakers. When searching for a starting point to draft laws in their own jurisdictions, lawyers may rely on the laws of those countries where they received their basic legal training or pursued graduate studies in law. There can be other advantages from having securities laws with which lawyers may be familiar from their earlier studies. In particular, lawyers should be more readily able to assimilate such securities laws, thereby lowering the cost of legal services associated with compliance.

Certain countries may occupy a leading position in education, resulting, to some extent, in a convergence of ideas. The United States and the United Kingdom arguably occupy such leading positions and this may account, in part, for the relative dominance of U.S. or U.K. securities laws in several countries.

*(iii) Language*

Closely related to the effects of educational links is the effect of sharing a common language. There may be a tendency to copy the laws of a country whose securities laws can be more readily ascertained because they are set out in a language that is understood in the country borrowing the securities laws. Sharing a common language may also affect the way people think about securities law issues.

As with education, one or more languages tend to dominate in the international setting. For instance, English has arguably taken a dominant position in the world.[88] This may contribute to a

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discussed in *supra* notes 21-24, dealing with the copying of certain features of U.S. securities laws in Malaysia, Singapore, and especially Japan.

[88] In terms of the language persons speak as their native tongue, English ranks fourth (with Mandarin, Hindi, and Spanish ranking first, second, and third respectively). *See* WORLD ALMANAC AND BOOK OF FACTS 642-43 (1997). However, English is spoken by between 700 million and 1 billion persons as a native, second, or foreign language. English is used in over 60 countries as an official or semi-official language. It is prominent in another 20 countries and is either dominant or well-established on six continents. *See* ALASTAIR PENNYCOCK, THE CULTURAL POLITICS OF ENGLISH AS AN INTERNATIONAL LANGUAGE 7-8 (1994). By 1980, two-thirds or more of the world's scientists were writing in English, and 80% of the world's electronically stored information was in English. *See* 3 THE ENCYCLOPEDIA OF LANGUAGE AND LINGUISTICS

convergence of ideas that are linked to the way problems are conceived of in English. The dominance of English may also facilitate the adoption of securities laws from other English-speaking countries, such as the United States or the United Kingdom. Many countries have a group of persons who are sufficiently conversant in English to read the securities laws of English speaking jurisdictions, making the laws of these jurisdictions more accessible than those of other jurisdictions.[89]

*(iv) Extent of Commercial Links*

Close commercial links, whether due to the proximity of countries or otherwise, may also encourage countries to adopt similar securities laws. Close mercantile ties, particularly when they involve capital flows between countries, may bring political pressure from securities industry participants and investors to make the securities laws of different countries compatible. Compatibility can reduce the transaction costs associated with raising capital and thus increase the amount of capital that is likely to be raised. The compatibility of Canadian and U.S. securities laws, joint U.S.-Canadian interjurisdictional policy releases, and memoranda of understanding on securities law matters are good examples of attempts to achieve compatibility when there are significant commercial links between the countries.[90]

*(v) Common Legal Tradition*

The similarity between the securities laws of Singapore and

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§ 2, at 1121 (1994).

[89] The securities laws of other jurisdictions are also becoming more readily available in English. *See, e.g.*, INTERNATIONAL SECURITIES REGULATION (Robert C. Rosen ed., 1998); INTERNATIONAL SECURITIES REGULATION: PACIFIC RIM (Gordon R. Walker ed., 1996). Some securities law related provisions can also be found in DIGEST OF COMMERCIAL LAWS OF THE WORLD (Lester Nelson ed., 1998). Some translations are available from securities regulatory authorities or private law firms. For instance, the author has an English translation of the Securities and Exchange Act of Thailand prepared by both the Office of the Securities and Exchange Commission and Chandler & Thong-ek Law Offices Limited. This availability of securities laws in English from non-English speaking countries may facilitate borrowing from other jurisdictions. However, U.S. and U.K. securities laws are likely to continue to dominate due to the effects of the various other factors mentioned in the text.

[90] *See supra* note 82.

Malaysia—and their borrowing from Australian and British securities laws—suggests that policymakers may have a tendency to look to jurisdictions with similar legal systems and traditions.[91] It may be easier for policymakers to understand and assess the likely effects of the laws of jurisdictions with similar legal traditions, thus lowering the information costs associated with such assessments. It may also be easier to incorporate the laws of such jurisdictions into the domestic legal system, thereby lowering the costs of implementing borrowed laws. Thus, common law jurisdictions may tend to follow other common law jurisdictions, and civil law jurisdictions may tend to follow other civil law jurisdictions.

