Critical Perspectives on regulation of international financial markets

- assessing the possibilities for transatlantic regulatory cooperation

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Abstract:

Lapin yliopisto, oikeustieteiden tiedekunta

Työn nimi: Critical Perspectives on Regulation of International Financial Markets

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Tiivistelmä:

Tutkielman tarkoituksena on tarkastella keskeisiä kysymyksenasetteluita liittyen kansainvälisten rahoitusmarkkinoiden sääntelyyn. Tarkoituksena on luoda yleistajuinen esitys, millainen säänneltävä ilmiö nykymuotoiset rahoitusmarkkinat ovat. Tutkielma esittää historiakatsauksen ja yhteiskunta- sekä taloustieteiden näkökulmia rahoitusmarkkinoiden kansainvälistymiseen. Juridinen perusongelma on, että rahoitusmarkkinat ovat aidosti kansainväliset, mutta sääntely on kansallista. Tutkielma pyrkii näyttämään, että Euroopan unionin ja Yhdysvaltojen sääntelyviranomaiset voisivat toimivaltansa puitteissa kohentaa sääntely-ympäristöä keskinäisen yhteistyön kautta. Tutkielman tarkoituksena onkin esittää näkökulmia ja pohdittavan arvoisia kysymyksiä tulevan mahdollisen sääntely- ja valvontayhteistyön pohjaksi. Tutkielmassa tarkastellaan sääntely-yhteistyön juridisia ongelmakohtia ottaen esille perusoikeuskollisiotilanteita, joita sääntelyviranomaisten tulee punnita sijoittajansuojan ja tehokkaan pääomanmuodostumisen välillä. Samaten tutkielmassa puntaroidaan sääntely-yhteistyön elementtejä pakottavan lainsäädännön ja soft law – lähestymistavan välillä.

Avainsanat: Kansainväliset rahoitusmarkkinat, arvopaperimarkkinaoikeus, sääntelyteoria, kansainvälinen sääntely-yhteistyö.

Muita tietoja:

Suostun tutkielman luovuttamiseen Rovaniemen hovioikeuden käyttöön X

Suostun tutkielman luovuttamiseen kirjastossa käytettäväksi X

Suostun tutkielman luovuttamiseen Lapin maakuntakirjastossa käytettäväksi X

(vain Lappia koskevat)

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Abbreviations:

AIFMD – Alternative Investment Fund Manager Directive of the European Union

BIS – Bank of International Settlements

CFTC – Commodities and Futures Trade Commission

C.F.R. – Code of Federal Regulation

CRA – Credit Rating Agencies

ECOFIN – Economic and Financial Ministers of European Union

EMIR – European Market Infrastructure Regulation of the European Union

EMU – European Monetary Union

EU and Union – European Union

EUC – European Union Court

ESMA – European Securities and Markets Authority

FED and / or Fed – Federal Reserve of the United States of America

FFF – Four Fundamental Freedoms of European Union

FSA – Financial Supervisory Authority of United Kingdom

GAAP – General Accepted Accounting Principles

GDP – Gross Domestic Product

IFRS – International Financial Reporting Standards

IMF – International Monetary Fund

IOSCO – International Organization of Securities Commissions

IPO – Initial Public Offering

MiFID – Markets in Financial Instruments Directive of European Union

MiFIR – Markets in Financial Instruments Regulation of European Union

MOU – Memorandum of Understanding and / or Memoranda of Understanding

NYSE – New York Stock Exchange

OTC – Over the Counter trade

SEC – Securities Exchange Commission

SRO – Self Regulatory Organization

UK – United Kingdom

U.S. and / or US – United States of America

TEU – Treaty of the European Union

TFEU – Treaty on the Functioning of the European Union

PART I CONTEMPLATING INTERNATIONAL FINANCIAL MARKETS – HISTORICAL AND THEORETICAL ASPECTS

1 Introduction

1.1 Perspectives on financial markets

Finance has revolved around all human activities for centuries if not millenniums. As Roy C. Smith puts it *"[financial profession's] frequent association with 'the world's oldest profession' may simple be because it is almost as old"*. Environment of finance is universal. Smith determines it as follows *"any situation that involves money, property or credit, all of which are commodities that have been in demand since humankind's earliest days"*.[1]

Market is considered as a concept of exchange for goods, commodities and services. Financial market is a concept of exchange for financial commodities and services ("financial product/s" or "product/s"). The exchange, trade and / or use of such products are all defined as transactions. The financial products have been invented to facilitate trade, commerce and investment and to accommodate the accumulation, preservation and distribution of wealth by states, corporations and individuals.[2]

The actors on financial markets can be described by various terms and definitions. The markets include suppliers and users of funds, intermediaries, service providers and regulators.[3] Therefore on this respect actors could be systemized on five main categories:

i) Issuer or borrower; user of the funds.

ii) Investor, depositor or lender; the supplier (saver) of the funds.

iii) Intermediaries; actors between the users and suppliers connecting supply and demand.

iv) Service providers; acting as supporting function for the financial transaction without direct involvement in it. Providers include clearing

[1] Smith 1997, pp. 1-16.
[2] Smith 1991, p.1.
[3] Scott 2012, p.1.

platforms that transfer securities, information providers as rating agencies and e.g. lawyers that draft the contracts for transactions.

v) Regulators; governmental bodies that can be national or international. They supervise and regulate the actors on markets.

It is notable that numerous individual entities operating in the financial markets hold several aforementioned positions at the same time and even sometimes they might hold multiple positions on the same particular transaction. For example imagine a situation in which government is issuing bonds (issuer) that it should supervise (regulator) and the buyer of the bonds (investor) to be a company in which the government has a stake as a shareholder. This all together creates quite a complex system to picture, understand and control.

If not delved more deeply into financial terms and history, at this point, it can be concluded that the operational environment of financial markets have varied during centuries. There have been times of open cross-border interaction and times of protectionism in relation to sovereign states. Depending on the definition there are and have been several regional and / or national financial markets acting individually and separately on different eras. The 21st century financial markets are often referred as international and / or globalized. Sometimes international financial markets are considered as a one whole. This does not exclude the fact that to some extent financial markets have always been international and to some extent the financial markets are still to be considered national. How it can be argued, on juridical terms, that 21st century financial markets are international; and how international they are (cross-border perspective)?[4]

Definitions for international financial transactions vary depending on the view point (economic, political, sociological, or legal). Also in legal sense international connection can be determined in multiple ways. In order to be international factual transactions need to have some cross-border and / or multi-jurisdictional aspects.

[4] In this context "cross-border perspective" means that transactions have certain cross-border and multi-jurisdictional aspects. Amount of cross-border and multi-jurisdictional elements can be seen as a scale of internationality, as it will be contemplated further on this study. On the other hand, national markets are concept in which all transactions are explicitly conducted under one jurisdiction.

In Private International Law it has been systemized that one of the three following characters need to be in use before a transaction or a factual case can be considered to have a link to Private International Law:

1. Question over international jurisdiction: which tribunal is competent to solve the possibly arising civil disputes pertaining to the transaction and / or which tribunal has a jurisdiction regarding possible criminal proceedings?[5]

2. Rules on choice of law: which law shall be applied to the transaction and which law applies to the possible civil disputes in case they occur and need to be solved or which law applies to possible criminal proceedings that might take place?[6]

3. Recognition and enforcement of judgments: is there a need to apply or summon enforcement actions on a different jurisdiction than under the jurisdiction of the judicial system in which the resolution has been delivered?[7]

The aforementioned definition of juridical international engagement suits for certain purposes, especially for case law orientated approach. In generally, on the field of International Law of Property it is common that dispute resolution clauses and law references are agreed in contract when parties enter into agreement on particular transaction. This might be the case also among financial transactions. In fact there are instances where contractual choice of law and extraterritorial application of regulations make law itself an additional independent factor in making transactions international.[8]

Financial transactions (national and transnational) are mostly covered by mandatory legislation due to the authorities' interest to effect on capital formation, protection of investors and control the systemic risk under its jurisdiction. Also, authorities' interests may revolve around preventing frauds. The nature of international financial markets, and therefore international

[5] Stone 2010, p.3. and Klami 2000, pp. 15-18.
[6] Ibid.
[7] Ibid.
[8] Scott 2012, p. 2.

financial transactions, can be considered more complex environment than regular commercial transaction landscape which has international connection. Simply due to the reason that financial transactions, usually, have the regulated market place and the products are also under special regulatory scrutiny and control in comparison to e.g. international trade of plywood. National authorities tend to have a higher interest in extending their regulatory mandate when it comes to financial transactions. Therefore possible international engagements and conflicts of interest may occur more frequently than in "regular" commercial transactions. Thus definitions and interpretations of international financial transactions are challenging at times. The aspects on why authorities tend to have an interest to regulate financial markets and transactions (national and transnational) are dealt more closely in Section 3 of this study.

The financial transaction, to be considered international, needs to involve some cross-border activity with respect to payment, credit or investment.[9] This definition originates from the thinking that parties of the transaction are located in two different countries. It can be concluded that regulators in both parties' jurisdictions may claim to have an interest in such transaction[10]. Suitable addition to the aforementioned definition might be Bryant's typology of international financial transactions which includes the claims on domestic residents[11] in foreign currencies[12]. In generally, the key factors in determining the international character of a financial transaction are: i) location of transaction, ii) residence of the parties and iii) currency of denomination. These factors have also historically determined the law governing the transaction and regulators' authority over it, unless contractually agreed differently in case deviation from governing laws is possible.[13]

The definitions and notions presented above are worthwhile to keep in mind throughout the study. Definitions on financial transactions' internationality in perspective of International Property Law as well as regulators and supervisors

[9] Dufey 1990, p.3.
[10] Scott 2012, pp. 1-5.
[11] Note: residence is distinct from citizenship.
[12] Bryant 1987, p. 26.
[13] Scott 2012, pp. 1-5.

intrest on cross-border financial transactions are essential for this Thesis. The economic and political analyses of the historical developments and contemporary aspects of the operational environment on international finance will be assessed. Before making any juridical implications the phenomenon itself needs to approach. Though, while focusing as comprehensively as possible on international financial markets as a socio-economic phenomenon the juridical aspects are reasonable to bear in mind.

1.2 Variety of approaches to confront the (international) financial markets; few historical perspectives

"...a new man, who has his way to make in the world, knows that…changes are his opportunities; he is always on the lookout for them, and always heeds them when he finds them. The rough and vulgar structure of English commerce is the secret of its life…"

- Walter Baeghot[14]

"…one of the main objectives of financial law and regulation is to mitigate the risk of breakdown."

- Philip R. Wood[15]

Aforementioned quotations present two distinguishing approaches and features to financial markets. They reflect the debate around questions: to regulate or not to regulate, and if answering yes; how to regulate.

To put it bluntly: The first quotation describes the mind-set from which arise the innovations of new financial market products. Products that at best might provide prosperity, products that at worst might plunge the financial system into chaos. On the other hand the second quotation stems from the aim to avoid a "breakdown" that might occur if the lucrative financial innovations, shall prevail in the markets without proper control.

[14] Baeghot 1873.
[15] Scott 2012, foreword.

Baeghot's creative approach derives from the belief to capacity of cunning humans who can provide success not only for themselves but also environment around them by their eagerness for commercial wisdom. This is to be considered as a typical pro-market economist's view of the markets. Aforementioned words were written on an era when United Kingdom ("UK") was still on the top of its colonial euphoria and London's Lombard Street was the undisputable "The Street" on the world of finance.

Mr. Wood's risk orientated perspective reflects the view which has evolved from the lessons of various financial market crises during previous centuries. His thinking seems to set into the position that ongoing crises and continuous threat of financial structure's breakdown needs to be taken as ever looming possibilities. It can be thought his legalistic opinion stems from the urge for certain new regulatory initiatives for international financial markets e.g. regulatory / supervisory cooperation.

These two, still quite pro-market, perspectives are not directly comparable nor do they rule out each other. They have solely been selected hereto in order to illustrate the variety of views and conflict in opinions that churn and have churned for centuries in discussions concerning the financial markets; even among pro-market thinkers.[16] This conflict of opinions and chosen perspectives is a continuous debate that affects throughout the theoretical and practical field on research field of economics, politics, and law.

The variety of opinions, which state back to the question on characters of human nature, makes the purely legal approach to the topic challenging. Therefore while discussing the issue in a juridical context it needs to be remembered that economic and political disputes are very much to determine the contemplated issues. In this study certain key assumptions, pertaining to economics and politics, need to be predicated even though these mentioned

[16] Preceding chapters are solely interpretation and individual thinking of the undersigned. In fact it is worth to mention that Walter Baeghot was also advocating how to avoid panic when the markets were on turmoil; nevertheless he was a strong believer of human innovations on financial products. It should also be acknowledged that both aforementioned views are, in principle, in favour of international market economy. In the era of economic uncertainty, which we are still enduring to some extent at the moment, there are well argued critical voices against the international market economy system as a whole. In this study the existence and legitimacy of international financial markets and international market economy have been taken for granted.

sciences might have a lot to debate on these assumptions. Nevertheless, in order to complete a fluent juridical study certain predications need to be made to some extent.

1.3 Defining the Study

This study is to focus on the critical perspectives and possible future landscape for regulatory cooperation mechanisms on the international financial markets. One important part of the Thesis is to contemplate and illustrate the international mandate for certain regulatory / supervisory organisation. Financial markets shall be scrutinised as a socio-economic phenomenon, in light of history and the contemporary operational environment. This approach is necessary in order to understand which activity is to be put under juridical examination.

The perspective of the study is juridical. To some extent the international financial markets are examined as a whole and at some points the main focus shall concentrate solely to securities markets.[17],[18] The more specific regional touch shall concentrate on the transatlantic aspects of the possible regulation mechanisms; particularly contemplating the European Union's ("EU" or the "Union") regulation to the corresponding one in the United States of America ("U.S.") in order to discover means of cooperation and convergence for authorities and market supervisors between these jurisdictions. Therefore purpose of the study is not only to present prevailing legal state or current landscape of regulatory debate but also to discover certain possibly useful elements for forthcoming development in relation to convergence mechanisms and regulatory cooperation mainly on transatlantic financial markets.

The Thesis does not involve case study due to the reason that there is a lack of jurisprudence pertaining to the recent regulation and / or convergence methods presented on this study. The differences between legal origins, i.e. Common Law vs. Civil Law, and their relation to hinder the possibilities of

[17] According to Hal S. Scott, see Scott 2012, p. 11, the major financial markets are foreign exchange, lending and securities (debt and equity) and derivatives.
[18] I prefer the definition of International Organization of Securities Commissions (IOSCO) in which 'securities markets' are also used, where the context permits, to refer compendiously to the various market sectors (also reference to derivatives markets). See IOSCO 2010, p.3.

regulatory development are mainly excluded from the study. In this study the goals for sound financial regulation are to be reflected mainly on the light of three objectives of the International Organization of Securities Commissions ("IOSCO"):

1. Protecting investors,

2. Ensuring that markets are fair, efficient and transparent;

3. Reducing systemic risk.[19]

Though the approach of this study is juridical it circles around economics and politics. The economic and political perspectives may not be ignored given the conditions on which the international financial markets have been established and developed to; even though economics and politics are not the core of the study.

