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Introduction

The recent expansion of computer technology allows people to communicate like never before. By using e-mail or visiting a web site, they can access foreign information and services through electronic media with minimal effort and expense. The computer revolution has opened up attractive

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32 CORNELL INT'L L.J. 209 (1998)

opportunities for investors in foreign securities.[1] The internet and other alternative trading systems (ATSs)[2] decrease the costs associated with cross-border securities trading.[3] Unfortunately, this new era presents some pressing dilemmas for the Securities and Exchange Commission (SEC or "Commission").[4] Whereas trades on foreign markets[5] traditionally were made through direct contact with an SEC-registered foreign broker-dealer,[6] U.S. investors today find it easier to purchase securities on

1. During the 1980s alone, the number of trans-border securities transactions increased twenty-fold. Paul G. Mahoney, *Securities Regulation By Enforcement: An International Perspective*, 7 YALE J. REG. 305, 306-07 (1990). Because it reduces the costs of performing transactions, the Internet is expected to continue to cause the number of cross-border transactions to increase. Trotter Hardy, *Law and the Internet: What Are the Dangers of Putting the World at Your Fingertips?*, 5 BUS. L. TODAY 8, 13 (1996). One source predicts that cross-border stock trading might reach $5 trillion by the year 2000. *See* Jill E. Fisch, *Imprudent Power: Reconsidering U.S. Regulation of Foreign Tender Offers*, 87 NW. U. L. REV. 523, 523 n.3 (1993).

2. Buyers and sellers of securities utilize alternative trading systems to execute securities trades through a computer terminal. The buyers and sellers have no direct contact when they trade through alternative trading systems. Paul G. Mahoney, *Technology, Property Rights in Information, and Securities Regulation*, 75 WASH. U. L.Q. 815, 824 (1997). An ATS integrates the order collecting, routing, matching, and clearing elements in a securities transaction. Jan De Bel, *Automated Trading Systems and the Concept of an "Exchange" in an International Context Proprietary Systems: A Regulatory Headachel*, 14 U. PA. J. INT'L BUS. L. 169, 169 (1993).

3. *See* Regulation of Exchanges, SEC Concept Release No. 34-38672, [1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,942, at 89,683 (May 23, 1997) (addressing impact of technological advances on regulation of securities exchanges and markets and soliciting comment on various issues, such as oversight of alternative trading systems, national securities exchanges and foreign market activities) [hereinafter Concept Release].

4. The SEC is a regulatory body devoted primarily to protecting the integrity of the American securities markets through direct regulation of stock exchanges (the forums for trading activity), as well as issuers, underwriters, brokers and other market participants. By imposing anti-fraud and disclosure requirements on broker-dealers who trade U.S.-issued securities or transact trading activity within the United States jurisdiction, the Commission preserves marketwide transparency and, hence, fosters efficient domestic securities markets. For a more comprehensive description of SEC's policy goals, *see infra* notes 29-38 and accompanying text.

5. For the purposes of this Note, the terms "national exchange" and "national market" are used interchangeably to describe a stock exchange (such as the New York Stock Exchange or the American Stock Exchange), as defined in the Securities Exchange Act of 1934, 15 U.S.C. § 75c(a)(1) (1934).

6. A broker is any person who is "in the business of effecting transactions in securities for the account of others." Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(4) (1934). A dealer is a person "engaged in the business of buying and selling securities for his own account through a broker or otherwise." *Id.* at § 78c(a)(5). Brokers and dealers are regulated almost identically under the Act. Rules pertaining to broker-dealers primarily focus on assuring that individuals conduct themselves in a non-fraudulent manner when effectuating transactions. *See* Securities and Exchange Act of 1934, 15 U.S.C. § 78o(b)(4). Under the Securities Exchange Act of 1934, an individual market (or "exchange") is "any organization, association, or group of persons . . . which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood." *Id.* at § 78c(a)(1) (1934). The SEC's rules for exchanges "are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination . . ., to remove impediments to and perfect

foreign markets through non-registered foreign broker-dealers.[7] Under certain conditions, investors can use the internet or other computer information systems to invest through an unregistered foreign broker-dealer without violating SEC regulations.[8] These transactions pose risks to investors when a foreign government fails to subject its own broker-dealers to strict surveillance and examination.[9] Because many foreign regulatory regimes do not enforce the same consumer safeguards that the United States enforces,[10] the SEC fears that some consumers will overlook the risks posed by trading on the foreign exchanges.[11] The SEC realizes that the current regulatory regime does not specifically require foreign broker-dealers to comply with its regulations,[12] and seeks to alter its policy to protect U.S. investors from the evils of inadequate foreign regulatory control.[13] On May 23, 1997, the SEC issued a concept release that summarized the void in the current regulatory regime caused by cross-border trading over the internet.[14] It suggested three policy solutions, indicated the SEC's favored policy, and solicited public comments on the issue.[15]

The purpose of this Note is to assess whether the SEC's proposal is the best avenue of reform, given its powerful ramifications on other nations' sovereignties. This Note evaluates the SEC's suggested solution from two viewpoints. First, this Note traces the SEC's historic role in securities regulation and cites the SEC's justifications for extending its influence into international securities law. Part I provides a brief summary of how advances in the computer industry precipitated the SEC's current dilemma and describes the SEC's proposed solutions to the problem. This Part reviews the SEC's role as a securities regulator and examines its justifications for regulating foreign persons who provide access to non-U.S.

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the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest." *Id.* at § 78f(b)(5). The rules restricting exchanges require participants to act not only in a non-fraudulent manner, but also to take affirmative steps to maintain a free, open, and competitive market. Therefore, a broker-dealer is subject to less stringent regulation than an exchange. Rule 17a-23 under the Exchange Act established recordkeeping and reporting requirements for broker-dealers that utilize alternative trading systems to execute trades. Recordkeeping and Reporting Requirements for Trading Systems Operated by Brokers and Dealers, Securities Exchange Act Release No. 35,124, Fed. Sec. L. Rep. (CCH) ¶ 85,478 (Dec. 20, 1994). As discussed in Part I.C.3., foreign broker-dealers can evade these requirements when they work on foreign soil and do not solicit investors directly. *See infra* Part I.C.3.

7. *See* Concept Release, *supra* note 3, at 89,863-84.

8. Under current SEC guidelines, foreign broker-dealers are not subject to SEC oversight if they merely receive and execute orders from U.S. investors and do not solicit business in the U.S. *See infra* Part I.C.3.

9. *See* Concept Release, *supra* note 3, at 89,686. *See infra* note 99 and accompanying text.

10. For example, many foreign regulators do not enforce disclosure guidelines comparable to those enforced by the SEC. *See infra* Part I.C.2.

11. *See* Concept Release, *supra* note 3, at 89,685.

12. *See* Peter E. Millspaugh, *Global Securities Trading: The Question of a Watchdog*, 26 GEO. WASH. J. INT'L L. & ECON. 355, 358 (1992).

13. *See* Concept Release, *supra* note 3, at 89,633.

14. *Id.* at 89,633-35.

15. *Id.*

exchanges. Second, this Note evaluates whether the SEC is the governmental entity best suited to deal with the problems caused by the proliferation of cross-border trading by U.S. citizens. Part II explains the institutional forces that led the SEC to select its course of action, and assesses whether an international policing agency or a Congressionally-led international securities regulation committee is better suited to lead these reforms.

This Note concludes that Congress should be more directly involved in the formulation of SEC rules that violate foreign nations' sovereignties. In particular, Congress should issue a mandate halting further SEC rulemaking where obvious sovereignty issues are implicated. Furthermore, Congress should develop a policy that specifies when international relations can be sacrificed to implement the U.S. securities regulation model in the worldwide market.

I. The Concept Release and the SEC's Solution to Its Regulatory Dilemma

A. The Precipitating Events

Recent advances in computer and communications technologies have altered the character of stock trading. Instead of using a broker to research a company and purchase its stock, investors are switching to alternative systems at an alarming rate.[16] Investors are turning to electronic information exchange because it merges the information and trading aspects of securities markets.[17] In other words, just by logging on to a computer, an investor can research a company's financial status and purchase stock via electronic transmission. People can access real-time information and make trades electronically, rather than over the telephone or facsimile.[18] As of 1996, over 120,000 investment accounts existed on the internet.[19] A recent study conducted by Forrester Research predicted that by 2001 there will be 9.3 million internet accounts, equal to about eight and one-half percent of the total retail stock trading market.[20] In May 1997, the SEC estimated that ATSs handle about twenty percent of trades in over-the-counter stocks and about four percent of New York Stock Exchange-listed stock orders.[21] Much of the increase can be traced to the rise of the internet and ATSs such as Reuters' Instinet.[22]

16. The SEC now estimates that approximately 20% of over-the-counter orders are executed on alternative trading systems. *See* Concept Release, *supra* note 3, at 30,486.

17. *See* Les Riordan, Comment, *Three Proposals For a Latin American Stock Exchange in Miami: Full-Service Exchange, Private Offshore Market, or a Computerized Financial Information Service*, 27 U. MIAMI INTER-AM. L. REV. 585, 630-31 (1996).

18. *See* Concept Release, *supra* note 3, at 89,683.

19. *See* Kimberly Weisul, *Report: New "Mid-Tier" Brokers to get 60% of On-Line Trades*, INV. DEAL. DIG., Sept. 30, 1996, at 11.

20. *See id.*

21. *See* Concept Release, *supra* note 3, at 89,632-33.

