BOOK REVIEW

INTERNATIONAL SECURITIES REGULATION. By Norman S. Poser.*

Reviewed by PAUL G. MAHONEY**

At first glance, the title of Norman Poser's book, International Securities Regulation, 1 seems curious. The book focuses primarily on a single regulatory system, that of the United Kingdom. Specifically, it covers the set of market reforms and regulatory initiatives, known collectively as "Big Bang", that accompanied the abolition of fixed brokerage commissions on the London Stock Exchange on October 27, 1986. On another level, however, the title is perfectly appropriate. After Big Bang, London's securities markets rely on and encourage international investment to a greater extent than their New York and Tokyo competitors. 2 That the London Stock Exchange emerged from Big Bang as The International Stock Exchange was more than symbolic; it was an acknowledgment of the underpinnings of Big Bang's dramatic reforms. Any book about regulating the London markets, then, is also about regulating international securities transactions.

International Securities Regulation provides a thorough and acces-

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2. The International Stock Exchange has more foreign listed companies than any other stock exchange. Id. at 75. The value of equity securities of foreign companies purchased by U.K. investors exceeded that purchased by nationals of any other country in each of the years 1986, 1987, and 1988. International Monetary Fund, International Capital Markets: Developments and Prospects 25, 88 (1990). U.K. companies are also the largest class of participants in cross-border mergers and acquisitions. Id. at 25, 89.
sible discussion of Big Bang and its impact on capital markets in the United Kingdom and elsewhere. Given the amount of change that occurred essentially simultaneously, this is an impressive feat. Poser first describes the reforms in the Stock Exchange itself: 1) the abolition of fixed brokerage commissions and of the "single-capacity system", whereby each member of the Stock Exchange might deal either as agent for customers or as principal for its own account, but not both; 2) the opening up of Exchange membership to foreigners and to diversified investment firms and banks; and 3) the displacement of the trading floor by a screen-based inter-dealer quotation system. The book then provides a summary and analysis of the principal provisions of the Financial Services Act 1986 (FSA), which brought London's investment professionals for the first time under a comprehensive and unified set of regulations. Poser finishes up by discussing the interplay between London's new market and regulatory systems and the creation of a single European market.

Throughout, Poser complements his explanation of regulatory provisions and Stock Exchange rules with discussions of the history of British securities markets, practical problems faced by securities professionals, and the theories underlying the reforms. The result is tolerable reading for a book that is mostly about regulations. The book will certainly be useful to U.S. practitioners whose clients increasingly look overseas for both capital and investment opportunities; it should also help to frame discussion in the United States of the meaning and impact of Big Bang.

The latter point implicates the principal weakness of *International Securities Regulation*, which is Poser's general failure to draw conclusions from the British experience that can be applied to U.S. markets. This is a surprising lapse for an American academic whose goal is to provide something more than "a hornbook of British securities law". Poser is exceptionally well qualified, as a former staff member of the U.S. Securities and Exchange Commission (SEC), a former officer of the American Stock Exchange, and an academic who has written extensively on U.S. securities regulation, to take a hard, critical look at both systems and compare strengths and weaknesses. Poser's failure to do so is forgivable (the book covers a lot of material as it is) but disappointing.

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3. N. Poser, supra note 1, at xvi.
Big Bang unquestionably has lessons to teach U.S. policymakers. The Stock Exchange and the British Government set out with one eye on the American system of securities regulation and consciously sought to incorporate its strengths (especially the perception of U.S. markets as relatively fair and transparent) while avoiding its weaknesses (in the British view, inflexibility, high costs, and an overemphasis on litigation). In part, therefore, the FSA is an attempt to improve on U.S. securities regulation. It is easy to conclude after reading the book that this effort has succeeded in several particulars.

The post-Big Bang regulatory structure incorporates and extends several trends that have been apparent in the SEC's latest thinking. For example, the FSA takes an explicitly territorial approach to regulating market professionals; in general, one is subject to regulation if one engages in securities business in the United Kingdom. This focus would be familiar to anyone who has observed the SEC's recent tentative shifts from regulating conduct that affects U.S. investors to regulating conduct that occurs in the United States. The FSA also extends many of its protections only to "private investors", a residual category defined by excluding institutional and professional investors. Again, this is consistent with the SEC's gradual relaxation of protections afforded sophisticated investors. The FSA was written to conform to the European Communities' standards on mutual recognition of national regulatory standards. The SEC has taken prelimi-

