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Channeling Competition in the Global Securities Market

*Stephen J. Choi**

I. INTRODUCTION

In the wake of Enron, WorldCom, and other recent scandals in the United States, several have called for regulatory reform. In response, Congress enacted the Sarbanes-Oxley Act of 2002 that, among other things, implements a new five-member auditor oversight board consisting of a majority of non-accounting professionals.[1] Sarbanes-Oxley also restricts the ability of firm managers to purchase a wide range of delineated consulting services from the same firm providing the outside audit of the firm's financials.[2] Similar calls for reform exist to separate investment banking and analyst services within the same financial house.[3] Soon, managers may no longer have the ability to influence an analyst's recommendation through the direction of investment banking business to the same firm. Even prior to the Enron and WorldCom scandals, the SEC and others have sought to limit the amount of choice available to corporate managers. In 2000, for example, the Securities and Exchange Commission (SEC) promulgated Regulation FD, limiting the ability of corporations to distribute inside information selectively to outside analysts among others.[4]

Perhaps the position of those who fear corporate choice is taken with good reason. Where managers of large publicly held corporations have a choice, ranging from the decision to pay themselves a high salary to the decision to hire an auditor for consulting services, managers may abuse this choice leading to a "race to the bottom."[5] On the other hand, for those commentators that argue

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1. *See* Sarbanes-Oxley Act of 2002, P.L. 107-204 §§ 101-09, 116 Stat. 745. The five-member oversight board tracks an earlier nine-member board proposed by the SEC. *See* Michael Schroeder, *Critics Take Aim at SEC's Plan for Auditor-Oversight Board*, WALL ST. J., June 20, 2002, at A2 (noting that "SEC Chairman Harvey Pitt has said the agency plans to unilaterally set up such a board by year's end").

2. *See* Sarbanes-Oxley Act of 2002, § 201.

3. The Sarbanes-Oxley Act directs the SEC or the securities exchanges (including the NASD) to adopt "not later than 1 year after the date of enactment of this section, rules reasonably designed to address conflicts of interest that can arise when securities analysts recommend equity securities. . . ." *Id.* § 501.

4. For an analysis of the desirability of Regulation FD, see Stephen J. Choi, *Selective Disclosures in the Public Capital Markets*, 35 U.C. DAVIS L. REV. 533 (2002).

5. For a discussion of the race to the bottom hypothesis, see Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1455–56 (1992); William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 705 (1974) (arguing that competition for corporate charters results in a race to the bottom). To the extent managers do not own all of the outstanding equity, they will have incomplete incentives to maximize the value of equity and may choose to increase their own net worth at the expense of shareholders. For a discussion of this agency problem, see ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 6 (1933) (noting that "[t]he separation of ownership from control produces a condition where the interests of owner and of ultimate manager may . . . diverge"). Managerial opportunism may become particularly problematic where managers may force firms to engage in a "mid-stream" shift. *See* Jeffrey N.

corporate choice is good, particularly with respect to the precise corporate and securities law regime that should apply to a specific company, the recent scandals in the United States pose a difficult critique.[6] How can we advocate for greater choice in regulatory protection when self-interested managers abuse the limited choice presently available to them? The same impulses that may lead managers to corrupt analysts and auditors through the provision of consulting and investment banking services may also lead managers to opt for progressively weaker investor protection if given the ability to select the governing corporate and securities legal regime.

Rather than provide a direct defense of the desirability of regulatory competition even in the face of Enron and WorldCom, this brief essay takes a different approach. The essay makes the argument that regulators themselves may face a number of perverse incentives in how they regulate. Leaving regulators with monopoly jurisdiction over issuers and investors may simply give regulators large latitude to expropriate value for themselves at the expense of investors. Regulators may also suffer from a number of behavioral biases in their decision-making. One of the biggest benefits of competition lies in constraining the actions of self-interested regulators laboring under behavioral illusions.

