

Sunlight, Disinfectants and Globalization

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“Sunlight is the best of disinfectants; the electric light, the most efficient policeman.” This famous aphorism of Supreme Court Justice Louis Brandeis represents the first principle on which US securities law is based. The theory is that good disclosure is the best way to protect investors and the securities markets. For Americans, this theory of the proper role of regulation is as sacred as the notion that “all men are created equal.” It is self-evident.

The difficulty is that outside the United States, people don’t believe that sunlight is the best of disinfectants. The most efficient policeman, in the minds of most of the world outside the United States, is, well, a policeman. The cultural difference of opinion about the proper role of regulation divides us from the rest of the world in a much more profound way than subtle differences in the meaning of “best execution.” As Rick Ketchum famously observed: “There is no regulatory arbitrage.”

This difference in regulatory philosophy has a profound impact on regulatory policy. If you believe that disclosure is the way to protect investors, then any product, no matter how much it sounds like snake oil, can be sold, provided that the investment risks are carefully described. The efficient policeman, by contrast, doesn’t allow snake oil to come to market.

On both sides of the ponds, stock market listing is the preferred method of determining what is an appropriate investment. Stock exchanges take a hard look at their issuers, and if they fail to meet listing standards – or in Eurospeak, are not “fit and proper” – their securities aren’t listed. The difference is that in the United States, more than half of the equities that trade on the public markets, and the vast majority of debt instruments, trade over-the-counter. In the over-the-counter markets, sunlight is all the protection investors are entitled to receive. Outside the United States, if it isn’t listed, it doesn’t trade.

Facts on the ground are now forcing us to confront these cultural differences. US institutions have for some time been investing abroad in increasingly great numbers. And now, thanks to the Internet, retail investors are also dabbling in foreign investments. The New York Stock Exchange and NASDAQ are engaged in global acquisitions of securities markets. All but the smallest financial services firms have major operations abroad. Nor is this a one-way street. Increasing numbers of non-US broker-dealers are setting up operations in the United States, marketing products to US investors. And, their law firms are setting up shop here as well, horror of horrors.

As a result, our most sacred beliefs are on a collision course with global reality. Americans are horrified by the lack of meaningful disclosure by many foreign issuers. Foreign investors, on the other hand, find it incredible that investments in obviously flaky schemes are openly marketed to gullible investors.

These cultural conflicts are creating for the first time a powerful drive to harmonize US securities law with European and Asian legal systems, all with a view to achieving a globally consistent body of securities regulation. Foreign regulators are beefing up disclosure requirements. American regulators are looking hard at over-the-counter issuers and clamping down on snake oil salesmen. The pressing needs of the global financial services industry are forcing changes in the way securities markets are regulated and in the way we think about regulation.

There are some who think this regulatory divide will never be bridged. I don't believe it. Globalization is upon us, and the forces of economic change have always overwhelmed the most strongly-held cultural beliefs. The fact is that securities lawyers these days are doing a lot of thinking about ways to merge the regulatory apparatus that exists on both sides of the "pond." Roundtables of wise men have assembled to consider the similarities and differences that exist and look for ways to achieve harmony. Progress is being made on numerous fronts.

In future articles, I will discuss some of the initiatives that are going on here and in Europe to achieve a consistent set of regulations.