7. Compare Sec. Act Rel. 4708 (July 9, 1964) (registration requirement does not apply to offerings of securities "distributed abroad to foreign nationals") with Rule 901 of Regulation S, 17 C.F.R. § 230.901 (1991) (registration requirement does not apply to offerings of securities "that occur outside the United States"). The SEC has failed to carry this trend over into other areas. In particular, it has continued to apply its rules on market-making in the course of a distribution, 17 C.F.R. § 240.10b-6 (1990), and on stabilization, 17 C.F.R. § 240.10b-7 (1990), to the offshore portions of offerings that take place in the U.S. and in other countries simultaneously. See Hanks, Proposed Changes to SEC Rule 10b-7 Regarding Stabilizing Transactions, 4 Intl Sec. Reg. Rep. No. 6, at 4 (Feb. 25, 1991).
8. See, e.g., N. Poser, supra note 1, at 139 ("know your customer" rule not applicable to sophisticated investors); id. at 147 (prohibition on "cold calls" not applicable to sophisticated investors); id. at 295, 298 (only "private investors" may sue under civil liability provisions).
nary but very limited steps in the direction of international coordination as well. In each case the FSA, written on a clean slate, goes well beyond where the SEC's gradualist approach currently stands. And, arguably, in each case the FSA's approach thereby represents an improvement on the SEC approach.

American policymakers should also pay attention to developments in the U.K. because the growth of British securities regulation will affect the SEC's own efforts to regulate international markets. Although the SEC has begun to move in the direction of territory-based regulation, it still attempts to regulate a great deal of conduct that takes place in foreign markets. Given the comprehensive scope of the new British regulatory scheme, the number of transactions over which both U.K. and U.S. authorities may assert jurisdiction is bound to increase, and some amount of friction is inevitable. The FSA, therefore, should cause American policymakers to sharpen their thinking about the precise boundaries of legitimate U.S. regulatory interest.

I. THEORY: THE CARTEL/FRAUD TRADEOFF

Poser's introductory chapter provides his only attempt at a framework for evaluating securities regulation. This chapter could easily have been omitted; the analysis is simply too superficial to serve as a basis for criticism. Poser begins by stating that Big Bang contained elements of deregulation and regulation. In Poser's view, the deregulatory element involves the dismantling of "economic regulation", a term he uses to describe market segmentation, price fixing, exclusive dealing, and other rent-seeking behavior (without, however, distinguishing between that enforced by private actors and that enforced by government). The regulatory element involves the enactment of "investor protection" laws to protect the public against investment professionals who may be tempted by newly-unleashed competitive pressures to take advantage of their customers and counterparts.

The dichotomy is more apparent than real: Regulation of markets affects competitive conditions no matter what the stated reason for the regulation. It may be impossible to guess precisely what competitive conditions in the U.S. investment banking, legal, and accounting

12. See Hanks, supra note 7 (discussing offshore application of SEC's "trading rules", 10b-6 and 10b-7); see also Mahoney, Securities Regulation by Enforcement: An International Perspective, 7 Yale J. on Reg. 305, 314-19 (1990) (discussing offshore application of antifraud rules).
professions would be absent the investor protection provisions embodied in the U.S. securities laws, but they would certainly be different. Poser's own views on the relationship between market structure and investor protection also undermine his argument. Poser believes that the deregulatory aspects of Big Bang necessitated a higher level of investor protection regulation. That suggests that in his view "economic regulations" that reduce competition also reduce the amount of deceptive or fraudulent activity by market professionals. This may be true: A cartel might seek to prevent fraud by its members because fraud increases the profits of some cartel members (thus upsetting an implicit or explicit division of profits) and may decrease the profits of the cartel as a whole (as the price customers are willing to pay is discounted for the possibility of future fraud). But, if so, the opposite must be true as well. Governments may find that a relatively easy way to reduce fraud is to offer the services of government in enforcing a cartel.

