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"Between markets, competition is all" by Michael Mann published by *Financial Times*

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A consensus is embracing a new solution to the challenges posed by the integration of global securities markets: mutual recognition. Today, the Securities and Exchange Commission will hold a round-table discussion to consider how to assess regulatory comparability and its effects on investors and markets.

But neither convergence nor mutual recognition will work. Instead, regulators should recognize that two markets exist in every country – a local one subject to domestic regulation and an international one subject to foreign laws. The solution is not to make these markets the same, but to educate investors about the differences between them and to allow these markets to compete to the benefit of investors.

Harmonized regulation will not yield consistent market scrutiny or investor protection. The same securities laws and accounting rules in different jurisdictions can still produce divergent regulation. While no one could argue that there is any similarity between US and Japanese market regulation, the US and Japan have the same basic laws. What assurances, then, does the convergence of laws offer investors?

Perhaps in light of this reality, US regulators are now talking about recognizing other nations' regulation as close enough to our own to grant equal treatment. But regulatory regimes change and the methods and priorities for implementation can change as well. As SEC chairman Christopher Cox said about his agency's changed approach to the Sarbanes-Oxley law: "We don't need to change the law; we need to change the way it is implemented."

All robust regulatory systems undergo periodic adjustment. How would we regard changes to laws or practices in a foreign market after recognition was granted? Would we find ourselves in endless negotiations over mutuality after every major adjustment? Recognition could foster an even less predictable standard for investor protection than exists today and could lead us to a race to the bottom, in which the US recognizes regulatory regimes that lack the protections offered by our own.

The US market has been grounded in regulation since the 1929 crash, a disaster caused by the fact that there was no regulatory system and investors were oblivious to risk. The world has changed: investors seek international investments and recognize that different markets have different risks. The US system recognizes this as well. US international mutual funds are already traded without any regulation of the issuers, brokers or home markets. Instead, the funds must warn American investors that their stocks, the exchanges on which they are purchased and the brokers used are not subject to US regulation.

"BETWEEN MARKETS, COMPETITION IS ALL" BY MICHAEL MANN PUBLISHED BY *FINANCIAL TIMES* (Cont.)

It is time to build a system based on educating investors instead of offering them protections that will not work. This system would encompass two markets; one regulated pursuant to US rules and the other regulated under home country rules. Those offering securities or services in the US would have to be regulated in their home markets. The extent and nature of the regulation in terms of investor protection would have to be fully disclosed to the US investor.

The ”one system/two markets” (OSTM) approach would allow investors to choose the system in which they wanted to invest. It would separate the markets so an investor would not be confused about whose rules applied.

Foreign securities could be held only in special accounts subject to clear warnings about the applicability of US law. The extent to which the conduct of the broker or marketplace would be governed by US law would be disclosed as well.

US regulatory philosophy holds that full, transparent disclosure puts investors in the best position to make their decisions. The OSTM approach preserves this philosophy by increasing transparency. It would make the degree to which participants sought out the discipline and protection of the US regulation a matter of choice.

But perhaps the best argument for the OSTM approach is that it is already happening. US issuers tap the unregistered “sophisticated markets” and choose the regulation they want. The OSTM approach accepts these realities and builds a system that ensures that investor choices are knowingly made.

The OSTM approach obviously raises issues regarding the limits of US legal jurisdiction and the extent to which investors can waive their rights under US law. When and where would US anti-fraud statutes apply to a transaction or a security? Can investors waive their rights to US protections at all?

The answers are unclear, but the reality is that investors are already choosing the regulation they want by choosing the markets in which they invest. The job of regulators is to ensure that their choices are knowingly made.

Harmonization and mutual recognition can never keep up with rapidly changing global markets. Instead, let us strengthen our own system, educate investors about those strengths and challenge other markets to do the same in a transparent, global competition.

About the Author: Mr. Mann was the founding director ofthe SEC's Office of International Affairs. He currently is a partner in the law firm of Richards Kibbe & Orbe LLP in Washington, DC.