European Capital Markets Law

Third Edition

Edited by
Rüdiger Veil

• HART •
OXFORD • LONDON • NEW YORK • NEW DELHI • SYDNEY

HART PUBLISHING

Bloomsbury Publishing Plc

Kemp House, Chawley Park, Cumnor Hill, Oxford, OX2 9PH, UK

1385 Broadway, New York, NY 10018, USA

29 Earlsfort Terrace, Dublin 2, Ireland

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First published in Great Britain 2022

A catalogue record for this book is available from the British Library.

Library of Congress Cataloging-in-Publication data

Names: Veil, Rüdiger, 1966-, editor.

Title: European capital markets law / edited by Rüdiger Veil. Other titles: Europäisches Kapitalmarktrecht. English

Description: Third edition. | Oxford, UK ; New York, NY : Hart Publishing, an imprint of Bloomsbury Publishing, 2022. | Includes bibliographical references and index.

Identifiers: LCCN 2021059531 (print) | LCCN 2021059532 (ebook) | ISBN 9781509958481 (hardback) | ISBN 9781509942114 (paperback) | ISBN 9781509942121 (pdf) | ISBN 9781509942138 (EPub)

Subjects: LCSH: Capital market—Law and legislation—European Union countries. | Financial institutions—Law and legislation—European Union countries.

Classification: LCC KJE2245 .E9213 2022 (print) | LCC KJE2245 (ebook) | DDC 346.24/09—c23/eng/20220131

LC record available at https://lccn.loc.gov/2021059531

LC ebook record available at https://lccn.loc.gov/2021059532

ISBN: PB: 978-1-50994-211-4
ePDF: 978-1-50994-212-1
ePub: 978-1-50994-213-8

Typeset by Compuscript Ltd, Shannon

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§ 2

Concept and Aims of Capital Markets Regulation

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I. Concept

1 In academic literature, no clear definition of the term capital markets law has emerged. However, there is probably agreement that capital markets law deals with (i) the **organisation** of **capital markets**, (ii) **access** to them and (iii) the **trading** of **securities** both on **markets** and **bilaterally** (so-called over-the-counter transactions).

2 The first aspect (**organisation of markets**) has a long tradition in the legal systems of the Member States. Markets used to be organised as **stock exchanges.** The legislature of European countries reacted to manipulation and fraud by enacting stock exchange laws as early as the 19th century. Since the beginning of the 2000s, markets have also been operated by investment firms and there is competition between the different types of trading venues (regulated markets, MTFs and OTFs), which leads to better conditions and prices for investors. The term stock exchange no longer plays a role in European law. However, the market-based approach of European law does not exclude the possibility of markets being organised as stock exchanges. The operation and organisation of stock exchanges is governed by the national laws of the Member States.

3 Capital markets law also deals with **access to capital markets**. On the one hand, it deals with access of **issuers** to capital markets, especially as an alternative to bank financing and private equity (corporate finance). In order to be able to offer securities to the public or to admit securities to trading on a regulated market, an issuer is required by European law to provide investors with information on all relevant circumstances in a prospectus so that they can make an informed investment decision. An information document is required even if an issuer's securities are to be traded on a less regulated capital market (MTF or OTF) or if the issuer wishes to raise money through crowdfunding. On the other hand, European law regulates **investor** access to capital markets as well. Investors cannot, in principle, trade in securities on the exchange themselves, but must instead bring in securities dealers, as only these have the necessary expertise to trade on the exchange. Investors may also be limited in their ability to acquire particularly risky securities. In this context, the law on collective investment schemes also becomes relevant. It governs the acquisition of fund units, ie financial products by which investors are indirectly involved in a large number of issuers (whose securities are held in the fund assets).

4 Finally, capital markets law comprises the legal requirements for **trading in securities**. The rules were formerly provided for in the stock exchange laws of Member States and can now be found in the so-called Single Rulebooks of the EU. Securities trading law consists of two areas of regulation, which differ considerably with regard to the level of protection for investors. The first concerns the general **market conduct** regimes for **issuers** of securities and **investors**. Firstly, this includes the market abuse regime, which in Europe consists of a regulation directly applicable throughout the Union as well as of harmonised national criminal law provisions. Furthermore, securities trading law consists of disclosure requirements concerning price-sensitive circumstances that apply to issuers of securities as well as investors and that are designed to enable market participants to make informed investment decisions. This area of capital markets law is still largely based on the concept of a reasonable investor, who is basically able to understand all the information and draw conclusions from it for an investment decision. The second area of regulation concerns the **conduct** and **organisation** of **intermediaries**, in particular firms providing investment services such as investment advice and brokerage, asset management, investment research, etc. Other important information

intermediaries include rating agencies, proxy advisors and producers of benchmarks and securitisations. The regimes concerning intermediaries have developed into an independent area of capital markets law with increasingly paternalistic features. This applies in particular to the law on investment services, which no longer assumes that an investor can understand all information, but must be protected in a similar way to a consumer.

The legal sources of capital markets law consist of public law, private law and criminal law. 5
A large part belongs to **public law**. Compliance with these regimes is supervised by public authorities. Therefore, the rules are also called **supervisory law**. These rules are almost entirely provided for in Union law. Furthermore, capital markets law consists of private law. The relevant **private law** is not harmonised throughout the Union. The purchase of securities is a purchase of rights, ownership is acquired in accordance with the private law of the respective Member State and, since investors on stock exchanges may not act for themselves but must involve banks as commission agents, in accordance with the rules of the applicable commercial law. There are often contractual relationships between intermediaries on the one hand and investors and issuers on the other. The rights and obligations of the parties arise primarily from the applicable private law. It is not yet clear whether the supervisory rules can determine the contractual obligations.[1] Finally, **criminal law** may be applicable. Violations of disclosure obligations and prohibition of market abuse are sanctioned by way of administrative penalties, and the prohibitions of market abuse can even be enforced by imprisonment.

II. Regulatory Aims

EU primary law does not contain any explicit provisions on the objectives of capital markets 6
law. However, it clearly states that the EU is establishing a single market (Article 3(3) TEU). The capital market is part of the internal market. An integrated capital market results in a larger number of investments so that investors can better diversify their risks. A broader and larger investment in turn results in lower capital costs for issuers and lower transaction costs for investors.[2] The macro- and microeconomic effects of capital market integration are enormous.[3] This explains why the EU's Capital Markets Union project[4] aims to further unify regimes.

1. Efficiency of Capital Markets and Investor Protection

The level 1-acts aim to ensure the institutional **functioning** of **markets** in Europe.[5] The 7
proper functioning of securities markets requires public confidence in the markets.[6]

[1] On the relevance of supervisory law for obligations under private law, see R. Veil § 30 para. 62.
[2] See A. Brüggemeier, *Harmonisierungskonzepte im europäischen Kapitalmarktrecht*, 79.
[3] Ibid. 81, with reference to studies according to which an internal capital market should reduce the capital costs of a listed company by an average of 0.467%.
[4] See R. Veil § 1 para. 50.
[5] This corresponds to ESMA's task of ensuring the integrity, transparency, efficiency and proper functioning of financial markets. Cf. Art. 1(5)(b) ESMA-Regulation.
[6] Recital 2 MAR; recital 7 PR.

A further regulatory objective is to ensure that efficient securities markets allow a better allocation of capital and a reduction in costs.[7]

8 The **allocation function** of capital markets means that the capital collected (from private households, institutional investors and investment-seeking companies) should flow to where the money is most urgently needed and where the highest return can be achieved with sufficient investment security. This requires investor confidence in the markets, which can be achieved by the disclosure of price relevant information and transparency concerning market participants' conflicts of interest.[8]

9 The aim of **ensuring the proper functioning** of capital markets concerns the basic requirements for an efficient mechanism of market segments. It requires access to the market to be as unhindered as possible, as well as for sufficient supply and demand by investors. A market that attracts a lot of capital is a liquid market, ie investors can expect to be able to sell their securities at a later date. Measures must therefore be taken to increase **investor confidence** and ensure the **integrity of** the **market.**[9]

10 Finally, capital markets law pursues the goal of optimising the **operational functioning** of capital markets by minimising the costs incurred by a transaction. On the one hand, issuers' efforts must be kept as low as possible; costs incur when securities are listed on the stock exchange (admission fees, costs of the prospectus, etc.) and for the subsequent publication of information and organisational arrangements. Secondly, the operational functioning of a market depends on the costs incurred by investors in investing in securities.[10] These costs can be reduced by imposing disclosure obligations on the issuer, who is usually the cheapest cost avoider.

11 The proper functioning of the markets and investor protection are two 'communicating vessels'[11] that support each other.[12] This explains why European legislature wants to achieve a 'high level of investor protection'.[13] What exactly the term **investor protection** encompasses, in particular whether even property interests of investors are protected,[14] is still an open question. In recent legislation, moreover, investor protection is repeatedly linked to the concept of consumer protection. The Prospectus Regulation 2017/1129, for example, intends to achieve a 'high level of consumer and investor protection'.[15] However, it is not apparent from the legislative act whether a higher level of protection should be associated with consumer protection than with investor protection. The European Commission and ESMA have not yet expressed their views on this either. For the interpretation of specific legal questions, the reference to consumer protection is unlikely to be helpful. The situation may be different in financial services law, where the focus is now on consumer protection, thereby implying that investors may be particularly vulnerable and in need of protection

[7] Recital 1 TD.
[8] For details on transparency and capital market efficiency, see H. Brinckmann § 16 para. 4–16.
[9] European legislature also assumes that market integrity serves to ensure investor confidence in the markets. See recital 2 MAR.
[10] In detail: G. Franke and H. Hax, *Finanzwirtschaft des Unternehmens und Kapitalmarkt*, 56.
[11] K. Hopt, *Der Kapitalanlegerschutz im Recht der Banken*, 52.
[12] C. Bumke, in: Hopt et al. (eds.), *Kapitalmarktgesetzgebung im europäischen Binnenmarkt*, 107, 119.
[13] Recitals 5 and 7 TD.
[14] This question becomes relevant in the context of investor protection under private law, ie the question of whether investors can claim damages for breach of disclosure requirements. See R. Veil § 19 para. 80 ff.
[15] Recital 4 PR.

because they are not capable of interpreting the information provided by issuers and intermediaries correctly.[16]

Understanding why **investor confidence** is protected, as well as identifying the subject of investors' trust, is important for understanding capital market regulation. As a starting point, trust can be understood as an alternative mechanism for information in order to reduce complexity.[17] The trusting person refrains from exploring facts through information, but has trust in the (past, present or future) behaviour of persons or organisations. Thus, trust replaces an information deficit. A distinction can be made between personal trust (in a specific person, such as a bank advisor), organisational trust (in a legal entity, such as a public limited company with its management staff) and trust in a system (in institutions, such as the banking system or a market segment[18]). Trust in a system plays a major role in capital markets law, as capital markets are anonymous. Parties to a transaction do not usually know each other, so they cannot develop personal trust. In addition, investors cannot examine the financial products that are being traded. Therefore securities are also described as credence goods, as opposed to inspection goods. An investor who enters into securities transactions trusts that other investors will not cheat him and that all information relevant to his decisions will either be disclosed or kept secret from all market participants. 12

The **equal treatment** of **capital market participants** is a central **principle** of **European capital markets regulation**.[19] EU insider trading law is based on the idea of equal information opportunities for investors.[20] In addition, a large number of provisions can be identified that manage the equal treatment of intermediaries and investors. Issuers and investors should have equal access to markets. Furthermore, investors should have equal access to the information they need to acquire or dispose of securities. First of all, equal treatment means that market participants must not be discriminated against. The principle of equal treatment may require treating market participants equally. An unequal treatment may be justified if there is an objective reason and the unequal treatment is proportionate.[21] Whether the principle of equal treatment impacts the interpretation of legal provisions can only be assessed in individual cases. 13

Equal treatment of market participants is also a key principle for the further development of the regimes that strengthen investor confidence in the functioning of markets. However, other objectives of capital market regulation may justify unequal treatment. This will be illustrated by an example: The purpose of European law is to ensure that all investors can take note of new price-sensitive information at the same time. Article 2(1) of Regulation (EU) 2016/1055 requires that inside information be disseminated 'to as wide a public as possible on a non-discriminatory basis' and 'free of charge'. In addition, the issuer has to use 'electronic means that ensure that the completeness, integrity and confidentiality of the information is maintained during the transmission'. These procedural requirements are to ensure equal information opportunities for investors. However, European law allows high-frequency traders to exploit information before other investors, for 14

[16] Cf. recital 13 PRIIPS: 'Given the difficulties many retail investors have in understanding specialist financial terminology, particular attention should be paid to the vocabulary and style of writing used in the document'.

[17] P. Mülbert and A. Sajnovits, 2 ZfPW (2016), 1, 6, with reference to N. Luhmann, *Vertrauen*, 27 ff.

[18] P. Mülbert and A. Sajnovits, 2 ZfPW (2016), 1, 7–10.

[19] Cf. S. Heinze, *Europäisches Kapitalmarktrecht*, 7; G. Bachmann, 170 ZHR (2006), 144 ff.; C. Mehringer, *Das allgemeine kapitalmarktrechtliche Gleichbehandlungsprinzip*, passim; D. Mattig, *Gleichbehandlung im europäischen Kapitalmarktrecht*, passim.

[20] Cf. R. Veil § 14 para. 16.

[21] Cf. D. Mattig, *Gleichbehandlung im europäischen Kapitalmarktrecht*, 177–183, 288–300, 334–351, 376.

example by placing their computers directly in the trading computers' data centres (co-location).[22] This privilege can be justified by the positive aspects of high-frequency trading, in particular the improved liquidity of capital markets.

2. Financial Stability

15 Another regulatory objective of capital markets law is one that has only emerged in the last decade: financial stability. The financial market crisis 2007/08 demonstrated the importance that individual financial market participants, in particular systemically relevant banks, but also certain trading practices, such as short selling, can have for the stability of financial markets, and that financial markets are closely interlinked. Not all risks that endanger a financial system can be prevented solely by supervising banks. It has, rather, become apparent that the financial system must be regarded in its entire complexity. The European legislature has therefore created the European System of Financial Supervisors (ESFS).[23] The ESFS consists of three European supervisory authorities (EBA, EIOPA and ESMA), the European Systemic Risk Board (ESRB), the Joint Committee of European Supervisory Authorities and the supervisory authorities of the Member States.

16 Financial stability could also be understood as being a part of the regulatory objective of ensuring the proper functioning of markets. However, legislature considers financial stability as a separate regulatory objective. This applies above all to banking law.[24] One of the main goals of the CRD IV regime is to ensure financial stability, because the failure of large credit institutions has unfavourable consequences for payment systems and the real economy. Issuers and intermediaries on capital markets do not pose a comparable risk. Nevertheless, serious negative consequences for the financial system and the real economy may also arise on capital markets. According to Article 1(5) ESMA Regulation, the objective of **ESMA** is to '**protect** the public interest by contributing to the **short-, medium- and long-term stability** and effectiveness of the **financial system**, for the Union economy, its citizens and businesses.'[25] Financial stability is highlighted here as the second prominent objective of European capital markets law, alongside the proper functioning (effectiveness) of capital markets.

17 The regulations and directives adopted since 2009 are partly justified by the fact that they are intended to ensure financial stability in Europe. For example, the amendment to the Regulation on Credit Rating Agencies adopted in 2011 (CRAR-II) underlines the importance of these intermediaries for the stability of financial markets.[26] Furthermore, the regulation on short selling (SSR), which entered into force in 2012, also aims to ensure financial stability.[27] MiFID II and MiFIR are also supposed to help ensure stability of the financial markets.

22 Cf. M. Lerch § 25 para. 42 on rules re. co-location.
23 For more detail, see F. Walla § 11 para. 55 ff.
24 Cf. J. Bauerschmidt, 17 ECFR (2020), 155, 158–178.
25 See also recital 17 ESMA-Regulation.
26 See recital 11 CRAR-II. The 2009 CRAR-I was still based exclusively on ensuring the functioning of the markets and the internal market.
27 For more detail, see F. Walla § 24 para. 12.

For the interpretation of the respective supervisory rules, it may be necessary to specify the concept of financial stability, especially when the term 'financial stability' or 'stability of financial systems' is provided as a prerequisite for intervention by NCAs or the ESAs. For example, ESMA may prohibit or restrict certain financial activities if they threaten financial stability (Article 9(5) ESMA Regulation). In addition, the intervention powers of NCAs with regard to short selling and credit default swaps presuppose that financial stability is seriously threatened.[28] The product intervention powers of NCAs and ESAs under Articles 40–43 MiFIR also relate to the stability of the financial system. 18

The concept of financial stability must therefore be put into more concrete terms. Garry Schinasi describes financial stability as follows: 'Financial Stability is a situation in which the financial system is capable of satisfactorily performing its three key functions simultaneously. First, the financial system is efficiently and smoothly facilitating the intertemporal allocation of resources from savers to investors and the allocation of economic resources generally. Second, forward-looking financial risks are being assessed and priced reasonably accurately and are being relatively well managed. Third, the financial system is in such condition that it can comfortably if not smoothly absorb financial and real economic surprises and shocks.'[29] So financial stability depends very much on whether **internal** and **external shocks** are **overcome** by **self-correction mechanisms** without the real economy suffering as a result. While external shocks have their origin outside the financial system, such as a sharp rise in commodity prices, terrorist attacks or natural disasters, internal shocks have their origin within the financial system. Banks are already unstable due to their business model. If they have to correct valuations significantly or even become insolvent, this can result in companies and other market participants losing confidence in the markets.[30] This shock poses a significant threat to the stability of the financial system. Self-correction mechanisms include the adjustment of market prices, the exit of failed market participants and the entry of new ones.[31] 19

These findings are helpful in a legal context.[32] However, for the application of the law, the concept of financial stability must be further developed.[33] This is done in the Single Rulebooks at Level 2. The regime on short selling, for example, provides a number of 'criteria and factors' that must be taken into account when a supervisory authority decides on its powers of intervention.[34] The authorities are given a wide margin of discretion in this respect.[35] 20

3. Sustainability

In Paris, the global community agreed on the goal of limiting global warming to well below 2°C compared to the pre-industrial era and also committed to a 1.5°C scenario with less dramatic effects. Since the Paris Climate Change Agreement 2015, the EU has been reshaping the financial system.[36] Following the UN General Assembly's 2030 agenda for sustainable 21

28 For more detail, see F. Walla § 24 para. 52.
29 G. Schinasi, *Safeguarding Financial Stability: Theory and Practice*, 82.
30 D. Klingenbrunn, *Produktverbote zur Gewährleistung von Finanzmarktstabilität*, 15.
31 Cf. J. Stark, *Das internationale Finanzsystem*, 7.
32 Cf. D. Klingenbrunn, *Produktverbote zur Gewährleistung von Finanzmarktstabilität*, 17 ff.
33 See J. Bauerschmidt, 17 ECFR (2020), 155, 180: 'interpretative function'.
34 Cf. Art. 24 Delegated Regulation No. 918 of 5 July 2012, OJ L 274, 9 October 2012, p. 1 regarding unfavourable events or developments according to Art. 30 SSR.
35 Cf. Art. 24 Delegated Regulation No. 918: 'which can reasonably be assumed or could reasonably be assumed'.
36 See R. Veil § 1 para. 59.

development, sustainability has three dimensions for the EU: an **economic**, **social** and **environmental dimension**. The EU legislature is aligning the regimes for financial markets with these dimensions (Sustainable Finance). The main focus of European legislation so far has been on environmental sustainability.

22 Achieving the SDGs in the Union requires the channelling of capital flows towards sustainable investments.[37] A fundamental reorientation of capital markets law has not yet taken place. Rather, the measures to ensure sustainability introduced in European capital markets law are consistent with the traditional regulatory objectives. European legislation contributes to overcoming information asymmetries by requiring **financial market participants** (asset management companies; investment firms; insurance companies; etc.) to **disclose ecological risks** of **financial products**. In addition, financial market participants are to explain the ecological aspects of financial products distributed to their clients.[38] These **investor- and product-related disclosure requirements** of Regulation (EU) 2019/2088 (SFDR) have an informational and regulatory function.[39] Investors (in the terminology of European law: 'end clients') are encouraged to evaluate their investments with a view to environmentally sustainable economic activities and to take into account any (transitory or physical) sustainability risks of the financial product when making investment decisions.[40] Finally, it is also useful to define the concept of sustainability with as much certainty as possible. Regulation 2020/582 (SFTaxR)—also referred to as the Taxonomy Regulation—is necessary to develop a uniform understanding of environmental objectives throughout the Union.[41] This is particularly important when developing and distributing 'green' financial products.[42] The regime (consisting of numerous and extensive Level 2 legal acts) is dynamic[43] and will continue to develop in exchange with the Sustainable Finance.

23 Providers of financial products generally have no legal right to demand from companies the information they need to assess the environmental characteristics of a financial product. The European Commission's proposal to reform the CSR Directive (in future referred to as the **Non Financial Reporting Directive**)[44] therefore aims at improving access to information. In the future, **companies** should provide information on the sustainability aspects of their business activities in a **sustainability report** (which should be part of the management report). Furthermore, they are to state how they ensure that their business model and strategy is in line with the goal of a sustainable economy and the goal of limiting global warming, as agreed in the Paris Agreement in 2015.[45] This reporting obligation also has an information and regulatory function.

[37] Cf. recital 9 Regulation (EU) 2020/852.
[38] See R. Veil § 23 para. 8–11.
[39] Cf. R. Veil, in: Tountopoulos and Veil (eds.), *Transparency of Stock Corporations in Europe—Rationales, Limitations and Perspective* (2019), 129 ff. See also R. Veil § 23 para. 10.
[40] Cf. on these types of sustainability risks BaFin, *Fact sheet on dealing with sustainability risks*, p. 13: 'Events or conditions in the environmental, social or corporate governance fields […], the occurrence of which would have an actual or potential negative impact on the net assets, financial position and results of operations as well as on the reputation of a supervised entity.'
[41] Vgl. Cf. M. Stumpp, ZBB (2019), 71 ff.; E. Bueren, WM (2020), 1611 ff., 1659 ff.
[42] See on green bonds and ESG-funds R. Veil § 8 para. 28 ff.
[43] Vgl. N. Ipsen and L. Röh, ZIP (2020), 2001, 2010.
[44] Cf. European Commission, COM(2021) 189 final, 21.4.2021.
[45] See R. Veil § 7 para. 27.

Sustainable finance is a major challenge in its concrete implementation. The protection of the environment is not one of the established objectives of capital market law to ensure the institutional functioning of markets (see para. 11) and financial stability (see para. 15). Rather, it is traditionally realised in environmental, subvention and tax law. However, it is consistent with the traditional goals to enable sustainability-related investor decisions and to promote sustainable capital investments through disclosure obligations. This regulatory approach balances out information asymmetries between the issuer or provider of a green investment product on the one hand, and investors on the other. In contrast, the Commission's proposal for sustainability reporting by companies (see para. 23) can hardly be justified by the goals of accounting law. The disclosure requirements deeply interfere with entrepreneurial freedom. Finally, more far-reaching requirements on the consideration of ESG issues in investment decisions—for example, that asset managers would be obliged to invest a certain percentage in ecologically sustainable products—would lead to distortions with the traditional objectives of capital markets regulation. 24

III. Regulatory Strategies and Instruments

1. Disclosure

The regulatory objectives of European capital markets law are mainly pursued by the disclosure of price relevant information.[46] If **information is publicly available**, transparency exists. Anyone can then take note of the information.[47] Means for public disclosure used to be daily newspapers and financial newspapers in printed form. Today, information is transmitted via electronic information dissemination systems and the Internet, and in the future it will probably also be transmitted on the blockchain. Another traditional means of publicity are registers, which of course are now also kept in digital form. 25

(a) Information Function

Disclosure has various functions. The traditional and most established function is to enable investors to assess the **quality of an investment.** Securities are so-called credence goods. When purchasing a bond or share, an investor is not able to assess the expected return and the risks of the security without information about the issuer and the characteristics of the security (so-called *hidden information*). In the case of a derivative, information asymmetries exist with regard to the underlying and the structure of the derivative. One goal of capital markets regulation is to balance information asymmetries in order to enable investors to make an **informed decision** on the purchase and sale of the security or derivative (information function). But does this require disclosure obligations? The *market* 26

[46] Cf. E. Avgouleas, in: MacNeil and O'Brian (eds.), *The Future of Financial Regulation*, 205, 209; C. Bumke, in: Hopt et al. (eds.), *Kapitalmarktgesetzgebung im europäischen Binnenmarkt*, 107, 126.

[47] H. Merkt, *Unternehmenspublizität*, 11 f.; H. Brinckmann, *Kapitalmarktrechtliche Finanzberichterstattung*, 18.

for lemons[48] described by *Akerlof* suggests that an issuer that wants to sell its securities should have sufficient incentives to explain the quality of its security on its own initiative (*signaling*), otherwise there is a risk of market failure. The issuer should have sufficient incentive to disclose even unfavourable information, because otherwise market participants would give less weight to positive news in the future.[49] In addition, some argue that issuers are incentivised to disclose negative information to counteract the market's alleged worst-case assumptions ('*no news is bad news*').[50]

27 Nevertheless, European capital markets law provides for a large number of **disclosure obligations**. From an economic point of view, regulation can be justified by the fact that disclosure obligations best meet investors' information needs by focusing on 'relevant information' and therefore reduce transaction costs.[51] Statutory disclosure obligations are also suitable for standardising information. This makes it easier for investors to compare issuers with each other, which becomes particularly relevant in financial reporting. As an alternative to a mandatory statutory disclosure requirement, it may be appropriate to provide for a report-or-explain mechanism, so that the person required to disclose information can refrain from disclosing it, stating his or her reasons.

28 European capital markets regulation is based on the information paradigm. For example, the recitals to the Market Abuse Regulation state that 'immediate public **disclosure** of inside information is **essential**'.[52] The Transparency Directive also argues that the timely disclosure of reliable and comprehensive information on securities issuers strengthens investor confidence in the long term and enables a sound assessment of the company's business performance and financial position.[53] Finally, financial services legislation is based on the idea that investment firms must provide their clients with information about all relevant aspects of a security. MiFID II aims to ensure that clients receive 'all relevant information' about the financial service and the security.[54] It is not possible to give a general answer to the question of whether the disclosure obligations also serve as an instrument of **corporate governance**. According to the European legislature, the disclosure of major shareholdings in accordance with the Transparency Directive also improves the governance of listed companies.[55] In contrast, the European legislature understands ad hoc disclosure according to Article 17 MAR primarily as an instrument to prevent market abuse. Admittedly, the obligation of the issuer to disclose violations of law (to be qualified as inside information) can have a disciplinary effect on the management board.[56] However, the dislosure obligation does not serve purposes of corporate law and should therefore be interpreted in the light of its goal to improve market efficiency.[57]

[48] The *market for lemon* describes the danger of a race to the bottom if no information is available for high quality products. In the absence of demand, suppliers of such products withdraw from the market, with the result that the market collapses. See H. Brinckmann § 16 para. 7.

[49] K. Werner, *Publizitätskonzept*, 104.

[50] Cf. P. Milgrom, 12 Bell J. Econ. (1981), 380, 387.

[51] See H. Brinckmann § 16 para. 20.

[52] Recital 39 MAR.

[53] Recital 1 TD; also recital 3 and 7 PR.

[54] See for example recital 72 MiFID II.

[55] See R. Veil § 20 para. 4.

[56] See R. Veil § 19 para 8.

[57] Cf. M. Habersack, in: FS 25 Jahre WpHG, 217, 227.

29 According to the **Efficient Capital Market Hypothesis** (ECMH), securities prices reflect all publicly available information.[58] The theory distinguishes between weak, semi-strong and strong capital market efficiency. On a weak efficient market, securities prices reflect all (known) historical information. When a capital market is semi-strong efficient, securities prices reflect all generally available information, such as earnings estimates and securities analysis. A strong efficient market is characterised by the fact that prices are based on all relevant information, ie including non-publicly available inside information. In that case, investors cannot obtain any returns and insider trading is impossible. This form of efficiency has not yet been empirically proven.

30 According to Eugene Fama, the ECMH is based on the assumption that no transaction costs are incurred in securities trading, all information is available to market participants free of charge and all market participants agree on the impact of the information.[59] Though the reality is different,[60] it is justified to assume for the purposes of capital market regulation that the market price behaves as if the publicly available information is known to all market participants. This means in particular that market prices reflect the entire level of information made public.[61]

31 An explanation for the mechanisms of capital market efficiency is provided by Ronald Gilson and Reinier Kraakman.[62] Their academic work explains the central role of information costs. They distinguish between acquisition, processing and verification costs. Their central thesis is that the speed at which information is reflected in price is determined by the extent to which the information is disseminated. This depends very much on the costs of information incurred by investors. 'The lower the cost of particular information, the wider will be its distribution, the more effective will be the capital market mechanism operating to reflect it in prices, and the more efficient will be the market with respect to it.'[63]

32 The thesis developed by Gilson and Kraakman recognises that market prices do not necessarily reflect the **fundamental value** of a security.[64] This can have different reasons. Gilson and Kraakman assume four **market mechanisms of price formation**.[65] First, market prices can immediately reflect information that is known to all traders because this information has necessarily been made public to all market participants ('universally informed trading'). Second, information that is less well known but still public is incorporated into share prices almost as quickly as information that is known to everyone, through trading by professionally informed traders ('professionally informed trading'). Third, information known to very few traders would also find its way into prices (albeit more slowly), as uninformed traders learn of its content by observing activities of presumably informed traders or unusual price and volume movements ('derivative-informed trading'). Finally, information that is not known to anyone could be reflected in stock prices that aggregate the forecasts of numerous

[58] E. Fama, 25 J. Fin. (1970), 383 ff.

[59] E. Fama, 25 J. Fin. (1970), 383, 387.

[60] The Adaptive Markets Hypothesis (AMH), developed by A. Lo, 30 JPM (2004), 15–29, recognises that markets are not always efficient. It takes into account the limited rationality of market participants and their learning and adaptation behaviour. Cf. for a legal reception of the AMH, D. Klingenbrunn, *Produktverbote zur Gewährleistung von Finanzmarktstabilität*, 54–69.

[61] A. Brüggemeier, *Harmonisierungskonzepte im europäischen Kapitalmarktrecht*, 115.

[62] R. Gilson and R. Kraakman, 70 Va. L. Rev. (1984), 549–644: 'What makes the market efficient when it appears to be so?'.

[63] R. Gilson and R. Kraakman, 70 Va. L. Rev. (1984), 549, 593.

[64] See on the concept of the fundamental value R. Veil § 14 para. 56.

[65] *Gilson/Kraakman*, The Mechanisms of Market Efficiency, 70 Va. L. Rev. (1984), 549, 569.

market participants with heterogeneous information, albeit slowly and imperfectly ('uninformed trading', also called 'noise trading'). A proper functioning capital market is capable of recognising misjudgements, so that in the long run, at least, security prices are formed that reflect the fundamental value.

33 Against this background, the difficult question arises whether the ECMH can also be used for the interpretation of norms and further development of the law. It is assessed differently by the courts.