22. *See* Gerri Willis, *Electronic Marketplace Takes Byte of Wall St.*, CRAINE'S N.Y. BUS., Apr. 15, 1996, at 27. Instinet is the largest private electronic stock trading network and the third largest U.S. market. It employs over 600 people and had a net worth of $327,000,000 in fiscal year 1995. *See id.*

The SEC is particularly concerned about on-line trading of stocks listed on foreign exchanges.[23] The Commission warned that "the impact of technological change has not been limited to domestic markets."[24] Broker-dealers' increased use of alternative systems allows U.S. citizens to trade on foreign exchanges from the United States.[25] Foreseeing that the current regulatory regime is inadequate to respond to the expansion of on-line foreign securities trading, the SEC issued a concept release on May 23, 1997, soliciting public comment on future oversight of ATSs and foreign broker-dealers.[26] The following excerpt summarizes the SEC's reasons for issuing the concept release:

> Technological changes have posed significant challenges for the existing regulatory framework, which is ill-equipped to respond to the innovations in U.S. and cross-border trading. Specifically, two key developments highlight the need for a more forward-looking, flexible regulatory framework: (1) the exponential growth of trading systems that present comparable alternatives to traditional exchange trading; and (2) the development of automated mechanisms that facilitate access to foreign markets from the United States.[27]

By issuing the concept release, the SEC launched an attack against the regulatory problems caused by the proliferation of on-line foreign securities trading by U.S. investors.[28]

The SEC is concerned that the current regime is not structured to regulate on-line foreign securities purchases by U.S. investors.[29] Initially, the SEC discusses the problems caused by domestic on-line stock purchases.[30] The SEC suggests that because ATSs are usually regulated via broker-dealer regulation,[31] rather than as individual markets themselves,[32] broker-dealers that utilize ATSs are permitted to be "anticompetitive or otherwise detrimental to the market."[33] For example, if an ATS maintains a monopoly

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23. *See* Concept Release, *supra* note 3, at 89,633.
24. *Id.*
25. *See id.*
26. *See* Concept Release, *supra* note 3, at 89,630.
27. *Id.* at 89,632.
28. *See id.* at 89, 632-33. Under the Administrative Procedure Act, the SEC is required to solicit comments from the public before enacting a rule. KENNETH CULP DAVIS, DISCRETIONARY JUSTICE: A PRELIMINARY INQUIRY (1980). A rule must be published as a proposed rule for public comment before it can become effective. *See* 5 U.S.C. § 553(b)(1) (1966). After the SEC receives public comment, it "sifts the written presentations and the proposed rule may be revised." *Id.*
29. As one author has pointed out, "the transnational nature of global trading has removed it from the full jurisdictional reach of national and local regulation." Millspaugh, *supra* note 12, at 358.
30. *See* Concept Release, *supra* note 3, at 89,632-33.
31. Alternative Trading Systems are regulated only to the extent that broker-dealers who utilize them are subject to disclosure and anti-fraud requirements. *See supra* note 6.
32. *See* Concept Release, *supra* note 3, at 89,633. Under SEC rules, registered exchanges are required to "establish rules that assure fair representation of members and investors in . . . administering [the exchanges]." *Id.* at 89,640.
33. *Id.* As the Commission cautions, "trading activity on these systems may not be adequately surveilled for market manipulation and fraud." *Id.* at 89,633. Therefore, broker-dealers themselves can be "anticompetitive" by using ATSs to defraud investors or illegally manipulate the market.

on the volume of trading in a certain region, the ATS can choose to favor one broker-dealer over another and drastically affect competition between broker-dealers.[34] Because a major goal of the Exchange Act is to ensure that securities exchanges treat investors and their broker-dealers fairly, the Commission is evaluating whether some ATSs should be regulated as national exchanges.[35] Even without requiring ATSs to register as national exchanges, many foreign-broker dealers fear SEC action and are unwilling to conduct transactions with U.S. investors.[36] If the SEC requires certain ATSs to abide by national exchange requirements, many *foreign* broker-dealers would be hesitant to provide U.S. investors with access to their markets, and U.S. investors would find it more difficult to make cross-border stock purchases.[37] Fearing that the present regulatory system cannot assure broker-dealer competitiveness or the free availability of foreign stock purchases to U.S. investors, the SEC took the first step toward solving the problem by issuing the concept release.[38]

The SEC has attempted other methods to protect U.S. investors from the dangers of foreign securities practices. The SEC has entered into bilateral agreements with numerous foreign governing bodies. In 1991, the SEC and the European Commission announced their intention to cooperate in regulating the international securities markets.[39] Under the agreement, the parties promised to conduct regular meetings to discuss policy and enforcement issues.[40] The SEC has also produced Memoranda of Understanding (MOU) with foreign securities regulators, formally indicating the parties' intent to cooperate in structuring international enforcement policies for cross-border offerings.[41] The MOU allows the SEC to access evidence on foreign trading activity.[42] On October 5, 1995, the SEC signed an MOU with the Hong Kong Securities and Futures Commission giving "reciprocal access to files, the taking of testimony and statements, and obtaining information and documents."[43] Subsequently, the SEC signed similar arrangements with Russia, Israel and Egypt.[44] In an October 1995 release, the SEC allowed exemptions for certain highly-capitalized

34. *See id.* at 89,633.
35. *See id.* at 89,634.
36. *See id.* at 89,633.
37. *See id.* at 89,684-85. Following the Commission's logic, many foreign broker-dealers and the ATSs they utilize would be unable to meet the SEC's strict disclosure and anti-fraud guidelines. *See id.*
38. *See* Concept Release, *supra* note 3.
39. *See* George A. Bermann, *Regulatory Cooperation Between the European Commission and U.S. Administrative Agencies*, 9 ADMIN. L. J. AM. U. 933, 971 (1996).
40. *See id.*
41. *See* Theresa A. Gabaldon, American Bar Association Continuing Legal Education ALI-ABA Course of Study, Postgraduate course in Securities Law: *International Developments (Excluding Developments Relating to Regulation S)*, SB09 ALI-ABA 7, 14 (1996).
42. *See* Lee S. Richards, III, *Legal Representation in the International Securities Markets: Representing Client in Securities and Exchange Commission, Department of Justice or Self-Regulatory Organization Proceedings Involving Foreign Citizens or Foreign Trading*, 683 PLI/CORP 143, 176 (1990).
43. Gabaldon, *supra* note 41, at 14.
44. *See id.* at 15.

Dutch companies seeking to offer securities on U.S. exchanges.[45] By meeting certain disclosure and recordkeeping requirements, the companies can make transactions that U.S. law otherwise prohibits.[46]

Furthermore, the SEC set a March 1998 target date for the promulgation of international accounting standards, which will afford companies easier access to worldwide securities markets.[47] The standards will be used to prepare the financial documents disclosed in cross-border offerings.[48] The SEC hopes that universal accounting services will ensure capital market fairness by fostering equal access to information among investors.[49]

The MOU and the proposed universal accounting standards indicate that the SEC is pursuing a multi-front attack on the problems caused when U.S. investors trade on foreign markets. However, worldwide acceptance of international standards alone will not solve the new problems in global securities trading. Although the United States has signed bilateral agreements to cooperate, and most nations will be speaking the same regulation "language" in the future, the different levels of regulatory enforcement that exist worldwide are a significant impediment to an objectively fair international securities market.[50] The SEC's proposals in the May 1997 concept release are thus one essential step in the overall strategy to restructure the regulatory standards for cross-border securities trading.[51]

B. The Three Proposals and the SEC's Favored Solution

The SEC included three proposals in the May 1997 concept release. Under Proposal 1, the SEC would rely on foreign regulators to oversee their home markets and provide U.S. investors with necessary protections.[52] The SEC would designate foreign regulators as those that provide safeguards comparable to the safeguards enforced in the United States.[53] The Commission would base its decision on an assessment of the foreign regulatory regime's overall structure and whether the regime adequately provides the key disclosure and anti-fraud protections that the SEC provides.[54] The SEC would make this determination on a case-by-case basis.[55] This proposal is attractive because it would not cause foreign markets to suffer any additional

45. *See id.* at 17.
46. *See id.*
47. *See Securities Pros Grapple With Topic Of Investing Internationally At Financial Conference*, SECURITIES WEEK, Apr. 15, 1996, at 4 (quoting Paul Leder, SEC's Deputy Director of International Affairs).
48. *See* Gabaldon, *supra* note 41, at 10.
49. *See* SECURITIES WEEK, *supra* note 47, at 4.
50. The inadequacy of enforcement in select foreign countries is discussed in greater depth later in this Note. *See infra* Part II.C.2.
51. *See* Practicing Law Institute, The SEC's International Enforcement Program and Bilateral and Multilateral Initiatives, 927 DLI/Corp 125, 131 (1996).
52. *See* Concept Release, *supra* note 3, at 89,685.
53. *See id.* at 89,685-86.
54. *See id.* at 89,685.
55. *See id.*

regulatory costs[56] and because it creates "regulatory certainty."[57] The SEC admits, however, that the proposal has considerable drawbacks.[58] Investors might believe that comparable safeguards are equal safeguards.[59] Practices in SEC-approved foreign markets could still affect market integrity because the foreign regulations, while comparable to those in the United States, nonetheless may differ to some degree.[60] For example, the foreign market may allow insider trading or have primitive surveillance capabilities.[61] Under Proposal 1, U.S. consumers might suffer losses if they rely on protections that are simply not offered by a foreign exchange.[62] Finally, investors may not be able to recover damages incurred while trading on an SEC-approved market.[63]

Under Proposal 2, the SEC would subject foreign markets to traditional SEC regulation as if the markets resided within U.S. jurisdiction.[64] Foreign markets would need to register as a national securities exchange or satisfy certain criteria for exemption from exchange registration.[65] The advantage of this approach over Proposal 1 is that U.S. investors could be absolutely certain that the foreign exchange offers the same protections that the U.S. provides.[66] However, the SEC believes Proposal 2 suffers from three major drawbacks. First, under Proposal 2 the SEC cannot exempt a foreign exchange from regulations when the exchange's domestic regulator offers similar safeguards.[67] Second, the limits of the Commission's jurisdiction may make it difficult to impose exchange requirements on foreign markets that offer electronic trading capabilities to U.S. citi-

56. *See id.* at 89,686.

