INTRODUCTORY ESSAY

A PANORAMIC VIEW OF THE FINANCIAL CRISIS THAT BEGAN IN 2008: THE NEED FOR DOMESTIC AND INTERNATIONAL REGULATORY REFORM

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On March 20, 2009, the Porter Wright Morris & Arthur LLP Program in Law, Religion and Ethics[1] and the University of Dayton School of Law Project for Law and Business Ethics[2] presented: *The Fallout from the Bailout: The Impact of the 2008 Bailout on Lending Regulation, Securities Regulation, and Business Ethics*. This symposium brought together academics, practitioners, and regulators to discuss the legal implications and consequences of the financial crisis that began in 2008 and to explore the government's focus on bailouts of private institutions as a means of combating the financial crisis.[3] Panels during the symposium focused on whether the 2008 bailout was an economic necessity or government folly, if and how lending and securities regulation should be reformed to prevent a future financial crisis, and how the bailout impacts business ethics and corporate responsibility.[4] Speakers from the event authored each of the following six articles.

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[1] The Program in Law, Religion and Ethics was founded in 2005 from a generous donation by the law firm of Porter Wright Morris & Arthur LLP. The Program supports research and scholarship in the areas of law, religion, and ethics and fosters discussions between the bench, bar, and legal academy regarding the intersection of these three topics. In support of its mission, the Program regularly hosts symposia on topics relating to law, religion, and ethics.

[2] The Project for Law and Business Ethics was founded in 2007 from a generous donation by Fran Evans and Jon Hoak for research, teaching, and scholarship relating to ethics in the business world. The Project's mission is to explore the role of law and lawyers in promoting the ethical operation of business entities and preventing ethical breaches before they occur. The Project is designed to improve the legal profession and business community by generating a dialogue on what constitutes the best practices for creating and maintaining an ethical environment in a business setting. About the Project for Law and Business Ethics, http://law.udayton.edu/ProjectForLawAndBusinessEthics (last visited November 30, 2009).

[3] University of Dayton School of Law Bailout Symposium, http://law.udayton.edu/NR/exeres/A4EA357C-51A4-449C-AB22-28095892019B.htm (last visited November 30, 2009) (providing a list of speakers, schedule, and audio and video recordings from the symposium).

[4] *Id.*

The symposium at the University of Dayton School of Law was arguably the first symposium that focused on the significance of government bailouts in dealing with the financial crisis. The role of bailouts is significant, because the radicalism of the government's response to a financial downturn is a leading indicator in determining whether a financial crisis constitutes a depression, rather than a recession.[5] This is because the radicalism of the response to a downturn correlates to the perceived economic threat of the downturn itself. The 2008 bailout represents a striking departure from the way that the government has dealt with previous recessions in the United States, and because of this, a strong argument exists that the financial downturn should be considered a depression.[6] Of course, the depths of the downturn do not appear to be as severe as the Great Depression, but this implies that the federal government has become better equipped to deal with depressions than it has been in the past. Even if that may be the case, the speakers at the symposium and the authors within this symposium issue remind us that the financial crisis suggests the need to reevaluate our financial system at every level.

The purpose of this introductory essay is two-fold. First, this essay provides context for the following six articles by explaining that their authors' overarching goal is to present an expansive reassessment of the United States financial system in the wake of the downturn that began in 2008. From a general statement that our financial regulatory system desperately needs an overhaul[7] to a plea for individuals to make sound judgments based on the information disclosed to them,[8] the following articles examine the implications of the downturn on every level of the American financial system. Notably, although many of the articles hint at the importance of international regulatory reform as a means of preventing or lessening any future financial crisis, none of the articles focus on the importance of international reform. Therefore, a second purpose of this essay is to discuss the importance of reform in international securities regulation as a means of preventing or lessening any future financial crisis. Because financial markets are now global, the role of international regulation must also be considered in addressing the causes of the downturn that began in 2008.

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[5] *See also* RICHARD A. POSNER, A FAILURE OF CAPITALISM: THE CRISIS OF '08 AND THE DESCENT INTO DEPRESSION x (2009) ("It is the gravity of the economic downturn, the radicalism of the government's responses, and the pervading sense of crisis that mark what the economy is going through as a depression.").

[6] *See id.* at vii (arguing that "[w]e are in the midst of the biggest economic crisis since the Great Depression of the 1930s.").

