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Recommended Citation

Mark K. Brewer, Orla Gough & Neeta S. Shah, *Reconsidering Disclosure and Liability in the Transatlantic Capital Markets*, 9 DePaul Bus. & Com. L.J. 257 (2011)

Available at: <https://via.library.depaul.edu/bclj/vol9/iss2/4>

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Reconsidering Disclosure and Liability in the Transatlantic Capital Markets

*Mark K. Brewer, Orla Gough, & Neeta S. Shah**

The history of global finance since 1980 has . . . been one of frighteningly expensive financial crises—expensive not just in terms of the costs to the taxpayer or of output foregone, but in terms of the shattered lives of innocent victims.¹

I. INTRODUCTION

In response to the global recession, governments around the world are introducing financial regulation reforms and pledging increased global coordination of regulatory efforts. While these reforms will introduce some of the most significant changes to financial regulation since the Great Depression, they fail to fundamentally alter the current overreliance on disclosure and fail to achieve international cooperation in deterring the next financial crisis. This article aims to explore some of the limits of disclosure as a basis for financial regulation and suggests that international regulatory coordination of liability standards can help curtail the risky behavior that often leads to the pattern of boom and bust in the global financial markets. The purpose of this article is to evaluate previous research challenging the assumption that disclosure of information forms a sufficient basis for regulating securities, as well as to call for more rigorous enforcement of existing laws and cooperation on standards of liability by regulators in the United States (“U.S.”) and the European Union (“EU”).

The U.S. and the United Kingdom (U.K.), along with the other member states of the EU, have explored a number of measures to deter future financial crises. Such cooperation builds upon previous commitments to cooperate on financial regulation. Following the wave of corporate scandals in the early 2000s, including those involv-

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1. MARTIN WOLF, *FIXING GLOBAL FINANCE* 1 (2d. ed. 2010).

ing Enron, WorldCom and Parmalat, the European Securities and Markets Authority (ESMA)² and the U.S. Securities and Exchange Commission (SEC)³ have pledged to pursue convergence of norms, standards, and regulations in the transatlantic capital markets to achieve the creation of a barrier-free market.⁴ A true transatlantic market in securities,⁵ supervised by regulators on both sides of the Atlantic⁶ as well as by other marketplace actors, could greatly enhance efficiency.⁷ However, in addition to working toward convergence in national disclosure standards (which currently form the basis of securities regulation in both the U.S. and the EU),⁸ cooperation on enforcement and levels of liability for wrongdoing could greatly enhance investor protection. In particular, governments should agree on common liability standards which can disincentivize overly risky behavior.

2. ESMA is an independent EU Authority that attempts to maintain the stability of the European market and enhance investor protection. See EUROPEAN SECURITIES AND MARKETS AUTHORITY, FREQUENTLY ASKED QUESTIONS: A GUIDE TO UNDERSTANDING ESMA 3 (2011), available at <http://www.esma.europa.eu/popup2.php?id=7366>. In contrast to the SEC, ESMA does not have enforcement powers over securities issuers, but it can issue recommendations. *Id.* at 5.

3. Founded by the U.S. Congress in 1934, the Securities Exchange Commission has the task of enforcing securities laws, promoting stability in the securities markets and protecting investors. See *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, SEC.GOV, <http://www.sec.gov/about/whatwedo.shtml> (last visited Jan. 18, 2011).

4. See SEC PRESS RELEASE 2004-75, SEC-CESR SET OUT THE SHAPE OF FUTURE COLLABORATION (June 4, 2004), available at <http://www.sec.gov/news/press/2004-75.htm>.

5. The academic literature offers two means of harmonization. See Eric J. Pan, *Harmonization of U.S.-EU Securities Regulation: The Case for a Single European Securities Regulator*, 34 LAW & POL'Y INT'L BUS. 499, 504 (2003). First, the EU and the U.S. could pursue harmonization by implementing mandatory rules applicable to all issuers. *Id.* Second, regulatory competition in which both the EU and the U.S. permit issuers to select the regime which is most efficacious could also achieve harmonization. *Id.* at 504-05 citing, *inter alia*, Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998); Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903 (1998); and Stephen Choi, *Regulating Investors Not Issuers: A Market-Based Proposal*, 88 CALIF. L. REV. 279 (2000).

6. Experts have even called for a single European regulator to act in conjunction with the SEC. See generally Pan, *supra* note 5, at 534-35. Currently, the regulators in Europe are national, including, among others, the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* (BaFin)) in Germany and the Financial Services Authority (FSA) in the United Kingdom.

7. See generally John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641, 683-91 (1999).

8. Iris H-Y Chiu, *Delegated Regulatory Administration in Mandatory Disclosure—Some Observations from EU Securities Regulation*, 40 INT'L LAW. 737, 739 (2006) (noting that “[t]he mandatory disclosure regulation for public offers is a foundational form of securities regulation, whether in the United States or in the EU.”).

Part II of this Article will briefly survey the current financial regulatory environment in the U.S. and in the EU, with an emphasis on the U.K.⁹ Part III will summarize the weaknesses of disclosure as the basis of a securities regulation regime.¹⁰ Finally, this article will survey international efforts to regulate securities as well as make proposals to extend cooperation from the formulation of international disclosure standards to the setting of liability standards as well as enforcement of such standards by national regulators.¹¹

II. CURRENT FINANCIAL REGULATION IN THE U.S. AND EU

A. *United States*

In the United States, the SEC has the authority to regulate the securities markets,¹² and both federal and state laws¹³ form the legal framework for regulating the sale of securities.¹⁴ In the aftermath of the Great Depression, the United States adopted a securities regulations system based on mandatory disclosure and registration.¹⁵ The system has been summarized as follows:

The logic is that by arming investors with information, mandatory disclosure promotes informed investor decision making, capital market integrity, and capital market efficiency. Once they are empowered with information, the argument goes, investors can protect themselves against corporate abuses and mismanagement, and there is no need for the government to engage in more substantive securities regulation – merit review in the parlance.¹⁶

9. See *infra* notes 12-178 and accompanying text.

10. See *infra* notes 183-225 and accompanying text.

11. See *infra* notes 226-65 and accompanying text.

12. See generally LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 37-51 (4th ed. 2001) (describing the SEC's remit of administrative authority); *id.* at 56-61 (describing the SEC's organization and rules).

13. State laws are called "blue sky laws." See generally HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW, part XI, § 26.1 (2d ed. 2004). The term "blue sky" denotes the purpose of state securities laws: they are designed to prevent "speculative schemes which have no more basis than so many feet of blue sky." *Id.* (quoting *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 550 (1917)).

14. See generally LOSS & SELIGMAN, *supra* note 12, at 9-56 (describing the development of state and federal law).

15. Irina Shirinyan, *The Perspective of U.S. Securities Disclosure and the Process of Globalization*, 2 DEPAUL BUS. & COM. L.J. 515, 520 (2004) (citing Frode Jensen, III, *The Attractions of the U.S. Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the U.S. Markets: From a Legal Perspective*, 17 FORDHAM INT'L L.J. S25, S26-S27 (1994)). See generally Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1209-35 (1999) (discussing the use of disclosure as a regulatory mechanism); LOSS & SELIGMAN, *supra* note 12, at 114-80 (describing the procedure and content for securities registrations).

16. Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L. Q. 417, 418 (2003).

This disclosure-based regime is built on the premise that providing investors with all material information will lead to the most rational investment decisions and in the long-run, the highest levels of efficiency in the capital markets.¹⁷

Financial regulation has depended on whether a particular instrument constitutes a “security” in which case regulation falls within the SEC’s regulatory authority.¹⁸ Financial instruments which do not fall within the concept of a security are supervised by other regulators, most notably the Commodity Futures Trading Commission (CFTC), which has had some authority for regulating derivatives. The regulation of banking activities is not within the authority granted to either the SEC or the CFTC, and as such falls outside the scope of this article.¹⁹ Widespread disagreement on how to classify credit derivatives²⁰ – the instruments which lay at the heart of the subprime mortgage crisis – has caused difficulty in assigning regulatory responsibility for regulating such financial instruments.²¹ In the wake of the subprime mortgage crisis, efforts are under way to clearly assign joint responsibility to the CFTC and the SEC to regulate derivative financial instruments.²² The lack of regulatory supervision for derivative instruments illustrates the damaging consequences of financial innovation that is not suitably regulated. The U.S.’s rule-based system²³ applies not only to U.S. companies but also extraterritorially to non-U.S. issuers.²⁴

17. See generally Frank Jan de Graff & Cynthia A. Williams, *The Intellectual Foundations of the Global Financial Crisis: Analysis and Proposals for Reform*, 32 U. NEW S. WALES L.J. 390, 393-94 (2009) (describing the neoclassical economic assumptions underlying the efficient capital markets hypothesis).

18. See generally LOSS & SELIGMAN, *supra* note 12, at 201-77 (discussing the statutory definition and judicial interpretation of the term “security”).

19. For an analysis of the tension between the regulatory authority of the SEC and U.S. banking regulators, see Eugene F. Maloney, *Banks and the SEC: A Regulatory Mismatch*, 25 ANN. REV. BANKING & FIN. L. 443 (2006) (arguing that the SEC and banking regulators should work together to improve the oversight of banking securities activities and enhance investor protection).

20. See generally Lily Tijoe, *Credit Derivatives: Regulatory Challenges in an Exploding Industry*, 26 ANN. REV. BANKING & FIN. L. 387 (2007) (discussing the problems associated with assigning responsibility for regulating derivatives).

21. Colleen M. Baker, *Regulating the Invisible: The Case of Over-the-Counter Derivatives*, 85 NOTRE DAME L. REV. 1317 (2010).

22. *Id.* at 1336-38.

23. See, e.g., William W. Bratton, *Enron, Sarbanes-Oxley and Accounting: Rules Versus Principles Versus Rents*, 48 VILL. L. REV. 1023 (2003).

24. Anupama J. Naidu, *Was Its Bite Worse than Its Bark? The Costs Sarbanes-Oxley Imposes on German Issuers May Translate into Costs to the United States*, 18 EMORY INT’L L. REV. 271, 271-72 (2004).

Several federal statutes form the basic regulatory framework, including the Securities Act of 1933 (the “Securities Act”),²⁵ the Exchange Act of 1934 (the “Exchange Act”),²⁶ the Trust Indenture Act of 1939,²⁷ the Investment Company Act of 1940,²⁸ the Investment Advisers Act of 1940,²⁹ the Sarbanes-Oxley Act of 2002,³⁰ and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”).³¹ Due to the wide scope of these laws, this Article focuses only on the Securities Act, the Exchange Act, Sarbanes-Oxley, and the Dodd-Frank Act.³²

1. Securities Act

The Securities Act regulates the initial distribution of securities by an issuer.³³ With certain limited exceptions,³⁴ § 5 of the Securities Act makes it illegal for any person to offer to sell or buy any security unless the security is registered with the SEC.³⁵ The SEC regulates the sale of securities through requiring issuers to disclose certain informa-

25. 15 U.S.C.A. §§ 77a-77aa (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)).

26. 15 U.S.C.A. §§ 78a-77jj (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)).

27. 15 U.S.C.A. §§ 77aaa-77bbb (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)).

28. 15 U.S.C.A. §§ 80a-1 to 80a-64 (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)).

29. 15 U.S.C.A. §§ 80b- to 80-b21 (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)).

30. 15 U.S.C.A. §§ 7201-66 (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)).

31. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203 (2010).

32. The statutes not included herein regulate interstate holding companies concerned with trust indentures which publicly issue more than \$5 million worth of debt securities, Trust Indenture Act of 1939, 15 U.S.C.A. §§ 77aaa-77bbb (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)); companies which either have the primary purpose of investing securities or holding, trading, investing, reinvesting, or owning certain securities which account for more than forty percent of the value of their assets, Investment Company Act of 1940 15 U.S.C.A. §§ 80a-1 to 80a-64 (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)); and investment advisors who give advice on securities if not incidental to a brokerage business, Investment Advisers Act of 1940, 15 U.S.C.A. §§ 80b- to 80-b21 (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)).