57. *Id.*

58. *See id.*

59. *See id.*

60. *See id.*

61. *See id.*

62. If a foreign exchange requires a lower amount of disclosure than the SEC does, investors face a higher risk when trading in a particular foreign security. *See* James D. Cox, *Rethinking U.S. Securities Law in the Shadow of International Regulatory Competition*, 55 LAW & CONTEMP. PROBS. 157, 160 (1992). Under Proposal 1, U.S. investors would not be informed of this risk.

63. *See* Concept Release, *supra* note 3, at 89,687.

64. *See id.* at 89,634.

65. *See id.* at 89,687.

66. *See id.*

67. The SEC stated:

> The U.S. regulatory scheme applicable to exchanges . . . is not necessarily designed to accommodate entities that only engage in limited activities in the United States and that are primarily regulated in foreign jurisdictions. It may not be feasible, therefore, to regulate a foreign market's activities under a regulatory scheme that applies to domestic markets, particularly if a foreign market's only activity in the United States is to provide its U.S. members with the ability to trade directly on its facilities or to allow its members to provide U.S. persons with electronic linkages to trade outside of the United States. For example, U.S. exchange regulation could conflict with the regulation to which these markets are already subject in their home countries or could subject these markets to unnecessarily duplicative and expensive obligations.

zens.[68] Third, Proposal 2 may violate federal securities laws and therefore may be difficult to implement.[69]

Under Proposal 3, the SEC would regulate each foreign broker-dealer directly rather than regulating foreign exchanges.[70] The SEC would classify foreign broker-dealers into one of two categories. The first category includes broker-dealers that *distribute or publish information* about foreign market transactions and that offer U.S. citizens a direct link to a particular foreign exchange.[71] The SEC would regulate these types of broker-dealers as "securities information providers" (SIPs), subjecting them to regulation under Section 11A of the Exchange Act.[72] Section 11A allows the Commission to regulate agents who distribute securities price quotes.[73] The second category includes agents who provide U.S. citizens with the technological link to trade directly on a foreign exchange, but do not distribute information regarding stock prices.[74] The SEC would require these broker-dealers to abide by basic recordkeeping, antifraud, and disclosure requirements.[75] Because Proposal 3 regulates the broker-dealers rather than the foreign exchanges, the SEC could decrease the chances for conflicts with foreign countries' domestic market regulations.[76] As Proposal 3 regulates only those specific activities that take place in the United States, the SEC believes it avoids the jurisdictional problems posed by Proposal 2.[77]

The SEC clearly favors Proposal 3 over the other proposals. The Commission describes Proposal 3's advantages, but does not discuss any drawbacks associated with its implementation.[78] Instead of soliciting criticisms

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Id.

68. *See id.*

69. *See id.*

70. *See id.*

71. *See id.* U.S. citizens can use this link to execute trades without direct contact with the broker-dealer. *Id.* at 89,688.

72. *See id.* at 89,687-88.

73. *See* Securities Exchange Act of 1934, 15 U.S.C § 78c(a)(22) (1934). The general anti-fraud provision governing price-quotes is § 78j, which reads:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
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> (a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as *necessary or appropriate in the public interest or for the protection of investors.*

Securities Exchange Act of 1934, 15 U.S.C. § 78j (1934) (emphasis added).

74. *See* Concept Release, *supra* note 3, at 89,688.

75. *See id.*

76. *See id.*

77. *See id.*

78. *See id.* at 89,689.

of Proposal 3, the SEC solicits public comment as to its advantages.[79] After describing Proposal 3's advantages, the SEC asks thirty-one questions relating to the implementation of Proposal 3.[80] Although the SEC allows the public to suggest which proposal is best,[81] the SEC strongly supports Proposal 3 in the concept release.[82]

C. Why the SEC Favors Regulating Foreign Broker-Dealers as the Solution to the Problem

1. *The SEC's Historic Role in Regulating Markets*

The SEC grew out of the stock market crash of 1929, as people felt that speculation and fraud in the stock market led to the Great Depression.[83] Originally instituted as part of the New Deal in the 1930's,[84] the Securities Exchange Act of 1934 regulates the exchange of securities.[85] The Act's major provisions cover the initial securities registration, the filing of periodic financial reports, the registration of broker-dealers, and general disclosure and anti-fraud provisions.[86] The regulation of securities exchange was based on the notion that the government should promote efficient stock markets.[87] An efficient stock market is deemed to be essential to the efficient allocation of capital and other resources.[88] SEC regulation of securities markets thus grew out of a fear of economic collapse and showed a concern for the most efficient allocation of resources in the market.[89]

According to market failure theory,[90] fraud and deception cause market failure.[91] Hence, the SEC spends significant resources to reduce fraud

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79. *See id.*

80. For example, the Commission asks, "if the Commission decides to regulate access providers to foreign markets, what criteria should the Commission use in determining whether an exchange is a bona fide foreign market?" *Id.* at 89,691.

81. Question 143 states: "Would any of the approaches described above provide an effective means of addressing the issues raised by foreign market activities in the United States, including providing key protections for U.S. investors?" *Id.* at 89,696.

82. The SEC proposed a rule that would allow an ATS to choose whether to register as a national exchange or a broker-dealer. Perhaps foreseeing jurisdictional disputes, the SEC combined Proposals 2 and 3 in the proposed rule. *See* Regulation of Exchanges and Alternative Trading Systems, SEC Release No. 34398:4, 63 F.R. 23,504, at 23,504 (1998).

83. *See* SUSAN M. PHILLIPS & J. RICHARD ZECHER, THE SEC AND THE PUBLIC INTEREST 5 (1981).

84. *See id.* at 9-11.

85. Securities Exchange Act of 1934, 15 U.S.C. § 78a (1934).

86. *See* PHILLIPS & ZECHER, *supra* note 83, at 10.

87. *See* Lynn A. Stout, *The Unimportance of Being Efficient: An Economic Analysis of Stock Market Pricing and Securities Regulation*, 87 MICH. L. REV. 613, 615-16 (1988).

88. *See id.* at 617.

89. Some authors question whether stock market efficiency should be a goal. For instance, economist Lynn Stout finds a weak connection between stock prices and the allocation of resources. Therefore, Stout does not think the SEC should be concerned with protecting the efficiency of markets. *See id.* at 618.

90. Market failure occurs "when the free market produce[s] too much or too little of some product or service . . . at too high or too low a price." PHILLIPS & ZECHER, *supra* note 83, at 18.

91. *See id.*

or deception in securities transactions.[92] From the outset, one of the SEC's major devices for protecting the efficiency of markets[93] was to prevent fraud and price manipulation by broker-dealers.[94]

During the revival of the SEC under President John F. Kennedy in 1960,[95] the Securities Act Amendments of 1964 strengthened the regulations regarding broker-dealer activity.[96] The SEC subjects broker-dealers to anti-fraud restrictions.[97] They must pass examinations before working in the securities field,[98] have a positive net worth, and maintain a certain ratio of liquid assets to total indebtedness.[99] Broker-dealers also must submit to a general duty of disclosure requiring the broker-dealer to promptly provide the investor with any relevant investment information.[100] The SEC's strict regulation of broker-dealers corresponds with its position that broker-dealers can have a direct effect on the efficiency of the marketplace. Because of this anti-fraud policy, it is not surprising that the SEC's favored proposal for regulating international stock purchases centers on broker-dealer activity.

2. *Diversity of Securities Regulation Worldwide*

The securities laws of different nations offer a wide variety of market protections.[101] One scholar has described the diversity of the global securities market as "a nightmare,"[102] due in part to the variety of stock markets that exist worldwide.[103] World stock markets differ considerably in terms of investors' access to information, the market's financial stability, and other important characteristics that determine market efficiency.[104]

One striking difference between U.S. securities regulation and other countries' regulation is that in some countries, such as Germany, Austria, and Switzerland, banks, rather than national governments, are the primary securities market regulators.[105] The regulation in these countries is, therefore, vastly different than the U.S. governmentally-led regulatory regime.

Other important differences exist between securities regulation in the United States and foreign nations. For example, the United Kingdom and

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92. *See id.*

93. An efficient exchange means that stock prices rapidly reflect changes in information, making it impossible to predict stock price changes. In sum, you "can't beat the market" in an efficient market. Stout, *supra* note 87, at 620-21.

94. *See* PHILLIPS & ZECHER, *supra* note 83, at 7.

95. *See id.* at 13.

96. *See id.* at 14.

97. *See* SHELDON M. JAFFE, BROKER-DEALERS AND SECRUITIES MARKETS: A GUIDE TO THE REGULATORY PROCESS 17 (1977).

98. *See id.* at 16.

99. *See id.*

100. *See id.* at 1 (1997 Supp.).

101. *See* Millspaugh, *supra* note 12, at 358.

102. *Id.* at 359.

103. *See id.*

104. *See id.* at 359.

