April 21, 2010

RE: Concept Release on Equity Market Structure
File No. S7-02-10

We welcome the opportunity to comment on the Securities Exchange Commission's Concept Release on Equity Market Structure. The Commission has requested comment on a number of issues relating to the current structure of U.S. capital markets. These topics include the risks posed by high-frequency trading, regulatory proposals to address "dark pools" of liquidity, as well as the impact of globalization on U.S. capital market regulation. In an effort to identify new initiatives that can further improve the strength of U.S. capital markets within our global marketplace, we wish to address our comment to this last question.

The recent financial crisis has led to sustained calls for newly reinvigorated financial regulation and enforcement. The profound impact of this crisis has made it abundantly clear that U.S. regulatory authorities must modify and enhance their approach in order to identify and mitigate the risks posed by systemically important institutions. A number of perceived regulatory failures leading up to the crisis have also led many to call for improved regulatory scrutiny and investor protection.

At the same time, however, several policymakers, scholars, and economists have expressed concern about the effect of U.S. securities regulations on the competitiveness of U.S. capital markets. They argue that stringent disclosure, accounting, and governance standards in the United States are overly burdensome, and may ultimately result in fewer firms listing on U.S. exchanges in years to come.[1] Any increased regulatory burden, the argument goes, may further encourage companies to avoid those burdens by listing outside the United States.[2]

The result, as one author has written, is that U.S. securities regulators are now "in a bind"[3]—regulators are caught between pressures for more stringent regulation and fears that increased regulation may harm the international competitiveness of U.S. capital markets. How, then, should competition from international capital markets affect the SEC's regulatory approach? Do the higher disclosure, accounting, and corporate governance standards in the United States threaten the competitiveness of our capital markets?

In this comment, we argue that, while the SEC should take steps to promote the competitiveness of U.S. capital markets, there are reasons to think that strong and

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[1] *See* Committee on Capital Markets Regulation, *The Competitive Position of the U.S. Public Equity Market* (2007); Luigi Zingales, *Is the U.S. Capital Market Losing its Competitive Edge?*, ECGI Working Paper Series in Finance No. 192 (2007).
[2] *See, e.g.*, Chris Brummer, *Stock Exchanges and the New Markets for Securities Law*, 75 U. Chi. L. Rev. 1435 (2008).
[3] Donald C. Langevoort, *Introduction: U.S. Securities Regulation and Global Competition*, Georgetown Law Faculty Working Papers Series No. 89 (2008), 1.

effective regulation would not necessarily weaken our international competitive position going forward. Specifically, we suggest:

- The evidence that existing regulatory standards have caused U.S. capital markets to become less competitive is inconclusive, and requires further study by the SEC.
- In the wake of the crisis, regulatory standards in the United States have arguably helped preserve the strength of our capital markets relative to international competitors
- Further, regulatory standards can also encourage firms to opt-into U.S. capital markets, in order to signal their ability and willingness to comply with rigorous corporate governance standards.[4]

I. Background: Global Market Maturation

Since the early 1990s, the global economy has experienced market integration at an unprecedented pace. This momentum has been advanced by developments that have reduced the barriers to the free movement of capital and include events such as the collapse of the Soviet Union, the adoption of a single currency in Europe, and China's move to a market economy.[5] Countries around the world have increasingly adopted policies and market structures that embrace economic growth and the development of financial centers. As a consequence, the United States' position as the global financial leader is under increasing pressure.[6]

Furthermore, financial globalization and innovation have decreased the barriers to cross-border trade in securities. Transaction costs from international trade are now lower, and technological advances have reduced information asymmetries resulting from geographical distance. Accordingly, capital can flow more freely between global markets.[7]

Yet, despite this increasing market integration, national capital market structures remain important. Recent market data confirms that investors still possess a strong preference for domestic equities, despite the well-documented gains from international diversification. This phenomenon, known as "home bias,"[8] speaks to the importance of nations and their respective domestic markets. Sovereign nations play a critical role, in part, because they create the laws and regulations that impact the issuance and trading of securities and thus,