[7] *See infra* notes 9-12 and accompanying text.

[8] *See infra* notes 34-37 and accompanying text.

DOMESTIC PERSPECTIVES: SIX AUTHORS' VIEWS ON THE FINANCIAL CRISIS THAT BEGAN IN 2008

This symposium issue begins with an article by Harvey Pitt, a former chairman of the United States Securities and Exchange Commission.[9] Pitt's article offers a wide view of the financial crisis that began in 2008 by discussing the root causes of the crisis, proposing various reforms, and offering strategies for individuals coping with the crisis.[10] Pitt argues that it is "inevitable that our regulatory system is in for a thorough overhaul very soon,"[11] and that regulatory reform must occur now to keep the capital markets within the United States competitive.[12]

Professors Robert Hardaway, Barbara Black, and Steven Ramirez then offer focused studies of major components of the financial crisis that began in 2008. In *The Great American Housing Bubble: Re-Examining Cause and Effect*, Professor Robert Hardaway explores the creation of the housing bubble that ultimately gave birth to the financial crisis.[13] Hardaway chiefly credits politicians with creating the bubble, because of government subsidies of home purchases, political pressure to force lenders to grant mortgages to those unable to repay, and restrictions on the availability of housing through local exclusionary practices.[14] Hardaway then argues that the key to preventing a future crisis is for politicians to discard these policies.[15] This is because these policies will inevitably create a new housing bubble, and bubbles invariably collapse.[16]

In *Protecting the Retail Investor in an Age of Financial Uncertainty*, Barbara Black continues the discussion began by Robert Hardaway by offering her analysis of the role of the United States Securities and Exchange Commission ("SEC") in the financial downturn that began in 2008.[17] The improvidently granted mortgages discussed in the previous paragraph were ultimately securitized and sold to investors as mortgage-

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[9] Harvey L. Pitt, *Financial Services Regulatory Reform in the Face of an Economic Meltdown*, 35 U. DAYTON L. REV. 15 (2009).

[10] *Id.* at 16 ("To consider the implications of our current economic predicament, I would like to identify some of the landmarks on the road to our current market mess, discuss some features to look for along the road to reform and recovery, and then offer some thoughts on how to cope with downward-spiraling markets.").

[11] *Id.* at 17-18.

[12] *Id.* at 24 ("Revamping our regulatory system must begin now, because our antediluvian system is undermining the inherent vitality of America's capital markets and threatens the freedoms we all enjoy that flow from an efficient economic system.").

[13] Robert Hardaway, *The Great American Housing Bubble: Re-Examining Cause and Effect*, 35 U. DAYTON L. REV. 33 (2009).

[14] *Id.* at 59.

[15] *Id.* (arguing that a future housing bubble can be prevented by "eliminating home mortgage tax subsidies for the richest Americans, repealing laws pressuring banks to extend mortgages to marginal buyers, and prohibiting the practice of local exclusionary practices.").

[16] *Id.* at 40 ("Economic history reveals that all financial bubbles . . . have inevitably collapsed. The only question is when.").

[17] Barbara Black, *Protecting the Retail Investor in an Age of Financial Uncertainty*, 35 U. DAYTON L. REV. 61 (2009).

backed securities.[18] When the default rate on the mortgages increased dramatically, the financial downturn occurred as a result of the mortgage-backed securities being devalued.[19] After noting that all branches of government must be blamed for the regulatory failures that created the financial crisis,[20] Black charges that the SEC's "hands off" approach to institutional investors played a major role in the creation of the crisis.[21] Black questions whether the Obama Administration's efforts to reform the SEC will be sufficient to protect institutional investors and to maintain the integrity of the markets.[22] Black ultimately believes that the SEC must really become the "Investors' Advocate" to help lessen or avoid any future financial crisis.[23]

Next, in *Subprime Bailouts and the Predator State*, Professor Steven Ramirez offers his views on the government bailouts of private institutions that occurred in response to the financial crisis.[24] Ramirez argues that the rule of law has been violated, because the government bailouts altered the existing legal regime to rescue businesses that should have faced the consequences of insolvency.[25] Ramirez also contends that the bailouts were contrary to sound macroeconomic principles, because they failed to stabilize the economy, do not prevent future losses, and incentivize future reckless behavior by managers and creditors.[26] Ramirez concludes that these issues can be remedied by using civil and criminal sanctions to incentivize managers of business entities not to seek "too-big-to-fail" status.[27] With these sanctions in place during a future financial crisis, the federal government would not need to guarantee and bail out business entities in the absence of the "too-big-to-fail" status.[28]

