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FOREIGN TRADING SCREENS IN THE UNITED STATES

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& Mark Gurevich

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FOREIGN TRADING SCREENS IN THE UNITED STATES

Howell E. Jackson,^{*} Andreas M. Fleckner^{**} and Mark Gurevich^{***}

Abstract

Trading screens allow investors to trade on an exchange without being physically present at the exchange or even in the same jurisdiction where the exchange is located. Europeans have repeatedly urged the United States to facilitate the placement of such remote trading screens from European exchanges in the United States. The U.S. Securities and Exchange Commission (the “SEC” or “Commission”), however, has objected to the placement of any such terminals in the United States unless the foreign marketplace first registers itself as a securities exchange under U.S. law. The controversy over remote trading screens is emblematic of a range of controversies between U.S. and E.U. regulators. Europeans see the SEC’s position as an unvarnished act of economic protectionism, designed to preserve the position of the New York Stock Exchange and other U.S. trading markets. The SEC views its requirements as essential to safeguard U.S. investors from trading on inadequately regulated markets and from purchasing the securities of foreign issuers that do not comply with U.S. disclosure requirements.

This article argues that technological advances in the securities industry have to some degree mooted the controversy. Notwithstanding the SEC’s efforts to insulate U.S. retail investors from overseas markets, there are other ways for U.S. residents to reach these venues. In light of these alternative trading channels, the principal effect of the SEC’s rules on foreign trading screens for U.S. investors is to raise the cost of foreign investments and inhibit certain trading strategies. On the other hand, the SEC does not hinder cross-border competition among securities exchanges to the extent that many critics of the Commission have suggested.

While the issue of foreign trading screens has for many years been a peripheral issue in the E.U.- U.S. financial services dialog, the looming mergers of major European and U.S. exchanges might intensify the discussion about the regulatory treatment of trading markets that transcend international boundaries. At the same time, as disclosure requirements and accounting requirements head towards trans-Atlantic convergence in the next few years, regulatory officials may finally be able to resolve the controversy about the placement of foreign trading screens in the United States. Once the SEC has satisfied itself that accounting standards of European issuers are functionally equivalent to those applicable to U.S. firms, the Commission may find it much easier to liberalize its treatment of remote trading screens, at least those associated with European markets.

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INTRODUCTION

In recent years, the United States and the European Union have waged a smoldering battle over the regulation of securities exchanges. Europeans have repeatedly urged the Securities and Exchange Commission (the “SEC” or “Commission”) to grant European exchanges authority to locate remote trading terminals and screens in the United States without complying with SEC rules applicable to domestic exchanges.¹ These terminals would allow U.S. broker-dealers to become members of European exchanges and trade on these marketplaces, without the need of being physically present in Europe or routing orders through European intermediaries. The SEC has, to date, generally insisted that a foreign exchange cannot locate such remote access terminals on U.S. soil unless the exchange fully complies with U.S. regulatory requirements applicable to U.S. exchanges.²

This paper takes on the controversy over the placement of foreign trading screens in the United States with a three-step-analysis.

Part I explains how this dispute reflects different approaches to cross-border securities transactions and different assumptions about the need for national treatment in this area. Because of the European Union’s historical mission to reduce trade barriers, the article argues, people from the European side tend to view restrictions on cross-border transactions as potential barriers to trade, designed to protect local firms from cross-border competition. Although the SEC’s regulatory mandate also includes the promotion of competition among exchanges, the Commission tends to give greater weight to investor protection when addressing cross-border transactions.

¹ See particularly Paul Arlman (then Secretary General of the Federation of European Securities Exchanges), *Relations Europe-U.S.: The New Stock Exchanges Challenges in the Context of the Sarbanes-Oxley Act*, Speech on September 25, 2003, Paris, France, ¶ 16-19 (available at http://www.fese.be/initiatives/speeches/2003/arlman_25sep2003.htm); Heiko Beck (then General Counsel of Deutsche Börse), *Grenzüberschreitende Tätigkeit und Zusammenarbeit von Börsen*, in: BANKRECHT UND KAPITALMARKTRECHT IN DER ENTWICKLUNG, FESTSCHRIFT FÜR SIEGFRIED KÜMPEL (ed. Jens Ekkenga et al.; 2003), p. 20, 46 (hereinafter: *Tätigkeit und Zusammenarbeit von Börsen*) (concluding with the vehement demand that the U.S. open its market to German exchanges, arguing that the German level of securities law was equal to U.S. law); Frits Bolkestein (then the E.U.’s Internal Market Commissioner), *Towards an Integrated European Capital Market, Some of the Major Issues Reconsidered*, Speech on June 13, 2003, London, U.K. (available at http://www.fese.be/efmc/2003/report/efmc_bolkestein.htm). (“The current situation is very unsatisfactory.”); EUROPEAN COMMISSION, GREEN PAPER ON FINANCIAL SERVICES POLICY (2005-2010), COM (2005) 177, from May 3, 2005, Annex I, p. 15 (available at http://europa.eu.int/comm/internal_market/finances/docs/actionplan/index/green_a1_en.pdf); EUROPEAN ASSOCIATION FOR LISTED COMPANIES, EALIC’S ANSWER TO THE COMMISSION’S GREEN PAPER ON FINANCIAL SERVICES POLICY 7 (August 1, 2005) (available at http://www.ealic.com/openfree.php?lien=docs/consultation_list/greenpaper050801_ealicanswer_tocommissionpdf.pdf).

² Roel C. Campos (SEC Commissioner), *Convergence and Beyond*, Speech on November 15, 2003, U.S.-Europe Symposium, Program on International Financial Systems, Armonk, N.Y. (available at <http://www.sec.gov/news/speech/spch111503rcc.htm>) [hereinafter: *Convergence and Beyond*]. As discussed *infra* in Part I. D, the SEC has indicated that it may eventually change its attitude. See William H. Donaldson (then SEC Chairman), *SEC Chairman Addresses U.S.-EU Regulatory Cooperation*, Speech on January 26, 2004, Brussels, Belgium, (available at <http://www.useu.be/Categories/CorporateGovernance/Jan2604DonaldsonSpeechEPC.html>).

The regulation of remote trading screens for foreign exchanges is no exemption, reflecting an implicit assumption that investor protection in foreign jurisdictions is generally inferior to those of the United States. In other words, where the European Union sees thinly disguised protection of U.S. exchanges, the SEC sees essential investor protection.

Part II argues that, while public authorities and other observers have sometimes engaged in spirited debates over the validity of the SEC's concerns, technological advances in the securities industry have to some degree mooted these controversies. Notwithstanding the SEC's efforts to insulate U.S. investors from less regulated overseas trading markets, there are a number of ways in which U.S. investors can already gain access to those markets. Placing foreign trading screens in the United States would merely make it easier (and presumably cheaper) to effect such trades, but would add little to what is already available to U.S. investors. This means that probably both sides overstate their arguments: banning foreign trading screens from U.S. soil neither completely insulates U.S. investors from European markets, nor does it prevent these markets from accessing U.S. capital.

Part III concludes with the notion that, because foreign trading screens are only one element within the broader landscape of cross-border investment, the SEC should not only consider how to deal with isolated trading channels, but rather with the broader range of trading options. This wider perspective will be particularly important as the Commission considers its position with respect to looming mergers between U.S. and E.U. trading markets and the convergence of disclosure standards before the end of the decade.

I. U.S. AND E.U. PERSPECTIVES ON THE REGULATION OF FOREIGN EXCHANGES

The controversy about the placement of foreign trading screens in the United States arises from differing views about the concept and purpose of securities law. While the SEC's focus is clearly on investor protection, the European Union and its predecessors (collectively hereinafter the "European Union") traditionally used intervention into financial markets as a means for breaking down trading barriers. Although these differing perspectives on financial regulation may be understandable, the fact that regulators on both sides of the Atlantic enter the debate on trading screens with different assumptions has led to confusion and misunderstandings.

A. The U.S. View

The U.S. securities laws are based on a philosophy of protecting investors through mandatory disclosure. These laws focus on two principal settings in which securities are bought and sold: *issuer transactions* (where securities are sold directly by an issuer, such as in a public offering or a private placement) and *trading transactions* (where securities are traded on secondary markets). Regulation of public offerings by issuers is principally achieved through the Securities

Act of 1933 (the “1933 Act”),³ which seeks to assure full and fair disclosure to investors by requiring registration for securities offered by the issuer (unless an exemption applies). The 1933 Act also subjects the issuer, its directors and officers as well as its underwriters to a strict regime of civil liability for omissions and misstatements in the registration statement or the prospectus.⁴ The Securities Exchange Act of 1934 (the “1934 Act”)⁵ extends this regime of investor protection by requiring issuers of publicly traded securities to comply with extensive periodic disclosure requirements, ranging from annual reports to proxy statements and various other specialized reporting obligations. The 1934 Act also establishes statutory predicates for what has evolved as an extensive system of civil liability for issuers accessing U.S. capital markets as well as professionals who provide assistance in these transactions.⁶ Finally, and most importantly in this context, the 1934 Act regulates exchanges and intermediaries (such as brokers and dealers) that are involved in the sale and trading of securities.

1. Regulation of Stock Exchanges

From its establishment in 1934, the SEC has had a limited mandate to regulate the exchanges on which securities trading is conducted.⁷ The Commission’s jurisdiction over exchanges was hardly surprising given the economic history leading up to the enactment of the 1934 Act and the creation of the SEC. As the Pecora hearings of the early 1930s vividly revealed, the country’s stock exchanges – most notably the New York Stock Exchange – had exposed investors to a host of manipulative and abusive schemes in the years leading up to the Stock Market Crash of 1929, and had also failed to require adequate disclosures from listed companies.⁸ A central concern of the original 1934 Act sought to protect investors from such abuses by imposing SEC oversight of exchanges.⁹ The 1934 Act required exchanges to register with the SEC and take on self-regulating responsibilities with respect to their members and traders and generally to provide mechanisms to monitor and eliminate abusive trading practices.¹⁰ The overarching theme running

³ Securities Act of 1933, codified in 15 U.S.C. § 77a et seq. (2006).

⁴ See particularly Securities Act § 11 & 12, codified in 15 U.S.C. § 77k & 77l (2006).

⁵ Securities Exchange Act of 1934, codified in 15 U.S.C. § 78a et seq. (2006).