34 The famous decision of the US Supreme Court in the case *Basic v. Levinson* took the ECMH into account when developing principles for interpretation. Among other things, it dealt with the question of whether investors rely on information when buying securities. The court argued that this could be rebuttably presumed, because all publicly available information would be reflected in the prices of securities: 'The presumption is also supported by common sense and probability: an investor who trades stock at the price set by an impersonal market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations may be presumed for purposes of a Rule 10b-5 action.'[66] Interestingly two judges disagreed with these principles, also known as the fraud-on-the-market theory. Justice White, who was joined by Justice O'Connor, stated in his dissenting opinion: 'For while the economists' theories which underpin the fraud-on-the-market presumption may have the appeal of mathematical exactitude and scientific certainty, they are – in the end – nothing more than theories which may or may not prove accurate upon further consideration.'[67]

35 In Germany, the BGH refused in the Comroad IV decision to acknowledge a reversal of the burden of proof: The fraud-on-the-market theory would lead to a boundless extension of liability under torts law. If one were to follow the fraud-on-the-market theory, this would have the consequence of dispensing with the need to prove the concrete causal connection between the deception and the investor's decision to buy or sell securities.[68] The BGH did not even deal with the theoretical assumptions (at least not in the judgment), but in fact—unlike the US Supreme Court and unlike the two judges in their dissenting opinion—exclusively referred to the doctrines under German torts law.

36 Disclosure obligations should apply to those who can provide the information at the lowest costs. Usually the issuer is the *cheapest cost avoider*. The difficulty in **designing disclosure requirements** is to determine the content and scope of the information subject to disclosure. Firstly, 'too much' information results in higher capital costs for companies, although nowadays data is digitally recorded and processed in companies. However, the more complex disclosure obligations are, the more costly the processing of the information is. Secondly, too much information can also be disadvantageous for investors because they either cannot recognise the relevant information or can only recognise it in a time-consuming and therefore costly manner. The **information overload**[69] causes problems for private and institutional investors alike.

37 For the design of disclosure obligations it must also be clarified to whom information should be disclosed: an institutional investor or a private investor? Both categories cover a

[66] *Basic, Inc. v. Levinson*, 485 US 224, 225 (1988).
[67] *Basic, Inc. v. Levinson*, 485 US 224, 255 (1988).
[68] BGH of 4.06.2017 – II ZR 147/05, AG 2007, 620, 621.
[69] Cf. C. Stahl, *Information Overload auf dem Kapitalmarkt*, 2013.

wide range of investors that are difficult to define in more detail. It is today recognised that the private investor in particular does not act as *homo oeconomicus*, but behaves irrationally (herd behaviour, etc.)[70] and has disparate knowledge of financial markets. Investment services law increasingly takes account of these findings of Behavioural Finance and requires comprehensible information for retail investors.

38 Finally, the interests of issuers must be taken into account when designing disclosure obligations. They may have **secrecy interests** that outweigh the information interests of market participants.[71] This conflict can be solved by providing for exceptions or (temporary) exemptions under certain conditions. The most prominent example of a temporary exemption is the right of the issuer to delay the publication of inside information in case of a legitimate interest to keep the information confidential.[72]

(b) Regulatory Function

39 Disclosure requirements may also serve a regulatory function. This is well acknowledged in capital markets regulation in the context of **conflicts of interest** of intermediaries. Such conflicts arise from the remuneration system and business model of intermediaries. For example, credit rating agencies (CRAs) are paid by issuers to carry out ratings. This *issuer pays model* gives rise to concerns that the intermediary may not take due care in the rating. Conflicts of interest are even more serious when the intermediary provides other services to the issuer. For example, CRAs have provided additional advisory services to issuers that created (financial and economic) dependencies. A requirement to disclose the conflict of interest is a more proportionate solution to the problem than a prohibition, thus serving not only an information function, but also a regulatory function, as legislature requires that the intermediary behaves properly and makes best efforts to ensure that the conflict of interest does not become relevant.

40 When **designing disclosure obligations** about conflicts of interests, policymakers have to decide whether a conflict of interest is so serious that disclosure appears necessary. This depends on market conditions and the fairness perceptions of market participants. In addition, the obligation to ensure transparency entails costs for the intermediary, which the intermediary will ultimately shift to the investors via its remuneration. Moreover, disclosure requirements about conflicts of interest have a great potential for circumvention. European legislation considers this problem by generally defining conflicts of interest in an abstract way and then provide for precise examples in order to ensure legal certainty. Nevertheless, it is usually necessary to define the legal terms by soft law. This results in complex disclosure obligations, the usefulness of which is doubtful. In particular, investors often cannot draw reasonable conclusions from the conflicts of interest made public by the intermediary.

41 Disclosure requirements serve another regulatory function. They can be a more proportionate **alternative** to **substantive law.** For aspects of corporate governance, compliance and risk management, legislature has already implemented this regulatory strategy. Its application has now been extended to CSR reporting. Instead of introducing substantive

[70] See R. Veil § 6 para. 33.
[71] Cf. V. Tountopoulos, in: Tountopoulos and Veil (eds.), *Transparency of Stock Corporations in Europe*, 353, 359.
[72] Cf. Art. 17(4) MAR; see R. Veil § 19 para. 51.

legal requirements on the ecological and social behaviour of companies, legislature has introduced disclosure obligations concerning ESG issues, which indirectly affect companies' business strategies and policies. This mechanism for regulating corporate behaviour is the basis of the CSRD.[73] The disclosure obligations require companies to develop a policy on ESG issues (comply) or, if they fail to develop such a policy, to at least address that lack of policy (explain). Addressing its non-compliance with the disclosure requirements puts the company's reputation at risk of 'scrutiny' by consumers, investors, other companies, interest groups and other stakeholders.

(c) Monitoring Function

42 Finally, public disclosure requirements can improve the supervision of companies by public authorities. This is recognised for both financial and non-financial accounting information. Firstly, disclosure may serve to prepare possible substantive legislation.[74] Second, in the context of capital markets legislation, disclosure improves market supervision by NCAs as they have better access to information. The obligation to publish directors' dealings (Article 19 MAR) makes it easier for supervisory authorities to detect market abuse. The situation is similar with the disclosure requirements for short sales, which in some cases only exist vis-à-vis the national supervisory authorities.

2. Prohibition

43 A further key regulatory strategy is to prohibit certain behaviour on capital markets. Admittedly, bans have a negative impact on innovation. European capital markets law therefore only stipulates prohibitions if a certain conduct substantially undermines investor confidence and thus endangers the institutional functioning of the markets. The most prominent examples in European capital markets law are the **prohibitions of insider trading**[75] and **market manipulation**.[76] The regulatory objective of financial stability may also justify a prohibition. For example, **uncovered short selling** is prohibited without exception.[77]

44 The sale of financial products is generally permitted. However, national supervisory authorities and ESAs have **product intervention powers** under Articles 40-43 MiFIR. The NCAs and ESAs can restrict or prohibit the distribution of financial products if a financial instrument raises significant concerns for investor protection or represents a threat to the stability of the financial system.[78] However, this power of intervention may only be exercised if existing disclosure requirements fail to sufficiently address the risks to investor protection and financial stability.

45 In principle, European legislation is based on the idea that **transparency** through disclosure obligations (disclosure of information to the public) and reporting obligations (disclosure

[73] P. Hell, *Offenlegung nichtfinanzieller Informationen*, 98.
[74] P. Hell, *Offenlegung nichtfinanzieller Informationen*, 113.
[75] See R. Veil § 14 para. 65 ff.
[76] See R. Veil § 15 para. 12 ff.
[77] See R. Veil § 24 para. 6.
[78] See R. Veil § 31 para. 8.

of information to the supervisory authorities) are sufficient to achieve the regulatory objectives[79] and to counter conflicts of interest of market participants, in particular intermediaries. The legal policy question as to whether a particular matter should (only) be disclosed or rather be prohibited altogether usually resurfaces after scandals such as Enron, Worldcom, Parmalat and Wirecard. Whether behaviour on capital markets should be penalised under criminal law can only be assessed in the context of the established criminal law systems of the Member States.

Insofar as there are **exceptions** to prohibitions, European capital markets regulation aims to ensure through procedural requirements that the regulatory goals of the prohibition are not impaired. The Market Abuse Regulation, for example, provides for exceptions to the prohibition of the disclosure of inside information. In case of a so-called market sounding, the insider may be authorised to disclose inside information to another person.[80] However, the market abuse regime requires to record communications and make them available to the respective supervisory authority. 46

Prohibitions are typically enforced by **administrative** (fines) and **criminal sanctions** (imprisonment). In view of the seriousness of the sanctions, it is necessary to identify the behaviour penalised as clearly as possible. This explains the detailed regulation of the prohibitions of manipulation. 47

3. Enforcement

Finally, a central regulatory strategy is to introduce a system of enforcement.[81] It is supposed to prevent and avert the risk of market abuse and at the same time secure the quality of relevant information. Possible approaches to enforcement include private self-monitoring, private external monitoring and administrative supervision by public authorities. The European Union's legislative activities differ vastly between these three areas. Since they are described in detail in the disclosure obligations and in the market abuse law, only the essential aspects need to be described here. 48

Private self-monitoring is primarily articulated in specifications on the organisation of a company and on dealing with conflicts of interest (compliance).[82] It is legally required for investment firms and other financial intermediaries (financial analysts and rating agencies). Listed companies, on the other hand, are only required in certain cases to take organisational measures to ensure compliance with supervisory obligations.[83] 49

The **external private monitoring** by expert auditors is hardly to be found in European capital market law. An example of an external private control is the audit of annual and biannual financial reports. The audit is carried out by auditing companies that are subject to strict rules, the purpose of which is to avoid conflicts of interest. 50

79 Cf. D. Klingenbrunn, *Produktverbote zur Gewährleistung von Finanzmarktstabilität*, 125–135.
80 See R. Veil § 14 para. 86.
81 C. Bumke, in: Hopt et al. (eds.), *Kapitalmarktgesetzgebung im europäischen Binnenmarkt*, 107, 126, 130 ff.
82 See for financial analysts R. Veil § 26 para. 43 and for rating agencies R. Veil § 27 para. 30–33.
83 On compliance requirements for the delay of the publication of inside information, see R. Veil § 19 para. 61.

51 **Supervision** of capital markets is carried out by the national supervisory authorities.[84] A European supervisory authority does not yet exist. ESMA's key role remains to coordinate national supervisors and develop common supervisory standards.[85] However, this could change in the future. ESMA has already been given some supervisory tasks.

[84] See F. Walla § 11 para. 7.
[85] See F. Walla § 11 para. 97.

§ 4

Rule-Making Process

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I. Historical Development

1 Since the year 2002, rule-making in European capital markets law has been conducted via the so-called **Lamfalussy Process**.[1] The Lamfalussy Process is a **comitology process** based on Article 202 of the former EC Treaty which established four layers of regulation. Whilst it was originally restricted to the regulation of capital markets it was later applied in all areas of financial market regulation.[2]

2 The Lamfalussy Process was introduced to effectively fulfil the **Financial Services Action Plan (FSAP)**.[3] The measures referred to in the FSAP were to be achieved through a more efficient, flexible and faster legislative process and with the help of external expert knowledge.[4]

[1] The process is named after Baron Alexandre Lamfalussy († 9 May 2015), chair of the expert committee whose draft propositions are the basis for the present legislative procedure. See R. Veil § 1 para. 16.

[2] Commission Decision of 5 November 2003 (2004/5/EC) establishing the Committee of European Banking Supervisors, OJ L 3, 5 November 2003. This extension was initiated by the German and the British governments; cf. A. Möller, *Kapitalmarktaufsicht*, 149. On the comitology procedure in general see M. Horspool and M. Humphreys, *European Law*, para. 5.33 ff.

[3] Communication from the Commission implementing the framework for financial markets: action plan, 11 May 1999, COM(1999) 232 final. See in more detail R. Veil § 1 para. 13.

[4] N. Moloney, *EU Securities and Financial Markets Regulation*, 862 ff.

The creation of two pan-European committees who were to participate in the process of law making was a fundamental component: The **European Securities Committee (ESC)**,[5] a body composed of high-ranking officials of the Member States and chaired by a representative of the Commission, and the **Committee of European Securities Regulators (CESR)** as a committee of representatives of all national supervisory authorities plus their counterparts from Norway, Liechtenstein and Iceland as well as the Commission. CESR was the nucleus of the **European Securities Markets Authority (ESMA)**.

The Lamfalussy Process has been modified significantly due to the enactment of the **Treaty of Lisbon** on 1 December 2009 and the formation of **ESMA**.[6] ESMA assumed an important role within the European regulatory process.[7] The procedural requirements for the post-Lisbon process were laid down in the Comitology Regulation, enacted in 2011.[8] The legislative procedure based on these amendments can be referred to as the **Lamfalussy II Process**.[9] 3

II. The Lamfalussy II Process

The Lamfalussy II Process is based on **four layers** of regulation. 4

1. Framework Acts

(a) Concept

Level 1 of the process concerns the enactment of broad but sufficiently precise **framework directives or regulations** which have been developed in the legislative process (Article 294 TFEU), ie under participation of the European Parliament and the Council, based on proposals by the Commission.[10] 5

The Level 1 acts should in theory only contain **basic principles**, to be put into more concrete terms on Level 2 and Level 3 of the Lamfalussy Process. In reality, however, the four initial Lamfalussy directives—especially MiFID I—were in parts already very precise in their specifications for the Member States.[11] In the course of the latest round of reform 6

[5] See Commission Decision of 6 June 2001 establishing the European Securities Committee (ESC) and the Committee of European Securities Regulators, OJ L 191, 13 July 2001, p. 45.

[6] For more details on the concept of European supervision see F. Walla § 11.

[7] See below para. 24 and F. Walla § 11 para. 67.

[8] Regulation (EU) No. 182/2011 of the European Parliament and of the Council of 16 February 2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers, OJ L 55, 16 February 2011, p. 13–18.

[9] The same terminology is used by J. Schmidt, in: Lutter et al. (eds.), *Europäisches Unternehmensrecht*, 252; L. Klöhn, in: Langenbucher (ed.), *Europäisches Privat- und Wirtschaftsrecht*, § 6 para. 21 ff.; T. Möllers, 31 BFLR (2015), 141, 143; other scholars still refer to the process as the Lamfalussy procedure or the revised Lamfalussy procedure, cf. eg R. Veil, 43 ZGR (2014), 544, 551 ff.; S. Kalss, 26 EuZW (2015), 569, 570.

[10] See on this N. Moloney, *EU Securities and Financial Markets Regulation*, 888 ff.

[11] E. Wymeersch, 42 CML Rev. (2005), 987, 991.

for European capital markets law Level 1 acts have become more and more concrete.[12] In particular, they provide for **annexes** that include important substantiations of the rules.[13]

7 Example: Under the initial Lamfalussy directive MAD the key term '**inside information**' was defined as '*information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instrument*' (Article 1(1) MAD). The MAD Level 2 Directive 2003/124/EC substantiated this broad definition in Article 1(1) and defined '*precise information*' as an information '*that indicates a set of circumstances which exists or may reasonably be expected to come into existence or an event which has occurred or may reasonably be expected to do so and if it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of financial instruments or related derivative*'. Article 7 MAR (as the currently in force Level 1 act) provides for the aforementioned basic definition in Article 7(1),(2) MAR. It is, however, complemented by various substantiations, inter alia, the aforementioned definition of 'precise' in Article 7 para. 2–4 MAR. The Level 1 prerequisites are now to be put into further concrete terms by ESMA guidelines as Level 3 (and ESMA Q&A on Level 4) as soft law and not by a Level 2 act.[14]

8 However, the basic approach of the Lamfalussy II procedure still is to have broad principles on Level 1. *Example*: A prime case for such interaction between Level 1 and Level 2 is Article 19(1) MAR. Under this provision persons discharging managerial responsibilities (PDMR), as well as persons closely associated with them, shall notify the issuer and the NCA about the existence of every '*transaction*' conducted on their own account relating to the shares or debt instruments of that issuer. A non-exhaustive but rather detailed list of transaction types is provided by Article 10 Delegated Regulation (EU) 2016/522 as a Level 2 measures on the basis of Article 19(14) MAR.

(b) Trialogue Procedure

9 In practice, the design of a Level 1 act is elaborated in extensive informal consultations between the three key European institutions, ie the European Parliament, the Council and the Commission. This informal procedure is commonly referred to as the '**Trialogue**'. Whereas the TFEU requires a Trialogue for matters related to the budgeting (Article 324 TFEU), pursuing a Trialogue procedure has become standard practice for rule-making on the European level.[15]

10 The aim of the Trialogue procedure is to reach an **early-stage consensus** between the institutions so that a legislative act can be approved in the first reading of the European Parliament ('early agreement' or 'first reading agreement').[16] The Trialogue should, in particular, avoid

[12] R. Veil, 43 ZGR (2014), 544, 577.

[13] See for example the indications of market manipulation provided for in Annex I of the MAR.

[14] Art. 7(4) MAR. Cf. on the European regulatory approach regarding inside information R. Veil § 14 para. 52.

[15] Cf. for empirical data on recent Trialogues in European law-making F. Giersdorf, *Der informelle Trilog*, 163 ff.; T. Wischmeyer, in: Dauses and Ludwigs (eds.), *Handbuch des EU-Wirtschaftsrechts*, A. II. para. 274; according to P. Stöbener de Mora, 27 EuZW (2016), 721, 722 around 85% of the legislative processes in the EU level are currently conducted with the help of an informal Trialogue procedure.

[16] T. Wischmeyer, in: Dauses and Ludwigs (eds.), *Handbuch des EU-Wirtschaftsrechts*, A. II. para. 273; on the reasoning for the implementation of the Trialogue R. de Ruiter and C. Neuhold, 18 European Law Journal (2012), 536 ff.

the formal legislative conciliation procedure between the European Parliament and the Council required by Article 294 TFEU.

11 The Trialogue is informal but not a legal vacuum. It is governed by **inter-institutional agreements**[17] and the respective **rules of procedures** of the institutions involved. In the course of a Trialogue, representatives of the three institutions try to reach an agreement on the substance matter of legislative proposal. All institutions have created specific guidelines to structure their involvement in the process.[18] In practice, the Trialogue discussions are typically divided between issues with **political relevance** and those of a rather **technical nature.**[19] The Trialogue procedure in general is subject criticism with regards to a **lack of transparency**[20] and **democratic legitimation**.[21]

12 The key importance of the Trialogue in European capital markets was illustrated by the revision of the core Lamfalussy acts (PR, MAR, TD, MiFID II/MiFIR):[22] In each case, the final design of the revised basic act was subject to intense discussion in the Trialogue procedure.

13 *Example*: During the Trialogue procedure for the revision of the MAR the question if the term '*inside information*' should be relevant for insider trading rules as well as for ad hoc disclosure was intensely discussed. Whereas in the beginning of the Trialogue a distinction between 'inside information' and 'relevant information not generally available' (following the UK's '*RINGA concept*'[23]) was favoured, a final compromise was achieved which sustained that status quo under the MAD, ie with the term 'inside information' as the key term for insider trading and ad hoc disclosure.[24]

2. Delegated Acts and Implementing Measures

14 Already under the initial Lamfalussy I scheme Level 2 enabled the Commission to enact so-called **implementing measures** regarding the framework directives without having to adhere to the usual legislative procedure.[25] The Commission may enact implementing regulations or directives,[26] depending on the aim of the framework provision. The Commission made use of both regulatory instruments.[27] Both former committees—the ESC and CESR—held advisory functions for the Commission in this process. The implementing measures led to a further harmonisation in the European Union due to their very

[17] See Joint Declaration on Practical Arrangements for the Codecision Procedure, OJ C 145, 30 June 2007, p. 5; Interinstitutional Agreement of 13 April 2016 on better law-making, OJ L 123, 12 May 2016, p. 1.

[18] Cf. F. Giersdorf, *Der informelle Trilog*, 70 ff.

[19] Cf. C. Roederer-Rynning and J. Greenwood, 22 Journal of European Public Policy (2015), 1148, 1153 ff.; F. Giersdorf, *Der informelle Trilog*, 72.

[20] Cf. European Ombudsman, Decision of the European Ombudsman setting out proposals following her strategic inquiry OI/8/2015/JAS concerning the transparency of Trilogues, 12 July 2016, para. 15 ff.

[21] Cf. T. Wischmeyer, in: Dauses and Ludwigs (eds.), *Handbuch des EU-Wirtschaftsrechts*, A. II. para. 278 ff.

[22] N. Moloney, *EU Securities and Financial Markets Regulation*, 856; M. Parmentier, 4 BKR (2013), 133 ff. (on the MAR revision).

[23] See on this C. Seibt, 2-3 ZHR 177 (2013), 388, 402 ff.

[24] See for more details on the term 'inside information' R. Veil § 14 para. 19.

[25] Scholars are critical regarding the lack of certainty regarding the Commission's competences, cf. eg S. Kalss et al., *Kapitalmarktrecht I*, § 1 para. 43.

[26] On the legislative instruments in general see R. Veil § 3 para. 13.

[27] Under the Lamfalussy I scheme five implementing directives and five implementing regulations have been enacted on the basis of the framework directives.

specific provisions. The downside to this was the fact that the autonomy of Member States was restricted significantly.[28]

15 As a consequence of the Treaty of Lisbon and ESMA's formation Level 2 became significantly more complex. One now has to distinguish between **delegated acts** under Article 290 TFEU and **implementing acts** under Article 291 TFEU.[29]

16 Regarding delegated acts under **Article 290 TFEU** one again has to distinguish between delegated acts enacted by the Commission after consultation of ESMA[30] and the Expert Group of the European Securities Committee (EGESC)[31] and **Regulatory Technical Standards (RTS)**. The latter are delegated acts drafted by ESMA under Article 10 ESMA Regulation which have to be endorsed by the Commission to become effective.[32] Regarding regulatory technical standards ESMA, in practice, is the body determining the content of such acts as the Commission can only object to ESMA's drafts under exceptional circumstances.[33]

17 Delegated acts can in theory be directives or regulations. However, regulations are most recommendable to achieve the harmonisation intended by Level 2 measures to the largest possible extent. As yet, most delegated acts on Level 2 of the Lamfalussy II procedure are designed as regulations.[34] ESMA submits the drafts of its RTS to the European Parliament and the Council, respectively, for their information (Article 10(1) ESMA Regulation). Both institutions have a veto right against each RTS under Article 13 ESMA Regulation. They are also competent to completely revoke ESMA's mandate to draft RTS (Article 12 ESMA Regulation) in case they generally disapprove the rule-making by ESMA. The design of the Level 1 acts is not consistent as to the use of delegated acts and RTS. In practice, the Commission frequently requests the **technical advice** of ESMA in case it is supposed to create a delegated act. In the course of the latest revision of the ESMA Regulation, a legal basis for such technical advice was added to the ESMA Regulation (Article 16a(4)). Thus, ESMA is influencing most Level 2 rules regardless of the nature of the delegation of set forth on Level 1.

18 *Examples*: (i) The MAR empowers the Commission to adopt a delegated act specifying the circumstances under which trading of PDMR during a closed period may be permitted by the issuer (Article 19(13) MAR).[35] The Commission requested ESMA to prepare the regulation by

[28] This is pointed out by W. Groß, *Kapitalmarktrecht*, Vorb. BörsG para. 18.

[29] The scope and distinction between these two provisions of the Treaty of Lisbon is still not completely clear, cf. R. Streinz et al., *Vertrag von Lissabon*, § 10 para. 3; A. Kahl, in: Braumüller et al. (eds.), *Die neue Europäische Finanzmarktaufsicht—Band zur ZFR-Jahrestagung 2011*, 55, 71; J. Kämmerer, in: Kämmerer and Veil (eds.), *Übernahme- und Kapitalmarktrecht in der Reformdiskussion*, 45, 58; U. Stelkens, 47 EuR (2012), 511 ff.; T. Kröll, in: Debus et al. (eds.), *Verwaltungsrechtsraum Europa—51. Assistententagung Öffentliches Recht Speyer 2011*, 195 ff.

[30] ESMA usually delivers so-called *technical advice* upon the request of the Commission during the drafting process for a Level 2 act, cf. F. Walla § 11 para. 97.

[31] See under http://ec.europa.eu/finance/securities/egesc/index_en.htm.

[32] Cf. also N. Moloney, in: FS Hopt, 2265, 2271–2272. A list of all regulatory technical standards in force can be found under www.esma.europa.eu/system/files/technical_standards_in_force.pdf. The list is updated on an ongoing basis.

[33] Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (ESMA), recital 23; cf. also R. Veil, 43 ZGR (2014), 544, 553 ff. As yet, the Commission declined to endorse a draft technical standards only on very rare occasions, see eg Commission, Letter of 4 July 2013 (on an RTS under the AIFM Directive), Commission, Letter of 24 August 2018 (on an RTS under the Securities Financing Transactions Regulation).

[34] See R. Veil, 43 ZGR (2014), 544, 549.

[35] Commission Delegated Regulation (EU) 2016/522 of 17 December 2015 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council as regards an exemption for certain third countries

technical advice.[36] (ii) At the same time, the MAR empowers ESMA to draft an RTS on the conditions that buy-back programmes and stabilisation measures (Article 5(6) MAR),[37] ie conferring a rule-making power to ESMA which is at least as important (and far-reaching) as the Commission's power under Article 19(13) MAR.

Delegated acts are complimented by **implementing acts** as described in **Article 291 TFEU**. Such implementing acts only define the conditions for the application of the law. Again, one has to distinguish between implementing acts adopted by the Commission and **Technical Implementing Standards (ITS)** drafted by ESMA that require endorsement by the Commission. Implementing acts by the Commission and ITS by ESMA mainly concern procedural requirements and put the requirements for the applicability of a provision into more concrete terms. The European Parliament and the Council do not have a veto right with regards to ITS. Both institutions are, however, informed by ESMA when a draft ITS is submitted to the Commission (Article 15(1)(3) ESMA Regulation). The Member States are competent to control ESMA and the Commission under the procedural rules stipulated in Regulation (EU) No. 182/2011.[38] 19

Examples: (i) The Commission adopted implementing measures regarding the specific procedures for report of breaches of the market abuse regime (Article 32(5) MAR).[39] (ii) ESMA drafted technical implementing standards with regard to the disclosure procedure for inside information (Article 17(10) MAR) adopted by the Commission.[40] 20

This variety of legal sources on Level 2 of the Lamfalussy II Process can be structured as a **continuum with regard to the policy implications** of the respective legislative acts: The Commission's delegated acts put the framework provisions on Level 1 into more concrete terms. Whilst Article 290 TFEU only allows them to 'supplement or amend certain non-essential elements of the legislative act', the Commission is granted a creative power in fact, allowing it to exert significant influence through its delegated acts.[41] ESMA's leeway for policy decisions expressed via RTS is supposed to be narrower than the Commission's discretion with regard to delegated acts.[42] Under Article 15 ESMA Regulation regulatory technical standards may not 'imply strategic decisions or policy choices'. Implementing acts, finally, serve as the layer below two kinds of delegated acts. They should only substantiate the application of the law, ie primarily contain procedural rules without policy implications. 21

public bodies and central banks, the indicators of market manipulation, the disclosure thresholds, the competent authority for notifications of delays, the permission for trading during closed periods and types of notifiable managers' transactions, OJ L 88, 5 April 2016, p. 1.

[36] ESMA, Final Report, Technical advice on possible delegated acts concerning the Market Abuse Regulation, 3 February 2015, ESMA/2015/224.

[37] ESMA, Final Report, Draft technical standards on the Market Abuse Regulation, 28 September 2015, ESMA/2015/1455.

[38] Regulation (EU) No. 182/2011 on the European Parliament and the Council of 16 February 2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers, OJ L 55, 28 February 2011, p.13–18.

[39] See ESMA/2015/224 (fn. 36).

[40] ESMA, Final Report, Draft technical standards on the Market Abuse Regulation, 28 September 2015, ESMA/2015/1455.

[41] Cf. N. Moloney, in: FS Hopt, 2265, 2271 ff.; N. Moloney, *EU Securities and Financial Markets Regulation*, 902 ff.; C. Fabricius, *Der Technische Regulierungsstandard für Finanzdienstleistungen—Eine kritische Würdigung unter besonderer Berücksichtigung des Art. 290 AEUV*, 23 ff.

[42] C. Fabricius, *Der Technische Regulierungsstandard für Finanzdienstleistungen—Eine kritische Würdigung unter besonderer Berücksichtigung des Art. 290 AEUV*, 70 ff.

22 It is doubtful if this theoretical system suffices to ascertain whether a substantiation of a Level 1 rule has to be made via a delegated act by the Commission or if a RTS drafted by ESMA can be sufficient.[43] The latest Level 1 regulations at least do not show a consistent system: It is, for example, highly questionable if the power to specify the criteria for an accepted market practice under Article 12 MAR (market manipulation) can be de facto deferred to ESMA (Article 13(7) MAR) considering the importance of the safe harbour rules for legal practice.[44]

23 In the course of the latest round of reforms of European capital market law Level 2 became more important. For example, the MAR empowers the Commission to adopt seven delegated acts and 15 technical standards. Legal practitioners thus have to consider a wide range of Level 2 acts. Such detailed Level 2 rules are a core part of the **ESMA Single Rulebook**.[45]

3. Guidelines and Recommendations

24 Level 3 is concerned with ESMA's task of developing guidelines and recommendations for a consistent interpretation of capital markets law throughout Europe in order to ensure a level playing field of all European capital markets.[46] Recommendations and Guidelines find their legal basis in Article 16 ESMA Regulation. They can be directed to the national supervisory authorities or to market participants.[47] ESMA has taken over this role and issued guidelines for a number of fields of law.[48] The guidelines and recommendations are not binding,[49] but rather a significant **interpretational help** for the national supervisory authorities and the market participants.[50] They are **soft law**, ie non-binding rules which have a high impact on legal practice.[51]

25 *Examples*: (i) The MAR requires ESMA to develop a non-exhaustive indicative list of information which is reasonably expected to be disclosed as inside information (Article 7(5) MAR); (ii) and to provide guidelines on the legitimate interests of issuers to delay the disclosure of inside information as well as on situations which are likely to mislead the public (Article 17(11) MAR). These terms to be substantiated by ESMA are vital for legal practice.