The possibility of creating or reinforcing a cartel is one of the costs of regulation that must be weighed against the reduction in losses from fraud. The task is complicated because, contrary to Poser's assumption, the identification of "anticompetitive" rules is not straightforward. The licensing of exchanges, for example, raises barriers to entry for competing securities markets. Government prescription and oversight of stock exchange rules can also protect a cartel. But stock exchange rules that impose costs on non-members are not always anticompetitive; stock exchanges create positive externalities in the form of valuable information and reductions in transaction costs, and unless members can obtain compensation from non-members for the use of those products, exchanges will not produce them up to a socially optimal level. The task for policymakers (or for competitive forces, depending on one's predilections) is to separate those rules that enable exchanges to capture part of the value of positive externalities from those that create economic rents. This is a more complicated undertaking than simply easing explicitly anticompetitive regulations and imposing new ones that fly an "investor protection" banner.13

13. Poser's framework is similar to that of Professor Warren, who distinguishes between "access deregulation" and "prudential deregulation". Warren, Global Harmonization of Securities Law: The Achievements of the European Communities. 31 Harv. Int'l L.J. 185, 187 (1990). Assuming that the label attached to a regulation is not dispositive, however, there is again little to distinguish the two categories. In each case, a sensible regulatory scheme would balance benefits (investor protection) and costs (curtailment of competition). All we can say about rules struck down as "economic regulation" or "access regulation" is that at some time
The history of the Stock Exchange reforms as Poser presents it provides evidence that competitive pressures, once permitted to operate, can play an important role in separating efficient from inefficient stock exchange rules. Once the Thatcher government abolished exchange controls in 1979 and thereby opened British capital markets to competition from abroad, the end of the cozy market segmentation and fixed commissions on the Stock Exchange came swiftly. A large portion of corporate bond issuance and trading had already migrated from the Stock Exchange to the Eurobond market; a substantial amount of equity trading subsequently fled the Stock Exchange for overseas trading markets where commissions were lower. Indeed, it might be that the Stock Exchange was able to resist change until 1986 only because the Bank of England was willing to suffer the high costs imposed by these practices on the trading of British government securities, which accounted for 67 percent of the Stock Exchange’s trading volume in 1985.

London’s securities markets prior to 1986 were relatively free from government regulation that could be used to shield the Stock Exchange and its members from competition. It was therefore easy for the Eurobond market to establish itself in London and induce customers to abandon the Stock Exchange, as well as for customers to move their trading to overseas markets. It was similarly easy, however, for the Stock Exchange to protect its market share by changing its rules. Although the British government put pressure on the Stock Exchange to abolish fixed commissions, the Stock Exchange members themselves were an important force for change once they became convinced that their economic survival necessitated an end to restrictive rules. Thus, as Poser notes, the British government played a less significant role in bringing about the demise of fixed commissions and the opening up of exchange membership than did the French government in the analogous reforms in the more highly-regulated French markets. Moreover, by the time of Big Bang the strongest voice for change within the British government was that of the Bank of England which, as noted above, was a customer as well as an informal

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14. N. Poser, supra note 1, at 20-23.
15. Id. at 24.
16. Id. at 18.
17. Id. at 29.
18. Id. at 381. The SEC also played a pivotal role in the abolition of fixed commissions on the New York Stock Exchange. See id. at 14-17.
regulator.\textsuperscript{19}

Poser believes that foreign competition had a significant impact on the Stock Exchange's reforms.\textsuperscript{20} In light of the above discussion, however, the lack of regulatory protection from foreign competition also appears as a critical factor. That is certainly a lesson that policymakers everywhere should consider.

II. PRACTICE: THE FSA IN ACTION

Although Poser draws only weak and unpersuasive conclusions from the history just described, his description of the resulting structure of the Stock Exchange and the FSA is thorough and interesting at the same time. Poser expertly describes such issues as the mechanics of exchange trading and the regulation of business conduct by market professionals. This perspective is particularly helpful because issues of market structure and business conduct usually take a back burner in discussions of securities regulation in the United States. Academic writings tend to focus on the relatively narrow issues of mandatory disclosure and the prevention of fraud by issuers and promoters. After reading Poser's discussion of the less glamorous but arguably more important rules governing the day-to-day conduct of an investment business, one comes away with a better understanding of market practices in the United Kingdom and the United States as well.