⁶ See particularly Rule 10b-5, 17 C.F.R. § 240.10b-5 (2006). See also Securities Exchange Act § 18, codified in 15 U.S.C. § 78r (2006).

⁷ 1 LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 226 (3d ed. 1998) [hereinafter: *SECURITIES REGULATION*]. Notwithstanding the SEC’s powers under the 1934 Act, the stock exchanges remained to a considerable degree unregulated. See Andreas M. Fleckner, *Stock Exchanges at the Crossroads*, 74 *FORDHAM L. REV.* 2541, 2550-2554 (2006) (also available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=836464).

⁸ For an illustration of the reasons that led to the enactment of the Act, see Securities Exchange Act § 2, codified in 15 U.S.C. § 78b (2006) (titled “Necessity for Regulation”).

⁹ LOSS & SELIGMAN, *SECURITIES REGULATION*, *supra* note 7, at 221-22. See also Paul G. Mahoney, *The Exchange as Regulator*, 83 *VA. L. REV.* 1453, 1464 (1997).

¹⁰ See Fleckner, *supra* note 7, at 2582-89 (overview of the regulation of stock exchanges and by stock exchanges).

through all these regulatory mechanisms is protection of the investing public from trading abuses and fraudulent practices on U.S. exchanges.¹¹

While the 1933 and 1934 Acts were drafted with investor protection as their first priority, fostering competition in the finance industry later emerged as another important goal in U.S. securities regulation.¹² Specifically, in 1975 Congress enacted extensive amendments to the 1934 Act directing the SEC to facilitate the creation of a single central market system on a national level (the National Market System) to promote efficiency and “fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets”.¹³ The law called for loosening or removal of anti-competitive restraints based on a belief that market forces would reduce the need for regulation, but at the same time the law expanded the SEC’s regulatory powers.¹⁴ The fierce debate about the overhaul of the National Market System in recent years again illustrated the difficulties in balancing investor protection and competition as the main objects of the Securities Exchange Act.¹⁵

2. Regulation of Alternative Trading Systems

Technological developments since the 1970s have presented substantial challenges to the SEC’s traditional approach to the regulation of the securities markets. As financial entrepreneurs introduced new trading platforms, the SEC had to determine whether to subject them to the relatively expensive regime that applies to the regulation of stock exchanges or to less onerous requirements.¹⁶ Similarly, numerous foreign exchanges overhauled their trading systems, potentially offering new trading opportunities and products for U.S. investors.

¹¹ See Stephen Choi, *Regulating Investors Not Issuers: A Market-Based Proposal*, 88 CAL. L. REV. 279, 280-283 (2000).

¹² See generally Laura Nyantung Beny, *U.S. Secondary Stock Markets: A Survey of Current Regulatory and Structural Issues and a Reform Proposal to Enhance Competition*, 2002 COLUM. BUS. L. REV. 399 (2002).

¹³ Securities Exchange Act § 11A(a)(1)(C)(ii), codified in 15 U.S.C. § 78k-1(a)(1)(C)(ii) (2006). See also Joel Seligman, *The Future of the National Market System*, 10 J. Corp. L. 79, 117 (1984). These amendments originated as a response to perceived abuses in NYSE’s monopolistic hold on the securities markets, exercised through its fixed commission practices, and the attempts by many institutions to evade fixed commissions by joining regional exchanges. See Walter Werner, *The SEC as a Market Regulator*, 70 VA. L. REV. 755, 771 (1984).

¹⁴ Werner, *supra* note 13, at 783 (arguing that despite SEC’s success in disclosure and antifraud areas, the Commission has failed to fully implement its mandate as a market regulator, granted both in the 1934 Acts and in the 1975 Amendments thereto). See also Donald L. Calvin, *The National Market System: A Successful Adventure in Industry Self-Improvement*, 70 VA. L. REV. 785, 789-795 (1984) (responding to Werner’s article and interpreting the 1975 Amendments as merely a call to “existing markets to undertake a major adventure in self-improvement of which public investors would be the principal beneficiaries”).

¹⁵ Securities and Exchange Commission, Release No. 34-513808 (File No. S7-10-04): *Regulation NMS* (June 9, 2005), 70 Fed. Reg. 37,496 (2005). For the long debate, see, e.g., Craig Pirrong, *Thirty Years War*, Regulation, Summer 2005, p. 54.

¹⁶ See Securities and Exchange Commission, Release No. 34-38672, International Series Release No. IS-1085 (File No. S7-16-97): *Regulation of Exchanges* (May 23, 1997), 62 Fed. Reg. 30,485 (1997) [hereinafter: *ATS Concept Release*].

While both kinds of marketplaces provide competition to established U.S. exchanges, the SEC over the years has come to treat the two differently: The approach to domestic alternative trading systems emphasizes competition in the securities industry as articulated in the 1975 Amendments, while the regulation of foreign exchanges is more focused on investor protection. Prior to 1998, the SEC regulated domestic alternative trading systems as broker-dealers, not exchanges, and thus subjected them to less onerous regulation than traditional exchanges.¹⁷ Over time, however, the SEC recognized that technological advances used by some electronic systems blurred the distinctions between those systems and traditional exchanges and made their regulation under the “broker” and “dealer” definition inappropriate and inconsistent with its general regulation of the securities markets.¹⁸ The SEC responded to this realization in 1998 by adopting Regulation ATS.¹⁹ Regulation ATS broadened the “exchange” definition so as to capture domestic alternative trading systems,²⁰ but gave these alternative systems the option of registering as broker-dealers and complying with a more limited set of requirements.

3. Regulation of Foreign Markets

The Commission formulated three potential approaches to regulating U.S. activities of foreign exchanges: (i) relying solely on the foreign market’s home regulator; (ii) requiring all foreign markets to register as U.S. exchanges or apply for an exemption from such registration; or (iii) developing a regulatory scheme focusing on the “entity that provides U.S. investors with the ability to trade directly on foreign markets,” rather than the foreign exchange itself.²¹ At that time, the Commission appeared to be most favorably disposed towards the third approach, that of regulating access providers, rather than exchanges themselves.²² This attitude was consistent with

¹⁷ The SEC generally follows “functional regulation” and classifies trading systems not by what they are called, but by the functions they perform. See Paul D. Cohen, *Securities Trading Via the Internet*, 4 Stan. J. L. Bus. & Fin. 1, 19 (1999).

¹⁸ See *ATS Concept Release*, *supra* note 16, at 30,490 (stating that regulation of trading systems as broker-dealers had “two significant, unintended effects: (1) It has subjected alternative trading systems to a regulatory scheme that is not particularly suited to their market activities; and (2) it has impeded effective integration, surveillance, enforcement, and regulation of the U.S. markets as a whole.”).

¹⁹ Securities and Exchange Commission, Release No. 34-40760 (File No. S7-12-98): *Regulation of Exchanges and Alternative Trading Systems* (December 8, 1998), 63 Fed. Reg. 70,844 (1998) [hereinafter: *Regulation ATS*], implementing Rules 300-303 under the Securities Exchange Act of 1934, codified in 17 C.F.R. § 240.300-303 (2006).

²⁰ Under the amended Rule 3b-16(a), an “exchange” includes an “organization, association, or group of persons [which] (1) Brings together the orders of securities of multiple buyers and sellers; and (2) Uses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade.” 17 C.F.R. § 240.3b-16(a) (2006).

²¹ *ATS Concept Release*, *supra* note 16, at 30,522.

²² See Derek W. Kaczmarek, *Note: The SEC’s Role in the Global Era: How the SEC Will Protect U.S. Investors in Foreign Markets*, 9 IND. J. GLOBAL LEG. STUD. 529, 550 (2002).

the overall focus of the SEC's ATS Concept Release on electronic trading systems, both domestic and foreign.

Ultimately, however, the Commission chose not to regulate domestic alternative trading systems and foreign exchanges in the same manner. Regulation ATS, as adopted, did not address foreign exchanges' ability to install remote access terminals in the United States, implicitly ruling against foreign exchanges seeking some form of generalized regulatory relief akin to what Regulation ATS made available for alternative trading systems located in the United States.²³ Although SEC Commissioner Campos subsequently indicated that certain accommodations could be made should foreign exchanges decide to register as exchanges in the United States,²⁴ this concession seemed to be an unpromising alternative to the general relief the European exchanges had been hoping for, especially when taking into account how burdensome the standard exchange registration process is. Even the Nasdaq Stock Market, a well-established domestic marketplace, had to wait for roughly five years before the SEC approved its stock exchange application.²⁵ And none of the alternative trading systems that applied for this status has received approval so far.²⁶ Particularly for foreign marketplaces, the case of the U.S. Futures Exchange (USFE, commonly known as Eurex U.S.) was another problematic example.²⁷ Although the Treasury Department, the Federal Trade Commission, and the Federal Reserve supported Eurex's application,²⁸ its rivals in the futures markets opposed the application before the Commodities Futures Trading

²³ The Commission stated in the ATS Release:

While the revised regulatory scheme implemented today is designed to address changes in the way securities are traded, the Commission's assessment of the *impact* that these systems may have on the trading of unregistered securities (*i.e.* of both domestic and foreign issuers), and of the appropriate regulatory posture to these developments, is still ongoing. This matter and the broader issues involving recent trends and initiatives that give U.S. investors greater and more instantaneous access to foreign securities markets create tensions between competing Commission goals. The Commission, for example, wishes to foster developments that enable U.S. investors to execute securities trades more efficiently, but it also desires that foreign securities traded in U.S. markets have full and fair disclosure. These tensions and issues will be addressed by the Commission in the future.

Regulation ATS, *supra* note 19, at 70,846.

²⁴ Campos, *Convergence and Beyond*, *supra* note 2.

²⁵ See Securities and Exchange Commission, Release No. 34-44396 (File No. 10-131): *The Nasdaq Stock Market, Inc.; Notice of Filing of Application for Registration as a National Securities Exchange Under Section 6 of the Securities Exchange Act of 1934* (June 7, 2001), 66 Fed. Reg. 31,952 (2001); Release No. 34-53128 (File No. 10-131): *In the Matter of the Application of the Nasdaq Stock Market LLC for Registration as a National Securities Exchange; Findings, Opinion, and Order of the Commission* (January 13, 2006), 71 Fed. Reg. 3,550 (2006).