26 Under Article 16(3) ESMA Regulation Member States have to confirm that they comply with a guideline or recommendation or state the reasons why they refused to comply. This **comply or explain-mechanism** should ensure compliance with these acts despite their non-binding character. In practice, ESMA's guidelines and recommendations are generally

[43] Cf. also N. Moloney, *EU Securities and Financial Markets Regulation*, 923 ff.
[44] See R. Veil § 15 para. 39 on the legal implications of an accepted market practice under the MAR.
[45] Cf. on the scope and implications of the single rulebook R. Veil, 43 ZGR (2014), 544, 601 ff.; since 2018 an interactive version of the Single Rulebook can be found under https://www.esma.europa.eu/rules-databases-library/interactive-single-rulebook-isrb.
[46] S. Kalss et al., *Kapitalmarktrecht I*, § 1 para. 48.
[47] R. Veil, 43 ZGR (2014), 544, 589 ff.; S. Kalss et al., *Kapitalmarktrecht I*, § 1 para. 63.
[48] See for an updated overview https://www.esma.europa.eu/system/files/guidelines_list_of_final_guidelines.pdf.
[49] Lamfalussy Report, p. 47; cf. also T. Möllers, 3 ZEuP (2008), 480, 491 ff.
[50] See R. Veil § 5 para. 22.
[51] Cf. N. Moloney, *EU Securities and Financial Markets Regulation*, 874 ff., R. Veil, 1 ZBB (2018), 151, 159 f.; O. Achtelik and A. Mohn, 50 WM (2019), 2339, 2342.

complied with by national authorities. However, in a few cases national supervisory authorities have declared non-compliance or partial non-compliance.[52]

Although non-binding, other indirect legal effect may ensue from these measures. In German legal literature, for example, it is argued that the disregard of the ESMA's recommendations may facilitate the **proof of liability** for private law liability claims.[53] Furthermore, the German Federal Supreme Administrative Court held that the opinion of ESMA's predecessor CESR results in a presumption of a correct interpretation of the law.[54] Also a criminal offence may be classed as an unavoidable mistake of law if ESMA recommendations were adhered.[55] 27

The ECJ has not yet had the opportunity to decide on the implications of ESMA/CESR's soft law. Regarding other fields of law the ECJ, however, held that a deviation from soft law might lead to a violation of the principles of equality and legitimate expectations of the law.[56] The Member States' authorities have to at least consider EU soft law.[57] In German legal literature it is argued that a national court has to submit a case to the ECJ if it would like to deviate from ESMA's interpretation laid down in a guideline or recommendation.[58] 28

4. Supervisory Convergence

On the last level of the Lamfalussy II Process the Commission and ESMA monitor and evaluate the enforcement of the European rules on capital markets law by the Member States. Article 29 ESMA Regulation sets forth that ESMA should achieve **supervisory convergence** among the NCAs.[59] Enhancing supervisory convergence across the EU was defined as one of the core strategic aims of ESMA after in the ESA review that was completed in 2019. ESMA will start to develop an **EU Supervisory Handbook** for this purpose.[60] 29

Supervisory convergence should, for example, be achieved by **peer reviews** pursuant to Article 30 ESMA Regulation. Such Article 30 stipulates detailed rules for the peer review procedure which were included as a result of the latest ESA review; in particular, the ESMA 30

[52] Four Member States (Denmark, France, Germany and Sweden) and the former Member State United Kingdom, for example, expressed full or partial non-compliance with ESMA's guidelines on the interpretation of the SSR, cf. N. Moloney, *EU Securities and Financial Markets Regulation*, 934 f.; R. Veil, 43 ZGR (2014), 544, 591.

[53] G. Spindler and J. Hupka, in: Möllers (ed.), *Geltung und Faktizität von Standards*, 117, 135 ff.

[54] BVerwG of 24.05.2011 – 7 C 6.10, 32 ZIP (2011), 1313, 1316.

[55] J. Hupka, 29 WM (2009), 1351, 1355 ff.; T. Möllers, 8 NZG (2010), 285, 286; A. Frank, 4 ZBB (2015), 213, 218. For a more general approach see S. Kalss, in: Riesenhuber (ed.), *Europäische Methodenlehre*, 606. Opposing view (no exculpation) P. Buck-Heeb, 4 WM (2020), 157, 162.

[56] See eg ECJ Case C-189/02 (*Dansk Rørindustri et al./Commission*), para. 211 ff.; see on the applicability of the existing ECJ case law to ESMA's soft law R. Veil, 43 ZGR (2014), 544, 593; A. Frank, 4 ZBB (2015), 213, 217 ff.

[57] Case C-207/01 (*Altair Chimica/ENEL Distribuzione SpA*); Case C-188/91 (*Deutsche Shell AG/Hauptzollamt Hamburg-Harburg*), para. 18; Cases C-317/08 (*Rosalba Alassini/Telecom Italia SpA*); C-318/08 (*Filomena Califano/Wind SpA*); C-319/08 (*Lucia Anna Giorgia Iacono/Telecom Italia SpA*) and C-320/08 (*Multiservice Srl/Telecom Italia SpA*).

[58] J. Hupka, 29 WM (2009), 1351, 1355 ff.; T. Möllers, 8 NZG (2010), 285, 286; on the private law effects see G. Spindler and J. Hupka, in: Möllers (ed.), *Geltung und Faktizität von Standards*, 117, 135 ff.; on ESMA's soft law A. Frank, 4 ZBB (2015), 213, 218; R. Veil, 1 ZBB (2018), 151, 160; for a more general approach see S. Kalss, in: Riesenhuber (ed.), *Europäische Methodenlehre*, 606.

[59] See for details: N. Moloney, *EU Securities and Financial Markets Regulation*, 935 ff. and 989 ff.

[60] See ESMA, Strategic Orientation 2020–22, 9 January 2020, ESMA22-106-194.

Regulation now calls for special committees at ESMA level that conduct peer reviews (Article 30(2) ESMA-Regulation). Peer reviews are conducted on a regular basis. However, they can also be initiated on an ad hoc basis via a so-called **fast track procedure**.

31 *Example*: As a result of the *Wirecard* case,[61] ESMA recently reviewed the supervisory practice in Germany. It identified a number of deficiencies in the national supervision of Wirecard's financial reporting.[62]

32 As a last resort, the Commission is to commence an infringement proceeding against a Member State when a breach of European law becomes apparent. In order to facilitate the supervision, the Member States have to report on the progress of implementation vis-à-vis ESMA (Article 35 ESMA Regulation).

33 Over the last years, a tool to ensure supervisory convergence became more and more important: ESMA so far issued over 30 **Question and Answer-Lists (Q&A-Lists)** which are in part continuously updated.[63] ESMA's Q&As were initially designed as measures to ensure a common supervisory culture under Article 29(2) ESMA Regulation. As a result of the latest ESA review,[64] a distinct legal basis was enacted (Article 16b ESMA Regulation). This provision also includes details on the Q&A process. Inter alia, it requires ESMA to sustain a **web-based system** to process questions submitted by market participants.

34 As opposed to guidelines and recommendations, they do not trigger a comply or explain obligation for the NCAs. However, some NCAs (eg. the German BaFin) have issued a policy that they comply with Q&A unless they indicate the opposite. ESMA's Q&As are of high practical importance. Market participants rely on ESMA's Q&As de facto the same way they rely on Level 3 acts. Thus, complying with them should have the same legal consequences as adhering to ESMA's guidelines and recommendations.[65] In particular, after the Q&A's recognition in the ESMA Regulation there is no reason to make a distinction between Q&A and guidelines with regards to the legal consequences of such measures.

5. Stakeholder Involvement

35 One of the main original objectives of the Lamfalussy procedure was to include **stakeholder expert knowledge** in the law-making process. To achieve this goal the Lamfalussy II scheme includes a number of groups which deliver advice to European institutions: The Commission regularly asks relevant stakeholders (in particular: market participants) for their opinions in a formal consultation process in the very beginning of the legislative process for reforms on Level 1. Furthermore, ESMA has various committees where market participants and other stakeholders are represented. The most important

[61] See for other aspects of this case F. Walla § 24 para. 65 (short selling).

[62] ESMA, Fast Track Peer Review on the Application of the Guidelines on the Enforcement of Financial Information by BaFin and FREP in Context of Wirecard, 3 November 2020, ESMA42-111-5349; cf. also the ESMA, Q&A on the Fast Track Peer Review on the Wirecard Case, 3 November 2020, ESMA71-99-1423.

[63] See eg ESMA, Q&A on the Market Abuse Regulation (MAR), ESMA70-145-111, Version 15, last update on 6 August 2021; ESMA, Q&A on MiFIR data reporting, 16 July 2021, ESMA70-1861941480-56; ESMA, Q&A Transparency Directive (2004/109/EC), 9 November 2020, ESMA31-67-127; ESMA, Q&A on the Prospectus Regulation, ESMA/2020/ESMA31-62-1258, Version 10, last update on 27 July 2021.

[64] Cf. F. Walla § 11 para 57.

[65] Opposing view R. Veil, 1 ZBB (2018), 151, 165; concurring H. Anzinger, 3 RdF (2018), 181, 184.

committee is the **Securities and Markets Stakeholder Group (SMSG)** established pursuant to Article 37 ESMA Regulation.[66] Moreover, ESMA's various Standing Committees have created Consultative Working Groups which, respectively, provide a forum for stakeholders to share their views on the regulatory development in the relevant fields of capital markets law with ESMA, such as market abuse, corporate finance, etc.[67]

6. Graph: Lamfalussy II Process

EUROPEAN CAPITAL MARKETS LAW'S REGULATORY PROCESS 36

Levels	Sources of law	
Level 1	Legal Acts of the European Parliament and the Council (Articles 294 et seq. TFEU)	
Level 2	Delegated Acts by the Commission (Article 290 TFEU)	Regulatory Technical Standards developed by ESMA and endorsed by the Commission (Article 290 TFEU; Article 10 ESMA-Regulation)
	Implementing Acts by the Commission (Article 291 TFEU)	Implementing Technical Standards developed by ESMA and endorsed by the Commission (Article 291 TFEU; Article 15 ESMA-Regulation)
Level 3	Guidelines and Recommendations by ESMA (Article 16 ESMA-Regulation)	
Level 4	Supervisory Convergence via ESMA measures (Articles 16b, 29, 30 ESMA-Regulation)	Control of the Member States by ESMA (Article 17 ESMA-Regulation) and by the Commission (Article 258 TFEU)

Figure 1 shows a schematic of the Lamfalussy II process.

III. Evaluation of the Lamfalussy II Process

The Lamfalussy Process was revised and officially evaluated in 2007[68] and found not to be 37
in urgent need of reform.[69] The aim of a **more efficient, flexible and faster legislative** process largely appears to have been achieved.[70] The use of expert knowledge and a faster and

[66] Statements and advice by the SMSG can be downloaded under www.esma.europa.edu/page/SMSG-Documents.

[67] See also F. Walla § 11 para. 72.

[68] Commission, Review of the Lamfalussy process strengthening supervisory convergence, 20 November 2007, COM(2007) 727 final; Inter-Institutional Monitoring Group, *Final Report Monitoring the Lamfalussy Process*, 15 October 2007, available at: http://ec.europa.eu/internal_market/finances/docs/committees/071015_final_report_en.pdf.

[69] N. Moloney, in: Tison et al. (eds.), *Perspectives in Company Law and Financial Regulation*, 449, 472; similarly N. Moloney, in: FS Hopt, 2264, 2281; N. Moloney, *EU Securities and Financial Markets Regulation*, 866 ff. For an overview of the points of criticism, especially of the work of the committees on Level 3, see I. Leixner, *Komitologie und Lamfalussyverfahren im Finanzdienstleistungsbereich*, 24 ff.

[70] T. Möllers, 3 ZEuP (2008), 480, 502 ff.; K.-U. Schmolke, 22 NZG (2005), 912, 918. See also the various reports published by the Inter-Institutional Monitoring Group, established by the Commission. With regard to this, the

more flexible legislative process are essential in an area subject to such continual changes as capital markets.

38 One may argue that the downside of this is that the legislative process in capital markets law lacks **democratic legitimacy and transparency.** However, the European Parliament and the Council are still competent for basic policy decisions on Level 1 and have comprehensive participation rights on Level 2.[71] Thus, at least the conformity of the Lamfalussy II Process with European primary law cannot be doubted.[72] The rapidly changing capital markets environment and the complexity of the issues to be solved,[73] require strong expert participation which justifies a well-balanced reduction of the European Parliament's and the Council's involvement in the rule-making process.

39 In particular, ESMA's involvement in the process has to be welcomed as it contributes to a higher degree of harmonisation within a short period of time and it provides the necessary expertise to the law-making process. Thus, an even stronger integration of ESMA into the law-making process would be recommendable.[74]

40 It also has to be admitted that another side of the coin is that Lamfalussy II has turned European capital market law into a **highly complex field of law**. It thus has been argued that legal practice can hardly comply with the current set of rules provided by European and national law.[75] This criticism is certainly true to a certain extent, in particular for market participants without pan-European operations.[76] However, it should not give rise to doubts with regards to the general Lamfalussy II approach but should rather lead to a more thorough choice of the measures used by the law-making authorities involved.

criticism expressed in the literature at the outset of this procedure is unsubstantiated. On this see G. Hertig and R. Lee, 3 J. Corp. L. Stud. (2003), 359, 364 ff.

[71] S. Kalss et al., *Kapitalmarktrecht I*, § 1 para. 50; regarding the Lamfalussy I procedure already K. Langenbucher, 2 ZEuP (2002), 265, 283 ff.; B. Scheel, 9 ZEuS (2006), 521 ff.; K.-U. Schmolke, 41 EuR (2006), 432, 443. Cf. also K. von Wogau, 4 ZEuP (2002), 695, 699–700 for a summary of the European Parliament's doubt at this time.

[72] Cf. K.-U. Schmolke, 41 EuR (2006), 432, 441. The ECJ explicitly confirmed that ESMA's rule-making powers are in compliance with the TFEU, see Case C-270/12 (*UK/Council and Parliament*), see on this case F. Walla § 24 para. 25.

[73] Cf. F. Walla, *Die Konzeption der Kapitalmarktaufsicht in Deutschland*, 39 ff.

[74] From a policy standpoint it would be advisable to allow ESMA to enact delegated acts without an involvement of the Commission, cf. the letter of ESMA's chairman Steven Maijoor to the Commission of 31 October 2013, Review of the European System on Financial Supervision (ESFS), 31 October 2013, ESMA/2013/1561. However, such delegation of powers to ESMA is currently not feasible as the 'Meroni Doctrine' of the ECJ prohibits any delegation of rule-making to European authorities apart from the Commission, cf. J. Kämmerer, in: Kämmerer and Veil (eds.), *Übernahme- und Kapitalmarktrecht in der Reformdiskussion*, 45, 65; N. Moloney, *EU Securities and Financial Markets Regulation*, 909 ff. and 921 ff.

[75] See S. Kalss, 26 EuZW (2015), 569, 570.

[76] J.-H. Binder, 1 GPR (2011), 34, 38.

§ 7

Capital Markets

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I. Overview

1. Trading Venue

1 A market is a system in which supply and demand meet. A capital market is thus a market where companies can raise equity or borrow capital and where these financial instruments are publicly traded. Debt capital is generally raised by issuing bonds,[1] whilst equity is raised by issuing shares.[2] Secondary markets are also called cash markets in order to underline the fact that turnover transactions take place here. Generally, **stock transactions** have to be fulfilled within a period of **two days** (**settlement period**). Thus, the buyer is obliged to transfer cash to the seller and the seller must transfer ownership of the stock to the buyer within two days after the trade was made (T+2).[3] The largest stock markets are in the US, followed by Asia, Europe and Canada.[4] The same applies to the bond markets. The largest markets for sovereign bonds are in the US, China and Japan.[5] The market for sovereign bonds is larger than that for corporate bonds.[6]

2 European law defines a '**trading venue**' as a regulated market (RM), a multilateral trading facility (MTF) or an organised trading system (OTF).[7] MiFID II establishes transparent and non-discriminatory rules for all three trading venues that govern access to the system.[8] On the other hand, so-called OTC trading concerns trading that takes place directly between two or more investors, ie outside of regulated markets, MTFs or OTFs. The practical importance of OTC trading is significant. In 2019, it accounted for almost one-third of equity trading in the EEA.[9] ESMA has recorded a total of 430 trading venues for 2019.[10] The number of companies listed has declined steadily in recent years, from 5,414 (2010) to 5,024 (2018) in the EU 27.[11]

[1] See R. Veil § 8 para. 16–18.

[2] See R. Veil § 8 para. 11–15.

[3] Art. 7(2) Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, OJ L 87, 31 March 2017.

[4] Market capitalisation 2018 in trillions US-$: USA 68,65; Asia (Eastasia and Pacific) 23,82 (data for 2019); EU 5,768; Canada 1,938 (World Bank data, available at: https://data.worldbank.org/indicator/CM.MKT.LCAP.CD); cf. on market size of financial market infrastructures C. Di Noia and L. Filippa, in: Binder/Saguato, (eds.), *Financial Market Infrastructure: Law and Regulation* (2022).

[5] ICMA, Bond marke seize, available at: https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Secondary-Markets/bond-market-size/: 'The SSA bond markets are dominated by the US ($22.4tn), China ($19.8tn), and Japan ($12.4tn). Between them they make up 62% of the global SSA market. Sovereign bonds constitute 73% ($63.7tn) of the global outstanding SSA market.'

[6] Cf. ICMA, ibid.: 'As of August 2020, ICMA estimates that the overall size of the global bond markets in terms of USD equivalent notional outstanding, is approximately $128.3tn. This consists of $87.5tn SSA bonds (68%) and $40.9tn corporate bonds (32%).'

[7] Cf. Art. 4(1)(24) MiFID II.

[8] Recital 14 MiFID II.

[9] Cf. ESMA, EU securities markets, ESMA Annual Statistic Report, 18 November 2020, ESMA-50-165-1355, p. 2.

[10] Cf. ESMA, EU securities markets, ESMA Annual Statistic Report, 18 November 2020, ESMA-50-165-1355, p. 10.

[11] Cf. European Commission, Primary and secondary equity markets, Final report, 2020, sub 2.3.2.

Capital markets must be distinguished from money markets, foreign exchange markets and futures and derivatives markets. The **money market** consists of banks procuring liquidity by borrowing and lending to each other, using short-term loans and credits. The **foreign exchange market** is where cheques and bills denominated in foreign currencies can be traded with foreign banks. It is usually an interbank market. The **derivatives markets**—closely connected to the capital markets[12]—trade in futures and options.[13] 3

In Europe, derivatives markets have been subject to considerable developments in the last decade.[14] Exchange traded derivatives are generally confined to more standard products such as options and futures, whilst OTC derivatives are not and may include products such as swaps and forward rate agreements.[15] This approach has been challenged by the devastating consequences of the opaque and highly systemic OTC derivatives markets during the financial crisis.[16] Therefore **MiFIR** introduced an **obligation** to **trade derivatives** on **trading venues**.[17] Whether a class of derivatives is subject to that obligation depends on ESMA's decision.[18] MiFIR also introduced the obligation to clear such derivatives via a Central Counterparty (CCP),[19] which accompanies the similar obligation in EMIR concerning OTC-traded derivatives.[20] 4

2. Primary and Secondary Markets

Two types of markets can be distinguished: primary and secondary capital markets. The **primary market** deals with issuing new securities (so-called initial public offering, **IPO**). Shares will generally be issued by stock corporations and acquired by investors. However, the shares may also be offered by a major shareholder.[21] In practice, both the stock corporation and the existing shareholders frequently put shares up for sale.[22] Unlike secondary markets, primary markets are not organised. 5

Shares can be issued by the issuer itself or through securities underwriting, the latter being predominant in practice. In these cases a syndicate of banks underwrites the transaction, subsequently selling the newly issued shares to the public.[23] The legal basis is an underwriting agreement between the stock corporation (and, if applicable, existing shareholders) and the bank consortium. A well-known example of a self-issuance is the IPO of the music streaming provider Spotify in 2018 (direct listing on the Nasdaq). 6

[12] Cf. G. Fuller, *The Law and Practice of International Capital Markets*, para. 1.214.

[13] Cf. A. Rechtschaffen, *Capital Markets, Derivatives and the Law*, 19.

[14] Cf. Commission, Commission Staff Working Paper, 20 October 2011, SEC(2011) 1217 final, p. 98 with reference to data on global OTC derivatives markets, mainly generated from statistics compiled by the Bank for International Settlements (BIS); cf. ECMI, *ECMI Statistical Package 2015*, Table 4.1.a, the notional amount outstanding of OTC Derivatives sums up to € 500.404,39 billion in December 2014.

[15] SEC(2011) 1217 final, ibid., p. 98.

[16] Recital 25 and 26 MiFIR.

[17] Art. 28 MIFIR.

[18] Art. 32 MiFIR.

[19] Art. 29 MiFIR.

[20] P. Gomber and F. Nassauer, 26 ZBB (2014), 250, 255 ff.

[21] This is also termed a secondary offer, the offer by the company being termed a primary offer, cf. R. Panasar et al., in: Panasar and Boeckman (eds.), *European Securities Law*, para. 2.32.

[22] Cf. ibid.

[23] See para 37.

7 Issuing shares through securities underwritings confers numerous advantages as opposed to issuing shares directly. Banks will generally have better business relations with institutional investors willing to buy shares. Banks are furthermore familiar with customs of capital markets and will thus be able to determine the best time to raise capital and the issuing price in a so-called bookbuilding procedure[24] more easily. This includes direct contact with the institutional investors. However, the underwriting fee the issuer must pay the bank for its services may be considerable.[25]

8 The **secondary market** is the market where previously issued securities and financial instruments are bought and sold. It allows investors to dispose of previously acquired securities, making these investments once again available to the public. The market participants of secondary markets are usually institutional investors, such as banks, pension funds, investment funds, hedge funds, but also private investors.[26]

3. Stock Exchanges

9 The large secondary markets are highly organised markets, operated by stock exchanges. What is meant by an exchange is not regulated in European capital markets law. Union law does not refer to the concept of an exchange, but to the concepts of RM, MTF and OTF. Consequently, the organisation of stock exchanges is subject to the laws of the Member States.

10 The details of national regulations for stock exchanges cannot be described here. It should be sufficient to present essential aspects of the role of stock exchanges, be it that they are organised in the legal form of a corporation (eg London Stock Exchange) or that they are institutions under public law with only partial legal capacity (eg Frankfurter Wertpapierbörse). Stock exchanges are subject to special rules intended to ensure the correct determination of stock prices, enabling them to represent the actual market situation. Additionally, the exchange prices must be made public. The stock exchange's management can suspend or prohibit trading if regulated stock exchange dealings are in its opinion endangered or no longer guaranteed.

II. Trading Venues under MiFID II

1. Regulated Market (RM)

11 A regulated market as defined in Article 4(1)(21) MiFID II 'means a **multilateral system** operated and/or managed **by** a **market operator**, which brings together or facilitates

[24] See para 38.

[25] Usually the issuer will owe a certain percentage of the volume of shares issued or its proceeds as commission. Cf. H. Haag, in: Habersack et al. (eds.) *Unternehmensfinanzierung am Kapitalmarkt*, para. 23.30: between 1% and 3%.

[26] See R. Veil § 9 para. 14 f.

the bringing together of multiple third-party buying and selling **interests** in **financial instruments**—in the system and in accordance with its non-discretionary rules—in a way that **results** in a **contract**, in respect of the **financial instruments** admitted to trading under its rules and/or systems, and which is **authorised** and functions regularly and in accordance with Title III' of the MiFID II.

This definition proves to be laborious. A regulated market must be authorised,[27] distinguishing it from an MTF.[28] However, the definition gives rise to a number of further questions: What is a 'system'? What does 'the bringing together of multiple third-party buying and selling interests' mean? What do the 'non-discretionary rules' refer to? And finally, when does a system not function 'regularly'? A 'multilateral system' is defined in Article 4(1)(19) MiFID II as 'any system or facility in which multiple third-party buying and selling trading interests in financial instruments are able to interact in the system'. The definition excludes bilateral systems.[29] However, the term system is not defined. Recital 6 of the former MiFID indicated that the notion of a system should encompass all those markets that are composed of a set of rules and a trading platform as well as those that only function on the basis of a set of rules, whilst the term buying and selling interests is to be understood in a broad sense and includes orders, quotes and indications of interest. Auction systems, traditional server-based trading platforms and peer-to-peer systems are examples of the organised matching of supply and demand.[30] Recital 6 further laid down that the interests be brought together in the system by means of non-discretionary rules set by the system operator, meaning that they are brought together under the system's rules or by means of the system's protocols or internal operating procedures (including procedures embodied in computer software). The term 'non-discretionary rules' means that these rules leave the investment firm operating an MTF with no discretion as to how interests may interact. These interpretations are still valid under the new regime though the MiFID II does not contain the former recital anymore. 12

The reference to Title III of the MiFID II finally indicates that a regulated market is subject to certain requirements regarding market management,[31] persons exercising significant influence over the management of the regulated market[32] and market organisation.[33] The operator of the regulated market must perform tasks relating to the organisation and operation of the regulated market under the supervision of the national competent authority (NCA).[34] 13

The list maintained by ESMA provides information on the regulated markets in the EU and the EEA states.[35] According to this list,[36] there are currently (in October 2021) a total of 128 regulated markets;[37] the most prominent are the regulated markets of Euronext (operated in France, Belgium, Portugal, the Netherlands, Ireland and the United Kingdom), 14

[27] Art. 54 MiFID II determines the requirements for a regulated market to be granted authorisation.
[28] See para. 16.
[29] Cf. ECJ of 16.11.2017 – Case C-658/15 *(Robeco Hollands Bezit)* para. 30.
[30] A. Fuchs, in: Fuchs (ed.), *Wertpapierhandelsgesetz, Kommentar*, § 2 para. 159.
[31] Cf. Art. 45 MiFID II.
[32] Cf. Art. 46 MiFID II.
[33] Cf. Art. 47 MiFID II.
[34] Cf. Art. 36(2) MiFID; Art. 44(2) MiFID II.
[35] Art. 56 MiFID II requires Member States to submit to ESMA a list of regulated markets, which shall publish a list of all regulated markets on its website and update it regularly.
[36] However, the registration of a market in this list is not a necessary condition for the qualification of the respective market as a regulated market. Cf. Case C-248/11 (*Nilaş*) guiding principle 2.
[37] Cf. ESMA, MiFID Database, available at: https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_upreg#.

the Frankfurt Stock Exchange and the NASDAQ Group (operated in Denmark, Norway, Finland, Estonia, Lithuania and Iceland). The list can also be used to identify which national supervisory authority is responsible for the separate markets.

15 Most important regulated markets are divided into segments.[38] The FWB, for example, distinguishes between Prime Standard and General Standard listing. The Prime Standard segment is a sub-segment of the regulated market segment, with a range of obligations that exceeds the rules provided for by the European legislative acts. These include the disclosure of corporate calendar and the organisation of annual analyst conferences. The admission to the Prime Standard listing is a prerequisite for the inclusion in one of the FWB indices, including DAX (large cap), MDAX (mid cap), TecDAX (technology issuers) and SDAX (small cap).

2. Multilateral Trading Facility (MTF)

16 A multilateral trading facility (MTF) means 'a **multilateral system** operated by an investment firm or a market operator, which **brings together multiple third-party** buying and selling **interests in financial instruments**—in the system and **in accordance with non-discretionary rules**—in a way that **results** in a **contract** in accordance with Title II of this Directive.'[39] Unlike a RM, an MTF is not subject to authorisation, but to supervision, which monitors compliance with organisational requirements and rules and procedure for fair and orderly trading.[40]

17 Like an RM and an OTF, an MTF requires a multilateral system.[41] However, the concept of RM is broader in that it includes a multilateral system that *promotes* the *pooling* of multiple third-party buying and selling *interests* in financial instruments.

18 The operation of an MTF constitutes an **investment service** under MiFID II[42] and a financial service under the CRD IV regime. The investment firm operating an MTF therefore requires a licence as an investment firm or financial services institution from the NCA.[43]

3. Organised Trading Facility (OTF)

19 The term 'organised trading facility' was introduced in the wake of the financial market crisis (MiFID II and MAR). The European legislature had observed that financial instruments had not been traded on an RM or MTF, but in other types of organised trading systems or over-the-counter. It was a declared aim of the European legislature to prevent market abuse for these transactions as well.[44]

[38] Cf. P. Storm, *Alternative Freiverkehrssegmente im Kapitalmarktrecht*, 149 ff.
[39] Art. 4(1)(22) MiFID II.
[40] Art. 16 and 18 MiFID II.
[41] See recital 13.
[42] Art. 4(1)(2) in conjunction with Section I Annex A No. 8 MiFID II.
[43] See R. Veil § 30 para. 4.
[44] Recital 8 MAR.

An OTF is defined as 'a **multilateral system** which is not a regulated market or an MTF and in which **multiple third-party buying** and **selling interests** in **bonds**, **structured finance products**, **emission allowances** or **derivatives** are able to **interact** in the system in a way that results in a contract in accordance with Title II of this Directive'.[45] The characteristic feature is therefore that the trading venue is a multilateral system.[46] This is the case with an electronic trading platform, but also for the systematic transmission of an investor's intention to trade with other investors, irrespective of the technical means used. However, it must be a multilateral system, which implies that an investor's intention to trade must interact with that of other investors (at least three market participants). The consequence of this broad definition is that a large proportion of the transactions in financial instruments that were previously carried out over-the-counter are now classified as OTF trading.[47] 20

It follows from the definition that no shares can be traded on an OTF, but only non-equity instruments,[48] and that **selling** and **buying interests** are **brought together on a discretionary basis** (which must not only be laid down in the rules of the investment firm operating an OTF but must also be in line with its daily practice). The operator of an OTF therefore has discretion as to how to execute a transaction (Article 20(6) MiFID II), but must observe certain rules of conduct (*best execution*).[49] This means that the OTF operator has discretion as to (i) whether to execute a client's order at all (it takes back an order already placed and executes it on another trading venue) or to execute it only partially (it executes the order only partially on the trading venue and forwards the remaining order to another trading venue) or (ii) whether, when and to what extent it matches two executable orders in the system. 21

The operation of an OTF represents both an investment service within the meaning of MiFID II[50] and a financial service under the CRD IV regime. 22

III. SME Growth Markets

With the so-called Jobs Act,[51] the US legislature aimed to facilitate and promote access to capital markets for emerging growth companies (EGCs). European legislature pursues a similar goal. MiFID II introduced a new category of MTF with the SME Growth Market. The SME Growth Market is intended as a **quality label** for **alternative trading venues**. The label should 'raise their visibility and profile and aid the development of common regulatory standards in the Union for those markets',[52] thus facilitating access to capital for SMEs.[53] 23

[45] Art. 4(1)(23) MiFID II.
[46] See recital 13.
[47] See N. Clausen and K. Sørensen, 9 ECFR (2012), 275, 285.
[48] P. Gomber and F. Nassauer, 26 ZBB (2014), 250, 253; M. Güllner, 71 WM (2017), 938, 943.
[49] N. Clausen and K. Sørensen, 9 ECFR (2012), 275, 292; see also recital 9 MiFIR.
[50] Art. 4(1)(2) in conjunction with Section I Annex A No. 9 MiFID II.
[51] Jumpstart Our Business Jobs Act of 5.4.2012; see also W. Cunningham, *The JOBS Act*; R. Veil, *Kapitalmarktzugang für Wachstumsunternehmen*, 3–34.
[52] Recital 132 MiFID II.
[53] See recital 132 MiFID II; for more details on this regulatory concept see R. Veil, *Kapitalmarktzugang für Wachstumsunternehmen*, 128 ff.

24 The term SME Growth Market describes an **MTF** that has been registered in accordance with Article 33 MiFID II.[54] Registration can be applied by the operator of an MTF at the NCA (AMF in France, Consob in Italy, CNMV in Spain, BaFin in Germany, etc.). It requires that at least 50% of the issuers whose financial instruments are admitted to trading on the MTF are SMEs at the time of registration of the MTF as an SME growth market and in each subsequent calendar year.[55] An **SME** is defined as a small and medium-sized enterprise whose **average market capitalisation**, based on year-end quotations, was **less** than **€ 200 million** in the last three calendar years.[56] The NCA registers the market, if the issuer complies with the requirements for an SME Growth Market. These are laid down in regulations adopted by the European Commission (level 2 regulation)[57] and the Member States under Article 33(3) MiFID II.