105. *See* Lewis D. Solomon & Louise Corso, *The Impact of Technology on the Trading of Securities: The Emerging Global Market and the Implications For Regulation*, 24 J. MARSHALL L. REV. 299, 329 (1991).

the United States have dissimilar underwriting methods[106] and broker-dealer liability provisions.[107] The United States and Japan also have strikingly different regulatory regimes. The SEC's 2,600 regulators[108] have wide regulatory responsibility,[109] whereas the 200 regulators[110] in Japan's Ministry of Finance play more of an advisory role than a policing role.[111]

The advisory position of the Japanese regulators has fostered a corrupt securities market. Although the Japanese disclosure requirements are extensive,[112] "many problems of market manipulation, dishonesty, and unfair dealings still frequently arise."[113] Insider trading on the Tokyo Exchange is rampant.[114] The lack of regulatory enforcement in Japan differs greatly from the SEC's active and expansive securities regulation.[115] These examples illustrate that the SEC cannot rely on many foreign nations to provide equivalent protections against fraud and manipulation.[116] Fearing that U.S. citizens are ignorant of the perils of investing in foreign stock exchanges and will therefore make misinformed investments, the SEC proposes to regulate the individuals who provide them access to foreign markets.[117]

3. *Why the SEC Is Forced to Formulate New Rules to Restrict Foreign Broker-Dealers' Activities*

By targeting broker-dealers and subjecting them to U.S. securities regulation, the SEC hopes to protect U.S. investors while simultaneously respecting foreign nations' control over activities within their borders.[118] Under existing SEC regulations, broker-dealers are subject to SEC oversight if they "wish to have access to U.S. capital markets."[119] Broker-dealers who wish to provide foreign investors access to U.S. exchanges must comply with domestic broker-dealer guidelines.[120] Furthermore, broker-dealers who

106. *See* Joel Seligman, *The Obsolescence of Wall Street: A Contextual Approach to the Evolving Structure of Federal Securities Regulation*, 93 MICH. L. REV. 649, 663 (1995). "Underwriting method" in this context refers to the financing and marketing aspects associated with the issuance and trading of the security. *See* CARL SCHNEIDER ET AL., GOING PUBLIC: PRACTICE, PROCEDURE, AND CONSEQUENCES 6 (1996).

107. *See* Seligman, *supra* note 106, at 663.

108. *See* Millspaugh, *supra* note 12, at 359-60.

109. *See* Bradley Scott Riller & William R. Dauber, *The Present and Future Role of the Electronic Trading Linkage in the Developing International Securities Markets*, 22 GEO. WASH. J. INT'L L. & ECON. 639, 664 (1989).

110. *See* Millspaugh, *supra* note 12, at 359-60.

111. *See* Nicole J. Ramsay, *Japanese Securities Regulation: Problems of Enforcement*, 60 FORDHAM L. REV. S255, S255-56 (1992).

112. *See id.* at S257.

113. *Id.* at S271.

114. *See* Mahoney, *supra* note 1, at 319.

115. *See* Ramsay, *supra* note 111, at S271.

116. *See* Concept Release, *supra* note 3, at 89,685.

117. *See id.*

118. *See id.* at 89,688.

119. Carl E. Stetz, *International Equity Offerings and Market Making Activities on Foreign Stock Exchanges Under Rule 10b-6: Has the Securities and Exchange Commission Gone Too Far?*, 14 BROOK. J. INT'L L. 389, 390 (1988).

120. *See* Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(1) (1934).

help U.S. citizens purchase U.S.-issued stocks traded on foreign exchanges are subject to 15 U.S.C. § 78dd(a).[121] The statute provides that:

> It shall be unlawful for any broker or dealer, directly or indirectly, to make use of the mails or of any means or instrumentality of interstate commerce for the purpose of effecting on an exchange not within or subject to the jurisdiction of the United States, any transaction in any security the issuer of which is a resident . . . of the United States, in contravention of such rules and regulations as the Commission may prescribe as necessary.[122]

This statute prohibits foreign broker-dealers from using U.S. commerce for trading U.S.-issued stocks on foreign exchanges. However, if foreign broker-dealers wish to provide foreign market access to U.S. citizens, they may do so under certain guidelines. Subsection (b) of the statute exempts "any person insofar as he transacts a business *without* the jurisdiction of the United States."[123] Therefore, as long as a broker-dealer does not transact business in the United States, he is exempt from the restrictions.[124] The SEC's control over foreign broker-dealers who make transactions on foreign exchanges involving U.S.-issued securities can be summarized as restrictive, yet avoidable.

Section 78dd regulates the act of providing U.S. investors with access to foreign markets for trades in U.S.-issued securities.[125] Other SEC regulations cover the solicitation of U.S. investors, whether or not the trades involve U.S.-issued securities.[126] The Commission requires broker-dealers to register if, from outside the United States, they "induce or attempt to induce trades by persons in the United States."[127] If a foreign broker-dealer "solicits" a transaction with a U.S. citizen, "the broker-dealer effect-

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121. *See* 15 U.S.C. § 78dd(a) (1934).

122. *Id.*

123. 15 U.S.C. § 78dd(b) (1934) (emphasis added). Transactions are "inside" only if "necessary and substantial conduct occurs in the United States *and* the transaction has a foreseeable impact on U.S. investors or securities markets." THOMAS LEE HAZEN, 3 THE LAW OF SECURITIES REGULATION 64 (3d ed. 1995). *See generally*, Sam Miller & Andrew Farber, *Regulation of Foreign Broker-Dealers in the United States*, 34 N.Y.L. SCH. L. R. 395, 397 (1989). Under 15 U.S.C. § 78dd(b), the SEC has required foreign broker-dealers to register if they have a "branch or an affiliate" in the United States. *Id.*

124. *See* HAZEN, *supra* note 123, at 64. *See generally*, Robert D. Blanc, *Broker-Dealer Regulation: Recent Developments Affecting the Capital Markets*, SB35 ALI-ABA 215 (1997); Frederick W. Gerkens, *Opportunities For Regulatory Arbitrage Under the European Community's Financial Services Directives and Related United States Regulations*, 16 N.Y.L. SCH. J. INT'L & COMP. L. 455, 462 (1996). It is not settled whether a person outside the United States transacting business with U.S. citizens over the internet is considered "transacting business in the United States" under 15 U.S.C. 78dd. However, because the SEC allows unsolicited transactions over the mails or telephone, this exemption presumably would also apply to unsolicited internet transactions. *But see infra* note 131 (noting that the SEC has yet to take an official position on this matter).

125. 15 U.S.C. § 78dd(b) (1934).

126. LOUIS LOSS & JOEL SELIGMAN, 6 SECURITIES REGULATION 3012-27 (3d ed. 1990).

127. *Id. See also* Miller & Farber, *supra* note 123, at 396-97 (noting that SEC "rule 15a-6 itself assumes that the registration requirements apply to any foreign broker-dealer who solicits United States investors, without reference to whether the foreign broker-dealer is in fact transacting business *within* the United States").

ing the transaction must be registered."[128] The Commission defines "solicitation" as follows:

> Solicitation includes efforts to induce a single transaction or to develop an ongoing securities business relationship. Conduct deemed to be solicitation includes telephone calls from a broker-dealer to a customer encouraging use of the broker-dealer to effect transactions, as well as advertising one's function as a broker or a market maker in newspapers.[129]

Since the SEC subjects foreign broker-dealers to SEC registration if they use telephones to solicit U.S. investors, the SEC presumably would require broker-dealers to register in the U.S. if they solicit U.S. investors via the internet, through a web page or chat group.[130] However, if the U.S. investor contacts the foreign broker dealer to use the broker-dealer's connection to the foreign exchange, current SEC rules do not subject the broker-dealer to U.S. regulatory oversight.[131] The concept release endorses clearer rules that would cover this relatively new trading technology, making unsolicited trades abroad possible.[132]

The SEC contends that regulation of entities that offer access to foreign exchanges is necessary to protect the efficiency of the market.[133] The SEC seeks reform[134] because the present regulatory oversight fails to assure broker-dealer competitiveness or the free availability of foreign stock purchases to U.S. investors.[135] The SEC is committed to "preserving market-wide transparency, fairness, and integrity," and seeks to establish a level playing field in the cross-border trading market.[136] The SEC may also hope to foster greater efficiency in the world securities market by inducing foreign market regulators to compete for the most efficient mix of domestic regulatory regimes.[137] According to securities expert James Cox, "the standard argument favoring diversity [of regulatory regimes worldwide] is that it fosters experimentation and innovation using differing regulatory approaches."[138] Hoping that the international market will benefit in the

128. LOSS & SELIGMAN, *supra* note 126, at 3019.

129. Sec. Ex. Act Rel. 27,017, 43 SEC Dock. 2079, 2087-88 (1989).

130. *See* LOSS & SELIGMAN, *supra* note 126.

131. *See* Concept Release, *supra* note 3, at 89,683. As the SEC itself acknowledges, "the Commission to date has not expressly addressed the regulatory status of entities that provide U.S. persons with the ability to trade directly on foreign markets from the United States." *Id.* at 89,684.

132. *Id.* at 89,684-85.

133. *See supra* note 33 and accompanying text. For the view that the Commission is not responding to any actual wrongdoing by market participants and that the Commission's proposal might actually stagnate market gains, see Sam S. Miller et al., *Tethering Technology: The SEC's Market Structure Concept*, INSIGHTS, Sept. 1997, at 7.

134. *See* Concept Release, *supra* note 3, at 89,685.

135. *See supra* Part I.A.