Poser describes the self-regulatory theme of the FSA and provides a road map through the alphabet soup the FSA has created. Each type of investment business, including that of brokers, dealers, investment advisers, and collective investment vehicles, is regulated by a Self-Regulatory Organization (SRO). The SROs are organized on functional lines, and a diversified firm may therefore have more than one regulator. The quasi-governmental Securities and Investments Board (SIB) supervises the SROs. The FSA requires that any person carrying on an investment business in the United Kingdom receive a license from the SIB or from an SRO that is recognized by the SIB. The FSA also provides rules concerning the conduct of various types of investment business, and directs or authorizes the SIB and SROs to adopt more detailed rules. Poser provides a useful summary of the FSA's provisions on conduct-of-business rules, insider trading, conflicts of interest, takeovers, public offerings, capital and financial requirements, and civil liability, and offers critiques of the FSA's

\textsuperscript{19} Id. at 29-30.
\textsuperscript{20} Id. at 24, 29.
treatment of some of these areas. I will focus briefly on two examples of the latter to highlight both the strengths and weaknesses of the analyses.

A. Conflicts of Interest

Poser’s discussion of those portions of the FSA designed to deal with the conflicts of interest faced by diversified securities firms is particularly insightful. His careful analysis of these issues is an exception to the general absence of critical comparisons between the U.S. and British systems. Conflicts of interest are inevitable in a securities business. The desire of one customer to keep information about its business or market activities secret conflicts directly and unavoidably with the desires of other customers to know as much as possible about business and market conditions. The broker, acting as fiduciary for both clients, cannot fully accommodate both desires. The problems multiply for diversified securities firms, which may act in a variety of agency capacities and as principal. In such situations, the U.S. courts have unhelpfully insisted on something approaching a Cardozoan formulation of the duties owed by an investment firm to its clients.21 When the investment firm argues that it cannot make all the information in its possession available to all clients while simultaneously honoring duties of confidentiality, the standard answer has been that the investment professional put herself in the position where a conflict was inevitable and therefore must bear the consequences.22

Poser points out the shortcomings of this approach. He notes that the strict formulation of fiduciary duties fails to take into account the tension between the customer’s desire for the broker’s undivided loyalty and the desire to benefit from economies of scale.23 It is unlikely that most customers would demand undivided loyalty in all circumstances if the cost was a substantial increase in brokerage commissions and other fees. Poser analyzes the approach of the FSA and the SIB and compares it to the SEC approach. In general, the FSA and the rules of the SIB provide defenses to certain types of liabilities to customers if the securities firm had a “Chinese Wall”, that is, a set of procedures designed to ensure that information does not cross func-

23. N. Poser, supra note 1, at 194-95.
tional lines. For example, a firm might erect a Chinese Wall to prevent information generated by the firm’s investment banking operations from being communicated to its brokerage operations. A Chinese Wall cannot satisfy a strict formulation of fiduciary duty, for the knowledge of the investment banking arm would be imputed to the brokerage arm, which would have failed to use the information for the benefit of its customers. On the other hand, the Chinese Wall serves to put the brokerage customer in no worse a position than if the investment banking arm were a separate firm, and also assures that no brokerage customer will get preferential access to the information.

The SEC’s preferred solution is somewhat more strict. In general, the SEC recommends that firms that obtain confidential information about corporate clients both erect Chinese Walls and put the stock of corporate clients, during periods when confidential information might be generated, on a “restricted list” that prevents the firm’s brokers and traders from trading or recommending the stock. But more importantly, the SEC has not suggested that such procedures should provide a defense against suits by customers charging a breach of fiduciary duty. Such procedures merely ensure that the SEC will not impute the knowledge of the investment banking arm to the trading or brokerage arm for purposes of insider trading liability. The issue is not just academic, as the brokerage firm in Slade v. Shearson, Hammill & Co. learned when the district court rejected its “Chinese Wall” defense to fiduciary liability.

Notwithstanding these problems, Poser carefully weighs the pros and cons of the British and American approaches, focusing primarily on the difference between using a Chinese Wall as a defense to insider trading charges and breach of fiduciary duty claims. Poser concludes that the SEC’s practice is better. In his view, the threat of liability to customers has not been sufficient to keep U.S. securities firms from expanding their operations, but it probably has made them highly attentive to potential conflicts. While it is easy enough to argue with the conclusion, the efforts to reach that conclusion provide the book’s strongest analytic sections.

24. Id. at 189-90.
25. Id. at 195-96.
26. Id. at 204.
B. Regulatory Structure

By contrast, Poser's critique of the regulatory structure that the FSA created is less careful and less persuasive. Poser is concerned that the three-tiered structure that includes multiple SROs supervised by the SIB, which is in turn supervised by the government's Department of Trade and Industry (DTI), is too unwieldy to be effective. As one example of the shortcomings of the structure, Poser notes that while the SIB is an important rulemaking body, it has only such enforcement powers as the DTI chooses to delegate to it.