In the study suitable theories of Law and Economics and principles of Regulation Theories will be assessed in a critical perspective. The study examines possible ways to approach the international financial regulation, as if:

1. Binding treaties which the undersigned parties shall ratify and implement (direct and complete harmonization of legislation).

2. Adapting the same basic legislative principles and legal interpretation practices among jurisdictions (harmonization through certain principles; e.g. IOSCO).

3. Soft law orientated cooperative approach: Convergence between regulatory and supervisory entities without agreeing on binding legislation (as measures: for example information sharing agreements, substituted compliance and ways of mutual recognition).

4. Let the market practices and participants determine "best possible" compliance measures and standardized contractual clauses etc.

[19] IOSCO 2010, p.3.

(laizzes faire –approach or self-regulation by market participants e.g. Basel Committee).

5. Some sort of combination from Sections 1-4.

At first, in the Thesis, it is in place to picture contemporary nature of the dealt phenomenon: A) generically operational environment of global economy and B) particularly of international financial markets (Section 2). Secondly it is worthwhile to be asked why a phenomenon such as financial markets and transactions of financial products should be even regulated with detailed and additional rules than other traded goods, commodities and services. And why there should be taken an additional international aspect to the scrutiny of the regulation on financial markets. These issues are dealt in light of appropriate theories on Law and Economics and Regulation Theories. This (Section 3) shall contribute the major theoretical part of the study.

Then thirdly it is observed the historical and recent actual development of the regulatory landscape; A) generally at the globe and B) especially in EU and U.S. (Section 4). The specific touch shall concentrate on the authorities' jurisdiction, ability and willingness to participate on international regulatory / supervisory cooperation. Special scrutiny will be placed to illustrate EU's authorities mandate on international cooperation as well as Union's track record to combine 28 sovereign jurisdictions under one juridical umbrella. On Section 5 the recent flaws of international financial markets are briefly discussed.

Finally (Sections 5, 6 and 7) I'll try to frame a picture, in principle, of possible regulatory strategies for the international financial markets in relation to relevant theories and reality. The study shall examine the scope of the obstacles, challenges and possibilities that regulatory environment might endure and / or achieve in the coming years. A concrete case example is also provided and briefly analysed in light of appropriate theoretical aspects and legal-eco-political reality. Major goal for the study is to contemplate and illustrate which aspects and perspective are essential for further, more in depth, scrutiny on the topic.

In order to define the subject of the study on mainly juridical basis some political and economic terms, views and presumptions, which have an influence on the topic, have been taken into legal context straightforwardly without debating about their nature comprehensively by methods of their 'home sciences'. Therefore it can be argued that these terms and presumptions are disputable in political sciences and in economics. Nevertheless to simplify the study some of these perspectives have had to be left out of discussion in this context all though their existence is recognized and they will be covered in the study to some extent.

One purpose of this study will be to serve as a base for forthcoming assessments. Therefore it shall be illustrated and framed the core juridical questions pertaining to future developments.

2 The nature and development of international financial markets

2.1 A Review to history of globalisation and defining the current globalized economic operational environment

2.1.1 History review

Intensifying internationality on finance as well as on every other aspect of human lives can be seen as part of the globalisation process. The term globalisation has dominated the past decades of debate in social sciences, economics and it has reached its effect to legal discussions also. Some might imagine that globalisation as a phenomenon was a newly discovered topic due to the vigorous debate it has aroused in recent years. Though, that is not the case. It can be seen as a centuries lasting process or at least a fluctuating phenomenon which has existed on varying depth from the 15th century.

Some academics even state the 'origins' of the history of globalisation to the days of Alexander the Great (325 BCE) when link among overland routes between the Mediterranean, Persia, India, and Central Asia was established.[20] Many scholars, as Financial Times' Economic journalist Martin Wolf, argue that it can be said 'real globalisation' have begun with the voyages of European discovery of the 15th and 16th centuries. In the last decade of the 15th century, Christopher Columbus reached the Americas and the Portuguese entered the Indian Ocean. Since then peoples that had previously been isolated have become increasingly closely interconnected. This has been true of relations among the civilisations of the Eurasian land-mass. It has been still truer of relations between Eurasia and the hitherto largely - or entirely - isolated continents of Africa, the Americas and Australasia. Humanity had become aware both of itself and of the globe, as a whole. [21],[22]

It was the era before the First World War (mainly 19th century), when world was experiencing economically flourishing era of globalisation. Then trade barriers and a change on international political situation led to a decline in the

[20] History of Globalisation.
[21] Wolf 2004.
[22] The Economist, on 23 September 2013.

volume of internationality during the early decades of 20th century. This situation lasted until after the Second World War the surge on international trade was finally picking pace.[23]

The fluctuations on the level of interconnection on international trade have affected to the international finance. At times capital markets have been significantly open and converged; at times protectionism has shaken the operational environment. Mainly the levels of openness on trade and finance have gone together.

When contemplating the nature and history of international finance, one notable classic, which provides great deal of perspective to the topic, is Kindleberger's *Manias, Panics and Crashes*. The book was first published on 1978 and the latest revised version on 2005. The main credit for the work is that Kindleberger has been able to detect certain functions and errors that keep repeating on financial markets. Kindleberger's touch to the issue is crisis orientated. Therefore it functions arguable well as a side material in studying the nature of international financial regulation; given that it may very well be argued the one core purpose of regulation is preventing crisis and systemic risks. Kindleberger's findings could be summoned that there can be found a standard pattern in which speculative bubbles are caused by new, unusually profitable investment products. Often, products reflect movements toward globalisation as new markets or technologies appear that can be exploited by a given country or by an economic sector in several countries.[24]

Internationality and / or globalism in economic activity as well as in finance has been present for centuries and the level of it has varied; that is also the case of agreements, rules and regulation stipulating the trade and finance. The summary on the respect of history on globalisation of regulation shall be concluded on Section 4.

[23] Trade Survey 2002, p.2.
[24] Kindleberger 2005.

2.1.2 The current global economic operational environment

It is in place to define current global economic environment in order to be able to contemplate the globalisation and / or internationality of regulation i.e. international regulation for financial markets. To do so, the social sciences need to be used, as an adjutant, in order to understand the basics of economic operational environment from which arises the need for possible international financial regulation.

Social science, i.e. sociology, shall be used to define globalisation and to connect the socio-economic and political debate to juridical argumentation on regulation. Globalisation can be defined as the *"intensification of economic, political, social, and cultural relations across borders"*[25]*.* In this sense description involves more than the geographical extension of a range of phenomena and issues. What comes to globalisation of economy, in juridical sense, as Drahos and Braithwaite determine it, it has always at least three (3) distinct processes: *i) the globalisation of firms, ii) the globalisation of markets, iii) the globalisation of regulation*[26]*.*

In generally the argumentation can be interpreted in a way that incrementally evolved operational landscape has diminished the previous legal power and ability of sovereign nations. Therefore it can be seen worthwhile to contemplate certain reasonable possibilities in order to fit the regulatory framework to correspond the contemporary reality. In this study this issue is approach from the perspective of regulatory cooperation between the supervisory authorities. But there are and has been more idealistic and ambitious approaches to confront the changed operational environment.

One approach to control the distinct aspects of complex globalisation process has been idealistic prescription of World Government.[27] Though, it can be concluded that given the complexity of current political climate on the globe, this goal is challenging to achieve. Or as Drahos and Braithwaite put it; the World Government "*as a solution to the globalisation of markets and regulation*

[25] Holm 1995, p.1.
[26] Drahos 2001, p. 103.
[27] Habermas 1996, p. 456.

might be empirically shown to be utopian in the face of the capacity of some states with mighty treasuries and armies to defend their sovereign powers"[28].

Therefore some other 'moderate' solutions might be in place to be sought. This study endeavours answering that question, at least, to some extent. On the next Section the internationality of contemporary financial markets shall be contemplated with concrete examples and measurements.

2.2 How international the contemporary financial markets are?

It is in place to describe the structure and functions of contemporary international financial markets before it shall be considered how to regulate the mentioned phenomenon, in case regulation is needed. Given the definitions for international financial transactions on Section 1.1., it can be easily concluded, in layman's terms, that we are truly living in a world where the financial products are traded cross-border, the actors of financial markets operate in multi-jurisdictional landscape and the market sentiment spreads around the globe rapidly. But what is the factual evidence behind this assumption and how international or global financial markets truly are?

Defining and measuring the level of globalization on financial markets is challenging by absolute numbers and comprehensively. The next paragraphs will illustrate certain tools to measure the level of internationality and interconnection between markets with suitable scales including few examples. Following examples can be contemplated in correspondence with the Private International Law; i.e. do these examples prove that multijurisdictional questions are increasing on international financial markets?

1. Price correlation between the markets: The higher the correlations in rates of returns on similar assets across countries, arguably the more integrated the markets.[29] After the Second World War the price

[28] Drahos 2001, p. 107.
[29] Scott 2012, p. 16.

correlation between all financial markets around the world has steadily and significantly increased.[30]

2. Quantitative approaches:

i) For example looking the portfolio diversification in light of 'home bias' effect which illustrate how eagerly the investors prefer domestic investment versus foreign. From 2001 to 2008 'home bias' effect has decreased from 78 per cent to 66 per cent among US investors.[31]

ii) More drastic numbers can be found when looking the cross-border trading by foreign investors in the U.S. The sum of transactions in long-term securities (stocks and bonds), in the U.S. between foreign investors and residents from 1977 through 2003 rose significantly. Over that period, the ratio of these transactions to GDP increased from 5.76% to 344.18%, or by a factor of 60.[32]

iii) The portion of foreign companies in the largest stock market in the world, New York Stock Exchange ("NYSE"), was 2.12% of total amount of listed companies in 1975 and 5.14% in 1990.[33] In 2007 before the recent financial crisis the same portion was already 16.9%.[34] In terms of market capitalization the portion of foreign companies was more significant already in 2005: the foreign companies had remarkable 37% of the NYSE's total market capitalization at that time.[35]

3. Contagion effect, no matter where and why it occurs, provides an argument that financial markets are profoundly connected and international.

[30] Goetzmann 2001, Figure 3 p.45. and Aslanidis 2008, Table 4 p. 28.
[31] Coeurdacier 2011.
[32] Stulz 2005, pp. 7-8.
[33] Coffee 2002.
[34] Tafara 2007, p. 34.
[35] Public letter 2006.

i) On September 2008 when a giant financial service company Lehman Brothers Holdings Inc. ("Lehman") filed for bankruptcy in US, the securities worldwide plunged. In Europe, FTSE index in London declined 3.92 percent while the Paris CAC 40 was down 3.78 percent. It was the worst day for the index since the 9/11 terror attacks in 2001.[36]

ii) In the beginning of 2014 the turbulence with no significant straightforward connection between the countries hit the emerging markets. Even though many financial institutions around the globe are exposed to the risks of these nations, there is no clear straightforward link between the countries but the fact their societies progress as "emerging market nation", economically and politically, is more or less at the same phase. The turbulence that commenced by freefall of Argentinean peso has affected to the currencies of Brazil, Chile, Turkey, South-Africa, Russia and even China.[37] Through a decline of Russian rouble it has already impacted to Finnish export industry.[38]

Given the aforementioned details, financial markets can be considered international and interconnected in various ways. It can also be seen, in light of aforementioned examples, that cross-border financial transactions are completed increasingly. This raises many questions in multijurisdictional, Private International Law, perspective: which authorities and or tribunals are competent to rule over the transactions, which laws to apply and how the resolutions are enforceable. Therefore in the contemporary financial markets the question over international regulatory approach can be seen increasingly present.[39]

The regional touch of this study focuses on transactions and possible cooperation between U.S. and EU in particular. This approach is supported by

[36] CNN Lehman on 15 September 2008.
[37] FT 31 January 2014.
[38] Kauppalehti 31 January 2014.
[39] Please see the definition on Private International Law on Section 1.1.

the fact that transatlantic markets still have over 50% stock market capitalisation on the globe and the transatlantic share in global stock trading covers approximately 70%.[40]

2.3 So what? Is there any connection to 'Main Street'[41]?

On the above section it has been argued that there is a deepening interconnection between different regional financial markets and therefore it may be concluded that financial markets are international and / or global, at least to some extent. Thus, the conclusion can be followed with an argument that there are multi-jurisdictional elements and cross-border activity on the financial markets. It can also be seen that corporations which participate to financial markets in order to seek funding are exposed to these unpredictable contagion effects. Notwithstanding the aforementioned, is there any real connection to the 'main street' and to the lives of millions of human around the globe or is this talk about integrated financial markets just an academic discussion which has a real impact only to big global corporations and players on the financial markets? In other words, how significant issue we are assessing in relation to ordinary citizens, their lives and legal protection?

Given the determinations on importance of foreign exchange markets on the previous sections, it could be argued that all humans who use currencies, which are part of foreign exchange markets, are part of the financial markets. Therefore almost every individual around the globe living in somewhat humane conditions is liable to the influence of financial markets in some scope. The analogy might be close to truth; though some further argumentation is in need to support it. The main issue revolves around the question how deeply affected ordinary citizens are to financial market fluctuations and what this could mean for future regulatory approach?

The debate among academics whether macroeconomics and financial markets correlate has, and still is, a continuous topic. Macroeconomic views many

[40] AmCham 2012, p. 17.

[41] Main Street is a term used widely in US to symbolize normal citizens and households and to illustrate the "imaginary" difference, which can be argued does not exist, between "financial markets" and "real economy". The term is an opposite of "Wall Street" which symbolizes the financial markets.

times highlight that there is 'something wacky with stocks' or 'stocks are driven by fads and fashions disconnected from the real economy'. On the contrast financers may argue that 'something is desperately wrong with most macroeconomic models' and 'asset markets are the mechanism that does all this equating' instead of created theories and models.[42] These two distinguishing features can be synchronised to help and explain each other; they do not need to rule out other approach. Both real economy and financial economy (or financial markets and macroeconomics) are in a linkage, for example by the influence of financial conditions of firms and households on consumption and investment, as it is pictured in an understandable way by Konstantinos Tsatsaronis on a study of Bank of International Settlement's ("BIS").[43]

The ongoing debate among economic / finance scholars is how tight this connection is and how it should be measured. Classic example is Deutsche Bundesbank's illustration that a 100 euro decline in the value of stock holdings decreases the private consumption in Germany by 1 to 2 euros[44]. Studies show that consumer confidence and stock markets correlate; as does the private consumption with the markets. Financial market fluctuations and developments have some, but weak, straightforward reflection to Gross Domestic Product ("GDP") growth, even though the links are debatable on economic studies. Some argue that due to the reason that securities markets always predict the future the better measurement would be how GDP follows the securities indices afterwards. This evaluation provides a slightly stronger link between the financial markets and GDP development.[45]

An important manifestation of the importance and interconnection of international financial markets for individuals might be following examples on recent developments and incidents in the world of finance.