²⁶ See Diana B. Henriques, *Testing an Emerging Market—Can Wall St.'s Old Guards Cope With the New Trading*, N.Y. TIMES, May 12, 1999, p. C1. Inet Stock Exchange, a subsidiary of Instinet, submitted a draft application in May 2004 (see Letter from Edward J. Nicoll to Jonathan G. Katz from March 8, 2005 n. 4; available at <http://www.sec.gov/rules/proposed/s73904/ejnicoll030805.pdf>).

²⁷ For the application submissions, public comments, and approval documents see http://www.cftc.gov/dea/deausfesubmissions_and_comments_table.htm.

²⁸ Letters available at http://www.cftc.gov/dea/deausfesubmissions_and_comments_table.htm.

Commission (CFTC),²⁹ the SEC's alter ego in the futures markets, and caused the CFTC to delay the application process, thereby giving U.S. competitors more time to establish a competitive electronic trading system.³⁰ Against this background, it is not surprising that foreign marketplaces would prefer to avoid having to apply for U.S. exchange status and would rather prefer to be exclusively regulated by their home regulator or, as a second option, be regulated by the SEC only to the extent that the Commission regulates domestic alternative trading systems that register as broker-dealers.

4. The Tradepoint Release

While none of the European exchanges has applied for registration as a national securities exchange under U.S. law so far, the Commission in 1999 exempted from registration as an exchange Tradepoint Financial Networks plc (Tradepoint), then a U.K. screen-based electronic market for securities that were listed on the London Stock Exchange (now virt-x).³¹ To date, this exemption constitutes the only direct U.S. access to foreign exchanges.

The exemption for Tradepoint was contingent on the trading volume remaining low.³² In addition, Tradepoint could only offer to general investors securities already registered under the 1934 Act, i.e. securities of foreign issuers that were already substantially in compliance with the

²⁹ See the letters available at http://www.cftc.gov/dea/deausfesubmissions_and_comments_table.htm as well as Jeff Bater & Christine Marie Nielsen, *Chicago Exchange Officials Argue Against Eurex License*, THE WALL STREET JOURNAL, November 7, 2003, p. C12.

³⁰ See, e.g., Peter McKay & Silvia Ascarelli, *Eurex's Bid to Challenge CBOT is Hurt by Regulator's Delay*, THE WALL STREET JOURNAL, January 21, 2004, p. C3. Eurex U.S. is still waiting for the final approval for its planned transatlantic clearing linkage. See Sharon Brown-Hruska (then Acting Chairman of the CFTC), *Market Competition and Regulatory Cooperation: A New Dynamic in US-EU Financial Relations*, Speech on May 24, 2005, Brussels, Belgium (available at <http://cftc.gov/opa/speeches05/opabrownhruska32.htm>) ("At this time, my staff is working extraordinarily hard in reviewing further proposals to expand on the initial clearing linkage. We are reviewing the proposal to ensure that the combined market will be monitored appropriately and that there will be no gaps in supervision and are consulting with German authorities in this review").

³¹ Securities and Exchange Commission, Release No. 34-41199, International Series Release No. 1189 (File No. 10-126): *Tradepoint Financial Networks plc; Order Granting Limited Volume Exemption From Registration as an Exchange Under Section 5 of the Securities Exchange Act* (March 22, 1999), 64 Fed. Reg. 14,953 (1999) [hereinafter: *Tradepoint Release*]. See also Virt-X Press Release, *U.S. Members Gain Direct Access to European Equity Trading* (June 20, 2001) (emphasizing that virt-x will be "the only stock exchange to be able to offer trading in European blue chip equities to U.S. buy and sell side members"). For an introduction to Tradepoint's/virt-x's business model, see Craig Karmin & Erik Portanger, *Pan-European Market That is Already Trading Stocks Gets Second Look in Wake of LSE News*, THE WALL STREET JOURNAL, September 14, 2000, p. C16.

³² The SEC made the exemption effective only if "(i) The average daily dollar value of trades (measured on a quarterly basis) involving a U.S. member does not exceed \$40 million; and (ii) Its worldwide average daily volume (measured on a quarterly basis) does not exceed ten percent of the average daily volume of the LSE [London Stock Exchange]." *Tradepoint Release*, *supra* note 31, at 14,957.

SEC's periodic disclosure requirements for publicly-traded U.S. issuers.³³ Bids and offers for other securities could only be made to qualified institutional buyers ("QIBs"), international agencies, and non-U.S. persons.³⁴ The Tradepoint exemption was thus restrictive in two ways: (1) the type of investors with access to trading in unregistered securities, and (2) the total volume of trading allowed. The SEC emphasized the importance of both of these factors, making it clear that neither a low volume exchange offering access to retail investors, nor a higher volume exchange limited to QIBs would be eligible for exemptive relief.³⁵ These limitations were critical since the Tradepoint release was based on the 1934 Act's low volume exemption,³⁶ not on the Commission's general exemptive authority.³⁷ The SEC extended its exemption in 2001 through a no-action letter, allowing Tradepoint's successor virt-x³⁸ to trade shares listed on markets other than London, however, within the limits of the original release.³⁹

In a way, the Tradepoint Release can be seen as an implicit implementation of the second approach to foreign exchanges that the SEC outlined in its 1997 ATS Concept Release. Under the Tradepoint Release, a foreign exchange was granted an exemption from SEC exchange regulation even though the company was proposing to offer trading services to U.S. investors using physical equipment located in U.S. territories. The scope of the exemption, however, was quite narrow. In particular, U.S. retail investors were limited to trading in foreign securities that were already eligible for (and quite likely trading on) U.S. exchanges. Similarly, foreign issuers have long been able to access QIBs in the United States without having to comply with SEC disclosure rules, even if the securities could be traded on specialized trading systems limited to QIBs.

While some have applauded the Tradepoint Release as a first step in the direction of granting U.S. access to foreign exchanges,⁴⁰ in fact, it may have been a step in the opposite direction, considering the options that the SEC rejected in giving Tradepoint a low-volume exemption. The SEC could have regulated Tradepoint using the other two alternatives discussed in the ATS Concept Release, namely by regulating Tradepoint as a mere access provider to a foreign market, the

³³ The SEC provides foreign private issuers limited relief from certain aspects of the disclosure rules applicable to U.S. issuers, but the regulatory requirements for these foreign issuers are still substantial. *See, e.g.*, Form 20-F (Annual and transition report of foreign private issuers).

³⁴ *Tradepoint Release*, *supra* note 31, at 14,957.

³⁵ *Id.*

³⁶ Securities Exchange Act § 5(2), codified in 15 U.S.C. § 78e(2) (2006).

³⁷ Securities Exchange Act § 36, codified in 15 U.S.C. § 78mm (2006).

³⁸ *See* Virt-X Press Release, *Tradepoint Signs Agreements with SWX Swiss Stock Exchange and Tradepoint Consortium Relating to the Creation of the Virt-X Market for Pan-European Blue Chip Stocks* (October 23, 2000). *See also* VIRT-X—THE GATEWAY TO EUROPE (available at http://www.virt-x.com/virtx/virtx_factsheet.pdf).

³⁹ SEC No-Action letter, *Tradepoint Stock Exchange/virt-x* (June 21, 2001).

⁴⁰ *See, e.g.*, Elizabeth M. McCarroll, *Note: Regulation of Electronic Communications Networks—An Examination of Tradepoint Financial Network's SEC Approval to Become the First Non-American Exchange to Operate in the United States*, 33 CORNELL INT'L L.J. 211, 239 (2000).

third approach outlined in the ATS Concept Release.⁴¹ Such regulation would presumably impose relatively limited additional U.S. requirements on foreign entities involved and thereby reduce the likelihood of conflicts with the market's home country regulations.⁴² This approach would recognize that U.S. investors trade directly on the foreign markets through a variety of means (as will be outlined in Part II), and could permit the Commission to regulate, in a similar manner, all entities that provide this service.⁴³ Tradepoint's electronic platform made it a plausible case for regulation as an access provider, since the system allowed a high degree of surveillance.⁴⁴ Further, the Tradepoint computer linkages generated a perfect audit trail and minimized opportunities for fraud and manipulation.⁴⁵

Alternatively, the Commission could have followed the first and most liberal approach suggested in the ATS Concept Release: simply requiring Tradepoint to comply with its home regime and relying on U.K. regulators to monitor and enforce such compliance. This approach – complete deference to home country regulation – was urged by many of the European exchanges. For example, Deutsche Börse stated in response to the ATS Concept Release: “Deutsche Börse believes that foreign exchanges contemplating limited activities and maintaining a limited physical presence in the United States should generally be permitted to offer membership to registered broker-dealers and to other highly sophisticated investors in the United States on the basis of their home country regulation”⁴⁶ Under this approach, the SEC would have imposed no additional regulations – exempting Tradepoint from both U.S. broker-dealer and exchange regulations.

Had the SEC chosen either of these two alternatives – subjecting Tradepoint to relatively limited regulation as an access provider or deferring completely to U.K. regulation – the ruling would have provided U.S. investors with a new mechanism for trading in foreign securities. In particular, retail investors working through U.S. broker-dealers would have had direct access to foreign markets selling securities of foreign issuers without being required to trade through, directly or indirectly, a foreign broker-dealer. Indeed, the significance of the Tradepoint Release was that it revealed the SEC's unwillingness to allow this access to occur.

⁴¹ This would include two options: Regulation either as *securities information processor* (as defined in Securities Exchange Act § 3(a)(22)(A), codified in 15 U.S.C. § 78c(a)(22)(A) (2006)) or as *broker-dealer* (as defined in Securities Exchange Act § 3(a)(4) & (5), codified in 15 U.S.C. § 78c(a)(4) & (5) (2006)). See also *ATS Concept Release*, *supra* note 16, at 30,524 et seq.

⁴² *ATS Concept Release*, *supra* note 16, at 30,524.

⁴³ *Id.*

⁴⁴ See McCarroll, *supra* note 40, at 252, citing Roger D. Blanc, *Broker Dealer Regulation: 13 Letters Regarding SEC File No. S7-16-97*, ALI-ABA COURSE OF STUDY MATERIALS 33 (Jan. 8, 1998).

⁴⁵ *Id.*

⁴⁶ Deutsche Börse, Comment on Securities and Exchange Commission File No. S7-16-97 (October 3, 1997) (available at <http://www.sec.gov/rules/concept/s71697/franke1.htm>).