25 The requirements for an SME Growth Market are less stringent than for a RM. With regard to **admission to trading**, issuers benefit firstly from the fact that they do not have to publish a prospectus under the EU Prospectus Regulation. Instead, it is sufficient for them to publish an **information document** under the rules of the market operator, which is not subject to approval by the national supervisory authority.[58] Another important difference is that **issuers** are **not** obliged to publish **financial reports** in accordance with **IFRS** (but may apply national accounting law). They are also not required to publish half-yearly financial reports unless required by the rules of the market operator. Unlike the RM, the notification and disclosure requirements on changes in major shareholdings and financial instruments provided for under the Transparency Directive do not apply. This is also true for the requirements on corporate governance and related party transactions provided for listed companies by the Shareholder Rights Directive. In addition, issuers benefit from some facilitations in **market abuse law**.[59] However, these does not offer any significant cost advantages. The European legislature has not made any concessions to the obligation to publish inside information pursuant to Article 17(1) MAR, though recognising that the 'requirement to disclose inside information can be burdensome for small and medium-sized enterprises, whose financial instruments are admitted to trading on SME Growth Markets, given the costs of monitoring information in their possession and seeking legal advice about whether and when information needs to be disclosed.'[60] The European legislature argued that 'prompt disclosure of inside information is essential to ensure investor confidence in those issuers.'[61]

26 The concept of SME Growth Markets has so far had varying degrees of success in the Member States. There are 822 companies listed on the AIM London, 142 on the AIM Italia, 48 on Scale

[54] Art. 4(1)(12) MiFID II.
[55] Art. 33(3)(a) MiFID II.
[56] Art. 4(1)(13) MiFID II.
[57] Art. 77 Commission Delegated Regulation (EU) 2017/565, p. 1 ff.
[58] However, the rules of the market operator usually require the issuer to appoint an adviser to assist it in the admission of the securities (so-called nominated adviser). Cf. R. Veil, *Kapitalmarktzugang für Wachstumsunternehmen*, 44.
[59] Cf. Art. 17(9) MAR on the publication of inside information and Art. 18(6) MAR on the insider list.
[60] Recital 55 MAR.
[61] Recital 55 MAR. This is criticised in literature, cf. R. Veil and C. Di Noia, in: Busch and Ferrarini (eds.), *Regulation of the EU Financial Markets*, para 13.01.

of the Frankfurt Stock Exchange, 399 on Euronext Growth, 428 on the First North Growth Market and 120 on the Spanish BME Growth Market (as of July 2021). It is noteworthy that there were 68 listings in Italy between 2018 and 2019, which can be explained by tax incentives for investors.

Not all SME Growth Markets in the Member States have seen a significant increase in listings. On the AIM London there were even 1,694 companies listed in 2007 and 1,056 companies in 2015.[62] There are many reasons for the decrease in listings. Institutional investors are not interested in securities admitted to trading on SME growth markets because the investment volume and liquidity of the markets are too low.[63] In addition, there is a lack of ***research*** for small issuers. The high degree of regulatory complexity is also lamented. Finally, for some market operators the label SME growth market does not seem appropriate. The *m:access* segment (with 67 companies listed in July 2021) operated by the Munich Stock Exchange as an MTF, for example, sees itself as a trading center for SME financing and not primarily for growth companies. Börse München has therefore not applied for registration as an SME growth market. 27

With **Regulation (EU) 2019/2115** of 27.11.2019, the European legislator has attempted to take account of criticisms. The reform is based on the idea that only issuers admitted to trading on SME Growth Markets benefit from lower regulatory requirements. However, if a market operator does not apply for registration, SMEs do not benefit from reduced unnecessary administrative burdens. 28

The facilitations introduced by Regulation (EU) 2019/2115 are intended to reduce the administrative burden for SMEs and thus ensure greater liquidity on these markets. The Regulation addresses numerous regulatory requirements of the market abuse regime. An important issue is the obligation to draw up a list of all persons who have access to price-sensitive information (**insider lists**). Issuers on SME Growth Markets only have to put a limited number of persons on such a list, namely those who can access inside information at all times ('permanent insiders'). With regard to **directors' dealings**, the reform aims to ensure that issuers on SME Growth Markets have sufficient time to disclose transactions after notification by the manager. A further issue of the reform concerns the obligation to disclose inside information. If an issuer listed on a SME Growth Market decides to delay the disclosure of inside information (Article 17(4) MAR), it only has to justify such delay if requested by the competent national authority. In addition, the issuer is exempted from the obligation to keep continuous records of such justifications. 29

The success of the SME Growth Market can certainly not be assessed by the number of listed companies alone. Instead, it is more important that the SME Growth Market is associated with a high-quality listing.[64] Nevertheless, access to capital markets for SMEs can still be improved. The European Commission therefore continues to pursue the goal under the *von der Leyen* administration with a targeted consultation on the listing act (November 2021). 30

[62] R. Veil, *Kapitalmarktzugang für Wachstumsunternehmen*, 53 ff.
[63] A. Harwood and T. Konidaris, *WPS7160*, 20.
[64] R. Veil and C. Di Noia, in: Busch and Ferrarini (eds.), *Regulation of the EU Financial Markets*, para. 13.49.

IV. OTC Trade

31 The market structure established by MiFID I was characterised by intense competition between markets (regulated market, MTFs). In addition, for cost reasons and to ensure anonymity, a significant proportion of trading (in particular of derivatives) took place outside the trading venues[65] (so-called OTC trading - over-the-counter) and in so-called **dark pools** (such as broker-crossing systems),[66] where no pre-trade transparency existed and market participants therefore had no knowledge of existing orders and their volumes.[67] The aim of the reform of market infrastructures in Europe 2014 (MiFID II regime) and market abuse law (MAR/CRIM-MAD) was to direct this trading to (regulated) trading venues as far as possible and to prevent abusive behaviour.

32 To this end, the European legislature introduced the concept of an OTF and declared the regime on market abuse applicable to any multilateral trade (on RMs, MTFs and OTFs). It did not prohibit **bilateral trading**, but required **investment firms** to **ensure** the **trades** it undertakes in shares admitted to trading on an RM or traded on a trading venue generally **take place** on an **RM**, **MTF**, systematic internaliser or a third-country trading venue.[68]

33 Furthermore, legislature extended the scope of application of European market abuse law. The MAR regime also applies to transactions outside regulated trading venues (RM, MTF and OTF), ie to any transaction, order or behaviour concerning any financial instrument as referred to in Article 2(1) and (2) MAR, irrespective of whether or not such transaction, order or behaviour takes place on a trading venue (Article 2(3) MAR). According to the legislator, 'it is possible that certain financial instruments which are not traded on a trading venue are used for market abuse.'[69]

V. Access to Markets and Market Exit

34 Going public for the first time—also known as an Initial Public Offering (IPO)—is a complex transaction. On the one hand, it is necessary to make the company interested in accessing the capital market 'ready for the stock exchange'. This concerns in particular questions of corporate governance and accounting. On the other hand, numerous steps necessary for the capital market transaction must be taken. The focus is on the securities prospectus, which is required for the public offering, but in any case for the listing at a regulated market. An IPO can therefore take several months. This explains why alternative procedures have also become established in practice, which on the one hand promise a higher degree of transaction security, but on the other hand are particularly risky for investors. In recent years, the

[65] Cf. P. Gomber and F. Nassauer, 26 ZBB (2014), 250, 252.
[66] Cf. M. Güllner, 71 WM (2017), 938, 940.
[67] Cf. P. Gomber and F. Nassauer, 26 ZBB (2014), 250, 252; M. Güllner, 71 WM (2017), 938, 940.
[68] See Art. 23 MiFIR. This obligation also applies to proprietary trading, see P. Gomber and F. Nassauer, 26 ZBB (2014), 250, 255.
[69] See recital 10 MAR with specific examples.

IPO via Special Purpose Acquisition Companies (SPACs) has become attractive, especially in the USA. In this process, initiators raise money from investors via a shell company, which is then used to acquire a target company within two years.

1. IPO and Listing

A stock corporation must generally increase its capital in order to issue shares, unless the corporation holds own shares and wants to offer them publicly. On the other hand, the board of directors of a stock corporation does not need a resolution of the general meeting if the company wants to issue bonds. If an issuer wishes to offer mezzanine financial instruments, such as convertible bonds and profit participation rights, it may be necessary to obtain a resolution of the general meeting of shareholders. This is governed by corporate law of the Member States, which has not yet been harmonised in this respect. 35

Both the **increase in capital** and the issue of **bonds** usually require the **involvement of banks** that have the necessary business contacts to institutional investors and are familiar with the customs and expectations of the capital markets. Banks organise roadshows and conferences with analysts. Due to banks' expertise they are further able to judge the ideal time for the issuance better than the investor. They can further coordinate the cooperation with legal advisors, and together with these they correspond with the supervisory authorities.[70] Banks further fulfil a number of obligations after the issuance, including serving as the paying agency for the issued shares, ensuring trade for less liquid shares[71] and, if necessary, carrying out price-stabilising measures. 36

An issuer will generally assign a number of banks the task of carrying out the issuance,[72] the financial risk of larger transactions being too big for an individual bank. This association of banks is called a **banking syndicate** and is led by one of the participating banks (also referred to as lead manager, global coordinator or book runner).[73] A banking syndicate takes over all the shares from the capital increase and offers these to existing shareholders or interested third parties. The rights and obligations of the banks are laid down in an **underwriting agreement**.[74] This also contains provisions on the liability for the prospectus.[75] 37

One of the most difficult tasks is the determination of the issue price. In practice, three different procedures are known: the fixed price procedure, the auction procedure and the **book-building procedure**—the last one being the most important.[76] In book-building 38

[70] Cf. on the basic rules regarding communication with the supervisory authorities: R. Panasar et al., in: Panasar and Boeckman (eds.), *European Securities Regulation*, para. 2.60: 'There are three basic rules that market participants should follow when dealing with the regulator: (i) be nice to them; (ii) do not upset them; and (iii) do not be unpleasant to them. In addition, there is one overarching principle: tell the truth'.

[71] This function is also named Designated Sponsoring. See on market making R. Veil § 9 para. 8.

[72] Cf. R. Panasar et al., in: Panasar and Boeckman (eds.), *European Securities Regulation*, para. 2.04.

[73] Ibid.

[74] Cf. G. Fuller, *The Law and Practice of International Capital Markets*, para. 6.11–6.15; A. Meyer, in: Marsch-Barner and Schäfer (eds.), *Handbuch börsennotierte AG*, § 8 para. 104–191.

[75] On prospectus liability see R. Veil § 17 para. 75–93.

[76] Cf. G. Fuller, *The Law and Practice of International Capital Markets*, para. 6.17–6.18; A. Meyer, in: Marsch-Barner and Schäfer (eds.), *Handbuch börsennotierte AG*, § 8 para. 30–34.

procedures shares are not offered at a fixed price, the prospectus rather only containing a price range. During a so-called order-taking period the investors then have the opportunity to submit orders, listing the maximum number of shares they are willing to buy and the maximum share price they are prepared to pay. When the order-taking period is over, the banking syndicate will evaluate the information, allowing the management of the company to fix an issuing price.

39 The details of the underwriting are beyond the scope of this book, being a matter that is largely influenced by legal practice and varies widely between the Member States due to the different legal requirements in corporate law with regard to capital increases.

40 The success of an issue of securities usually requires that investors can sell the securities on a market. This is particularly important for the issuance of shares. It is not sufficient for a company to offer its shares publicly.[77] It must rather also apply to have its **shares traded** on a regulated **market**[78] or another market,[79] pursuant to the national stock exchange provisions in the Member States and the market operator's regulations. Some rules are harmonised by European law: Directive 2001/34/EC coordinates the rules of Member States on the admission of securities to official stock exchange listing (so-called listing directive).[80] Most of the provisions have been repealed in the meantime.[81] However, the rules on admission requirements for shares and bonds are still in force.

41 The Directive 2001/34/EC requires 'the provision of information which is sufficient and as objective as possible concerning the financial circumstances of the issuer and particulars of the securities for which admission to official listing is requested'.[82] Furthermore, issuers are to fulfil certain requirements, such as a minimum market capitalisation. In addition, the shares must be freely negotiable and a sufficient number of shares must be distributed to the public in one or more Member States not later than the time of admission. These requirements aim at protecting investors.

2. Delisting

42 Market exit is also termed '**delisting**' and constitutes the **revocation** of the **admission** of **shares** to **trading** on a regulated **market** or an MTF (going private). The transition from a regulated market to an MTF is called downgrading. The market operator revocates the admission either because an issuer failed to comply with the law or at the request of the issuer. The legal requirements can be found in the national laws of the Member States and the stock exchange operator's regulations. No provisions thereon exist at a European level as yet.

[77] On the term public offer see R. Veil § 17 para. 18.

[78] On the term regulated market see para. 11.

[79] On MTFs see para. 16.

[80] Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities, OJ L 184, 6 July 2001, p. 1.

[81] This applies to the obligation to publish financial reports, the disclosure of major shareholdings (both requirements provided for by the Transparency Directive) and the obligation to publish a prospectus for the admission of securities to trading (regulated by the Prospectus Regulation).

[82] Recital 9.

43 There are numerous reasons for a delisting. The issuer may be interested in avoiding the costs resulting from the admission to the stock exchange due to numerous disclosure obligations and compliance requirements. The issuer can then either abstain from trading its shares on the stock exchange entirely or apply for the admission of its shares at a market with lowers requirements, such as the AIM in London, Scale in Frankfurt or Euronext Growth in Paris (downgrading).[83] The stock exchange operator may revoke the admission to the stock exchange, if the trade of the shares is no longer ensured or the issuer has breached important obligations.

44 For the **shareholders** of an issuer the delisting involves considerable disadvantages. Whilst they can legally still sell their shares, they have no market to operate over. This gives rise to the question of whether shareholders are protected in the event of a delisting. A uniform answer to this question for the whole of Europe is not possible as the European legislature has not addressed this question and the legal situation in the Member States is too disparate to be described in this book.[84]

[83] These alternative markets are organised as MTFs and registered as SME Growth Markets. See para. 23.

[84] Cf. for an analysis of the German and UK law P. Maume, 16 EBOR (2015), 255, 264–275; for the legal situation in Spain L. de Carlos and M. Rios, in: Panasar and Boeckman (eds.), *European Securities Regulation*, para. 20.305–20.307.

§ 8

Financial Instruments

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I. Introduction

The **Prospectus Regulation** (PR) harmonises the requirements for the drawing up, approval and distribution of the prospectus to be published when '**securities'** are offered to the public or admitted to trading on a regulated market.[1] The **Transparency Directive** (TD) establishes requirements in relation to the disclosure of periodic and ongoing information about issuers whose '**securities'** are already admitted to trading on a regulated market.[2] 1

[1] Cf. Art. 1(1) PR.
[2] Cf. Art. 1(1) TD.

Both legislative acts hence contain provisions on the disposal of and trade in securities. A precise definition of the term 'securities' is thus essential for determining the scope of application of both legal acts. However, it is not defined in the PR and TD. Instead, the two legislative acts refer to the concept of a security under MiFID II.[3]

2 The other level 1 regulations and directives operate largely with the term 'financial instruments'. The **MAR** and the **CRIM-MAD**, for example, demand from the Member States that they apply the prohibitions regarding insider dealings and market manipulation and the requirements on the disclosure of inside information and director's dealings to actions concerning '**financial instruments**'.[4] They do not define this term, but refer to Article 4(1)(5) MiFID II, which in turn refers to Annex I Section C MiFID II. Financial instruments are not only transferable **securities**, but inter alia also money market instruments, units in collective investment undertakings, physically or cash settled derivative contracts and financial contracts for difference.

3 The following section deals with **securities** as the key instrument for capital markets. However, it also examines other financial instruments in this context. Whilst this book places emphasis on the regulation of debt and equity capital markets, the derivatives markets are closely connected thereto and have been of increasing importance since 2008.[5] It is therefore necessary to make a few remarks to the concept of derivatives. Derivatives are used to limit risks from securities, currency risks or business risks. However, derivatives are also used to profit particularly strongly from the performance of a security (speculation).[6] Derivatives trading has grown enormously in importance in Europe over the last two decades. In recent years, financial instruments have been created and publicly offered for purchase on the blockchain, which are qualified as securities by national supervisory authorities (NCAs). This has led to an intensive discussion about the regulation of **DLT-based securities**. These instruments are explained in § 10 of this book.

II. Securities

1. Definitions in MiFID II

4 The MiFID II contains a definition of securities, which is referred to in the other Level 1 directives and regulations.[7]

> '**Transferable securities**' means 'those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as:
>
> (a) **shares** in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares;

[3] Cf. Art. 2(a) PR and Art. 2(1)(a) TD.
[4] Cf. Art. 2(1) MAR.
[5] Cf. R. Veil § 1 para. 48 and § 7 para. 3.
[6] See R. Veil § 23 para. 6.
[7] Cf. Art. 4(1)(44) MiFID II.

(b) **bonds** or other forms of securitised debt, including depositary receipts in respect of such securities;
(c) any **other securities** giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures.'

This provision defines the concept of a security typologically by listing a number of instruments that qualify as securities, instead of providing an abstract definition of the term. This is the difference between the European and US concepts of securities.[8] It follows firstly that a security is characterised by three elements. After all, MiFID states that a security must be transferable, standardised and tradeable. 5

The requirement of **transferability** already follows from the wording of the provision. It means that there must be no legal obstacles to the disposal of the instruments. One such obstacle would be, for example, the requirement of a notarial certification of the transfer. 6

The **standardisation** of an instrument can also be derived from the wording of Article 4(1)(44) MiFID II ('categories' of securities). Consequently, securities may not be individually structured, but must have standardised (identical) features.[9] There must also be no personal liability of the owner of the instrument.[10] Otherwise, effective trading of the instrument would not be possible. It is sufficient if the rights vis-à-vis the issuer are standardised (issuer-related understanding). A bond issued by an issuer is therefore standardised if it gives all investors the same rights (for example, the right to repayment and interest). 7

Finally, the instrument must be '**negotiable** on the capital market'. The European concept of securities does not require tradability on a regulated market, MTF or OTF (trading venues under Article 4(1)(24) MiFID II). It is sufficient that the instrument can generally be negotiated on a market. Whether acquisition in good faith is possible is irrelevant under MiFID II.[11] 8

Secondly, qualification as a security requires that an **instrument** is functionally **comparable** to the examples of a security according to Article 4(1)(44) MiFID II (**shares** in companies, bonds or other forms of securitised debt, etc.).[12] In the absence of ECJ case law, there is no certainty about the characteristics of 'shares' (Article 4(1)(44)(a) MiFID II) and 'bonds' (Article 4(1)(44)(b) MiFID II).[13] 9

Whether the securities are securitised in (global) certificates is irrelevant according to the definition of MiFID II, which follows a technology-neutral approach. Thus, DLT-based instruments may also qualify as securities.[14] 10

[8] The US concept of securities is defined by the ruling of the US Supreme Court, *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), also known as the Howey Test. The judgment concerns the term 'investment contract'. This is a 'contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.'
[9] Cf. H.-D. Assmann, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, § 2 WpHG para. 11; S. Kalss et al. (eds.), *Kapitalmarktrecht I*, § 1 para. 4.
[10] Cf. S. Kalss et al. (eds.), *Kapitalmarktrecht I*, § 1 para. 4.
[11] P. Zickgraf, 63 AG (2018), 293, 302.
[12] Cf. recital 8 MiFID II.
[13] See para. 11 and 16.
[14] See R. Veil § 10 para. 7 f.

2. Shares

11 Shares are the prototype of negotiable securities on capital markets.[15] They are thus the first mentioned security in the MiFID's definition. Neither the understanding of shares nor that of shareholders is clearly described in European capital markets law. The TD merely defines the shareholder as any natural person or legal entity who holds shares of the issuer.[16]

12 In the absence of specifications in MiFID II the term must be construed in accordance with European corporate and accounting law. It follows from that: A share is a **participation** in the **company's capital** in **return** for a **contribution** in **cash** or in **kind**. Shares may confer different rights, including voting rights and profit-sharing rights. A shareholder is permanently associated with the company through the share[17] and has a residual claim on the company's assets after deduction of all debts.[18]

13 The rights and obligations of a shareholder are governed by national corporate laws. **Shares** can be issued as par shares or non-par shares.[19] For example, a stock corporation can issue shares with a nominal value of € 1 or higher or instead issue shares representing a fraction of ownership in a company. Non-par shares of a company must participate equally in its share capital. In many Member States, **preferred stocks** to which no voting rights are attributed are also commonly used. They are characterised by preferred share dividends which take precedent over common share dividends when an issuer allocates its profits. Preferred stocks normally carry no shareholder voting rights. They can also be traded on capital markets.

14 Generally, shares are **freely transferable**. Whether the transfer of shares can be restricted depends on the national corporate law of each Member State. In Germany, a restriction (*Vinkulierung*) is only possible for registered shares and has an immediate legal effect (in rem).[20] Therefore, the transfer of shares with restricted transferability is only possible with the consent of the issuer. This does not prevent registered shares with restricted transferability from being tradable on the capital markets. Smooth trade can, however, only be ensured if the company's consent can easily be obtained.[21]

15 If an issuer of shares from Europe wants access to the US capital market, this is usually done with **depositary receipts**. Such certificates securitise ownership rights in shares (or other securities). The depository receipts are issued by a custodian bank and can be traded on a capital market. The holder has the right vis-à-vis the depositary bank to exchange the depository receipt at any time for the underlying shares (deposited by the issuer). The most prominent example is American Depository Receipts (**ADRs**). To be traded on a US market, ADRs must be registered under the U.S. Securities Act.

[15] A. Rechtschaffen, *Capital Markets, Derivatives and the Law*, 43.
[16] Cf. Art. 2(1)(e) TD.
[17] Cf. Art. 2(2) Directive 2013/34/EU of 26 June 2013.
[18] Cf. R. Veil, 183 ZHR (2019), 346, 358 f.
[19] Cf. E. Werlauff, *EU Company Law*, chapter 9.3.
[20] Cf. § 68(2) AktG.
[21] H.-D. Assmann, in: Assmann/Schneider/Mülbert (eds.), *Kommentar zum Wertpapierhandelsrecht*, § 2 WpHG para. 184.

3. Bonds

16 Debt securities, especially bonds, play an important role in financing companies (**corporate bonds**) or states (**sovereign bonds**).[22] Similar to shares, they can also be traded on secondary markets.[23] The TD defines the term 'debt securities' as bonds or other forms of transferable securitised debts, with the exception of securities which are equivalent to shares in companies or which, if converted or if the rights conferred by them are exercised, give rise to a right to acquire shares or securities equivalent to shares.[24] Bonds may not be customised. The legal nature of a bond under civil law and the requirements for it to be effectively issued are to be determined pursuant to the national provisions of the respective Member State.

17 A debt instrument is any **tradable right** that entitles the **issuer** to **demand payment** of a specified **sum** of **money**, which the issuer must repay at maturity. Typical shareholders rights (voting rights, right to information, right to participate in a general meeting, right of appeal) as well as profit-sharing rights are not common to bonds and other debt instruments, although they can in principle be granted to the holder of the instrument, unless this is not permitted under national company law.

18 The holder (investor) of a debt instrument has a creditor stake as opposed to an equity stake in the company. In the case of the issuer's insolvency its claim is thus senior to the residual claims of the shareholders. The **interest rate** (coupon) the issuer has to pay to the bond holders is usually fixed throughout the life of the bond. The interest rate that the issuer of a bond must pay is influenced by a variety of factors, in particular the creditworthiness of the issuer, the length of the term and the mode of repayment. Due to the policy of the ECB, however, zero-interest bonds have now also become established, with sovereign bonds sometimes even yielding a negative return. Most bonds are annual, meaning that interest is paid at fixed yearly intervals. However, other agreements may also provide that the coupon is only paid on maturity of the bond. The terms of bonds vary, short-term bonds having an average maturity of four years, whilst long-term bonds have a maturity of more than eight years. On maturity, the issuer is obligated to repay the nominal amount to the investor.

19 The details of the term, in particular when the repayment claim is due, whether it is secured and whether the investor is entitled to a share of the issuer's profits (profit participation bond), are set out in the bond terms and conditions. These also govern protection against dilution. Whether the terms and condition are subject to a judicial control to ensure investor protection depends on the applicable national law.

4. Other Investment Products

20 The concept of financial instrument in EU capital markets law covers a wide range of instruments offered by issuers for the purpose of raising capital. However, there are debt instruments, which do not qualify as securities and do not fall under any other category of

[22] G. Fuller, *The Law and Practice of International Capital Markets*, para. 1.62; A. Rechtschaffen, *Capital Markets, Derivatives and the Law*, 18.

[23] See R. Veil § 7 para. 2.

[24] Art. 2(1)(b) TD. Cf. also Art. 4(1)(44)(b) MiFID II.

financial instrument. Thus, only national law of a Member State applies to the public offer of such assets. Examples are participatory loans and subordinated loans used in crowdfunding. Shares in partnerships are also not securities under Union law because they are not tradable.

III. Derivatives

21 Derivatives are **contracts** that are to be **fulfilled** at **fixed terms** and at a specific **future date**. This distinguishes them from normal (spot) transactions, which must be settled within two trading days.[25] **Futures** and **options** refer to a specific financial product (so-called underlying).[26] Underlying assets may be securities, currencies, interest rates, emission certificates or any other derivative instruments, financial indices or measures that can be effectively delivered or settled in cash. Futures are irrevocable for both parties. As opposed to this, an option grants the holder the right, but not the obligation, to buy (**call option**) respectively sell (**put option**) the underlying asset at a predetermined price. Certain options (premium deals) may require the buyer or seller to pay a premium (abandon) if it decides to withdraw from the contract.

22 Derivative contracts are transactions under uncertainty. In contrast to spot transactions, derivative transactions are not intended to transfer the underlying assets to the contracting party. For the purpose of derivatives, only the **market price** of the **underlying asset** and its further development is of interest. Thus, a small monetary investment promises a high profit (**leverage effect**). For example, with a call option for € 2 for a share at € 100, a profit of 50% can be achieved if the price rises to € 103 (3%). Derivative transactions are therefore mainly used for **speculation**.[27] The aim is then to make profits by correctly estimating future price developments or the intensity of price fluctuations. The risks of loss are therefore characterised by the price risks of the underlying asset. Furthermore, just as with securities, there is also a credit risk resulting from the creditworthiness of the issuer. Finally, derivatives can serve to **hedge** risks.

23 A bilateral OTC derivative construction proceeds in four steps. At the beginning (i) the parties conclude a master agreement that applies to a large number of transactions (**pre-trading phase**). This is followed by (ii) the trading phase (also called **matching**), which takes place either bilaterally or organised in a multilateral system. This is followed by the so-called clearing (iii). In this process, the outstanding claims between the parties are offset against each other (**netting**).[28] This has the advantage that the counterparty default risk is reduced.[29] Furthermore, open positions are collateralised. Finally, (iv) **settlement** takes place. In cash settlement, the parties owe money; in physical

[25] Art. 7(2) Delegated Regulation (EU) No. 2017/565 of 25 April 2016, OJ L 87, 31 March 2017, p. 1.

[26] A. Rechtschaffen, *Capital Markets, Derivatives and the Law*, 18.

[27] See on speculation R. Veil § 23 para. 7 f.

[28] In practice, different types of netting have emerged, namely payment netting, novation netting and liquidation netting. Cf. M. Brambring, *Zentrales Clearing von OTC-Derivaten unter EMIR*, 80 ff.

[29] Cf. M. Brambring, *Zentrales Clearing von OTC-Derivaten unter EMIR*, 71, 97.

settlement, they owe the transfer of the underlying asset. This process of a derivatives contract is being drastically changed by the regime the EU enacted in the aftermath of the financial market crisis of 2007/08 in order to counter the systemic risks of derivatives trading. EMIR[30] stipulates that standardised OTC derivative contracts must be cleared via central counterparties (CCPs) (clearing obligation). This means that the CCP joins as a contracting party and replaces one of the two contracting parties in each case. The CCP becomes the buyer on the one hand and the seller on the other.[31] This shifts the counterparty default risk to the CCP. As a consequence, the CCP requires collateral (so-called margins) from the parties. For non-standardised OTC derivative contracts, EMIR provides for risk mitigation obligations. Finally, EMIR requires all derivative contracts to be reported to trade repositories (supervised by ESMA).

The **variety** of **derivatives** is impressive. They can be divided into four categories:[32] 24
(i) swaps; (ii) options; (iii) futures and forwards; (iv) stock loans and repos. Depending on the type of underlying, the MiFID II distinguishes between derivatives relating to securities and relating to commodities.[33]

Forwards and futures obligate the seller to deliver the underlying asset, eg shares, to the buyer at a 25
specific time in the future (maturity) at a certain price (forward price).[34] The value of the forward on the settlement date is the difference between the agreed settlement price (forward price) and the current price of the security (underlyings). A future is a subtype of a forward. Unlike the forward, it is traded on stock exchanges.[35] As opposed to this, an **option** grants the buyer (beneficiary) the right but not the obligation to demand fulfilment by the other party (writer).[36] An option and a future can be either physically settled or cash settled. Under a cash settled option, physical delivery of the security is not required. The difference in price between the stock price and the fixed price in the option (strike price) is settled in cash.

With a swap, the contracting parties agree to exchange certain payments on future dates. The most 26
prominent cases are interest rate and currency swaps. In the case of an **interest rate swap**, for example, one party may have a payment obligation that is fixed in the amount and the other party may have a payment obligation that is variable in the amount, depending on the current market interest rate. In contrast, a currency swap requires the parties to exchange payments in different currencies over a specified period of time.[37] A **cash settled swap** does not involve an exchange of payments. Instead, there is a cash settlement, for example between the price of the security on the financial market and the strike price specified in the warrant.

With a **total return swap** (TRS), the parties agree that one side must pass on the return on the 27
reference asset and its increase in value to the other side, while the latter undertakes to compensate for any decrease in the value of the reference asset. Typically, a cash settlement is agreed. If the TRS

[30] Regulation (EU) No. 648/2012 of the European Parliament and the Council of 4. July 2012 on OTC derivatives, central counterparties and trade repositories, OJ EU L201 of 27. July 2012, p. 1.

[31] Cf. M. Brambring, *Zentrales Clearing von OTC-Derivaten unter EMIR*, 140.

[32] G. Fuller, *The Law and Practice of International Capital Markets*, para. 1.215.

[33] Cf. Annex I Sec. C (4), (5)–(7) MiFID II.

[34] Cf. G. Fuller, *The Law and Practice of International Capital Markets*, para. 1.226; C. Kumpan, in: Schwark and Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, § 2 WpHG para. 37.

[35] Cf. C. Kumpan, in: Schwark and Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, § 2 WpHG para. 40; U. Schüwer and S. Steffen, in: Zerey (ed.), *Finanzderivate*, § 1 para. 6.

[36] Cf. G. Fuller, *The Law and Practice of International Capital Markets*, para. 1.220; C. Kumpan, in: Schwark and Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, § 2 WpHG para. 37.

[37] Cf. U. Schüwer and S. Steffen, in: Zerey (ed.), *Finanzderivate*, § 1 para. 7.

relates to a share, this means that the bank (writer) is obliged to pay the investor the difference between the value of the share at the beginning and end of the swap transaction plus any dividends; in return it receives interest and fees. If the share price rises, the investor is entitled to the difference; if the share price falls, the bank is entitled to the difference. Thus, both parties bear price risks of the share. The bank typically hedges against the risk by acquiring the shares of the company in question and holding them until the swap is terminated. The investor has no right to delivery of the shares. It is solely at the discretion of the writer whether to deliver the shares. In the end, the investor bears the economic consequences of the ownership of the shares.