Lehman's collapse on September 2008 finally burst the looming bubble of US mortgage markets. It can be simplified that seeds of the crisis were planted on

[42] Cochrane 2005, pp. 2-4.
[43] BIS Paper, pp. 1-4.
[44] Bundesbank 2003, p. 40.
[45] Stock Markets vs. GDP 2012, p. 3.

the ‘main street’ by reckless lending practices, delivered to financial system by securitisation and finally the effects were once again returned to the real economy when ‘sub-primes’ started falter and the stagnation of finance led to drying up the investments which resulted as unemployment. Given the globalised markets of securitised debt (mortgages), the phenomenon shocked, at least, the whole semi-developed world.[46]

Other example is the hedge fund giant Bernie Madoff who led the multibillion dollar Ponzi-scheme, in which participated many of the wealthiest people on earth. But also the ‘regular payroll earners’ were scammed to trust their savings on the hands of Madoff.[47] The savers were convinced that through Madoff’s brilliance they could participate directly to financial markets with low risk and high reward; a mind-set that never can be true. Madoff-case is one example of new direct ways how ‘regular payroll earners’ have been seeking involvement on the financial markets.

One additional example illustrates how the ‘main street’ itself is even more intensively participating to Financial Markets. The changes in public pension policies have driven the regular households to save directly or indirectly on financial markets. This has led to a greater retail participation in capital markets on both sides of the Atlantic.[48] The medium wage earners have been more consent that they might have to secure their retirement days by themselves; also the awakening that private social welfare programmes might be needed has swept the European consumer landscape. As European Commission noted on 2005, the issue need to be dealt by improving financial literacy programmes in order to safeguard that investors participating to the financial markets would be more aware of their risk positions, *“as the public sector gradually withdraws from financing some aspects of social systems, there is a need for increased awareness and direct involvement of citizens in financial issues”*[49].

[46] Scott 2012, pp. 31-38.
[47] Madoff Victims, BBC on 12 March 2009.
[48] Alexander 2007, p. 323.
[49] EC 2005, p.7.

It is worthwhile to mention that the households' willingness to participate to the financial markets is not only driven by the insecurity of pension and welfare policies. I tend to argue that globalised information era itself increases the enthusiasm to participate on financial markets. It might simply be due to the fact that investing seems easier and less burdensome than before; also information about finance is available from various sources around the clock. When these factors are combined to basic human urge to improve living conditions, we have a bubbling financial cocktail. To put it bluntly, a Finnish grocery store cashier can easily generate that much extra savings per month that he / she is able to buy a piece of Brazil's growth through various mutual funds. Therefore it is reasonable once again to remind about the question what challenges this creates for regulators?

At this point it is worth to mention the old saying that when "*a taxi driver advises you to buy stocks to make a quick buck, run like the wind in the opposite direction and sell, as valuations are likely in bubble territory*".[50] This old, slightly elitist, view may not apply straightforwardly to modern world put it has some notable value at least on the perspective of future challenges of regulation.

How judicial systems and regulation should confront the reality where there are increasing numbers of investors with different professional capabilities? Should it be in place to initiate totally different regulatory approaches towards different investor classes; should there be more investor classes created? Of course the securities regulation already recognises widely the distinction of non-professional and professional investors; their levels of protection vary,[51] but is this enough and suitable level of regulation? Or should professional investors also be part of governmental paternalism, to some extent, given latest financial crisis and criticism towards the concept of 'reasonable investor' from behavioural economics scholars[52]?

All together the development which has led to increasing retail participation on the financial markets can be seen as a progressive way to promote 'people's

[50] Marketwatch 2012.
[51] Example from EU: CESR/10-1040.
[52] Black 2012, p. 12.

capitalism' that should create more liquidity on the markets which again should promote innovations, investments, growth and better opportunities for humans to improve their living conditions. To stop the idealism at this point, it is worthwhile to mention widening participation (direct and indirect) on the financial markets by non-professional investors creates more entry points for crisis into the system and arguable might facilitate fraud possibilities. Also the increase on liquidity has a tendency to create bubbles. All together this emphasizes the importance of appropriate regulation and efficient supervision that corresponds to the current reality of financial world; not only for investor protection, efficiency and transparency but also in order to prevent frauds on the system.

It can be concluded, the connection between these concepts, financial markets and real economy, is getting seriously profounder than before. Thus, the terminological separation of 'Wall-Street' and 'Main Street' may not apply anymore to the reality of contemporary world. Also it can be concluded, that not only the financial markets itself are interconnected but also the financial markets have some straight link to macroeconomics and to the daily lives of regular citizens around the globe.

In modern democracies regulation should always have its legitimacy among citizens, at least to some extent. Even though this is well-known fact that arguable almost everyone with juridical education supports; the legitimacy question is quite often disregarded when it comes to arguing about proper financial regulation. For example I tend to argue that in the field of securities law fundamental right orientated weighing has not gained ground. It could be stated that Securities Law scholars seem to be mainly concentrated on practical implications when arguing whether certain regulation is appropriate or not. The legitimacy of the regulation and fundamental right orientated approach should not be disregarded from the debate. More diverse perspectives could provide arguments to just regulation but also they might deliver some practical insight for efficiency debate given the fact that retail participation on financial markets is increasing. In this study legitimacy and fundamental rights implications are dealt on Sections 3, 6 and 7.

3 Regulation needed? In case answering yes; why and how? Relevant applicable theoretical perspectives and reality on international financial regulation

3.1 Financial markets and transactions as targets of regulation

3.1.1 General goals and drivers for regulation of economic activity

Human activity and interaction are based on certain rules. Rules might be tacit agreements constituted by practice without noticing their existence as well as rules can be well planned and agreed in writing. Rules may be binding in nature or they might appear as guidelines. Rules can be socially and culturally structured and supervised by peers. Rules may very well be enacted explicitly by legislation, passed in force by other means of public authorities in accordance with their jurisdiction or rules can be created by precedents of the courts. Especially the aforementioned 'officially created rules' are normally (should be) well enforceable and also sometimes supervised by certain official authority.

Mature legal systems have general legislation which covers economic transactions between individuals (legal and natural persons). Legal Transactions Act, Commercial Code etc. determine the juridical basis for commercial transactions among individuals. Nevertheless legal systems have special regulation to control various activities when it has considered that the nature of certain activity needs detailed rules. This is the case with financial markets and transactions also. As defined in Section 2 financial markets affect basically all humans and their basic ability to be economic individual actors in their daily lives. The legislators seem to have considered that, given the importance of the phenomenon, financial markets need to be controlled by special authorities and with detailed regulation. Further on it will be asked why.

In this study there is no intention to determine strict borderlines between private law and public law. Neither there is any intention to fit certain phenomenon into explicit branch of law. It may very well be expressed financial markets and transactions have at least a linkage to several branches of Property Law as well as Administrative Law and Criminal Law. To put it bluntly,

financial transactions could be characterised as private contracts that are mainly executed on regulated and supervised market places. In this Thesis a phenomenon is intended to be put under assessment as it exists across branches of law. It can be stated that financial markets and transactions are mostly economic phenomenon that has its connection to behavioural sciences and political reality. Therefore it is reasonable to contemplate the rules and regulations of financial markets in accordance with relevant theories on regulation of economic activity; without forgetting the political and group dynamic aspects of the phenomenon.

Traditionally laws, decrees and rules have been seen as reflections of public interest. In a democratic society a change in public opinion should be channelled to an amendment on provisions stipulating the matter in question. In regulation of the economic activity it is often stated that certain market failures need to be corrected and / or the public interest and vulnerable market participants needs to be protected.[53] This control action of the authorities is also referred as public intervention. Traditional regulatory theory, or the public interest theory, has often stated that authorities should react if the public demands for changes in order to correct inefficient or unjust practices for example in the financial markets[54]. This approach stems from the idea that regulation is to be justified from the public interest and regulators are to do good for the public.

In Law and Economics, which is a suitable theoretical framework to confront the problems and possibilities of regulation on financial transactions, it has constructed a Public Choice Theory that critically assesses regulatory interventions and their success. The theory goes even beyond by arguing that public officials would not (always) promote public good but the interest of their personal welfare or benefits of particular authority or agency or branch of business that they supposed to be regulating.[55] This feature is also defined as Agency Capture which means that the regulator itself is actual part of the industry (an agent for it) that it regulates and therefore in the end regulator is

[53] Määttä 2006, p. 21.
[54] Posner 1974, p. 335.
[55] Gwartney 1988, p. 7.

'doomed' to support and promote the interest of particular branch of business.[56] It has also been noted that even though politicians or regulators would not be agents for interest groups behind them, these powerful interest groups often tend to control available public information and opinion formation of the topics.[57] This sort of argumentation is often used to promote SROs and their ability to determined suitable practices for particular branch of business.

Altogether this makes the authorities work to deliver appropriate regulation on financial markets challenging; given the fact that substantial economic interest are in play and the branch of business has a significant interest groups that possess a great deal of lobbying power and control on information.

3.1.2 Approaches to regulation of financial markets and transactions

As mentioned above there are certain policy areas on regulation of economic activities in which legislators seem to have had an interest to specific intervention i.e. general rules of commercial transactions have not been seen sufficient. But what are the common arguments among scholars or regulators how they justify and argue the intervention by regulation on financial markets?

In U.S. the basic rationale to justify the regulation on securities markets is based on information asymmetries. It could be concluded that, traditionally in U.S., securing the quantity and quality of available information has basically considered sufficient argument and also goal for regulation.[58] In EU, if we contemplate the preambles of recent legislative initiatives (directives and regulation), it seems that the rationale for regulation is justified by straightforward reference to the public interest. Of course it may very well be argued that in U.S. the public interest is covered by providing sufficient amount of information for the markets in general and that the main rationale behind disclosure requirements is executing the public interest in practice. Especially,

[56] Stigler 1971, pp.3-21.
[57] Macey 1988, pp.1275-1280.
[58] Scott 2012, pp. 87–91.

taking notice the introduction of SEC and its rationale of existence, provided on agency's web page[59].

It might be concluded, given the legislators' agenda and comments of scholars stated above, that direct or indirect protection and fulfilment of the public interest seem to be the reasons behind regulation on financial markets even though this goal can be considered challenging to satisfy. As expressed on Sections 1-2 of this study, given the importance of financial markets for societies as well as for individuals and deepening connection between 'main street' and 'wall street', legislators can be seen to have an interest on facilitating the effective capital formation with the appropriate control of systemic risk and investor protection.

Well established goals for sound financial regulation could be the main principles of IOSCO[60]. The following core questions to be asked for could be simplified as: How these goals can be measured and enhanced for? Or how activities between the parties of certain financial transaction should be interpreted appropriately in legal weighting, given the fact that in reality the aforementioned IOSCO principles might and will collide? It is not an oxymoron to say that both principles can be improved in tandem, but it is reasonable to note that in reality these goals will collide at times.

Interesting perspectives for controlling the free markets can also be found from Finnish legal literature. Pekka Timonen has concluded that occasion where completely unregulated markets would function in a satisfactory way is rare. Timonen also notes that the main focus should not be in a question to regulate or not; but how to regulate.[61] For example in Finland there has been a Public Stock Exchange since 1912 but the Securities Laws were established in the late 1980'. So did Finnish Stock Exchange function without regulation almost 90 years? The Rules of the Stock Exchange were the detailed regulation framework which covered the transactions on Finnish securities markets[62]. This is a notable example how regulation and / or rules can be constructed by

[59] Introduction to SEC.
[60] Please see Section 1.3.
[61] Timonen 1997, p.357.
[62] Rudanko 1998, pp. 6-7.

various other means than with mandatory legislation. Though, the rationale behind the regulation might remain same and it might be reasonable to ask is self-regulation really enough for contemporary financial markets in mature legal systems.

3.2 Principles of theories on law and economics in relation to financial markets regulation

3.2.1 Framing of questions in traditional Law and Economics

The core theoretical or philosophical questions to be asked for could be simplified as: How private economic activity should be regulated with just, efficient and effective manner? How these issues can be measured and enhanced for? Or how economic activity between the parties of certain transaction should be interpreted appropriately in legal weighing?

Law and Economics is a multifaceted research tendency that studies e.g. how economic analyses can be utilised in interpreting the law. Also the interest can be focused how appropriate (just, effective and efficient) regulation is or how economic actors can be better regulated in order to achieve best possible outcome for example in a society as a whole. This tendency is often referred as Regulation Theory. Law and Economics can also be used to evaluate and analyse the reactions of independent entities to legislation (both natural and legal persons); e.g. 'effect analyses' can be used to measure how certain tax increase effects on individuals' behaviour.[63]

Law and Economics can be divided and systemised in various ways. Common distinction is A) positive and B) normative Law and Economics. In positive Law and Economics it is studied if certain legal state is in accord with economic realities. Positive approach analyses the effects legislation has on behaviour. In normative Law and Economics it is analysed how the legal state should be,

[63] Määttä 2006, p.2.

in order to promote policy aims. One core field on Law and Economics is regulation theory, which has its normative and positive sides.[64]

Regulation theory can serve the legislator by concentrating on the study of appropriate regulation. The focus can be on legal state that is in force and its appropriateness (de lege lata) or the perspective might include aims to reconstruct the legal state (de lege ferenda).[65]

Normative regulation theory, in Law and Economics, can also be seen as study of steering mechanisms or regulation options that would serve the best in achieving certain socio-political goal. It can be also contemplated if particular regulation is needed or not. In positive regulation theory's approach it is analysed legislator's choices; whether the legislator's decision making has been affected by lobbying groups and the interests' of officials.[66]

In this study there has not been adapted any particular doctrine and / or approach. The goal is to combine different theoretical possibilities to practical reality as suitable. In studying the regulation and regulatory cooperation on international financial markets current legal state is to be evaluated and possible useful proposals are scrutinized in the light of IOSCO principles[67] i) protecting investors, ii) Ensuring that markets are fair, efficient and transparent, iii) reducing systemic risk; by the mechanisms of suitable theories (and practice).

The goal of the study is to illustrate the current legal state on international mandate of regulatory / supervisory entities; and how their mandates could be applied, in the perspective of relevant theories on Law and Economics, to fortify and improve the fulfilment of aforementioned IOSCO principles in international financial markets, in particularly on transatlantic markets. It can be concluded that one interesting perspective for the study is the internal conflict of the IOSCO principles. The conflict between efficiency and fairness has been contemplated on the field of Law and Economics since decades.[68] It

[64] Ogus 2004, pp. 383-401 and Määttä 2006, pp. 21-22.
[65] Hertog 2000, pp. 223-247.
[66] Ibid.
[67] IOSCO 2010, p.3.
[68] Samuels 1981, pp. 147-172.

has become increasingly interesting topic on recent years given the financial turmoil and its wide spread effects.

Efficiency itself as term is a continuous topic of debate in Law and Economics. So called pareto-efficiency is a form of efficiency analyses where wealth creation for some is justified in case it does not affect negatively to others wealth status and / or welfare. In Kaldor-Hicks efficiency wealth maximising can be justified even if the result affects negatively for some in case there is a possibility to compensate these effects (i.e. overall welfare increases).