33. See generally LOSS & SELIGMAN, *supra* note 12, at 38.

34. Exemptions exist for certain transactions and particular types of securities. The most common transaction exemptions include 15 U.S.C.A. § 77(c)(11) (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)), which allows intrastate offers and sales only; § 77(d), which allows for private placements, i.e., where no public offer is made; § 77c(b), which allows for offerings of no more than \$5 million; and Regulation S which allows for offers and sales outside the United States. Securities issued or guaranteed to by federal, state or municipal governments are exempt as well those issued by not-for profit organizations, those maturing in less than nine months, those which are part of a reorganization plan under bankruptcy and those which are exchanged for no associated commission pursuant to an exchange exclusively with existing holders by the issuer are all exempt according to § 77(c)(a)(10).

35. 15 U.S.C.A. § 77e (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)).

tion, rather than examining the offer itself³⁶ or “substantively regulating corporate behavior.”³⁷ Depending on the type of issuer, or transaction, the securities laws require different registration forms and levels of disclosure.³⁸ Regardless of the issuer or transaction, however, the issuer must describe its financial condition and operating results, as well as other matters related to its business.³⁹ Since 1998, the SEC has enforced a “Plain English” rule that requires financial reports and offering documents to be written in a manner that is clear, precise and accessible to investors.⁴⁰

If the registration statement⁴¹ contains any material misstatement of fact or material omission,⁴² the purchaser has a cause of action against the issuer and its directors, the underwriters of the offering, each person who signed the registration statement, and each expert (which includes accountants and appraisers) who prepared and consented to be named in the registration statement.⁴³ Such liability provisions are severe and are designed to convey all relevant details to the markets and investors. However, as will be shown in Part III, such a disclosure-based approach is not necessarily effective in deterring the type of behavior that led to the financial crises of the past and that are likely to lead to potential crises in the future.⁴⁴

2. Exchange Act

The Exchange Act regulates securities traded in the secondary market after initial distribution.⁴⁵ Under the Exchange Act, issuers with securities that are either listed on a U.S. national exchange or have

36. EDWARD F. GREENE ET AL., 1 U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES MARKETS, § 1.01 (9th ed. 2009).

37. Susanna Kim Ripken, *The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation*, 58 BAYLOR L. REV. 139, 143 (2006).

38. See generally LOSS & SELIGMAN, *supra* note 12, at 139. The SEC requires different levels of disclosure based on whether the issuer is a U.S. or non-U.S. issuer. *Id.*

39. In particular, each registration statement requires a management discussion and analysis section. See generally GREENE ET AL., *supra* note 36, § 2-218.

40. See generally SEC RELEASE NO. 33-7497, THE PLAIN ENGLISH RELEASE, (Jan. 28, 1998), available at <http://www.sec.gov/rules/final/33-7497.txt>. See also Andrew T. Serafin, *Kicking the Legalese Habit: The SEC's "Plain English Disclosure" Proposal*, 29 LOY. U. CHI. L.J. 681 (1998).

41. For further details on the contents of registration statements, see LOSS & SELIGMAN, *supra* note 12, at 138-44.

42. 15 U.S.C.A. § 77k(a) (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)); see generally LOSS & SELIGMAN, *supra* note 12, at 1149-52.

43. LOSS & SELIGMAN, *supra* note 12, at 1152. Several statutory provisions grant remedies for misleading or fraudulent disclosures, including 15 U.S.C.A. §§ 77h, 77k, 77l(a)(2) and 77q (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)). See generally GREENE ET AL., *supra* note 36, § 15.03.

44. See *infra* notes 183–225 and accompanying text.

45. See generally LOSS & SELIGMAN, *supra* note 12, at 435.

500 or more shareholders of any class of equity securities and greater than \$10 million in assets must file periodic reports⁴⁶ with the SEC.⁴⁷ In addition, issuers who engage in the public offering of debt or equity securities in the U.S. are required to file periodic reports.⁴⁸ Recognized as the primary remedy for violations,⁴⁹ § 10(b) of the Exchange Act prohibits the use of any manipulative or deceptive device in interstate commerce in the sale or purchase of a security.⁵⁰ Promulgated pursuant to § 10(b) of the Exchange Act, Rule 10b-5 makes it unlawful to use any direct or indirect means of interstate commerce or to employ any deceptive or manipulative device, or make any material untrue statement or material omission in connection with the purchase or sale of any security.⁵¹

3. Sarbanes-Oxley Act

Following Enron's spectacular financial meltdown⁵² and the litany of other financial scandals that rocked markets around the world at the dawn of the twenty-first century,⁵³ the U.S. Congress engaged in a feverish attempt⁵⁴ to put into place new legal structures to increase investor protection.⁵⁵ The Congressional reform efforts culminated in

46. For its annual report, quarterly report and current report (for any material event or corporate change), a domestic issuer must file a Form 10-K, Form 10-Q and a Form 8-K, respectively, while a foreign issuer must file a Form 20-F, which is effective for both the Securities Act and the Exchange Act, and a Form 8-A is used if the issuer is registering under the Exchange Act in a public offer. See GREENE ET AL., *supra* note 36, § 3.03[1].

47. See GREENE ET AL., *supra* note 36, § 1.03.

48. See generally GREENE ET AL., *supra* note 36, § 1.03.

49. GREENE ET AL., *supra* note 36, § 15.03.

50. See generally LOSS AND SELIGMAN, *supra* note 12, at 839-40.

51. 17 C.F.R. § 240.10b-5 (2010). See LOSS & SELIGMAN, *supra* note 12, at 962-76. See also Donald C. Langevoort & G. Mitu Gulati, *The Muddled Duty to Disclose Under Rule 10b-5*, 57 VAND. L. REV. 1639 (2004) (surveying the case law and discussing different disclosure duties in various contexts).

52. See generally William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275 (2002); Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. CHI. L. REV. 1233 (2002); John C. Coffee, Jr., *Understanding Enron: It's About the Gatekeepers, Stupid*, 57 BUS. LAW. 1403 (2002).

53. See generally Scott Green, *A Look at the Causes, Impact and Future of the Sarbanes-Oxley Act*, 3 J. INT'L BUS. & L. 33, 34-46 (2004); John Plender, *Problems at Ahold, Parmalat, and Now Adecco Raise New Questions About How Global Accounting Firms Should Work with Multinationals and the Risks of Modern Investment Management Techniques*, FIN. TIMES, Jan. 22, 2004, at 15; Tobias Buck, *Alarm Spreads as Virus Across the Pond*, FIN. TIMES, Dec. 24, 2004, at FT Report: Corporate Governance 2.

54. Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1523-24 (2005).

55. See Shirinyan, *supra* note 15, at 524.

the adoption of the Sarbanes-Oxley Act⁵⁶ (“SOX”) in the summer of 2002. SOX is a far-reaching statute,⁵⁷ which imposes significant new corporate governance, certification, disclosure and other requirements that directly impact U.S. and non-U.S.⁵⁸ companies with securities listed on national securities exchanges in the U.S. (e.g., the New York Stock Exchange (“NYSE”) and NASDAQ⁵⁹).

SOX is the most significant statute relating to securities regulation over the past several decades.⁶⁰ It created a significant regulatory regime for accountants including independence, certification, and attestation requirements, as well as requiring the establishment of an accounting oversight board called the Public Company Accounting Oversight Board (the “PCAOB”).⁶¹ Furthermore, Title III of SOX sets forth standards of corporate responsibility, including independence standards for audit committees.⁶² The increased disclosure⁶³ and costs⁶⁴ associated with SOX have caused much reluctance and opposition from foreign private issuers⁶⁵ in particular.⁶⁶ Many experts have harshly criticized Sarbanes-Oxley,⁶⁷ arguing that “the corporate governance provisions in SOX are ill conceived.”⁶⁸ Although SOX imposes significant costs⁶⁹ on all registered companies and disproportionately affects foreign issuers,⁷⁰ the additional layers of pro-

56. 15 U.S.C.A. §§ 7201-66 (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)).

57. Stephen C. Gara & Craig J. Langstraat, *The Sarbanes-Oxley Act of 2002: A New Ballgame for Accountants*, 34 U. MEM. L. REV. 73, 74-76 (2003).

58. For foreign issuers in particular, SOX has resulted in significant direct and indirect costs to issuers as well as to their advisers and the exchanges upon which they list. See Shirinyan, *supra* note 15, at 525. See also Naidu, *supra* note 24, at 277.

59. See generally NASDAQ Stock Market – Stock Quotes – Stock Exchange News – NASDAQ, <http://www.nasdaq.com> (last visited Jan 21, 2011). Operated under the supervision of the National Association of Securities Dealers (NASD), the NASDAQ Stock Market (“NASDAQ”) is the securities market formerly operating under the name the “National Association Securities Dealers Automated Quotation System.” Securities are quoted on NASDAQ (rather than listed).

60. Gara & Langstraat, *supra* note 57, at 74.

61. BLUMENTHAL & WOLFF, *supra* note 13, §§ 30:5-30:17.

62. 15 U.S.C.A. § 7213 (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)).

63. See generally Larry Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1, 16 (2002).

64. See generally Larry Cata Backer, *Surveillance and Control: Privatizing and Nationalizing Corporate Monitoring After Sarbanes-Oxley*, 2004 MICH ST. L. REV. 327, 338-40 (2004).

65. Rule 405 under the Securities Act and Rule 3b-4 under the Exchange Act define the term “foreign private issuer.” See 17 C.F.R. §§ 230.405, 240.3b-4 (2010).

66. See generally Naidu, *supra* note 24.

67. See generally Romano, *supra* note 54, at 1521, 1528; see also Ribstein, *supra* note 63.

68. Romano, *supra* note 54, at 1528.

69. See generally Ribstein, *supra* note 63, at 35-45; Romano, *supra* note 54, at 1588.

70. The SEC received a number of comment letters regarding SOX’s impact on foreign issuers. See generally Letter from Todd M. Malan to Jonathan G. Katz (Aug. 19, 2002), available at <http://www.sec.gov/rules/proposed/s72102/tmmalan1.htm> (discussing the extremely high level of liability SOX § 304 could impose on officers of foreign private issuers); Letter from Alexander

tection offered by SOX cannot ensure ethical behavior,⁷¹ and history indicates that unethical companies simply will become more creative in thwarting new regulations.⁷²

4. Dodd-Frank Act

On July 21, 2010, President Obama signed the Dodd-Frank Act,⁷³ which contains wide provisions for regulating the financial markets. Among other changes, the Dodd-Frank Act establishes the Financial Stability Oversight Council, whose purpose is to identify risks to U.S. financial stability, promote marketplace discipline, and respond to threats to financial stability.⁷⁴ In response to criticisms against companies considered “too big too fail,” the Act creates a mechanism through an “orderly liquidation authority” that allows the Federal Deposit Insurance Corporation to take control over financial institutions whose collapse might threaten the entire U.S. economy.⁷⁵ The Act also introduces new regulatory measures related to the hedge fund and private equity industries as well as adjusts the standards for an “accredited investor.”⁷⁶ In addition to creating the Federal Insurance Office within the Department of the Treasury to monitor most lines of insurance,⁷⁷ the Act also introduces stricter regulation, oversight, and enforcement powers over depository institutions and their subsidiaries.⁷⁸ Further, the Dodd-Frank Act assigns primary regulatory responsibility to the CFTC and the SEC to regulate the swaps market

Schaub to Jonathon G. Katz, (Feb. 18, 2003), available at <http://www.sec.gov/rules/proposed/s70203/aschaub1.htm> (discussing the potential conflicts of law between SOX and laws of the European Union and the difficulty European issuers may face in complying with both).