5. The Commodity Futures Trading Commission's Approach

In stark contrast to the SEC's rejection of direct access to foreign markets is the manner in which the Commodity Futures Trading Commission (CFTC) has developed a limited system of mutual recognition for dealing with foreign futures exchanges.⁴⁷ In the mid-1990's – at roughly the same time the SEC was drafting its ATS Concept Release – the CFTC granted an exemption from registration to Deutsche Terminbörse (DTB), then a Germany-based electronic futures and options exchange (predecessor of Eurex, today the world's largest derivatives exchange), to install direct access terminals in the United States for its members.⁴⁸ Unlike the low-volume Tradepoint system, DTB was a major player in futures trading and expected significant volumes of trades through its U.S. terminals.⁴⁹ Its successor Eurex has today roughly sixty U.S. members.⁵⁰

In giving DTB access to the U.S. market, the CFTC focused its analysis on the high level of internal monitoring performed by DTB and its compliance with domestic regulation in Germany,⁵¹ emphasizing the readiness of the German regulators to cooperate in information exchange and other matters connected to the regulation of DTB.⁵² Since its ruling in the DTB case, the CFTC has granted no-action relief to other foreign futures and options markets for access to the United States and reported being pleased with the results (at least until recently).⁵³ As a result, U.S. market participants can gain direct access to foreign futures markets, provided the CFTC determines that home jurisdiction regulation is adequate to safeguard U.S. investors. Were the SEC to have followed a comparable approach in dealing with the Tradepoint application, it would have first inquired as to the adequacy of U.K. oversight and then, if the inquiry generated a favorable result (which is quite likely), it would have granted Tradepoint full exemption from

⁴⁷ For a historical analysis of the differences between the CFTC and the SEC, see Jerry W. Markham, *Super Regulator: A Comparative Analysis of Securities and Derivatives Regulation in the United States, the United Kingdom, and Japan*, 28 BROOK. J. INT'L L. 319, 341-46 (2003) (tracing the differences in regulatory philosophies of the two agencies to the different histories of their creation and early development).

⁴⁸ Commodity Futures Trading Commission, Interpretative Letter No. 96-28: *No-Action Request To Permit DTB Screen Trading in the United States* (February 29, 1996), Comm. Fut. L. Rep. (CCH), ¶ 26,669 [hereinafter: *DTB-Letter*].

⁴⁹ *Id.*

⁵⁰ See <http://www.eurexchange.com/marketaccess/search/findaMember.html>.

⁵¹ *DTB-Letter*, supra note 48.

⁵² *Id.* At that time, the federal regulator was the *Bundesaufsichtsamt für den Wertpapierhandel* (BAWe), now part of the *Bundesanstalt für Finanzdienstleistungsaufsicht* (BaFin). See <http://www.bafin.de>. In addition, EUREX is regulated on the state level, by the *Hessische Börsenaufsichtsbehörde* (Exchange Supervisory Authority of the State of Hesse, see <http://www.boersenaufsicht.de/hessen.htm>).

⁵³ See Commodity Futures Trading Commission, *Notice of Statement of Commission Policy Regarding the Listing of New Futures and Option Contracts by Foreign Boards of Trade That Have Received Staff No-Action Relief To Place Electronic Trading Devices in the United States* (June 30, 2000), 65 Fed. Reg. 41,641 (2000). But note the recent debate about the trading of oil futures contracts on the Intercontinental Exchange, which led to a revision of the CFTC's general policy. See Commodity Futures Trading Commission, *Notice of Revision of Commission Policy Regarding the Listing of New Futures and Option Contracts by Foreign Boards of Trade That Have Received Staff No-*

U.S. exchange regulation, opening the way for all U.S. investors to gain access to securities traded on the London Stock Exchange, without being required to transact through a foreign broker-dealer.

To be sure, the SEC and the CFTC operate in distinctive institutional contexts, and these distinctions undoubtedly influenced the agencies' differing approaches to the issue of foreign market organizers. While the regulation of venues for futures or stock trading is broadly comparable, the regulation of the products traded on those markets and the institutional background of the traders is not. Even though the contract terms and trading practices are an important part of the CFTC's regulation of futures and options, there is hardly an analog to the level of on-going disclosure obligations that the SEC imposes on issuers in the securities field: Pork bellies do not need to make GAAP-compliant periodic reports of the sort that the SEC expects from issuers of securities. In addition, with fewer unsophisticated retail investors on the futures markets, there doesn't seem to be the same need for the kind of paternalistic protection that the SEC tries to maintain on the stock markets. Last but not least, there are differences in the statutory grounds under which the CFTC and SEC exempted DTB and Tradepoint, respectively, suggesting a potential doctrinal basis for the CFTC's more liberal approach.⁵⁴

B. The E.U. View

The European regulation of securities and investment services has aimed for a single or integrated market, within which investors and issuers can access national markets across the European Union irrespective of their home country.⁵⁵ This historic mission has shaped the substantive agenda of the regime (at least until recently) and gave it content quite different from the investor-focused securities regulation in the United States. As one observer noted:

[I]n the investment services areas ... the single market objective has resulted in a focus on the free movement of the investment firm and its market-access rights and on the stability of the integrated market; limited attention has been given to the proactive protection of the investor who accesses the market-place. Indeed, as a regulatory priority, the investor as a focus for protection has generally been secondary to the investment firm as a beneficiary of liberalization and as an agent for the construction of the internal market.⁵⁶

Action Relief to Provide Direct Access to Their Automated Trading Systems From Locations in the United States (April 14, 2006), 71 Fed. Reg. 19,877 (2006) (corrected at 21,003).

⁵⁴ Compare Commodity Exchange Act § 4(b), codified in 7 U.S.C. § 4(b) (2006), with Securities Exchange Act § 5, codified in 15 U.S.C. § 78e (2006). *But see also* the SEC's general exemptive authority under Securities Exchange Act § 36, codified in 15 U.S.C. § 78mm (2006).

⁵⁵ NIAMH MOLONEY, EC SECURITIES REGULATION 6 (2002).

⁵⁶ *Id.* at 9.

The development of the E.U. securities regulation can be divided into three distinct phases:⁵⁷ In the first phase, marked by the 1966 Segré Report, regulation was primarily directed at the construction of a single deep and liquid securities market accessible to issuers across the European Union. During this phase, the European Union focused on harmonization of member states' listing rules and rules on disclosure accompanying such listing and public offerings. This was done through detailed directives promoting equivalence and generally requiring some minimum harmonization and mutual recognition between the member states.

In phase two, regulation shifted from issuer market access to creating a single market in investment services. This shift originated from the Commission's White Paper on the internal market presented in 1985, which first introduced the concept of a passport device to the regulation of securities. The Investment Services Directive implemented this approach in 1993.⁵⁸ The Directive (which has been repealed by the Directive on Markets in Financial Instruments in 2004)⁵⁹ was based on three related principles: Harmonization between the member states of minimum standards pertaining to supervision of financial institutions, mutual recognition of the competence of each member state to govern according to these minimum standards, and the supervision of these financial institutions by the regulators in the home country.⁶⁰ Under the Directive, if an investment firm was appropriately authorized in its home member state, the firm was also permitted to offer its services in all other member states without further authorization.⁶¹ The Directive also stipulated that authorized investment firms must be allowed to become members of, or be given access to, all regulated markets in any other member state, subject to certain conditions.⁶² The Directive required member states to allow foreign investment firms to become remote members of that state's regulated markets, also subject to a range of conditions.⁶³

⁵⁷ For the following, *see id.* at 21 et seq.

⁵⁸ *See* COUNCIL DIRECTIVE 93/22/EEC of 10 May 1993 ON INVESTMENT SERVICES IN THE SECURITIES FIELD, Official Journal L 141 (June 11, 1993), p. 27 (*available at* http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=31993L0022) (hereinafter: INVESTMENT SERVICES DIRECTIVE).

⁵⁹ DIRECTIVE 2004/39/EC 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, Official Journal L 145 (April 30, 2004), p. 1 (*available at* http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/l_145/l_14520040430en00010044.pdf) (hereinafter: DIRECTIVE ON MARKETS IN FINANCIAL INSTRUMENTS).

⁶⁰ INVESTMENT SERVICES DIRECTIVE, *supra* note 58. *See also* RUBEN LEE, WHAT IS AN EXCHANGE? THE AUTOMATION, MANAGEMENT, AND REGULATION OF FINANCIAL MARKETS 136-137 (1998).

⁶¹ Art. 3 INVESTMENT SERVICES DIRECTIVE, *supra* note 58.

⁶² Art. 15(1) INVESTMENT SERVICES DIRECTIVE, *supra* note 58.

⁶³ Art. 15(4) INVESTMENT SERVICES DIRECTIVE, *supra* note 58. For example, Tradepoint (now virt-x) is able to operate in all the E.U. member states pursuant to this directive. *See* Norman S. Poser, *The Stock Exchanges Of The United States And Europe: Automation, Globalization, And Consolidation*, 22 U. PA. J. INT'L ECON. L. 497, 508 (2001).

The current (third) phase of the E.U. regulation of securities markets was marked by a 1998 Commission Communication entitled “Financial Services: Building a Framework for Action.”⁶⁴ The Communication reported that, despite some improvements, financial services markets generally remained segmented and cross-border provision of financial services remained low. The Communication identified, among other issues, a need for further market-driven modernization to remove barriers to cross-border IPOs and investment-related activities.⁶⁵ These findings were later translated into a specific work program in the Financial Services Action Plan (FSAP), which involved 42 separate proposals envisioning a radical reshaping of financial services and securities regulation.⁶⁶ Most importantly, after long discussions and many proposals, the Directive on Markets in Financial Instruments could finally be enacted.⁶⁷

Another landmark in the E.U. securities regulation is the Final Report of the Committee of Wise Men on the Regulation of European Securities Markets in 2001, known as the *Lamfalussy Report*.⁶⁸ The report delivered a searing indictment of the inadequately harmonized securities and financial services markets, the structural inability to support further integration and cope with market developments and the delays and inefficiencies of the E.U. legislative process.⁶⁹ It recommended a major restructuring of the law-making system: by separating political, regulatory, enforcement and other problems into four levels, the system could avoid handling at a higher level those problems that could well be resolved at a lower level.⁷⁰

Although the report’s primary value may be in its recommendations for structural change, for the present purposes it serves as an example of the European Union’s main preoccupation with competition. Consistent with this attitude, the Lamfalussy Report refers to the SEC’s position of requiring direct access terminals of foreign exchanges to register in the United States as an “external trade barrier” to competition.⁷¹ Instead, the European model envisions integration of the securities markets of the member states. Thus, the report identifies as one of the top priorities for the securities regulation in Europe the creation of a single passport for recognized marketplaces on the basis of the home country control principle.⁷² This preference for liberalization

⁶⁴ FINANCIAL SERVICES: BUILDING A FRAMEWORK FOR ACTION (1998) (available at http://europa.eu.int/comm/internal_market/finances/docs/actionplan/index/fs_en.pdf).