In financial regulation it is very hard to imagine a situation where certain rule could serve the benefits of all market participants. Therefore it should be more suitable to look for balancing the cost effects and search for less damaging solution for non-beneficiary market participants. Therefore Kaldor-Hicks efficiency might seem more realistic and reasonable efficiency approach for financial market regulation. Though, it is very well debateable if efficiency is the best measurement of good regulation. As mentioned above the constant discussion concerning the relation of efficiency and equitability is arising at the moment. Therefore I am trying to emphasise the multifaceted character of financial regulation. Political reality and its aspects to regulation are to be taking under consideration as well as fundamental right orientated approach.

3.2.2 Useful ideas from the concept of 'New Property Law' and other additional theoretical perspectives

'Weighting of Fundamental Rights', as a concept, could be characterised as a major theme on legal debate, at least in Europe, for past decades. Final phase of the essential process was adoption, entry into force on 2009, of the EU's Charter of Fundamental Rights as a part of the Union treaties. As of its entry into force Union entities and Union law interpretation may not disregard weighting of fundamental rights[69].

In legal theory it is a well-established principle that fundamental rights are on the higher level on the hierarchy of legal sources than regular legislation.

[69] 2010/C 83/02, Articles 51 and 52.

Fundamental rights can be seen in a horizontal perspective affecting in relationships between individuals or in a vertical dimension between individual and public authority. It is typical for fundamental rights that in practice they collide and therefore the legal interpreter needs to execute weighting between these fundamental rights in resolving factual situations.

Property Law has not been the most eager adapter of fundamental right based interpretations. Under the concept of 'New Property Law' there has been systemised a comprehensive 'tool box' to put use the fundamental right orientated perspective on interpreting the factual situations as comprehensive manner. In the concept of New Property Law wealth / property has been systemised as comprehensive manner as a legal triangle of proprietary right, contract and indemnity.[70] In this sense individual cases should be dealt as a whole, not in light of certain juridical segment.

Fundamental right positive interpretation on law has fortified the 'fundamental right sensitive' norms in Property Law[71]. This basically means that in particular transaction and / or situation different interest quarters have their position covered by one or several competing fundamental rights. Each individual case should be sensitively contemplated in relation to the principle of proportionality.[72]

The core of each fundamental right should be evaluated and protected. When weighting the fundamental right positions of each party certain principles as precautionary, transparency and fiduciary protection should be applied[73]. In the perspective of financial markets especially the principle of transparency is applicable. Transparency can be seen as a key principle to picture and solve problems pertaining to relation of investor protection and efficient capital formation.[74]

Also it is suitable, in perspective of financial transactions, to note that at times weighting need to be made in relation to parties' autonomy of contract and

[70] Pöyhönen 2000, p. 15.
[71] Pöyhönen 2000, p. 78.
[72] Pöyhönen 2000.
[73] Ibid.
[74] Ibid.

other fundamental rights protected by society. This collision might occur for example when certain party has contractually limited its individual rights or in consent posed itself under considerable risks.[75]

It is reasonable to argue that fundamental rights orientated approach should be applied both horizontally and vertically. Therefore fundamental rights orientated approach to Property Law has perspectives to provide for international regulatory cooperation pertaining to the question how to treat regulated entities. Especially it can be used to determine which means and ends could be valued the most in the agenda while authorities are contemplating forms to execute cooperation.

In this perspective it should also be noted that behavioural economics have criticised the concept of rational / reasonable investor which has been a clear tendency in securities law[76]. This perspective also emphasises the need to more comprehensive theoretical thinking 'outside the box' when contemplating the legal nature of financial transactions and their regulation. Fundamental rights orientated approach could be one suitable solution in respect of balancing between the appropriate protection of investors and effective capital formation. Behavioural economics, agency capture and group behaviour theories could also be used to explore the problematic position of regulatory / supervisory entities when they are reaching for liaison on cross-border relation. As noted by Olsson, a group theories' scholar, all the groups have a tendency to only maximize their success.[77] It should be assessed the possibilities how regulatory organisations operating on different jurisdictions could win this superstition and work genuinely together in juridical cooperation for long term view; not only to promote their self-interest goals on short term.

Also it is legitimate to question the illusion of reasonable gatekeepers that financial system heavily relies on, for example Credit Rating Agencies ("CRA"). As stated by Coffee, the recent financial crisis has illustrated numerous flaws in this respect[78]. Given the aforementioned paragraphs, a question can be

[75] Chantal 2008, p.4.
[76] For example Black 2012 and Stoutt 2002.
[77] Olsson 1971, pp. 5-9.
[78] Coffee 2009, pp. 10-15.

raised that disregarding the investor classes (professional / non-professional) should all investors and gatekeepers need government paternalism to some extent? The problem revolves around the efficiency debate. If paternalism is to be increased by justifying it in terms of investor protection and control of the gatekeepers, there is a great doubt that the efficient capital formation is to be hindered. This again will have an effect to consumers when the cost of regulation shall be transferred to the prices of financial services. One perspective is to search balance between the necessary protection and the harmful cost effects that protective stipulations might create. Other suitable aspect might be to execute weighting between competing fundamental rights, i.e. protection of property and freedom of trade.

Fundamental right orientated approach might be evaded or at least not warmly welcomed by e.g. certain traditional scholars of securities laws. Nevertheless fundamental rights perspective delivers not only legitimacy to legal system of economic relations but also additional useful 'solution power' to Property Law and to financial regulation. If used properly, it could deliver efficiency in Kaldor-Hicks perspective. As mentioned before, the situation in which the wealth increase (benefits) of all participants could be promoted through regulation is quite unrealistic on financial markets regulation. Therefore the concept of New Property Law might deliver some efficiency implications to particular judgement situations in order to find 'less damaging solution as a whole'. This perspective suits to the idea on Kaldor-Hicks efficiency.

PART II TRANSATLANTIC PERSPECTIVES ON PROBLEMS AND POSSIBILITIES OF REGULATORY COOPERATION

4 Developments on financial regulation and regulatory entities' jurisdiction – particularly on EU and U.S.

4.1 Historical review to 'globalisation of financial regulation'

Throughout ancient times powerful city-states and / or regions, after gaining their stance on power or their autonomy, were eager to emit their proper currency.[79] Therefore monetary control can be seen as a mean of power since the early stage of civilisations. Monetary harmonisation and monetary unions were also common. The Persian and Roman Empires, for example, tried to gain control over coinage[80]. Therefore right to coin became a hallmark of sovereign power. The power over coinage was used as a mean to political supremacy[81]. This could be compared to nowadays power of central banks to determine the value of money, inflation and liquidity.

Financial Regulation can be divided to various 'regimes', e.g.: monetary, banking, securities and insurance regulation (the aforementioned classification adapts actually more or less to the newly established supervisory structure in EU). Historically these regulation 'regimes' have globalised on different degrees. On ancient times as well as on the early days of the 20th century the main concern of national states on global financial regulation was concentrated around the international monetary system due to the reason that sovereign states had an interest to equilibrate the imbalances of payments between states. Monetary union agreements were completed among independent city republics of Greece already on the fifth century. The main goals for such settlements were reciprocal trade interests. [82]

That argument does not sound so far-fetched on nowadays terms either. When one thinks about the European Single markets and European Monetary Union ("EMU"); the similar arguments prevail. As it goes on bilateral and multilateral trade negotiations that are taken place at the moment. Also the discussions

[79] Drahos 2001, p.113.
[80] Ibid.
[81] Ibid.
[82] Ibid.

concerning cooperation and convergence on international financial regulation stem from the corresponding idea: reciprocal actions are needed to secure the interests of a many on changed operational environment.

After the Second World War in Bretton Woods the modern basis for convergence on financial regulation was created. Even though the cooperation was mainly focused on monetary issues and did not include other ideas of regulatory convergence nor did the liaison go to lengths and depths some were picturing. As British representative economist John Maynard Keynes wrote to the UK's Chancellor after the meeting "*Fund [IMF] can scarcely be, at any rate in the early years, the nucleus of a super-central bank, such as we hoped*"[83].

When studying the history of globalisation of regulation on financial markets, Drahos and Braithwaite seem to conclude in their article that historically the monetary regulation and keenness to control capital markets through banks have been the main concern for sovereign states. The argument is supported by the fact that IOSCO, which has its interest on creating security regulation standards and convergence, was established on 1983; way later than Bretton Woods's institutions and also almost a decade later than establishment of the Basel Committee (1974). Therefore widely recognised debate on other than global banking and monetary regulation has taken its time to arrive at stage.

What comes to contemporary debate concerning the regulation of international financial markets, there are some educative points to notice from history. Capital market integration has had various forms in the past. Still some similarities can be found during centuries and therefore historical approach to regulation is also in place. As it has been shown by Kindleberger (please see Section 2.1.1.) financial crisis tend to have repeating features like tendency of international contagion. Still the regulatory entities have not been able to prevent, and sometimes not even mitigate, the crisis from eruption. Nation-states have been exposed to volatilities and crashes in foreign financial markets. The key difference on 21st century is that the crises have various

[83] Braithwaite 2000, p. 100.

possible entry points to the financial system and therefore detecting them is not that easy.

It seems that for long time it was considered that only the control of prudential rules of banking system is enough to tackle the possibility of risks on the international finance. Given the knowledge of previous decades this obviously has not been functioning well or in a satisfactory way. Though prudential rules of banking lay an interesting historical example how 'soft law-self regulation' approach may have significant and efficient results[84], at times.

This example of prudential rules might serve as a useful tool how convergence can be sought with the result of better transparency between the market places as well as private entities and regulators. The manoeuvre how prudential rules were implemented also serves as an example how light touch 'best practices' and soft law orientated approach serves sometimes more efficiently than mandatory legislation.

4.2 Recognising the need for structural reform and cooperation before and after the crisis that erupted in 2008

4.2.1 Dialogue before the crisis in academic circles

Among academic circles it has been discussed for quite a time about convergence and cooperation on international financial market regulation.

The interconnection that was steadily increasing on international financial markets had aroused the curiosity of legal academics to join the conversation on developing the regulatory infrastructure for this changed operational environment. The academic conversation accelerated on 2000-2008. At the same time it became more and more evident that around the world corporate sector looks international financial markets as a major source of new capital.[85] This is once again a clear sign of further market convergence. This fact has encouraged even intensified conversations among legal scholars.

[84] Drahos 2001, pp.114-116.
[85] Alexander 2007, p.321.

Also other indicators (please see Section 2.) were showing that multifaceted interconnection was deepening while not only corporate sector searched capital on international markets but institutional investors were seeking to diversify their portfolios by acquiring securities outside the country where they were domiciled. Also financial firms were strengthening their presence in the international marketplace.[86]

It can be considered that the evolving academic literature can contribute, and has contributed, valuable insights to the Transatlantic Financial Regulation Dialogue. The importance of the academic discussions has been contemplated in various studies. Still critics may argue that academic intelligence fails to effect on actual policy making due to the reason that politicians tend to lack the determination to but ideas into practices when it is not necessary (lack of momentum) and the issues are too complex in gaining credit from the public i.e. voters.

4.2.2 Actions between EU and U.S. before the crisis – in light of Sarbanes-Oxley (IFRS / GAAP and Corporate Governance)

While academic debate was churning the regulators and government officials did not stand by doing nothing even though the political landscape was not most enthusiastically corresponding to the approach of cooperation. International accounting standards and corporate governance issues were the main topics of the actual actions on EU-US financial regulatory development on the early 2000.[87]

Major concessions for companies under IFRS accounting standards were made. They are no longer subject to report also under GAAP in U.S. but U.S. authorities recognise the IFRS standards as suitable and comparable accounting standard.[88]

At this time Union did not have such a clear regulatory and supervisory structure than nowadays. Also it seemed that academic arguments did not

[86] Ibid.
[87] Ilmonen 2012, pp. 148-149.
[88] Ibid.

manage to break the political line in a way that regulatory initiatives would have passed to enforcement actions. It needed the Lehman to come before enthusiasm surged. Also it could be stated that at the moment Union has a comparable regulatory / supervisory organisational structure with clearer jurisdiction as it will we assessed and illustrated on Section 4.3.

4.2.3 Accelerated enthusiasm to enhance global regulation after Lehman Brothers collapse

The G-20 nations[89] were the group which declared the need for improvements on global financial markets' regulatory framework after the financial crisis struck worldwide on September 2008 after Lehman filed for bankruptcy. After G-20 declaration / agreement / statement on September 2009[90] the legislators on various countries have created new regulation for financial markets under their jurisdiction. There has not been signed any significant treaties which would harmonize the legislation between different jurisdictions albeit the politician were utterly demanding cooperation approach to deal with the issue. Though, the passed new regulation, in various jurisdictions, is based on the commonly declared principles and there is certain oversight in this respect (soft law, SRO's).

It can be concluded, given the latest example of actual development on regulatory framework that even the academics were discussing and setting policy initiatives in front of the regulators and politicians, the decision makers were only keen to act after the crisis had swept the markets. Also it can be concluded that it seems international regulatory initiatives need to be delivered from top down i.e. academic circles had the lack of impact to force enactment and implementation on passing their voice to political level. This means it can be argued that unfortunately some sort of crisis is needed to deliver political support for reforms, and by that way speed up the regulatory process. On the other hand it can be argued that regulators were on the map regarding the need for reforms. European Commission and SEC were preparing and

[89] A group, which was originally created to cooperate pertaining to control of the financial market turmoil in Asia, in the end of 1990's.
[90] The Statement 2009.

discussing separately and jointly about the need for convergence in creating stronger EU-US partnership and open transatlantic markets for the 21st century[91]. Though, any significant results were not gained on this respect before the crisis of 2008.

On next sections I will quickly summarize the principles of new legislation and regulation amendments which have been implemented after the financial crisis of 2008-2010 in U.S. and EU. The more specific touch is concentrated to EU because the newly passed regulatory initiatives and the supervisory structure finally establishes the Union's jurisdiction and legitimacy to rule more decisively on financial regulation.

Given the scope of the study there will not be conducted a comprehensive comparison on the new legislation on EU and U.S. In the future there should be concluded studies on the differences between new EU financial regulations and directives in comparison to corresponding Dodd-Frank Act in U.S. Still it can be considered too early to state explicitly what implications to practice this enacted legislation has. There is a lack of practice and existing jurisprudence on this regard. The purpose of this study is to frame possible juridical approaches to new cooperative practices what regulators / supervisors could implement in practice in relation to cross-border transactions and supervision of multijurisdictional entities on transatlantic financial markets, in principle.

4.3 US and EU regulatory authorities and their mandate for cooperation in contemporary financial markets

4.3.1 Definite federal structure of US – regulation and supervision authorities, their legislative framework and recent developments

In comparison to EU's regulatory and supervisory authorities the mandates for U.S. corresponding ones are more definite due to the clear federal structure of the U.S. judicial and political system. Even though in this study EU is considered, in various contexts, as a semi federal judicial entity, the difference between US and EU is still notable.

[91] EC 2005, p. 9.

EU has various federal elements but some still can argue that federal structure is not that definite that is the case with US. Therefore it takes more juridical arguments to explain on which grounds the regulatory power of EU-authorities could rule over international cooperation than corresponding entities on U.S. The main scrutiny shall be concentrated to US Securities Exchange Commission ("SEC") and European Securities and Markets Authority ("ESMA"). In some contexts other regulatory organisations will be cited to.