71. See generally Ribstein, *supra* note 63, at 61. With regard to corporate governance, Enron itself appeared to be a model of good corporate governance before it unravelled. See generally Ronald B. Davis, *Fox in S-OX North, A Question of Fit: The Adoption of United States Market Solutions in Canada*, 33 STETSON L. REV. 955, 968 (2004). Professor Davis points out the limitations of corporate governance: “On the one hand, the board of directors is the only existing device for monitoring managers. On the other, both more and less sympathetic observers of boards of directors have come to acknowledge what should have been obvious all along: The traditional corporate solution of introducing outside directors to bridge the separation between ownership and control has dramatic limitations.” *Id.* at 970-71 (citing Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 876 (1991)).

72. GREENE ET AL., *supra* note 36, § 4.02(2).

73. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. 111-203, 124 Stat. 1376 (2010).

74. See *id.* tit. 1 (Financial Stability).

75. See *id.* tit. 2 (Orderly Liquidation Authority).

76. See *id.* tit. 4 (Regulation of Advisers to Hedge Funds and Others).

77. See *id.* tit. 5 (Insurance).

78. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. 111-203, 124 Stat. 1376 (2010), tit. 6 (Improvements to Regulation of Bank and Savings Association Holding Companies and Depository Institutions).

and other aspects of the derivative industry.⁷⁹ The Act also increases regulation of financial market utilities and institutions engaged in payment, clearing, and settlement activities⁸⁰ as well as enhancing regulatory requirements relating to broker-dealers, credit rating agencies, structured finance products, executive compensation and corporate governance.⁸¹ The Act also introduces changes at the Federal Reserve, including limiting its authority to engage in emergency lending,⁸² and it creates of the Bureau of Consumer Financial Protection to issue rules applicable to financial institutions that offer financial products and services to consumers.⁸³ Additionally, the Act enables the Secretary of the Treasury to establish programs aimed at improving underserved communities' access to financial products⁸⁴ and contains amendments to the American Recovery and Reinvestment Act of 2009, which was passed in response to the financial crisis precipitated by the failure of the subprime loan industry.⁸⁵ Finally, among its other provisions, the Act increases disclosure obligation requirements relating to residential mortgage loans.⁸⁶

5. Other Regulators

The U.S. Congress created the CFTC in 1974 to regulate commodity futures and option markets in the United States.⁸⁷ Although its original mandate largely concerned the agricultural sector, a series of legislative actions, most notably the Commodity Futures Modernization Act of 2000 and most recently the Dodd-Frank Act, has increased its regulatory authority significantly.⁸⁸ The CFTC works to encourage competitiveness and efficiency in the futures markets, to help protect market participants from manipulation, fraud, and abusive trading practices, and to ensure the financial integrity of clearing processes.⁸⁹

Self-regulatory organizations ("SROs") have an important role in monitoring the capital markets in the United States. These non-governmental entities, including the NYSE and the National Association

79. *See id.* tit. 7 (Wall Street Transparency and Accountability).

80. *See id.* tit. 8 (Payment, Clearing, and Settlement Supervision).

81. *See id.* tit. 9 (Investor Protections and Improvements to the Regulation of Securities).

82. *See id.* tit. 11 (Federal Reserve System Provisions).

83. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. 111-203, 124 Stat 1376 (2010), tit. 10 (Bureau of Consumer Financial Protection).

84. *See id.* tit. 12 (Improving Access to Mainstream Financial Institutions).

85. *See id.* tit. 13 (Pay It Back Act).

86. *See id.* tit. 14 (Mortgage Reform and Anti-Predatory Lending Act).

87. *U.S. Commodity Futures Trading Commission, Mission & Responsibilities*, CFTC.gov, <http://www.cftc.gov/About/MissionResponsibilities/index.htm> (last visited Feb. 16, 2011).

88. *Id.*

89. *See id.*

of Securities Dealers, Inc. (“NASD”), work in concert with the SEC and act with quasi-governmental authority to adopt rules for the enforcement of federal securities laws.⁹⁰

6. Enforcement and Liability

Enforcement of securities laws in the U.S. is largely posited on mandatory disclosure and antifraud rules. Sections 77k, 77l(a)(2), and 77q(a) of the Securities Act all allow for liability for failure to disclose all material facts.⁹¹ These and other similar provisions “are designed to work hand-in-hand to protect investors and promote market integrity.”⁹² In addition, § 78j of the Exchange Act,⁹³ as well as Rule 10b-5, further provide for liability for failures to disclose all material facts.⁹⁴ The United States Private Securities Litigation Reform Act of 1995 was designed to offer protection against frivolous lawsuits.⁹⁵ The so-called fraud-on-the-market theory has been the general presumption in U.S. securities litigation since the Supreme Court’s decision in *Basic Inc. v. Levinson*, which guides shareholder class action suits in the U.S. and is posited on the efficient market hypothesis, which broadly assumes that stock values always reflect all relevant information and therefore trading prices on exchanges reflect the stock’s actual value.⁹⁶ A plaintiff may also rely on the common law theory of deceit, although this is more difficult to prove in practice.⁹⁷

90. See generally Ernest E. Badway & Jonathan M. Busch, *Ending Securities Industry Self-Regulation As We Know It*, 57 RUTGERS L. REV. 1351, 1352-56 (2005).

91. In *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), the U.S. Supreme Court addressed the meaning of the term “material” in the following manner: “An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.” *Id.* at 449.

92. Joan MacLeod Heminway, *Personal Facts about Executive Officers: A Proposal for Tailored Disclosures to Encourage Reasonable Investor Behavior*, 42 WAKE FOREST L. REV. 749, 753 (2007).

93. 15 U.S.C.A. § 78j (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)).

94. 17 C.F.R. § 240.10b-5 (2010).

95. Pub. L. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.).

96. 485 U.S. 224 (1988).

97. See Frederick C. Dunbar & Dana Heller, *Fraud on the Market Meets Behavioral Finance*, 31 DEL. J. CORP. L. 455, 458 (2006). In describing the requirements to prove deceit in reliance on *Greenwald v. Integrated Energy*, 103 F.R.D. 65, 68 (S.D. Tex. 1984), the authors note that it requires “among other things, the following: (1) materiality – whether the misstatement or omission was important to a reasonable investor; (2) scienter – whether defendants acted with some degree of intent; (3) reliance – whether the investor’s decision to trade was affected by the omission or misstatement (also sometimes called transaction causation); and (4) loss causation – whether the misstatement or omission was the proximate cause of the loss to the investor.” Frederick C. Dunbar & Dana Heller, *Fraud on the Market Meets Behavioral Finance*, 31 DEL. J. CORP. L. 455, 458 (2006).

The SEC's Division of Enforcement has the authority to investigate alleged securities violations, and it may bring an action in federal court or through an administrative proceeding.⁹⁸ While the SEC's statutory purpose is to deter violations and provide remedial relief to aggrieved investors, its enforcement actions have become punitive over the past two decades.⁹⁹ The regulatory measures and penalties available to the SEC are significant, including an injunction prohibiting the improper conduct, disgorgement of ill-gotten gains, civil monetary penalties, a prohibition against a person serving as an officer or director in a public company, and suspension from practice before the SEC.¹⁰⁰ However, the SEC has no authority to bring a criminal case against a defendant, but it may recommend that the Department of Justice prosecute a defendant in a criminal proceeding.¹⁰¹ Although the U.S. Supreme Court has not determined whether the provision provides a private cause of action,¹⁰² the provision grants the SEC significant power to pursue wrongdoing.

B. *The European Union and the United Kingdom*

In the context of creating a true internal market, the EU seeks to eliminate all barriers to the free movement of goods, services, people, and capital among the EU member states according to the terms of the Treaties forming the European Union.¹⁰³ The EU has worked toward further integration with the adoption of the Euro as the common currency among many of its member states, the establishment of the European Central Bank, and the introduction of European citizenship. Nonetheless, the patchwork of securities regulations in Europe

98. U.S. Securities and Exchange Commission, *About the Division of Enforcement*, SEC.GOV, <http://www.sec.gov/divisions/enforce/about.htm> (last visited Feb. 16, 2011).

99. Paul S. Atkins & Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program*, 13 FORDHAM J. CORP. & FIN. L. 367, 383 (2008). The authors point out that through Congressional legislation, "the SEC gained three significant new sets of powers: (1) the ability to seek civil monetary penalties against persons and entities that may have violated federal securities laws; (2) the authority to bar directors and officers of public companies from serving in those capacities if they violated federal antifraud provisions; and (3) the authority to issue administrative cease-and-desist orders, temporary restraining orders, and orders for disgorgement of ill-gotten profits to violators of federal securities laws." *Id.* at 385.

100. *Id.*

101. Lisa Schultz Bressman & Robert B. Thompson, *The Future of Agency Independence*, 63 VAND. L. REV. 599, 645 (2010).

102. See *Herman v. Huddleston*, 459 U.S. 375, 378 n.2 (1983).

103. For a discussion of the internal market and its development, see John F. Mogg, *Regulating Financial Services in Europe: A New Approach*, 26 FORDHAM INT'L L.J. 58 (2002).

“lacks any sort of legal uniformity in terms of laws.”¹⁰⁴ In an attempt to identify measures for promoting harmonization among the member states, the EU Economic and Finance Ministers appointed the Committee of Wise Men to investigate the regulation of the securities market in the EU.¹⁰⁵ The culmination of the Committee of Wise Men’s work was the recommendation for the creation of the European Securities Committee (the “ESC”) and the Committee of European Securities Regulators (“CESR”).¹⁰⁶

Although the U.K. Government has planned fundamental reforms to financial regulation,¹⁰⁷ the principles which have underpinned the regulatory framework in the U.K. since the late 1990s continue to be relevant. These principles have focused on the avoidance of duplication between the roles assigned to the each of the Tri-partite Authorities (Financial Services Authority, Bank of England and Treasury); on achieving clarity of responsibility and of decision making; and on adequate structural flexibility to respond to an increasingly complex, global, and integrated financial services market place. The principles which inform the practice of regulation are a risk-based approach,¹⁰⁸ based on a balance between general principles and specific rules. The following discussion sketches the regulatory framework in the EU, focusing on the U.K. in particular.

1. European Union

In order to achieve a greater degree of financial markets integration, the European Commission issued a plan in 1999 to further and more effectively harmonize EU securities laws with the Financial Services Action Plan (“FSAP”),¹⁰⁹ which the Lisbon European Council

104. Alexander B. St John, *The Regulation of Cross-Border Public Offering of Securities in the European Union: Present and Future*, 29 *DENV. J. INT’L L. & POL’Y* 239, 241 (describing the various directives regulating the capital markets in the European Union).

105. See FINAL REPORT OF THE COMMITTEE OF WISE MEN ON THE REGULATION OF EUROPEAN SECURITIES MARKETS, http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf (last visited Oct. 2, 2010).

106. See *id.* at 28. The ESC is comprised of representatives from the member states while CESR is comprised of senior representatives from the member states’ securities regulators.

107. HM TREASURY, A NEW APPROACH TO FINANCIAL REGULATION: JUDGEMENT, FOCUS AND STABILITY 4 (2010), available at http://www.hm-treasury.gov.uk/d/consult_financial_regulation_condoc.pdf.

108. Margaret Cole, Director of Enforcement, FSA, Speech at Fordham Law School (Oct. 17, 2006), available at http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2006/1017_mc.shtml.

109. COMMISSION (EC), FINANCIAL SERVICES: IMPLEMENTING THE FRAMEWORK FOR FINANCIAL MARKETS: ACTION PLAN, COM(99)232 (May 11, 1999).

endorsed in March 2000¹¹⁰ to create the necessary regulatory environment to help achieve the integration of financial markets in the EU by 2005.¹¹¹ The FSAP was implemented through a number of legislative measures regulating or de-regulating financial services, securities markets, and corporate governance.¹¹² A number of European directives form the securities regulatory framework, including the Prospectus Directive,¹¹³ the Takeover Directive,¹¹⁴ the Transparency Directive,¹¹⁵ the Market Abuse Directive,¹¹⁶ and the Markets in Financial Instruments Directive.¹¹⁷

a. Prospectus Directive

As part of its effort to create a true pan-European securities regime and enhance consumer protection, the European Commission adopted the Prospectus Directive in December 2003, and the implementation of the directive in the national laws or regulations was to occur no later than July 1, 2005.¹¹⁸ The Directive specifies the disclosure requirements relating to initial information for securities offered

110. HM TREASURY ET AL., THE EU FINANCIAL SERVICES ACTION PLAN: A GUIDE 6 (July 31, 2003), available at http://www.fsa.gov.uk/pubs/other/fsap_guide.pdf.