IV. ESG Financial Products

28 The global community agreed at the UN Climate Change Conference in Paris that financial flows should be aligned with a pathway towards low greenhouse gas emissions and climate resilience.[38] The EU is reshaping financial markets law for this reason. The legal framework on sustainable finance has grown steadily over the past five years.[39] This also results in requirements for providers of financial products that pursue environmental goals and take social aspects into account (also referred to as ESG investments). In addition, the financial industry has developed best practices for financial market participants who distribute green financial products.[40] A characteristic feature of these financial products is that the financial means provided by investors are used to pursue specific environmental purposes.[41] The European regimes and non-binding best practices are primarily aimed at overcoming information asymmetries between providers of ESG financial products and investors. Above all, green washing is to be prevented. For providers, the information and disclosure requirements increase the cost of capital. However, the disclosure rules are essential to ensure investor confidence in environmentally sustainable financial products.

29 The range of ESG financial products is wide. The market for so-called impact investing is growing rapidly, **green bonds** being the most important ESG product. These bonds are usually designed in accordance with the ICMA's Green Bond Standards. A central element of these standards is the issuer's obligation to inform investors by means of a report on the appropriate use of funds (debt governance).[42] However, an expert group set up by the European Commission has proposed that the EU adopts a standard for green bonds.[43]

30 ESG fund units, when traded on the stock exchange, referred to as **Sustainability** Screened **ETFs**, play also a major role. These are shares in a UCITS that meet certain ESG criteria. France was the pioneer for this type of financial product with a detailed regime

[38] Art. 2 Abs. 1 lit. c) Paris Agreement.
[39] See R. Veil § 1 para. 59 und § 2 para. 22.
[40] Cf. ICMA, Green Bond Principles. Voluntary Process Guidelines, June 2021; Climate Bond Initiative, Climate Bonds Standard and Certification Scheme, Version 3.0.
[41] See on different objectives of investors R. Veil § 23 para. 8.
[42] Cf. R. Veil, WM (2020), 1093, 1098 ff.
[43] EU Technical Expert Group on Sustainable Finance, Report on EU Green Bond Standard, June 2019.

for the label Greenfin (originally named TEEC).[44] In addition, the financial industry has developed numerous labels to express that a fund meets minimum criteria and can therefore be considered ecologically and/or socially sustainable. Characteristically, a certain percentage (usually 50 or 75%) of the fund's assets consists of ecologically sustainable securities (stocks; bonds; etc.). The asset management company is obliged to disclose the sustainability risks to the investors and must explain the ecological sustainability of the fund, and also ensure that the companies in the portfolio act in an ESG-compliant manner (fund governance).

With green financial products, the question always arises as to the conditions under which 31
the product may be called environmentally sustainable. To prevent **greenwashing**, the EU requires financial market participants to inform investors about the green characteristics of the financial product (disclosure obligations provided for by the SFDR). This requires classifying economic activities, ie whether nuclear power, for example, is 'green' or not. These aspects are regulated by the EU Taxonomy Regulation (SFTaxR).

[44] Cf. R. Veil, in: Tountopoulos/Veil (eds.), *Transparency of Stock Corporations in Europe* (2019), 129 ff.

§ 9

Market Participants

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I. Introduction

1 Capital market participants can be divided into four categories: (i) **providers** of **market infrastructures**; (ii) **issuers** of **securities**; (iii) **investors**; (iv) **intermediaries**. On a primary market, investors act as buyers and **issuers** as sellers, whilst on a secondary market investors act both as buyers and sellers. Investors typically engage intermediaries because they do not have the expertise required for stock exchange transactions and rely on experts to

evaluate the information (usually disclosed by the issuer). The financial intermediaries—primarily investment firms, financial analysts and rating agencies—play an important role, filtering the relevant information from the flood of information and submitting investment recommendations on its basis. Intermediaries are also in the interest of issuers whose costs for capital are reduced by letting financial analysts evaluate the information.[1] As opposed to this, rating agencies such as Standard & Poor's, Moody's and Fitch restrict themselves to evaluating the relative creditworthiness (solvency) of issuers of equity and debt in order to provide investors with the information necessary for well-informed investment decisions.[2]

2 This section deals with providers of market infrastructures, investors and issuers. It explains their role on capital markets and discusses whether they can be further categorised. The role of intermediaries and their specifics are not dealt with separately in this section, but are described in the sixth and seventh chapters of the book in the sections on the regulation of intermediaries.

II. Providers of Market Infrastructures

3 Market infrastructures are **trading venues** for **investors**. MiFID II provides for three types of trading venues (Regulated Market (RM)), Multilateral Trading Facility (MTF), Organised Trading Facility (OTF)) and thus aims to cover all types of multilateral trading of securities and derivatives.[3] The providers of market infrastructures are stock exchanges and investment firms. They operate trading venues and generate income from securities trading. Under MiFID II, a RM is operated by a market operator,[4] which may also operate MTFs and OTFs. MiFID II qualifies the operation of MTFs and OTFs as investment services.[5] The distinction is important because the governance and capital requirements for a market operator differ from those for investment firms.[6]

4 Turnover from stock trading is marginal today compared to other business of stock exchanges.[7] At Deutsche Börse AG, the 'Xetra' division (trading, clearing and listings) accounted for 7.58% of the turnover in 2019. In contrast, the financial derivatives business unit contributed 32.6% to the turnover. At the London Stock Exchange, Capital Market Formation and Trade (primary and secondary market for equity trading, excluding fixed income, derivatives and other) accounted for 14.5% of the turnover. In contrast, the division Financial Market Information contributed 39% to the turnover.

[1] See R. Veil § 26 para. 2.
[2] See R. Veil § 27 para. 1.
[3] See R. Veil § 7 para. 19.
[4] See Art. 4(1)(18) MiFID II.
[5] Cf. Art. 4(1)(2) in connection with Annex I Section A MiFID II.
[6] Market operators are subject to the rules of MiFID II. The capital requirements are laid down in Art. 47(1)(f) MiFID II. Investment firms were previously subject to the CRD IV-regime. This will not change for large investment firms. For others, Regulation (EU) 2019/2033 (Investment Firm Regulation – IFR) and Directive (EU) 2019/2034 (Investment Firm Directive – IFD) will apply from 26 June 2021.
[7] The information is taken from the Annual Reports 2019 of Deutsche Börse AG and the London Stock Exchange.

It is important for investors to be able to carry out transactions at the lowest possible cost on a trading venue. This implies, firstly, that they will find a buyer or seller at all and, secondly, that the transaction will have little impact, if any, on the price of the security. Investors therefore have an interest in a liquid capital market. The more frequently a share is traded, the greater the **liquidity** of the capital market. 5

Liquidity is a **term** from **financial market theory** that captures market quality.[8] The liquidity of capital markets can be considered from four points of view.[9] The first aspect of *market depth* concerns the possibility to execute transactions close to the existing market price (price continuity). Market depth is measured in terms of the number of orders whose price differs only slightly from the price at which the largest number of existing orders can be executed. *Market breadth* is the ability of the market to execute larger orders (so-called *block trades*).[10] Another aspect to describe liquidity is *market resiliency*. This refers to the ability of the market to offset price movements resulting solely from (large-volume) orders in the short term. If these lead to a fall in price and this fall is not due to new information, the market is resilient if the price moves quickly back to the original price. The *immediacy of orders* expresses the fact that an order can be executed promptly. 6

The term liquidity is also a **legal concept. Example a)** MiFID II allows investment firms to engage in **high frequency trading** under certain conditions,[11] because it has a **positive impact** on the **liquidity** of capital markets.[12] MiFID II therefore defines the concept of a liquid market in Article 4(1)(25). This is 'a market for a financial instrument […], where there are ready and willing buyers and sellers on a continuous basis, assessed in accordance with [certain] criteria, taking into consideration the specific market structures of the particular financial instrument'. The criteria listed are: (i) the average frequency and size transactions over a range of market conditions, having regard to the nature and life cycle of products within the class of financial instrument; (ii) the number and type of market participants; (iii) the average size of spreads, where available**.** **Example b)** A national supervisory authority (NCA) may establish an **accepted market practice** (AMP) if the market practice has a **positive effect** on **market liquidity** and efficiency (Article 13(2)(c) MAR). Further specifications are laid down in Article 5 Regulation (EU) 2016/908. The NCA shall assess the impact the market practice has on at least the following elements: (i) volume traded; (ii) number of orders in the order book (order depth); (iii) speed of execution of the transactions; (iv) volume weighted average price of a single session, daily closing price; (v) bid/offer spread, price fluctuation and volatility; (vi) regularity of quotations or transactions. The definitions of MiFID II and MAR are based on financial market theory of liquidity, but also take into account the content and purpose of the rules. 7

The problem of illiquid markets is faced by **market makers.** According to the legal definition in European capital markets law, a market maker is a 'person who holds himself out on the financial markets on a continuous basis as being willing to deal on own account by buying and selling financial instruments against that person's proprietary capital at prices 8

[8] See on the information efficiency of markets as a further criterion of market quality R. Veil § 2 para. 29 ff.

[9] See on the four aspects P. Gomber, *Elektronische Handelssysteme*, 13 ff.; J. Hofschroer, *Market Making und Betreuung im Börsenaktienhandel*, 25 ff.

[10] What is meant by a block trade is not regulated by law and is understood differently in market practice. Cf. *Gomber*, Elektronische Handelssysteme, 43 with reference to the NYSE's practice of qualifying transactions involving more than 10,000 shares as block orders.

[11] See M. Lerch § 25.

[12] See recitals 62 and 113 MiFID II and Art. 17 MiFID II.

defined by that person'.[13] Thus, a market maker permanently indicates his willingness to trade on the financial markets for his own account. It makes a commitment to the market operator to place buy and sell orders for a certain quantity of securities, which may only differ by a certain percentage (so-called **spread**).[14] Investors can therefore rely on finding a buyer or seller, at least as long as the minimum volume promised by the market maker is not reached. Market makers do not receive a brokerage fee, but profit from the realised spread (difference between the price at which they sell and at which they buy securities), which represents the remuneration. Market makers improve liquidity and contribute to the institutional functioning of capital markets. For this reason, they also enjoy regulatory privileges in some areas.[15] Market makers are also known as designated sponsors. Stock exchanges are to ensure that a sufficient number of investment firms are admitted as market makers who post firm quotes at competitive prices with the result of providing liquidity to the market on a regular and predictable basis.[16]

9 The *spread* between buy and sell (bid and ask) prices is the difference between the bid and ask price. It is an important indicator of liquidity. For example, a small spread indicates a high market depth, whilst a high spread reflects different opinions of market participants about the fair price of the security and may reflect a high level of risk. An investor learns about the current bid and ask price on a market through his broker.

III. Issuers

10 In principle, anyone can be the issuer of a security, but only a stock corporation can issue shares. The European legislative acts waste few words on issuers. The PR defines the issuer as a **legal entity,** which **issues** or proposes to issue **securities**.[17] The TD extends this definition to 'a legal entity governed by private or public law, including a State, whose securities are admitted to trading on a regulated market, the issuer being, in the case of depository receipts representing securities, the issuer of the securities represented'.[18] The MAR provides for a similar definition.[19]

11 The PR refers to the situation of a securities issuer acting directly as a market participant by selling securities on the primary market.[20] Regarding securities traded on the secondary market, the issuer is no longer directly involved as the transaction takes place between investors, ie the individual seller and buyer. However, the issuer remains liable for the securitised claims. The issuer, for example, remains obligated to the buyer of bonds to repay the money

[13] Cf. Art. 2(1)(n) TD and Art. 4(1)(7) MiFID II.
[14] P. Gomber, *Elektronische Handelssysteme*, 51; J. Hofschroer, *Market Making und Betreuung im Börsenaktienhandel*, 34.
[15] Cf. Art. 9(2)(a) MAR and Art. 9(5) TD.
[16] Cf. Art. 48(2) MiFID II.
[17] Cf. Art. 2(1)(h) PR.
[18] Cf. Art. 2(1)(d) TD.
[19] Cf. Art. 1(1)(21) MAR.
[20] Shares can be issued by the issuer itself or through securities underwriting. See R. Veil § 7 para. 34 f.

on maturity.[21] Trading in securities on the secondary market is ensured by subjecting the issuer to numerous disclosure obligations in the MAR and the TD. The issuer must therefore be regarded as an **indirect market participant** on the secondary market.[22]

European capital markets law is limited to imposing obligations on issuers. However, market abuse law also imposes specific obligations on the issuer's executive bodies, such as the obligation to disclose directors' dealings. In this respect, **directors** and **members of** a **supervisory body** are indirect market participants. In addition, more stringent insider trading rules apply to members of executive bodies, as MAR considers them to be primary insiders. 12

IV. Investors

1. Types

Investors can be divided into **private investors** and **institutional investors**. Institutional investors encompass banks, insurance companies, investment funds, hedge funds, sovereign wealth funds and pension funds. They are indirect capital market participants,[23] as they are generally not permitted to participate directly in the conclusion of contracts on a regulated market. 13

The commonly used term '**financial investor**' is not a legal one. Financial investors are investors who do not pursue business policy strategies, but rather only pursue financial interests with their investments. Whilst a strategic investor will also follow financial aims, it must be distinguished from the financial investor who follows no long-term business strategy for making profits but rather aims at making profits from investment to investment.[24] 14

Private equity companies and hedge funds are typical financial investors.[25] **Hedge funds** usually make use of certain types of financial instruments and certain trading practices, such as short selling, in order to attain leverage.[26] Activist hedge funds aim to improve the governance of companies and increase the value of the company. They are thus especially interested in publicly listed companies in which the principal-agent conflict is especially apparent. In order to achieve their aims, hedge funds must acquire a critical 3–10% of company shares. Generally, they will need, and search for, assistance by other investors to achieve this. 15

[21] On the duties of the issuer of a bond see R. Veil § 8 para. 17.

[22] Cf. M. Oulds, in: Kümpel et al. (eds.), *Bank- und Kapitalmarktrecht*, para. 10.68.

[23] Cf. M. Oulds, in: Kümpel et al. (eds.), *Bank- und Kapitalmarktrecht*, para. 10.79.

[24] R. Schmidt and G. Spindler, *Finanzinvestoren aus ökonomischer und juristischer Perspektive* (2008).

[25] In more detail M. Kahan and E. Rock, 155 U. Pa. L Rev. (2007), 1021–1094; A. Klein and E. Zur, 64 J. Fin. (2009), 182–229; C. Gringel, *Die Regulierung von Hedgefonds zwischen Anleger- und Fondsinteressen*; C. Wentrup, *Die Kontrolle von Hedgefonds*.

[26] Leverage means that an equity investor increases the return on equity by using debt (loans) or derivatives. Leverage depends on the debt ratio and can be positive, but also negative if the interest on the debt is greater than the return on total capital.

16 The **providers of collective investment schemes** are regulated by Union law. The regimes distinguish between Undertakings for Collective Investment in Transferable Securities (**UCITS**)[27] and Alternative Fund Managers (**AFM**).[28] There is no European regulation for sovereign wealth funds yet, although the European Commission has already started thinking about it.[29] The rules on the harmonisation of investment funds, which were introduced at a European level more than three decades ago,[30] constitute a separate regulatory area which cannot be described in detail here. However, three principles are to be examined in more detail.

17 The portfolio of a collective investment scheme typically comprises numerous assets (securities, derivatives, etc.). The large number of assets allows the **risks to be diversified**. This principle goes back to the **portfolio theory**[31] developed by *Harry M. Markowitz*. Among other things, portfolio theory deals with the fundamental question of how a portfolio should be rationally structured.[32] It is based on the assumption of a risk-averse investor who wants to achieve the highest possible return, but who only wants to take a certain risk that she considers appropriate. The investor best achieves the goal of an optimal return through diversification, which excludes a detrimental correlation of the investment securities as far as possible. The broader an investor invests in different asset classes (equities, bonds, derivatives), the more he reduces the risk of total loss.

18 The distinction between systematic risks (also called market risks) and unsystematic risks (also called specific risks) is one of the portfolio theory principles.[33] Systematic risk concerns external and uncontrollable variables related to the market or a market segment. It affects not only a single security, but a large number of securities. Examples include market risks, interest rate risks, currency risks and political risks. Protection can be achieved through asset allocation. This means that the assets are spread across various asset classes (shares, bonds, real estate, currencies, etc.). Unsystematic risks refer to the risks associated with a particular security or issuer. Examples are business risks and financial risks. Protection against these risks is achieved by diversifying the portfolio.

[27] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), OJ L 302, 17 November 2009, p. 32.

[28] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers, OJ L 174, 1 July 2011, p. 1–73.

[29] Cf. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions of 27 February 2008—a common European approach to Sovereign Wealth Funds, COM(2008), 115 final. For literature on sovereign wealth funds see M. Audit, *Les fonds souverains sont-ils des investisseurs étrangers comme les autres?*, 21 Recueil Dalloz (2008), 1424–1429; F. Bassan, *Host States and Sovereign Wealth Funds, between National Security and International Law*, 21 EBLR (2010), 165–201; R. Beck and M. Fidora, *Sovereign Wealth Funds—Before and Since the Crisis*, 10 EBOR (2009), 353–367; B. de Meester, *International Legal Aspects of Sovereign Wealth Fund Investments: Reconciling Economic Law and the Law of State Immunities with a New Role of the State*, 20 EBLR (2009), 779–817; M. Preisser, *Sovereign Wealth Funds*.

[30] Cf. Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), OJ L 375, 31 December 1985, p. 3. Recast by Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), OJ L 302, 13 July 2009, p. 32–96.

[31] H. M. Markowitz, *Portfolio Selection* (1952); H. M. Markowitz, *Portfolio Selection, Efficient Diversification* (1991).

[32] R. A. Brealey, *Corporate Finance*, 178 ff., 198 ff.

[33] R. A. Brealey, *Corporate Finance*, 170.

The law on collective investment schemes is based on the portfolio theory. An efficient portfolio diversification takes into account not only the systematic risks but also the unsystematic risks. The principle of risk diversification is supplemented by the principle of risk avoidance by limiting the permissible assets. 19

The second principle of a collective investment scheme is the **principle of third-party management** of **portfolios**. A management company acts as fiduciary for investors. Third-party management results in principal-agent conflicts (information asymmetries between manager and investor; remuneration interests of the manager). Investors also have costs because they should control the manager. Investment law (UCITS and AIFM Directives) addresses these problems mainly through information obligations on the manager, in particular on its investment policy and strategy. It takes into account that professional investors and private investors need to be protected differently. 20

Finally, it is characteristic that a large number of investors with comparatively small amounts are enabled to invest in a diversified portfolio of assets. The concept of **collective investment** works best when there is no outflow of assets from the fund. In principle, investors have therefore no right of termination and no claim to repayment. However, it is basically possible to allow the trading of fund units on a secondary market (so-called exchange traded funds).[34] 21

2. Level of Protection

In academic discussion, a distinction is made between **information traders**, **liquidity traders** and **noise traders.**[35] According to *Goshen* and *Parchomovsky*, securities regulation should protect the interests of information traders, as they are best placed to ensure efficient and liquid capital markets.[36] They claim a core concern of securities regulation should be to ensure a competitive market for information traders.[37] 22

Goshen and *Parchomovsky* argue market participants be divided into four categories.[38] The first category consists of insiders who have access to inside information and the knowledge and ability to assess the information. The second group are information traders. These are experienced professional investors who have analytical models for their investment decisions, and analysts who act as buy-side or sell-side analysts or are independently. These information traders, like insiders, have the knowledge and ability to collect, evaluate and price company- and market-specific information. Thirdly, there are utility traders who do not collect and evaluate information, but buy securities according to a specific strategy independently of information (eg for pension purposes). Finally, there are noise traders who invest as if they were in possession of information. These may be irrational investors who invest based on rumours, or stock pickers who act in a similar way to information traders but are slower to gather and evaluate all relevant information. 23

[34] Although a fund unit does not qualify as a security, it has the same characteristics as a security (see R. Veil § 8 para. 6–8), so that it is justified to qualify it as a security *sui generis.*

[35] Z. Goshen and G. Parchomovsky, 55 Duke Law Journal (2006), 711; L. Klöhn, 177 ZHR (2013), 349 ff.

[36] Z. Goshen and G. Parchomovsky, 55 Duke Law Journal (2006), 711, 715.

[37] Z. Goshen and G. Parchomovsky, 55 Duke Law Journal (2006), 711, 716: 'Thus, the aggregate effect of securities regulation is to create and secure a competitive market for information traders.'

[38] Z. Goshen and G. Parchomovsky, 55 Duke Law Journal (2006), 711, 722 ff.

24 According to *Goshen* and *Parchomovsky*, disclosure obligations and market abuse prohibitions should ensure that information traders can fulfil their role in ensuring efficient securities markets. It would therefore be necessary, among other things, to reduce the information costs of information traders through mandatory disclosure requirements.[39] Furthermore, disclosure should not be limited to hard information, but should also encompass soft information, ie prognoses and other information about future circumstances. In addition, *Goshen* and *Parchomovsky* argue the Fraud-on-the-Market Theory[40] should also be applied as a presumption rule if the capital market is not efficient due to lack of liquidity.[41]

25 The concept of information traders is a typological classification of market participants, which reflects the observation that firstly investors invest money for different goals and with different strategies and secondly have limited access to information and limited abilities to evaluate information. This highlights the importance of information intermediaries and illustrates the concern of European capital markets regulation to ensure that intermediaries provide professional services in the interests of investors. However, no conclusions for the interpretation of standards can be drawn from the idea of a 'competitive market for information traders'.[42] The European legislature has not based securities regulation on this thesis. Problems of interpretation should be solved with regard to the declared regulatory objectives of market abuse and transparency law (market efficiency, equal information opportunities for investors, etc.).

26 The MAR does not differentiate between private and institutional investors. The disclosure requirements and prohibitions benefit all investors, the European legislature seeing **private** and **institutional investors** as **equally worthy of protection**.[43] In particular, the disclosure regimes of the MAR and TD for the secondary market assume that all investors are able to understand the information. This is clearly the idea of the obligation of an issuer to disclose inside information immediately to the public (Article 17 MAR). 'In order to guarantee at Union level equal access of investors to inside information, the inside information should be publicly disclosed free of charge, simultaneously and as fast as possible amongst all categories of investors throughout the Union'.[44] Consequently, ad hoc notifications are also addressed to private investors,[45] who must be able to assess the price relevance of the event disclosed. TD's disclosure requirements also aim at enabling all investors to make an investment decision.[46]

27 **Primary market disclosure** differentiates more between the two categories of investors because professional investors do not need to get the information in prospectuses. They either already have the information or they can obtain the information cheaply and reliably by talking to the issuer's management. The PR therefore provides for exemptions from the obligation to publish a prospectus when securities are offered to **qualified investors**, ie

[39] Z. Goshen and G. Parchomovsky, 55 Duke Law Journal (2006), 711, 738, 755 ff.
[40] See R. Veil § 2 para. 34.
[41] Z. Goshen and G. Parchomovsky, 55 Duke Law Journal (2006), 711, 738, 766 ff.
[42] Dissenting opinion: L. Klöhn, 177 ZHR (2013), 349 ff.
[43] See recitals 14 and 55 MAR.
[44] Recital 1 Regulation (EU) 2016/1055.
[45] Cf. R. Veil and A. Brüggemeier, in: Meyer et al. (eds.), *Handbuch Marktmissbrauchsrecht*, § 10 para. 168 ff.; critically H.-D. Assmann, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, Art. 7 MAR para. 65 f.
[46] Cf. recital 5 and 7 TD: 'a high level of investor protection'.

credit institutions, investment firms, other authorised or regulated financial institutions and insurance companies.[47]

28 The MiFID II also distinguishes between different types of investors. Annex II lists who must be regarded as **professional clients** for the purpose of the directive. '**Retail clients**' are clients who are not professional clients.[48] The MiFID II assumes that professional clients require less protection, having sufficient experience, knowledge and expertise to make their own investor decisions and correctly assess the risks connected thereto. It thus abstains from protecting professional investors as recipients of investment advice or other investment services. The information obligations laid down in Articles 24(3)–(4), 25(2)–(3) MiFID II only apply to retail investors and potential retail investors.

29 MiFID II and PRIIPS are based on the premise that retail investors are particularly vulnerable.[49] This implies that retail investors have no experience with securities and do not understand the language of financial markets, or at least not sufficiently. Investment firms must take this into account when providing investment services

[47] Cf. Art. 2(e)(i) PR.
[48] Cf. Art. 4(1)(11) MiFID II.
[49] See R. Veil § 6 para. 36.

§ 11

Capital Markets Supervision

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I. Introduction

The European and national supervisory authorities ensure the market participants' compliance with capital markets law. Capital markets law is therefore to a large extent **supervisory law**.[1] Notwithstanding the recent developments towards a further European harmonisation, the capital and financial markets supervision is **predominantly executed by the Member States** and its **National Competent Authorities (NCAs)**.[2] The mandate of the **European Securities and Markets Authority (ESMA)** is still rather limited.[3] 1

II. European Law Requirements

1. Institutional Organisation

European law only contains relatively few provisions on the structure of the Member States' NCAs. It hence comes as no surprise that the national supervisory concepts vary from one Member State to another, even though the recent reforms in European capital markets law resulted in a significant higher harmonisation of the NCAs' sanctioning powers.[4] 2

Regarding the institutional organisation of the national supervisory systems, European law merely requires that the Member States designate **a single administrative competent authority** competent to ensure that the provisions of the MAR (Market Abuse Regulation), the PR (Prospectus Regulation) and the TD (Transparency Directive) are complied with.[5] The regulatory approach of these Level 1 acts thus renounces the approach pursued in former European legislative acts and the revised Market in Financial Instruments Directive (MiFID II) which required only a *competent authority*.[6] The later 3

[1] Cf. on the scope of the term R. Veil, in: Grundmann et al. (eds.), in: FS Hopt, 2641, 2644 (fn. 19).
[2] N. Moloney, *EU Securities and Financial Markets Regulation*, 965.
[3] See below para. 89 ff.
[4] See R. Veil § 12 para. 10.
[5] Art. 31(1) PR; Art. 22 MAR; Art. 24(1) TD.
[6] See Art. 67(1) MiFID II; Art. 8(1) Directive on Insider Dealings; Art. 9(1) Council Directive 79/279/EEC of 5 March 1979 coordinating the conditions for the admission of securities to official stock exchange listing, OJ L66/21, 16 March 1979; Art. 18(1) Directive 94/18/EC of the European Parliament and of the Council of

wording is wider as it does not require a governmental (administrative) institution but also allows for bodies under private law entrusted with public powers.[7]

4 Even in the aftermath of the financial crisis of 2008 reforms for European capital markets law, no proposal has been brought forward to subject the Member States to coherent rules regarding the national supervisory structure. Considering the general tendency towards more harmonisation in European capital markets law this is surprising at first glimpse. However, the design of national institutions relates to the core of national sovereignty and will therefore remain one of the few elements of European capital markets law that are likely to be resistant to further harmonisation.

5 European law occasionally allows the Member States to delegate supervisory tasks of public authorities to other entities.[8] This is, nevertheless, only permitted under certain conditions, eg. that the entity to which the tasks are to be delegated is organised in such a manner as to avoid a conflict of interest.[9]

6 The Level 1 acts contain no further requirements regarding the institutional and internal organisation or the areas of responsibility of the national authorities. In particular, the decision whether the supervision of securities trading should be joined with bank and insurance supervision, resulting in one authority being responsible for the entire financial supervision, hence remains with the Member States.[10]

2. Powers

7 European law contains relatively detailed provisions with respect to the NCAs' powers. The Level 1 directives and regulations enumerate a **minimum of powers and sanctioning competences** with which the NCAs shall be provided. European law accordingly follows the concept of minimum harmonisation in this respect.[11] The minimum powers are, respectively, complemented by a **general clause requiring an effective enforcement** of the supervisory powers.

(a) Administrative and Investigation Powers

8 The core Level 1 acts (ie the MAR, PR, TD and MiFIR/MiFID II) contain a catalogue of minimum requirements regarding the administrative powers of the NCAs. They require,

30 May 1994 amending Directive 80/390/EEC coordinating the requirements for the drawing up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing, with regard to the obligation to publish listing particulars, OJ L135/1, 31 May 1994; Art. 9(1) Interim Report Directive; Art. 12(1) Council Directive 88/627/EEC on the information to be published when a major holding in a listed company is acquired or disposed of. Art. 22(1) Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field, OJ L 141/27, 11 June 1993, already used the term 'competent authorities'.

[7] S. Weber, in: Dauses (ed.), *Handbuch des EU-Wirtschaftsrechts*, F.III para. 101.

[8] In Germany, for example, a private body is supporting BaFin with the supervision of financial reporting under the TD. In the UK (as a former EU member state) the competence to oversee the EU law based takeover law were delegated to the Takeover Pane as private self-regulatory body. On the legal status of this body see T. Ogowewo, 12 J. Int. Bank Law (1997), 15 et seq.

[9] Art. 31(2) PR; cf. also Art. 67(2), 29(4) MiFID II.

[10] See in more detail below para. 18.

[11] See R. Veil § 3 para 21.

inter alia, that the NCAs must at least have the right to access any document and to receive a copy, demand information from any person involved, request existing telecommunication records, carry out on-site inspections or request the temporary prohibition of professional activity. The NCAs must further be empowered to require the cessation of any practice that is contrary to EU law and the freezing or sequestration of assets.[12] Notwithstanding their European determination, also such minimum powers are always to be used in accordance with the national administrative law. The NCAs, however, are under an obligation to consider the fundamental rights as set forth in the Charter of Fundamental Rights of the European Union.[13]

In particular, under the MiFID II the NCAs have received some remarkable additional powers: They may suspend the marketing or sale of financial instruments or structured deposits and suspend the marketing or sale of financial instruments if an investment firm has not developed or applied an effective product approval or require the removal of a natural person from the management board of an investment firm or market operator.[14] 9

In addition to these minimum powers the Level 1 acts contain general clauses ensuring that the competent authorities have the powers 'necessary'[15] for enforcement. Whether this is the case must be determined according to national law.[16] At the same time, general clauses must be understood as an expression of the legislator's aim to ensure effective enforcement,[17] hence constituting a form of the **effet-utile-principle** in secondary legislation.[18] 10

(b) Administrative Fines

All Member States provide for the possibility to impose administrative fines for non-compliance with capital markets law provisions. The post financial crisis reforms for the first time stipulated for fixed amounts of fines which the NCAs have to be at least able to levy on market participants (**minimum maximum fines**). 11

Under the new rules the NCAs must be in a position to impose fines of up to at least several million Euros.[19] The minimum maximum fines in the Level 1 acts vary: Breaches of the transparency obligations under the reformed TD must at least result in fines up to € 10,000,000 or up to 5% of the total **annual turnover** (or the double amount of profits gained/losses avoided, whichever is higher).[20] The bottom line of a national maximum 12

[12] Cf. Art. 38(2) PR; Art. 21(1) MAR; Art. 24(4) TD; Art. 69(2) MiFID II.

[13] See the recent judgment of the ECJ regarding the sanctioning powers of the Italian NCA (Consob) under Article 30(1)(b) MAR, Case C-481/19 (*DB v Commissione Nazionale per le Società e la Borsa (Consob)*).