Definite federal structure as well as long and profound jurisprudence of SEC's wide mandate is easier to illustrate. Therefore in this study it has taken for granted that U.S. is a federal state and SEC has a mandate to govern all the actions that are in relation to its scope under U.S. federal jurisdiction. Although SEC's mandate shall be examined and explained as well as it is contemplated how SEC might be able to justify its extraterritorial engagements. In the contrary, as mentioned, EU is a semi-federal entity formed by sovereign national states. Thus more scrutiny will be concentrated to picture EU's authorities' jurisdiction to act regarding financial markets. Some constitutional aspects need to be dealt more closely in the EU's context than in US.

The fundamental mandate for Securities and Exchange Commission ("SEC") has remained the same, as of year 1934, despite the evolution of the market infrastructure around it and several additional legislative initiatives that have passed in to force during decades. SEC considers all its regulatory, supervisory and rule creation actions in relation to goals of protecting investors, ensuring the efficiency and transparency of US markets, and facilitating capital formation in the US.[92] Commentators as well as SEC itself interpret its mandate to be broad authority to rule all and every aspect of the financial industry in US.[93]

SEC pictures itself as an active actor which does not only have a possibility to govern securities markets but a mandatory duty to do so. SEC's interpretation of its position in the society reaches even deeper to enforcement practice. SEC considers that under its jurisdiction it has a mandate to help in creating

[92] SEC Act 1934.
[93] Tafara 2007, p. 1.

jobs and improving living conditions for Americans. In order to do so it acts promoting the capital formation that is necessary to sustain economic growth. SEC considers that the main tool to achieve the mentioned goals is to ensure the proper supply of information for investors:

"The laws and rules that govern the securities industry in the United States derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it. To achieve this, the SEC requires public companies to disclose meaningful financial and other information to the public. This provides a common pool of knowledge for all investors to use to judge for themselves whether to buy, sell, or hold a particular security. Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions. The result of this information flow is a far more active, efficient, and transparent capital market that facilitates the capital formation so important to our nation's economy."[94]

As it has been argued on the American legal literature the changes on real operational environment of financial markets have led to the situation where SEC needs to re-evaluate its position regarding to international context. Even though SEC's mandate remains the same, scholars argue that financial markets are so interconnected and they operate cross-borders among jurisdictions that viewing them in isolation will no longer serve SEC in order to comply with its core functions.

Vigorous advocates for this approach have been e.g. Ethiopis Tafara and Robert J. Peterson which both have served as SEC's officials. They have been raising these concerns already before the latest crisis on 2007. Their argumentation goes even further that in order to actually comply with its fundamental mandate SEC does not have any other possibility than start operating by new cooperative means with its foreign counterparties.[95]

[94] Introduction to SEC.
[95] Tafara 2007, p.34.

Similar tones have been raised by Edward F. Greene who has a long history in banking and legal business from both sides of the Atlantic. In his commentary note to Tafara's and Peterson's Blueprint Greene highlights that SEC has taken no significant steps toward improving the access of US investors to non-US markets since the adoption of Rule 15a-6, which has supplemented Securities Exchange Act of 1934 as of 1989 and which provides an exemption of certain foreign broker-dealers.[96]

The critics of SEC nationalistic policy approach state that even though there have been clear legal principles to enhance market participation for foreign investors, the SEC have failed to do so. Greene refers to the concept of 'investor-friendly substituted compliance'.[97] In a matter fact he takes an example from another US governmental entity US Commodity Futures Trading Commission ("CFTC") which has put to use its 'Part 30 Rules'[98] that enable to grant a non-US firm an exemption from compliance with certain requirements.

The advocates of open cross-border cooperation have had the tendency to refer that SEC (as well as CFTC) must emphasise their mandate to facilitate capital formation and thus the need for more flexible cross-border interaction which would decrease transaction cost for market participants. During the 2000s US regulatory scheme has been criticised as costly and inefficient in light of cross-border investment.[99] On the other hand the critics of 'investor friendly' approach express that when efficiency is raised as a key issue there might be created, unwillingly, a shortage in the perspective of investor protection, as mentioned above in this Thesis.

For example, in US Partnoy and Stoutt in the field of law, have been prolonged critics of the 'efficiency approach'. They claim that investors themselves, as regulators also, lack the ability to protect the investors and to detect frauds. The arguments of critics can be interpreted in a way that the concept of investor protection has not been understood properly among regulators and academics in the field of securities law. It is claimed that legal scholars and

[96] Greene 2007, p.2. and SEC Act 1934, Rule 15a-6.
[97] Greene, 2007, p.3.
[98] 17 C.F.R., §30.10, app. A
[99] Greene 2007, pp. 2-3.

regulators have a tendency in which they derive their opinions from the law and economics analyses' that believes in 'rational expectations' investor model or 'reasonable investor'. In this model the investors are described sophisticated who can pick the correct securities, are well aware of the risks that certain securities include and can safeguard themselves contractually without deep governmental intervention in order to protect them.[100]

Even though the critics of 'efficiency approach' are mainly concerned about investor protection itself they are also sceptical about SEC's international cooperation while they fear that this would deteriorate US investor protection. The argumentation does not deny SEC's fundamental mandate to act on the international field. It seems that core of the critics is to challenge the point of view which has been seen more a legal theoretical question: how juridical professionals think that investors call their decisions; so from which perspective and how they should be regulated? This theoretical question, how scholars on law should treat investors as regulated entities in the future, shall be dealt more in depth on Sections 6 and 7.

In conclusion it can be noted that SEC's mandate to participate in international cooperation is not forbidden and it has been argued, among scholars, that it should take this sort of actions. The constitutionality of its powers has not been that heavily tested among academic circles. The critics point has mainly been concentrated on which means SEC should use and which ends to promote on its international cooperation. According to the Securities Exchange Act of 1934 and 17 Code of Federal Regulations ("C.F.R."), SEC may, under its discretion participate for example information exchange with foreign entities.[101]

The above referred cooperation has mainly applied to investigation of criminal charges i.e. securities frauds, insider trading, corruption or market manipulation cases. The mentioned paragraphs determine reciprocal principles on information sharing: to both receive and deliver information abroad under certain guidelines.

[100] Stoutt 2002, pp. 5-11.
[101] 17 C.F.R Ch. II (4–1–12 Edition), § 240.24c-1 (Rule 24c-1) and Sections 3(a) (50), 21(a) (2) and 24(c) of the SEC Act of 1934.

In addition, SEC notes on its own web-page that it considers possessing powers to *"enforcement-related information sharing on a multilateral, bilateral, and ad hoc basis"*. These arrangements are mainly done through memoranda of understanding ("MOU"). Good example is IOSCO principles. In generally the problem (and also benefit to some regard) of these MOUs is that they are only guidance in principle without binding obligations.

Could U.S. Commodity Futures Trading Commission ("CFTC") and U.S. Board of Governors of the Federal Reserve System ("FRB"), as independent and proactive actors in international cooperation, be an example to SEC?

"Commodity Futures Trading Commission (CFTC) is to protect market participants and the public from fraud, manipulation, abusive practices and systemic risk related to derivatives – both futures and swaps – and to foster transparent, open, competitive and financially sound markets."[102]

The aforementioned quotation has been taken from the agency's web page. CFTC's mission does not differ that much from the wording of SEC's task even though both agencies are working slightly separate fields of financial regulation. CFTC's focus is on commodity futures and swaps, e.g. derivatives related to oil, soybean, wheat etc. CFTC is not the core of this study but given its more active role, than SEC's so far, in participating to the international regulatory cooperation on financial markets, it is worthwhile to have a review to CFTC's mandate and actions which the agency is applying. Same notice applies with the FRB; it is not the fundamental interest of the study but still it is another US governmental entity which has incorporated 'substituted compliance approach' on the cross-border actors in relation to foreign banks.[103] FRB is the key of the US Federal Reserve System ("Fed" or "US Central Bank") which main function is to provide safer, more flexible and stable monetary and financial system in the US[104].

Commentators like Edward Greene have argued, already before the most recent financial crisis, that SEC should take these agencies as a guideline and

[102] CFTC introduction.
[103] Greene 2007, p.3.
[104] Fed's mission.

start applying the similar practices as aforementioned entities. Greene has noted that when there is a comparable regulatory system in a non-US firm's home country and certain safeguards are in place to protect US investor's then there should be no reasons not to apply and / or grand possible exemptions and reliefs for non-US entities.[105]

The economic arguments that legal scholars have adapted pertaining to international 'substituted compliance' approach is that breaking down the barriers between US financial markets and comparably regulated non-US financial markets will benefit both US and non-US market participants. If there are no extra burdens for cross-border engagement then markets are truly open and this creates more liquidity that helps the efficient capital formation on both sides of the Atlantic, the advocates' state. This will, according to their argumentation, also reduce the cost of capital.[106] If the cost of capital decreases, it could be furthermore argued that investment activity increases which will spur economic growth and create more jobs inside the jurisdictions whose regulators apply this cooperative approach of 'substituted compliance' and / or 'mutual recognition'. The terms 'substituted compliance' and 'mutual recognition' shall be dealt further on the study.

It can be considered that the main goal and merit of this argumentation is the ability to illustrate existence of legal regulatory mandate which allows US financial supervisors to participate on international cooperation; as FRB and CFTC have done. The academic rationale, among both economic and legal scholars, goes that not only the markets have changed and regulation has to adapt but also regulatory entities have to step up proactively to facilitate, promote and enhance this cross-border interaction.

Critics can, once again, point out that are the current economic rationales ('rational / reasonable investor') behind the legal scholars' argumentation valid. Also it is notable that the current debate of appropriate financial regulation for 21st century is practical in nature. It seems that securities law experts do not concentrate their focus on the theories behind mainstream interpretations of

[105] Greene 2007, pp. 3-5 and 17 C.F.R. §30.10, 17 C.F.R. §30.4, 12 C.F.R. §211.24(c)(1)(ii).
[106] Steil 2002, pp. 27-29.

law and economics. The 'rational investor' approach has been often taken as granted.

Therefore it could be argued that more theoretical approach across the borderlines of different sciences, as well as inside the juridical fields, should be in place to enhance financial regulation's correspondence to the real needs of societies. This phrasing of a question shall be examined more in forthcoming Sections of the Thesis.

4.3.2 European Union and its mandate to act on financial regulation[107] – inside the Single Market as well as represent the Union and its member states towards third parties

SEC's position, mandate and legitimacy are undisputable. Though, its charter and legal basis have been opened to scrutiny, to some extent in this study, mainly in relation to SEC's jurisdiction on international cooperation. In the EU's context it is worthwhile to delve into the regulatory structure a bit deeper. Union's financial market regulation has a shorter history and practice than in the States and EU's financial regulatory entities are newly established.

Also it is notable that Union still is a combination of sovereign national states, not a pure federalist state as if US even though EU has strong federalist characters when it comes to Union judicial system and its effects to member states as well as individuals residing on those states. For purposes of this study it is reasonable to address the Union's financial regulation structure and the entities governing the regulation and supervision; as well as the basis in which they derive their mandate.

Also it is notable difference, in relation to US, that National Financial Supervisors are not played out from the picture. They are still vital actors under their national jurisdiction. Therefore the field, especially in enforcement, of Union wide financial supervision is still in its infancy. Though, the praxis of the European Union law, in jurisprudence and policy creation, has a lot to provide

[107] In this study the term 'regulation' is to refer all sorts of regulatory concepts: laws, directives and guideline principles when spoken general context. On the other hand Union's regulation refers EU's directly enforceable 'decrees' and directive refers to regulation that needs to be implemented by Member States.

for transatlantic cross-border regulatory cooperation, given the fact that Union has succeeded to integrate 28 sovereign national legal systems under the same juridical umbrella.

EU-entities' mandate to enact, regulate and supervise need to be well argued regarding every branch of law and particular policy initiatives. As well as EU's general jurisdiction and where it derives from are to be justified and referred before every action. The core of EU and its judicial power is without arguing concept of Single Market (also referred as Internal Market or Common Market). If a matter is to be considered an issue of the Single Market, EU has exclusive authority over it. The key idea is that all factors of production can move freely across the member states. Union's entities have a jurisdiction by all means in order to guarantee the proper functioning of the Single Markets. This legal concept that guarantees the basis for Single Market is also referred as Four Fundamental Freedoms ("FFF"); free movement for:

i) People

ii) Goods

iii) Services

iv) Capital[108]

The legal core basis of the EU is established in two treaties, as referred above: Treaty on the European Union ("TEU") and Treaty on the Functioning of the European Union ("TFEU") (together as "Treaties"). All Union member states have signed and adapted the Treaties. By doing this they have decreased their sovereignty on some extent.

All Union regulations and directives need to be justified through Treaties i.e. their legal basis need to derive from them. To put it bluntly, there is no Union entity that could exist or have power to enact, regulate and / or supervise on certain policy area without reference or connection to the Treaties or to the rules and principles that could be justified from the Treaties. Same applies to all policy decisions itself: in case the Treaties do not deliver enactment power

[108] TEU: 2012/C 326/15, Article 3 and TFEU: 2012/C 326/47 Articles 21, title I, 26, 28, 29, title IV, title V, articles 114, 115.

on certain policy area, then the Union entities do not possess jurisdiction regarding the subject in hand.

The aforementioned principles apply to the Union's operations itself but what do the Treaties and FFF's guarantee for citizens and businesses e.g. participants on the financial markets inside the Union? Professor Klaus-Dieter Borchardt sums the concept as follows:

"Freedom results directly from peace, unity and equality. Creating a larger entity by linking 27 States affords at the same time freedom of movement beyond national frontiers. This means, in particular, freedom of movement for workers, freedom of establishment, freedom to provide services, free movement of goods and free movement of capital. These fundamental freedoms guarantee business people freedom of decision-making, workers freedom to choose their place of work and consumers' freedom of choice between the greatest possible varieties of products. Freedom of competition permits businesses to offer their goods and services to an incomparably wider circle of potential customers. Workers can seek employment and change job according to their own wishes and interests throughout the entire territory of the EU. Consumers can select the cheapest and best products from the far greater range of goods on offer that results from increased competition."[109]

This statement and point of view could be interpreted in a way that EU individuals possess a subjective right (legal guarantee) to participate on cross-border financial markets inside the Single Markets. Further on it could be concluded that Union needs to protect and enhance the possibility for its residents to participate on these markets.