⁶⁵ MOLONEY, *supra* note 55, at 26.

⁶⁶ *Id.* at 27.

⁶⁷ DIRECTIVE ON MARKETS IN FINANCIAL INSTRUMENTS, *supra* note 59.

⁶⁸ FINAL REPORT OF THE COMMITTEE OF WISE MEN ON THE REGULATION OF EUROPEAN SECURITIES MARKETS (February 15, 2001) (hereinafter: *Lamfalussy Report*).

⁶⁹ MOLONEY, *supra* note 55, at 29.

⁷⁰ *Lamfalussy Report*, *supra* note 68, at 22-41.

⁷¹ *Id.* at 11.

⁷² *Id.* at 13.

over investor protection once again illustrates the different approach of the European Union compared to the United States, the divergence that is the source of the conflict over trading screens.

Obviously, an analysis of the European securities law that limits itself to the removal of trade barriers would be incomplete. Overall, the European Union did provide for a higher level of investor protection than existed in most of the member states before the harmonization process began.⁷³ This is especially true for the directives and regulations enacted in recent years, which were subject to increasing opposition based upon the concern that the European Union might go too far with investor protection and unduly hinder businesses.⁷⁴ The point in this context, however, is that traditionally the main focus of the European Union was breaking down market barriers rather than protecting investors. All respective directives in this field included "passporting" schemes where a central idea was that host jurisdictions should defer to and accept home country oversight, without providing for a uniform regulatory regime in all member states (only minimum standards). The European Union therefore oftentimes opened the markets before ensuring that investors were comparably protected. And even considering the level of protection achieved in recent directives and regulations, without harmonized enforcement rules the European Union is not likely to achieve a comparable level of investor protection in all twenty-five member states.⁷⁵

C. The Member State View

The Investment Services Directive and the Directive on Markets in Financial Instruments do not provide for an exhaustive regime but are limited both in their scope and their applicability.

⁷³ See particularly Manning Gilbert Warren III, *Global Harmonization of Securities Laws: The Achievements of the European Communities*, 31 HARV. INT. L.J. 185 (1990); Manning Gilbert Warren III, *The Harmonization of European Securities Law*, 37 INT'L. L. 211 (2003). Both articles, among other related contributions, are reprinted in MANNING GILBERT WARREN III, *EUROPEAN SECURITIES REGULATION* (2003).

⁷⁴ Those worries arose particularly in connection with the DIRECTIVE ON MARKETS IN FINANCIAL INSTRUMENTS, *supra* note 59, and the DIRECTIVE 2003/6/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 28 January 2003 ON INSIDER DEALING AND MARKET MANIPULATION (MARKET ABUSE), Official Journal L 96 (April 12, 2003), p. 16 (available at http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/l_096/l_09620030412en00160025.pdf) (hereinafter: DIRECTIVE ON MARKET ABUSE).

⁷⁵ See generally Howell E. Jackson, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications* (working paper; August 2005; available at http://www.law.harvard.edu/programs/olin_center/corporate_governance/papers/Jackson_521.pdf); Howell E. Jackson, *An American Perspective on the U.K. Financial Services Authority: Politics, Goals & Regulatory Intensity* (working paper, August 2005; available at http://www.law.harvard.edu/programs/olin_center/corporate_governance/papers/Jackson_522.pdf). See also Luca Enriques, *Conflicts of Interest in Investment Services: The Price and Uncertain Impact of MiFID's Regulatory Framework* (working paper, August 2005; available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=782828) (arguing that even under the new investment services directive, preference was given for market integration rather than for investor protection, and that together with lenient enforcement in some member states, the new directive might even lead to decreased investor protection).

Most importantly, they do not touch the member states' authority to regulate foreign exchanges from outside the European Union. Viewed in this light, the European Union's role in the controversy over trading screens in the United States is better described as that of an agent acting on behalf of its member states rather than as that of a principal with own interests.

The United Kingdom has established a mutual recognition system for foreign exchanges. The Financial Services and Markets Act of 2000 generally requires all persons engaged in the investment business to seek authorization or an exemption.⁷⁶ A U.K. trading system or an investment institution may apply to the Financial Services Authority to become a "Recognised Investment Exchange".⁷⁷ To be eligible for the status, the entity must have sufficient financial resources, afford investor protection and meet certain other conditions.⁷⁸ A similar regime is available for incoming foreign exchanges, if the entity is subject to home country supervision that ensures investor protection equivalent to that in the U.K.⁷⁹

Interestingly, Germany changed its treatment of foreign exchanges during the controversy with the United States over remote trading terminals. In 1999, the Frankfurter Wertpapierbörse (Frankfurt Stock Exchange, operated by Deutsche Börse) filed an application with the SEC for the placement of trading screens in the United States.⁸⁰ The SEC, however, did not approve the application. At that time, Germany did not have any special rules about the treatment of foreign exchanges.⁸¹ Whether in reaction to the SEC's refusal to allow German trading screens being placed in the United States or not, the German legislature in 2002 amended the Securities Trading Act with provisions that require marketplaces from outside the European Union to file an application with the *Bundesanstalt für Finanzdienstleistungsaufsicht* (BaFin, the German equivalent to the SEC) before they commence their activities.⁸² The reasons for refusal, however, are fairly limited in the statute and wouldn't pose a substantial challenge for an exchange from a seasoned securities market.

⁷⁶ Financial Services and Markets Act of 2000 (2000 ch. 8).

⁷⁷ Financial Services and Markets Act § 285 et seq.

⁷⁸ For the details, see Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001 (SI 2001/995) and the FINANCIAL SERVICES AUTHORITY HANDBOOK, REC (available at <http://fsahandbook.info/FSA/html/handbook/>).

⁷⁹ Financial Services and Markets Act § 292(3). See particularly FINANCIAL SERVICES AUTHORITY HANDBOOK, REC 6.

⁸⁰ Beck, *Tätigkeit und Zusammenarbeit von Börsen*, supra note 1, at 27.

⁸¹ The German supervisory authority (then *Bundesaufsichtsamt für den Wertpapierhandel*, now part of the *Bundesanstalt für Finanzdienstleistungsaufsicht*) relied on the catch-all provision (Wertpapierhandelsgesetz § 4) and informally required foreign exchanges to inform the agency when they started their business. See Heiko Beck, in: *KAPITALMARKTRECHTSKOMMENTAR* (ed. Eberhard Schwark; 2004), WpHG § 37i note 1.

⁸² Wertpapierhandelsgesetz § 37i et seq., introduced by Gesetz zur weiteren Fortentwicklung des Finanzplatzes Deutschland (Viertes Finanzmarktförderungsgesetz) Art. 2 No. 24 from June 21, 2002, BGBl. I, p. 2010. For the question of under which circumstances a trading system is foreign or domestic, see Fabian Reuschle & Andreas M.

D. The U.S.-E.U. Conflict

At the heart of the controversy over the placement of European trading screens on U.S. soil lies a disagreement over the right balance between protecting investors and fostering competition, the two conflicting goals in securities regulation on both sides of the Atlantic.

1. Public Statements

The SEC has been repeatedly urged to adopt a mutual recognition regime similar to that of the CFTC and its European counterparts.⁸³ Benn Steil, of the Council of Foreign Relations (also a board member of virt-x, Tradepoint's successor), has been particularly vocal in criticizing the SEC, accusing the agency of "Stalinist thinking", of punishing Europe for its Iraq stance and of furthering a foreign policy agenda instead of addressing its more legitimate sphere of economic concerns.⁸⁴ Most European critics – unhappy with the SEC position – saw it, as did Benn Steil, as anti-competitive and unfair toward European exchanges.⁸⁵ As described above, this attitude is understandable inasmuch as European regimes allow marketplaces to compete freely within Europe and even grant U.S. exchanges remote access in Europe under certain conditions. Benn Steil probably captured the essence of this position when he reminded the SEC that its mandate was "protecting investors, not exchanges."⁸⁶

In contrast to the competition-focused European position, the U.S. response predictably emphasized investor protection. Commissioner Roel Campos summarized the U.S. position succinctly: "foreign exchanges are more than welcome in our markets – under the same terms that apply to U.S. exchanges."⁸⁷ Although Campos elsewhere conceded that competition with non-

Fleckner, *Börsenähnliche Einrichtungen—die privatrechtliche Organisation einer Börse im materiellen Sinne*, 2 ZEITSCHRIFT FÜR BANK- UND KAPITALMARKTRECHT 617, 620 (2002).

⁸³ See, e.g., Benn Steil, *Is Exchange Reciprocity Doomed? Not At All: The Goal of a Vast, Integrated Transatlantic Securities Market Would Increase Investment Returns, Lower Capital Costs and Increase Growth*, Editorial, National Post, March 27, 2003. See also Arlman, *supra* note 1, and Beck, *Tätigkeit und Zusammenarbeit von Börsen*, *supra* note 1.

⁸⁴ See Michael Forman, *Access Issue Hints at Broader SEC Problems*, SECURITIES INDUSTRY NEWS, May 12, 2003; Benn Steil, *U.S. Regulator Punishes Old Europe*, FINANCIAL NEWS, April 20, 2003; (without author) *SEC's Campos Tells Foreign Markets No Easy Access to U.S.*, WALL STREET LETTER, June 16, 2003.

⁸⁵ See particularly *Lamfalussy Report*, *supra* note 68, at 11 (characterizing the SEC ban on E.U. trading screens as an "external trade barrier").