136. *See* Concept Release, *supra* note 3, at 89,633. *See also* James R. Doty, *Colloquium: The Role of the Securities and Exchange Commission in an Internationalized Marketplace*, 60 FORDHAM L. REV. 77 (1992) (explaining how market transparency "enhances market integrity and investor confidence").

137. *See* Cox, *supra* note 62, at 158.

138. *Id.*

long run,[139] the Commission could be pursuing foreign broker-dealer regulation to invite an innovative regulatory response by foreign regulators. Legal theorist Edmund Kitch predicts that individual governments can foster more efficient trade law through slight impingements on foreign jurisdictional authority.[140] Explaining how this practice can be used to pursue free trade policy, Professor Kitch states:

> Free trade among decentralized authorities will result from voluntary cooperation, motivated by the fact that free trade will produce greater wealth for all to share. In the short run, this approach to free trade may cause significant bargaining instability, as each jurisdiction tries to establish bargaining position through bluff, threat, and implemented threat. But in the long run, this system may provide more free trade than centralized authority because *it places stronger incentives on each jurisdiction to promulgate efficient rules for both its internal and external commerce.*[141]

By enacting a policy that partially infringes on other countries' rule-making authority, the SEC could be sending a veiled signal to foreign regulators to enact reforms that will improve the efficiency of the world securities market. Although the SEC does not specifically state that it hopes foreign regulators will respond with measures designed to protect the efficiency of the world market, it believes that foreign regulators are not offering sufficient protections for U.S. investors to make informed investment decisions.[142] Perhaps the SEC has challenged foreign regulators to strengthen their own domestic regulation in hopes of improving the efficiency of the international securities market.

The SEC's proposal to subject foreign broker-dealers to SEC regulation stems from the agency's historic role in regulating U.S. securities markets.[143] Established to promote efficiency through full disclosure and minimum fraudulent activity, the SEC traditionally requires broker-dealers and other access providers to abide by anti-fraud regulations and other restrictions.[144] This is one way that the SEC believes it can protect against market failure.[145] Because regulatory regimes vary greatly among nations, especially in terms of the strength of enforcement,[146] the increase in cross-border trading activity produces challenging issues for the SEC. The existing regulations limit foreign broker-dealers' activities only if they deal in U.S.-issued securities or directly solicit U.S. citizens through media transmission.[147] Hoping to nurture an efficient world securities market, the SEC strongly favors reforms that would put foreign broker-dealers

139. Professor Cox predicts that experimentation and confrontation will help improve the efficiency of securities regulation worldwide. *Id.*

140. *See* EDMOND KITCH, REGULATION, FEDERALISM, AND INTERSTATE COMMERCE 13 (Dan A. Turlock, ed., 1981).

141. *Id.* at 13-14 (emphasis added).

142. *See* Concept Release, *supra* note 3, at 89,685.

143. *See supra* Part I.C.2.

144. *See supra* notes 86-94 and accompanying text.

145. *See supra* note 94.

146. *See supra* Part I.C.2.

147. *See supra* Part I.C.3.

under SEC oversight, irrespective of whether the broker-dealers solicit U.S. investors or trade in U.S.-issued securities.[148]

II. Is the SEC Concept Release the "Best" Route for International Securities Reform?

The SEC is responding to the regulatory problems caused by the proliferation of cross-border trading in the midst of a boom in the use of electronic communications.[149] Faced with an inability to protect U.S. investors from the ills of weaker foreign securities regulation, the SEC proposes to extend its control across U.S. borders and impose its regulatory strategy abroad.[150] This Part analyzes the SEC's answer to the cross-border trading problem – stricter regulation of foreign broker-dealers – from a broad perspective. The central question this Part answers is whether the SEC is properly suited to enact policies that may influence the decisions of foreign governments and impinge upon their sovereignty. Although the SEC is following policy guidelines by issuing the concept release,[151] this procedure is inadequate for structuring regulatory policy that has such strong international implications. If Congress decides that an expanded U.S. regulatory regime presents efficiency gains that sufficiently outweigh the dangers it creates in the area of international relations, it should issue a mandate to the SEC outlining its general policy objectives in the area of international securities regulation. Rather than allow the SEC to formulate a more expansive policy as a natural consequence of its institutional momentum, Congress should advise the SEC as to what measures are likely to violate another nation's sovereignty. At the very least, Congress should prevent the SEC from attempting to enact a rule when it is clear that the rule violates the basic sovereignty rights of foreign governments.

A. The SEC Should Not Be Forcing Its Own Policies of International Securities Regulation on Other Nations

Because it is becoming more difficult to police the international marketplace,[152] the SEC has already taken a step toward international securities regulation reform. To protect U.S. investors in the world securities markets, the SEC proposes to regulate foreign broker-dealers under U.S. regulations, rather than relying on foreign governments for supervision.[153] The SEC should effectuate such a reform by misusing its congressional mandate.

The expansion of SEC power is not a recent development.[154] The SEC

148. *Id.*
149. *See supra* Part I.
150. *See supra* Part I.C.3.
151. *See supra* note 28.
152. *See* Riller & Dauber, *supra* note 109, at 645.
153. *See supra* Part I.C.
154. *See* Miller et al., *supra* note 133, at 7 (commenting that "The Commission is suggesting a regulatory tack reminiscent of the sweeping regulatory protectionism of the New Deal").

has expanded throughout its history due to congressional or SEC staff actions.[155] This expansion is unique because the United States "is the only country in which a government agency has the expansive scope of oversight responsibility that the SEC has over U.S. securities transactions."[156] With the internationalization of world markets, however, the SEC's role has taken on a new dimension. Securities law practitioner Lee S. Richards, III summarizes the SEC's evolution into an international regulatory agency:

> For better or for worse, the internationalization of securities markets has encouraged the SEC to regard itself as an international policing agency. From the outside looking in, it would appear that internationalizing its efforts is now a major SEC priority. Indeed, the SEC now has a whole division devoted to this subject.[157]

The SEC is not only a rapidly expanding agency devoted to protecting domestic securities markets, but it is also a growing power in international securities regulation. The SEC's proposal to regulate foreign broker-dealers is consistent with this trend. Although the SEC professes that Proposal 3 "focuses on the limited activities occurring in the United States, rather than on the activities that a foreign market or third party conducts primarily in a home country,"[158] the SEC is clearly extending beyond its current regulatory reach and into foreign countries' territories. This stage in the SEC's expansion of power should be questioned and ultimately checked.

The limits of the SEC's expansion and the SEC's role in international regulation are difficult issues. The SEC's congressional mandate and literature discussing the discretionary powers of administrative agencies provide some guidance as to the proper level of SEC influence over international transactions.

In the interests of efficiency, Congress may delegate its powers to administrative agencies.[159] As integral components of the executive branch of government,[160] administrative agencies receive their mandates from Congress and are vested with the power to execute the will of Congress. Congress provides the agencies with mandates, which are typically broad and non-specific[161] because Congress does not have time to approve every administrative action.[162] Congress also is permitted to delegate its authority because it cannot possibly anticipate what rules will be necessary at the time it issues a mandate. Davis argues that:

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155. *See* Richards, *supra* note 42, at 150.

156. Riller & Dauber, *supra* note 109, at 664.

157. Richards, *supra* note 42, at 145.

158. Concept Release, *supra* note 3, at 89,688.

159. *See* Peter Marra, Comment, *Have Administrative Agencies Abandoned Reasonability?*, 6 SETON HALL CONST. L.J. 763, 770 (1996).

160. *See* 16 AM. JUR. 2d. *Constitutional Law* § 263 (1998). An administrative agency's authority may arise under statue or executive order. *See* AM. JUR. *Administrative Law* § 55 (1998).

161. *See* DAVIS, *supra* note 28, at 41.

162. *See id.*

> Inventing rules to answer all regulatory questions is far beyond the intellectual capacity of the ablest men. Rules are essential, but discretion is also essential—and the right mixtures of rules and discretion. Our objective should be to find for each case or each problem the right proportion of rule and discretion.[163]

When the subject is purely domestic economic regulation, the legislature typically answers all legislative questions through mandate.[164] However, with other policy issues, safeguards for preventing unchecked discretionary power must give way to concern for an efficient bureaucracy.[165] Inevitably, the administrative agency will have some discretionary power over major policy issues.[166]

The Constitution limits administrative agencies' ability to promulgate rules. Although the Supreme Court stated that "delegation by Congress has long been recognized as necessary in order that the exertion of legislative power does not become a futility,"[167] decisions of "great constitutional import and effect"[168] cannot be relegated to the discretion of an administrative agency.[169] Similarly, a regulatory agency such as the SEC may "overstep constitutional bounds"[170] when it enacts a rule which contravenes the Constitution. Furthermore, the Court has made it clear that it will protect people from administrative rules which infringe on fundamental rights.[171] The Court does not classify economic rights as fundamental, but the proposed SEC rules infringe upon the Congressional right to regulate commerce with foreign nations.

Article I, Section 8, clause 3 of the U.S. Constitution states, "The Congress shall have Power . . . to regulate Commerce with foreign Nations. . . ."[172] The SEC's principal role is to protect the interests of U.S. investors,[173] not to regulate the interaction of U.S. investors with foreign market participants. By proposing to expand its foreign broker-dealers

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163. *Id.* at 42.

164. *See id.* at 28.

165. *See* JAMES T. O'REILLY, ADMINISTRATIVE RULEMAKING: STRUCTURING, OPPOSING, AND DEFENDING FEDERAL AGENCY REGULATIONS 3 (1983).

166. *See* DAVIS, *supra* note 28, at 39-42.