Professors Robert Miller and Jeffrey Lipshaw continue the discussion by focusing on the role of individuals in the financial crisis. In *Morals in a Market Bubble*, Professor Robert Miller argues that likely no one is morally responsible for the financial crisis, because everyone was acting rationally and honestly during the events that preceded the financial

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[18] *Id.* at 64.
[19] *Id.* at 68.
[20] *Id.* at 65 (discussing the reasons why "all branches of government must share the blame for the regulatory failures").
[21] *Id.* at 77.
[22] *Id.* at 63 ("It remains very much to be seen whether [the Obama Administration's] efforts will be sufficient to protect the retail investor from future fraud and to restore her confidence in the markets.").
[23] *Id.* at 79.
[24] Steven A. Ramirez, *Subprime Bailouts and the Predator State*, 35 U. DAYTON L. REV. 81 (2009).
[25] *Id.* at 82 ("[The rule of law] means that legal rules are announced in advance, with clarity, not changed *ex post*; market actors face the same rules regardless of their wealth or political influence, and no economic actor has the power to change the rule in light of an unpleasant economic outcome.").
[26] *See id.* at 100-01 (discussing the "numerous and serious macroeconomic flaws" of the 2008–2009 bailouts).
[27] *Id.* at 111.
[28] *Id.*

meltdown.[29] Miller contends that the Federal Reserve's Federal Open Market Committee made some "mistakes" in deciding to keep interest rates low at the beginning of this decade, because it made huge amounts of credit available, which created a housing bubble.[30] Miller does not believe that the Federal Reserve's Open Market Committee is morally culpable, however, because the Committee believed that it was making sound policy decisions during that period.[31] Miller also does not fault anyone else, e.g., the mortgage issuers, speculators in the real estate market, those that securitized the mortgages, and purchasers of mortgage-backed securities, because these individuals and entities were operating within a housing bubble, and human beings are arguably unable to accurately detect bubbles when they are operating within one.[32] Miller believes that these individuals and entities were simply making investment decisions, and as he puts it, "[a]ll investments involve risk, and there is nothing immoral in making more risky rather than less risky investments."[33]

Finally, in *Disclosure and Judgment: "We Have Met Madoff and He Is Ours,"* Professor Jeffrey Lipshaw argues that the key to avoiding or lessening any future financial crisis is for individuals to make better judgments based on the information that has been disclosed to them.[34] Lipshaw contends that "[l]ots of money in the system, loose standards for credit ratings, undue faith (or hubris) in the science of financial models, and the usual psychology of bubbles took greed and fear out of the appropriate equilibrium."[35] Put another way, Lipshaw believes that the crisis resulted from failures in human judgment, rather than a failure of the laws and regulations mandating that information be disclosed.[36] Lipshaw concludes that the key to preventing or lessening any future financial crises is to continue to make sure that all material information is disclosed and for people to use sound judgment when acting upon that information.[37]

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[29] Robert T. Miller, *Morals in a Market Bubble*, 35 U. DAYTON L. REV. 113 (2009).

[30] *Id.* at 136.

[31] *Id.* at 136-37 ("Even if Alan Greenspan and other members of the Federal Open Market Committee were solely responsible for the whole thing, they were not *morally* at fault; they just made some honest policy mistakes that, at the time, virtually everyone thought were right.").

[32] *Id.* at 115 ("The key principle to understand is that bubbles are no one's *fault.* Bubbles are simply a product of the limits of human cognitive powers. As long as people can buy and sell based on their expectations about the future . . . , and as long as the human ability to predict the future is limited, it will sometimes happen that people are reasonably but mistakenly optimistic for prolonged periods of time.").

[33] *Id.* at 126.

[34] Jeffrey M. Lipshaw, *Disclosure and Judgment: "We Have Met Madoff and He is Ours"*, 35 U. DAYTON L. REV. 139 (2009).

[35] *Id.* at 140.