Moreover, those that oppose regulatory competition must contend with the fact that some degree of competition is already present among global financial centers. The clean vision espoused by supporters of the race to the bottom school of a monopolistic (and hopefully benevolent) regulator insulated from the pressures of competition and thereby able to take into account the interests of investors and third parties while avoiding pressure from corporate managers simply does not exist. Investors and issuers can generally obtain the regulatory protection of a particular regime through transactions within that regime's territory, for instance.[7] Significantly, competition among regulators today may often occur along dimensions other than investor protection. Regulators, for example, may seek to usurp authority over transactions

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Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1574 (1989) (noting that "mandatory law is a hands-tying mechanism that provides assurance against opportunistic charter amendment").

6. Proponents of choice in the regulatory regime governing a particular corporation found their start in the area of corporate law. Such proponents argued that choice among state corporate law regimes in the United States resulted in a "race to the top" toward better regulations from the perspective of investors. For a discussion of the race to the top argument, see FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 212–27 (1991); ROBERTA ROMANO, GENIUS OF AMERICAN CORPORATE LAW 2–12 (1993); Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913, 919–20 (1982); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 258 (1977).

In the context of securities regulation, several commentators have argued for greater regulatory competition. *See* Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903 (1998); Alan R. Palmiter, *Toward Disclosure Choice in Securities Offerings*, 1999 COLUM. BUS. L. REV. 1; Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998).

7. Indeed, many foreign issuers may seek to cross-list inside the United States specifically to bond the credibility and value of their offering as a means of obtaining a higher issue price. For a discussion of the bonding phenomenon, see John C. Coffee, Jr., *Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance* (Working Paper, 2002).

extraterritorially and prevent home issuers and investors from exiting the home regime.[8] Competition, therefore, may result in greater costs than benefits as regulators waste resources attempting to expand their own authority and block investors and issuers from escaping to other jurisdictions.

Even for those who fear a race to the bottom, the present multi-dimensional aspect of competition may, therefore, pose greater problems than a system under which regulators compete solely on the basis of supplied investor protection. To the extent turning back the clock and undoing decades of increasing integration between world financial centers is impossible, a move toward greater issuer choice may provide the better solution from the standpoint of investor welfare compared with the status quo. While commentators have noted that the self-interest of regulators may also make a move toward more unrestricted levels of competition based on investor protection difficult, the growing integration of world financial markets reduces the cost of implementing such a system of issuer choice.[9] Moreover, the high costs associated with the present multi-dimensional level of regulatory competition may spur greater efforts at allowing choice based solely on investor protection.

II. POLITICAL ECONOMY

Public choice theory provides a well-known critique of the incentives of regulators. Simply put, financial regulators may not always act in the best interests of investors.[10] Regulators acting rationally out of their own self-interest may attempt to expand the size of their agency.[11] Greater size leads to higher levels of prestige (and possibly compensation for regulators). The ever-expanding number and complexity of SEC rules and regulations provide some evidence for the size hypothesis. Similarly, regulators may tailor regulations to favor particular industry groups at the expense of dispersed investors out of a hope of obtaining a job within the industry once they leave the SEC.

In theory, regulatory competition over types of investor protection may help alleviate the public choice problems facing regulators. Once in a competitive environment, issuers will have a strong incentive at the time they raise capital from the public markets to install credible and effective forms of investor protection.[12]

8. For an early discussion of the costs of extraterritorial application of the U.S. securities laws, see Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Law*, 17 NW. J. INT'L L. & BUS. 207 (1996).

9. Frederick Tung, in particular, has advanced the argument that the self-interest of regulators may act as a barrier to choice of law rules that implement an issuer choice regime. *See* Frederick Tung, *From Monopolists to Markets?: A Political Economy of Issuer Choice in International Securities Regulation* (Working Paper, 2002).

10. *See generally* Jonathan R. Macey, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty*, 15 CARDOZO L. REV. 909, 926 (1994) (providing a public choice explanation for the continued existence of the SEC despite its obsolescence).