⁸⁶ Cited pursuant to Vincent Boland, *Enthusiasm is Growing for Direct Access in U.S. and European Securities Markets*, FINANCIAL TIMES, May 24, 2003, p. 23. For criticisms that the SEC was overly protective of the traditional U.S. exchanges in the years prior to the 1975 Amendments, see Gregg A. Jarrell, *Change at the Exchange: The Causes and Effects of Deregulation*, 27 J. LAW & ECON. 273 (1984) ("The NYSE was a cartel, and the SEC its enforcement arm."). See also recently during the discussion about the new national market system (NMS) (without author) *SEC Loves NYSE*, THE WALL STREET JOURNAL, December 6, 2004, p. A14.

⁸⁷ Campos, *Convergence and Beyond*, *supra* note 2.

U.S. participants would benefit investors in U.S. markets,⁸⁸ competition for Campos does not seem to mean unrestrained access to U.S. capital. He asked, rhetorically, “how the presence of foreign exchanges in the United States, *on terms other than those that apply to U.S. exchanges*, will benefit our [U.S.] markets and investors?”⁸⁹ His response to the argument that European exchanges are subject to home country regulation is that “investor protection means different things to Americans and Europeans” and that the SEC must retain authority over anyone who commits wrongdoing while taking advantage of the U.S. markets.⁹⁰

In response to European concerns, the SEC toyed briefly with the idea of relaxing the regulation of foreign trading screens under Harvey Pitt’s leadership, but abandoned it shortly afterwards.⁹¹ In January 2004, William Donaldson, then SEC Chairman, again stated that the SEC would consider possible exemptive relief to foreign exchanges wishing to place direct trading terminals in the United States, but only after the SEC completes its examination of domestic market structure issues.⁹²

2. U.S. Concerns

The 1933 and 1934 Acts establish a strict regulatory regime with detailed rules not only regarding the regulation of securities exchanges but also about the extent of issuer disclosure, the liability of violators, and the process of enforcing the compliance with the regulatory requirements. Even when investors trade in securities on a domestic alternative trading system, the SEC can be reasonably confident that the issuer of the underlying securities is subject to a comprehensive set of rules that protect investors. In contrast, securities traded on foreign markets are not

⁸⁸ Roel C. Campos, *Embracing International Business in the Post-Enron Era*, Speech on June 11, 2003, Centre for European Policy Studies, Brussels, Belgium (available at <http://www.sec.gov/news/speech/spch061103rcc.htm>) (hereinafter: *Embracing International Business*).

⁸⁹ Campos, *Convergence and Beyond*, *supra* note 2. Mr. Campos repeatedly gave the impression that marketplaces – including foreign exchanges – have only the possibility to register as national securities exchanges (Securities Exchange Act § 6, codified in 15 U.S.C. § 78f (2006)). With the enactment of Regulation ATS, however, entities that are virtually stock exchanges can choose between stock exchange status and being regulated as broker-dealers, as long as they are domestic (!) marketplaces. *See supra* note 23 and accompanying text. Viewed in this light, Mr. Campos’s call for equal treatment of domestic and foreign exchanges becomes somewhat unclear.

⁹⁰ *Id.*

⁹¹ *See* David Reilly, *Plan Would Let Exchanges Sell to U.S. Investors*, THE WALL STREET JOURNAL EUROPE, October 14, 2002, p. M1; (without author) *SEC’s Campos Tells Foreign Markets No Easy Access to U.S.*, WALL STREET LETTER, June 16, 2003.

⁹² Donaldson, *supra* note 2. *See* Securities and Exchange Commission, Release No. 34-50699 (File No. S7-39-04): *Fair Administration and Governance of Self-Regulatory Organizations; Disclosure and Regulatory Reporting by Self-Regulatory Organizations; Recordkeeping Requirements for Self-Regulatory Organizations; Ownership and Voting Limitations for Members of Self-Regulatory Organizations; Ownership Reporting Requirements for Members of Self-Regulatory Organizations; Listing and Trading of Affiliated Securities by a Self-Regulatory Organization* (November 18, 2004), 69 Fed. Reg. 71,126 (2004); Release No. 34-50700 (File No. S7-40-04): *Concept Release Concerning Self-Regulation* (November 18, 2004), 69 Fed. Reg. 71,256 (2004). *See also* Fleckner, *supra* note 7.

necessarily subject to U.S. requirements, but only to the rules that exist on those foreign markets.⁹³ Any approach based on regulating access or recognizing home country law for foreign exchanges might entail considerable deviations from the U.S. regime and raises regulatory concerns in at least two regards:

First is investor confusion. Allowing remote trading screens into the United States without subjecting the associated exchanges to full SEC oversight might lead U.S. investors – particularly retail investors – to make ill-informed or misinformed investment decisions. Even though the investor might be dealing with an American broker-dealer, located in Des Moines or Cincinnati, the investor's order could be transmitted via remote trading screens to an offshore market with none of the trading requirements imposed on U.S. exchanges applying and with trading in securities of issuers not bound by U.S. disclosure and accounting rules. This intermingling of foreign markets with U.S.-based securities firms is, in large part, what motivates the SEC to deny special accommodations to foreign trading screens.⁹⁴

A second concern is the fear of regulatory arbitrage. Remote trading screens – if broadly distributed across the United States – could allow foreign markets and foreign firms an efficient channel for raising capital in the United States. Once this channel is established, there would be little reason for foreign firms to list their securities on the NYSE or NASDAQ, and incur all the costs associated with complying with U.S. securities regulation requirements for foreign private issuers publicly traded in U.S. markets. While the passage of the Sarbanes-Oxley Act has already substantially slowed the rate of new European listings on U.S. trading markets,⁹⁵ the presence of remote trading screens could choke off new listings entirely and even encourage deregistration of existing foreign registrants once the SEC new rules are finalized.⁹⁶ The fear of this sort of regulatory arbitrage is one of the reasons why trading markets such as the NYSE have strenuously opposed any liberalization of SEC rules on remote trading screens. In the extreme, some have suggested, domestic U.S. companies might choose to list on foreign exchanges and link back to U.S. investors through remote trading screens.⁹⁷

⁹³ See particularly Section 12 of the 1934 Act (registration requirements), which is limited to transactions on “national securities exchanges.” (15 U.S.C. § 78l(a) (2006)).

⁹⁴ See *ATS Concept Release*, *supra* note 16, at 30,523.

⁹⁵ See Andreas M. Fleckner, *Foreign Issuers on the New York Stock Exchange* (February 17, 2006) (unpublished manuscript, on file with authors) (earlier draft prepared for the EU-US Financial Services Roundtable on September 30, 2005 & October 1, 2005, Cambridge, United Kingdom).

⁹⁶ Securities and Exchange Commission, Release No. 34-53020; International Series Release No. 1295 (File No. S7-12-05): *Termination of a Foreign Private Issuer's Registration of a Class of Securities Under Section 12(g) and Duty To File Reports Under Section 15(d) of the Securities Exchange Act of 1934* (December 23, 2005), 70 Fed. Reg. 77,688 (2005).

⁹⁷ For a variety of reasons, however, concerns over regulatory arbitrage with respect to domestic U.S. issuers are less plausible at the present time. To begin with, the home country bias of investors makes it likely that most U.S. issuers will find it preferable to list on domestic exchanges notwithstanding regulatory advantages of other markets. Moreover, the operation of the 1933 Act – and in particular the requirements of Regulation S – would make it difficult for

3. European Interests

From the European perspective, placing trading screens of European exchanges in the United States does not raise significant regulatory concerns. As long as the U.S. broker-dealers that make use of the remote screens comply with applicable European law, no problems should arise. The principal concern of the Europeans is getting their exchanges access to American markets.

Thus, the primary beneficiaries of a liberalized SEC for remote trading screens would be the exchanges in Europe: Getting new members from the United States would not only increase member fees but also, more importantly, help boost revenues from trading transactions, as the new members would try to route more orders to European exchanges to break even on their expenses. More generally, additional orders from U.S. investors to Europe would deepen liquidity on the European markets, thus reducing the costs and risks for both issuers and investors in Europe. To a degree, the European exchanges' interest in getting access to U.S. markets is the flip side of the NYSE's fear of losing market share in listings of European firms that might follow a more liberalized trading screen rule.

For the European Union, the SEC's continued reluctance to accept remote terminals based on concerns over the level of investor protection in Europe also has a political dimension, which has become the source of increasing aggravation. To begin with, no jurisdiction would be keen to have its own regulatory system characterized as insufficiently protective of investors. But what is particularly frustrating for the Europeans is that the SEC has not changed its position on this matter following the new directives that the European Union has enacted in the roughly seven years since the conflict first arose.⁹⁸ That puts the European authorities in a complex and bizarre situa-

U.S. issuers to raise capital in foreign markets composed in large part of U.S. resident investors. See Rules 901 et seq. under the Securities Act, codified in 17 C.F.R. § 230.901 et seq. (2006). Regulation S, however, does not appear to impose a substantial barrier to many foreign private issuers from raising capital in off-shore markets and then having their securities sold almost immediately to U.S. domestic investors in secondary market transactions. See S. Eric Wang, *Investing Abroad: Regulation S and U.S. Retail Investment in Foreign Securities*, 10 U. MIAMI BUS. L. REV. 329, 349 (2002).

⁹⁸ Most importantly (in chronological order) the DIRECTIVE 2001/34/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 28 May 2001 ON THE ADMISSION OF SECURITIES TO OFFICIAL STOCK EXCHANGE LISTING AND ON INFORMATION TO BE PUBLISHED ON THOSE SECURITIES, Official Journal L 184 (June 7, 2001), p. 1 (available at http://europa.eu.int/eur-lex/pri/en/oj/dat/2001/l_184/l_18420010706en00010066.pdf); REGULATION (EC) No 1606/2002 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 19 July 2002 ON THE APPLICATION OF INTERNATIONAL ACCOUNTING STANDARDS, Official Journal L 243 (September 11, 2002), p. 1 (available at http://europa.eu.int/eur-lex/pri/en/oj/dat/2002/l_243/l_24320020911en00010004.pdf); DIRECTIVE ON MARKET ABUSE, supra note 74; 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, Official Journal L 345 (December 31, 2003), p. 64 (available at http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/l_345/l_34520031231en00640089.pdf); DIRECTIVE ON MARKETS IN FINANCIAL INSTRUMENTS, supra note 59; DIRECTIVE 2004/109/EC 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, Official Journal L 390 (December 31, 2004), p. 38 (available at http://europa.eu.int/eur-lex/LexUriServ/site/en/oj/2004/l_390/l_39020041231en00380057.pdf).

tion: At home, they face increasing opposition claiming that its efforts to protect investors go much too far and overly hamper business. Abroad, the European Union faces implicit criticism from the SEC that the level of investor protection that has been achieved is still not high enough to open its market to U.S. investors.