111. Financial Services: Latest Report Highlights Need to Boost EU Capital Market Integration in Next Nine Months, IP/03/778 (June 2, 2003).

112. See Luca Enriques & Matteo Gatti, *Is There a Uniform EU Securities Law After the Financial Services Action Plan?*, 14 STAN J.L. BUS. & FIN. 43, 44-45 (2008).

113. Directive of the European Parliament and of the Council (EC) No. 2003/71 of 4 November 2003, 2003 O.J. 344/64 (prospectus to be published when securities are offered to the public or admitted to trading and amending Directive No. 2001/34 (2003) O.J. 345/64 (Prospectus Directive)).

114. Directive 2004/25, of the European Parliament and of the Council of 21 Apr. 2004, 2004 O.J. (L 142) 12.

115. Directive 2004/109, of the European Parliament and of the Council of 15 Dec. 2004, 2004 O.J. (L 390) 38. (harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, and amending Directive No. 2001/34/EC, O.J. 390/38 (Transparency Directive)).

116. Directive 2003/6, of the European Parliament and of the Council of 28 Jan. 2003, 2003 O.J. (L 96) 16 (insider dealing and market manipulation (market abuse)).

117. Directive 2004/39, of the European Parliament and of the Council of 21 Apr. 2004, 2004 O.J. (L 145) 1 (markets in financial instruments). For implementation of the Directive in the U.K. see Policy Document, FSA Implementing the Markets in Financial Instruments Directive (MiFID), available at http://www.fsa.gov.uk/pubs/policy/ps07_02.pdf.

118. See HM TREASURY ET AL., THE EU FINANCIAL SERVICES ACTION PLAN: DELIVERING THE FSAP IN THE UK 3-7 (2004), available at <http://www.hm-treasury.gov.uk/d/1B4C6967-BCDC-D4B3-124E99B62E501FCD.pdf>; Directive 2003/71, of the European Parliament and of the Council of 4 November 2003 on the Prospectus to be Published When Securities are Offered to the Public or Admitted to Trading and Amending Directive 2001/34/EC, 2001 O.J. (L 345) 64, 81 (indicating that the implementation deadline is July 1, 2005).

publicly or admitted to trading on a EU regulated market.¹¹⁹ As the Prospectus Directive is a “maximum harmonization” directive, the member states are not able to impose additional requirements regarding the content of a prospectus or the circumstances requiring a prospectus on issuers from other member states.¹²⁰ The importance of the Prospectus Directive is that it provides a single platform for issuers to raise capital in the EU, and has created a far more harmonized European regime across the member states.¹²¹

b. Takeover Directive

The Takeover Directive establishes a common EU framework to regulate takeover bids of companies whose securities trade on EU regulated markets.¹²² The Directive is modelled closely on the U.K. Takeover Code, which is strongly weighted toward protecting the shareholders’ interests.¹²³ However, member states have implemented the Takeover Directive in different manners. These various national approaches have hindered the development of a transparent and stable cross-border restructuring environment.¹²⁴

c. Transparency Directive

The Transparency Directive covers the content and regularity with which companies should report financial information, and ensures that such information is appropriately disseminated to the market.¹²⁵ The Transparency Directive requires member states to take measures to

119. See Jorge de Pereira & Sónia Teixeira da Mota, *The Pros and Cons of the Prospectus Directive*, 24 INT’L FIN. L. REV. 79 (2005). The Prospectus Directive should be put in action by all EU Member states by July 1, 2005. *Id.* at 79.

120. See CESR, CESR’S REPORT ON THE SUPERVISORY FUNCTIONING OF THE PROSPECTUS DIRECTIVE AND REGULATION 5 (June 2007); Edward F. Greene, *Resolving Regulatory Conflicts Between the Capital Markets of the United States and Europe*, 2 CAPITAL MARKETS L.J. 5, 16 (2007).

121. CENTRE FOR STRATEGY & EVALUATION SERVICES, STUDY ON THE IMPACT OF THE PROSPECTUS REGIME ON EU FINANCIAL MARKETS 7 (June 2008), available at http://ec.europa.eu/internal_market/securities/docs/prospectus/csese_report_en.pdf.

122. Directive 2004/25, of the European Parliament and of the Council of 21 Apr. 2004, 2004 O.J. (L 142) 12.

123. See John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why? — The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727, 1729 (2007).

124. See generally Matteo Gatti, *Optionality Arrangements and Reciprocity in the European Takeover Directive*, 6 EUR. BUS. ORG. L. REV. 553 (2005).

125. Directive 2004/109, of the European Parliament and of the Council of 15 December 2004 on the Harmonisation of Transparency Requirements in Relation to Information About Issuers Whose Securities are Admitted to Trading on a Regulated Market and Amending Directive 2001/34/EC, 2004 O.J. (L 390) 38.

comply with the directive by January 20, 2007.¹²⁶ In contrast to the Prospectus Directive, the Transparency Directive is not a “maximum harmonization” directive; therefore, the member states are able to impose additional requirements on issuers incorporated in their respective countries.¹²⁷ The Transparency Directive requires issuers of debt or equity securities traded on a stock market or other regulated market in the EU to publish within four months of the end of the financial year, file with the appropriate authority with the issuer’s home member state, and make publicly available in the EU an audited financial statement under the International Financial Reporting Standards or its equivalent, and a management report and statements made by the persons responsible within the issuer.¹²⁸ Similarly, the Transparency Directive requires companies to issue half-year reports using international accounting standards within two months of the issuer’s financial half-year, and be accompanied by a management report and statements made by the persons responsible within the issuer.¹²⁹ Irrespective of whether the issuers report quarterly because they are required to by their national legislation or by the rules of the regulated market or by its own initiative, they are required to make an interim statement explaining material events and transactions that occurred during the period and its impact on the financial position of the issuer and a general description of its financial position and performance.¹³⁰ The Transparency Directive further requires the disclosure of significant changes in securities holdings as measured by voting rights beginning with five percent and thereafter at each five percent interval to thirty percent, then at fifty percent and finally at seventy-five percent.¹³¹

d. Market Abuse Directive

Effective April 2003, the Market Abuse Directive sets forth regulations to address insider trading and market manipulation, affecting all firms and individuals participating in a regulated market in the EU.¹³² The primary requirements for firms are mandatory suspicious transaction reporting and preventative requirements for issuers and their ad-

126. *Id.* at 56.

127. *Id.* at 42.

128. *Id.* at 44-45.

129. *Id.* at 45.

130. Directive 2004/109, of the European Parliament and of the Council of 15 December 2004 on the Harmonisation of Transparency Requirements in Relation to Information About Issuers Whose Securities are Admitted to Trading on a Regulated Market and Amending Directive 2001/34/EC, 2004 O.J. (L 390) 38, 46.

131. *Id.* at 47.

132. Directive 2003/6, of the European Parliament and of the Council of 28 January 2003 on Insider Dealing and Market Manipulation (Market Abuse), 2003 O.J. (L 96) 16.

visers to keep lists of staff who have inside information.¹³³ The Market Abuse Directive requires the dissemination of inside information as soon as possible in order to avoid market abuse.¹³⁴ The Market Abuse Directive adopts a uniform definition of “inside information” where information must be of a precise nature, be price sensitive, not have been made public, and related to issuer(s) of financial instruments or of related derivative financial instruments.¹³⁵

e. Markets in Financial Instruments Directive

The Markets in Financial Instruments Directive (MiFID), which came into force in April 2004, replaces the existing Investment Services Directive and regulates the authorization and conduct of securities firms and markets.¹³⁶ The purpose of MiFID is to promote the cross-EU provision of investment services while protecting the investor and supporting market integrity.¹³⁷

2. *United Kingdom*

a. The Financial Services Authority

The Financial Services Authority (the “FSA”) is the single statutory regulator for financial services in the UK,¹³⁸ which was formed from the merger of nine sector-based regulatory bodies.¹³⁹ The reasoning for an integrated financial services regulator is indicative of market developments: for example, the increase in the number of financial corporations and the blurring of boundaries between financial prod-

133. *Id.* at 22.

134. *Id.* at 17.

135. *Id.* at 20.

136. Directive 2004/39, of the European Parliament and of the Council of 21 April 2004 on Markets in Financial Instruments, amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, 2004 O.J. (L 145) 1.

137. FSA, CURRENT EU ISSUES IN FINANCIAL SERVICES REGULATION (2005), available at <http://www.fsa.gov.uk/pages/about/media/notes/bn011.shtml>.

138. CLIVE BRIAULT, THE RATIONALE FOR A SINGLE NATIONAL FINANCIAL SERVICES REGULATOR 5, FINANCIAL SERVICES AUTHORITY OCCASIONAL PAPERS SERIES (1999), available at <http://www.fsa.gov.uk/pubs/policy/p15.pdf>.

139. The previous regulatory bodies consisted of the following: The Securities and Investment Board, the Personal Investment Authority, the Investment Management Regulatory Organisation, the Securities and Futures Authority, the Supervision and Surveillance Division of the Bank of England, the Building Societies Commission, the Insurance Directorate of the Department of Trade and Industry, the Friendly Societies Commission and, the Registrar of Friendly Societies.

ucts which make sector-based regulation less viable.¹⁴⁰ The Memorandum of Understanding (“MOU”) importantly sets out the role of each principal authority of the tripartite oversight framework for financial stability, a responsibility collectively shared between the Bank of England, the FSA and the Treasury.¹⁴¹ The MOU includes a revised description of the role and function of each of the three groups. The Bank of England is to continue to add to the maintenance of the stability of the financial system as a whole based on its macro-economic and financial analysis and its operational involvement in the markets, payment systems, and market infrastructure.¹⁴² The FSA has responsibilities for the authorization and supervision of financial institutions, supervision of financial markets, securities clearing and settlement systems, and for relevant regulatory policy.¹⁴³ The Treasury is responsible for the overall institutional structure of regulation and the legislation governing it, including the negotiations of EC directives.¹⁴⁴ It has been argued that the UK’s principle-based approach has been seen as an attractive model compared to more stringent regulatory requirements.¹⁴⁵

The Financial Services and Markets Act 2000 sets out four statutory regulatory objectives and several regulatory principles,¹⁴⁶ including maintaining market confidence in the financial system, promoting public awareness of the financial system, securing consumer protection, and preventing the financial sector firms from being used for a purpose connected with financial crime.¹⁴⁷ In fulfilling these objectives, the FSA is guided by a number of particular considerations, including: the efficient and economic use of resources; financial services firms’ management role in meeting regulatory responsibilities; the principle that a burden or restriction on regulated activity should be

140. CLIVE BRIAULT, REVISITING THE RATIONALE FOR A SINGLE NATIONAL FINANCIAL SERVICES REGULATOR 6, FINANCIAL SERVICES AUTHORITY OCCASIONAL PAPERS SERIES (2002), available at <http://www.fsa.gov.uk/pubs/occpapers/op16.pdf>.

141. See BANK OF ENGLAND ET AL., MEMORANDUM OF UNDERSTANDING BETWEEN HM TREASURY, THE BANK OF ENGLAND AND THE FINANCIAL SERVICES AUTHORITY (2006), available at <http://www.bankofengland.co.uk/financialstability/mou.pdf>.