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[4] *See* John Coffee, *Racing Towards the Top*, 102 Colum. L. Rev. 1757, 1762 (2002).
[5] Stavros Peristani, *Evaluating the Relative Strength of the U.S. Capital Markets*, Current Issues in Economics and Finance, Federal Reserve Bank of New York, Volume 13. No. 6 (2007).
[6] Nicoal Cetorelli and Stavros Peristani, *Prestigious Stock Exchanges: A Network Analysis of International Financial Centers,* Federal Reserve Bank of New York.
[7] McKinsey & Company, *Sustaining New York's and the U.S. Global Financial Services Leadership,* January, (2007).
[8] Joshua D. Coval and Tobias Moskowitz, *Home Bias at Home: Local Equity Preference in Domestic Portfolios,* The Journal of Finance, Volume 54, No. 6 (1999)

the framework for the movement capital.[9] These laws differ significantly across countries[10] and can have a profound impact on the efficiency and effectiveness of nation's capital markets and economic growth.

Over the last ten years, the laws and regulations imposed on the U.S. capital market system have been increasingly debated. It is argued that our regulatory structure has decreased the competitive position of the U.S. financial sector with respect to other countries, such as the United Kingdom, Japan, and U.A.E. (Dubai). According to this opinion, stringent regulations introduced by Sarbanes-Oxley have raised the cost of listing in the Unites States[11] and this, coupled with the costs of implementing U.S. accounting standards and adhering to its stringent legal guidelines have forced companies to look elsewhere. Specifically, the debate has largely focused on the ability of the New York Stock Exchange (NYSE) and the National Association of Securities Dealers Automate Quotations system (NASDAQ) to remain the world's preeminent stock markets.[12]

These concerns have been widely expressed by the financial press, scholars, and policymakers. Research organizations, such as the Committee on Capital Market Regulation, believe that the position of the U.S. dominance is receding. The Committee has proposed a number of solutions, including eliminating or revising sections of the Sarbanes-Oxley Act of 2002, curbing securities litigation, and restructuring existing enforcement guidelines.[13] Indeed, this sentiment was also expressed by a highly circulated 2007 report, commissioned by Senator Charles Schumer and Mayor Michael Bloomberg, which cited a greater need for the United States to balance innovation and regulation.[14]

The evidence garnered to support this view is focused on three main trends:

1) <u>U.S. declining share of global IPO volume:</u>
   In 2000, the United States' total IPO volume was more than \$70 billion compared to London and Hong Kong, which averaged around \$20 billion. By 2006, this difference shrunk as London and Hong Kong almost matched the \$52 billion issuance volume in the United States.[15]

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[9] René M. Stulz, *Securities Laws, Disclosure, and National Capital Markets in the Age of Financial Globalization*, ECGI Law Working Paper No. 112(2208)
[10] Rafael LaPorta, Florencio Lopez de Silanes, and Andrei Shleifer, *What Works in Securites Laws*, The Journal of Finance, Volume 61, No. 1 (2006)
[11] Stavros Peristani, *Evaluating the Relative Strength of the U.S. Capital Markets*, Current Issues in Economics and Finance, Federal Reserve Bank of New York, Volume 13. No. 6 July (2007)
[12] Stavros Peristani, *Evaluating the Relative Strength of the U.S. Capital Markets*, Current Issues in Economics and Finance, Federal Reserve Bank of New York, Volume 13. No. 6 July (2007).
[13] Committee on Capital Markets Regulation, *Re: Comments on Proposed Interpretation and Proposed Rule, Management's Report on Internal Control over Financial Reporting*, Release Nos. 33-8762; 34-54976, File No. S7-24-06
[14] McKinsey & Company, *Sustaining New York's and the U.S. Global Financial Services Leadership*, January, (2007)
[15] Stavros Peristani, *Evaluating the Relative Strength of the U.S. Capital Markets*, Current Issues in Economics and Finance, Federal Reserve Bank of New York, Volume 13. No. 6 July (2007)

2) U.S. equity market loss of distinction as the first choice of foreign IPOs:
During the 1990s the NYSE and the NASDAQ attracted a substantial share of foreign IPO firms. This trend has changed, as foreign equity issuers now prefer to issue in their home market. The percentage of European firms listing domestically rose from about 60% in 1995 to more than 90% in 2005.[16]

3) Drop off in cross listing ratios:
The share of foreign companies listed on U.S. exchange has remained flat since 2000.[17]

II. The evidence that higher regulatory standards have caused U.S. capital markets to become less competitive is inconclusive.