Here, in particular, a comparative analysis would be valuable. The U.K. did not adopt a decentralized system of regulation by accident. Many British policymakers and market participants were adamantly opposed to creating an agency resembling the SEC, which they viewed as inflexible and arrogant.28 The SEC, of course, combines rulemaking and enforcement authority under one roof. It is not clear, however, that the goals of regulatory transparency (that is, the ability to understand the rules and obtain advance warning of changes) and fairness (like cases being treated alike) have been furthered by that combination of functions in a single agency.

A look at the last two decades of securities regulation in the United States would suggest that the SEC's regulatory agenda can be dominated by its enforcement function. There are at least two possible reasons. First, securities enforcement, like most law enforcement, has to rely to some extent on high-profile, glamorous cases to assure continued success in public opinion, legislative funding, and personnel recruitment. The page-one drama of arrests, large sums of money, and the downfall of the powerful, however, may give the SEC's Enforcement Division an advantage over the regulatory staff in the competition for limited resources and for control of the agency's agenda. For example, the SEC's Enforcement Division provided the impetus behind the 1970's crusade against foreign bribes and other "improper payments" as well as the 1980's crusade against insider trading.29 In each case, items of equal regulatory importance but considerably less glamour, such as penny-stock fraud, took a back seat.30

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30. Penny stock fraud, like insider trading, was identified early in the 1980's as an issue of regulatory concern. See id. at 272; see also "Breeden's Attempts to Preempt State Blue-Sky Laws Called Arrogant", Sec. Week, Feb. 25, 1991, at 4. In contrast to the SEC's swift and
A second source of conflict is the difference between the forward-looking perspective of regulation and the backward-looking perspective of enforcement. The more vague the description of prohibited conduct, the more flexibility enforcement personnel have to determine \textit{ex post} which activities should be sanctioned. The more closely connected the rulemaking and enforcement arms are, the greater the chance that the preference of the latter for vague rules will prevail. In the case of insider trading, for example, the SEC enforcement staff’s desire for maximum flexibility has caused a considerable lack of transparency. The federal securities laws contain no definition of insider trading, in part because the Enforcement Division resisted adding one on the grounds that slick operators would work around it (i.e., obey the law).\textsuperscript{31} Thus, the contours of the crime are determined by case-by-case construction by the SEC and the courts of the very general language of the anti-fraud prohibitions of the federal securities laws. There is a growing recognition of these tensions between regulation and enforcement,\textsuperscript{32} yet Poser ignores the topic and thus fails to weigh the advantages as well as the disadvantages of a more decentralized system of regulation.

The book’s final chapter puts Big Bang into the larger context of European integration. The brief discussions of the changing landscape of market practices and regulatory structures in other EC countries provides strong support for Poser’s view that Big Bang is one part of a more general reexamination caused by the growth of cross-border investment. Part of the value of \textit{International Securities Regulation} is the possibility that it will contribute to that reexamination.

\textbf{CONCLUSION}

\textit{International Securities Regulation} ably introduces an American

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\textsuperscript{31} See Pitt & Shapiro, supra note 29, at 234. The SEC later supported legislation that would have added a definition of insider trading. It appears, however, that the reason for the SEC’s support was a fear that the Supreme Court, which had granted \textit{certiorari} in the insider trading case of R. Foster Winans, would reject the SEC’s “misappropriation” theory. In the event, the Supreme Court affirmed Winans’ conviction without reaching the merits of the misappropriation theory, Carpenter v. United States, 484 U.S. 19 (1987), and the proposed legislation was never enacted. See Pitt & Shapiro, supra note 29, at 234-36.

\textsuperscript{32} See id. and sources cited therein; R. Karmel, Regulation by Prosecution: The Securities and Exchange Commission vs. Corporate America (1982).
reader to an unfamiliar set of market practices, institutional structures, and laws. Poser leaves to others the necessary task of dissecting the new market and regulatory structures of the United Kingdom and other nations and looking for ways to improve our own structures. The book does, however, make it clear that the task must be undertaken. The dramatic increase in international investment will change the investment and capital-raising choices available to U.S. market participants, and thereby affect the competitive position of the U.S. capital markets. Whether that impact is good or bad depends on how rapidly and appropriately those markets respond to internationalization. By providing a case study of London's dramatic response to competitive pressures, Poser provides a helpful starting point for those who wish to shape the U.S. response.