11. *See* W. A. NISKANEN, JR., BUREAUCRACY AND REPRESENTATIVE GOVERNMENT 38 (1971).

12. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 305–07 (1976) (noting that corporations have strong incentives to choose corporate law rules that maximize shareholder welfare at the time they initially go public).

Issuers that fail to do so may be forced to accept a larger discount from investors. Conversely, once protected, investors are more likely to price an offering higher. Issuers will then select a level of investor protection—whether provided through private contract or through a regulatory regime—where the benefit from receiving a higher offering price outweighs the added costs of such protection. Competition in theory, therefore, may lead to the joint maximization of the wealth of issuers and investors.

What we have today, however, is not solely regulatory competition over investor protection. Certainly, investors and issuers have much greater choice in the regulatory regime that governs their transactions than in the past. Greater integration between world financial centers is largely responsible for this greater level of choice. Several decades ago, most investors stayed within their domestic capital markets. Today, it is possible for U.S. investors to purchase securities (often through a mutual fund intermediary) of German companies from French investors in a transaction that occurs, for example, on the London Stock Exchange (LSE).[13] And with the choice of a particular financial market often comes a set of regulatory protective measures originating from the home country of the selected financial market. An investor that invests in companies trading on the LSE receives the benefits of the LSE's listing requirements (among other protection).[14] Of course, the present choice in regimes often does result in substantive changes in the level of investor protection. In the United States, for example, the threat that issuers and investors would otherwise go to offshore markets led to the promulgation of Rule 144A, among other provisions, on the part of the SEC.[15]

One drawback of the current level of regulatory competition is that it is not entirely clear what other countries may also have the ability to regulate a transnational transaction. Theoretically, four possible jurisdictions may take an interest in any one securities transaction. Consider the example above. The U.S. may care about its own investors (purchasing the securities); France may care about its investors

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13. This is not to say the choice is unfettered. Investors and issuers may very well have a bias to stay within their home country. *See* Stephen J. Choi & Andrew T. Guzman, *National Laws, International Money: Regulation in a Global Capital Market*, 65 FORDHAM L. REV. 1855, 1876 (1997) (noting that "[a]ll other things being equal, [] firms may desire to raise capital domestically due to several natural advantages of their home country").

> But even with a home field advantage, competition will occur as regulators attempt to keep those investors and issuers at the margin between staying at home and going to a foreign securities market. Moreover, the more ill-suited the level of investor protection, the more likely investors and issuers will exit despite the home field advantage.

Id.

14. For a discussion of the impact from listing on the LSE, see HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, 3F SECURITIES AND FEDERAL CORPORATE LAW § 28.9 (2d ed. 2002).

15. *See* Josh Futterman, Note, *Evasion and Flowback in the Regulation S Era: Strengthening U.S. Investor Protection While Promoting U.S. Corporate Offshore Offerings*, 18 FORDHAM INT'L L.J. 806, 840-41 (1995); Samuel Wolff, *Offshore Distributions Under the Securities Act of 1933: An Analysis of Regulation S*, 23 LAW & POL'Y INT'L BUS. 101, 112-16 (1991-1992).

(selling the securities); Germany may care about its own companies and the perception of the world generally about the credibility of German companies; and finally, Great Britain may care about the reputation of the LSE. Without a clear demarcation of regulatory authority, investors and issuers face uncertainty as to what regulations will apply to their transactions.