Although these developments do point to a diminished role for the United States prior to the financial collapse of 2007 to 2009, analyses by the Federal Reverse Bank of New York and some scholars suggest that it may be too soon to determine whether these changes suggest a permanent trend or just a temporary shift.[18] Indeed, there are several reasons to think that the United States' reduced share of global IPOs may not indicate that U.S. capital markets have become less competitive.

First, it is common for IPOs to fluctuate based on the investment opportunities across sectors. International interest in U.S. capital markets during the 1990s may have been largely due to the prominence of high-tech IPOs during this time period. Therefore, the recent reduction in the number of listing on the NYSE and the NASDAQ may be a consequence of the boom and bust cycle of the U.S. technology sector.[19]

Second, the decline in foreign equity issuers does not necessarily imply that U.S. capital markets are becoming less competitive in an absolute sense. Rather, it may indicate that markets in other countries have now matured to a point where firms can efficiently access domestically.

Finally, the drop off in cross listing cannot be solely attributed to the strict corporate governance standards of Sarbanes-Oxley, since data indicates that movement out of US.

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[16] Stavros Peristani, *Evaluating the Relative Strength of the U.S. Capital Markets*, Current Issues in Economics and Finance, Federal Reserve Bank of New York, Volume 13. No. 6 July (2007)
[17] Stavros Peristani, *Evaluating the Relative Strength of the U.S. Capital Markets*, Current Issues in Economics and Finance, Federal Reserve Bank of New York, Volume 13. No. 6 July (2007)
[18] Luigi Zingales, *Is the U.S. Capital Market Losing its Competitive Edge?*, ECGI Working Paper Series in Finance No. 192 (2007)
[19] Luigi Zingales, *Is the U.S. Capital Market Losing its Competitive Edge?*, ECGI Working Paper Series in Finance No. 192 (2007)

exchanges by UK and European issuers started in the mid 1990s, which is well before the adoption of this law.[20]

Overall, despite these concerns, the global share of the U.S. equity market has actually remained quite stable from 1995 to 2005. While it did briefly peak above 50% during the internet boom, this can be attributed largely due to NASDAQ trading. These levels have since returned to the pre- tech boom levels, hovering around the 50% range.

III. In the wake of the financial crisis, higher regulatory standards in the United States have arguably helped preserve the strength of U.S. capital markets relative to international competitors.

Prior to the financial crisis of 2007 to 2009 it was common for policymakers, scholars, and business professionals to cite the above trends as evidence that our rigorous regulatory framework and robust legal enforcement acted as major deterrents for international investment. However, in the wake of the crisis, it has become evident that these very laws have helped preserve the strength of the U.S. capital markets and economy better than its counterparts.

In the post-crisis environment the "more amenable and collaborative regulatory environment"[21] in London now appears to have been an inadequate market standard. Indeed, the United Kingdom, whose regulatory framework enabled investors to heavily invest in exotic derivatives, is still attempting to regain footing on the global market stage. While the United Kingdom and other countries continued to struggle, the United States is steadily emerging, as the Dow Jones recently hit 11,000 for the first time since September 2008.[22] The resilience of our countries capital markets—fostered by our regulatory framework—is real.

Furthermore, going forward, there is also reason to expect that U.S. capital markets will be able to maintain their ability to attract high-quality foreign IPOs. It is undoubtedly true that U.S. regulations remain costly for international firms looking to raise capital; however international firms may continue to "bond" themselves by cross-listing due to benefits such as higher IPO valuations associated with increased compliance, greater liquidity, diversification of shareholder base, and additional visibility.[23] Indeed, the wake of the financial crisis, the US was able to attract three of the top twenty global IPOs in the first half of 2009. This compares with the fact that the US captured none of the top global IPOs in 2008 and 2007.[24] Further, as the global economy rebounds, the U.S. has already

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[20] Stavros Peristani, *Evaluating the Relative Strength of the U.S. Capital Markets*, Current Issues in Economics and Finance, Federal Reserve Bank of New York, Volume 13. No. 6 July (2007)