[14] Art. 69(2)(s), (t), (u) MiFID II.

[15] Art. 32(3) PR; Art. 24(4) TD ('Each competent authority shall have all the powers necessary for the performance of its functions'); Art. 69(1) MiFID II ('Competent authorities shall be given all supervisory and investigatory powers that are necessary to fulfil their duties'). The MAR does not contain such explicit clause. However, under the *effet-utile*-principle an effective enforcement is also required.

[16] Case C-45/08 (*Spector*), para. 71.

[17] R. Veil, 11 EBOR (2010), 409, 411; R. Veil, in: Grundmann et al. (eds.), in: FS Hopt, 2641, 2642.

[18] The ECJ is entitled to put general clauses into more concrete terms, having, however, failed to make public its understanding of these terms as yet. In *Spector* the ECJ did, in fact, rule that when determining an administrative financial sanction, the general clauses in the former MAD cannot be interpreted as an obligation for the competent national authorities to take the possibility of a subsequent criminal sanction into account, cf. Case C-45/08 (*Spector*), para. 74.

[19] See for a comprehensive overview R. Veil § 12 para. 18.

[20] Art. 28(b)(1)(c)(i) TD.

fine for market manipulation or insider dealing (Articles 14 and 15 MAR) is fixed at € 15,000,000 or 15% of the total annual turnover of the legal person or the treble amount of profits gained or losses avoided because of the breach, where those can be determined.[21] The annual turnover is determined according to the last available accounts approved by the management body on a **group level**. MiFID II stipulates a maximum fine of at least € 5,000,000 or of up to 10% of the total annual turnover.[22]

13 Most national legislators have transposed these European requirements without any amendment to their national laws. However, other Members States (ie France, Italy, Hungary and the Czech Republic) included even higher maximum administrative fines in their national law.[23]

(c) Other Administrative Sanctions

14 In the course of the reforms of European capital markets law also administrative sanctions which can be imposed by the NCAs were harmonised. In particular, the Level 1 acts do not – as previously – only set forth that the NCAs may have the competence to publish a violation of the revised European law.[24] They rather oblige the Member States to publish any sanction imposed (**naming and shaming**).[25] The NCAs may only refrain from such publication regarding violations of the MAR and the MiFID II under narrow conditions.[26] In case of violations of the revised TD, they may even only delay (and not refrain from) the publication.[27]

15 Under Article 28b(2) TD the Member States shall ensure that their laws provide for the possibility of **suspending the exercise of voting rights** attached to shares in the event of breaches of the rules on transparency of major shareholdings. The Member States may provide that the suspension of voting rights is to apply only to the most serious breaches. Many Member States have equipped their NCAs with such a competence. However, other Member States such as Germany opted for **a loss of voting rights ex lege**.[28]

(d) Choice of Sanctions/Administrative Measures

16 Moreover, the MAR, the TD and the MiFID II now stipulate for criteria the NCAs have to consider when assessing which sanction is to be chosen and how the sanction is to be imposed; in particular, how the amount of possible fines shall be determined.

17 Under the new European laws the NCAs shall take into account the following criteria:

- gravity and duration of the infringement;
- the degree of responsibility;
- the financial strength;

[21] Art. 30(2)(h) MAR; Art. 30(2)(j)(i) MAR.
[22] Art. 70(6)(f) MiFID II.
[23] J. v. Buttlar, 14 EuZW (2020), 598, 601.
[24] Art. 29 TD; see on the relation between Art. 28b TD and Art. 29 TD U. Nartowska and F. Walla, 24 AG (2014), 891, 898; U. Nartowska and M. Knierbein,7 NZG (2016), 256, 257 (as well on the German transposition of the TD).
[25] Art. 34 MAR; Art. 29 TD; Art. 71 MiFID II.
[26] Art. 34(1) subsec. 3(c) MAR; Art. 71(1) subsec. 1 MiFID II.
[27] Art. 29(1) subsec. 2 TD.
[28] See on this R. Veil § 20 para. 123.

— the profits gained or losses avoided;
— the level of cooperation with the competent authority;
— previous infringements; and
— measures taken by the person responsible to prevent a repetition of misconduct.[29]

Some NCAs have implemented these criteria with own enforcement guidelines or manuals (eg. the *Bußgeldleitlinien* of Germany's BaFin[30]).

III. Supervision by the NCAs

18 Taking into account the vague legal requirements of European law, the disparate nature of the supervisory structure, practice and culture throughout the European Union is hardly surprising.[31] A **comparative study** is indispensable in order to achieve an overview of capital markets supervision as practised in Europe. It must contain an examination of the different institutional concepts concerning supervision and the respective internal organisation.

1. Institutional Design

19 The various institutional concepts for the design of the national supervisory systems show the different understandings that are predominant in the Member States. The two 'classic' concepts are as follows:

— supervisory authorities with exclusive competence regarding capital markets supervision (**sectoral supervision**); and
— concentration of the entire financial markets supervision, ie securities trading, banking and insurance supervision, under the roof of one supervisory body (**integrated supervision**).

20 As a result of the financial and sovereign debt crisis of the past years, a number of jurisdictions have modified their concepts and separated **prudential supervision** and **conduct of business supervision** (**twin peak approach**).[32]

(a) Model of Integrated Supervision

21 In the first decade of the twenty-first century integrated supervision of securities trading appeared to prevail throughout Europe[33]—Sweden[34] and Denmark[35] being amongst the

[29] Art. 31 MAR; Art. 28c TD; Art. 72(2) MiFID II; Art. 39(1) PR; see on this J. v. Buttlar, 14 EuZW (2020), 598, 599.
[30] The guidelines can be downloaded at www.bafin.de; cf. on for further details U. Nartowska and F. Walla, 25 NZG (2015), 977 ff.
[31] N. Moloney, *EU Securities and Financial Markets Regulation*, 1104; E. Ferran, in: Wymeersch et al. (eds.), *Financial Regulation and Supervision*, 111 ('cluttered landscape').
[32] See para. 28.
[33] For example K.-B. Caspari, *Allfinanzaufsicht in Europa*, 5–6.
[34] The Swedish supervisory authority *Finansinspektionen* (FI) was established in 1991. On its organisation and functions see R. Veil and F. Walla, *Schwedisches Kapitalmarktrecht*, 8 ff.
[35] The Danish supervisory authority Finanstilsynet was established on 1 January 1988.

first to follow this concept. In 1997, also the United Kingdom established an integrated supervision and thus confirmed the tendency towards a single supervisory authority. The UK aggregated its supervision of the banking, insurance and securities sectors 'under one roof' by founding the **Financial Services Authority (FSA)**.[36]

22 After the formation of the FSA, Germany was the most prominent example of change towards integrated supervision. In 2002 the former *Bundesaufsichtsamt für den Wertpapierhandel* (BAWe), *Bundesaufsichtamt für das Kreditwesen* (BAKred) and *Bundesaufsichtamt für das Versicherungswesen* (BAV), ie the supervisory authorities for securities, banking and insurances, were combined in the **Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)**.[37] Austria followed suit and introduced a new supervisory authority, the **Finanzmarktaufsicht (FMA)**, in 2002.[38] Identical developments can be observed in Belgium, Finland and in the Eastern European Member States Poland, Slovenia, Hungary, Latvia, Estonia as well as in Malta and Cyprus.[39] Ireland, Slovakia and the Czech Republic concentrated their supervision with the respective national central bank.

23 States outside the European Union, such as Switzerland, Norway, Kazakhstan, Iceland and Lichtenstein, together with Australia, Columbia, South Korea, Ruanda, Nicaragua and Japan,[40] have also adopted this approach.[41] The degree to which the three supervisory sectors are integrated varies largely from state to state.[42]

24 The concept of integrated supervision was justified by the assumption that developments in the capital markets would make a distinction between the banking and insurance sector and the other financial services difficult in future,[43] as insurance companies, banks and other financial services companies increasingly compete for the sale of financial products.[44] A separation of the supervisory authorities could therefore lead to regulatory arbitrage.[45] Additionally, it was argued that the number of financial conglomerates active in all three economic sectors would increase.[46]

(b) Model of Sectoral Supervision

25 Other Member States, such as Spain with its **Comisión Nacional del Mercado de Valores (CNMV)** or Italy with its **Commissione Nazionale per le Società e la Borsa (Consob)**, have adhered to the concept of sectoral supervision. Similarly, Greece, Portugal, Slovenia, Lithuania and Romania all have an additional authority exclusively responsible for the supervision of capital markets. The European financial supervisory structure with its

[36] E. Wymeersch, 42 CML Rev. (2005), 987, 990.
[37] Cf. F. Walla, *Die Konzeption der Kapitalmarktaufsicht in Deutschland*, 19 ff.
[38] Finanzmarktaufsichtsgesetz (Financial Market Supervision Act), BGBl. I 2001/97.
[39] See table in E. Wymeersch, 8 EBOR (2007), 237, 256.
[40] For more details see H. Aoki, 6 ZJapanR (2001), 101, 106 ff.
[41] This enumeration is based on the research of D. Masciandaro, 6 ECL (2009), 187 and E. Wymeersch, 8 EBOR (2007), 237, 256–257.
[42] E. Wymeersch, 8 EBOR (2007), 237, 268.
[43] See the explanatory notes of the FinDAG, Allgemeiner Teil, 31, or the statements of HM Treasury regarding the establishment of the FSA as quoted in E. Wymeersch, 8 EBOR (2007), 237, 253.
[44] K.-B. Caspari, *Allfinanzaufsicht in Europa*, 7–8.
[45] K.-B. Caspari, *Allfinanzaufsicht in Europa*, 11–12.
[46] K.-B. Caspari, *Allfinanzaufsicht in Europa*, 7.

European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and ESMA also follows this approach.[47]

The main advantages of this concept are the possibility of referring to the expertise which has grown historically and preventing a single supervisory institution from becoming too powerful.[48] Additionally, one may assume that individual authorities will be in better position to specialise in their respective field of activity. 26

(c) Hybrid Models

Numerous Member States have developed hybrid forms of these two models. In Bulgaria, for example, capital markets supervision and insurance supervision are combined, whilst in Luxembourg, the local authority **Commission de Surveillance du Secteur Financier (CSSF)** is responsible for capital markets supervision as well as the for banking supervision. 27

(d) Twin Peaks Model

As a result of the financial crisis of 2008 there was a strong tendency among the Member States to reform the design of the national financial supervision by separating conduct of business supervision and prudential supervision. Prudential supervision covers the control of the financial institutions' solvency whereas conduct of business supervision monitors the financial institutions' compliance with rules of conduct and organisational requirements. Such a structure is referred to as a twin peaks scheme.[49] It was primarily initiated in order to prevent systemic risks in the field of prudential supervision. 28

This twin peak approach has been, for example, followed by the Netherlands since 2007. The **Autoriteit Financiële Markten (AFM)** assumed the conduct of business supervision over all sectors while the prudential supervision is executed by the national central bank. In 2010, France reformed its financial supervisory structure as well: It assigned the prudential supervision to the **Autorité de Contrôle Prudentiel (ACP)** and the conduct of business supervision to the **Autorité des Marchés Financiers (AMF)**.[50] Since 2011, Belgium likewise has adhered to the twin peaks model.[51] 29

Also the United Kingdom has meanwhile given up its integrated approach and abolished the former FSA. It instead divided its tasks between two new institutions:[52] The **Prudential Regulation Authority (PRA)**[53] and the **Financial Conduct Authority (FCA)**. The PRA is designed as a subsidiary of the Bank of England and carries out the prudential regulation of financial firms, including banks and significant investment firms and insurance companies. The conduct of business supervision of all market participants and the prudential 30

[47] See below para. 55.
[48] Cf. R. Romano, 107 Yale Law J. (1997–98), 2359 ff.
[49] See M. Taylor, *Twin Peaks: A Regulatory Structure for the New Century*, passim; N. Moloney, in: Ferran et al., *The Regulatory Aftermath of the Financial Crisis*, 111, 119.
[50] P.-H. Conac, in: Grundmann et al. (eds.), in: FS Hopt, 3027 ff.
[51] Cf. European Central Bank, *Recent development in supervisory structures in the EU member states (2007–10)*, p. 12 ff.
[52] Cf. E. Ferran, 31 Oxford J. Legal Studies (2011), 455 ff.
[53] Cf. Bank of England/FSA, *The Bank of England, Prudential Regulation Authority – Our Approach to Banking Supervision* (2011).

regulation over regulated firms not supervised by the PRA is now assigned to the FCA. The FCA is further supposed to ensure a high level of consumer protection.

(e) Direct Banking Supervision by the European Central Bank (ECB)

31 In 2014, the financial supervision scheme in Europe was (again) modified significantly with regards to the supervision of banks. The European Central Bank (ECB) assumed the direct supervision over all systemically significant banks of the Eurozone in cooperation with the national authorities via the **Single Supervisory Mechanism (SSM)**.[54] Currently, the ECB directly supervises 115 banking groups via the SSM.[55]

(f) Generally Preferable Supervisory Model?

32 Intensive economic and legal studies have not been able to prove the superiority of any one supervisory concept.[56] The German Scholar K.J. Hopt[57] therefore concludes that the decision regarding the institutional organisation of capital markets supervision is solely political, subject mainly to **national path dependence**.[58] The effectiveness of supervision is rather determined by the exact competencies of the respective supervisory authority.

33 Hopt's conclusions appear to be correct. Taking his conclusions into consideration, it can in particular not be assumed that the latest institutional reforms of the financial supervision structure (ie the establishment of the ESFS and SSM)[59] alone suffice in order to overcome the consequences of the financial crisis of 2007 and to prevent a further crisis.

2. Internal Organisation and Independence

34 There is a further diversity of methods with regard to the internal organisation of the national supervisory institutions. Most national authorities are managed by a collegiate body. The head of this body, however, has a very different function in each Member State. Germany, for instance, adheres to a concept in which the president of the managing body

[54] Cf. on the implications of the SSM for the supervision of financial markets N. Moloney, *EU Securities and Financial Markets Regulation*, 1019 ff.

[55] A continuously updated list of institutions supervised under the SSM can be downloaded under www.banking supervision.europa.eu.

[56] R. Abrams and M. Taylor, FMG Special Papers No. 134, passim; D. Llewellyn, in: Carmichel, Fleming and Llewellyn (eds.), *Aligning Financial Supervisory Structures*, 17 ff. According to M. Cihák and R. Podpiera, in: Masciandaro and Quintyn (eds.). *Designing Financial Supervision*, 309 ff., empirical studies have been able to prove the advantages of the model of integrated supervision. According to M. Arnone and A. Gambini, in: Masciandaro and Quintyn (eds.), *Designing Financial Supervision*, 262 ff., empirical studies have proven that an organisational connection between solvency supervision and organisational supervision is recommendable.

[57] K. Hopt, 36 NZG (2009), 1401, 1402. Nevertheless, empirical studies about the effectiveness of a certain supervisory design can deliver important findings for possible reforms, cf. eg W. Sohn and I. Vyshnevskyi, 20 Journal of Accounting and Finance (2020), 82 ff.

[58] D. Masciandaro and M. Quintyn, CEPR Policy Insight No. 30, 9; J. Westrup, in: Masciandaro and Quintyn, *Designing Financial Supervision*, 117 ff. Similarly E. Wymeersch, 8 EBOR (2007), 237, 264. On path dependence of legal systems L. Bebchuk and M. Roe, 52 Stan. L. Rev. (1999–2000), 127, 137 ff. With regard to the national supervisory systems the national central banks in particular have a certain path dependence, cf. D. Masciandaro et al., CEPR Policy Insight No. 37, 5.

[59] See para. 55.

holds a strong position.[60] The supervisory authorities' degree of **independence** towards the government moreover varies significantly.[61]

35 It must further be noted that in some Member States sanctions are imposed by an independent authority, eg by the **Commission des Sanctions** of the French AMF.

3. Administrative and Criminal Powers

36 As described above, the European capital markets law contains a catalogue of minimum powers for the NCAs combined with additional general clauses. In the past, the sanctions provided for in the various Member States differed widely.[62] The last reforms of the European capital markets law harmonised these national supervisory powers.

37 Some supervisory authorities – in particular the Irish supervisory authority[63] – also institute criminal proceedings against market participants. This once again demonstrates the differences that exist between the national systems of enforcement. The attribution of criminal powers to an administrative authority outside the rules on administrative offences is, for example, entirely unknown in other European legal systems.

4. Liability of Supervisory Authorities

38 Significant differences between the Member States are evident with respect to the liability of the NCAs.[64] Whilst in Germany, the BaFin is protected from any liability towards a third party under national law,[65] the Netherlands[66] and Sweden[67] have no rules limiting the liability of their supervisory authorities. In Ireland, France,[68] Belgium and Luxembourg certain restrictions on the liability for damages caused by their supervisory authorities apply.[69] Some legal scholars even argue that European law requires a state liability vis-à-vis market

[60] In 2002, when the German BaFin was established, it was organised as being managed solely by a president. This concept was, however, reorganised in 2008, newly introducing a managing body and giving the head of this body a strong position. On the background of these reforms see RegBegr. BR-Drucks. 671/07, 7–8 (explanatory notes).

[61] Cf. D. Masciandaro and M. Quintyn, CEPR Policy Insight No. 37, 7–8 who attempt to quantify the amount of independence of the national supervisory authorities.

[62] See 1st ed. (2013), F. Walla § 11 para. 20 ff.

[63] CESR, Report on administrative measures and sanctions as well as the criminal sanctions available in Member States under the Market Abuse Directive (MAD), CESR/08-099, February 2008, p. 13.

[64] According to D. Masciandaro and M. Quintyn, CEPR Policy Insight No. 37, 17 the immunity of the national supervisory authorities is an essential step for a further harmonisation of supervision in Europe.

[65] See § 4(4) *Gesetz über die Bundesanstalt für Finanzdienstleistungsaufsicht* (FinDAG). Despite this provision, claims for liability were recently brought forward against BaFin as a result of the *Wirecard* case. While BaFin has certainly made significant mistakes when supervising Wirecard, these claims are unlikely to be successful because of the FinDAG's statutory rule (dissenting: M. Renner, 1 ZBB (2021), 1 ff.). For more details on the Wirecard case cf. F. Walla § 24 para. 65.

[66] Cf. E. de Kezel, 6 ECL (2009), 211, 213.

[67] The liability of the Swedish supervisory authority is, however, not relevant in practice, cf. R. Veil and F. Walla, *Schwedisches Kapitalmarktrecht*, 18.

[68] On this R. Veil and P. Koch, *Französisches Kapitalmarktrecht*, 17.

[69] On the conflict of laws regarding liability of the supervisory authorities see E. de Kezel, 6 ECL (2009), 211, 214 ff.

participants in case of misconduct by the NCA.[70] However, considering that European law does not explicitly address this obvious issue, such interpretation seems to be an overstatement of the *effet-utile*-principle.

5. Use of Resources and Sanctioning Activity

39 Apart from these differences in the national legal concepts regarding the supervisory institutions, empirical studies have brought to light further differences regarding the resources used by the Member States in capital markets supervision and the activity of the supervisory authorities.

40 US scholar Howell E. Jackson, in particular, proved that large differences exist not only with regard to the financial and personal resources employed,[71] but also with regard to the supervisory activity measured by the frequency and severity of sanctions.[72] The most significant discrepancies can be found between legal systems adhering to common law rules and those based on civil law.[73]

41 Whilst such complex empirical studies are associated with a relatively high degree of uncertainty concerning their completeness, correctness and the comparability of data, this study does at least allow the definite conclusion that differences exist in the severity with which the supervisory institutions use their powers to enforce sanctions. The ensuing question, controversially discussed in the international legal literature,[74] is whether a high or rather a low level of supervision is recommendable.[75]

42 As a matter of fact, in the aftermath of the financial crisis of 2007 the supervisory activity and enforcement intensity has significantly increased throughout Europe.[76]

IV. Cooperation between the NCAs

43 Currently, capital markets are primarily supervised by the national authorities.[77] In order to adapt to the growing interaction between the European capital markets and the increasing number of cross-border cases resulting therefrom, cooperation between the supervisory authorities within the different Member States is therefore inevitable.

[70] M. Renner, 1 ZBB (2021), 1, 10 ff.

[71] H. Jackson, 24 Yale J. Reg. (2007), 253, 266 ff. Also see H. Jackson and M. Roe, Public Law & Legal Theory Research Paper Series Paper No. 0-28 and John M. Olin Center for Law and Business Law & Economics Research Paper Series Paper No. 638, 41 (table 2).

[72] H. Jackson, 24 Yale J. Reg. (2007), 253, 278 ff.

[73] Ibid., 272.

[74] Supporting a high intensity of supervision J. Coffee, 156 U. Pa. L. Rev. (2007), 229 ff.; T. Tröger, 10 U. Pa. J. Bus. & Emp. L. (2007–08), 89 ff. Dissenting: E. Ferran, *Capital Market Competitiveness and Enforcement*, passim; H. Jackson, 156 U. Pa. L. Rev. (2007), 400 ff.

[75] See on this also N. Moloney, *EU Securities and Financial Markets Regulation*, 946 ff.

[76] N. Moloney, *EU Securities and Financial Markets Regulation*, 967 ff.

[77] See para. 89 on the regulation directly supervised by ESMA.

1. Cooperation within the European Union

The Level 1 acts form the framework for the cooperation between the supervisory authorities. All contain an obligation for the national supervisory authorities to cooperate whenever necessary for the purpose of fulfilling their duties and a competence of **ESMA to coordinate and control the NCAs' cooperation**.[78] 44

A particularly high degree of cooperation is necessary in matters referring to the concept of a **single passport**, ie the supervision of investment firms and the admission of securities prospectuses. The single passport effects that securities prospectuses approved by one NCA are valid in all other Member States (Article 24 PR) and that an authorisation to provide investment services granted by the home Member State is valid for the entire EU (see eg Article 6(3) MiFID II). Yet, the host Member State of a branch of an investment firm is responsible for the authorisation and supervision of the respective branch.[79] In legal practice, this supervision over branches plays a major role in the day-to-day supervisory activities.[80] 45

European law also contains detailed rules on the cooperation among the NCAs as well as between the NCAs and ESMA: A competent authority may refuse to act on a request for cooperation only on very limited grounds specified in the Level 1 acts.[81] If a NCA is convinced that the European rules are being, or have been, breached on the **territory of another Member State**, it shall notify the NCA of the other Member State which must then take appropriate actions.[82] This NCA may then decide that an investigation is carried out by the competent authority of another Member State, on the latter's territory.[83] Such an investigation would, however, always be subject to the overall control of the Member State on whose territory it is conducted. 46

Despite the far-reaching obligations to cooperate all Level 1 acts of European law underline the importance of guarding **professional secrecy** with regard to information exchanged with other authorities.[84] 47

2. Cooperation with Third Countries' Authorities

The Level 1 acts, furthermore, contain rules on cooperation with third countries, leaving the Member States room to design their cooperation with non-EU members. Under European law, the NCAs are obliged to ensure an efficient exchange of information with competent authorities of third countries.[85] However, any exchange of information is subject to guarantees of professional secrecy at least equivalent to the European law standard.[86] 48

[78] Art. 25 MAR; Art. 25(2) TD; Art. 79 ff. MiFID II; Art. 34 PR.
[79] See Art. 35(8) MiFID II.
[80] N. Moloney, *EU Securities and Financial Markets Regulation*, 970 ff.
[81] Art. 25(2) MAR; Art. 83 MiFID II.
[82] Art. 25(5) MAR; Art. 79(4) MiFID II.
[83] Art. 25(6) MAR; Art. 80 MiFID II.
[84] Art. 27 MAR; Art. 35 PR; Art. 25(1), (3) TD; Art. 76 MiFID II.
[85] Art. 26(1)(2) MAR; Art. 25(4) TD; Art. 88(1) MiFID II; Art. 30(1) PR.
[86] Art. 88(1) subsec. 3 MiFID II; Art. 30(3) PR.

49 The cooperation with third countries is often carried out through so-called **memoranda of understanding (MoU)** concluded between the supervisory authorities of the Member State and the third country.[87] These agreements usually contain the obligation for both states to exchange information and consult each other before taking certain administrative measures.[88] In legal practice, such MoU are often constructed following the recommendations of the International Organisation of Securities Commissions (IOSCO) of 1991.[89]

50 The MoU between all Member States of the IOSCO from 2002 is especially relevant in practice, obligating the supervisory authorities of the IOSCO to pursue mutual cooperation. The last modifications of this MoU were agreed in 2012.[90] It must, however, be underlined that MoU can only legally obligate the supervisory authorities to cooperate but do not confer duties or powers or establish new powers.[91] MoU have no legally binding effect. They can, however, help to improve coordination and cooperation between the national supervisory authorities.[92]

51 After **Brexit** and the subsequent transition period on 1 January 2021 the UK (and in turn its supervisory authority FCA) is now to be considered such third country as well. To ensure a smooth cooperation, the FCA and ESMA[93] as well as the FCA and the NCAs[94] have, respectively, concluded comprehensive **MoUs** that outline the cooperation in the future. Notwithstanding such MoUs, it remains to be seen if and how ESMA and the NCAs will manage to sustain a co-operative relationship with their UK counterpart, in particular if the UK law should deviate from European capital markets law.[95]

V. Competition between the National Supervisory Institutions

52 The supervision of capital markets is subject to competition between the national supervisory authorities, especially within the European Union.[96] This is triggered by the options

[87] The conclusion of MoU between supervisory authorities within the European Union remains common practice even after the introduction of the new directives on cooperation, cf. M. Lamandini, 6 ECL (2009), 197, 198–199 (referring to banking supervision).

[88] E. Wymeersch, 42 CML Rev. (2005), 987, 995–996.

[89] IOSCO, Principles of Memoranda of Understanding, September 1991, available at: www.iosco.org/library/pubdocs/pdf/IOSCOPD17.pdf.

[90] IOSCO, Multilateral memorandum of understanding concerning consultation and cooperation and the exchange of information, May 2002 (revised May 2012), available at: www.iosco.org/library/pubdocs/pdf/IOSCOPD386.pdf.

[91] D. Döhmel, in: Assmann et al. (eds.), *Wertpapierhandelsrecht*, § 18 para. 58; J. v. Hein, in: Schwark and Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, § 18 WpHG para. 17; F. Boehn, in: Park, Kapitalmarktstrafrecht, Chapter 1.2 para. 108; see already E. Wymeersch, 42 CML Rev. (2005), 987, 996.

[92] D. Döhmel, in: Assmann et al. (eds.), *Wertpapierhandelsrecht*, § 18 para. 57.

[93] Memorandum of Understanding concerning consultation, cooperation and the exchange of information between ESMA and the UK Financial Conduct Authority.

[94] Multilateral Memorandum of Understanding concerning consultation, cooperation and the exchange of information between each of the EEA competent authorities and the UK Financial Conduct Authority.

[95] As of 1 January 2021, the UK onboarded the substantive rules of European capital markets law in its entirety under the European Union (Withdrawal) Act 2018, as amended by the European Union (Withdrawal Agreement) Act 2020.

[96] E. Wymeersch, 42 CML (2005), 987, 1004 who assumes the existence of market for supervision in the European Union. Cf. for the impact of competition between NCAs F. Walla, *Die Konzeption der Kapitalmarktaufsicht in Deutschland*, 45 ff.

supervised institutions have as to which supervisory authority should be responsible. The concept of a **single passport** for security prospectuses and the admission of investment firms, as initially introduced by the PD and the MiFID I, grant a large amount of flexibility to investment firms and issuers. Said flexibility allows them to in fact choose which supervisory authority should approve their prospectus or decide on their admission as an investment firm. A prime example of the results of this competition is, for example, the fact that the Luxembourg supervisory authority CSSF has established a de facto position as the first port of call for the approval of bond prospectuses in the EU.

Whilst generally **no competitive atmosphere** between the supervisory institutions can as 53
yet be observed, the NCAs are nevertheless aware of the continual competition.[97] This may either be greeted as a means for increasing their efficiency and innovation[98] or seen critically as hindering European integration.[99] The fact that some competition exists must at least be taken into consideration when analysing the European supervisory landscape.

VI. The European System of Financial Supervision (ESFS)

International legal literature has long been discussing whether a central European supervi- 54
sory institution,[100] following the example of the US Securities and Exchange Commission (SEC), should be introduced. The financial crisis of 2007, finally, gave a strong incentive for introducing a **European System of Financial Supervision (ESFS)**.

The Commission laid down the cornerstones of the new supervisory system, based largely 55
on the work of an expert group under the chair of **Jacques de Larosière**[101] in its legislative package of 2009.[102] In September 2010, the Parliament accepted the Commission's proposal, suggesting only few amendments.[103] The proposal was approved by the Council in November 2010 and the ESFS become operative 1 January 2011. The legal foundation for the ESFS is Article 114 TFEU.[104]

[97] Cf. BaFin's longtime President, Jochen Sanio, in the preface of L. Frach, *Finanzaufsicht in Deutschland und Großbritannien* (2008); further N. Moloney, in: Grundmann et al. (eds.), in: FS Hopt, 2264, 2274.

[98] Centre for European Policy Studies, *Financial Regulation and Supervision Beyond 2005*, p. 10.

[99] CESR, A proposed evolution of EU securities supervision beyond 2007, CESR/07-783, November 2007, p. 3 ('referees should not compete').

[100] L. Gower, in: Buxbaum et al. (eds.), *European Business Law*, 307, 315 ff.; E. Pan, 34 L. & Pol'y Int'l Bus. (2003), 499, 526 ff.; G. Thieffry, 18 Fin. L. Rev. (1999), 14 ff.; G. Thieffry, in: Ferran and Goodhart (eds.), *Regulation Financial Services in 21st Century*, 211, 220 ff.; R. Karmel, 38 Colum. J. Transnat'l L. Law (1999), 9, 32 ff.; E. Wymeersch, in: Ferran and Goodhart (eds.), *Regulation Financial Services in 21st Century*, 189, 193.

[101] See R. Veil § 1 para. 33.

[102] Commission Proposal for a regulation of the European Parliament of the Council on Community macro prudential oversight of the financial system and establishing a European Systemic Risk Board, 23 September 2009, COM(2009) 499 final; COM(2009) 500 final; COM(2009) 501 final; COM(2009) 502 final; COM(2009) 503 final. Cf. Communication from the Commission on European financial supervision, 27 May 2009, COM(2009), 252 final.

[103] On securities supervision: Legislative Proposal of the European Parliament of 22 September 2010 on the Proposal for a Regulation of the European Parliament and of the Council establishing a European Securities and Markets Authority, COM(2009) 0503, C7-0167/2009, 2009/0144(COD).

[104] See below para. 100 for details on this discussion on the scope of this legal basis.

56 A comprehensive legislative review was undertaken between 2017 and 2019 ('**ESA Review**').[105] The ESA Review included intense discussions between the European institutions on reforms for the ESFS. The result of the ESA review was a strengthening of ESMA's position, but without a paradigm shift with regard to the authority's powers. In particular, the voices calling for a far-reaching centralisation of capital market supervision in Europe at ESMA were not heard in the course of the ESA Review.[106]

1. Institutional Design

57 The European financial markets supervisory system consists of two pillars: The **macro-prudential level** aims to avoid systemic risks for the entire European financial system whilst the **micro-prudential level** is intended to develop a European system of supervision for the individual financial service providers and capital market participants.