Given the uncertainty in the boundaries of regulatory authority, competition may spur a competitive response of a more detrimental kind among regulators. In particular, regulators from different countries faced with the possibility that issuers and investors may exit for the regimes of other jurisdictions may act affirmatively to block such an exit. Home country regulators generally enjoy the power to force domestically-located corporations and investors to remain under the home country regime regardless of the location of the transaction. In the United States, regulators have not in fact made this choice, allowing issuers pursuant to Regulation S the ability to partially escape the U.S. securities laws.[16] Nevertheless, the option remains available to regulators. Countries may place barriers on investors seeking to invest capital outside the country. Up until the mid-1990s, for example, Korea placed barriers on the ability of Korean investors to invest funds overseas.[17] Countries may also impose restrictions on the ability of a domestic company to follow the corporate laws of another country. Under the Korean Commercial Code, for example, a firm incorporated in a foreign jurisdiction is subject to all the provisions of the Code if it has its head office or main operation in Korea.[18]

Regulators may also seek to expand their authority aggressively. The United States, for example, presently fragments regulatory responsibility for various financial products among different agencies. The SEC has primary responsibility for the regulation of "securities."[19] The Commodities and Futures Trading Commission (CFTC) regulates "commodities" and "futures."[20] For the past several decades, the CFTC and SEC have engaged in costly "turf" battles over jurisdictional authority.[21]

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16. *See* 17 C.F.R. 230.901-05 (Regulation S). The exit option available under Regulation S is only partial. Issuers making an offshore offering may continue to face possible U.S. antifraud laws. As well, to the extent the issuer has a substantial number of securities trading in the United States (or is listed on a U.S. exchange), the issuer must comply with periodic disclosure requirements under the Securities Exchange Act of 1934.

17. *See* In-Kie Hong, *Securities Laws in Korea and Regulations on Foreign Investment*, 10 COLUM. J. ASIAN L. 157, 192-93 (1996).

18. *See* Korean Commercial Code, art. 617.

19. *See* 15 U.S.C. § 77b(1) (1994) (providing a definition of "security" for the Securities Act of 1933); *see also id.* § 78c(a)(10) (providing a definition of "security" under the Securities Exchange Act of 1934).

20. A futures contract is a standardized agreement involving a buyer and a seller. The buyer agrees to purchase a fixed quantity of a commodity at a specified date from the seller at a fixed price.

21. SEC officials during the 1970s feared that the term "commodity" encompassed even ordinary securities. Former SEC Chairman Roderick Hills noted in 1975 that "it is relatively easy to suggest that the most basic examples of what is unambiguously a security, such as a share of GM or AT&T, are literally within the definition of a 'commodity'. . . ." Letter from SEC Chairman Roderick M. Hills to CFTC Chairman William T. Bagley, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) P20, 117 (Nov. 13, 1975). The SEC's battle with the CFTC culminated in the Shad-Johnson Accord of 1982. For an account of the SEC-CFTC conflict leading up to the Shad-Johnson Accord and the inadequacies of the Accord, see William J. Brodsky,

While interesting from the perspective of public choice theorists, the turf battle between the SEC and the CFTC has generated large lobbying costs and distraction costs among regulators. Investors, moreover, have been left with a large degree of uncertainty and often have been simply locked out of certain types of financial products (including, up to recently, futures in single stocks).[22] As financial markets continue to integrate and transactions increasingly involve multiple jurisdictions, absent an international agreement, pressures will build on regulators to extend their jurisdiction extraterritorially to cover such transactions.[23]

Alternatively, regulators in one country may work to harmonize the level of investor protection across several countries to reduce the effective choice available to issuers and investors (and thereby the incentives of market participants to choose a different regime). The SEC, for example, for years attempted to obtain the passage of U.S. style insider trading laws in a number of countries.[24] Such efforts toward harmonization, however, are both costly and questionable in effectiveness. While many countries have adopted formal insider trading prohibitions, for example, only a relative few have ever enforced these prohibitions.[25]

In sum, where competition does exist, opportunistic regulators may compete not with better investor protection but rather with aggressive grabs of authority. Such grabs introduce both uncertainty costs for investors and may result in unwarranted levels of harmonization in securities laws. Moving back to a system of isolated islands of financial activity and regulatory authority, moreover, is simply not an option in today's global marketplace. Those opposed to increased levels of regulatory competition over investor protection must therefore consider that the alternative is not a clean, monopolistic regulatory world but rather the present multi-dimensional competitive regime.

