End of American dominance in capital markets
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Is a ticker-taped Trojan Horse soon to be planted on European shores, filled with an army of US regulators, Sarbanes-Oxley accountants and overzealous plaintiff lawyers? These fears, recently voiced on both sides of the Atlantic, fundamentally misperceive what the possible New York Stock Exchange/Euronext and Nasdaq/London Stock Exchange mergers represent – a way for US exchanges to offer listing and trading alternatives to non-US companies wishing to avoid the US regulatory regime. The last thing the merger partners want is to Americanise foreign exchanges. Indeed, such a development would probably kill the deals. The real issues are whether these potential mergers reflect the end of US dominance in world capital markets and the extent to which European-style corporate governance would adequately protect investors.

What we are witnessing is the latest chapter in the evolution of the euromarkets. In the past, US banks moved to London to escape onerous banking regulation and the eurobond market was created in part to avoid US taxes. Now exchanges are moving abroad in part to avoid the US capital market's regulatory regime. Europe should not be threatened. It is the US that should be concerned. Once a market moves abroad it is difficult to get it back.

Fear of regulatory merger is belied by recent history. The Euronext network shows that the merger of exchanges into one corporate entity can leave each with its own national governance standards and regulatory requirements intact. Unless there are revolutionary developments in regulatory sovereignty – highly unlikely – a business combination of US and European exchanges would not result in US regulatory requirements being imposed on European listed companies. Harvey Pitt, writing recently in the Financial Times ("Sarbanes-Oxley is an unhealthy export", June 21), wrongly suggests that European listed companies would be subject to Sarbanes-Oxley in a scenario involving a merger of US and European exchanges. This is not the case. Non-US companies would not be subject to US regulation, as long as they are not listed on US stock exchanges or on the Over-the-Counter Bulletin Board (OTCBB). The Securities and Exchange Commission has indicated that "a non-US exchange would only become subject to US securities laws if that exchange is operating within the US".

Fear of regulatory merger is also belied by considerations of corporate strategy and regulatory competition. Merged exchanges seek to build diverse "regulatory portfolios" relating to corporate governance law and regulation. The basis of the diversity lies in the contrast between the more prescriptive form of governance regulation in the US compared with Europe's more principles-based "comply or explain" approach. For US exchanges, a stake in European exchanges that may be more issuer-friendly can provide an alternative to the less flexible, more costly and more litigious US environment.

Emerging market issuers, including many from Russia and China, have increasingly been attracted to list in London or Hong Kong, respectively, as alternatives to the US. In 2005, of the 24 largest global initial public offerings only one was listed in the US. Hence, instead of focusing on the red herring of regulatory merger, we should be discussing two real concerns about these exchange mergers: the consequences for the US economy and for good corporate governance. Once foreign companies find foreign markets preferable, US companies may not be far behind. Europe is the big economic winner.

While the European approach to regulation may prove to be a more adaptable and sustainable model for global companies, we also need to be alert to its vulnerabilities. The effectiveness of the "comply or explain" regime, with fewer regulatory teeth, will hinge on greater discipline by market participants. Investors, intermediaries and other gatekeepers increasingly must seek credible explanations from companies that do not comply with voluntary governance codes and must be prepared to alter investment strategies if these explanations are lacking.

We are witnessing a crucial moment in economic history – the movement of US capital markets abroad. The US must be more realistic about its ability to remain the centre of capital market activity and investors in all jurisdictions must intensify efforts to maintain market discipline as companies move to a less regulated environment.

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