167. Sunshine A. Co. v. Adkins, 310 U.S. 381, 397 (1940) (holding that the Bituminous Coal Act, which authorized the National Bituminous Coal Commission to fix maximum prices when deemed necessary at a uniform increase above minimum prices, subject to specified standards restricting the Commission, did not constitute an invalid delegation of legislative power).

168. U.S. v. Eastland, 694 F. Supp. 512, 515 (N.D. Ill. 1988) (holding that Congress improperly delegated to the Sentencing Commission authority to set sentences for criminal penalties by allowing the Commission to promulgate binding sentencing guidelines). *See also* Greene v. McElroy, 360 U.S. 474 (1959) (holding that without explicit authorization from Congress, the Department of Defense was not empowered to deprive an employee of a government contractor of his position in a proceeding in which he was not afforded confrontation and cross-examination safeguards).

169. *See* U.S. v. Eastland, 694 F. Supp. at 515.

170. O'REILLY, *supra* note 165, at 321.

171. *See Eastland*, 694 F. Supp. at 514. If fundamental rights are involved, the Court will subject the administrative ruling or rule to "closer" judicial scrutiny. *Id.*

172. U.S. CONST. art. I, § 8, cl. 3.

173. *See supra* notes 83-89 and accompanying text.

registration, the SEC intends to protect U.S. citizens against fraud and market manipulation.[174] The international legal implications are sufficiently serious to require that Congress, not the SEC, guide this policy. The SEC oversteps its bounds when it enacts rules that infringe on the sovereignty of other nations.

Notwithstanding constitutional interpretation, some commentators argue that "unnecessary discretionary power"[175] should be confined, structured, and checked to a greater degree.[176] They view the expansion of administrative agencies' discretionary power as something that, if left unchecked, can destroy everything in its path.[177]

Theories on the limits of administrative agencies' discretionary power indicate that securities regulation might harm relations between the United States and other countries. In order to prevent this, the SEC's discretionary power must not exceed its boundaries.[178] Although the international securities market does affect the United States market, the SEC's perceived need for worldwide market transparency cannot justify the SEC's attempted domination over worldwide securities market participants.[179]

To date, no political interest group has launched a serious effort to curtail the SEC's broadening influence in the international arena.[180] Thus, it is no surprise that "the SEC's most creative efforts to pursue and prosecute securities law violations abroad have been upheld."[181] The acceleration of international market integration spurred by the computer age, however, presents a scenario in which the boundaries of SEC's power must be delineated. With few exceptions, the SEC has responded to the internationalization of securities markets by attempting to impose its regulatory authority abroad.[182] Once the SEC is permitted to promulgate rules that

174. *See supra* Part I.C.3.

175. DAVIS, *supra* note 28, at 3-4. Professor Kenneth Culp Davis describes the dangerous effects of ill-intentioned use of discretionary power: "discretion is a tool only when properly used: like an axe, it can be a weapon for mayhem and murder." *Id.* at 25.

176. *See id.* at 3-4.

177. Specifically addressing concerns that the SEC has perverse incentives to expand its influence worldwide, professors Colombatto and Macey assert that the SEC has begun to sacrifice its "devotion to sovereignty" to maintain its livelihood. *See* Enrico Colombatto & Jonathan R. Macey, *A Public Choice Model of International Cooperation and the Decline of the Nation State*, 18 CARDOZO L. REV. 925, 925-26, 954 (1996).

178. *See id.* at 954-56.

179. *See* Stetz, *supra* note 119, at 391.

180. *See* Richards, *supra* note 42, at 145.

181. *Id.* at 146. *See* SEC v. Wang, 88 Civ. 4461 (S.D.N.Y. 1989) (SEC successfully compelled customer deposits from a bank's Hong Kong branch).

182. The SEC has accommodated foreign companies wishing to register their securities on U.S. exchanges. The most notable are the multi-jurisdictional disclosure system, Rule 144A, and relaxed accounting standards for certain foreign issuers. Adopted in 1991, the multi-jurisdictional disclosure system permits Canadian issuers to submit Canadian offering documents to satisfy U.S. registration and disclosure requirements. Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers, Securities Act Release No. 6,902, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,812, 81,860 (July 1, 1991). *See also* Bevis Longstreth, *A Look at the SEC's Adaption to Global Market Pressures*, 33 COLUM. J. TRANSNAT'L L. 319 (1995). Rule 144A provides a safe-harbor to certain foreign issuers selling to

infringe upon foreign sovereignties, it violates norms of international law. Under the non-intervention doctrine, each state has a duty not to intervene in the internal affairs of other states.[183] Aside from being an impermissible extension of power over national boundaries, this is also an inadequate way for a representative democracy to formulate law. More appropriate would be the continued formation of bilateral agreements with foreign governing bodies under the direction of a specific Congressional mandate. Moreover, sporadically enacting rules when current regulations are inadequate inevitably results in a piecemeal formation of international law. Rather than promulgating rules from a broad international policy objective, the SEC's international securities law policy evolves from the inability to apply existing domestic law to a changing international environment. The SEC will enact rules with a dangerously limited focus because it does not consider the international legal norms that are more likely to be weighed in the legislative process. Its mandate is to protect the efficiency of the U.S. stock markets, without reference to international law.[184] Therefore, the SEC may enact rules that frustrate the legislature's international policy objectives.

B. Foreign Governments and Exchanges Do Not Support the SEC's Regulation of Their Broker-Dealers

Statements by foreign market officials indicate that growing SEC oversight in the international realm is not only a domestic concern, but a phenome-

certain "qualified institutional buyers," who are presumed to be able to make rational investment decisions without Securities Act protections. 17 C.F.R. § 230.144A (1991). Foreign issuers receive four general accommodations from the SEC with respect to disclosure: 1) the foreign issuer is not required to use U.S. Generally Accepted Accounting Principles (GAAP) so long as it uses the "accounting principles generally accepted in the domicile country, and a reconciliation of significant variations from United States GAAP and Regulation S-X [is] furnished," 2) Unless otherwise specified, "only revenue information need be broken into categories of activity and geographic markets," 3) "[c]ompensation of directors and officers need be disclosed only in the aggregate unless the issuer discloses such information to its shareholders or otherwise makes this information public," and 4) "[i]nformation regarding transactions with management is required, but need be presented only to the extent the registrant discloses such information to its shareholders or otherwise makes public the information." Mark A. Saunders, *American Depositary Receipts: An Introduction to U.S. Capital Markets For Foreign Companies*, 17 FORDHAM INT'L L.J. 48, n.120 (1993). *See also* Uri Geiger, *The Case for the Harmonization of Securities Disclosure Rules in the Global Market*, 1997 COLUM. BUS. L. REV. 241, 255 (1997) (Foreign issuers may "choose to use any comprehensive body of accounting principles, provided that they reconcile certain information to U.S. GAAP.") (summarizing Rule 4-01(a)(2) of Regulation S-X, 17 C.F.R. §210.4-01(a)(2) (1997)); Jay D. Hensen, *London Calling?: A Comparison of London and U.S. Stock Exchange Listing Requirements for Foreign Equity Securities*, 6 DUKE J. COMP. & INT'L L. 197 n.38 (1995) (providing a summary of the specific accommodations afforded foreign issuers with respect to accounting disclosure).

Although the SEC has made some limited exceptions for foreign issuers, the SEC will still infringe upon other nations' sovereignty when it forces foreign broker-dealers to register with the SEC even if the broker-dealers do not solicit investors in the U.S.

183. IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 293 (5th ed. 1998).

184. *See supra* Part I.C.1.

non that worries foreign securities regulators as well.[185] The London Exchange's[186] response to the concept release conveys sentiments that the SEC might be exceeding its powers.[187] Mr. Sheridan indicated that the London Exchange's findings do not accord with the SEC's support for Proposal 3. Mr. Sheridan cautioned,

> Before commenting specifically on the questions you have raised, I should perhaps make clear the difference between exchange responsibilities within the UK and US. In the UK, the exchanges, whilst responsible for market integrity, are not responsible for monitoring the relationships between brokers and their customers or for regulatory oversight of the capital adequacy of member firms.[188]

The London Stock Exchange suggests that SEC regulation of cross-border securities trading should integrate two elements.[189] First, before U.S. citizens can make cross-border purchases, dealers should disclose that the foreign market is subject to different levels of regulatory oversight.[190] A disclaimer should be either displayed through the electronic trading interface or revealed to the investor by the broker-dealer.[191] The SEC could even compare acceptable foreign securities regulation enforcement with oversight offered in the U.S. and rank them accordingly.[192] Exchanges failing to achieve a ranking should not be accessible *except* through U.S. local brokers who would be subject to full Commission oversight.[193] Under this scheme, investors could evaluate differences between SEC and foreign securities regulation before executing a trade.[194] Second, the London Exchange suggests "there has to be a distinction between foreign markets which are actively seeking trading volume from the United States and access by overseas markets which is incidental, and which is carried out by U.S. broker-dealers or access providers."[195] Both comments convey the London Exchange's disagreement with the SEC's proposal to regulate foreign broker-dealers.

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185. Securities expert Paul Mahoney predicts that foreign regulators will oppose the plan because they "will view it as an attempt by the SEC to externalize the cost of its regulations so as to reduce the competitive disadvantages those regulations impose on U.S. markets." Mahoney, *supra* note 2, at 847. Nations with common law and statutory non-disclosure traditions will inevitably give the SEC's plan a cool reception. *See* Millspaugh, *supra* note 12, at 369.

