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Stock Market Consolidation: A New Game, But Who Sets the Rules?

Financial markets have a bad habit of moving too fast. Many on the marketplace had become used to think that the European monetary union (EMU) meant the creation of an integrated European capital market alongside the progressive disappearance of fragmented, national markets. This left plenty of room for difficult policy questions: should securities regulation be kept separated from prudential supervision, as in the US or France, or brought under the same roof, as in the UK or Germany? Should the system be based on the coordination of national authorities, as now in the so-called Lamfalussy process and its intricate architecture of Europe-wide committees, or should a new European agency be created? Should the approach cover the whole EU and its 25 (soon 27) member states, or be limited to the Eurozone or the continent to bypass a possible British veto? But one thing seemed sure: the relevant scope of the next steps would be of pan-European scale.

How things have changed. Nasdaq's offer on the London Stock Exchange (LSE) has been an eye-opening move, which suddenly made it obvious that market realities have already evolved way beyond the European borders and have become resolutely transatlantic. The fact that Nasdaq's proposal was withdrawn on 30 March does not change this realization. The important thing was not that the bid would succeed, but just that it could be launched at all.

Actually, the effective interpenetration of the European and American financial worlds has long been more advanced than the corresponding mental (and political) representations. This also applies to regulation. Not only have the large US investment banks, institutional investors and hedge funds long been active on European territory. Financial rating agencies are exclusively regulated in the US via the recognition of their national status by the Securities and Exchange Commission (SEC), without any comparable legal device in Europe. In accounting, the European endorsement of International Financial Reporting Standards (IFRS) has hardly resulted in autonomous European leadership: the London-based International Accounting Standards Boards (IASB), that drafts the IFRS, listens more carefully to US noises than to European ones, if only because it now wants to see the IFRS recognized at least partially by the SEC. And when Congress created the Public Company Accounting Oversight Board (PCAOB) to oversee the audit profession, many European member states followed suit and were later backed by new European legislation (the so-called 8th Company Law Directive), which essentially mirrored the US initiative even though a number of differences remain.

Regulatory concerns play a critical role in shaping financial markets. Shareholders of Euronext are certainly interested in knowing with whom it

may be going to merge; however, in an age of electronic trading, the important question is not where stock exchange companies are located, but rather to which rules they are subject, and more generally which are the rules of the game for issuers, investors and other market participants, which are the remit of public regulators and of the political and legal systems that back them. It is no easy matter: if the regulation is too lax, there will be market abuse, insider trading and misleading disclosures; if it is too tight, innovation may be hamstrung and dynamic companies will flee to other, less rigid-minded locations. In the US, the heated and almost non-stop controversies that have followed the adoption of the Sarbanes-Oxley Act in July 2002 show how economically significant financial rulemaking can be.

The new trend in Europe is that the nationality of a securities-issuing company and that of the relevant financial regulator can be increasingly disconnected. Granted, Euronext has so far halted this trend by keeping country-based lists in Belgium, France, the Netherlands and Portugal, thus preserving the remit of each national securities regulator; but maintaining this multiplayer game implies higher costs and diminishes the synergies potential that can result from the merging of trading platforms, and it is unlikely to survive untouched to the next steps of consolidation. The new European securities legal framework created by the European Commission's Financial Services Action Plan since 1999 and the simultaneous evolution of case law are likely to make Europe increasingly similar to the US for that matter. Many large American corporations are registered in Delaware but have their operating headquarters elsewhere, and are traded in New York. In Europe, an increasing number of holding companies are registered in the Netherlands or other low-tax countries, whatever the geographical footprint of the controlled activities; and the combined actions of the European Commission and European courts will certainly result, over the next few years, in a vastly increased ability of European companies to separate the head office building from the place of incorporation or of listing, and to move the addresses much more easily than in the past.

The implication: a more integrated market means more interdependent regulatory systems, which results in a mix of cooperation and competition between regulators. As the market integration happens on a transatlantic scale, the rules of the game in Europe will increasingly be influenced by the SEC and other US regulators more than by any single European player, if only because of the superior size and firepower of US participants.

This new context calls for institutional combinations that shall inevitably be both innovative and politically awkward. The relevant example is what happened with accounting standard-setting. Instead of trying to create European standards, the EU directly went one step further and chose to endorse the IASB-led global formula. This has given rise to significant political tensions, as regards both the content of standards, the consistency of their enforcement, and their recognition in the US. However, there is little choice but making more such experiments in different regulatory areas. The breakneck pace of integration of transatlantic finance means that the vision of

a European financial market under a European regulatory system is probably already outdated, even before it has had time to fully become a reality.

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