142. *Id.*

143. *Id.*

144. *Id.*

145. U.N. Conference on the World Financial and Economic Crisis and its Impact on Development, *Report of the Commission of Experts of the President of the United Nations General Assembly on the Reforms of the International Monetary and Financial System* 44-45 (June 24-26, 2009), available at <http://www.un.org/ga/president/63/interactive/financialcrisis/PreliminaryReport210509.pdf>.

146. BRIAULT, *supra* note 138, at 8; FSA, PRINCIPLES-BASED REGULATION: FOCUSING ON THE OUTCOMES THAT MATTER (2007), available at <http://www.fsa.gov.uk/pubs/other/principles.pdf>.

147. Financial Services and Markets Act, 2000, c. 8, § 2(2) (U.K.).

proportionate to the benefit conferred; the facilitation of innovation in the market; and maintenance of the U.K.'s competitive position.¹⁴⁸

b. The Financial Services and Markets Act 2000

Consolidating the previous main legislative regimes governing the marketing of deposits, insurance, and investments,¹⁴⁹ the Financial Services and Markets Act 2000 ("FSMA") came into force on November 30, 2001, and provides a single flexible legislative framework, conferring extensive powers on the Treasury and the FSA to devise the details of the regulatory regime by secondary legislation.¹⁵⁰ Part II of the Act sets forth the "general prohibition" such that only an authorized or an exempt person may carry on, or may purport to carry on, a regulated activity from the U.K.¹⁵¹ Under the FSMA, the FSA may impose disciplinary sanctions, including fines or public statements, for breaches of the Listing Rules.¹⁵²

3. The Bank of England, the Treasury, and Future Reforms

The Bank of England has an independent role in setting monetary policies. Its role exists in the area of macroeconomic stability, whereas the two microeconomic stability objectives of prudential supervision and investor protection are within the FSA's regulatory regime.¹⁵³ The Treasury has reserve powers to give orders to the Monetary Policy Committee of the Bank if they are required in the public interest and by extreme economic circumstances, but such orders must be endorsed by Parliament.¹⁵⁴

Chancellor George Osborne is convinced that the tripartite system of regulation set up in 1997, which split the control of the Bank, the Treasury, and the FSA, has been a contributory factor in the financial

148. See FINANCIAL SERVICES AUTHORITY, MEETING OUR RESPONSIBILITIES 19 (Aug. 1998), available at <http://www.fsa.gov.uk/pubs/policy/P05.pdf>. The FSA is fully committed to an open and responsive approach, for example, allowing the establishment of a practitioner forum whose function is to monitor the extent to which the authority is meeting its statutory objectives. *Id.* at 9.

149. See generally The Insurance Companies Act 1987 (U.K.); The Financial Services Act 1986 (U.K.); and the Banking Act 1987 (U.K.).

150. Financial Services and Markets Act, 2000, c. 8, § 2(4) (U.K.).

151. Financial Services and Markets Act, 2000, c. 8, § 19 (U.K.).

152. Financial Services and Markets Act, 2000, c. 8, §§ 85, 90, 91 (U.K.).

153. Giorgio Di Giorgio & Carmine Di Noia, *Financial Market Regulation and Supervision: How Many Peaks for the Euro Area?*, 28 BROOK. J. INT'L L. 463, 485 (2003).

154. Bank of England Act 1998, Part II, § 19 (U.K.).

crisis problems in U.K.¹⁵⁵ Since the formation of FSA in 1997 until 2010, the UK has presented a unified supervisory system with the FSA acting as a single supervisory agent, given statutory powers by the Financial Services and Markets Act 2000.¹⁵⁶ However, the tripartite relationship of the three authorities has been highly criticised since the failure of Northern Rock in 2007.¹⁵⁷ The new coalition Conservative-Liberal Democrat Government has pronounced the single regulatory model as dated. This initiative will involve the cessation of the FSA in its current form,¹⁵⁸ and greater power for the Bank of England with the formation of a new Financial Policy Committee¹⁵⁹ within the Bank to take responsibility of the macro-prudential regulation¹⁶⁰ and a new Prudential Regulatory Authority (“PRA”) as a subsidiary of the Bank to take responsibility of the micro-prudential regulation.¹⁶¹ In addition, a new Consumer Protection and Markets Authority (“CPMA”) will be formed with responsibility of the conduct of business and markets regulation.¹⁶² This supervisory and regulatory overhaul is expected to be completed in 2012 and the FSA will be split into CPMA and the PRA.¹⁶³ A consultation will commence to consider whether to transfer responsibility for prosecuting criminal offences involving insider dealing, market abuse, and other criminal law breaches to a new Economic Crime Agency.¹⁶⁴

4. Liability and Enforcement of U.K. and EU Law

With its power to initiate financial sector regulation, the European Commission plays a fundamental role in the formulation and monitoring of financial regulation in the EU. From 1999 to 2005, the Financial Services Action plan guided the European Commission’s initiatives, and since 2005, the White Paper on Financial Services has set the

155. See Jill Treanor & Larry Elliott, *George Osborne to Strip FSA of City Regulation Powers*, GUARDIAN, June 3, 2010, available at <http://www.guardian.co.uk/politics/2010/jun/03/george-osborne-fsa-city-bank?INTCMP=SRCH>.

156. FSA, *Who Are We?*, FSA.GOV.UK, <http://www.fsa.gov.uk/Pages/About/Who/index.shtml> (last visited Feb. 22, 2011).

157. FSA, *THE TURNER REVIEW: A REGULATORY RESPONSE TO THE GLOBAL BANKING CRISIS 88* (2009), available at http://www.fsa.gov.uk/pubs/other/turner_review.pdf.

158. HM Treasury, *Financial Services*, HM-TREASURY.GOV.UK, http://www.hm-treasury.gov.uk/reform_and_regulation.htm (last visited Feb. 22, 2011).

159. HM TREASURY, *supra* note 107, at 4.

160. HM TREASURY, *supra* note 107, at 4.

161. HM TREASURY, *supra* note 107, at 4.

162. HM TREASURY, *supra* note 107, at 4.

163. *Written Evidence Submitted by the FSA*, PARLIAMENT.UK (Sept. 27, 2010), <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/memo/financialreg/m27.htm>.

164. HM TREASURY, *supra* note 107, at 45.

objectives,¹⁶⁵ including soundly enforcing current rules, eliminating inconsistencies in regulation, and enhancing convergence among regulatory supervisors, promoting competition, and increasing the EU's influence on global capital markets.¹⁶⁶ The EU's financial regulation is designed to support the single market in financial services.¹⁶⁷ Named after Alexander Lamfalussy, the Lamfalussy framework endorsed by the European Council in 2001 provides a four-level approach for the adoption of EU financial regulation. The first two levels relate to the creation of regulation, with level one denoting the adoption of legislation and level two referring to technical rulemaking led by the European Commission for the implementation of level one legislation. Level three concerns the activities of the Committee of European Banking Supervisors ("CEBS"), the Committee of European Securities Regulators ("CESR"), and the Committee of European Insurance and Occupational Pensions Supervisors ("CEIOPS") to encourage supervisory convergence and best practices. Level four denotes regulatory enforcement, chiefly by national supervisory authorities, although the European Commission monitors the application of legislation while the European Court of Justice hears allegations of infringements.¹⁶⁸ Because of the complicated four-level approach to financial regulation, the enforcement of liability standards for infringement of financial regulation varies across the member states of the EU.¹⁶⁹

In the U.K., shareholders can potentially sue directors both under the FSMA and the common law to recover losses caused by false or misleading disclosure in documents supporting a public offering of

165. See COMMISSION OF THE EUROPEAN COMMUNITIES, WHITE PAPER ON FINANCIAL SERVICES POLICY 2005-2010 (Dec. 1, 2005), available at http://eur-lex.europa.eu/LexUriServ/site/en/com/2005/com2005_0629en01.pdf.

166. MYRIAM VANDER STICHELE, FINANCIAL REGULATION IN THE EUROPEAN UNION: MAPPING EU DECISION MAKING STRUCTURES ON FINANCIAL REGULATION AND SUPERVISION 13 (2008), available at http://www.eurodad.org/uploadedFiles/Whats_New/Reports/EUMapping_Financial_Regulation_FINAL.pdf.

167. See WHITE PAPER ON FINANCIAL SERVICES POLICY (2005-2010), available at http://europa.eu/legislation_summaries/internal_market/single_market_services/financial_services_general_framework/l33225_en.htm (last visited Feb. 22, 2011).

168. *The future of EU financial regulation and supervision*, Chapter 2: Regulation And Supervision In The European Union, UK PARLIAMENT, <http://www.publications.parliament.uk/pa/ld200809/ldselect/lddeucom/106/10605.htm> (last visited Feb. 7, 2011).

169. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Reinforcing Sanctioning Regimes in the Financial Services Sector 6-8 (2010), available at http://ec.europa.eu/internal_market/consultations/docs/2010/sanctions/COM_2010_0716_en.pdf.

shares.¹⁷⁰ Shareholders in a public company can potentially sue in their own name under U.K. securities law to recover losses caused by false or misleading corporate disclosures.¹⁷¹ Under S459 of the Companies Act 1985, the risks posed to non-executive directors are negligible due to the fact that the U.K. lacks an analogue to SEC Rule 10b-5.¹⁷² Theoretically, any negligent misstatements in the annual accounts and other documents disseminated by U.K. directors can be the base for a suit by investors; however, this is only successful in rare events that the information provided guides a specific purchase or sale of shares.¹⁷³

Directors of UK public companies can be held liable to shareholders for listing particulars that fail to include required material or that contain false or misleading disclosures. Any person who has suffered a loss due to false or misleading statements or omissions from listing particulars may be given compensation by the responsible person.¹⁷⁴ However, as of 2006, no claims had been brought forward under section 90 of FMSA 2000.¹⁷⁵ This claim is analogous to a U.S. claim under § 11 of the Securities Act of 1933 for a material misstatement in a prospectus.

The FSA's supervision and enforcement powers use individual responsibility and accountability as a core feature, with senior management responsibility a fundamental feature of the regulatory regime introduced by the FSMA.¹⁷⁶ Under the FSMA, authorized firms must ensure that individuals who carry out so-called "controlled functions" (certain key functions carried on in relation to regulatory activities specified in section 59 of the FSMA) obtain approval from the FSA before performing such functions.¹⁷⁷ After coming under much criticism following the onset of the financial crisis, the FSA is keen to assert an overtly strong regulatory approach.¹⁷⁸

170. PAUL DAVIES, DAVIES REVIEW OF ISSUER LIABILITY: LIABILITY FOR MISSTATEMENTS TO THE MARKETS 17 (2007).

171. PALMER'S COMPANY LAW ¶ 8.809 (G.K. Morse ed., 2001).

172. Brian Cheffins & Bernard Black, *Outside Director Liability Across Countries* 1411, EUR. CORP. GOVERNANCE INST., LAW WORKING PAPER NO. 71/2006, available at <http://ssrn.com/abstract=438321>.

173. See GORE-BROWNE ON COMPANIES ¶ 43.27 (Alistair Alcock ed., 50th ed. 2004).

174. Financial Services and Markets Act, 2000, c. 8, § 90 (U.K.).

175. Brian R. Cheffins & Bernard S. Black, *Outside Director Liability Across Countries*, 84 TEX. L. REV. 1385, 1411 (2006).

176. HM TREASURY, REFORMING FINANCIAL MARKETS 35-38 (2009).

177. See Financial Services and Markets Act, 2000, c. 8, § 59 (U.K.).

178. See generally FSA, THE FSA'S MARKETS REGULATORY AGENDA (2010), available at <http://www.fsa.gov.uk/pubs/other/markets.pdf>.