186. The London Stock Exchange is the second largest international market. *See* Geiger, *supra* note 182, at 248.

187. Letter from Dan Sheridan, Head of Market Regulation, London Stock Exchange, to Richard R. Lindsay, Director, United States Securities and Exchange Commission (Sept. 1997) (on file with author) [hereinafter Sheridan Letter]. On September 2, 1997, Dan Sheridan, Head of Market Regulation for the London Stock Exchange, sent Richard R. Lindsay a response to SEC Concept Release No. 34-38672. *See id.*

188. *Id.*

189. *Id.*

190. *See id.*, attachment at 28.

191. *See id.*

192. *See id.*

193. *See id.*

194. *See id.* at 28.

195. See *id.* at 36.

The London Exchange's proposal focuses heavily on disclosing the risks posed by trading in the foreign market, with a lesser emphasis on attempting to alter the framework of the foreign country's securities law. London Exchange regulators are apprehensive about imposing additional costs on foreign markets by requiring foreign access providers to submit to the requirements of two regulatory regimes.[196] They also fear that a "tit for tat" scenario will develop between the SEC and foreign regulatory bodies if the SEC requires foreign markets to submit to full SEC regulation.[197] Therefore, their proposal does not endorse the complete imposition of SEC regulation on a foreign market.[198]

The London Exchange's proposal allows the SEC to protect U.S. investors by informing them when they are investing in markets that do not provide the same level of protection found in the United States. However, the SEC cannot provide investors with the same level of protection that it provides for domestic transactions. Rather than prohibiting trades on a market that provides inadequate safeguards, the greatest protection the SEC can give is to require that SEC-regulated brokers execute the trades.[199] The London Exchange's proposal focuses on disclosing the risks of trading in a particular foreign market to U.S. investors and restricting the SEC's ability to apply its own layer of protection to the foreign markets' regulatory framework. The London Exchange's public statement that it would not endorse the SEC's plan to subject foreign broker-dealers to regulation indicates their disagreement with the SEC's expansion of regulatory power into the foreign securities market.[200]

C. Why the SEC Has Expanded Its Influence into International Securities Regulation

As indicated in Section B, foreign governments and exchanges do not support the SEC's proposal to submit foreign broker-dealers to SEC requirements, especially when the broker-dealers conduct securities transactions

196. *See id.* at 28. *See also* Geiger, *supra* note 182, at 259-60 (describing how additional disclosure requirements impose duplicative costs on multinational issuers).

197. *Id.* Though Sheridan does not explain what he means by "tit-for-tat," he is probably describing a situation in which, for example, British regulators would respond to SEC oversight of British broker-dealers by imposing British securities regulations on U.S. broker-dealers that provide market access to British citizens.

198. One reason why the London Exchange takes this stance might be that a company wishing to list on the London Exchange "may meet listing requirements without compiling and disclosing as much information as is disclosed for a U.S. listing." Hensen, *supra* note 182, at 221.

199. *See id.* If U.S. investors are prohibited from accessing inadequately policed foreign markets, the decrease in market participants will reduce competition and hurt the foreign market economically. However, because the SEC would be truly focusing on the "limited activities occurring in the United States," the foreign governments should not be threatened by the SEC forcing its own rules on foreign citizens. Concept Release, *supra* note 3, at 89,688.

200. The London Exchange's response to the Concept Release is not surprising, given the fact that the United States has made a habit of offending other countries' sovereignty, particularly in the area of securities regulation. *See* Fisch, *supra* note 1, at 523-24.

on their home markets for U.S. citizens.[201] This objection is not surprising. Allowing a foreign government to regulate U.S. citizens' domestic economic activity would be unacceptable. Countries "cannot be expected to adhere to technical rules which it perceives as having no relationship to how its markets work."[202] Foreign governments should have the same opportunity to regulate their own citizens. Why, then, did the SEC propose to regulate foreign broker-dealers when they merely provide U.S. citizens with the ability to buy or sell foreign-issuer shares that are traded on foreign exchanges? There are several possible answers

First, the SEC's bureaucratic inertia might have led the agency to assume that its congressional mandate is not limited by possible infringements upon foreign governments' sovereignty. Although the SEC is devoted to protecting the U.S. securities market, market internationalization has caused the SEC to pay less attention to national boundaries.[203] One of the SEC's goals in the internationalization of securities markets is to minimize discrepancies between different securities regulation schemes throughout the world.[204] This has led SEC regulators to believe that the SEC "has a responsibility to assume a leadership role in international securities regulation."[205] The assumption of this role becomes problematic when the SEC imposes its regulatory regime on foreign markets. Critics argue that "more uniform regulation of international markets would benefit investors, . . . [but] the uniform system the SEC advocates is one patterned on the American model."[206] Although it may soothe U.S. investors to learn that the SEC is confident in its regulatory regime, foreign regulators are not quite as supportive.[207] Many feel that the Commission's responsibility is to protect the U.S. securities markets and not the international securities market.[208] For example, if the U.S. investor is aware of the enforcement problems in French securities regulation,[209] the SEC assumes an improper role if it imposes U.S. regulations on the French government.[210] Surprisingly, foreign disagreement with SEC plans to infiltrate

201. *See supra* Part II.B.

202. Stetz, *supra* note 119, at 390.

203. *See supra* notes 22-24 and accompanying text.

204. *See* Millspaugh, *supra* note 12, at 359 nn.31-32.

205. *Id.*

206. Mahoney, *supra* note 1, at 306.

207. *See* Stetz, *supra* note 119, at 390.

208. *See id. Cf.* Mahoney, *supra* note 2, at 847 (predicting that "[f]oreign markets will view [the SEC's proposal] as an attempt by the SEC to externalize the cost of its regulations so as to reduct the competitive disadvantages those regulations impose on U.S. markets").

209. While French securities laws impose comparable disclosure requirements, the enforcement competency of the securities agencies in France is "lacking." Keith Dill Nunes, Louis Vogel, Chris X. Linn, & Peter Kostant, *French & SEC Securities Regulation: The Search For Transparency and Openness in Decisionmaking*, 26 VAND. J. TRANSNAT'L L. 217, 244 (1993).

210. *See* Stetz, *supra* note 119, at 390 ("One of the responsibilities of the Commission is to protect the integrity of the United States securities markets and not the foreign securities markets.").

foreign soil[211] fueled the SEC's quest to impose its policies abroad.[212] The SEC's institutional inertia can be summarized as follows: the SEC "faces genuine disagreement over the value of the American model of securities regulation and therefore has an incentive to use its enforcement authority whenever possible . . . to control behavior in the international marketplace."[213]

Unfortunately for the SEC, its policies do not enjoy worldwide support. Critics argue that extensive U.S. securities regulation actually disadvantages U.S. issuers and markets[214] and that duplicative regulation causes "positive transaction costs"[215] to all investors.[216] These criticisms lead one to question whether the SEC's policy is the most efficient solution for international securities regulation.[217] The SEC not only needs to pay closer attention to the boundaries of foreign nations when it attempts to influence worldwide regulation, but it must also provide stronger justifications for the policy it wishes to employ in the international market. The agency's bureaucratic inertia toward spreading the U.S. regulatory regime worldwide partially explains the agency's actions.[218]

Public choice theory further explains why the SEC is imposing its oversight on the rest of the world.[219] That theory predicts that regulations "will tend to favor (subsidize) relatively small and well-organized groups that have a high per capita stake in the regulations, at the expense of relatively large, poorly organized groups with a lower per capita stake in the program."[220] The groups that favor the SEC's expanding role in international regulation tend to be those who will benefit from the increase in foreign market investment that the SEC predicts will result from its policies.[221] The major supporters of the SEC's regulation are securities lawyers, accountants, and others who prepare documents, and financial analysts, portfolio managers and other securities market professionals who benefit from these efforts.[222] Because these individuals benefit from more

211. *See supra* Part II.B. (discussing the London Exchange's objection to SEC Proposal 3).

212. *See* Mahoney, *supra* note 1, at 306.

213. *Id.*

214. *See* Cox, *supra* note 62, at 157.

215. Douglas C. North, *Discussion, in* REGULATION, FEDERALISM, AND INTERSTATE COMMERCE, *supra* note 140, at 95, 104.

216. As Paul Mahoney argues, a quest for fullest disclosure should not overshadow the goal to encourage socially desirable investments. *See* Mahoney, *supra* note 2, at 848. The SEC's reliance on disclosure as its ultimate end is, therefore, questionable.

217. Jonathan Macey concludes that other, private forms of regulation have rendered the SEC's role in monitoring securities markets obsolete and that SEC regulation is, therefore, inherently inefficient. *See* Jonathan R. Macey, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty*, 15 CARDOZO L. REV. 909, 909-13 (1994).

218. *See supra* Part II.C.

219. PHILLIPS & ZECHER, *supra* note 83, at 22.

220. *Id.*

221. *See* Concept Release, *supra* note 3, at 89,684.