(a) Macro-prudential Level

58 The **European Systemic Risk Board (ESRB)** is responsible for the macro-level supervision,[107] ensuring the general stability of Europe's financial system.[108] The ESRB, however, does not have its own legal personality.[109] It is rather a body for cooperation between members of the Commission, the European Central Bank, the European supervisory authorities on the micro-prudential level (ESAs) together with the national supervisory authorities and central banks. The ECB provides the secretariat for the ESRB. The President of the ECB is also the Chair of the ESRB. The ESRB has the power to issue warnings regarding systemic risks and recommendations for their prevention. The ESRB is not, however, to be equipped with legally binding legislative powers or powers of intervention.[110]

(b) Micro-prudential Level

59 At a micro-prudential level, the supervision of the individual financial actors is the responsibility of the three central European authorities: **the European Banking authority (EBA)**, the **European Insurance and Occupational Pensions Authority (EIOPA)** and the **European Securities and Market Authority (ESMA)**, all of which have their own legal personality.[111]

[105] Cf. on the discussion in the course of the ESA review eg C. Gortos and K. Lagaria, EBI Working Paper Series 2020 No. 57, 8.

[106] See eg J. Krahnen and K. Langenbucher, SAFE Policy Letter No. 88; J. Payne, Oxford Legal Studies Research Paper No. 26/2017.

[107] Regulation (EU) No. 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, OJ L331, 15 December 2010, p. 1–11.

[108] See Commission Press Release of 23 September 2009, IP/09/1347.

[109] Cf. Recital 15 Regulation (EU) No. 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, OJ L331, 15 December 2010, p. 1–11.

[110] Cf. Art. 15 ff. Regulation (EU) No. 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, OJ L331, 15 December 2010, p. 1–11.

[111] COM(2009) 503 final (fn. 107), Art. 3(1). Cf. G. Granner, in: Braumüller et al. (eds.), *Die neue Europäische Finanzmarktaufsicht – ZFR Jahrestagung 2011*, 27, 31 ff.; H. Siekmann, IMFS Working Paper No. 24 (2009).

Together with the national supervisory authorities, these European authorities form a network responsible for the supervision of the financial markets.[112] As opposed to the macro-prudential level, the European authorities of the ESFS all have **legally binding legislative powers and powers of intervention**.[113] Yet, the day-to-day supervision of market participants is in general to be carried out by the national supervisory authorities with narrow exceptions for ESMA. Hence, the national level remains the centre of supervision.[114] The ESA's function is, therefore, predominantly **watching-the-watchers.**[115]

A **Joint Committee** is to ensure a cooperation and coordination between the macro- and the micro-prudential level and between the individual authorities on the micro-prudential level.[116] 60

(c) European Banking Union

Since 2014 the ESFS's banking supervision has been complemented by a pan-European supervisory scheme.[117] The financial crisis demonstrated that simple coordination of financial supervision via the ESFS was not sufficient to effectively supervise the European banking sector and pre-empt a future financial crisis. In order to overcome this obstacle, a **European Banking Union** was established. In this course, the **Single Supervisory Mechanism (SSM)**, the **Single Resolution Mechanism (SRM)** and a **common deposit guarantee scheme** were created. Not all EU Member States participate in the Banking Union but only the Member States of the Eurozone. Non-euro area Member States are invited to join. In October 2020, Croatia and Bulgaria made use of this option and joined the SSM as first non-Eurozone countries. 61

The SSM is the heart of the European Banking Union. Based on the SSM Regulation[118] most tasks relating to the prudential supervision of credit institutions in the participating Member States are now conferred on the ECB. The ECB directly supervises **115 banks** of the participating countries which a considered 'Significant Institutions (SI)'. These banks hold almost **82% of the aggregate banking assets** in these countries. All other banks (so-called 'Less Significant Institutions (LSI)') are supervised by the national authorities with the ECB overseeing their supervisory practice.[119] 62

Notwithstanding, the direct supervisory powers of the ECB the spirit of the SSM is that the national authorities and the ECB cooperate closely and exchange information. For this 63

[112] Recital 9 Regulation EU No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), OJ L331/84, 15 December 2010 (ESMA Regulation).

[113] See below para. 75.

[114] See A. Wittig, DB (2010) *Standpunkte*, 69.

[115] Cf. N. Moloney, *EU Securities and Financial Markets Regulation*, 973, for an analysis of ESMA's relation vis-à-vis the NCAs.

[116] E. Wymeersch, in: Wymeersch et al. (eds.), *Financial Regulation and Supervision*, 232, 288 ff.

[117] Cf. on the background N. Moloney, *EU Securities and Financial Markets Regulation*, 943 ff.

[118] Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ L287, 29 October 2013, p. 63–89; cf. also Regulation (EU) No. 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities, OJ L141, 14 May 2014, p. 1–50.

[119] A full list of all institutions currently qualified as SI and the allocation of the banking assets between SI and LSI can be found on www.ecb.eu.

purpose, they create **Joint Supervisory Teams (JSTs)** to execute the supervision over the significant institutions. The ECB is responsible for the effective and consistent functioning of the mechanism but is dependent on the support of the national authorities in order to execute the supervision. The SSM's mandate includes authorising credit institutions, ensuring compliance with prudential and other regulatory requirements, and carrying out supervisory reviews. Besides these micro-prudential tasks, the ECB also has a macro-prudential mandate. As a consequence, the ECB as well has macro-supervisory tools at its disposal, for example, in relation to capital buffers.

64 The SSM is closely linked with the SRM and the **Single Bank Resolution Fund (SBRF)**. Both institutions were founded on the basis of a European regulation.[120] The SRM provides tools for the recovery and resolution of credit institutions and certain investment firms in the Euro area and in other participating Member States. The SBRF serves as a financial backstop, ie should it become necessary to resolve a failed bank, in case a bank's shareholders and creditors prove insufficient to absorb a certain amount of losses, the SBRF can provide further funds. Some aspects of the SBRF, such as the transfer and mutualisation of national contributions, are not subject to an EU regulation but are covered by an intergovernmental agreement concluded between the participating Member States.

65 The last element of the European Banking Union is a common deposit protection mechanism. In 2015, the Commission published the proposal to establish a **European Deposit Insurance Scheme (EDIS)**.[121] However, no political agreement has yet been reached on the design of such a deposit protection scheme.

2. The European Securities and Markets Authority (ESMA)

(a) Foundations

66 ESMA was founded by the ESMA Regulation. It assumed all tasks and powers of the former CESR.[122] ESMA has its seat in **Paris**.[123] By the end of 2019, it had **233 full-time equivalent employees**.[124] The authority's mandate is to protect the public interest by contributing to the short-, medium- and long-term **stability and effectiveness of the financial system**.[125] The ESMA Regulation substantiates this mandate by point out that ESMA should ensure the functioning of the internal market and the supervisory convergence within the internal market. It should further protect the integrity, transparency and efficiency of the financial markets and support international supervisory cooperation. Finally, ESMA should

[120] See Regulation (EU) No. 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No. 1093/2010, OJ L225, 30 July 2014, p. 1–90.

[121] European Commission, A stronger Banking Union: New measures to reinforce deposit protection and further reduce banking risks, 24 November 2015.

[122] Recital 8 and 67 ESMA Regulation.

[123] Art. 7 ESMA Regulation.

[124] ESMA, 2019 Annual Report, ESMA20-95-1264, 15 June 2020, p. 73.

[125] Art. 1(5)(1) ESMA Regulation.

prevent regulatory arbitrage, regulate investment risks and strengthen investor as well as consumer protection.[126]

67 The authority's most important body is the **Board of Supervisors.**[127] Moreover, the authority's governance system includes a Management Board, a Chairperson, an Executive Director and a Board of Appeal.[128] In the course of the ESA Review the Board of Supervisors received the power to set up committees for specific tasks.[129]

68 The **Board of Supervisors** is composed of the heads of the NCAs and further non-voting members, namely the Chairperson, representatives of the Commission, the ESRB and one representative from each of the other two European Supervisory Authorities.[130] The Board of Supervisors appoints the **ESMA Chairperson**[131] who represents ESMA vis-à-vis third parties.[132] For up to one month after the selection, the European Parliament may, however, object to the designation of the selected person.[133] **Steven Maijoor** from the Netherlands was appointed the first Chairman and was re-appointment for a second five-year term.[134] The Chairperson's main task besides the representation of ESMA is chairing the meetings of the Board of Supervisors and the Management Board.[135] The Board of Supervisors must further elect an alternate to carry out the functions of the Chairperson in his absence and who may not be a member of the Management Board.[136]

69 After confirmation by the European Parliament, the Board of Supervisors must also appoint an **Executive Director** in charge of the management of ESMA and prepare the work of the Management Board,[137] which executes ESMA's day-to-day supervisory activities.[138] The Executive Director may participate in meetings of the Board of Supervisors but does not have the right to vote.[139] The first Executive Director was **Verena Ross**, a German national formerly working for the United Kingdom's supervisor. Verena Ross was also re-appointed for a second five-year term in 2015 before becoming Chair at ESMA in 2021.[140]

70 Besides the daily management the **Management Board** shall ensure that ESMA performs the tasks assigned to it and acts in accordance with its budgetary plan.[141] The Management Board is composed of the Chairperson and six other members of the Board of Supervisors,

[126] Art. 1(5) (2)(a-g) ESMA Regulation.
[127] Art. 43(1), (2) ESMA Regulation.
[128] Art. 6 ESMA Regulation.
[129] Art. 41 ESMA Regulation.
[130] Art. 40(1) ESMA Regulation. In general, decisions of the Board of Supervisors are taken by a simple majority of its members, each member having one vote, cf. Art. 44(1) ESMA Regulation. With regard to the acts specified in Art. 10–16 ESMA Regulation, however, the Board of Supervisors' decisions must be taken on the basis of a majority as defined in the Treaty of Lisbon, cf. Art. 44(1) subsec. 2 ESMA Regulation.
[131] Art. 43(3) ESMA Regulation.
[132] Art. 43(3) ESMA Regulation.
[133] Art. 48(2) ESMA Regulation.
[134] ESMA, Press Release of 24 September 2015, ESMA/2015/1425, 24 September 2015.
[135] Art. 48(1) ESMA Regulation.
[136] Art. 48(2) subsec. 3 ESMA Regulation. This position is currently held by Anneli Tuominen, Director-General of the Finnish Finanssivalvonta.
[137] Art. 51(2) ESMA Regulation.
[138] Cf. No. 6.3.3 COM(2009) 503 final (fn. 107).
[139] Art. 40(6) ESMA Regulation.
[140] ESMA/2015/1425 (fn. 145).
[141] Art. 47(1) ESMA Regulation.

elected by the voting members of the Board of Supervisors.[142] The Executive Director and a representative of the Commission participate in meetings of the Management Board but do not have the right to vote.[143]

71 In order to effectively fulfil its mandate ESMA makes use of advice by the NCAs and external experts.[144] The most important advisory body is the **Securities and Markets Stakeholders Group (SMSG)**.[145] Moreover, ESMA has created a number of committees that provide access to expertise in particular from market participants, consumers' and users of financial services' representatives as well as academics. In addition, ESMA has created several standing committees which draw together experts from the NCAs. Most standing committees have consultative working groups in which external stakeholders are represented.[146]

72 The Management Board further appoints the ESMA member of the **Board of Appeal**.[147] The Board of Appeal is a joint body of the three European Authorities providing legal protection against measures taken by ESMA, EIOPA or EBA.[148]

(b) Independence and Budget

73 According to the ESMA Regulation the authority is independent, acting **solely in the interest of the European Union**.[149] The autonomy of its bodies[150] and its budgetary autonomy do, in fact, provide such independence to a very large extent.[151] However, due to the fact that the members of ESMA's supervisory body stem from the NCAs, a certain adaptation towards the national interests might not be prevented.[152] Also, the involvement of the Commission in ESMA's bodies might give rise to a certain lack of independence.[153] This distinguishes ESMA from the ECB which is a fully independent institution.[154]

74 ESMA may decide autonomously over its budget. The authority's budget for 2020 amounts to **approx. € 58 million**.[155] This budget is financed by the NCAs (approx. 41%), by the EU (approx. 34%) and observers (below 1%) as well as by contributions and fees from directly supervised market participants (approx. 24%).[156] During the ESA Review, a direct contribution to ESMA by all market participants was discussed. This proposal, however, was rejected in the final negotiations between the European institutions.

[142] Art. 45(1) ESMA Regulation.
[143] Art. 45(2) ESMA Regulation.
[144] Cf. also R. Veil, 5 ZGR (2014), 544, 555 ff.
[145] See Art. 37 ESMA Regulation. The statements and recommendations of the SMSG can be downloaded under www.esma.europa.eu/about-esma/governance/smsg.
[146] A continuously updated overview over all committees of ESMA is available at www.esma.eu.
[147] Art. 47(8) ESMA Regulation.
[148] Cf. www.esma.europa.eu/about-esma/governance/board-appeal.
[149] Cf. Recital 59 ESMA Regulation.
[150] Art. 42, 46, 49, 52, 59 ESMA Regulation.
[151] Cf. M. Lehmann and C. Manger-Nestler, 3 EuZW (2010), 87, 89.
[152] Cf. also M. Hitzer and P. Hauser, 2 BKR (2015), 52, 53.
[153] Cf. N. Moloney, *EU Securities and Financial Markets Regulation*, 914 ff.
[154] Cf. M. Lehmann and C. Manger-Nestler, 3 EuZW (2010), 87, 89; M. Lehmann and C. Manger-Nestler, 1 ZBB (2011), 2, 8.
[155] ESMA, Budget for 2020, 13 January 2020, ESMA63-43-1444.
[156] ESMA, Budget for 2020, 13 January 2020, ESMA63-43-1444.

(c) Powers of Intervention vis-à-vis the NCAs

75 Generally, the concept of the European supervisory system does not provide for ESMA to have direct powers (of intervention) vis-à-vis issuers and market participants (‘**watching the watchers’**-model). The continuous supervision of market developments is rather to remain a matter of the Member States’ NCAs. The NCAs are coordinated by ESMA in order to ensure a consistent and coherent supervision of markets in the EU.[157]

76 To this end, peer reviews pursuant to Article 30 ESMA Regulation are an efficient and effective tool for analysing and comparing the national institutions’ activities.[158] According to Article 35 of the regulation, ESMA further has the right to request information from the competent authorities within the Member States in order to perform its supervisory duties.

77 There are, nevertheless, three ways of intervening against national authorities or – in exceptional cases – even against market participants.[159]

(aa) Breaches of EU Law by the National Supervisory Authorities

78 When a NCA has incorrectly or insufficiently applied European Union law, Article 17 ESMA Regulation provides a **three-step mechanism**[160] for the authority as a proportionate response thereto.

79 ESMA itself, the Council, Parliament, Commission or the SMSG may initiate investigations regarding the incorrect or insufficient application of EU law obligations by national authorities in their supervisory practice. Within two months after commencement of the investigations, ESMA may issue a recommendation to the competent national authority on how to overcome the breach.

80 In the case that the respective NCA does not follow the recommendation within a one-month period, the ESMA is empowered on a second level to issue a formal opinion taking ESMA’s recommendation into account and requiring the competent authority to take the actions necessary to ensure compliance with EU law.

81 To overcome situations in which these actions are not taken within the given time limit, ESMA may adopt **decisions addressed to individual participants** in the financial markets. These may obligate the respective participant to comply with its duties under EU law. This power, however, only exists where it is necessary to remedy such non-compliance in a timely manner in order to maintain or restore neutral conditions of competition on the market or ensure the orderly functioning and integrity of the financial system.[161] The breach must further affect directly applicable provisions of European law. ESMA is thus empowered to undertake a form of ‘right of entry’ in order to remedy breaches of EU law.[162]

82 During the first 10 years of its existence, ESMA has not yet made use of its powers in case of a breach of EU law at all.

[157] Art. 1(5)(c) and Art. 31 ESMA Regulation.

[158] Cf. Recital 41 ESMA Regulation; Cf. N. Moloney, in: Wymeersch et al. (eds.), *Financial Regulation and Supervision*, 71, 103 ff.; E. Wymeersch, in: Wymeersch et al. (eds.), *Financial Regulation and Supervision*, 232, 280 ff.

[159] See for an analysis also N. Moloney, *EU Securities and Financial Markets Regulation*, 976 ff.

[160] Recital 28 ESMA Regulation; cf. M. Lehmann and C. Manger-Nestler, 3 EuZW (2010), 87, 90.

[161] Art. 17(6) ESMA Regulation.

[162] M. Lehmann and C. Manger-Nestler, 3 EuZW (2010), 87, 91.

(bb) Decisions on Emergency Situations and Disagreements between NCAs

83 In cases of so-called **emergency situations**[163] and **disagreements between national supervisory authorities**[164] ESMA is permitted to address measures to individual national supervisory authorities. The measures must be necessary as a reaction to adverse developments which may seriously jeopardise the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the EU. Should the national authority not comply with the decision, ESMA may adopt an individual decision addressed to a financial market participant, requiring the necessary action to comply with its obligations.[165]

(1) Emergency Situations

84 The Council is empowered to determine the existence of so-called emergency situations in consultation with the Commission, the ESRB and, where appropriate, the ESAs.[166] The request for such a decision can be made by ESMA, the Commission or the ESRB. In an emergency situation ESMA **may issue decisions to the NCAs in order to overcome the thread for financial stability**. If a competent authority does not comply with the decision of ESMA, a decision addressed directly to a financial market participant requiring the necessary action to comply with its obligations under the directly applicable European law is only permitted under strict conditions: ESMA may only act if an urgent remedy is necessary in order to restore the orderly functioning and integrity of financial markets or the stability of the EU financial system.

(2) Disagreements between Competent Authorities in Cross-Border Situations

85 If permitted by a directive or regulation,[167] ESMA may adopt a decision in cases of disagreements between NCAs addressed to a financial markets participant. These decisions may include the action to be taken by the market participants to comply with its obligations under EU law. Prior to this, ESMA has, however, to act as a **mediator** between the authorities, setting a time limit for conciliation.[168] If a NCA does not comply with ESMA's decision, the latter may adopt an individual decision addressed to a financial markets participant requiring the necessary action to comply with its obligations under European law pursuant to Article 19(4) ESMA Regulation. Unlike in cases of emergency, this power is not subject to further conditions.

(3) National Fiscal Responsibilities Limit ESMA Powers

86 The limits to ESMA's powers are laid down in the **safeguard provision** in Article 38 ESMA Regulation, which prohibits any decisions adopted by ESMA from impinging on the fiscal

[163] Art. 18 ESMA Regulation.
[164] Art. 19 ESMA Regulation.
[165] M. Lehmann and C. Manger-Nestler, 3 EuZW (2010), 87, 91.
[166] Cf. Art. 18(2) ESMA Regulation.
[167] See eg Art. 13(6) MAR; Art 25(2a) TD; Art. 57(6) MiFID II; Art. 31(5) draft PR.
[168] Art. 19(2) ESMA Regulation.

responsibilities of Member States. In case a Member State argues that a decision impinges on its fiscal responsibilities, it may notify ESMA and the Commission within two weeks after it has been notified of ESMA's decision. As a result, this decision is suspended.

According to Article 38(2) ESMA Regulation, in cases of a disagreement being resolved by ESMA, the authority must then re-evaluate its decision. If it upholds it, the Council must take a decision according to the majority of the votes. It may then maintain the decision or revoke it (in which case the decision is terminated). 87

Should a Member State consider that an emergency decision taken under Article 38(3) impinges on its fiscal responsibilities, it may notify ESMA, the Commission and the Council that the decision will not be implemented by the competent authority. In this case, the Council is automatically responsible for deciding on the admissibility of the decision, without prior re-evaluation by ESMA. This requires a simple majority of its members. If the Council decides not to revoke the authority's decision relating to Article 18(3) ESMA Regulation and if the Member State concerned still considers that the decision of the authority impinges upon its fiscal responsibilities, it may again notify the Commission and the authority and request the Council to re-examine the matter, causing a suspension of ESMA's decision.[169] Article 38(5) ESMA Regulation clarifies that any abuse of this possibility is prohibited, as incompatible with the internal market. 88

(d) Direct Supervision of Market Participants

In some (still exceptional) cases ESMA regulation does not strictly abide by the concept of watching the watchers. In fact, the ESMA Regulation provides the authority with a limited number of direct powers of intervention towards individual market participants. In the course of the ESA Review further direct supervisory powers were granted to ESMA with effect from 1 January 2022 (supervision of benchmarks and data service providers).[170] 89

ESMA has such powers – as shown before[171] – in the exceptional emergency situations and in case of a disagreement between national supervisory authorities as well as a result of violations of EU law by a NCA; in each case provided the aforementioned strict conditions are all fulfilled and the respective NCA has not complied with the directions issued by ESMA. In addition, ESMA has a few further direct supervisory powers vis-à-vis market participant. 90

(aa) Warnings and Prohibition of Financial Activities

ESMA may also issue warnings in the event that a financial activity poses a serious threat to supervisory objectives.[172] In 2012, ESMA made use of this possibility for the first time, issuing a warning against dealing with unauthorised firms offering foreign exchange investments.[173] Pursuant to Article 9(5) ESMA Regulation the authority may furthermore temporarily prohibit or restrict certain financial activities if they threaten the orderly 91

[169] Cf. Art. 38(4) ESMA Regulation.

[170] The Commission was even advocating to confer the direct supervision on the approval of certain prospectuses and certain investment funds on ESMA. However, in the course of the Trialogue negotiations this position was dropped.

[171] See para. 84.

[172] Cf. Art. 9(3) ESMA Regulation.

[173] ESMA, Investor Warning against Trading in Foreign Exchange (Forex), ESMA/2011/412, 5 December 2011.

functioning and integrity of financial markets or the stability of the whole or part of the financial system in the EU. *Examples*: On this legal basis ESMA was assigned the right **to prohibit short sales** in emergency situations (Article 28 SSR)[174] or the **distribution, marketing or sale of certain financial products or financial services** (Article 40–42 MiFIR).[175]

92 An action of ESMA requires (i) either an emergency situation as laid down in Article 18 ESMA Regulation or (ii) that the respective special conditions laid down in another European legislative act (eg SSR, MiFIR) are fulfilled.

(bb) Supervision of Credit Rating Agencies (CRA) and Trade Repositories (TR)/ Security Repositories (SR)

93 As the only authority of the ESFS, ESMA has general and **direct supervisory powers** over entire groups of market participants. ESMA is responsible for registering and supervising **credit rating agencies (CRA)** and **trade repositories (TR)** as well as **security repositories (SR)**. It has the necessary sanctioning powers—such as withdrawal of registration, the suspension of ratings[176] and the ability to impose fines with a basic amount of up to € 750,000 (CRA) or € 20,000 (TR and SR)—as well as the accompanying investigatory powers for this task.[177]

94 The supervision of CRA is a key element of ESMA's mandate. In legal literature, this field of supervision was even regarded as a blueprint for the future developments of ESMA towards a '**European SEC**'.[178] Despite this, high importance, ESMA has made use of its sanctioning powers rather reluctantly in last years. It has only issued five public notices[179] and imposed six fines for breaches of the CRA Regulation.[180] The maximum fine was € 5.1 million.[181]

95 ESMA seems to follow this approach also when it comes to supervise TR under the EMIR[182] and SR under the Securitisation Regulation:[183] Until the end of 2020, ESMA has issued its two fines in this capacity.[184]

[174] The fact that this power of ESMA can have practical importance was demonstrated in the course of the COVID 19 pandemic for the first time: At the peak of the first pandemic wave in spring 2020, ESMA issued a EU-wide transparency requirement for short positions if these exceed the threshold of more than 0.1% of the share capital. Cf. on this F. Walla § 24 para. 32.

[175] See on this D. Klingenbrunn, 7 WM (2015), 315, 316.

[176] In particular, the powers laid down in Art. 23, 24 Rating Regulation are to be applied to the ESMA.

[177] Art. 36a CRA Regulation; Art. 65 EMIR (in conjunction with Art. 14 Securitisation Regulation). See also R. Veil § 27, for more details on the supervision of CRA.

[178] In this direction also E. Ferran, in: Ferran et al. (eds.), *The Regulatory Aftermath of the Financial Crisis*, 1, 48.

[179] See ESMA, Decision of the Board of Supervisors, ESMA/2014/544, 20 May 2014.

[180] See ESMA, Decision of the Board of Supervisors, ESMA/2015/1048, 24 June 2015.

[181] See ESMA, Public Notice of 28 March 2019, ESMA41-356-22, 28 March 2019 ('Fitch Ratings').

[182] Regulation (EU) No. 684/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, OJ L201, 27 July 2012, p. 1–59.

[183] Regulation (EU) No. 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No. 1060/2009 and (EU) No. 648/2012, OJ L347, 28 December 2017, p. 35–80.

[184] See ESMA, Press Release of 31 March 2016, ESMA/2016/468, 31 March 2016; ESMA, Public Notice of 15 July 2019, ESMA41-356-39, 15 July 2019.

(cc) Supervision of Benchmarks and Data Services Providers

Starting on 1 January 2022, ESMA will supervise EU critical benchmarks and their administrators. In addition, ESMA will be responsible for the recognition of third-country benchmarks. ESMA will also have the supervisory powers to authorise and supervise different types of Data Reporting Services Providers (DRSPs), ie Approved Publication Arrangements, Authorised Reporting Mechanisms and Consolidated Tape Providers under the MiFIR. 96

(e) Rule-making Powers and Supervisory Convergence

ESMA plays a major role in the European rule-making process.[185] The authority has an important function on Level 1, 2 and 3 of the Lamfalussy II Process.[186] Furthermore, it has assumed a further de facto rule-making power that are highly relevant for legal practice via its mandate to achieve supervisory convergence.[187] 97

(f) Compliance of ESMA's Powers with the TFEU

Since the formation of ESMA, compliance of the authority's supervisory and rule-making powers with the TFEU has been questioned by legal literature and by certain Member States.[188] The basis for these doubts was that under the ECJ's ***Romano***[189] judgment a conferral of legislative powers to bodies other than the EU institution is prohibited. Furthermore, under the ***Meroni***[190] ruling of the ECJ, powers involving a wide margin of discretion and policy decisions may not be delegated by EU institutions to other EU bodies. 98

The United Kingdom government challenged ESMA's powers to require market participants to notify the relevant NCA or disclose a net short position or to prohibit or impose conditions on short selling (Article 28(1) Short Selling Regulation)[191] arguing that the *Meroni* and the *Romano* rulings prohibit such delegation of powers. Moreover, it argued that ESMA's power to draft ITS and RTS violate Articles 290 and 291 TFEU[192] and that the EU could not even rely on Article 114 TFEU when establishing ESMA. 99

In 2014, the **ECJ dismissed the United Kingdom's actions** and ruled that ESMA's powers under the short selling regulation did not violate the TFEU.[193] In its decision the Court thoroughly analysed the framework of the ESMA Regulation and held it to be compliant with primary law and particularly concluded that ESMA's discretion is sufficiently limited.[194] The Court did not even follow the **concerns of Advocate-General Jääskinen** with regards to the compliance of ESMA's mandate with Article 114 TFEU.[195] 100

[185] See in detail F. Walla, § 4.
[186] Cf. N. Moloney, *EU Securities and Financial Markets Regulation*, 898 ff.; further F. Walla, § 4 para. 4.
[187] See F. Walla, § 4 para. 29.
[188] Cf. on this N. Moloney, *EU Securities and Financial Markets Regulation*, 994 ff.
[189] Case 89/90 (*Romano*).
[190] Case 9/56 (*Meroni/High Authority*).
[191] See on this provision F. Walla, § 24 para. 55.
[192] See on this F. Walla, § 4 para. 16.
[193] Case 270/15 (*UK v. Council and Parliament*).
[194] See for an analysis of the case C. Manger-Nestler, 3 GPR (2014), 141 ff.; N. Moloney, *EU Securities and Financial Markets Regulation*, 998 ff.; E. Howell, 11 ECFR (2014), 454 ff.
[195] Opinion of AG Jääskinen of 12 September 2013, Case 270/15 (*UK v. Council and Parliament*), para. 27 ff.

101 By dismissing the United Kingdom government's action the Court provided ESMA with legal certainty as to the compliance of its powers with primary law.[196] While this result is generally to be welcomed, the ECJ's ruling should nevertheless constantly remind ESMA that it is an independent body without direct democratic legitimation that should thus exercise its rule-making powers carefully.

(g) Judicial Review

102 The ESMA Regulation grants the market participants and national authorities legal protection against decisions made by ESMA on the grounds of Articles 17–19, providing them with the **right to make an appeal against any decision** addressed to them.[197] The Board of Appeal is a joint body of the ESAs and is composed of six members with a proven record of relevant knowledge and professional experience in the fields of finance and financial markets law.[198] The members of the Board of Appeal are to be independent in making their decisions and not bound by any instructions.[199]

103 Article 61 ESMA Regulation states that in order to contest a decision of the Board of Appeal, action may be brought before the ECJ in accordance with Article 263 TFEU.[200] In cases where there is no right to appeal laid down in the ESMA Regulation, proceedings may be brought before the ECJ directly. This particularly applies to proceedings against technical standards on the grounds of Article 263(4) TFEU.[201]

(h) Liability of ESMA

104 The ESMA Regulation clarifies in Article 69(1) that ESMA is to make good any damage caused by it or by its staff in the performance of duties according to the common general principles in the laws of the Member States. Respective claims for public liability are to be brought before the ECJ.

(i) Access to Information

105 Under Article 72 ESMA Regulation the public access to ESMA's documents is governed by the EU transparency regulation.[202] Under this regulation third persons are generally entitled to gain access to information. The access may, however, be denied because of public interests or to ensure the protection of personal data. Moreover, a request for information may be dismissed if an ongoing administrative of judicial proceedings might be affected or if the business interests of a third party are infringed.[203]

[196] Case C-270/15 (*UK v. Council and Parliament*).
[197] Art. 60(1) ESMA Regulation.
[198] Art. 58 ESMA Regulation.
[199] Art. 59 ESMA Regulation.
[200] Art. 47(1) ESMA Regulation.
[201] C. Manger-Nestler, *Kreditwesen* (2012), 528, 531.
[202] Regulation (EC) No. 1049/2001 of the European Parliament and of the Council of 30 May 2001 regarding public access to European Parliament, Council and Commission documents, OJ L145, 31 May 2001, p. 43–48.
[203] See on this exception G. Spindler, *Informationsfreiheit und Finanzmarktaufsicht*, 74.

3. Conclusion

During ESMA's formation numerous Member States did initially not agree with giving the European authorities the power to make decisions addressed directly to individual financial market participants.[204] The legal literature had **mixed opinions** on this matter: whilst some maintained the Commission's proposal did not go far enough,[205] not sufficiently ensuring the authority's independence and following the concept of sectoral supervision,[206] others claimed that the European Union ought to be more restrictive in introducing new harmonising provisions. They pointed out that difficulties in communication arise for the Member States when interacting with an authority at the European level.[207] 106

This criticism is certainly true to a certain extent. However, after the first years of its existence, one can already conclude that the European supervisory structure was **a step into the right direction**: increasing cross-border transactions and the growing unification of capital markets law at a European level make a European approach to supervision indispensable. Numerous questions of practical relevance are already decided by ESMA in Paris. ESMA's importance will continue to grow.[208] Legal practice is therefore well advised to continue to adjust to the European supervisory scheme. 107

Finally, one prediction of the first edition of this textbook[209] can be upheld: In the long run, ESMA has the potential to become the most important supervisory player in European capital markets law. The ESA Review was a further step into this direction. However, there is still a need to strengthen ESMA's role and mandate to build up a supervisor who is a true 'European SEC' in the long run. Further proposals for a partial extension of the mandate are made on an ongoing basis:[210] The European legislator should have the courage to take up these proposals and successively develop ESMA's powers. 108

[204] Cf. T. Möllers et al., 30 NZG (2010), 285, 290.