*(vi) The Roles of Particular Individuals and the Element of Chance*

In the process of developing a set of laws that responds to political pressures, it may make sense to assign tasks to a particular individual or a small group of individuals. This avoids transaction costs for coordinating an unwieldy network of interest group representatives and for reaching a joint position on a wide array of issues. Instead, the individual or small group can work to a solution that, while not representing the optimal solution for each participant, is one for which no interest group is willing to incur the costs involved in defeating it. There may be several solutions that meet such a criterion. Consequently the individual, or small group of individuals, may have a significant influence on the choice of a solution. The background of the persons involved may then be of some significance in the source of and extent of borrowing. For instance, where the person worked or did graduate studies may be significant in her choice of a source jurisdiction, since the person may feel she is in a better position to understand and communicate the impact of the source country's laws.

An element of chance may be involved in choosing individuals to lead the development of a particular set of laws. There may be a limited set of persons having credible expertise for such positions.

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[91] *See supra* notes 15-20 (noting similarities in Malaysian, Singaporean, Australian, and British securities laws).

The choice among this limited set may be based, in part, on chance connections between the person making the appointment and the appointee. The person or group of persons may have become influential in the development of securities laws through a series of coincidences involving contacts or friendships fostered professionally, during school years, or through chance meetings. Personal characteristics of the appointee may also influence the choice of the person making the appointment.

*B. Factors Contributing to Differences*

Though the securities laws of different countries contain similarities, differences of varying degrees of significance remain. It is implicit in the previous analysis concerning information and transaction costs that there may still be room for some degree of experimentation by individual countries. Experimentation may take the form of creating uniquely local laws, adopting variations on borrowed laws, and promulgating laws that consist of unique forms of multi-source borrowing. In addition, several factors may affect the kinds of political pressures brought to bear in a country, leading to different political pressures being placed on different countries. As a result, the securities laws of various jurisdictions may contain different features because divergent pressures affected the political processes of these countries differently. In the context of securities laws, these factors include the stage of a country's development, differences in legal systems, ideology, culture, local market conditions, and path dependence. These are canvassed below as possible explanations for observed differences in securities laws.

*1. Experimentation*

Some differences in securities laws may result from experimentation when policymakers take note of perceived deficiencies in the securities laws of other countries and seek to correct them with their own home-grown approach. There is still variation given uncertainty over the set of laws that will best attract investment. Thus, there may be continuous experimentation in an attempt to identify the set of laws that best attracts investment. The securities laws may also be complicated by attempts to achieve other policy goals through the regulation of securities markets.

*2. Stage of Development*

The stage of development may contribute to differences in the securities laws. When adopting their regulations, countries with more recent securities markets will not have the same experience to draw upon as those countries with older securities markets. Consequently, their laws may be less finely nuanced with, perhaps, less regulatory detail.[92]

The borrowing of securities laws can, to some extent, overcome a country's lack of experience with securities markets by drawing on the experiences of other countries. However, a lack of securities market expertise for the effective enforcement of securities regulations may also be a factor that limits the regulatory complexity of securities laws. Because of strong pressures to provide higher standards of living and because of demands from entrepreneurs and foreign investors, developing countries may be less inclined to place regulatory hurdles on the sale of securities that provide the necessary funds for investment to promote development.

Further, less developed securities markets may have yet to develop the same institutional structures as more developed securities markets. Thus, the kinds of political pressures brought to bear during the creation of securities laws in developing markets may not be the same as those in more developed securities markets. Divergent political pressures, therefore, can lead countries to promulgate securities laws with contrasting features.

*3. Legal System Differences*

The existence of contrasting legal systems may be another source for the differences in securities laws. As noted above, it may be easier to implement and assess the effect of securities laws

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[92] It has been suggested that securities commissions, once in place, have a tendency to increase steadily in the amount of regulatory detail. *See* Wolfson, *supra* note 44, at 124-27; Langevoort, *supra* note 44, at 531-32. Thus, more recently developed regulatory frameworks are less likely to have developed the same degree of regulatory detail.

that are drawn from a country having a similar legal system.

If common law countries borrow primarily from other common law countries while civil law countries borrow from other civil law countries, then one might expect to find at least two securities law models with different approaches attributable to the different characteristics of the competing legal systems. The fact, however, that securities regulation in common law countries has become predominantly a matter of statutory law, administered largely by regulatory bodies, tends to reduce the significance of the distinction between the civil law and common law approaches.