[36] *Id.* at 144 ("I want to move from disclosure to judgment, because it seems to me the systems to insure the former were in place, but that the latter broke down in the current crisis.").

[37] *Id.* at 148.

AN INTERNATIONAL PERSPECTIVE: THE NEED TO REFORM INTERNATIONAL SECURITIES REGULATION

The financial crisis that began in 2008 may have started in the United States, but it quickly spread around the world. As Professor Ramirez reports, "the reckless lending in America soon infected the entire global financial system and ultimately caused a global synchronized recession costing trillions in foregone output."[38] Similarly, Professor Black writes, "[t]he year 2008 was a devastating one for all investors as the financial meltdown wreaked havoc on the world's economy and left no form of investment unscathed."[39] Because the financial crisis was a global event, this suggests that international reforms are necessary in addition to any reforms within the United States.

Beyond explaining that the following six articles are intended to provide an expansive reassessment of the United States financial system in the wake of the downturn that began in 2008, this introductory essay is also designed to highlight the importance of reform in international securities regulation as a means of preventing or lessening any future financial crisis. In other articles, I have discussed the opportunity that the financial crisis affords for reimagining international securities regulation,[40] the importance of harmonization and centralization of international securities regulation and enforcement,[41] the need for the creation of a centralized global securities regulator,[42] and the potential role of the United States federal government in the creation of a centralized global securities regulator.[43] This essay continues and furthers the discussion within those other articles in three main ways. First, this essay explains how the crisis that began in 2008 resulted in part from weaknesses in international securities regulation. Second, this essay emphasizes the need to reform international securities regulation and enforcement in addition to answering the calls for domestic regulatory reform, which are found in the following articles. Third, this essay explains how a centralized global securities regulator might come into being.

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[38] Ramirez, *supra* note 24, at 85.

[39] Black, *supra* note 17, at 61.

[40] *See* Eric C. Chaffee, *A Moment of Opportunity: Reimagining International Securities Regulation in the Shadow of Financial Crisis*, 15 NEXUS (forthcoming 2010) (arguing that the financial crisis that began in 2008 should provide a catalyst for change in the field of international securities regulation).

[41] *See* Eric C. Chaffee, *Finishing the Race to the Bottom: An Argument for Harmonization and Centralization of International Securities Law*, 40 SETON HALL L. REV. (forthcoming 2010) (arguing that the key to stabilizing and maintaining the global securities markets is harmonization and centralization of international securities regulation).

[42] *See* Eric C. Chaffee, *Evolution, Not Revolution, in International Securities Regulation: A Modest Proposal for a Global Securities and Exchange Commission* (forthcoming) (providing a model for a centralized global securities regulator and discussing how such a regulator might come into being).

[43] Eric C. Chaffee, *The Internationalization of Securities Regulation: The United States Government's Role in Regulating the Global Capital Markets*, 5 J. BUS. & TECH. L. (forthcoming 2010) (discussing the need for the United States federal government to support the creation of a centralized global securities regulator).

The financial crisis resulted in part from weaknesses in international securities regulation that were created by the waning dominance of the United States in terms of its capital markets and its role as a securities regulator. Because the dominance of the United States has been challenged, many have pushed for an unhealthy level of federal deregulation in hopes of restoring the United States to its former dominant position. This push for deregulation contributed to an international race-to-the-bottom in which national systems of securities regulation were ratcheted down to suboptimal levels that did not allow for the proper level of regulation of the mortgage-backed securities that were at the heart of the crisis.

The role of the United States in the world has been changing. During much of the twentieth century, the United States was viewed as having the world's premier capital markets and as having the world's premier system of securities regulation.[44] During the twenty-first century, however, this dominance of the United States has begun to wane for a variety of reasons. First, the securities markets outside of the United States have grown in size and sophistication.[45] Second, the United States no longer has the world's fastest growing economy.[46] Third, institutional and retail investors now commonly invest outside of the United States as a means of portfolio diversification.[47] Fourth, technology affords institutional and retail investors with nearly limitless information about investment opportunities around the world.[48] Fifth, because the recent wave of demutualization

[44] *See* Robert G. DeLaMater, *Recent Trends in SEC Regulation of Foreign Issuers: How the U.S. Regulatory Regime Is Affecting the United States' Historic Position as the World's Principal Capital Market*, 39 CORNELL INT'L L.J. 109, 109 (2006) ("Since World War II, the United States has been the world's principal capital market. This market has been uniquely broad and deep, with substantial retail participation by individual investors and small institutions, plentiful capital for equity financing and a willingness to hold long-term debt securities, with tenors of thirty years being common even for corporate issuers."); *see also* Howell E. Jackson, *A System of Selective Substitute Compliance*, 48 HARV. INT'L L.J. 105, 119 (2007) ("For much of the twentieth century, the [United States Securities and Exchange] Commission justly considered itself to be the world's premier securities market regulator.").

