Originally published in French in *La Tribune*, 20 November 2006

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The Global Stock Market and the Challenge of Regulatory Competition

On 19 May this year, Nasdaq completed its purchase of one fourth of the London Stock Exchange's equity. On 2 June, Euronext and the New York Stock Exchange (NYSE) Group announced their intention to merge, soon challenged by Deutsche Börse on 19 June. On 17 October, the two Chicago-based derivatives marketplaces, CME and CBOT, decided to join forces. On 15 November, while Deutsche Börse eventually renounced its plans for Euronext, a consortium of leading banks publicised its intention to create a new cut-price trading platform. What is at stake in all this turmoil for the financial system as a whole?

The combined impact of new communication technology and of global economic integration is gradually commoditising the exchanges' business. Existing rents are eroding rapidly with market opening, as issuers are increasingly able to choose the platform on which their securities are traded. As a consequence, the only way for today's near-monopolies to thwart the emergence of alternative offers is to be competitive. Furthermore, it is already no longer possible to speak of a stand-alone, quasi-autonomous European capital market. Russian, Indian and Chinese companies are eagerly listing themselves in London, and the transatlantic financial market is now for real. The fight over Euronext was sometimes reported as a choice between a 'European' and an 'American' option, but this depiction was mistaken from the start. The real choice was between different business models, all of which intended to serve what increasingly resembles a global capital market.

This is good news for businesses. It should contribute to lowering the cost of capital through more competition between trading platforms, and also thanks to the prospect of better clearing and settlement in Europe in the future. However, other implications of the same trend are more difficult to grasp, because competition now happens not only between trading platforms but also between regulatory systems.

In the US, a vigorous debate still rages about the Sarbanes-Oxley Act of July 2002. Among the 25 largest IPOs worldwide in 2005, only one was in the US. Some analysts there fear that London, which recently feted the anniversary of its landmark 1986 "Big Bang" in great shape, could be taking the lead in the delivery of financial services to the world. The underlying rationale is that Wall Street is hamstrung by burdensome legislation while London benefits from its regulators' light touch. In reality, SarbOx is only one among many factors, and its most negative effects have already been overcome. Both Clara Furse at the LSE and John Thain at the NYSE have admitted as much, even though they have no reason to defend the same positions in a debate where their interests are clearly not aligned. But the controversy clearly illustrates that national or local legislation and regulation are key facets of the now worldwide competition among financial centres.

In the European Union, directives adopted since 1999 have the effect of granting companies unprecedented freedom to pick their place of listing, and the corresponding regulator, according to their individual preferences. Most of today's big companies in Europe are still incorporated, headquartered and listed in their country of origin. By contrast, in the US many large groups are incorporated in Delaware, listed in New York, and managed from somewhere else. The enabling conditions are now met for Europe to shift towards a comparable model, and there will be some winners and losers in the transition process.

Global financial integration is now a fact, and we are just beginning to understand the consequences. Europe's policymakers are wasting their time when they try to influence choices on who will marry and with whom: the decision on specific deals belongs to the exchanges' shareholders. Policymakers, however, are the only people who can possibly build any common mechanisms that the new reality of regulatory competition may call for. All candidates in the forthcoming French presidential election talk a lot about reining in the forces of capitalism. But it seems to escape them that securities regulation is one of the few available instruments by which collective-interest rules can be enforced in global markets, provided that market realities are effectively taken into account. In late October, Barney Frank, now likely to chair the House Financial Services Committee in the US Congress, publicly asked whether a new level of authority could become necessary to arbitrate possible differences between securities regulators on both sides of the Atlantic. Europe's policymakers are understandably mindful of national sovereignty, but the question of how to manage regulatory competition is one that they would be ill-advised to ignore.