Globalisation and the Securities Markets

Comments on a paper presented at:

The New Special Study of the Securities Markets, Initiating Conference[1]

Columbia University Law School, 22 – 24 March 2017

Joanna Perkins, Chief Executive, FMLC

The paper under discussion[2] explains how globalization has affected the operation of the securities markets to date. I think, however, that the biggest challenge for both regulators and for the New Special Securities Study is to anticipate how markets will be affected in the future by factors like globalisation and technological disruption and to make recommendations accordingly for future-proofing securities regulation.

In anticipating changes to the national market system in the future, it seems to me that we would want to have answers to each of at least four different types of questions:

1. Descriptive or definitional questions (questions about disrupters and innovators):
    - What will markets look like and where will they be located;
    - What forms of intermediation will exist; and
    - What will count as a "security" for the purposes of securities regulation?
2. Logistical questions (questions about infrastructure providers and users):
    - How will traders be connecting to markets in future; and
    - How will issuers be issuing securities (*via* depositories or straight onto blockchain)?
3. Conduct questions (questions about market leaders and "misleaders"):
    - Who will the dominant players be;
    - What are their incentives; and
    - Who—or, perhaps, "what" in the case of robo-advisers—will pose the greatest risk to fair and effective markets?
4. Policy questions (questions about stakeholders and the public interest):
    - How much market fragmentation is okay if it promotes investor choice;
    - Is it okay that large-in-scale orders have been effectively excluded from price discovery mechanisms;

1 The conference agenda is available at: http://www.law.columbia.edu/capital-markets/overview/speakers-schedule

2 Armour, Bengtzen, Enriques, "Investor Choice in Global Securities Markets" (2017, forthcoming).

Registered Charity Number: 1164902
"FMLC" and "The Financial Markets Law Committee" are terms used to describe a committee appointed by **Financial Markets Law Committee**, a limited company.
Registered office: 8 Lothbury, London, EC2R 7HH. Registered in England and Wales. Company Registration Number: 8733443.

- Do we care that public offerings are less common than they once were; and
- In future, will the public interest priority be liquid markets or choice and competition among trading venues?

These questions are implicit in the globalisation paper but as the New Special Study moves forward, it would do well to make them explicit.

So, how does globalisation bear on these questions? Well, I think it does so across four dimensions:

1. The regulatory coordination problem: international cross-border markets benefit from a coordinated international regulatory and supervisory response.

2. The phenomenon of increasing foreign ownership: the ideal policy response would achieve a sound balance between foreign and domestic ownership, noting both the advantages and disadvantages of foreign ownership of domestic assets and conversely of the exposure of domestic investors to foreign markets (both of which tend to import a valuable benefit in times of prosperity but can cause additional stresses at times of market disruption).

3. The issue of—and, many would say, need for—extraterritoriality in domestic regulation.

4. The growth of globally systemically important market participants: investors, issuers and intermediaries and the problems of adequately supervising and administering them in both life and death.

The paper focuses chiefly on the second and third of these issues, touching on the first, but the fourth may also be worth further attention in the context of this study.

So, I'm going to swallow a little of the medicine I've just prescribed and attempt just a few observations about the implications of globalisation for the questions (*above*) to which regulators need answers as they attempt to future-proof market regulation. And in the spirit of yesterday's technology sessions these observations focus on the role of innovation in shaping the future development of the securities markets.

First, globalisation implies that market conduct rules, and particularly market abuse rules, should converge across jurisdictions to avoid regulatory arbitrage. In this regard, it would be helpful in future to have geographically consistent answers to questions such as: "*can algorithms trade securities abusively?*" For example, we might want to agree on whether a firm which buys or sells securities algorithmically can be said to be trading them on inside information. In this regard, it is of interest that the European Court of Justice has held that a firm which trades securities while "in possession of" inside information is deemed to be "using" inside information, whether or not it trades "with knowledge of" or "on the basis of" inside information.[3]

Second, we need to think carefully about who is a liquidity provider and to what extent we want to incentivise the provision of liquidity of different types (both displayed and undisplayed). Different types of order matching—bilateral vs. multilateral—are going to throw up a variety definitional challenges as we attempt to distinguish between order matching and other forms of market activity. The European Securities Markets Authority has recently written to the E.U. Commission to express concern that broker-crossing networks which blur the boundary between bilateral and multilateral order matching may be established to circumvent current regulation designed to push trades onto exchanges.[4] In future, some commentators may even argue that unilateral order matching qualifies as liquidity provision. We have

3 See: *Spector Photo Group and Van Raemdonck v Commissie voor het Bank-, Financie- en Assurantiewezen (CBFA) (Case C- 45/08)*

4 The letter is available at: https://www.esma.europa.eu/sites/default/files/library/esma70-872942901-19_letter_chair_guersent_si_0.pdf

just seen here earlier today a slide which set out five milliseconds' worth of trading in Johnson&Johnson shares. And the trading was very active indeed. If I, as a high frequency trader, buy and sell the same stock within just a few milliseconds, can it not be said that I am matching my own sell order against a buy order? If so, where regulation is designed to foster liquidity by providing safe-harbours and similar protections for liquidity providers, should the benefits extend to unilateral order matching of this kind?

Third, we may need to think a little more imaginatively about what constitutes a security. If we look around the world at the moment we can see new issues of cryptoshares, straight onto blockchain. We can also see increased numbers of so-called initial coin offerings in the virtual space, which many commentators argue are really securities offerings. And, to return for a moment to the question of whether we can ever have real time trade settlement, which was addressed in yesterday's session on Technology, intraday settlement may be achievable where virtual securities pegged to real world stocks—say, virtual Apple shares—are settled against virtual tokens pegged to real world Sovereign currencies—say, virtual U.S. dollars. It seems to me that this is the most promising potential route to real time settlement. But in that eventuality, we would need swiftly to address a series of challenging legal and regulatory questions, including those about voting rights and what happens in circumstances of issuer default.

It would be as well to begin the analysis of questions like these before our markets, which operate increasingly without geographical boundaries, are disrupted by technological innovation, rather than afterwards.

Thank you.