[45] *See* DeLaMater, *supra* note 44, at 117 ("The securities markets outside the United States have grown in breadth and depth of their own over the past twenty years and now afford issuers in their home countries significant opportunities for financing that did not previously exist."); *see also* Roberta S. Karmel, *The EU Challenge to the SEC*, 31 FORDHAM INT'L L.J. 1692, 1711-12 (2008) (discussing the challenges posed to the regulatory dominance of the United States by the European Union and the emerging capital markets in Asia and South America).

[46] *But see* Ethiopis Tafara & Robert J. Peterson, *A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 31, 46-47 (2007) ("[E]ven though the United States is no longer the fastest growing economy in the world, foreign direct investment in the United States remains high, with capital flowing into the country even from the developing world in search of the historically high returns available in the U.S. capital markets.").

[47] *See* Edward F. Greene, *Beyond Borders: Time to Tear Down the Barriers to Global Investing*, 48 HARV. INT'L L.J. 85, 85-86 (2007) ("Investing in non-U.S. markets is no longer the exclusive province of megainstitutions or the ultrawealthy; it is an essential component of prudent portfolio diversification for all investors."); Tafara & Peterson, *supra* note 46, at 53 ("American investors--and particularly large U.S.-based institutional investors--are increasingly interested in buying and selling foreign securities, both to take advantage of currency exchange rate fluctuations and to better diversify their portfolios.").

[48] Greene, *supra* note 47, at 86 (discussing the role of the internet in providing information about investment opportunities throughout the world to institutional and retail investors in the United States); *see also* George W. Madison & Stewart P. Greene, *TIAA-CREF Response to a Blueprint for Cross-*

transformed most securities exchanges into for-profit entities, many exchanges have shed their previous nationalistic and protectionist attitudes to search for international opportunities.[49] Sixth, because of the recent wave of securities exchange consolidations, many exchanges are becoming transnational entities that transcend the laws of any one country.[50] Seventh, the United States has experienced a significant drop in initial public offerings by foreign issuers, because the Sarbanes-Oxley Act of 2002[51] placed substantial new corporate governance requirements on foreign companies wishing to issue securities in the United States.[52] Eighth, many companies are now reluctant to raise capital in the United States because of its culture of shareholder litigation.[53] Ninth, many companies are also reluctant to raise capital in the United States, because the SEC has a history of aggressively enforcing the federal securities laws.[54]

Within the past decade, many have pushed for the deregulation of the United States financial system to help maintain its dominance in terms of its capital markets and its role as a securities regulator. As late as 2008, individuals continued to push for reduced financial regulation and a reduced role for the SEC.[55] In light of the forces threatening the dominance of the United States, the behavior of these deregulationists is arguably both rational and laudable.

The problem, however, is that the deregulationist movement was too successful, because the movement instigated the failure to properly regulate

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Border Access to U.S. Investors: A New International Framework, 48 HARV. INT'L L.J. 99, 99 (2007) ("The rapid pace of technological advances is bringing us closer to the reality of a seamless global capital market. In such a world, investors would have access to increased liquidity, greater diversification, and a wider range of investment options regardless of their location. Capital would be more efficiently allocated throughout the global economy to benefit all participants.").

[49] Susan Wolburgh Jenah, *Commentary on a Blueprint from Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 69, 71 (2007) (reporting that the recent wave of securities exchange demutualization has "unleashed pressure from shareholders to increase profits through expansion, investment in new technology, and cost cutting, forcing these for-profit entities to eschew nationalistic or protectionist tendencies in the bid for value maximization").

[50] *See generally* Sara M. Saylor, Note, *Are Securities Regulators Prepared for a Truly Transnational Exchange*, 33 BROOK. J. INT'L L. 685 (2008).

