

HARMONY OR CACOPHONY?
A PRELIMINARY ASSESSMENT OF THE RESPONSES TO THE
FINANCIAL CRISIS AT HOME AND IN THE EU

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To be sure, the recent reforms to the U.S. regulatory system are far from final. Even if House Republicans do not succeed in turning back the clock, the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”)¹ require so many studies, interpretations, and effectuating regulations that it will evade meaningful analysis for years. And while the nominally bipartisan Financial Crisis Inquiry Commission recently issued its report on causes for the financial crisis, that spirited document both spread the blame and disclosed infighting so as to cloud sufficiently any lasting impressions.

Separately, the European Union—tasked with confronting the same economic foes while facing its own legislative obstacle of supranationalism—has issued robust rounds of Directives, Regulations, and Recommendations.² Similar to efforts in the United States, the culmination of these reforms will trigger debate about business regulation on that continent for years to come.

So where do the two regulatory mosaics agree on primary culprits? And how strongly do they endorse targeted reform? An initial analysis might support the conclusion that the EU feels stronger about the culpability of certain practices

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¹ Pub. L. No. 111-203, § 619, 124 Stat. 1376, (2010) (to be codified at 15 U.S.C. § 78o-7).

² Cf. *New regulations for hedge funds*, FT.COM (Oct. 10, 2010, 7:25 PM),

http://www.ft.com/cms/s/0/7da06198-d49b-11df-b230-00144feabdc0,dwp_uuid=79bea71c-a86b-11da-aeab-0000779e2340.html#axzz1HvwZOhgO.

and institutions than its American counterparts.

Take short selling, for example. While the SEC's response in recent years has crystallized into gradually squeezing the most offensive forms of the questionable trading into a non-controversial category termed "abusive short selling," this remedy has done little to quell the fires among aggrieved investors who feel that Dodd-Frank ultimately took aim at that pernicious practice only in the most oblique of fashions.³ Meanwhile, the EU, although similarly concluding that "short selling is often not abusive,"⁴ felt threatened enough by the practice to move to (i) enable the new EU regulatory body to suspend trading in a particular issue within a Member State for three months,⁵ and (ii) require that, for certain issues, the seller evidence his borrowing of the subject shares or entering into an agreement for the same.⁶ By contrast, requirements in the U.S. are less stringent, as the effectuating broker-dealer merely must possess "[r]easonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due" before accepting a short sale order in an equity security from another person.⁷

Separately, hedge funds, while coming involuntarily on the regulatory radar screen on both continents, in the EU are restricted from marketing to entities outside of the EU unless the counterparty is subject to an "equivalent [regulatory] regime."⁸

Concerning the regulation of OTC derivatives, while both the U.S. and the EU have endorsed the notion of transparency, pan-European regulators shall

³ See *Letter to Senator Dodd and Representative Frank on Abusive Naked Short Selling*, INV. VILL., <http://www.investorvillage.com/smbd.asp?mb=3532&mn=5603&pt=msg&mid=1683231> (last visited Mar. 27, 2011) (urging "hearings on abusive naked short selling and its effect on the market and public companies").

⁴ See *Commission Proposal for a Regulation of the European Parliament of the Council on Short Selling and Certain Aspects of Credit Default Swaps*, at 3, COM (2010) 483 final (Sept. 15, 2010), available at http://ec.europa.eu/internal_market/securities/docs/short_selling/20100915_proposal_en.pdf.

⁵ *Id.* at 9.

⁶ *Id.* at 7.

⁷ 17 C.F.R. § 242.203(b) (2008).

⁸ See Council Directive 2010/78, 2010 O.J. (L 331) 133 (EU), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:331:0120:0161:EN:PDF>; see also *Parliament ushers in new EU rules for hedge funds and private equity*, EUROPEAN PARLIAMENT PRESS SERV., <http://www.europarl.europa.eu/en/pressroom/content/20101110IPR93908/html/Parliament-ushers-in-new-EU-rules-for-hedge-funds-and-private-equity>.

have the authority to define subject derivatives within the Member State.⁹ The U.S. remains dependent upon the efforts of the SEC and the CFTC to identify the potentially troublesome vehicles (and to play nice in coordinating information thereon).

Finally, the very notion of fraud prohibitions is under review across the pond. In June 2010, the EU commenced a consultation period on the 2004 Market Abuse Directive.¹⁰ It is noteworthy that countries like Germany already outlaw even *attempted* insider trading. Conversely, Rule 10b-5,¹¹ America's broad, catchall antifraud prohibition, has been left to its cursed fate of continued ad hoc interpretation by federal courts, which see attempted insider trading cases only on the rarest of occasions and often via consent agreements.¹²

Overall, the two systems share many common responses, with a modicum of differences. But the significance of these dissimilarities (as inchoate as they may be) is more than just academic. Somewhere in the SEC it has no doubt been noted that the Europeans—at least in name—scrapped their pan-European regulator in favor of the new European Securities and Markets Authority authorized to directly oversee credit rating agencies within EU Member States.¹³ And the decades-old EU concept of “transfrontier insider dealing”¹⁴ may be a concept worth importing as SEC enforcement efforts go global. Finally, Europe's restrictions on hedge fund marketing outside the EU may inspire a wave of market protectionism viewed by some as pure jingoism.

One interesting side note concerns the role of the investor in this whole mess. While the SEC appears poised to remain true to its aged crusade to shield the

⁹ See *Commission Proposal for a Regulation on OTC Derivatives, Central Counterparties and Trade Repositories*, COM (2010) 484/5, available at http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/20100915_proposal_en.pdf.

¹⁰ *Public Consultation of the European Commission on a Revision of the Market Abuse Directive (MAD)*, SEC (June 25, 2010), available at http://ec.europa.eu/internal_market/consultations/docs/2010/mad/consultation_paper.pdf.

¹¹ 17 C.F.R. § 240.10b-5 (2011).

¹² Ann Hadley Vom Eigen, *Securities Fraud*, 24 AM. CRIM. L. REV. 687, 688 (1987).

¹³ Commission Regulation 1095/2010, of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory, 2010 O.J. (L 331) 84, available at <http://www.esma.europa.eu/popup2.php?id = 7331>.

¹⁴ Council Directive 89/592, of 13 November 1989 on Coordinating Regulations on Insider Dealing, 1989 O.J. (L 334) 30 (EC), available at <http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri= CELEX:31989L0592:EN: HTML>.

sheep investor from slaughter, the EU perhaps invites more useful debate on the role of the purchaser in the ever-complicating bazaar. For example, Britain's proposed Consumer Protection and Markets Authority¹⁵ from last year was drawn to serve the twin goals of investor protection and market integrity while balancing such protections with "consumer responsibility." As products grow more complicated and national interests in protecting home markets grow stronger, perhaps individual investor accountability will similarly grow from option to necessity.

¹⁵ Matthew Vincent, *Good Can Come of FSA's Demise*, FT.COM (Jun. 18, 2010, 7:27 PM), <http://www.ft.com/cms/s/2/54d4298c-7b06-11df-8935-00144feabdc0.html#axzz1Hoe9F2MD>.