III. ANALYSIS

Both the U.S. and the EU have largely adopted disclosure as the model underpinning securities regulation.¹⁷⁹ The current regulatory approach to financial regulation has failed to deter harmful behavior that has resulted in an unprecedented loss of value to shareholders as well as enormous liabilities to taxpayers. The current financial crisis is the most severe since the Great Depression.¹⁸⁰ There has been no shortage of new ideas to reform the financial system, although current efforts have largely focused on the symptoms of the excess, such as executive pay and bonuses, calling for further disclosure and caps on incentive-based compensation.¹⁸¹ However, disclosure-based regulatory safeguards have failed to protect investors from the risks of actors in the financial industry seeking short-term gains at the expense of the public, and an ever-growing body of research points out the weaknesses of disclosure regimes.¹⁸² Without a fundamentally different approach to regulation, the current disclosure-based regulatory model offers little hope of deterring the next major crisis.

The following discussion will examine the inherent weaknesses of the current disclosure-based financial regulatory system endorsed by the U.S. and EU (with particular attention paid to the U.K.) and the challenges of transnational regulatory cooperation in financial regulation. The discussion will critically analyze the current culture of risk-taking in the financial sector, which has had a detrimental impact on the public. Thereafter, this article will suggest alternatives for modifying behavior in lieu of additional disclosure-based rules as a means to deter excessively risky behavior by financial institutions.

179. See Chiu, *supra* note 8, at 739.

180. In August 2009, the International Monetary Fund estimated the cost of the financial crisis to be approximately \$11.9 trillion. See Edmund Conway, *IMF puts total cost of crisis at £7.1 trillion*, DAILY TELEGRAPH, Aug. 8, 2009. According to the news agency Reuters, market participants have estimated that 40-45% of the world's wealth has been destroyed in the crisis. See Megan Davies and Walden Siew, *45 percent of world's wealth destroyed: Blackstone CEO*, REUTERS, March 10, 2009, available at <http://www.reuters.com/article/idUSTRE52966Z20090311> (last visited Oct. 2, 2010).

181. The bonus system at large banks encourages individuals to seek short-term profits, which allows "members of the investment industry profit in good times but not share the losses in bad times and encourages unchecked risk taking." See Aaron Unterman, *Innovative Destruction – Structured Finance and Credit Market Reform in the Bubble Era*, 5 HASTINGS BUS. L.J. 53, 86 (2009).

182. See generally Donald C. Langevoort, *Selling Hope, Selling Risk: Some Lessons for Law from Behavioral Economics about Stockbrokers and Sophisticated Customers*, 84 CALIF. L. REV. 627 (1996); Stephen M. Bainbridge, *Mandatory Disclosure: A Behavioral Analysis*, 68 U. CIN. L. REV. 1023 (2000); Matthew A. Edwards, *Empirical and Behavioral Critiques of Mandatory Disclosure: Socio-Economics and the Quest for Truth in Lending*, 14 CORNELL J.L. & PUB. POL'Y 199 (2005).

A. Weaknesses of Disclosure

A cornerstone assumption of regulatory models based on disclosure is the rationality of market participants. Accordingly, a mandatory disclosure scheme can work most effectively where investors, analysts, brokers, and other actors have access to enough information, are able to process the information sufficiently, and behave in a rational manner.¹⁸³ Much of the current reliance on disclosure-based financial regulation is based on tacit acceptance of the efficient-market hypothesis,¹⁸⁴ and assumes rationality in the financial markets and that “the independent judgments of buyers and sellers in a securities market will best determine accurate prices for securities if those buyers and sellers have adequate information.”¹⁸⁵ However, the basic assumption of rationality may actually be flawed, which raises significant concerns with respect to investor protection.

Studies in behavioral finance have “documented aspects of ‘irrationality’ in investors’ behavior and explored the implications of these deviations from rationality on financial markets.”¹⁸⁶ The notion that investors always operate rationally is refuted by research on cognitive constraints and biases,¹⁸⁷ as well as the cycle of the growth of bubbles in the financial markets.¹⁸⁸ While a detailed discussion is beyond the scope of this article, research has shown that decision-makers routinely suffer from “information overload” and exhibit “herd behavior” by following the actions of others rather than displaying a rational approach to decisions.¹⁸⁹ Studies on rationality further suggest that decisions are the result of a host of factors and circumstances, and investors are often confronted with more information than they can

183. See generally Bradford Cornell & James C. Rutten, *Market Efficiency, Crashes, and Securities Litigation*, 81 TUL. L. REV. 443, 443-47 (2006) (discussing the endorsement of the efficient market hypothesis by the U.S. courts).

184. For a summary of the research on the efficient capital markets hypothesis, see Dunbar & Heller, *supra* note 97, at 462-65 (2006).

185. Paula J. Dalley, *The Use and Misuse of Disclosure as a Regulatory System*, 34 FLA. ST. U. L. REV. 1089, 1094 (2007).

186. Dunbar & Heller, *supra* note 97, at 471 (2006).

187. See generally Ripken, *supra* note 37, at 146 (citing Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1477 (1998); Donald C. Langevoort, *Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review*, 51 VAND. L. REV. 1499, 1503-06 (1998).

188. See generally Erik F. Gerding, *The Next Epidemic: Bubbles and the Growth and Decay of Securities Regulation*, 38 CONN. L. REV. 393 (2006) (discussing the cycle of growth and decay in the financial markets).

189. See generally Dalley, *supra* note 185, at 1114-15 (reviewing and summarizing research on the ability of individuals to correctly process information).

actually process.¹⁹⁰ With too much information to digest and too little time to process it, “information overload can result in confusion, cognitive strain, and poorer decision-making.”¹⁹¹ Additionally, the impact of financial disclosure on investors can lead to “irrational exuberance and anxiety,” and “[i]t is well-recognized that investors can suffer cognitively from . . . being unable to cognitively process and understand too much information.”¹⁹² Therefore, “one of the most significant problems with relying on a disclosure-based system to protect securities markets and investors is the flawed assumption that investors are purely rational actors who can utilize the disclosure effectively to make optimal investment decisions.”¹⁹³

Whether as a result of complexity, fraud, or confusion, both analysts and investors routinely misjudge the actual value of securities. Studies by behavioral finance theorists have also demonstrated that the prices of securities are often mispriced.¹⁹⁴ With respect to analysts, a growing body of research suggests that hypermotivated and super-optimistic insiders in firms may act irrationally in underestimating risks by “emphasizing positive returns as an indication of ability and downplaying trading losses as irrelevant.”¹⁹⁵ Likewise, investors may exhibit “judgment biases that lead them to underestimate the risk that bad things will occur.”¹⁹⁶ Furthermore, the proliferation of information in the age of the Internet where many investors rely less on experts to filter complex financial information may result in investors actually suffering from the requirements of securities regimes based on disclosure.¹⁹⁷ As one expert notes, “[m]ore information alone cannot cure investors of the judgment biases that supposedly lead them to misuse the information.”¹⁹⁸ Given all these contradictions to the assumptions underlying the efficient market theory, it is doubtful that disclosure in itself can adequately protect investors.

190. Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 2003 WASH. U. L. Q. 417, 418-19 (2003).

191. Ripken, *supra* note 37, at 160.

192. Peter H. Huang, *How Do Securities Laws Influence Affect, Happiness, & Trust*, 3 J. BUS. TECH. L. 257, 291 (2008).

193. Ripken, *supra* note 37, at 147-48.

194. See generally ROBERT J. SHILLER, *IRRATIONAL EXUBERANCE* 179-80 (2000). So-called “noise traders” – those who purchase and sell securities based on tips, reports of the media, misinterpretation of data and other reasons that do not reflect economic fundamentals – have been shown to explain irrational changes in the price of securities. See generally Cornell & Rutten, *supra* note 183, at 464.

195. Ribstein, *supra* note 63, at 20.

196. Ribstein, *supra* note 63, at 22.

197. Dalley, *supra* note 185, at 1090.

198. Ribstein, *supra* note 63, at 23.

Moreover, a disclosure-based regime can allow market participants to conceal investment risks behind opaque complex financial instruments that neither sophisticated nor retail investors actually understand.¹⁹⁹ Many experts blame the subprime mortgage crisis on the complexity in the financial markets along with a “lack of transparency” that caused even sophisticated investors to make poor investments, while “[f]inancial institutions overestimated their ability to disseminate values and comprehend risk.”²⁰⁰ The complexity of products in connection with the subprime mortgage industry illustrates the difficulty in relying on disclosure as a means to regulate financial instruments, especially with respect to derivative instruments which are largely unregulated.²⁰¹ With respect to some collateral debt obligations (“CDO”), for example, no amount of disclosure can adequately convey associated risks since investment banks “can tweak the inputs, assumptions, and underlying assets to produce a CDO that appears to add value, even though in reality it does not.”²⁰² Likewise, the corporate fraud crises of 2002 was perpetuated by structuring transactions which complied with disclosure obligations while companies such as Enron and WorldCom “pursued a single-minded policy of boosting the company’s stock price at all costs.”²⁰³ Accordingly, Enron was able to evade disclosure requirements with the help of “[u]niversal banks [which] orchestrated a myriad of complex transactions” that enabled Enron to conceal approximately \$25 billion in debt obligations.²⁰⁴

Beyond the issue of complexity, financial institutions routinely exploit areas of regulatory lacunae as well as take advantage of exemptions from regulation.²⁰⁵ In particular, certain types of transactions such as those involving sophisticated investors and specific areas including derivatives and hedge funds are largely unregulated by either

199. The opaqueness of such financial instruments raises ethical issues with respect to the duty of financial institutions to market instruments which the creators of such instruments do not fully understand or judge to be sound investments.

200. See Unterman, *supra* note 181, at 72.

201. Frank Partnoy & David A. Skeel, Jr., *The Promise and Perils of Credit Derivatives*, 75 U. CIN. L. REV. 1019, 1036 (2007).

202. *Id.* at 1044.

203. Arthur E. Wilmarth, Jr., *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 CONN. L. REV. 963, 998 (2009).

204. *Id.* at 999.

205. In 2008, private placements made pursuant to U.S. exemptions including Rule 144A, Regulation S, and Private Investment in Public Equity (PIPE) transactions amounted to \$117.6 billion. See Jennifer J. Johnston, *Private Placements: A Regulatory Black Hole*, 35 DEL. J. CORP. L. 151, 176 n.151 (2010) (citing Sagient Research Systems, Inc., Placement Tracker Private Placement Resources, <http://www.sagientresearch.com/pt/Stats.cfm?Type9>).

national or international rules.²⁰⁶ With respect to derivatives, in particular, the International Swaps and Derivative Association (ISDA)²⁰⁷ “has actively resisted disclosure of credit default swap documentation, insisting that this information is proprietary.”²⁰⁸ Accordingly, market practices evolve with little or no guidance from financial regulators.²⁰⁹ While the Dodd-Frank Act in the U.S. grants authority to the CFTC and SEC to oversee the derivative industry, many of the key terms in the legislation are undefined.²¹⁰ The subprime mortgage crisis that began in 2007 largely evolved from such a regulatory void, with financial institutions and other actors in the private sectors devising ever more exotic securitized instruments and off-balance sheet arrangements. To the extent that a regime of disclosure is incapable of offering adequate protection to investors, other measures to curtail unreasonably risky behavior by financial institutions could go a long way to protecting investors.

While disclosure regimes require companies and financial institutions to provide all material information, the offeror of securities has significant discretion in determining which details it deems material.²¹¹ Further, in the context of private placements which are effected pursuant to exemptions from disclosure requirements,²¹² it is unclear as to how the stakeholders in the purchasing entities are protected from overly risky investment decisions. Since many complex financial instruments are issued via private placements, a regime of disclosure will not adequately protect investors.²¹³ Investors in residential mortgage-backed securities (“RMBS”), the instruments that played a key role in the subprime mortgage crisis, “had very limited

206. See generally Unterman, *supra* note 181.

207. ISDA – International Swaps and Derivatives Association, Inc., <http://www.isda.org/> (last visited February 2, 2011).

208. Partnoy & Skeel, *supra* note 201, at 1036.

209. Indeed, the U.S. Supreme Court has recognized that certain transactions involving sophisticated investors do not require the protection afforded by the federal securities laws as they are able to “fend for themselves.” *SEC v. Ralston Purina Co.*, 346 U.S. 119, 125 (1953).