The obvious follow-up question is how are these rights protected; supervised and enforced inside the Single Market? The highest interpreter of Union law is the European Union Court ("EUC"). EUC's precedents have guided the development and establishment of Union law principles throughout the European Communities' history. The national courts and authorities are obliged to apply and follow the interpretation of the EUC. Also national courts can inquire interpretation guidance from EUC to certain Union law dilemma

[109] Borchardt 2010, p. 22.

that is on their table. This is called the 'Preliminary reference procedure' after which EUC delivers its 'preliminary ruling' that binds the pleading national court. [110]

A few main principles of EU-law which are established explicitly by the Treaties or by EUC or by both and which are applicable when analysing the Union's approach on financial regulation are, as follows:

i) Union law's direct effect / applicability: Member States nationals can plead in courts and authorities directly to Union law. States have limited their sovereign rights, albeit within limited fields, and the subjects of which comprise not only Member States but also their nationals.[111] This applies straightforwardly to regulation. It applies also to directive in case member states have not implemented it in a duly manner and if the directive constitutes an explicit rule, right and / or obligations. Possibility to plead directly to a rule established by a directive does not apply for cases between individuals.

ii) The primacy of Union law: Union law takes precedence over national law if the two conflict.[112]

iii) Interpretation of national law in line with the Union law: national law is to be interpreted in accordance with Union law; i.e. in accordance with the directives. This prevents matters from being differentiated at national level which have just been harmonised at Union level by means of the directive.[113]

iv) Subsidiarity and proportionality principles: Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by

[110] TFEU Article 267
[111] 26/62 Van Gend en Loos (1963) ECR 1 and Bochardt 2010, p. 30.
[112] 6/64 Costa v. ENEL (1964) ECR 585.
[113] 14/83 Von Colson (1984) ECR 1891 and Bochardt 2010, p. 123.

reason of the scale or effects of the proposed action, be better achieved at Union level.[114]

v) Mutual recognition principle: means that a product lawfully marketed in one Member State and not subject to Union harmonisation should be allowed to be marketed in any other Member State (principal rule; allows certain exemptions).[115]

So it can be concluded that together the Treaties and EUC's jurisprudence establish the principles for Single Markets which all and every sovereign national state and their governmental entities need to apply and respect. In the perspective of international financial market regulation, why are these legal principles important? It can be considered that these Union law principles, together with the FFFs', establish and protect the integrity and unity of the European financial market's regulatory regime. At the same time this concept as a whole enables and justifies the participants, products and services a fluent functional environment under the rule of law.

Therefore it can be argued that the EU's financial regulations and directives, as well as established regulatory entities, together create a comparable unitary regime which has the basic abilities to participate on international cooperation in enhancing the financial regulation. This definition of 'comparable regulatory regime' has been seen, among US scholars and SEC officials, as a mandatory element for SEC's cooperation. In the EU context term 'equivalent' regimes is used.

After all, is it still legitimate to raise questions as if is the financial market regulation even a Union issue at all and to which extent? Is the reality across the Union member states such a kind that we can really talk about unitary financial market in EU? EU's financial markets can be considered deeply integrated and cross-border transactions have become a reality in recent decades.[116] Therefore it can be argued that financial markets are actually Union wide and converged.

[114] TEU: 2012/C 326/15, Article 5.
[115] 120/78 Cassis de Dijon (1979) ECR 649 and EC 2008.
[116] See for example Bekaert 2012.

One could even ask that in case the reality of the financial markets would not be completely transnational and integrated inside the Union should the regulatory approach still streamline and harmonize the financial regulation among member states. Given the fact, financial markets arguable fit in to Union's 'exclusive competence', which derives from the Single Market reference; as stated above. Also it could have been easily argued, already years ago, that the regulatory effects could 'be better achieved at Union level' due to the reason that financial markets are interconnected, to some extent, and cross-border elements are essential for the phenomenon. This approach could be seen, theoretically, as a 'legislative proactive manner' to enhance the operational environment of finance in order to tear down barriers of cross-border interaction and to promote financial market actors to expand and establish their operations around the Single Market. Furthermore this could be seen as a Union's legislative method to improve efficient capital formation in its regime.

Though, nowadays the aforementioned discussion can be considered solely academic. The policy approach itself, which Union has adapted during recent decades, already illustrates that financial market regulation is to be considered a branch of law under EU's jurisdiction. Also Union's clear goal has been to support more integrated financial markets in its region.

The progress in developing Union's financial regulation has been incremental and slow due to the debate concerning appropriate mechanisms and content of the regulation. Until now financial legislation is not completely harmonized by Union laws among member states. Still significant enhancements have been made especially after the most recent financial crisis. At least after the mentioned crisis in 2008 it has been obvious that unitary Union wide measures are needed not only in policy harmonisation but also in incorporating new supervisory entities.

The modern day financial markets arguable fit in to Union's 'exclusive competence' and / or at least the regulatory effects can 'be better achieved at Union level'. Even though all and every aspect of financial legislation is not

harmonized by Union laws, through the aforementioned principles, existing regulation and established entities unitary regime arguable exists in the Union.

The Union law principles do not only establish EU entities as active actors in relation to international financial cooperation but they can also be used as guidelines and basis for this cooperation. The Union's approach to securities regulation has incrementally developed within the philosophy of harmonized disclosure standards and mutual recognition; host country recognises the legitimacy of home country rules.[117] When examining the possibilities of deeper transatlantic cooperation the applied EU procedure should be kept in mind. It might turn out to be useful practice to confront regulatory issues in wider cross-border sense.

Therefore it is worthwhile to scrutinize certain established practices and principles of the Union law even further. Regarding this study the main concern shall be on the principle of Mutual Recognition due to the reason that it can be considered the most applicable regarding the cooperation on international financial markets; given the fact that the main goal of the study is to examine possible transatlantic cooperation opportunities on financial markets.

4.3.3 EU's financial regulation and supervisory structure

As mentioned above, the EU's approach in enhancing financial regulation in its regime has concentrated on the basis of mutual recognition and partial harmonisation. During the 2000 and especially after the recent financial crisis the philosophy that Union should do more has gained ground. Herein, as follows, are listed a few major passed legislative initiatives regarding securities market regulation in EU (the list of initiatives presented herein is not comprehensive). After that the focus shall be turned to few specified topics and to briefly compare differences between the US and EU as well as to examine cooperation possibilities between the jurisdictions.

As an important first enactment achievement can be considered a Prospectus Directive in 2003. The Directive sets out the required principles for securities

[117] Scott 2012, p. 305.

that are offered to the public in primary markets or admitted trading in secondary markets.[118] The disclosure requirements are determined in accordance with the information requirements set out by IOSCO.[119] The Transparency Directive which was adopted in 2004 was to increase investor protection and transparency by setting out ongoing reporting standards for publicly listed companies on exchanges.[120]

Also in 2004 the Directive on Markets in Financial Instruments ("MiFID") saw daylight.[121] MiFID has already been set to renewal; the process has been divided separately to Market in Financial Instruments Regulation ("MiFIR") and MiFID II. Whereas, MiFIR is regulation from its nature and directly applicable, when MiFID II is supposed to be a directive which should be implemented by Member States. MiFIR contains provisions on transparency, exchange trading of derivatives, product intervention and services by non-EU firms. MiFID II on the other hand includes the provisions on authorisation and operating conditions on investment firms, passporting of activities across the EU, investor protection and powers of national authorities.[122]

European Market Infrastructure Regulation ("EMIR") delves into Over the Counter ("OTC") derivatives and their clearance procedures in order to promote transparency. Alternative Investment Fund Manager Directive ("AIFMD") on the other hand will regulate hedge funds and private equity funds.

In this study the closer look shall be directed mainly to AIFMD and at some points to EMIR. This approach is supported by the fact EMIR and AIFMD have already been under scrutiny in relation transatlantic cooperation between authorities in both jurisdictions.

Parts of the aforementioned directives have already been supplemented or amendment procedures are on the way, to some extent. The main notice to be considered, regarding regulatory environment as a whole, is that a

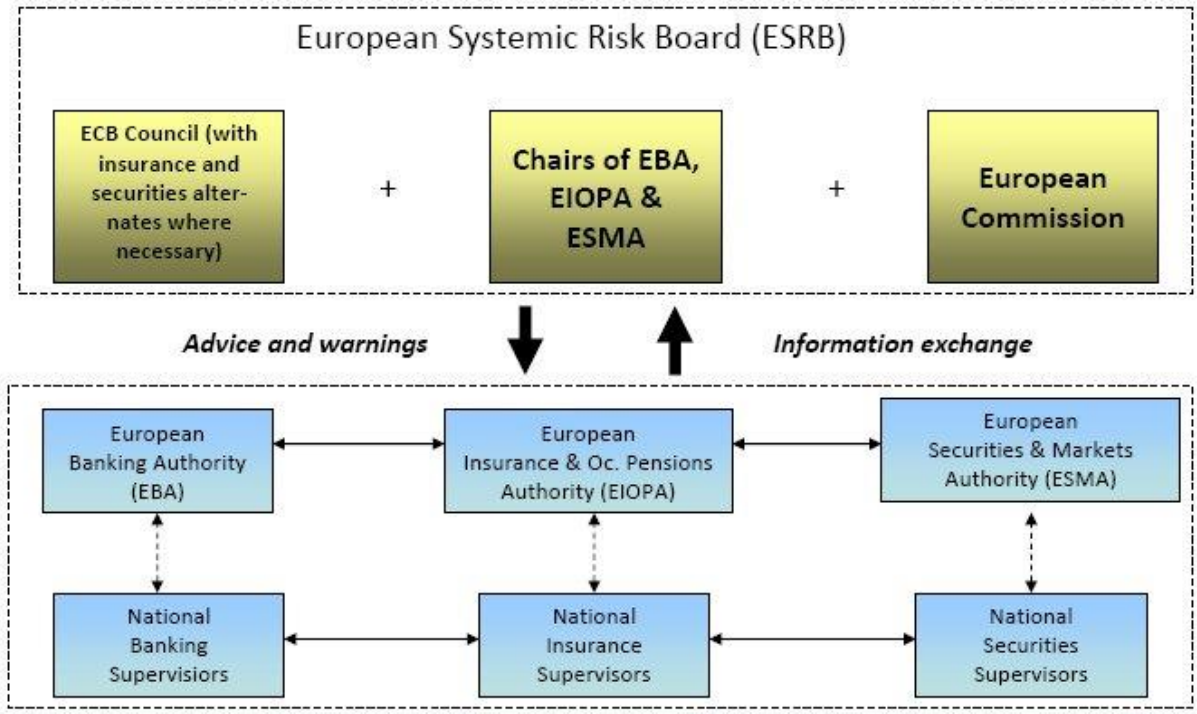
[118] Directive 2003/71/EC.
[119] Scott 2012, p. 311.
[120] Directive 2004/109/EC.
[121] Directive 2004/39/EC.
[122] For example Green 2011.

considerably unitary and new policy framework / regime has been established in the EU to strengthen Single Market's securities regulation, though there is still some work to be done in order to achieve as harmonised regulatory infrastructure than in US.

In conclusion it can be stated that EU has taken wide and strong initiative to enhance securities regulation under its jurisdiction. Though, the regulatory framework can be criticised fragmented and complex.

Newly established regulatory entities and their mandate shall be assessed on the following paragraphs.

In 2000 European Union's Economic and Finance Ministers ("ECOFIN") requested so called Wise Men Committee or 'Lamfalussy Committee' to recommend regulatory changes that could improve the functioning of the European Securities Markets. Some of the aforementioned regulatory initiatives derived directly from this committee work. Also the supervisory infrastructure started to evolve to correspond better to international operational environment of the financial markets. It is not useful to delve into details how the contemporary financial market supervisory framework was established but only to illustrate the current structure of it as follows:



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For securities supervision ESMA is the key entity. Therefore in this study the main interest revolves around ESMA; its jurisdiction and ability act on Single Markets and represent the Union towards third parties as mainly in actions with the SEC. What comes to ESMA's mandate; according to the establishing regulation ESMA's main goal can be condensed, as follows:

The objective of the Authority shall be to protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, for the Union economy, its citizens and businesses. The Authority shall contribute to:

> *(a) improving the functioning of the internal market, including in particular a sound, effective and consistent level of regulation and supervision,*
>
> *(b) ensuring the integrity, transparency, efficiency and orderly functioning of financial markets,*
>
> *(c) strengthening international supervisory coordination,*

[123] Supervisory Framework, ESMA Web page.

(d) preventing regulatory arbitrage and promoting equal conditions of competition,

(e) ensuring the taking of investment and other risks are appropriately regulated and supervised, and

(f) enhancing customer protection.[124]

The jurisdiction and justification of the ESMA is well established in its founding Regulation and in other related documents thereto (hereinafter jointly "ESMA's charter"). In the aforementioned Regulation's Article 1 it is referred that ESMA should strengthen the international supervisory coordination. Furthermore, it is noted in the preamble of the Regulation and in various Articles of the importance on enhancing coordination and cooperation among international supervisors:

"…the Authority [ESMA] *should foster dialogue and cooperation with supervisors outside the Union. It should be empowered to develop contacts and enter into administrative arrangements with the supervisory authorities and administrations of third countries and with international organisations…"*[125]

"Those arrangements shall not create legal obligations in respect of the Union and its Member States nor shall they prevent Member States and their competent authorities from concluding bilateral or multilateral arrangements with those third countries."[126]

Why are these Sections of the ESMA's charter important? These explicit notes deliver to the ESMA its mandate, and the scope of it, in relation to international actions. Together ESMA's mandate in its charter and newly passed legislation can be seen serving as a comparable regulatory regime with which US entities could cooperate.

[124] EU Regulation No. 1095 / 2010, Article 1(5).
[125] Ibid, Preamble (44).
[126] Ibid. Article 33 (1).

4.4 Comparability and / or equivalence of Dodd-Frank Wall-Street Reform / Consumer Protection Act ("Dodd-Frank") and EU legislation

As mentioned before, yet it can be considered too early to state explicitly what implications to practice the recently enacted legislation has. There is still a lack of comprehensive and substantial number of studies in this regard. Also the newly established legislations have not been tested and there is a lack of jurisprudence. The U.S. government's supervisory authorities still have a lot to play how they deliver the 'Dodd-Frank rulebook'. Still many of the massive 1000 page bill's rules are to come in force incrementally during the upcoming years. SEC itself described the process on April 2014 as follows:

"That Act [Dodd-Frank] contains more than 90 provisions that require SEC rulemaking, and dozens of other provisions that give the SEC discretionary rulemaking authority. Of the mandatory rulemaking provisions, the SEC has proposed or adopted rules for more than three-quarters."[127]

Dodd-Frank's differences with EU's EMIR and AIFMD have been assessed by law firms and risk management entities.[128] It can be concluded in general that there are differences between the legislation but they can be seen as comparable in respect of cooperation possibilities. Further on in this study it shall be assessed few key points in light of cooperative agenda, which differences the authorities might have to solve. Especially in relation to AIFMD of which has arisen certain debateable political hot spots.[129]

[127] Dodd-Frank process SEC webpage.
[128] Linklaters and MOFO.
[129] Scott 2012, pp. 978-979.