*4. Ideology*

Ideology may also play a role in some differences in securities laws. For instance, the development of securities laws in transitional economies, such as China and Vietnam, may be affected by a continuing controlled economy mentality in the minds of influential bureaucrats. Securities laws might, thus, be drafted with the intent to constrain securities trading or to direct securities markets towards achieving a particular economic outcome. For instance, trading in the securities of companies in specific industries that the government wants to promote might be encouraged over trading in securities of companies in other industries. A controlled economy mentality might also emphasize government access to information, at least as much or more so than investor access to information, since information is a key component to effective control over an economy. More generally, where a Marxist ideology has prevailed, there may be a skepticism towards the adoption of capitalist concepts, particularly those associated with such a central component of capitalism as the trading of securities.

Countries which are in a process of transition from command economies are also likely to have a pre-existing set of political pressures that differ from those present in a country with a market based economy. The groups in a command economy that stand to gain or lose economic rents from the development of securities markets and related securities laws are likely to be different from the groups that might gain or lose economic rents in the development of securities markets and securities laws in a primarily market based economy.

*5. Culture*

Differences in culture or religion also have an effect on securities laws. Such differences may be reflected in different ethics toward business relations, while also impinging upon such matters as good faith in securities trading or in provisions for securities market services. These differences in culture or religion may result in differences in the political pressures brought to bear in the context of the development of securities laws.

*6. Local Market Features*

While securities markets tend to develop similar structures with similar participants, there may also be features unique to local securities markets. These unique features may create different problems that call for unique regulatory responses. Unique regulatory responses may also be due to slightly different interest group pressures created by the unique features of local securities markets.

*7. Path Dependency*

The development of securities markets, while taking on similar overall characteristics, may, in some respects, have proceeded down different paths. As noted above, subtle variations in the development of securities markets, resulting in different interest group pressures, might lead to variations in securities laws. Once particular interest groups have something to lose through changes in securities laws, it may be difficult to closely follow the laws of another country. In short, once the securities laws have proceeded down one path, it may be difficult to follow the path taken by another country because the change will be resisted by those who believe they would suffer substantial losses as a result of the change.[93]

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[93] The concept of path dependence has been described in the following way:

> The strength of the concept of path dependence . . . is in its analytic power in explaining outcomes where strategic actors are deliberately searching for departures from long-established routines and attempting to restructure the rules of the game. Actors who seek to move in new directions find that their choices

## IV. Implications for Securities Laws in Developing Securities Markets

The factors contributing to similarities and differences in securities laws considered in the discussion above have implications for the introduction of securities laws in developing securities markets.

### A. *Good Reasons for Borrowing Securities Laws*

As suggested in Part III, there are several possible reasons for the borrowing of securities laws. Many of these reasons suggest it may be a good idea for a country with developing securities markets to borrow securities laws. Borrowing may be preferable to wholesale experimentation because the solutions of securities laws in other countries may have come, over time, to approximate optimal solutions.

Borrowing can also reduce information costs to investors associated with learning and assessing the effects of unique and untested securities laws, thereby reducing the level of residual uncertainty. Borrowing may also provide an initial approximation to a political compromise among developing market participants so as to avoid some of the costs associated with reaching a political compromise.

### B. *Consider Use of a Widely Known Set of Securities Laws*

A country with developing securities markets should also consider using a widely known set of securities laws since this reduces information costs to investors associated with learning and assessing the effects of the country's securities laws, thereby

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> are constrained by the existing set of institutional resources. Institutions limit the field of action; they preclude some directions; they constrain certain courses. But institutions also favor the perception and selection of some strategies over others. Actors who seek to introduce change require resources to overcome obstacles to change. This exploitation of existing institutionalized resources is a principal component of the apparent paradox that even (and especially) instances of transformation are marked by path dependence.

David Stark, *Path Dependence and Privatization Strategies in East Central Europe, in* COMPARATIVE NATIONAL DEVELOPMENT: SOCIETY AND ECONOMY IN THE NEW GLOBAL ORDER 169-70 (A. Douglas Kincaid & Alejandro Portes eds., 1994); *see also* NORTH, *supra* note 69, at 92-100 (discussing path dependence).

minimizing residual uncertainty.

*C. Limit the Number of Sets of Securities Laws Considered*

Limiting the number of countries whose securities laws are considered also reduces the costs of assessing the potential different effects of the securities laws.