II. INDUSTRY PRACTICES AND THE CONTROVERSY OVER FOREIGN TRADING SCREENS

Often overlooked in the controversy over remote access of foreign exchanges is the fact that market participants have found numerous ways of working around the SEC's limitations. Even without foreign trading screens on U.S. soil, traders willing to invest abroad have several ways of effecting such trades from the United States, including trades in securities that do not comply with 1934 Act periodic reporting requirements.

A. Order Routing Channels

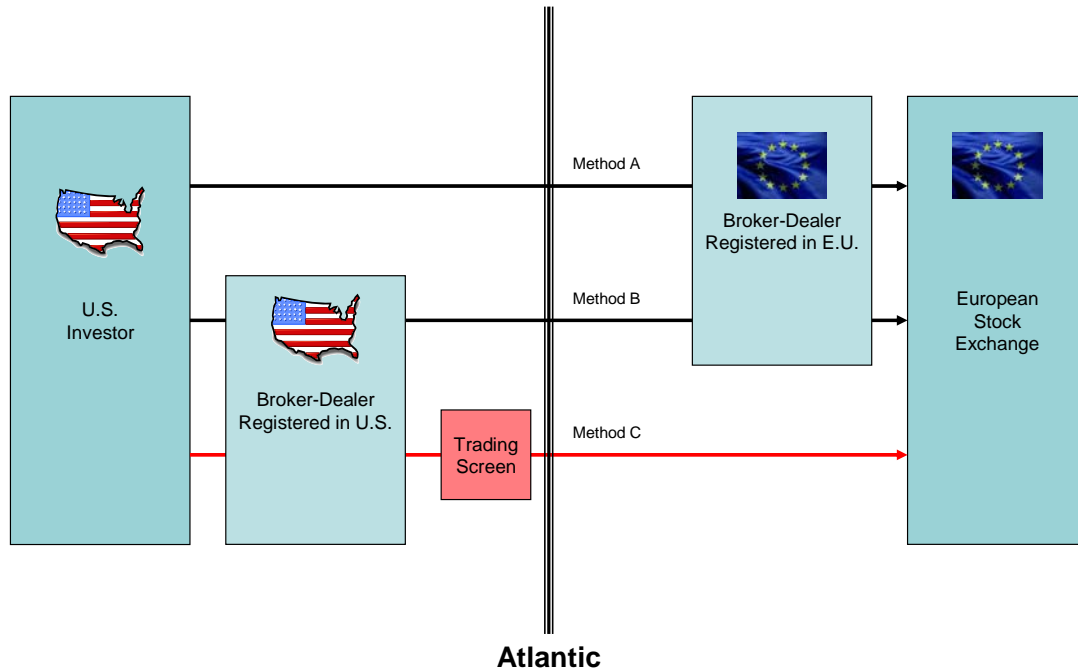
U.S. investors seeking to purchase securities on a foreign exchange can theoretically use one of three main channels:

Method (A): from the U.S. investor to the foreign exchange through a foreign broker-dealer;

Method (B): from the U.S. investor to the foreign exchange through a U.S. broker-dealer that then transmits the order to a foreign broker-dealer; or

Method (C): from the U.S. investor to the foreign exchange through a U.S. broker-dealer that is a member of that exchange (*using a trading screen placed in the United States*), without routing the order through a foreign broker-dealer.

The following chart illustrates the three methods to trade on a foreign exchange:



B. Regulation of the Trading Channels

Although all trading channels lead virtually to the same result, the methods differ in the involvement of intermediaries that are registered with the SEC and therefore subject to U.S. law.

1. Direct Access through a Foreign Intermediary

Method A (order flow solely through a foreign broker-dealer) is a close substitute to trading screens and is readily available to U.S. investors. Although SEC rules governing foreign broker-dealers are complex,⁹⁹ there are, in fact, a number of ways in which U.S. investors can open ac-

⁹⁹ Generally, the SEC follows a territorial approach in requiring broker-dealer registration: Unless exempt, all broker-dealers that are effecting, inducing or attempting to induce any securities transactions in the United States are required to register as broker-dealers with the Commission. See Aaron C. Ball & Thomas R. Rus, Rule 15a-6 and Beyond: Are U.S. Rules for Non-U.S. Broker-Dealers Workable in Today's Global Marketplace?, 29 U. Balt. L. Rev. 175, 182 (2000). See also 6 Louis Loss & Joel Seligman, Securities Regulation 3,059 (3d rev. ed. 2002). Likewise, the 1934 Act prohibits broker-dealers from engaging in trading of U.S. securities on foreign exchanges not in compliance with the 1934 Act. See Securities Exchange Act § 30(a), codified in 15 U.S.C. § 78dd(a) (2006). Rules promulgated by the SEC under the 1934 Act, however, provides exemptions from registration to foreign broker-dealers that engage in

counts with foreign broker-dealers and effect transactions on foreign exchanges in securities not subject to SEC oversight. So, while U.S. investors cannot contact a U.S. broker-dealer with remote access to foreign exchanges, in many instances U.S. investors can contact foreign broker-dealers with access to the very same exchanges.

For institutional investors, the options are multi-faceted. The most straight forward approach is simply to establish an office or branch overseas, most importantly in Frankfurt, London or Paris. By moving beyond the territory of the United States (as many have in the past decade) institutional investors can work directly with unregulated foreign broker-dealers and gain access to foreign exchanges. Institutional investors can also remain in the United States and do a limited amount of business with foreign broker-dealers without subjecting those broker-dealers to SEC oversight. For “major” institutional investors, the rules are most lax.¹⁰⁰ These investors can receive research reports from foreign broker-dealers and also execute trades through foreign broker-dealers, provided the foreign broker-dealer does not expressly solicit the order.¹⁰¹ The SEC also allows foreign broker-dealers to gain access to all U.S. institutional investors, provided the contacts are made in conjunction with an SEC-registered broker-dealer (which corresponds to Method B) and a number of other technical requirements are followed.¹⁰²

None of these rather technical exemptions is available for foreign broker-dealers seeking to contact retail investors. However, the SEC does not exert jurisdiction over foreign firms that do business with U.S. retail investors on an “unsolicited” basis.¹⁰³ Although the SEC interprets “solicitation” broadly to include any deliberate transmission of information, opinions, or recommendations to U.S. investors (whether directed at individuals or groups),¹⁰⁴ if a U.S. investor (even a retail investor) finds his or her way to a foreign broker-dealer without having been solicited, for instance through the internet, that foreign broker-dealer can provide the retail investor direct access to trading on foreign exchanges.¹⁰⁵

2. Access Through Both a U.S. and Foreign Intermediary

In those cases in which a U.S. investor cannot gain direct access to a foreign broker-dealer, the alternative is to make use of two intermediaries (Method B): the first a broker-dealer located and registered in the United States and the second located and regulated off-shore. SEC

narrowly defined transactions with U.S. investors. See Rule 15a-6 under the Securities Exchange Act, codified in 17 C.F.R. § 240.15a-6 (2006).

¹⁰⁰ The term “major U.S. institutional investor” is defined in 17 C.F.R. § 240.15a-6(b)(4) (2006), the term “U.S. institutional investor” in *id.* subsection (7).

¹⁰¹ 17 C.F.R. § 240.15a-6(a)(1) & (2) (2006).

¹⁰² 17 C.F.R. § 240.15a-6(a)(3) (2006).

¹⁰³ 17 C.F.R. § 240.15a-6(a)(1) (2006).

¹⁰⁴ *Cf.* Ball & Rus, *supra* note 99, at 185.

¹⁰⁵ *See, e.g.,* Wang, *supra* note 97.

rules are quite clear that a foreign broker-dealer does not become subject to U.S. regulation simply by accepting orders of this sort, regardless of the identity of the U.S. customers.¹⁰⁶ Thus, the principal impact of the SEC's position on remote trading screens is to force most U.S. investors – particularly retail investors – to effect their trades in foreign securities in this way, unless those securities also happen to be listed on U.S. markets, such as the NYSE or NASDAQ, in which case the U.S. broker-dealer can route the order directly to the domestic market or some alternative trading venue.

Given advances in technology, this second trading channel may often seem indistinguishable from doing business with a U.S. broker-dealer with remote access to foreign exchanges. Many of the larger U.S. securities firms will have off-shore affiliates with direct access to many foreign markets (such as Merrill Lynch International or Morgan Stanley & Co. International Ltd. on the London Stock Exchange). For these firms, U.S. customer orders will be routed electronically to the foreign affiliate and onto the foreign exchange. While the transmission of orders may be marginally slower than orders transmitted from remote terminals physically present in the United States, the difference may not be large. Order routing procedures are somewhat more complicated for U.S. regional firms without foreign affiliates. These firms will need to route their orders to an unaffiliated foreign broker-dealer, perhaps one associated with a major U.S. trading firm or perhaps one operating only overseas. In either case, however, the U.S. investor is having his or her order routed to a foreign market, not subject to SEC oversight, and is making an investment in securities of an issuer not subject to U.S. disclosure rules or accounting requirements.

3. Without a Foreign Intermediary (Trading Screen)

A final approach to foreign markets would be to let the order go directly from the U.S. broker-dealer to the securities market abroad, making use of the trading screen through which the U.S. broker-dealer could be a member of the foreign exchange without being physically present abroad (Method C). Unfettered access of this sort is what the SEC has been unwilling to authorize so far (aside from the Tradepoint release), and this trading channel is therefore not available to U.S. investors. As a result, for instance, while Frankfurt's electronic trading system (known as Xetra) has 130 foreign members (with forty from the U.K.), it has no U.S. member.¹⁰⁷

¹⁰⁶ 17 C.F.R. § 240.15a-6(a)(4)(i) (2006).