[21] McKinsey & Company, *Sustaining New York's and the U.S. Global Financial Services Leadership*, January, (2007)

[22] Donna Yesalavich, *Caterpillar Helps Power Dow Above 1100* Wall Street Journal Aptil 13, 2010, *available at* http://online.wsj.com/article/SB10001424052702304506904575180383379085308.html

[23] Amir Licht, *Cross Listing Governance: Bonding or Avoiding?* Tel Aviv University, February (2003)

[24] Committee on Capital Markets Regulation: *First Half of 2009 Demonstrates Continued Erosion in Competitiveness of US Public Equity Markets* September (2009)

experienced eight foreign IPOs in the first quarter of 2010, raising approximately $1.3 billion. As the data shows, foreign investors continue to be active in the U.S. market[25].

IV. Future Recommendation

Concerns regarding foreign IPOs issuance, global capital flows, and relative competiveness, highlight the growing importance of international markets. As the level of market integration and interaction continues to increase, countries around the world will continue to focus on increasing their relative economic prosperity. The efficiency and competitiveness of our markets and the safeguards for investors brought on by the right type of regulation must, therefore, be a central focus for policy makers. Leadership in the global financial sector is vitally important to the United States since preeminence in this arena leads to substantial economic growth via direct and indirect job creation, as well as tax revenues for cities and the country as a whole. Therefore, we recommend that the SEC form a committee, under its jurisdiction, dedicated to monitoring and analyzing the impact of established and proposed market regulations within a global context.

The SEC, in the wake of the financial crisis, has the opportunity to redefine and organize itself so that is can address these evident changes of global capital flows. While there is an Office of International Affairs at SEC, currently, there is no government sanctioned committee of experts that monitors such issues.[26] In recent years, the formation of a number ad-hoc commissions, such as the Commission on the Regulation of U.S. Capital Markets in the 21 Century or the Committee on Capital Regulation, have highlighted the need for such a committee. While although these groups have been informative sources of knowledge, they are not a substitute for a national effort with a mission to assess, maintain, and enhance the value of U.S. capital markets.

While the SEC does apply cost benefit analysis to proposed rules and regulations,[27] we believe that more can be done to evaluate whether regulations are achieving their intended effects within a global context. In accordance with similar proposals[28] for such regulatory oversight, we believe the SEC should develop an internal committee to establish a vision for the future of the U.S. financial sector within the international marketplace.[29] This committee's objective should be to evaluate and monitor the domestic regulatory framework to ensure that there is consistency between the committee's stated objectives and market developments. Over time, it should develop the ability to separate the effects of natural maturing of foreign markets from the regulatory

[25] Pricewaterhouse Coopers, *IPO Market Builds Momentum: 27 New Offerings in Q1as Issuers Regain Confidence, According to Pricewaterhouse Coopers,* PR News Wire, Apri1 14 (2010)
[26] R. Glenn Hubbard, *An Action Plan for U.S. Capital Markets¸* International Finance Volume 10 No. 1 pg 91-99, (2007)
[27] R. Glenn Hubbard, *An Action Plan for U.S. Capital Markets¸* International Finance Volume 10 No. 1 pg 91-99, (2007)
[28] Luigi Zingales, *Is the U.S. Capital Market Losing its Competitive Edge?*, ECGI Working Paper Series in Finance No. 192 (2007)
[29] Luigi Zingales, *Is the U.S. Capital Market Losing its Competitive Edge?*, ECGI Working Paper Series in Finance No. 192 (2007)

practices that make the United States more or less competitive in the global arena. Further, this committee should:

1) Evaluate existing and proposed regulatory, legal and enforcements systems it believes are significant to maintain U.S. capital markets competitiveness.
2) Evaluate and monitor proposed and implemented regulation to ensure they are achieving the intended effect.
3) Develop uniform metrics to determine international competitiveness.
4) Solicit feedback from the private sector, investors, and scholars to develop legislative recommendations.

Globalization, over the past two decades, has transformed the nature of capital markets and the SEC must keep pace by adopting an organizational structure that recognizes this market dynamism—a committee dedicated to the aforementioned priorities is a step in the right direction.

Sincerely,

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