New Legislation Permitting Stock Futures: The Long and Winding Road, 21 NW. J. INT'L L. & BUS. 573, 574-77 (2001).

22. The Commodities Futures Modernization Act of 2000 lifted the prohibition against futures in single stocks within the United States. *See* Commodities Futures Modernization Act of 2000, Pub. L. No. 106-554, § 1(a)(5), 114 Stat. 2763 (2000). For a description of the Act, see Brodsky, *supra* note 21, at 577-87.

23. Groups of countries have already entered into international agreements allowing for a degree of choice in the securities regulatory regime. *See* Howell E. Jackson & Eric J. Pan, REGULATORY COMPETITION IN INTERNATIONAL SECURITIES MARKETS: EVIDENCE FROM EUROPE IN 1999—PART I, 56 BUS. LAW. 653, 661-65 (2001) (describing the system of regulatory competition provided for in the European Union).

24. *See* Harvey L. Pitt & David B. Hardison, *Games Without Frontiers: Trends in the International Response to Insider Trading*, 1992 LAW & CONTEMP. PROBS. 199, 204-06 (reporting how Switzerland and Japan both adopted insider trading prohibitions under pressure from the United States). For a discussion of insider trading laws around the world, see Franklin A. Gevurtz, *The Globalization of Insider Trading Prohibitions*, 15 TRANSNAT'L LAW. 63 (2002).

25. At the end of 1998, 103 countries with stock exchanges prohibited insider trading, but enforcement had taken place at least once in only 38 countries. *See* Utpal Bhattacharya & Hazem Daouk, *The World Price of Insider Trading*, J. FIN. (forthcoming 2002), *available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=200914* (last visited Jan. 17, 2003) (copy on file with *The Transnational Lawyer*) (noting that prior to 1990, only nine of 34 countries with prohibitions on insider trading ever engaged in an enforcement action).

III. BEHAVIORAL BIASES

Even well intentioned regulators may face decision-making problems.[26] Regulators, typically, are experts in their field of regulation. Commentators have identified a great number of behavioral biases under which all people labor. Expertise may help alleviate some of these biases.[27] Certainly, many SEC staffers can claim a large degree of expertise in the functioning of the financial markets (as well as the various guises of fraud). However, with expertise often comes several behavioral illusions. Rather than catalog such biases systematically, this essay mentions a few biases particularly relevant to analyzing how regulators may make decisions.[28]

Commentators, for example, have noted that expert regulators may suffer from an overconfidence bias, believing too greatly in their ability to solve difficult regulatory problems.[29] Regulators may also make decisions with a tunnel vision-like view of a problem, applying a particular decision-making framework to all new problems uncritically despite the possibility that the framework may not apply. Regulators may also make decisions with bounded rationality. Not only is the information in the hands of regulators imperfect, but regulators may misinterpret the information in a systematic manner. For example, people often suffer from an availability bias, placing too great of a weight on more recent and immediate information.[30]

The availability bias, perhaps combined with overconfidence and tunnel vision, may then lead regulators and lawmakers into an overreaction when faced with a financial scandal.[31] Once in place, moreover, even regulations that are the product of an overreaction on the part of the SEC and lawmakers may take years to undo.[32]

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26. For an analysis of the behavioral problems facing SEC regulators, see Stephen J. Choi & A.C. Pritchard, *Behavioral Economics and the SEC* (Working Paper, 2002).

27. For a discussion of the benefit of expertise for certain behavioral biases, see Mark Seidenfeld, *Cognitive Loafing, Social Conformity, and Judicial Review of Agency Rulemaking*, 87 CORNELL L. REV. 486, 499-502 (2002); *see also* Jeffrey J. Rachlinski & Cynthia R. Farina, *Cognitive Psychology and Optimal Government Design*, 87 CORNELL L. REV. 549, 558-61 (2002).