¹⁰⁷ See http://deutsche-boerse.com/dbag/dispatch/de/notescontent/gdb_navigation/info_center/25_FWB_Information/40_Market_Participants/40_Xetra_Countries/page/INTEGRATE/infonexetra?doc=xetra_teilnehmer.

C. Implications for the Controversy

The existence of these alternative channels of access to foreign trading markets has important implications for both sides of the debate over remote trading screens.

Start first with the SEC's concerns over investor confusion and regulatory arbitrage. As explained above, U.S. investors – even retail investors – can place orders with U.S. brokerage houses and have those orders routed via a foreign broker-dealer to foreign exchanges. For most investors, the manner in which such trades are routed is a matter of indifference. If the SEC believes that U.S. investors are confused when trading foreign securities through domestic broker-dealers, it cannot make a difference whether those broker-dealers are themselves members of the foreign exchange or just forward the order to someone who is – both happen out of sight for the U.S. investors. So, whatever risks of investor confusion may be present were a U.S. broker-dealer to effect a trade through a remote trading screen to a foreign market, they are to the same extent present when the trade is routed through both a domestic and a foreign broker-dealer. Yet, the SEC prohibits the former, while it allows the latter. Similarly, the problems of regulatory arbitrage posed by unregulated remote trading screens in the United States seem also to be present with orders routed through foreign broker-dealers, as foreign securities markets don't need to place remote trading screens in the United States to gain access to U.S. investors. Other mechanisms of access exist; technological innovations are making them more viable over time; and foreign issuers no longer need to list on U.S. exchanges in order to gain access to U.S. investors. So the foundations of regulatory arbitrage for foreign issuers have already been laid.

Viewed in this light, the SEC's position on remote trading screens is merely a rearguard action, but one that imposes some genuine costs on U.S. investors.¹⁰⁸ First, the SEC's current approach may be hurting some U.S. investors by increasing their trading costs and limiting their trading strategies. Even though the various methods of order routing lead to virtually the same result, they do vary both in the costs investors incur and the trading strategies they allow. For example, if a U.S. investor has to route an order through a U.S. broker and a foreign one, there will likely be fees to pay each intermediary (which might be smaller if the second intermediary is an affiliate of the first).¹⁰⁹ A remote terminal placed by the foreign exchange directly in the United States, however, would allow execution of the trades without foreign intermediaries and would save the investor the corresponding fees.¹¹⁰ While the costs may be relatively small for the larger U.S. securities firms with affiliates operating in foreign markets, regional and local firms

¹⁰⁸ Compare Bolkestein, *supra* note 1 (stating that U.S. investors would “benefit through reduced costs and wider access to the listed securities” if the U.S. allowed the placement of European trading screens) with Campos, *Embracing International Business*, *supra* note 88 (admitting that U.S. investors would benefit). See also Tom Williams & Michael Evans, *E.U. Fights U.S. Rejection Of Mutual Recognition For Securities Trading*, INT'L FIN. L. REV., July 1, 2003, p. 5.

¹⁰⁹ Arlman, *supra* note 1 (“The current situation is a simple but expensive one; an American investor pays twice or more in order to access European Exchanges, firstly his American broker and the second time his European one”).

¹¹⁰ Williams & Evans, *supra* note 108.

may not have sufficiently efficient routing systems in place. Indeed, the investors most injured by the SEC's policies are likely retail investors doing business with smaller U.S. securities firms lacking good foreign access. Second, as a result of higher trading costs and more complicated trading processes, U.S. investors may be discouraged from investing in foreign securities. This could deprive U.S. investors of otherwise profitable investments and, more importantly, reduce the degree of diversification of their portfolios. In addition, for those investors pursuing strategies that require instantaneous execution – for example, certain arbitrage strategies – the additional steps required to route orders through two or more intermediaries can be an important impediment, perhaps enough to force some investors either to abandon these trading strategies in foreign markets or else to move their operations offshore. Third, giving U.S. investors access to foreign exchanges may increase competition between those marketplaces and domestic venues, which could foster innovation and reduce trading costs. The market entrance of Eurex U.S. is a striking example in this regard: Even though Eurex U.S. so far has not been able to garner considerable market share from its U.S. rivals,¹¹¹ trading costs have significantly decreased and, with the introduction of new technologies, trading has become more efficient.¹¹²

If the SEC is also concerned about the oversight of the intermediaries that facilitate the access to the foreign market, its current approach seems to be contrary to its underlying policy. If U.S. broker-dealers were allowed to become members of foreign exchanges, U.S. investors would be able to trade on foreign markets without the involvement of intermediaries that are not subject to the SEC's jurisdiction (Method C). While the SEC does not allow this channel where it would have extensive jurisdiction over the involved intermediaries, it does allow that investors trade through foreign broker-dealers that are out of the Commission's reach (Method A). The result of the current regime, then, is that U.S. investors who want to avoid the costs of twofold intermediation (as in Method B) are pushed to trade through foreign broker-dealers that are not subject to regulation by the SEC and, most likely, outside the scope of the U.S. liability regime (Method A).

The existence of alternative trading paths to offshore markets also has implications for the European side of the debate over trading screens. As the foregoing analysis demonstrates, European exchanges already have a number of ways to accessing U.S. investors, and European issuers do not have to list on major U.S. exchanges to attract U.S. investors. To be sure, liberalization of the SEC's rule on trading screens could reduce the costs for U.S. investors seeking to trade in foreign securities – particularly those trading through regional or local firms today – but the effect would most likely be incremental and marginal. To a degree, this change may encourage some European issuers to avoid a U.S. listing and others to deregister where they might not have. But

¹¹¹ See Peter McKay, *Eurex Futures Market Enters the Forex Fray*, THE WALL STREET JOURNAL, June 14, 2005, p. C3.

¹¹² Cf. Brown-Hruska, *supra* note 30 (“[W]e have seen a dramatic reduction in exchange fees as the Board of Trade has reacted to the competition from [Eurex U.S.] for its contracts, and the [Eurex U.S.] has moved to lower its fees, in turn. Ultimately, customers benefit from the lower costs and innovations that have followed from the increased global competition in our markets.”).

incentives to take these steps already exist wholly apart from the SEC's treatment of remote trading screens, and arguments in favor of U.S. listing – such as bonding or unfettered access to capital raising from retail investors in the United States – would still exist notwithstanding the liberalization of the SEC's trading screen rules.

In short, the facts on the ground with respect to secondary market linkages between U.S. and European capital markets undercut, to a considerable degree, both sides of the debate over trading screens.

III. OUTLOOK AND CONCLUSION

The controversy over remote trading screens is characteristic of many jurisdictional disputes in international finance. The cross-border delivery of financial services has the potential for improving competition in the delivery of financial services, as well as lowering the cost of capital and increasing the diversification of investors. However, the regulation of markets and issuers is not uniform around the world, and so unfettered access to foreign markets presents philosophical difficulties for jurisdictions, such as the United States, with strong commitments to investor protection.

The SEC's position with respect to foreign trading screens reflects these tensions. In its legal position, the Commission has favored investor protection over competition, while the European side would have preferred the SEC to have come out the other way around. Technological innovation, however, has somewhat ameliorated the dispute. Because foreign exchanges have several other viable channels to reach U.S. investors, the Commission can formally keep remote trading screens out, while functionally allowing at least some access to these markets. The European Union can continue to complain about constraints on market access in the United States, while its exchanges can in fact reach U.S. markets. To be sure, investors and exchanges do pay a cost for this jerry-rigged solution, and certain trading strategies might not be open to U.S. investors under the current regime. Nevertheless, there is a bit of official hypocrisy in public discussions of the issue, overlooking that a workable compromise has already evolved for the time being.

Looking ahead, however, the consolidation of global financial markets will likely put pressure on the current situation in the years ahead. To begin with, looming mergers of U.S. and European trading markets may force the SEC to reconsider its current position,¹¹³ inasmuch as exchanges with subsidiaries on both sides of the Atlantic will further promote cross-border trading. In addition, technological developments are likely to bring foreign trading markets ever closer to U.S. investors – if not via remote trading screens, then through the alternative trading

¹¹³ See Stephanie Kirchgaessner, *SEC and FSA to discuss exchanges*, FINANCIAL TIMES, April 26, 2006, p. 23.

channels described in this article. This combination of market forces and technological advances will likely put increasing strains on the unprincipled compromises inherent in the status quo.

Arguably, the seeds of resolving the dispute over remote trading screens and foreign market access may already have been sowed. To the extent that one of the SEC's major qualms with foreign trading screens is the concern that investors might buy foreign securities not subject to SEC disclosure and accounting requirements, that concern may be largely resolved – at least with respect to European issuers – once the SEC satisfies itself that international accounting standards (IFRS) implemented in European Union are functionally equivalent to U.S. accounting standards.¹¹⁴ That determination may take place as soon as 2009, and could then pave the way for the SEC allowing remote access of European exchanges into the United States. Most likely, the Commission will still want to establish some procedures, comparable to those developed by the CFTC for foreign futures exchanges, to ensure that European markets have adequate oversight of trading practices and other forms of market abuse. Once questions of issuer disclosure are resolved, one can imagine a variety of solutions to remote trading screens that would be consistent with the SEC's traditional commitment to investor protection.

Of course, this proposed solution to European trading screens – based as it is on determinations of functional equivalence for both issuer disclosure and market oversight in Europe – will pose another set of interesting challenges for the SEC. As soon as the Commission determines that European markets are eligible for unfettered access to U.S. investors, should the SEC do something more to address the other channels of market access outlined in this article. After all, these alternative channels provide U.S. investors access to financial markets anywhere in the world, not just the major European markets. Once the SEC provides stable linkages between the U.S. and European financial markets, the Commission may want to consider shutting down – or at least policing more closely – existing linkages with less well regulated markets around the world. But the SEC can't – or at least shouldn't – take that step until more stable financial linkages with the E.U. and perhaps also other major markets have been established.

¹¹⁴ See particularly MEMORANDUM OF UNDERSTANDING [between FASB and IASB] – “THE NORWALK AGREEMENT” (September 18, 2002), available at <http://www.fasb.org/news/memorandum.pdf>. See generally Stavros Gkantinis, *IFRS and US GAAP: Convergence and Equivalence* (September 12, 2005) (unpublished manuscript, on file with authors) (prepared for the EU-US Financial Services Roundtable on September 30, 2005 & October 1, 2005, Cambridge, United Kingdom).