5 Recent flaws – what behaviour and / or actions need to be set under international regulatory scrutiny?

5.1 Perspectives on recent financial crisis

So, what has gone wrong or which behaviour is needed to be tamed for in the international financial markets? It has been widely understood that certain wrongdoings and / or systematic flaws led to the widespread delivery of e.g. complex subprime-products across the international finance system without proper transparency on nature of the mentioned products. This eventually shook the market infrastructure into chaos and derailed the economic growth path to worldwide downturn.[130]

We shall assess which concrete perspectives the theoretical discussions may provide to the debate on restructuring the regulatory infrastructure of international financial markets. The root cause(s) of the financial crisis, and the followed slow economic growth pace across the developed countries, might be impossible to determine. Nevertheless, some essential flaws are recognized quite multifaceted among analytics. Lack of investor protection, lack of transparency on products and services and lack of harmonised control in relation to recognizing the potential factors of systemic risk, are all to be named as flaws that prevailed in the international financial markets before the crisis.[131]

Considering that the regulatory tasks, for e.g. both ESMA and SEC, requires the mentioned entities to protect investors and safeguard the transparency and avoidance of systemic risk on financial markets, it can be concluded that regulators should be interested in, and even forced, to improving these issues.[132] Furthermore, when it has concluded that financial markets are international in a sense that transactions are conducted cross-border basis on these jurisdictions, it is fair to argue that the mentioned regulatory tasks should also be completed on inter-jurisdictional level cooperatively.

[130] Scott 2012, pp. 685-766 and Coffee 2009.
[131] Ibid.
[132] Ibid.

One suitable solution to understand the existed regulatory problems might be 'benign big gun' illustration.[133] The theory has it that regulators should treat regulated entities well, possibly by means of proper incentives also. If the trust is broken then regulators should respond with punishments, in accordance with the severity of the breach. The success of this strategy depends on the ability to be credibly tough but at the same time reasonable.[134] On financial regulation, UK's Financial Services Authority ("FSA") has been criticised to be unduly light-touch and on the other hand U.S. SEC has a fame to deliver complex and hard to comply regulation that signal mistrust for anyone participating with the financial markets.[135] Though, when it comes to SEC's ability to tame the dirty big guns, their actions are more symbolic.[136] In the light of Benign Big Gun approach, it could be argued that regulators failed to set reasonable incentives in order to guide market participants to do well. At the same time there was a lack of tough enforcement measures taken proactively even supervisors had the reasonable information and a change to conduct such enforcement measures[137].

On this regard cooperation could serve to detect the risks that misbehaviour creates. Regulatory cooperation could at its best combine the aspects of soft law orientated 'light touch' and mandatory requirements by setting appropriate amount of different types of disclosure requirements. Cooperative arrangements might also trim the costly duplicative standards. Therefore cooperative approach includes both possibilities: to treat regulatees well by decreasing their transaction costs but also it facilitates the possibility to take enforcement actions when misdeeds are detected. Of course the problematic question over enforcement measures and lack of international tribunals would still be present.

But the question, which sort of approach to use when contemplating the international financial market regulation revolves and revolves over and over again. Should it be considered that financial market actors are greedy and

[133] Juurikkala 2010, p. 16.
[134] Ibid.
[135] Ibid., p.16-17.
[136] For example Partnoy 2003.
[137] SEC lawyer testimony.

selfish which need harsh scrutiny, heavy compliance practices and fierce punishments. Or could there be found some suitable solution, which can be argued by theories and applied into practice that could in the end of the day benefit all participants to some extent? Or is it too idealistic to even assume so?

For example, imagine if deeper cooperation between the regulatory authorities across borders could decrease some of the transaction cost for participants that are operating in a multi-jurisdictional environment. Would this touch deliver an incentive to comply, in a theoretical sense, with the current and / or future regulation in a more diligent way in order to serve authorities on proactive prevention of market failures and possible frauds?

Addressing this question is complex due to the fact that, as all individuals, the financial market actors may not be categorised by their actions or motives behind them. It could be concluded that certain participants on the financial markets are surely willing to play by the rules and their motive behind the participation is legitimate need for funding and / or investment opportunities. On the other hand it is obvious that speculators and rule twisters exist and have always existed among market actors. Given this multifaceted environment the regulation should also be able to serve all the angles of it: to encourage the ‘well doers’ to save and invest in order to create flow of capital and liquidity on the markets but also to restrict the possibility and eagerness to ‘misbehave’ that might create systemic risk and deteriorate the legitimacy of the financial markets in the eyes of audience and possible investors.

5.2 Is there a need for international financial regulatory cooperation?

If it can be argued that financial activity needs special regulation and oversight, how come the multi-jurisdictional scrutiny is in place? Even though it can be argued that financial markets need some sort of special regulation due to its unique characters and that the markets have influence and cross-border aspects, does it necessary mean that international regulation should be delivered?

In case some human activity is considered to be controlled with special regulation and rules, then it can be considered, by analogy, that whilst the phenomenon transforms its form, the regulation has to follow. To put it bluntly: when the world around evolves and changes the regulation should adapt too. As defined on previous sections, the financial markets nowadays are constructed on cross-border basis and internationality in its all forms is utterly present on those markets. Therefore it is appropriate to raise a question how the regulatory framework could be improved in order to adapt to the prevailing conditions of the real world.

When it comes to regulation of financial markets, it has been concluded that market regulation must reflect the market reality.[138] Therefore it can be stated that while financial markets have become more and more interconnected, the regulatory touch should transform also. The remaining question is how the regulatory developments should be initiated and which could be the most appropriate approach to step forward in enhancing the international financial regulation? It is worth to notice that a suitable way to confront the issue would be a transatlantic perspective, given the historical and cultural background and the market reality.[139] The transatlantic perspective would mean the EU-US based regulatory cooperation. Herein as conclusions it is worthwhile to raise a few questions that can serve as base to forthcoming studies which are to contemplate the regulatory cooperation on international financial markets between EU and US.

Especially the following questions are relevant to place under scrutiny: A) How to weight investor protection against efficient capital formation in an equitable and efficient way, B) what could be the practical applications for regulatory cooperation.

The question A can be confronted by contemplating Law and Economics in a critical perspective. The concept of ‘New Property Law’ can also serve as a ‘tool box’ for exploring the question in light of ‘fundamental right sensitiveness’[140]. For Question B the suitable approach could be examining

[138] Greene 2007, pp. 16–19.
[139] AmCham 2012, p. 17.
[140] Pöyhönen 2000, p. 78.

the recent actual developments on regulatory cooperation between the authorities across the Atlantic. Finally the goal could be to combine theoretical and practical aspects in order to find some possible useful implications to future regulatory processes. It can be considered that studies on this regard would be reasonable and useful to conduct.

On the following sections it is contemplated the possible regulatory approaches that could be adapted to construct a better operational environment, in legal sense, on international finance.

5.3 Possible Regulatory approaches

The treaties between sovereign nations regarding international financial regulation are seldom; especially when it comes to complete harmonization of the legislation. It seems that national governments and regulatory entities have had the tendency to consider that binding treaties and strict harmonization of the legislation are not the key factors in enhancing the progress of contemporary financial regulatory architecture. Though, in international level there are certain cooperation bodies to deliver non-binding guidelines and / or principles in which the financial regulation should be constructed for. The most appropriate and contemplated entity, regarding this study, is the aforementioned IOSCO and its principles. IOSCO covers basically all the significant market supervisors and regulatory entities around the globe. IOSCO principles are not binding in nature. In juridical typology they can be determined as information guidance which purpose is to state highly generic principles for best possible regulation.[141] The nature of this type of guidance is to provide an equal opportunity to learn best possible practices from corresponding entities. This factor emphasises the fact that certain regulatory competition is also in place to facilitate the possibility of legal innovations regarding regulation.

[141] Ferran 2011, pp. 4-14.

EU's securities regulation is developed, especially in recent years, with partial harmonisation of regulation on financial market legislation. Clear trend on this regard can be pointed out, as determined previously on this study.

If the treaties itself are not seen as appropriate measures in order to enhance international regulatory cooperation, it can be argued that a combination of regulatory choices might serve as a suitable option. The information guidance principles from IOSCO for example serve as functional basis to steer regulatory processes. The political declarations have the same generic impact. Together they form a base for partial harmonisation that could serve the global financial infrastructure in order to mitigate possibilities of regulatory arbitrage and forum shopping. These guidance principles also have the benefit that they do not outplay the possibility of healthy regulatory competition.

It could be characterised that after this partial harmonisation there is room for regulatory cooperation in terms of supervisory entities' administrative agreements. They serve as a soft law orientated approach. The agreements are not binding in nature but they determine the basis by which regulators can apply information sharing mutual recognition and substituted compliance procedures whenever it is considered convenient e.g. ad hoc basis.

Even though the above illustrated approach might seem very authorities' orientated solution, it does not exclude self-regulatory possibilities. The future regulatory process on financial markets can be seen as an incremental combination of different perspectives to confront the topic. Given the complexity of the phenomenon regulation also needs to be innovative and flexible by all possibly means.

5.3.1 What mutual recognition and substituted compliance means?

In EU context the principle of mutual recognition is applied. The substituted compliance on transatlantic perspective could and should function with the same procedure. The function of the principle should be constructed on reciprocity.

It can be considered that when legal systems are built on comparable cultural, legislative and operational environment there can be arguably reasons to apply ways of mutual recognition. In EU and US legal infrastructure and financial market oversight are based on considerably diligent and efficient compliance patterns. Therefore it can be argued that forms of mutual recognition might be applicable in transatlantic context.

Mutual recognition in EU is the principle that a product lawfully marketed in one Member State and not subject to Union harmonisation should be allowed to be marketed in any other Member State. By this conduct the national authorities recognise and respect the regulatory / supervisory resolutions executed by other jurisdiction's authorities.

Substituted compliance should function on similar principles. When a cross-border entity or certain product is under regulatory scrutiny and disclosure requirements in its home jurisdiction, the host jurisdiction's authorities withhold from certain compliance requirements by substituting their own surveillance with home jurisdiction's regulatory / supervisory actions and thereby granting and exemption on certain requirements.

Mutual recognition and substituted compliance can be determined as combined means of mandatory legislation and soft law on regulatory cooperation. They might also be seen as partial harmonization of legislation. The core principle of both concepts is reciprocity. In order to function properly there needs to be comparable regulatory regimes that are based on certain similar legal principles. The supervision and enforcement aspects are also to be considered essential; they need to be equivalent enough to meet the purpose of these procedures.

EU's successful history in relation on mutual recognition can be put to use while assessing the possibilities to apply this approach on transatlantic convergence. In EU the mutual recognition is binding in nature, excluding few exemptions. In the transatlantic cooperation mutual recognition and / or substituted compliance might serve better when implemented by soft law basis which allows the ad hoc evaluation and flexibility. It can be argued that best possible and realistic ways to conduct these arrangements are MOUs between

regulatory / supervisory organisations. This means that regulatory cooperation regarding every product, service provider and participant should be taken under consideration individually and a flexible administration agreement (MOU) on this regard could be completed on each particular case.

6 Mechanisms to understand, illustrate and evaluate forthcoming proceedings

6.1 Legal 'Trickle-down effect' on global decision making in relation to international financial markets

In order to illustrate and understand the recent decision making process on international financial regulation I have created a concept of 'legal trickle-down effect'[142]. The concept shortly describes procedural elements by which the recent reforms have been (and can be) passed and implemented from G-20 declaration as actual international rules. The concept assesses how the efficient cooperation between financial supervisors and regulators on cross-border perspective (multi-jurisdictional cooperation) can actually be a crucial element for rulemaking in relation to international financial markets. Therefore it illustrates how international financial regulation 'trickles down' from declarative statements to a point where regulators / supervisors are the main actors in international rule creation, instead of legislators.

When it seems that treaties are a too heavy instrument to deal with the issue, some alternative solutions are to be sought. The experience from the UK shows also the flaws of SRO orientated approach.[143] The recent 'case evidence' has shown that declarative general (soft law) principles to enhance the financial regulation are to be delivered from top down politically (G-20).[144] After this the legislators under their jurisdictions have delivered independently certain legislative initiatives implementing the declared principles as they have seen appropriate to fit the purposes on their home jurisdiction. The described practice could be systemised as a soft law orientated partial, non-binding, harmonization of regulation between jurisdictions. It is challenging to evaluate in which depths the legislative initiatives have been prepared in means of cooperation between jurisdictions. FSB of BIS and IOSCO have served as proactive parties building a newly established financial regulatory

[142] It is worth to notice the difference of economic and political terms of 'trickle-down' in comparison to legal one. In economics and politics trickle-down refers to theory of laizzes faire capitalism in which it has been taken for granted that eventually the welfare will 'trickle-down' for lower layers of society without governmental actions in relation to entitlements.
[143] Coffee 2009, pp. 35-36.
[144] The Statement 2009.

cooperation[145] but their power to guide the national legislative initiatives is hard to be measured. Nevertheless, the most interesting part on constructing the contemporary financial regulatory architecture evolves from the actions which are taken after the national legislative procedures. The convergence has been sought from regulatory / supervisory cooperation. This approach illustrates the possibilities of the mutual recognition / substituted compliance measures which could enhance both transparency and efficiency on the markets. For the purposes of this study the transatlantic case example is the most suitable illustration.

Memorandums of Understanding are a form of regulatory cooperation agreement. In legal hierarchy these MOUs could be systemised as non-binding intergovernmental agreements, which have steering power but no significant enforceability. They could be defined as juridical base which legitimises cooperation for governmental authorities. Therefore their legal weight is somewhere between SRO rules and decrees. So what makes these MOU's so interesting?

In their core is the idea and will to enhance cooperation on transatlantic financial market regulation. Certainly the MOUs are not creating any sort of concrete initiative to harmonization of legislation nor even binding forms of mutual recognition or substituted compliance. At least these administrative agreements are an endeavour where supervisors on both sides of the Atlantic are establishing their mandate for international cooperation. Especially this could be seen as an important step for ESMA which is a newly born organisation. Therefore these agreements justify and fortify ESMA's position as a seriously taken organisation on the field of international regulatory cooperation.

The core purpose of these administrative agreements (MOUs) is enabling information sharing and regulatory actions between supervisory authorities. If the possibilities of these agreements are properly used, the information sharing can increase transparency on the markets without creating unnecessary duplicative disclosure requirements and compliance obligations

[145] FSB working paper 2014.

that have a tendency to increase transaction costs and harm efficient capital formation. By using these regulatory cooperation agreements in practice the regulators itself create new actual rules (regulation) for international financial markets. The nature of these rules can be seen as a mixture of mandatory legislation and soft law orientated guidance. When put to use in practice incrementally they can create a tradition for future international regulation.

This final concrete rulemaking phase of 'legal trickle-down effect' shall be quickly examined on next section.

6.2 How to apply this approach – case example of AIFMD and Dodd-Frank?

Alternative Investment Fund Manager Directive ("AIFMD") is one suitable example to contemplate in this study regarding transatlantic regulatory cooperation. The implementation of the directive itself is politically and economically a hot topic inside the Union as well as on transatlantic cross-border sense. AIFMD is a directive that concerns the regulation on e.g. Hedge Funds and CRAs that are both often utterly interconnected across the Atlantic and multijurisdictional entities. Also some say that the mentioned entities were part of the root cause(s) of the recent financial crisis in 2008.

When assessing the appropriateness of AIFMD itself and international cooperation pertaining to it, investor protection and efficient capital formation can be seen colliding. This reflects a basic juridical question: to which limit certain fundamental rights should be protected and by which means. Also it challenges to think the purpose of the regulation and by which means these set goals can be best achieved.

Therefore the question over AIFMD can be seen as a challenging topic for regulation theory and law and economics. It is also interesting to contemplate what concrete possibilities for cooperation there are in this regard; on transatlantic regulatory point of view.