[51] *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified at 15 U.S.C. §§ 7201-66).

[52] *See* Roberta S. Karmel, *The Once and Future New York Stock Exchange: The Regulation of Global Exchanges*, 1 BROOK. J. CORP. FIN. & COM. L. 355, 356-57 (2007) ("[T]he primary reasons why the NYSE has been losing listings is that foreign issuers are disenchanted with the U.S. stock market because of the costs of compliance with the requirements of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) and because of the U.S. culture of shareholder litigation."). *But see* Jackson, *supra* note 44, at 108 ("Although many have pointed to the passage of the Sarbanes-Oxley Act of 2002 as damaging the ability of U.S. exchanges to compete for foreign cross-listings, there is ample evidence that the erosion of U.S. market power for foreign listings was already underway well before 2002.").

[53] *See* Jenah, *supra* note 49, at 71 ("Some claim that the increased regulatory burden in the United States, combined with mounting concerns over exposure to U.S.-style class actions and more aggressive enforcement, may be driving companies to raise capital in foreign markets.").

[54] *Id.*

[55] *See* Black, *supra* note 17, at 66-67 (discussing criticism of the United States financial regulatory system during 2008).

the mortgage-backed securities that were at the heart of the financial crisis. As previously explained, improvidently granted mortgages in the United States were ultimately securitized and sold to investors as mortgage-backed securities.[56] When the default rate on the mortgages increased dramatically, the mortgage-backed securities were devalued and the financial crisis ensued.[57] While all of this was happening, the SEC and other financial regulators were taking a "hands off" approach in hopes of maintaining the financial dominance of the United States.[58]

The financial crisis also cascaded to the rest of the world for similar reasons. Mortgage-backed securities were also sold to institutional investors around the globe, which allowed these entities to invest in the United States housing bubble.[59] Financial regulators in the United States and abroad engaged in a race-to-the-bottom in which no one wanted to call into question the true value of these mortgage-backed securities and ratchet up its regulatory regime out of fear that it would disadvantage the institutional investors from that particular country.[60]

To help avoid the continuation of a race-to-the-bottom amongst securities regulators throughout the world and to help avoid or lessen any future financial crisis, a pressing need exists to reform international securities regulation and enforcement. Financial markets are now global, which means any future financial crisis is likely to be global also. The patchwork of regulation that currently exists in the world today has generated a race-to-the-bottom, and the cure to prevent or lessen any future financial crisis is for nations to agree to the harmonization and centralization of international securities regulation.

Financial markets have become global for many of the same reasons that the dominance of the capital markets in the United States have been waning.[61] Investors now search to diversify their portfolios by seeking out international opportunities, and technology allows for fast and efficient trading that transcends national borders.[62] The creation of transnational

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[56] *See supra* notes 18-21.

[57] *See supra* notes 18-21.

[58] *See supra* notes 18-21; *see also* POSNER, *supra* note 5, at xii ("The movement to deregulate the financial industry went too far by exaggerating the resilience—the self-healing powers—of laissez-faire capitalism.").

[59] *See* Miller, *supra* note 29, at 133 ("[B]y allowing investors around the world to invest indirectly in the United States housing market, the securitization of home mortgage loans vastly expanded the amount of capital flowing into that market, and this contributed to generating the bubble.").

[60] *See* Donald C. Langevoort, *U.S. Securities Regulation and Global Competition*, 3 VA. L. & BUS. REV. 191, 193 (2008) ("The global scale of the current troubles shows that other countries have been too lax as well, so that there should be a ratcheting up of securities regulation not only in the United States, but worldwide.").

[61] *See supra* notes 44-54 and accompanying text (discussing the reasons why the dominance of the United States is waning in terms of its capital markets and its role as the world's premier securities regulator).