210. See Title VII: Wall Street Transparency and Accountability, The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, H.R. 4173 (2010).

211. See generally Janis Sarra, *Disclosure as a Public Policy Instrument in Global Capital Markets*, 42 *TEX. INT’L L.J.* 875, 888-95 (2007) (discussing various national regulatory approaches for materiality and management’s determination of whether information is material).

212. See 15 U.S.C.A. § 77d(2) (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)) (exempting “transactions by an issuer not involving any public offering”).

213. The market for private placements is significant. In terms of equity offers alone, \$162 billion was raised via Rule 144A equity offerings, which was more than the combined capital raised in IPOs on the New York Stock Exchange, NASDAQ and the American Stock Exchange in 2006. See William K. Sjostrom, Jr., *The Birth of Rule 144A Equity Offerings*, 56 *UCLA L. REV.* 409, 412 (2008).

opportunit[y] to perform their own due diligence”²¹⁴ and instead relied on the underwriters from which they purchased the RMBS, who “frequently cut costs and boosted profits by doing minimal due diligence of their own.”²¹⁵ The justification is that investors in private placements meet certain tests relating to size and financial sophistication. Yet, these investors manage the holdings of smaller and less sophisticated investors, the very individuals the securities laws were designed to protect. For example, ten times as much equity was raised by foreign companies in the private U.S. markets than in the public U.S. markets in 2005.²¹⁶ In the context of derivatives, not only is information on the instruments opaque, but the manner in which instruments are structured can make it difficult, if not impossible, to assess the associated risks.²¹⁷

Most regulators have detailed requirements for disclosure. In the U.S., the SEC specifies particular items in its various forms, and the EU Prospectus Directive contains similar corresponding disclosure requirements.²¹⁸ Nonetheless, these requirements do not necessarily capture the dynamic processes and personalities that lead to decisions in the boardroom since “information a firm’s managers use to understand a company’s operations varies from manager to manager and from company to company.”²¹⁹ Much of the information companies disclose in periodic reports and offering documents is only included if management deems it “material.”²²⁰ For example, decisions to include personal details under gap-filling and antifraud rules relating to non-corporate information are particularly sensitive, and “materiality determinations are perhaps the most tricky.”²²¹ With respect to the

214. Wilmarth, *supra* note 203, at 1026.

215. Wilmarth, *supra* note 203, at 1026.

216. See John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229, 234 n.10 (2007) (citing COMMITTEE ON CAPITAL MARKETS REGULATION, INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION 2-6 (2006), available at http://crao.senate.gov/documents/committee_capmarkets_reg.pdf).

217. See generally Partnoy & Skeel, *supra* note 201, at 1036.

218. Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, 2003 O.J. (L 345) 64.

219. Michael D. Guttentag, *An Argument for Imposing Disclosure Requirements on Public Companies*, 32 FLA. ST. U. L. REV. 123, 171 (2004).

220. See GREENE ET AL., *supra* note 36, at § 3.03[1].

221. Heminway, *supra* note 92, at 766. Heminway points out that: executives must make these decisions in what may be highly stressful or emotionally charged situations (e.g., under threat of criminal prosecution or civil enforcement, in the wake of a medical diagnosis of a serious or terminal illness, at a time of financial strife, or during the course of a divorce or nonpublic marital affair) [and] . . . decision making in times of stress, especially on matters involving a high level of sophistication and focus, has a low probability of being accurate, rational or optimal.

EU in particular, the creation of a single market lacks a consistent set of rules to establish an efficient single market for securities. The diversity caused by the various national rules and regulations can lead to competitive distortions among the financial institutions and encourage regulatory arbitrage.²²²

For the reasons discussed above, the current regulatory approach based on disclosure has proved to have significant defects in terms of protecting investors. The complexity of disclosure in public offerings raises questions as to whether any level of disclosure can adequately convey the risks of certain financial instruments,²²³ and it is doubtful that disclosure is even capable of conveying useful information in certain contexts. In his analysis of disclosure, Professor Steven Schwarcz has pointed out that certain transactions are so complicated that “few if any investors will actually understand the detailed disclosure.”²²⁴ In fact, disclosure requirements can actually be counterproductive, as they “may produce a wealth of complicated but ultimately unimportant information.”²²⁵ Both the regulatory systems of the U.S. and the EU face severe challenges in protecting investors and the financial markets under the current disclosure-based systems.

B. *Alternatives to Disclosure: International Regulatory Cooperation to Deter Overly Risky Behavior*

Beyond the inherent flaws of disclosure, the interconnectedness of the financial system and the widespread impact gaps in national regulation can have in the global economy necessitate a new approach to discouraging risky behavior. The patchwork of national financial regulators that constitute the current “national approach to securities regulation” allows for “large gaps between domestic regimes which provide ample opportunity for firms to adopt marginal practices in pursuit of profits.”²²⁶ Additionally, efforts to implement reforms that focus on more substantive issues can become overly complicated and lead to increased costs without clear benefits.²²⁷ Given the inherent

Id. at 767.

222. See de Larosière Group, *High-Level Group on Financial Supervision in the EU*, at 27, available at http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf.

223. See generally Unterman, *supra* note 181.

224. Steven L. Schwarcz, *Rethinking the Disclosure Paradigm in a World of Complexity*, 2004 U. ILL. L. REV. 1, 18 (2004).

225. J. Robert Brown, Jr., *Corporate Governance, the Securities and Exchange Commission, and the Limits of Disclosure*, 57 CATH. U. L. REV. 45, 79-80 (2007).

226. Aaron Unterman, *Exploring Risk: Global Implications of the Securitization of U.S. Housing Debt*, 4 HASTINGS BUS. L.J. 77, 109 (2008).

227. Many scholars have sharply criticized the Sarbanes-Oxley Act for precisely these reasons. In his analysis of the legislative response to the corporate scandals of the early 2000s that led to

weaknesses of disclosure, as well as the financial ingenuity that is usually one step ahead of regulators, other methods of influencing behavior are necessary to prevent overly risky behavior that damages the public good. According to one expert, "it is also clear that far too many members of the industry behaved extremely recklessly and greater mechanisms of deterrence could have prevented at least some of the pain being felt now."²²⁸ Investors can be also be misled during times of economic expansion, underestimating risks and placing too much trust in the markets. "Since trust is a behavioral phenomenon, the behavioral biases that contribute to investor euphoria and the development of a bubble can lead to an excess of trust in the integrity of market participants."²²⁹ Financial regulation inherently suffers from a free rider problem with an incentive to permit questionable practices as long as such behavior is tolerated by other regulators.²³⁰ Further, regulators are often reluctant to discourage banks from lending during asset bubbles since doing so could lead to a crisis.²³¹ Likewise, government may also be reluctant to alert voters to asset bubbles.²³² Bubbles actually trigger "political pressure to deregulate financial markets and dilute securities regulation . . . [which] manifests itself not only in efforts to roll back laws that would otherwise deter fraud, but also in under-enforcement of existing laws and resistance to proposals to address concerns about speculation or the growing risk of fraud."²³³ For these reasons, it is all the more important that national regulators work together to avoid a free rider problem as well as to de-politicize regulation which may stifle short-term innovation but protect long-term wealth.

Prior to the financial crisis, many of the largest banks were registered with the SEC and therefore required to file periodic and annual

the adoption of the Sarbanes-Oxley Act, Professor Coffee notes, "The only effective antidotes to fraud are active and vigilant markets and professionals with strong incentives to investigate corporate managers and dig up corporate information." See Ribstein, *supra* note 63, at 3. See generally Naidu, *supra* note 24; John Gibeaut, *New Twists in Sarbanes-Oxley May Compel More Smaller Companies to Exit the Market*, A.B.A. J., Jan. 2005, at 20; Cory L. Braddock, *Penny Wise, Pound Foolish: Why Investors Would Be Foolish to Pay a Penny or a Pound for the Protections Provided by Sarbanes-Oxley*, 2006 BYU L. REV. 175 (2006).

228. Unterman, *supra* note 181, at 80.

229. Gerding, *supra* note 188, at 421.

230. Professor Wilmarth has summarized the regulatory failures that led to the subprime mortgage crisis accurately and succinctly: "Over the past decade, regulators in developed nations encouraged the expansion of large financial conglomerates and failed to restrain their pursuit of short-term profits through increased leverage and high-risk activities." Wilmarth, *supra* note 203, at 1049.

231. JOHN CALVERLEY, *BUBBLES AND HOW TO SURVIVE THEM* 167 (2004).

232. *Id.*

233. Gerding, *supra* note 188, at 395.

reports. Yet, such disclosure failed to protect investors from a loss of \$8 trillion on the U.S. equity markets alone.²³⁴ Rather than continue the cyclical pattern of lax regulation during periods of rapid economic growth followed by the adoption of a hodgepodge of new draconian national laws which might do little to deter future detrimental behavior, the legislatures and securities regulators should agree to international standards of liability that will act to cure these market extremes. While this might appear overly ambitious, the alternative is to continue the ineffective, but politically expedient adoption of yet further regulations that are powerless to predict the next financial crisis. Financial regulators charged with ensuring efficient markets have been unable to provide regulatory supervision sufficient to prevent financial crises, and market participants are not deterred from the current liability regime. Indeed, many argue that penalties and the possibility of liability are already too high. In U.S. law, Rule 10b-5 has become synonymous with harsh regulation. The U.S. SEC also has a “reputation as a ruthless enforcer with a ‘take no prisoners’ mentality.”²³⁵ However, others have pointed out that the SEC has not always been aggressive in prosecuting wrongdoing.²³⁶ For example, in the case of the Sarbanes-Oxley Act, the SEC is sometimes reluctant to impose penalties since any penalties assigned to a corporation “ultimately . . . are borne by shareholders.”²³⁷ Closer examination shows that criminal prosecutions under 10b-5 “consistently offer[] neither effectual retribution nor effective deterrence.”²³⁸ However, “[c]orporate fraud scandals continue in the United States and resulting damages are growing, even with current regulations in place.”²³⁹ In addition, the

234. Lisa H. Nicholson, *The Culture of Under-Enforcement: Buried Treasure, Sarbanes-Oxley and the Corporate Pirate*, 5 DEPAUL BUS. & COM. L.J. 321, 323 (2007).

235. Eugene F. Moloney, *Banks and the SEC: A Regulatory Mismatch?*, 25 ANN. REV. BANKING & FIN. L. 443, 455 (2006). However, the SEC has often been regarded as less aggressive in pursuing possible violations.

236. See generally Jonathan R. Macey, *Wall Street in Turmoil: State-Federal Relations Post-Eliot Spitzer*, 70 BROOK. L. REV. 117, 118 (2004).

237. Atkins & Bondi, *supra* note 99, at 398. The authors describe Section 308's Fair Fund distribution in the following manner: “The Fair Fund distribution thus creates a circular situation: The Commission penalizes a corporation to put the money into a fund to reimburse the shareholders who were themselves just indirectly penalized.” Atkins & Bondi, *supra* note 99, at 398 n.171.

238. Joan MacLeod Heminway, *Hell Hath No Fury Like an Investor Scorned: Retribution, Deterrence, Restoration, and the Criminalization of Securities Fraud Under 10b-5*, 2 J. BUS. & TECH. L. 3, 7 (2007).