28. For a discussion of the behavioral biases plaguing regulatory experts, see Seidenfeld, *supra* note 27, at 496-99.

29. *See* Seidenfeld, *supra* note 27, at 498-99. SEC regulators are particularly slow in revising their prior held positions, a symptom of perhaps overconfidence in their positions (among other things).

30. *See id.* at 501-02.

31. For a more detailed discussion of the impact of behavioral biases on SEC regulators, see Stephen J. Choi & A.C. Pritchard, *Behavioral Economics and the SEC* (Working Paper, 2003) (copy on file with *The Transnational Lawyer*).

32. *See* Stuart Banner, *What Causes New Securities Regulation? 300 Years of Evidence*, 75 WASH. U. L. Q. 849, 850 (1997) (contending that over the past 300 years the major pieces of securities related regulation came about following a large and sustained price collapse in the stock market).

As with public choice problems, competition may have ameliorative effects on behavioral biases among regulators. Regulators facing competition for investors and issuers from other jurisdictions have less leeway to make behavioral mistakes. Regulators and lawmakers may then have a greater incentive to structure their organizations to minimize the size of behavioral problems. Commentators have suggested, for example, bringing in decision-makers from different disciplines as well as employing review of agency decisions as a means of reducing behavioral biases.[33]

The present multidimensional degree of regulatory competition, nevertheless, may also amplify behavioral biases among regulators. Regulators faced with competition may—out of overconfidence or a cognitive dissonance need to justify their authority—determine that alternative regulators simply cannot protect investors as well as they can. Regulators suffering from behavioral biases may then act to obtain regulatory authority solely for themselves. So long as regulators may react to competition along dimensions other than simply catering to the interests of issuers and investors, securities market participants are vulnerable to costly actions on the part of regulators under the cloud of behavioral biases.

IV. CONCLUSION

Global capital markets are becoming more integrated. With the free flow of capital has come increased competition between different financial centers. Part of the competition centers around the level of investor protection provided through different regimes. Studies have shown that foreign companies, in fact, may choose the U.S. capital markets, for example, because of the higher level of investor protection provided inside the United States.[34]

For those in favor of increased regulatory competition, the growing integration of world financial markets is generally viewed as a positive occurrence. Nevertheless, this essay casts some doubt as to the value of regulatory competition along dimensions other than the supply of investor protection. Certainly, regulators may respond to the threat of foreign market competition through increased attention to providing the level of investor protection that maximizes the joint welfare of issuers and investors. Nevertheless, the very public choice and behavioral bias problems that competition may help alleviate also may result in regulators taking actions to seize regulatory authority from one another.[35] Regulators may compete not over the types and quality of investor protection but rather over jurisdictional boundaries and the

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33. *See* Seidenfeld, *supra* note 27, at 526-47.

34. *See* William A. Reese, Jr. & Michael S. Weisbach, *Protection of Minority Shareholder Interests, Cross-listings in the United States, and Subsequent Equity Offerings* (Working Paper, 2000), *http://papers.ssrn.com/sol3/papers.cfm?abstract_id=194670* (last visited Feb. 12, 2003) (copy on file with *The Transnational Lawyer*); *see also* Craig Doidge et al., *Why Are Foreign Firms Listed in the U.S. Worth More?*, (NBER, Working Paper No. 8538, 2001), *http://papers.ssrn.com/sol3/papers. cfm?abstract_id=286963* (copy on file with *The Transnational Lawyer*); Coffee, *supra* note 7 (summarizing the empirical evidence on cross-listings into the United States).

35. For a discussion of the public choice barriers to competition, see Tung, *supra* note 9.

extraterritorial application of law. Much as the turf battle between the SEC and the CFTC, clashing regulators on a world stage promises to result in increased costs and uncertainty for investors, reducing overall welfare.