*D. Educational Links Should be Considered*

Educational links provide developing countries with ready sources of lawyers who can draft securities regulations. They also present developing countries with the added benefit of borrowing securities laws from those countries where a number of their lawyers received their legal training. Lawyers should be more readily able to assimilate such securities laws, thereby lowering the cost of legal services associated with compliance.

*E. Commercial Links Should be Considered*

Commercial links should also be considered since a country with which one has important commercial links may be a significant source of potential investors. Borrowing that country's securities laws would reduce, for these foreign investors, the information costs associated with learning and assessing the effects of the securities laws. Significant commercial links may also be a factor in the cost of legal services since lawyers in both countries will tend to have some familiarity with the securities laws of the country with the more developed securities markets.

*F. Potential Significance of the Legal System*

Before borrowing securities laws, a country should consider the legal systems of the possible source jurisdictions. Borrowing securities laws from a country with a significantly different legal system runs the risk of unintended inconsistencies with existing local laws and unintended gaps in the securities regulatory regime.[94]

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[94] In common law countries, the development of a body of common law through court decisions in substantive areas, such as contracts and torts, provides a backdrop against which securities laws in those countries are drafted. In these countries, securities statutes and regulations may not deal with certain issues because they are dealt with by

Misconceptions in the application of such laws by enforcement personnel or local lawyers may lead to an application of the laws that is quite different from that of the source country. This could result in uncertainty and confusion among investors, diminishing the benefits of reduced information costs and uncertainty that borrowing might have otherwise provided.

### *G. Potential Significance of a Common Language*

In a similar vein, borrowing securities laws from a country with a common language may be worth considering. It may not be easy to find persons with both expertise in translation and expertise in securities markets and securities laws. The possible result is confusion in the translation of the laws, creating confusion among investors, persons charged with the enforcement of the laws, and those involved in providing assistance in compliance.

### *H. Some Deviations from the Borrowing Source Should be Considered*

While there may be several advantages to borrowing securities laws, there may also be good reasons for some variations from the source country's laws. As noted in Part III, securities laws may, at least in part, be the result of inefficient rent-seeking activities. A country with developing securities markets, having as yet relatively less developed securities market participants, may be in a unique position to avoid such inefficient rent-seeking behavior.

Unique features of the country's markets may provide opportunities to create a securities market niche. Exploiting these opportunities may be facilitated by some deviations from the securities laws of the source country. As the markets become more established and investors become more comfortable with the administration of the country's securities laws, the risk of some experimentation will be reduced. Thus, initially, a country with developing securities markets should avoid significant deviations from its source country's securities laws. However, it may be possible to increase the degree of deviation as the markets develop.

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the common law. Similarly, in civil law countries, securities statutes or directives may leave some matters to be dealt with under existing civil or commercial codes.

### *I. Other Considerations*

#### *1. Allowing Entry of Foreign Securities Market Participants*

If a country with developing securities markets borrows the notion of licensing securities market participants, as most countries do, then it should also consider facilitating the licensing of foreign market participants. A number of securities market participants, such as accountants, engineers, underwriters, and rating organizations, provide important signals to investors. They can signal the credibility of information disclosed by issuers of securities and can condense complex sets of information into simpler bits of information. The credibility of these signals often depends on the reputation of the particular market participants, a reputation which can take a long time to develop. Market participants with sufficiently strong reputations are not likely to exist in developing securities markets. Securities market participants from countries with more developed securities markets will need to fill the gap, at least in the early stages of the development of a securities market. Otherwise it will be difficult for issuers to signal the credibility of their information disclosures to investors.

#### *2. Providing for Independent, Non-Corrupt Enforcement by Trained Personnel*

Benefits from borrowing securities laws in terms of reduced information costs and uncertainty may be severely restricted by an inconsistent enforcement of the laws. Ad hoc decisions, especially ones that favor particular individuals or institutions to the disadvantage of others, will create uncertainty for investors. Such decisions would make it more difficult and costly to give advice on the law and to comply with it. Thus, steps should be taken to ensure that the persons charged with enforcement, while accountable to political bodies, are independent of them in the enforcement of securities laws. The potential for corruption should be contained. This can be achieved through such mechanisms as having enforcement personnel disclose their assets and other interests and subjecting them to a range of sanctions, such as disciplinary actions—including dismissal—and penal sanctions.

The benefits of reduced information costs and uncertainty are more likely to be derived if the enforcement of the borrowed securities laws is consistent with that of the source country. Thus, to reap the benefits of borrowing, the borrowing country should consider having individuals trained in the source country or, in the interim, borrow enforcement staff from the source country.