222. *See* PHILLIPS & ZECHER, *supra* note 83, at 22-23. "There is also a management incentive to make the regulatory process obscure and complicated and to impose high costs on those who would challenge regulatory decisions." *Id.* at 25.

extensive and confusing regulation, regulatory managers have a natural disinclination to discuss specific goals or to implement low-cost policies when regulations are expanded.[223] This explains why the SEC may be claiming that market efficiency is its ultimate goal, but pursuing inefficient routes toward internationalization of securities regulation.[224] Until the SEC can convince Congress that its policies protect market efficiency and are not solely the product of political influence, the SEC should be especially hesitant to attempt to impose its regulatory authority on the worldwide securities market.[225]

D. An International Regulatory Agency Is Not the Answer

Some consider an international regulatory agency to be the answer to the dilemmas posed by the internationalization of markets and proliferation of cross-border trading.[226] This viewpoint focuses on establishing an entirely new form of regulation, rather than broadening national regulatory policies to fit the regulatory challenges created by the information age. The international body would design regulatory policies to govern international transactions, police the international securities marketplace, and effectively enforce the rules.[227] If the restrictions were enforced successfully, the international diversification opportunities offered under this type of regulation would benefit individual investors.[228] Most importantly, international enforcement would alleviate home country resistance to submitting to a foreign country's domestic regulatory regime. As is evident from the cold international reaction to the SEC, nations are extremely hesitant to relinquish their sovereignty.[229] If countries could be confident that their regulatory agencies were yielding to an international organization, rather than to a superpower, they might be more willing participants in securities regulation reform.[230]

An international securities regulator is unlikely to emerge in the near future, however. Although the internationalization of securities regulation is a popular topic of discussion,[231] many are skeptical that the formation

223. *See id.* Because the SEC is most concerned with "maximizing support . . . for their regulatory programs, . . [the agency] produces regulation insensitive to the costs of programs and to an evaluation of their effectiveness." *Id.* at 111.

224. With the exception of general accounting standards, "the much simpler question of how to measure the program's cost is systematically not addressed." *Id.* at 112.

225. Stetz, *supra* note 119, at 408.

226. *See* Solomon & Corso, *supra* note 105, at 338.

227. *See id.*

228. *See* Seligman, *supra* note 106, at 669; Mahoney, *supra* note 1, at 309.

229. *See* Millspaugh, *supra* note 12, at 374.

230. An international regulatory body would still need to eliminate the duplicative regulation problem. That subject will not be discussed in this Note because, as the following paragraph suggests, it is unlikely that an international securities regulator will emerge anytime soon.

231. *See e.g.*, Amir N. Licht, *Regulatory Arbitrage For Real: International Securities Regulation in a World of Interacting Securities Markets*, 38 VA. J. INT'L L. 563 (1998); Paul G. Mahoney, *Exchange as Regulator*, 80 VA. L. REV. 1453 (1997); William Hicks, *Protection of Individual Investors Under U.S. Securities Laws: The Impact of International Regulatory Competition*, 1 IND. J. GLOBAL LEGAL STUD. 431 (1994).

of international securities laws will be accomplished anytime soon.[232] Notwithstanding the attractiveness of international standards as the ideal solution, it is virtually impossible given the variety of financial institutions and regulatory regimes worldwide.[233] In addition to the vast differences in enforcement efforts against fraud and market manipulation,[234] traits unique to U.S. securities regulation hinder efforts to develop an international regulator. Ironically, the extensiveness and duplicativeness of SEC regulations are cited as a "major impediment"[235] to the development of international standards in securities law.[236] Although the internationalization of securities regulation would be an ideal solution, policy changes that are attainable in the immediate future would be an equally acceptable solution.

E. The Best Approach to Regulating Cross-Border Trading: Congressionally-Led Policy-Making and a Mandate to the SEC to Refrain from Formulating International Law

The SEC has responded to the internationalization of markets by expanding its influence beyond U.S. borders. These reforms respond to changes in the marketplace, but are improper transgressions of foreign states' sovereignties. Although the SEC has the authority to enter into bilateral agreements,[237] the agency should not be permitted to impose regulations on foreign citizens' domestic actions without a direct, express mandate from Congress. In addition, the SEC's congressional mandate extends only to the domestic securities market – *not the international market.* The United States must change its current regulatory strategy. Because the SEC proposals violate international legal norms, Congress must increase its control over domestic securities law formation and formulate a coherent international regulatory policy consistent with its duty of non-intervention. In the meantime, it should issue a mandate prohibiting the SEC from enacting rules that adversely affect Congress' ability to facilitate the formation of international law.

Although Congress regularly delegates its duties to administrative agencies,[238] Congress has the ultimate authority to enact provisions affecting international commerce.[239] The SEC's proposal to regulate foreign broker-dealers is clearly a matter of international commerce. As evidenced by the London Exchange's suggestion that the SEC's policy should focus on

232. *See* Hicks, *supra* note 230, at 458. *See also* David E. Van Zandt, *The Regulatory and Institutional Conditions for an International Securities Market*, 32 VA. J. INT'L L. 47, 76 (1991) (expressing skepticism that an international securities regulator will be realized in the near future).

233. *See* Solomon & Corso, *supra* note 105, at 331.

234. *See supra* notes 105-07 and accompanying text.

235. Hicks, *supra* note 230, at 459.

236. *See id.*

237. *See supra* notes 39-44 and accompanying text (discussing cooperation with the European Commission and MOU); Millspaugh, *supra* note 12, at 363, 364 n.61.

238. *See supra* note 159 and accompanying text.

239. *See supra* notes 164-67 and accompanying text.

disclosure to U.S. investors rather than regulation of foreign broker-dealers,[240] the SEC's proposal will not only benefit U.S. investors but will also alter the rights of foreign individuals. Therefore, Congress should assume a more visible leadership role in reform by halting the SEC's push to formulate international standards and issuing a mandate to the SEC voicing its specific objectives in the area of international securities regulation.

Because SEC administrators are more knowledgeable in the field of securities regulation than most individual congressmen, the agency must continue to be involved in the internationalization of securities law. Its role, however, should be limited by a Congressional mandate that prohibits the SEC from promulgating rules that conflict with basic norms of international law. At the very least, Congress should require the SEC to explain why the benefits of a particular rule exceed the costs of violating international law. If Congress requires the SEC to submit reports when it wishes to adopt policies that affect Congress' duty to structure agreements involving international trade, the SEC will be unable to expand its influence in the international securities market unless Congress specifically consents. It is possible that Congress would support the SEC's plan to regulate foreign broker-dealers,[241] but that point is irrelevant. Because Congressional oversight was established to protect against tyranny,[242] the device should be used to demonstrate that U.S. securities policy is created by a well-informed Congress, not the SEC's bureaucratic inertia.[243] For these reasons, it would be most desirable for the legislature to develop a coherent policy for integrating U.S. securities regulation into the rapidly expanding telecommunications age.

Conclusion

Since its inception, the SEC has been devoted to protecting the transparency and efficiency of the marketplace. Recent advances in the computer and telecommunications industry, however, force the SEC to alter its policies to keep pace with the internationalization of securities markets.

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240. *See supra* notes 185-86 and accompanying text.

241. Whether Congress should push for extending SEC oversight beyond U.S. borders is a question beyond the scope of this Note. This Note criticizes the procedure of promulgating international law from an administrative agency. The substance of the SEC's proposal is relevant only insofar as it illustrates the jurisdictional problems posed by the SEC's actions. Legislative enactments that infringe upon foreign governments' sovereignty are consistent with the Constitutional limits of administrative delegation, while the SEC's recent proposal represents an unpermissive delegation of legislative power. *See supra* Part II.A.

242. *See* KENNETH CULP DAVIS, ADMINISTRATIVE LAW AND GOVERNMENT 36 (1975).

243. University of Chicago law professor Cass Sunstein argues that the New Deal legacy of increased regulatory power and the growth of federal power to the detriment of states' rights has threatened the system of checks and balances. Professor Sunstein proposes that Congress, as well as the executive and judicial branches, should assume a greater supervisory role in administrative agency decisions. He advocates stricter rules restricting Congress' ability to delegate its legislative duties to regulatory agencies. *See* Cass R. Sunstein, *Constitutionalism After the New Deal*, 101 HARV. L. REV. 421, 422 (1987).

As a result of the increase in the number of cross-border securities transactions, future securities regulation must respond to the involvement of foreign broker-dealers as access providers to foreign exchanges. Present SEC regulations do not restrict foreign broker-dealers who transact unsolicited trades on foreign exchanges for U.S. citizens. The SEC's proposals issued in a May 23, 1997, concept release suggest that the SEC will enact a rule requiring foreign broker-dealers to comply with U.S. securities law, in addition to their home country's regulation. In order to protect U.S. investors from relying on the inadequate safeguards provided by many foreign regulators, the SEC seeks to impose its regulatory policy abroad.

There are three possible explanations for the expansion of SEC regulations into the international realm. First, in an effort to seek out the best regulatory regime for international transactions, the SEC could be challenging foreign regulators to participate in a healthy competition for the most efficient regulations. Second, the SEC might believe that its policies are better than all others in the world and might want the world securities markets to benefit from its "superior" form of governance. Third, public choice theory indicates that lawyers and market analysts might have mounted political pressure for more extensive regulation.

All of these possibilities provide ample reasons to question why the SEC is pursuing potentially aggravating policies without closer direction or oversight by Congress. One possible answer is that the SEC has been expanding since its inception and would only naturally respond to the internationalization of markets with policies that restrict cross-border trading. Because its congressional mandate permits the protection of U.S. investors' interests, the SEC is not ostensibly moving beyond its permissive role as an administrative agency.

Foreign regulators' cool reception of the SEC's plan to regulate foreign broker-dealers implies that some major disagreements between the U.S. and other countries over international securities regulation are on the horizon. Other countries will continue to object to the SEC's erosion of their sovereignty. Congress should step in and take a leadership role in structuring SEC policy that influences its international trade policy. Congress should oversee negotiations with foreign regulators to arrive at an agreeable compromise. In the meantime, Congress should issue a mandate halting the SEC's intrusions into the domestic affairs of other states and develop a long-term strategy for dealing with the sovereignty issues that will inevitably plague the U.S. if it attempts to impose SEC regulations on other nations.