[62] *See* Jenah, *supra* note 49, at 69-70 ("Globalization is a fact. Innovative technologies are driving faster and more efficient trading, and they do not recognize national borders. Capital market participants

securities exchanges through the recent wave of exchange consolidation also reflects the fact that the financial markets are global.[63]

Because financial markets are now global, this means that any future financial crisis is likely to be global also.[64] This fact is alarming, because the current patchwork of international securities regulation is inadequate to regulate the emerging global securities markets. As evidenced by the Great Depression in the United States, when it comes to ensuring the stability of securities markets, patchwork regulation does not work. Prior to the stock market crash of 1929, the securities markets in the United States were primarily regulated by state statutes known as "blue sky laws."[65] These state statutes created an inconsistent patchwork of regulation that was largely ineffective in preventing fraud and in regulating securities transactions within the United States.[66] In the wake of the stock market crash of 1929, Congress passed the Securities Act of 1933 ("Securities Act")[67] and the Securities Exchange Act of 1934 ("Exchange Act")[68] to help stabilize the national securities markets.[69] In the Exchange Act, Congress also created the United States Securities and Exchange Commission ("SEC") and assigned the SEC monitoring, regulatory, and enforcement functions.[70] By passing federal securities laws and creating the SEC, Congress arguably achieved its purpose, because although the United States did experience a number of recessions in the decades following the passage of the Securities Act and Exchange Act, it did not experience another depression for the remainder of the twentieth century.

The financial crisis that began in 2008, which arguably can be characterized as a depression,[71] is in part the result of a global patchwork of securities regulation. National systems of securities regulation are no longer adequate, because financial markets have become global. The national systems now create a patchwork of global regulation that is similar to the

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are expanding their business activities into foreign markets. Investors are seeking international investment opportunities.").

[63] *See* Tafara & Peterson, *supra* note 46, at 31 ("Today, mergers and talks of mergers among the world's stock exchanges make obvious what many finance professionals have long known: capital markets are global. Greater investor wealth and education have created the demand for such markets, and technology, in particular, has made globalized markets feasible.").

[64] *See* Roberta S. Karmel, *The Case for a European Securities Commission*, 38 COLUM. J. TRANSNAT'L L. 9, 33 (1999) ("Stock market crashes and financial firm failures have become international, just like trading markets.").

[65] *See* Eric C. Chaffee, *Standing Under Section 10(b) and Rule 10b-5: The Continued Validity of the Forced Seller Exception to the Purchaser-Seller Requirement*, 11 U. PA. J. BUS. L. 843, 851 (2009) (discussing the rise of federal securities laws in the United States).

[66] *Id.*

[67] Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (2006).

[68] Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78nn (2006).

[69] *See also* Eric C. Chaffee, *Beyond Blue Chip: Issuer Standing to Seek Injunctive Relief Under Section 10(b) and Rule 10b-5 Without the Purchase or Sale of Security*, 36 SETON HALL L. REV. 1135, 1139-40 (2006) (describing the Securities Act of 1933 and the Securities Exchange Act of 1934).

[70] 15 U.S.C. § 78d(a) (2006) (establishing the Securities and Exchange Commission).

[71] *See supra* notes 5-6 and accompanying text.

patchwork of regulation in the United States that was created by the blue sky laws prior to the stock market crash of 1929. The current global patchwork allows for the continuation of the race-to-the-bottom that was discussed earlier in this essay,[72] and it also permits monitoring, enforcement, and regulatory gaps that eventually will lead to future recessions and depressions.[73]

In addition to answering calls for domestic regulatory reform, which are found in the following articles, the United States government should also push for the harmonization and centralization of international securities regulation. Regulatory harmonization would require that the laws governing all nations' securities markets be uniform and identical. Regulatory centralization would require the creation of a global securities and exchange commission that would monitor, enforce, and create securities regulation. This is the same approach that was used by the United States in the wake of the stock market crash of 1929 to stabilize its national securities markets, and that worked effectively until the rise of global securities markets at the beginning of the twenty-first century.[74]

The emergence of regulatory harmonization and a centralized global regulator is likely to be a slow evolutionary process, rather than an instantaneous revolutionary process. The world's securities regulators have been slowly moving toward internationalization, but more than one financial crisis will likely be required to yield a harmonized and centralized regulatory regime.

Regulatory harmonization and centralization is likely to take years to evolve.[75] From a legal perspective, a harmonized and centralized regulatory regime could be created through treaties among various nations.[76] Drafting and negotiating such an agreement would likely be extraordinarily difficult, because of the reluctance of national securities regulators to cede

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[72] *See supra* notes 59-60 and accompanying text.