As described above, the illustrative concept of 'legal trickle-down effect' serves as a way to understand how the contemporary regulatory processes are put into practice from declarative ideas to actual international rules. On 2013 SEC

and ESMA entered into an administrative agreement (MOU) regarding AIFMD and current U.S. regulations (mainly Private Fund Advisers Registration Act).[146]

The core of this agreement is *"to consult, cooperate and exchange information"*[147] regarding entities that operate on a cross-border basis. Basically this covers CRAs and Hedge Funds that are functioning on cross-border basis. This *"cooperation will be primarily achieved*" by *"informal, oral consultations, supplemented by more in-depth, ad hoc cooperation*".[148]

"Cooperation will be most useful in, but is not limited to, the following circumstances where issues of regulatory concern may arise: a) The initial application of a Covered Entity for authorization, registration or exemption from registration in another jurisdiction…"[149]

Hereby the MOU delivers an example on which grounds regulators can implement information sharing, mutual recognition and substituted compliance measures on particular cases, if needed. Yet, the practice on this regard is missing.

The aforementioned citations to the MOU concludes the findings of this study that after the heads of states have declared (G-20) the need to enhance regulation on financial markets and the legislators under their jurisdictions have passed enabling legislation, the final phase of supervisory and enforcement actions can be conducted by regulatory / supervisory entities through these administrative agreements. On the final phase of this study I will contemplate the main questions what regulatory / supervisory entities could weight while completing these cooperation duties under the mentioned agreements.

[146] ESMA / SEC, MOU.
[147] ESMA / SEC, MOU Article 2.
[148] Ibid.
[149] Ibid. Article 3.

7 Conclusions

7.1 Regulators mandate for international cooperation and rationale to act

One of the core purposes of this study was to assess the mandates for financial regulatory / supervisory organisations regarding their ability to international cooperation. The interest was on transatlantic entities, especially on ESMA and SEC. As it has been concluded the aforementioned entities possess the ability to participate on regulatory cooperation. Some might even argue that their fundamental existence requires them to do so; given the fact that the operational environment of international financial markets has converged and multi-jurisdictional operations and participants are reality in the contemporary nature of the financial markets as illustrated in the study.

It can be concluded that all the elements for transatlantic regulatory cooperation are in place. The main questions revolve around the problems how to conduct this cooperation and which are the key perspectives to assess regarding possible cooperation. The last sections of this study are devoted to contemplate obstacles and possibilities for such cooperation as well as to legal weighting that needs to be executed in particular resolution situations.

7.2 Conclusions and perspectives on possibilities for future cooperation; legal weighting concerning the resolution situations

It may very well be stated that in order to comply with widely recognised IOSCO-principles for sound financial markets, the regulatory entities need to focus on one essential commodity: information. Information is money on financial markets. In contemporary society value of information and value of marketization are clear tendencies, as noted for example in the context of New Property Law.[150] Individuals characterises themselves as market actors and by market terms. Therefore it might be argued that cooperation in international regulatory environment needs to be assessed in light of these tendencies affecting in societies.

[150] Pöyhönen 2000.

In this chapter it shall be dealt the aspects regarding authorities' possibilities to regulate the information on transatlantic financial markets in an appropriate manner as well as authorities' possibilities on safeguarding the functioning market environment. Few essential questions which will be under juridical weighting with pro et contra arguments, in light of relevant theoretical aspects and political reality, are assessed. This assessment can serve as base not only for regulators but also in all types of legal resolution situations pertaining to the matter. Four examined aspects are as follows:

i) investor protection versus efficient capital formation
ii) freedom of investor versus governmental paternalism
iii) mandatory legislation versus flexible soft law approach
iv) European versus American approach to cooperation

As discussed above regulation of financial markets is a multifaceted problem which spreads across legal branches. Therefore, when conducting these final assessments the phenomenon is intended to be contemplated in comprehensive manner in which all borderlines between legal branches are disregarded.

Investor protection vs. effective capital formation

IOSCO principles, federal legislation in the U.S. and EU's regulations and directives are constructed more or less with the same fundamental goals. Also the regulators / supervisors across the Atlantic have a comparable fundamental mandate which they should promote, as noted in this study. Finding the balance between appropriate investor protection and facilitating the efficient capital formation, is a core issue to solve in relation to regulatory cooperation. It can be stated that many times these goals collide and legal weighting need to be executed. At first, in every particular resolution situation there should be recognised the operational environment of the contemplated issue as well as participating interest quarters and their possible risk positions.

When these issues are recognised, particular regulatory solution can be sought. Normally all the participants for certain type of financial activity have

their positions covered by one or more fundamental rights. When contemplating investor protection versus efficient capital formation, it can be seen that property protection and freedom of trade might collide on several resolution situation. As mentioned information can be considered essential commodity on financial markets, therefore the core of the legal weighting between parties could be seen as balancing between appropriate and sufficient transparency which serves and protects the fulfilment of the core of the fundamental rights for each party.

Under the concept of New Property Law this sort of balancing is defined as weighting in accordance with the transparency principle. To put it bluntly, weighting needs to be executed in order to safeguard all parties' sufficient fulfilment of their information interests. This weighting should be conducted in light of the principle of proportionality, with situation sensitive approach.

In practice when contemplating the content of regulatory cooperation or particular resolution situation it should be considered how it is possible to place sufficient information disclosure requirements in order to protect investors without harming too much the liberty of trade and efficient capital formation. Each situation, product and type of service provider should be evaluated separately without general doctrine. But aforementioned general tools can be put to use in all occasions. The principles of reciprocity, proportionality and equality should be used when evaluating regulatory approach to similar transactions in all market place.

The benefits of this approach are that each case can be evaluated in light of situation sensitiveness in order to conclude an appropriate resolution in particular case. The critics might state that this creates risks in relation to legal safety pertaining to lack of consistency on resolutions. But it can be argued that this evaluation process itself embraces equality which protects the legal safety on this respect.

The arguments in favour of investor protection approach are that with placing sufficient amount of mandatory disclosure requirements investors can genuinely assess their own risk position and also risk positions of other participants on the market. This enhances transparency also in relation to

regulators that they can detect possibly arising systemic risks and also proactively prevent frauds on the markets. Also the investor protection orientated approach increases the trust and fiduciary aspects between market participants and for markets itself. It can be argued that this approach increases the willingness to participate on markets and therefore in the long run increases liquidity, investment opportunities and decreases the cost of capital. Therefore enhancements on investor protection can be justified due to the reason that it facilitates economic growth, job creations and general welfare. Also investor protection itself can be seen as protection of fundamental proprietary rights and therefore it may legitimate public opinion towards financial markets.

On the other hand increasing disclosure requirements can increase transaction costs and can be seen as a partial intervention to liberty of trade. Disclosure standards can be criticised from their suitability. Following questions might be asked.

We might ask is it appropriate that more and more entities are obliged to produce publicly available information in order to promote transparency. What benefits it would provide, if amount of information would increase, given that we are already living in the middle of information flood in which essential knowledge is hard to contemplate comprehensively? Is producing information a value itself or should it have a concrete benefit in it? Is it enough that investors have more information or should the information be examined more closely by regulators? Is there sense to create regulatory burden unless there is no one that had the time to comprehensively investigate the provided data?

While balancing the appropriateness of disclosure standards it should be evaluated if there can be achieved concrete results by setting on a particular requirement. If explicit transparency advantage, which increases the confidence on the markets between participants or delivers regulators improved opportunity to supervise risks and prevent frauds, cannot be seen clearly, the standard should not be placed into practice.

Therefore it can be concluded that while regulators are contemplating the material content of their cooperation, they should always be able to justify their

actions regarding disclosure standards with clear benefit that regulatory action brings in relation to transparency. Otherwise the authorities should withdraw from the certain action.

Freedom of investor versus governmental paternalism

As stated in this study the securities law scholars tend to derive their juridical arguments pertaining to regulation from the concept of 'reasonable / rational investor'. When contemplating the regulatory cooperation and resolution situations, weighting should be executed between investor freedom and concept of governmental paternalism. While completing this weighting the idea of reasonable investor can be questioned, in light of the perspectives presented herein study.

Rationality of investors can be questioned as stated by behavioural economic scholars. But even though the rationality would be missing from particular transaction decisions, can governmental paternalism be justified or should the investors' freedom allow them to do mistakes on the markets. This question shall be assessed by balancing systemic risk perspectives with the individual freedoms.

Individual mistakes are part of the liberty of economic activity. But in which occasions this freedom to conduct mistakes should be tamed by governmental paternalism? Liberty of investor can be supported by argument that in case individual economic actors do not have the risk of failure, the whole concept of market economy in which failures are an essential part of it, is in question. Governmental paternalism on the other hand can be supported by argument that functioning markets itself has evolved as a fundamental right in principle and governmental obligation is to act in order to facilitate functioning markets. In regulatory cooperation weighting is to be executed between protecting the functioning markets and enabling the natural elements of liberty to failure.

Some might argue that functioning markets itself need the sufficient possibility of failure. But in this context failure can be seen as an action that creates systemic risk for functioning markets. Therefore it could be argued that

investors' freedom to fail need to be placed under regulatory scrutiny to some extent.

Once again, every particular resolution situation needs to be contemplated individually. Principal rule should be the protection of freedom of trade which includes liberty to fail. But in occasions when systemic risk comes in to play, there should be executed regulatory cooperation actions proactively where these risks could be mitigated. The problem of this approach is that there are numerous entry points for systemic risks and detecting them in a regulatory process beforehand might be challenging.

Regarding governmental paternalism a good argument by Lynn A. Stoutt, should be remembered. After losing their money on frauds that should have been detected by regulators, the investors rarely take it calmly without complaining the authorities of their inaction. Of course legal systems offer remedy option on this regard but the appropriate level of governmental paternalism should be implemented proactively in order to justify the legitimacy and functioning of the markets.

Mandatory legislation versus flexible soft law approach

As stated in this study, rules can be approached from various perspectives. The essential argument in every particular case should be the evaluation of how well the chosen mean serves the end in light of proportionality and appropriateness. The weighting between investor protection and efficient capital formation as well as balancing with investors' freedom to fail and governmental paternalism are the material part of the juridical choices for regulatory cooperation. Discussions between mandatory legislation and soft law approach as well as assessing the Europeanization versus U.S. perspective on regulatory cooperation can be considered procedural aspects of the cooperation.

Mandatory legislation would have the benefits that regulatory arbitrage and competition on the financial markets would decrease. Also mandatory legislation can be supported by the argument that soft law guidance is not

enforceable and does not constitute explicit obligations with sanctions if infringed.

Soft law orientated approach to deal with international financial markets regulation can be seen as a flexible approach. The administrative agreements between ESMA and U.S. which have been delivered as examples of cooperation in this study can be claimed to have the benefit that they leave more discretion in particular cases. Therefore soft law guidance on regulatory cooperation enables the situation sensitive weighting. Also it may very well be argued that certain amount of regulatory competition is vital in order to facilitate legal innovations. This supports the soft law touch.

Complete harmonisation of regulation and binding cooperation treaties can be argued to be politically unrealistic option, given the fact that pending transatlantic trade negotiations in relation to investment protection clauses and their dispute resolution are hindered by political opposition. Also it might be wise to consider that there should not be made a strict borderline for mandatory legislation and soft law orientated approach. Sometimes the chosen regulatory approach can include elements from mandatory rules and soft law guidance. They could be put to use simultaneously.

European versus American approach to cooperation

As contemplated in this study the U.S. has a long unitary (federal) history of financial regulation. On the contrary EU entities and unitary European approach are both notably young in this respect. Though, the academic discussions on convergence of international financial regulation have more history in U.S., EU has its benefits too. It is worthwhile to search guidance from the EU's history on incorporating 28 different regulatory systems and market places together. Also the EU authorities' freshness can turn as a benefit due to the reason that they do not have deeply rooted and established practices. Therefore they might be more flexible in adapting to the contemporary environment.

In generally, regulatory entities should abandon their trenches in relation to endeavouring to extent their extra juridical powers. This can be done by means of cooperation by administrative agreements that implement mutual recognition, substituted compliance and information exchange. But should this cooperation be approach more from American perspective or European?

American legal scholars on securities regulation have had the tendency to constitute their argumentation on the basis of 'rational investor' or 'reasonable investor'. Therefore their praxis has revolved around the question of efficiency and how juridical solutions can serve to support efficient capital formation and functioning markets. Also the U.S. financial markets are still the most attractive and liquid market place. Supported by the fact Chinese e-commerce giant Alibaba's recent IPO in New York. Therefore American approach can be stated as more suitable.

EU on the other hand has a substantial track record on mutual recognition and multijurisdictional intergovernmental operations. Given the fact that these might be the procedural elements for future cooperation, EU orientated approach can be supported. Also EU could deliver valuable aspects in relation to investor protection orientated arguments.

7.3 Final words – few principles

This study can be criticised as abstract and theoretical. Though, it was a suitable solution to picture international financial markets generally and theoretically as a multifaceted phenomenon so that the diversity of legal aspects pertaining to the matter in hand could be illustrated properly. One key purpose of the study was to contemplate the elements and framings of questions for forthcoming studies that can delve into the topic more in detail. In conclusion few final remarks need to be noted on this regard.

The current situation on the international financial markets is challenging in juridical perspective. Given the fact that there are no general treaty based solutions to supervise the interconnected markets, the juridical resolutions need to be sought elsewhere. Also the lingering problem is that there are no

intergovernmental regulatory / supervisory entities which had the power to implement enforcement actions with international jurisdiction. Also the international special tribunals are missing. Given the arisen tension on transatlantic trade negotiations on this regard, there is no enhancement on the horizon.

So, other solution should be implemented. One of the core assessments on this study was the possibilities for transatlantic regulatory cooperation. Regulation itself cannot solve problems that are economical by nature. Though, appropriate regulatory environment can serve as a risk prevention tool in order to detect, prevent and mitigate systemic risk and safeguard the functioning markets. Also regulation can serve as a tool to develop societies. On this regard the transatlantic regulatory cooperation has lot to offer.

As studied on the Thesis, information is essential commodity on the markets. Controlling and facilitating appropriate information needs for market participants should be the key element for regulatory cooperation. By controlling the disclosure requirements authorities can guarantee the appropriate level of transparency on the markets.

In particular legal resolution situation the authorities should contemplate the efficiency aspects as well as safeguarding the functioning markets and reasonable protection of fundamental rights. As stated before, a toolkit for legal weighting can include elements from fundamental right orientated balancing in order to protect appropriately the risk positions of the participants on the markets. Efficiency with transparency is not an oxymoron either. As mentioned, if appropriate level of transparency on the transatlantic financial markets can be guaranteed by regulatory cooperation, the transaction costs might actually decrease. This would in an idealistic situation improve efficient capital formation and functioning of the markets. Therefore the regulators should embrace cooperation and use comprehensive toolkit while executing particular operations on the grounds of administrative cooperation agreements. One important issue to contemplate in the future might be the question, which role the national supervisory authorities inside the EU would have in practice when the cooperation between ESMA and SEC is implemented.