239. See Shelley Thompson, *The Globalization of Securities Markets: Effects on Investor Protection*, 41 INT'L LAW. 1121, 1126 (2007). Thompson argues that the dramatic litigation settlements in recent years “are not driven by frivolous litigation,” but rather by the “massive fraud” by particular companies, including the \$6.2 billion WorldCom settlement out of a total of \$9.4 billion in securities litigation settlements in 2005. *Id.* at 1125. Thompson further notes that “[o]f

European regulatory framework suffers from a lack of cohesiveness owing to the various cultural and legislative practices among member states that lead to uneven enforcement of common directives.²⁴⁰ For example, the Transparency Directive only sets minimum standards which member states may enhance, thereby creating room for variations among member states with regard to ongoing disclosure obligations.²⁴¹ In addition, where EU securities law harmonization leaves member states no room for substantive variation in the design of national regulation, the fact that its private and public enforcement is almost purely a matter for the member states means that, in sum, differences in national securities law regimes are of significant relevance even with regard to the detailed prescriptions of EU directives. For example, in the U.K., the FSA is guided by principle-based regulation²⁴² that seeks, where possible, to avoid prescriptive rules which have not been able to prevent misconduct.²⁴³ However, the FSA has been criticized that its “light touch” principle-based regulation approach has been a primary catalyst for the failure of major U.K. banks and financial institutions as well as the collapse of the U.K. securitization market since the summer of 2007.²⁴⁴ Only rigorous sanctions that are administered fairly and consistently can provide the deterrence necessary to discourage overly risky behavior.

Rather than vigorously enforcing sanctions, the SEC and other regulators have been lax in prosecuting violations. The past three de-

the \$17.2 billion in settlements in 2006, \$7.1 billion came from the Enron settlement alone.” *Id.* at 1125-26.

240. See de Larosière Group, *supra* note 222, at 27.

241. See Enriques & Gatti, *supra* note 112, at 69. Additionally, the Takeover Bids Directive leaves the determination of the threshold percentage which activates the mandatory bid and its calculation to member states and allows defensive measures to both the restrictions for the target’s board deterring hostile bids and to the breakthrough rule that suspends voting caps and transfer restrictions. See Christian Kirchner & Richard W. Painter, *Takeover Defenses Under Delaware Law, the Proposed Thirteenth EU Directive and the New German Takeover Law: Comparison and Recommendations for Reform*, 50 AM. J. COMP. L. 451, 469 (2002).

242. See generally FINANCIAL SERVICES AUTHORITY, PRINCIPLES-BASED REGULATION: FOCUSING ON THE OUTCOMES THAT MATTER 6 (Apr. 2007), available at <http://www.fsa.gov.uk/pubs/other/principles.pdf>. Principles-based regulation relies less on prescriptive rules and places greater importance on high level principles to achieve regulatory goals. *Id.* The Turner Review also reaffirms the importance of the principles-based framework for U.K. financial regulation. See FINANCIAL SERVICES AUTHORITY, THE TURNER REVIEW: A REGULATORY RESPONSE TO THE GLOBAL BANKING CRISIS (Mar. 2009), available at http://www.fsa.gov.uk/pubs/other/turner_review.pdf. For a full discussion of principle-based regulation, see Julia Black, *Forms and Paradoxes of Principles-Based Regulation*, 3 CAP. MARKETS L.J. 425 (2008).

243. Kern Alexander, *Principles v. Rules in Financial Regulation: Re-assessing the Balance in the Credit Crisis Symposium at Cambridge University*, 10 EUR. BUS. ORG. L. REV. 169, 171 (2008).

244. *Id.* at 169.

ades have seen periods of economic bubbles accompanied by lax enforcement of regulation followed by aggressive steps by legislatures to adopt increased legislation.²⁴⁵ “This cycle of decay and re-growth is propelled by the dynamics of stock market bubbles and the epidemics of fraud that they generate.”²⁴⁶ Moreover, recent financial crises have seen the rise of a “new breed of corporate executives who are unconstrained by the traditional devices”²⁴⁷ of financial regulation. More worrying, at least in the context of the subprime crisis, governments have even tacitly endorsed and rewarded overly risky activities by bailing out financial institutions. One expert describes the dilemma in the following manner:

Allowing major institutions to profit from irresponsible financial dealings and then intervening when they get in over their heads makes it too easy for these firms to avoid the consequences of their actions. Morally, this action is reprehensible because it bails out the same people responsible for this crisis, inevitably with tax payer money, and has the effect of privatizing profit and socializing loss.²⁴⁸

Against this background, the various national and international securities authorities and regulators should work to establish and enforce common standards of liability which clearly define overly risky behavior and then consistently enforce sanctions to provide an effective deterrent. In the absence of coordinated regulatory cooperation, jurisdictions which adopt harsher financial regulations risk driving financial goods and services to other jurisdictions. According to Professor Coffee, “disparities in enforcement may be able to explain what marginal differences in formal legal rules or disclosure standards cannot explain.”²⁴⁹ In so doing, “[t]hese cascade effects will add up very quickly, carrying with them the potential to set up alternative business regimes that are beyond regulation.”²⁵⁰ In addition, “the competition between regulators is not necessarily geared towards achieving regula-

245. Gerding, *supra* note 188, at 448. Gerding criticizes regulatory responses to financial crises since they are often “just another episode of new securities laws designed to re-fight the last war by seeking to prevent the unique schemes just committed.” Gerding, *supra* note 188, at 448.

246. Gerding, *supra* note 188, at 394.

247. Ribstein, *supra* note 63, at 9. Ribstein identifies such executives in the aftermath of the Enron scandal, noting that, “These executives are hyper-motivated survivors of a highly competitive tournament . . . who have proven their ability to make money while putting on a veneer of loyalty to the firm.” Ribstein, *supra* note 63, at 9. Ribstein also observes a willingness of such players to engage in risky transactions in a “corporate culture that instils loyalty to insiders” and displays an “an obsession with short-term stock price.” Ribstein, *supra* note 63, at 9.

248. Unterman, *supra* note 181, at 81.

249. Coffee, *supra* note 216, at 242.

250. Richard A. Epstein, *The Dangers of “Investor Protection” in Securities Markets*, 12 TEX. REV. L. & POL. 411, 417 (2008).

tion that is most optimal for the beneficiaries of the regulation”²⁵¹ since the absence of common standards of liability exposes investors to greater risks depending on the effectiveness of local regulators. In a sense, “globalization of the markets results in less stable economies and increased risk for investors around the world” with volatility in one market increasingly affecting conditions in other markets.²⁵²

The IOSCO²⁵³ has led international efforts to harmonize the regulation of the capital markets²⁵⁴ and could provide an impetus for national regulatory cooperation on establishing such a common approach. With over one hundred seventy members, including both governmental and private securities regulators, IOSCO has an informal structure²⁵⁵ and works to achieve “regulatory harmonization through consensus.”²⁵⁶ IOSCO has formulated an array of principles and reports, largely through its Technical Committee.²⁵⁷ With regard to disclosure standards,²⁵⁸ IOSCO published its International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers in 1998²⁵⁹ to encourage harmonization. The SEC adopted these standards in 1999, by revising its Form 20-F, the form which outlines foreign issuers’ disclosure and accounting requirements.²⁶⁰ Following these efforts to cooperate in the area of disclosure, IOSCO should focus its attention on establishing an international liability standard that will be an effective deterrent against future overly risky behavior in the financial markets. The introduction and enforcement of a common international standard for liability would help to limit the ability of companies to engage in regulatory arbitrage. Likewise, such a common liability standard would enhance the scope of cooperation among national regulators in enforcing their respective securities regimes.

251. Chiu, *supra* note 8, at 765.

252. Thompson, *supra* note 239, at 1127.

253. See generally IOSCO, <http://www.iosco.org/> (last visited Feb. 7, 2011).

254. In May 2003, IOSCO published its Objectives and Principles of Securities Regulation which seeks to protect investors, encourage efficient and fair markets and minimize risks. See IOSCO, OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION, <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>.

255. David Zaring, *Informal Procedure, Hard and Soft, in International Administration*, 5 CHI. J. INT’L L. 547, 562 (2005).

256. *Id.* at 565.

257. *Id.* at 564.

258. See Roberta S. Karmel, *Will Convergence of Financial Disclosure Standards Change SEC Regulation of Foreign Issuers*, 26 BROOK. J. INT’L L. 486, 492 (2000).

259. See IOSCO, INTERNATIONAL DISCLOSURE STANDARDS FOR CROSS-BORDER OFFERINGS AND INITIAL LISTINGS BY FOREIGN ISSUERS (Sept. 1998), available at http://www.sec.gov/about/offices/oia/oia_corpfin/crossborder.pdf.

260. See Zaring, *supra* note 255, at 567.

The current research concedes that defining particular behavior to be discouraged is necessarily difficult, and the legislature and financial regulators must work in concert to determine what standards to adopt. Under U.S. law, § 24 of the Securities Act assigns criminal liability to “[a]ny person who wilfully violates” its provisions or rules and regulations adopted by the SEC thereunder.²⁶¹ However, the precise definition of “wilfully” remains elusive, with both courts and legal experts grappling over various formulations.²⁶² This regulatory lacunae necessarily leaves market participants open to develop practices without adequate guidance from regulators. It is therefore disingenuous of legislatures to create new laws in reaction to financial abuses without adequately providing standards that would have deterred such behavior in the first place. Without a robust legal regime to discourage overly risky behavior that can harm the public good, disclosure alone will be ineffective.²⁶³ Without vigorous enforcement, these penalties lack a deterrent effect as one expert eloquently points out:

The politicians appear to rely on the notion that potential offenders will be deterred from engaging in wrongdoing because they will fear longer terms of incarceration. This rationale relies on the faulty assumption: that these lengthy terms of imprisonment and high fines actually will be meted out. Numerous variables play a role in determining the actual sentence imposed by the courts . . . which enables greater judicial discretion in sentencing offenders.²⁶⁴

In response to the financial crisis, the FSA has taken a more aggressive approach, pledging to engage in enforcement actions as a “credible deterrence” tool against rogue firms or individuals.²⁶⁵ These aggressive actions by the FSA and the SEC in the wake of the financial crisis go a long way to restoring investor confidence in the market. However, these steps in the U.S. and U.K. fall short of a concerted approach to liability in the international regulation of securities. As has been argued above, only such a unified, consistent approach to liability and enforcement will deter future crises.

261. 15 U.S.C.A. § 77x (LexisNexis through P.L. 111-359 (with a gap of P.L. 111-350)).

262. See generally Michael L. Seigel, *Bringing Coherence to Mens Rea Analysis for Securities-Related Offenses*, 2006 WIS. L. REV. 1563 (2006). Professor Seigel summarizes various explanations of the meaning of “wilfully,” finally noting that the leading commentator on U.S. securities law Louis Loss had “also failed to adequately address the interpretation of the word ‘wilfully’ in his seminal work on securities regulation.” *Id.* at 1584-90.

263. See generally J. Robert Brown, Jr., *Corporate Governance, the Securities and Exchange Commission, and the Limits of Disclosure*, 57 CATH. U. L. REV. 45 (2007). According to Professor Brown, “In the absence of strong underlying legal obligations, the use of disclosure as a tool to regulate substantive behavior is far less effective.” *Id.* at 79.

264. Nicholson, *supra* note 234, at 344.

265. FINANCIAL SERVICES AUTHORITY, A REGULATORY RESPONSE TO THE GLOBAL BANKING CRISIS 21 (Mar. 2009), available at http://www.fsa.gov.uk/pubs/discussion/dp09_02.pdf.

IV. CONCLUSION

As investors have unprecedented access to opportunities around the globe, financial crises which begin in a particular sector or market have the potential to spill over into other sectors and markets. The global repercussions of the U.S. subprime mortgage crisis illustrate the interdependence of the modern international financial system and the speed with which localized problems can spread.

The history of financial regulation has been punctuated by regulators chasing after ever more innovative bankers and the products which earn their bonuses. "The only effective antidotes to fraud are active and vigilant markets and professionals with strong incentives to investigate corporate managers and dig up corporate information."²⁶⁶ While sunlight continues to be the best disinfectant, securities regulation systems based on disclosure could be substantially strengthened by adopting – and consistently enforcing in times of both boom and bust – stricter liability for fraudulent and overly risky investment activities, which could help to disincentivize reckless behavior.

266. See Ribstein, *supra* note 63, at 3.