[73] *See also* Tafara & Peterson, *supra* note 46, at 35 ("Technology and globalization have also created new opportunities for securities fraud. It is well recognized that the technology that allows for cross-border markets also allows for cross-border fraud."); Karmel, *supra* note 64, at 39 ("In globalized capital markets, many violations of securities laws are transnational. This means that unless national laws are given extraterritorial effect, there will be inadequate law enforcement, but if laws are applied extraterritorially, there will be conflict between regulators and confusion on the part of regulated persons as to what are the . . . proper rules.").

[74] *See supra* notes 65-70 and accompanying text.

[75] *See also* Chris Brummer, *Post-American Securities Regulation*, CAL. L. REV. (forthcoming 2010) (providing an excellent analysis of the current state of international securities regulation); Chris Brummer, *Stock Exchanges and the New Markets for Securities Law*, 75 U. CHI. L. REV. 1435 (2008) (arguing that the emerging system of international securities regulation is based upon regulatory competition, rather than moving toward harmonization and centralization).

[76] *See* Eric J. Pan, *A European Solution to the Regulation of Cross-Border Markets*, 2 BROOK. J. CORP. FIN. & COM. L. 133, 164 (2007) (discussing the creation of an international body to coordinate securities regulation between multiple countries).

any of their authority to a global securities regulator.[77] A number of commentators have noted that a global securities regulator is unlikely to emerge until national securities regulators are willing to relax their current approaches to regulation and jurisdiction.[78]

With that said, however, many national securities regulators have been slowly moving toward harmonization and the creation of a centralized global securities regulator through the formation of the International Organization of Securities Commissions ("IOSCO") and because of a greater openness to transnational cooperation. The IOSCO is an international organization founded in 1983 to foster cooperation among securities regulators throughout the world and to promote just and efficient markets.[79] The IOSCO is composed of securities regulation agencies that regulate more than ninety percent of the world's securities markets.[80] Although the IOSCO has achieved a number of successes in coordination of international securities regulation,[81] the IOSCO falls short of the regulatory harmonization and centralization necessary to regulate and stabilize the emerging global securities markets, because the IOSCO exists only to serve an advisory function.

The next evolutionary step in international securities regulation would be to provide the IOSCO or a successor entity with more robust monitoring, enforcement, and regulatory powers. The Obama Administration has stated a commitment to raising international regulatory standards and improving international cooperation.[82] If and how this might impact international securities regulation remains open to question.

In all likelihood, a number of recessions and depressions will probably be necessary to produce regulatory harmonization and the emergence of a centralized global securities regulator. Traditionally, periods of financial crisis are followed by increased financial regulation.[83] Harmonization and centralization, however, would require securities regulators to eschew their entrenched nationalistic and protectionist tendencies. Although harmonization and centralization might be the best

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[77] *See id.* ("International agreements are difficult to draft and negotiate. It is difficult to imagine drafting and negotiating the terms of an agreement specifying the details of how a country regulates its exchanges and broker-dealers.").

[78] *See* Langevoort, *supra* note 60, at 205 (discussing the possible creation of a "global securities and financial services regulator"); Saylor, *supra* note 50, at 713-16 (arguing that the world is probably not ready for the creation of a global securities regulator with regulatory and enforcement powers).

[79] *See* About IOSCO, General Information on IOSCO, http://www.iosco.org/about/ (last visited Nov. 11, 2009).

[80] *See* About IOSCO, IOSCO Historical Background, http://www.iosco.org/about/index.cfm?section=history (last visited Nov. 11, 2009).

[81] *Id.*

[82] *See* U.S. DEPT. OF TREASURY, FINANCIAL REGULATORY REFORM 80-88, *available at* http://www.financialstability.gov/docs/regs/FinalReport_web.pdf.

[83] *See* Tafara & Peterson, *supra* note 46, at 51 ("The history of financial legislation, from the Bubble Act of 1720 to the Sarbanes-Oxley Act of 2002, shows that it is usually the child of crisis.").

course for stabilizing the global securities markets, the emergence of such a system will likely take a long time to come into being.

CONCLUSION

As this introductory essay and the following articles demonstrate, preventing or lessening a future financial crisis is going to require systematic regulatory reforms both domestically and abroad. However, no simple solution exists for preventing another financial crisis. This proposition is especially true because of the emerging and evolving global financial markets. The March 20, 2009 symposium and this symposium issue provide a starting point for a debate over regulatory reform that is likely to rage for years to come.