Those who believe in regulatory competition must contend with the practical problem of exactly how to achieve greater levels of competition without incurring a backlash from regulators seeking to protect their regulatory turf. This, of course, does not mean that regulatory competition lacks merit. Indeed, those that take the view that regulatory competition will lead to a race to the bottom must contend with the reality that a degree of competition is already with us. Moreover, the present competition is more problematic compared to a regime under which competition occurs solely over investor protection given the possibility of turf battles and uncertainty. Investor welfare may be improved if we moved more toward a fully competitive system under which regulators could only compete along one dimension—the provision of investor protection.

The level of regulatory competition of course is not a given. While greater financial integration does lead to more competition, Frederick Tung has made the related observation that regulators will oppose any adoption of choice of law rules that allow the application of a foreign jurisdiction's securities law within a particular home country.[36] Whether in fact we will eventually move to a fully competitive system where regulators compete solely on the basis of supplied investor protection to attract issuers or investors, therefore, remains an open issue.[37] Reason exists, however, to be optimistic. The European Union, for example, already employs a regulatory structure that permits a degree of regulatory regime choice for issuers while curtailing the ability of individual country regulators to compete along other possible dimensions.[38]

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36. *See id.*

37. Of course, a country may nevertheless benefit through a unilateral move toward choice even if the rest of the world does not follow suit. *See, e.g.*, Stephen J. Choi, *Promoting Issuer Choice in Securities Regulation*, 41 VA. J. INT'L LAW 815, 847 n.115 (2001). The public choice problem, nevertheless, applies even in one country.

38. *See* Jackson & Pan, *supra* note 23, at 661-65 ("The mutual recognition provision creates a 'passport' under which an issuer from a different member state can choose to access the capital market of a host member state on the basis of having met the requirements of its home and not the requirements of the host.").

Jackson and Pan, nevertheless, present evidence that despite the choice available within the European Union, many issuers are simply avoiding the choice altogether, opting to use privately-determined levels of disclosure (mirroring U.S. style disclosures) in private placement style offerings. *See id.* at 654-55. Even where issuers are not actively selecting from among different regime options presented in the EU, the EU's competitive infrastructure, by allowing issuers to construct their own levels of disclosure in private placements free of interference from aggressive regulators that might otherwise wish to regulate such transactions within their home jurisdictions, allows private competition to center around the provision of value-increasing investor protection. *See id.* at 681-82 ("In compliance with the [EU's Public Offers Directive (POD)], the securities laws of member states must include a professionals exemption, which is analogous to the U.S. private placement exemption."). "Under this legal structure, as long as a European issuer plans its offering to include only institutional investors that qualify for the professionals exemption implemented under local laws, the issuer does not need to worry about local rules governing distribution of disclosure materials to local retail investors. . . ." *Id.*

Proponents of the race to the bottom school could offer an alternative response to the problem of multi-dimensional competition: global harmonization of securities regulations. Nonetheless, the costs for a move toward investor protection-based competition are undoubtedly lower than the costs of implementing global harmonization. A move toward investor-protection competition requires a one time enactment of choice of law rules forcing rivalry along the dimension of supplied investor protection (much as in the European Union). Global harmonization efforts, on the other hand, require an ongoing effort at determining the "right" level of regulations and obtaining repeated consensus among a number of different jurisdictions on every single new substantive regulatory provision (as well as assurances that enforcement in fact is taking place).[39] Competition, moreover, may potentially provide more benefits as regulators are spurred to provide value-increasing investor protection (in a way that regulators in a harmonized regulatory system may not necessarily face the same competitive incentive to do so).[40]

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39. Issuer choice, on the other hand, requires no ongoing consensus building among countries. Of course, individual countries may later attempt to modify an international agreement to allow an issuer choice regime once established. Nevertheless, issuer choice becomes relatively difficult to undo over time as investors and issuers come to rely on the availability of choice, forming a natural constituency in favor of issuer choice.

40. For a discussion of the perils of moving toward one world securities regulator, see Stephen J. Choi, *Assessing Regulatory Responses to Securities Market Globalization*, 2 THEORETICAL INQUIRIES L. 613, 643-45 (2001).