[205] K. Hopt, 36 NZG (2009), 1041, 1408; M. Lamandini, 6 ECL (2009), 197, 202.

[206] D. Masciandaro et al., CEPR Policy Insight No. 37, 16 ff.; T. Möllers et al., 30 NZG (2010), 285, 289.

[207] For example R. Veil, 11 EBOR (2010), 409, 422.

[208] See also E. Ferran, in: Wymeersch et al. (eds.), *Financial Regulation and Supervision*, 111, 156.

[209] 1st ed. (2013), F. Walla § 11 para. 79.

[210] See as an example the latest discussion on the supervision of the ESG ratings (cf. on this ESMA, Letter to the Commission of 28 January 2021, ESMA30-379-423).

§ 13

Foundations

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I. Introduction

The European Union has had a largely uniform legal framework to combat market abuse since 2003. The Market Abuse Directive 2003/6/EC (MAD 2003) from 22 December 2003[1] required the Member States to prohibit insider dealing and market manipulation. The Member States also had to ensure that inside information and directors' dealings were disclosed as soon as possible and recommendations published by financial analysts were subject to specific standards. However, the MAD 2003 only required a minimum harmonisation of the national laws. In 2008, the former CESR showed in a comprehensive study that, despite the harmonisation by the MAD 2003 and implementing directives, the market abuse law in the Member States differed and the existing administrative and criminal sanctions were disparate and not dissuasive.[2] The High Level Group, chaired by *Jacques de Larosière*, addressed this problem in the wake of the financial crisis and recommended the introduction of a coherent regulatory framework for Europe.[3] The European Commission responded to this recommendation with proposals for a Regulation and a Directive on market abuse (MAR and CRIM-MAD) published on 20 October 2011. 1

The **Market Abuse Regulation** (MAR) and the **Directive on criminal sanctions for insider dealing and market manipulation** (CRIM-MAD) were adopted on 16 April 2014 and 2

[1] See R. Veil § 1 para. 21.

[2] CESR, Report on Administrative Measures and Sanctions as well as Criminal Sanctions available in Member States under the Market Abuse Directive (MAD 2003), CESR/07-693, February 2008.

[3] Cf. The High-Level Group on Financial Supervision in the EU, 25.2.2009, 29.

published in the EU's Official Journal on 12 June 2014. The new regime has been applicable since 3 July 2016. The European legislator argued that the global economic and financial crisis had highlighted the importance of market integrity and it would be important to strengthen supervisory and sanctioning regimes in this regard. The legal framework established by the MAR and CRIM-MAD shall '**preserve market integrity**, **avoid regulatory arbitrage**' and 'provide more **legal certainty** and **less regulatory complexity** for market participants'.[4] It is based on the idea that 'an integrated, efficient and transparent financial market requires market integrity. The smooth functioning of securities markets and public confidence in markets are prerequisites for economic growth and wealth. Market abuse harms the integrity of financial markets and public confidence in securities and derivatives.'[5]

II. Legal Foundations

1. MAR

3 The main instrument for combating market abuse is the **Market Abuse Regulation** (MAR). It covers all regulatory areas of the MAD 2003 and is structured in a similar way. The first chapters set out the application of the Regulation, define important terms, establish prohibitions on insider trading and market manipulation and prescribe disclosure obligations for issuers and directors. As the rules are made in the form of a regulation, they have direct effect in the Member States (Article 288(2) TFEU). National legal provisions on insider trading and market manipulation are superfluous. Other chapters of the MAR include extensive new provisions on supervision by national authorities (NCAs) and administrative measures and sanctions to be introduced in the national laws of the Member States.

4 The legal instrument of a regulation is intended to achieve a **uniform interpretation** of the rules on market abuse. It also ensures that Member States no longer provide for divergent rules. The MAR implies that the same rules must be followed by all natural and legal persons throughout the Union. This helps to reduce compliance costs, especially for companies operating across borders, and to eliminate distortions of competition.[6] For these reasons, it can in principle be assumed that MAR aims at **full harmonisation of** the law on market abuse (with the exception of the rules on supervision in the Member States and the penalties to be provided for in the Member States).[7]

5 In order to achieve the objective of a single set of rules, the MAR empowers the Commission to adopt **delegated acts** (Art. 290 TFEU) and **implementing acts** (Art. 291 TFEU) (Level 2 acts). Furthermore, ESMA has to issue **guidelines** and recommendations, as set out in Art. 16 ESMA Regulation (Level 3 measures), to ensure uniform interpretation. The MAR and the national criminal legislation adopted in implementation of the CRIM-MAD, together with the Level 2 and Level 3 measures of the Commission and ESMA, form the '**Single Rulebook**

[4] Cf. Recital 4 MAR.
[5] Cf. Recital 2 MAR.
[6] See Recital 5 MAR.
[7] See para. 12.

on Market Abuse' (MAR regime). This is not a separate Securities Trading Act codifying the rules of market abuse law, but a compilation of Level 1, 2 and 3 acts and instruments.[8]

The European Commission has so far adopted 13 legal acts (Implementing Directives, Implementing Regulations and Delegated Regulations) on market abuse.[9] The following four measures should be listed here because they specify the prohibitions of insider dealing and market manipulation and the disclosure requirements for issuers and managers: **Delegated Regulation (EU) 2016/522** of 17 December 2015;[10] **Delegated Regulation (EU) 2016/958** of 9 March 2016;[11] **Delegated Regulation (EU) 2016/960** of 17 May 2016;[12] **Implementing Regulation (EU) 2016/1055** of 29 June 2016.[13] 6

So far, **ESMA** has issued **two guidelines** on the MAR[14] and a document on '**Q&As**' on market abuse law, which it regularly updates. The purpose of the Q&A document is to establish common, uniform and consistent supervisory practices with regard to the application of the MAR and its implementing acts. 7

Of even greater practical importance are **guidelines** and **circulars** by national supervisory authorities (**NCAs**) on their administrative practices. In Germany, the Issuer Guidelines of BaFin provides information on the administrative practice regarding market abuse law in Module C (5th ed. 2020). The Guidelines are designed as a hands-on guide to dealing with the requirements of securities trading legislation, albeit without constituting a legal commentary.[15] BaFin also publishes FAQs on its website. In France, the AMF has provided a guide explaining its administrative practices on the concept of inside information and obligations for issuers under MAR.[16] In Italy, Consob, the Italian supervisory authority, has also published guidelines on its administrative practices.[17] 8

The Single Rulebook aims at preventing harmful regulatory and supervisory arbitrage in Europe and creating legal certainty. Competition between Member States for the 'best market abuse law' is no longer possible due to the fully harmonising nature of the prohibitions and disclosure requirements. The 'price' is a highly **complex regulatory issue**. It was illusory from the outset to achieve the objective laid down in recital 4 of the MAR of creating 'less complex rules', because a uniform legal situation for all EU Member States can only 9

[8] Cf. R. Veil, ZGR (2014), 544, 601 ff.

[9] Cf. R. Veil, in: Meyer and Veil et al. (eds.), *Handbuch zum Marktmissbrauchsrecht*, § 2 para. 14.

[10] Delegated Regulation with regard to an exemption for certain public authorities and central banks of third countries, the indicators of market manipulation, the thresholds for disclosure, the competent authority to which a deferral has to be notified, the permission to trade during a closed period and the types of proprietary transactions to be reported by managers, OJ EU No. L88 v. 5.4.2016, p. 1 ff.

[11] Delegated Regulation as regards regulatory technical standards on the technical modalities for the objective presentation of investment recommendations or other information recommending or suggesting investment strategy and for the disclosure of certain interests or indications of conflict of interest, OJ EU No. L160 v. 17.6.2016, p. 15 ff.

[12] Delegated Regulation on appropriate rules, systems and procedures for market participants disclosing information for the purpose of carrying out market testing, OJ EU No. L160 v. 17.6.2016, p. 29 ff.

[13] Implementing Regulation laying down implementing technical standards as regards technical means for making adequate public disclosure of inside information and for the postponement of the public disclosure of inside information pursuant to Regulation (EU) No. 596/2014 of the European Parliament and of the Council, OJ EU No. L173 v. 30.6.2016, p. 47 ff.

[14] ESMA, MAR Guidelines Deferral of Inside Information Disclosure, 20.10.2016, ESMA/2016/1478; MAR Guidelines Information on commodity derivatives markets or related spot markets with regard to the definition of inside information on commodity derivatives, 17.1.2017, ESMA/2016/1480.

[15] BaFin, Issuer Guidelines, Introduction. See on the legal nature R. Veil § 5 para. 54.

[16] AMF, Guide de l'information permanente et de la gestion de l'information privilégiée, 26 October 2016.

[17] Consob, Gestione delle informazioni privilegiate, October 2017.

be achieved by making the obligations and prohibitions more concrete and by developing standards for the relevant questions of interpretation.

2. CRIM-MAD

10 The European legislator also enacted a Directive on criminal sanctions for insider dealing and market manipulation (CRIM-MAD).[18] Until this time, none of the Level 1 directives had required Member States to adopt criminal provisions. The CRIM-MAD thus marks the start of a new era in Union law.

11 The criminal sanctions are intended to demonstrate 'social disapproval of a qualitatively different nature compared to administrative sanctions or compensation mechanisms under civil law'.[19] The introduction of criminal sanctions for the most serious contraventions remains within the jurisdiction of Member States. However, the CRIM-MAD uses the most important definitions from the provisions of the MAR. In this way, EU law is 'incorporated' into national criminal laws.

III. Level of Harmonisation

1. Minimum versus Maximum Harmonisation

12 The **CRIM-MAD** establishes only 'minimum rules' for criminal sanctions.[20] It is expressly established as a minimum harmonisation legal instrument, so that Member States are allowed to impose or retain more stringent criminal sanctions.

13 It is more difficult to assess which strategy is followed by the **MAR**, which does not expressly address the issue of minimum or full harmonisation. Only the fifth chapter about administrative measures and sanctions explicitly allows for other sanctions or higher fines to be introduced by Member States.[21] The first argument in support of a fully harmonising approach is that the prohibitions are governed by a Regulation. In addition, the European Commission brought forward the effectiveness of the MAD 2003 was undermined by 'numerous options and discretions'.[22] The recitals therefore explain that a uniform legal framework be established.[23] Finally, the aim of the MAR to avoid potential regulatory arbitrage[24] is best achieved through maximum harmonisation.

[18] The CRIM-MAD is based on Art. 83(2) TFEU, which is seen critically in literature. Cf. P. Hauck, 6 ZIS (2015), 336, 346 ('disputable endeavor').

[19] See Commission, Proposal for a Directive of the European Parliament and of the Council on criminal sanctions for insider dealing and market manipulation, Explanatory Memorandum, 20 October 2011, COM(2011) 654 final, p. 3.

[20] Cf. Art. 1(1) CRIM-MAD.

[21] Cf. Art. 30(1) MAR.

[22] Cf. COM(2011) 654 final (fn. 19), p. 3.

[23] Cf. Recital 4 ('uniform framework'), Recital 5 ('more uniform interpretation' and 'uniform conditions') MAR.

[24] Cf. Recital 4 MAR.

2. Evaluation

14 The fully harmonising approach is convincing. In the past, many Member States 'gold plated' the provisions of the MAD 2003. Some had also retained some of their 'old' law. For example, insider dealing in the United Kingdom was covered by five different legislative provisions.[25] The disparate legal landscape lead to legal uncertainty and resulted in unnecessary costs for legal advice. In this respect, the MAR is an improvement. The limits of harmonisation are exposed in the area of criminal law: pursuant to Article 83(2) TFEU, minimum requirements for the determination of criminal offences and sanctions may only be implemented in the form of directives.

IV. Scope of Application

15 The MAR regime applies to all issuers whose financial instruments are traded on a regulated market (RM), MTF or OTF.[26] It does not differentiate between small, medium and large issuers. However, it provides for some (few) facilitations for issuers whose securities are traded on a SME growth market.[27] The concept of financial instrument and the listing of financial instruments are key elements determining the scope of the market abuse regime.

16 The concept of a **financial instrument** is further defined in Art. 3(1) No. 1 MAR.[28] This provision refers to the concept of financial instruments under MiFID II. Thus, the MAR applies to shares, bonds, derivatives, etc.

17 The listing requirement is laid down in Art. 2 MAR. The MAR applies firstly to financial instruments **admitted to trading** on a **regulated market** (RM) or for which an application for admission to trading on a regulated market has been made.[29] The admission of securities is carried out by the stock exchange or the market operator. In addition, the MAR applies to financial instruments traded on a **multilateral trading facility** (MTF), admitted to trading on an MTF or for which an application to trade on an MTF has been made.[30] The background to this extension of Union law is that financial instruments are increasingly traded on MTFs.[31] The European legislator explains that the MAR is already applicable when an application for authorisation has been made by stating that certain types of MTFs, like regulated markets, are designed to help companies raise capital. The applicability of the MAR improves investor protection, preserves the integrity of the markets and ensures that market manipulation is prohibited.[32] Finally, the MAR applies to (iii) financial instruments traded in an **organised trading system** (OTF).[33] This extension of the MAR also stems from the fact that financial instruments were traded on other types of organised trading systems in the past.[34]

[25] See 2nd edition of this book, R. Veil § 14 para. 55.
[26] See R. Veil § 7 para. 11, 16, 19.
[27] See R. Veil § 7 para. 23.
[28] See on the term R. Veil § 8 para. 2.
[29] See Art. 2(1)(a) MAR.
[30] Cf. Art. 2(1)(b) MAR.
[31] Recital 8 sentence 2 MAR.
[32] Recital 8 sentences 5–7 MAR.
[33] Cf. Art. 2(1)(c) MAR.
[34] Recital 8 sentence 3 MAR.

18 According to Art. 2(3), the MAR applies to all transactions, orders and actions concerning one of the financial instruments mentioned in Art. 2(1) and (2) MAR, regardless of whether such a transaction, order or action was carried out on a trading venue. It follows that the **place of action is** irrelevant. The MAR covers not only transactions, orders and actions on a RM, MTF and OTF, but also, according to Art. 2(3) MAR, transactions, orders and actions that take place elsewhere (**face-to-face transaction**).[35] However, this only applies if the financial instrument is admitted to trade on a RM, MTF or OTF. The European legislator has seen a need to ensure market integrity in order to prevent negative effects on investor confidence on the trading venues.

19 The prohibitions and requirements of the MAR shall apply to acts and omissions within the Union and in third countries in respect of the instruments referred to in Art. 2(1) and (2) MAR.[36] The **territorial scope** is therefore not limited to the Member States of the EU, but extends worldwide to acts and omissions relating to financial instruments traded on a RM, MTF or OTF[37] or to other financial instruments.[38] The European legislator has thus implemented the **principle of impact**. It depends on whether market manipulation or insider trading has had an impact on a market in the EU. The broad territorial scope ensures that the MAR cannot be circumvented. If the act is committed in a third country, the law of that country may also apply. This becomes particularly relevant in the case of multiple listings. Whether an equivalent prohibition of market abuse exists abroad is irrelevant for the application of Art. 2(4) MAR.[39]

V. Presentation of Market Abuse Law in this Book

20 European market abuse law consists of the insider trading prohibitions and the rules on market manipulation. Both regimes are described in the following paragraphs of this chapter, including a description of the powers of the supervisory authorities and the sanctions in this regard. The disclosure obligations (obligation to make public inside information and directors' dealings) will be examined more closely in Chapter 4, as their aim is not only to prevent market abuse but also to balance out information asymmetries. This justifies presenting these obligations in the context of the other rules on disclosure. As a consequence, the closed periods for directors will also be described in the paragraph on Directors' Dealings. Finally, the MAR contains directly applicable provisions on investment recommendations. These are described in the Chapter on financial intermediaries. This way, the additional organisational requirements for financial analysts can also be taken into account.

[35] K. Hopt and C. Kumpan, in: Schimansky and Bunte et al. (eds.), *Bankrechts-Handbuch*, § 107 para. 31.
[36] Cf. Art. 4 MAR.
[37] Cf. Art. 2(1) lit. a)–c) MAR.
[38] Cf. Art. 2(1)(d), second subparagraph and (2) MAR.
[39] K. Hopt and C. Kumpan, in: Schimansky and Bunte et al. (eds.), *Bankrechts-Handbuch*, § 107 para. 32.

§ 14

Insider Dealing

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I. Introduction

In the **United States**, legislation on capital markets law, including aspects of market abuse, was already on the agenda in 1934, when the federal legislature enacted the Securities Exchange Act and the Securities and Exchange Commission laid down the SEC Rules. Both the US Supreme Court and lower courts extended the provisions—especially Rule 10b-5—thus developing a powerful regime, based on the notion that all insider dealings are disadvantageous for the market in the longer term.[1] In the 1960s and 1970s, however, debates flared up in the United States[2] and Europe[3] as to whether insider dealings might after all have a positive effect and ought therefore to be legalised. It was argued that an investor who concludes a securities transaction with an insider will generally not suffer any damage as the investor would in any case have carried out the transaction. It was furthermore claimed that insider dealings allow inside information to access the capital markets, thus ensuring an appropriate pricing of securities and market efficiency. Additionally, legalising insider dealings was assumed to solve conflicts arising between principals and agents. This theory was based on the understanding that the possibility of abusing inside information has to be seen as a form of manager remuneration.[4] Due to the fact that inside information is only produced when risks are taken, legalising insider dealings would encourage the managers' willingness to take such risks. 1

Yet these arguments purported by the critics of a regulation restricting insider dealings are not convincing. Whilst it is true that an investor concluding a security transaction will mostly not suffer any damage as he would also have concluded the same transaction with another person, market makers will react to a possible risk of losses with larger margins of sales and purchases. Thus, insiders cause higher transaction costs that must be carried by all market participants. Furthermore, an investor may well suffer a loss if he is induced to enter into a transaction as a result of insider trading (*induced selling*).[5] The second argument must also be rejected: it has been proven that an issuer's obligation to disclose information immediately[6] is more likely to ensure market efficiency than dealings on the basis of inside information.[7] The opinion that the legalisation of insider dealing would serve as an incentive for the management to take risks and thus be advantageous for the company 2

[1] Cf. S. Bainbridge, in: Bainbridge, *Research Handbook on Insider Trading*, 80 ff.; W. Wang and M. Steinberg, *Insider Trading*.
[2] Cf. H. Manne, *Insider Trading and the Stock Market*, 131 ff.
[3] Cf. K. Hopt and E. Wymeersch, *European Insider Dealing*.
[4] Cf. F. Easterbrook and D. Fischel, *The Economic Structure of Corporate Law*, 257 ff.
[5] Example: The share price is € 10. Due to insider trading, it rises to € 15. An investor sells his securities at this price. After the information becomes known, the price goes up to € 20.
[6] Cf. Art. 17 MAR. For more details on this obligation see R. Veil § 19 para. 24–71.
[7] Cf. K. Lahmann, *Insiderhandel*, 169.

and its shareholders can also not prevail. By using put options the management could easily gain financial advantages from negative information, thus not necessarily maximising company value. A further problem of legalised insider dealings is the fact that third parties would also be able to profit from inside information, resulting in the so-called 'free rider problem'.

3 Despite all these arguments various countries in the EU were sceptical towards regulations on insider dealings, some not introducing the first provisions until well into the 1980s. In Germany, the prevailing opinion was that voluntary rules were sufficient. The Federal Minister for Economics engaged an expert committee which published 'Recommendations on the Solution of the Insider Problem' in 1970. The report included guidelines on insider dealings, prohibiting members of the management board and supervisory board, major shareholders and employees of a stock corporation from dealing in shares and bonds of the corporation by using inside information.[8] This self-regulatory approach, however, did not prove successful.

4 The legal situation in Europe changed with the enactment of Directive 89/592/EEC of 13 November 1989 coordinating regulations on insider dealings.[9] The European legislature justified the introduction of a European directive with the fact that investor confidence was based mainly on the assurance that all investors are placed on an equal footing and are protected against the improper use of inside information. The smooth operation of markets depends to a large extent on the confidence it inspires in investors. By benefiting certain investors as opposed to others, insider dealing is likely to undermine that confidence and may therefore prejudice the smooth operation of the market.[10] In the mid-1990s insider dealings were thus prohibited in Europe.[11]

5 Only eleven years later the changes on the financial markets and in European Community law caused the European legislature to carry out fundamental reforms of the regime in order to be able to prevent insider dealings and market manipulations more effectively.[12] To this end the **Market Abuse Directive** (MAD)[13] was enacted, replacing the Insider Directive. The MAD's objective was to ensure the integrity of the Community's financial markets and to enhance investor confidence in those markets.[14] The directive conceived the prohibition of insider dealings as a prerequisite for achieving 'full and proper market transparency'.[15] The prohibition was thus justified by the necessity of organising markets and ensuring their proper functioning.[16] The underlying principle was that of informational equality of all investors,[17] whilst the aspect of managers breaching their duty of loyalty by taking

[8] For the last version of the recommendations see WM (1998), 1105. An analysis of the sanction for breaches of these obligations is made by G. Villeda, *Prävention und Repression im Insiderhandel*, 46 ff.

[9] See R. Veil § 1 para. 11.

[10] Recitals of Directive 89/592/EEC.

[11] Pursuant to Art. 14(1), the Insider Directive was to be transposed by 1 June 1992.

[12] A reason for the directive was also the aim of combating the financing of terrorist activities; cf. recital 14 MAD.

[13] See R. Veil § 1 para. 22.

[14] Cf. recital 12 MAD.

[15] Cf. recital 15 MAD.

[16] On this regulatory aim see R. Veil § 2 para. 7.

[17] Cf. L. Klöhn, ECFR (2010), 347, 354 ff.; N. Moloney, *EU Securities and Financial Markets Regulation*, 702; on the legitimacy of equal access in US capital market law cf. S. Bainbridge, in: Bainbridge, *Research Handbook on Insider Trading*, 80, 81 ff.

advantage of inside information, which plays an important role in the US discussion,[18] was not referred to by European capital markets law.

6 The next reform was initiated by the European Commission on 20 October 2011 when it made public two proposals regarding the market abuse regime.[19] The worldwide economic and financial crises made clear the importance of market integrity, and the CESR's study[20] and the *de Larosière* Report[21] underlined the fact that the legal situation in the Member States regarding criminal and administrative sanctions was disparate and hardly provided incentives to act lawfully.[22] The European Commission therefore regarded it as necessary to extend the rules on market abuse to other markets, to ensure that there are uniform rules in the EU in order to prevent supervisory arbitrage and to develop stricter rules on supervision and sanctions.

7 These proposals were implemented by the **Market Abuse Regulation** (MAR)[23] and the **Directive on Criminal Sanctions for Market Abuse** (CRIM-MAD).[24,25] Pursuant to Article 2(1)(b) and (c) MAR and Article 1(2)(a)–(c) CRIM-MAD, the rules on insider dealing also apply to financial instruments traded on multilateral trading facilities (MTFs) or organised trading facilities (OTFs).[26] Over-the-counter (OTC) trading has also been included in the scope of the new regime.[27]

8 The MAR further contains a number of provisions that have the aim to strengthen the powers of the national supervisory authorities (NCAs).[28] The unification and intensification of the sanctions are to increase the dissuasiveness of insider trading prohibitions in the future.[29] The MAR focuses on administrative measures and sanctions. In Chapter 5 it contains requirements for the Member States, obliging them to implement provisions on the imposition of administrative pecuniary sanctions into their national laws. The MAR's respective provisions are thus not to apply directly. According to the CRIM-MAD, the Member States are further to prohibit certain forms of behaviour by criminal law. Rules

[18] Cf. *Chiarella/US*, 445 US 222 (1980); F. Easterbrook and D. Fischel, *The Economic Structure of Corporate Law*, 269 ff.; H. Merkt, *US-amerikanisches Gesellschaftsrecht*, para. 1044; cf. on the misappropriation theory M. Snyder, 27 Capital Univ. L. Rev. (1999), 419–447.

[19] Commission, Proposal for a Regulation of the European Parliament and of the Council on Insider Dealing and Market Manipulation (Market Abuse), 20 October 2011, COM(2011) 651 final; Commission, Proposal for a Directive of the European Parliament and of the Council on Criminal Sanctions for Insider Dealing and Market Manipulation, 20 October 2011, COM(2011) 654 final.

[20] Cf. CESR, Report on administrative measures and sanctions as well as the criminal sanctions available in Member States under the market abuse directive (MAD), February 2008, CESR/08-099.

[21] Cf. The High-Level Group on Financial Supervision in the EU (de Larosière Group), Report, 25 February 2009 (de Larosière Report).

[22] Cf. recital 3 MAR and recital 3 and 4 CRIM-MAD.

[23] Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC.

[24] Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive)), OJ L 173 of 12 June 2014, p. 179 ff. (CRIM-MAD).

[25] See R. Veil § 13 para. 3 ff. for a detailed presentation of the sources of law and the conditions for the applicability of the provisions.

[26] See R. Veil § 7 para. 11 ff.

[27] Cf. Art. 2(3) MAR and Art. 1(5) CRIM-MAD.

[28] See in more detail below para. 96.

[29] Cf. recital 70 MAR: 'equal, strong and deterrent sanctions regimes'.

on criminal sanctions are assumed to demonstrate 'social disapproval of a qualitatively different nature compared to administrative sanctions or compensation mechanisms under civil law'.[30]

II. Regulatory Concepts

1. Overview of the Market Abuse Regime

9 The MAR and its corresponding Level 2 acts (the so-called single rulebook on market abuse)[31] contain **prohibitions** on **insider dealings** (Article 14 MAR). In addition, **issuers** are obliged to **disclose inside information** (Article 17 MAR). This duty also has the purpose of preventing insider trading: 'The public disclosure of inside information by an issuer is essential to avoid insider dealing and ensure that investors are not mislead.'[32] However, there are exceptions to the disclosure requirement because the publication of uncertain events can be detrimental to the issuer. These exceptions play a great role in practice.[33] The disclosure obligation can therefore only fulfil the purpose of combating insider trading to a limited extent.

10 The MAR provides **three types of prohibitions**. A person shall not (i) engage or attempt to engage in insider dealing, (ii) recommend that another person engage in insider dealing or induce another person to engage in insider dealing and (iii) unlawfully disclose inside information.[34] These rather abstract prohibitions are put into more concrete terms[35] thus providing legal certainty as to which kind of behaviour might be punished with severe sanctions. They apply to any person who possesses inside information, ie not only primary insiders,[36] but also to any person who knows or ought to know that they possess inside information.[37]

11 The prohibitions and the ad hoc disclosure obligation operate with the same concept of inside information.[38] Thus the notion of inside information is the core element of the insider trading regime. The MAR defines the term 'inside information' as 'information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments'.[39] This concept which is further specified in Article 7(2)–(4) MAR is also relevant for criminal sanctions under the CRIM-MAD.[40]

[30] Cf. Commission, Explanatory Memorandum, 20 October 2011, COM(2011) 654 final, p. 3–4.
[31] See R. Veil § 13 para. 5.
[32] Recital 49 MAR.
[33] See R. Veil § 19 para. 51.
[34] Cf. Art. 14 MAR.
[35] Cf. Art. 8 and 10 MAR and Art. 3 and 4 CRIM-MAD.
[36] Cf. Art. 8(4) subsec. 1 MAR.
[37] Cf. Art. 8(4) subsec. 2 MAR.
[38] See on the different regulatory aims of the disclosure obligation R. Veil § 19 para. 1–9.
[39] Art. 7(1) MAR.
[40] Cf. Art. 2(4) CRIM-MAD.

2. Accompanying Rules

The prohibition of insider dealings is accompanied by numerous other rules in the MAR, the Transparency Directive (TD) and the Markets in Financial Instruments Directive (MiFID II), such as the issuer's obligation to make public inside information without delay.[41] The European legislature's aim was to ensure that all investors gain access to price-sensitive information as soon as possible and to counteract the dangers of insider dealings. 12

Other disclosure obligations, such as the obligation to notify and make public directors' dealings[42] and the TD's provisions on the notification and publication of changes in major shareholdings[43] are also aimed at preventing the misuse of inside information. The MiFID's rules of conduct for investment firms also pursue the goal of preventing prohibited insider dealings, especially by demanding the introduction of compliance structures,[44] such as Chinese walls. 13

3. Insider Compliance

European insider trading law provides some scattered rules on organisational requirements for market operators and issuers. **Market operators** and **investment firms** operating a trading venue under MiFID II are required to establish and maintain effective arrangements, systems and procedures for the prevention and detection of insider dealing.[45] The organisational requirements are supplemented by an obligation to **report suspicions** (regarding potential violations of the prohibition of insider trading).[46] Market operators and investment firms are required to train their staff on the regulatory requirements of MAR.[47] Finally, the compliance requirements of MiFID II (compliance function with compliance officer; Chinese walls; watch list and restricted list; etc.) aim to ensure that investment firms comply with the rules of MAR when providing investment services.[48] 14

With regard to issuers, the obligation to keep insider lists should be mentioned above all.[49] If an issuer decides to postpone the publication of inside information, it shall ensure the confidentiality of such information.[50] There are no further specific rules for issuers on insider compliance in European market abuse law. However, the board of directors of the issuer has duties (towards the company) regarding the management of inside information. Finally, effective compliance may become relevant if a supervisory authority imposes a fine on an issuer for violating Art. 17 MAR (fine-reducing effect).[51] 15

[41] Cf. Art. 17(4) MAR.
[42] Cf. Art. 19(1) MAR; see in more detail R. Veil § 21 para. 2.
[43] Cf. Art. 9 TD; see R. Veil § 20 para. 20.
[44] See M. Wundenberg § 33 para. 20 ff.
[45] Cf. Art. 16(1) MAR.
[46] Art. 16(2) MAR.
[47] Cf. Art. 4(1) Commission Delegated Regulation (EU) No. 2016/957 of 9 March 2016 supplementing Regulation (EU) No. 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the appropriate arrangements, systems and procedures as well as notification templates to be used for preventing, detecting and reporting abusive practices or suspicious orders or transactions, OJ L 160, 17 June 2016.
[48] See M. Wundenberg § 33.
[49] Cf. Art. 18(1) MAR.
[50] Cf. Art. 17(4)(c) MAR.
[51] Cf. C. Voigt, *Konzernumsatzbezogene Verbandsgeldbußen im Marktmissbrauchsrecht*.

III. Regulatory Goals

16 European market abuse law is based on the idea that market abuse violates the integrity of financial markets and undermines public confidence in securities and derivatives.[52] This applies in particular to insider trading. European insider trading law aims to ensure **equal informational opportunities for investors** in order to strengthen their **confidence** in the proper functioning of **capital markets**.[53]

17 Recital 23 MAR explains this regulatory approach and purpose as follows: 'The essential characteristic of insider dealing consists in an **unfair advantage** being obtained from inside information to the **detriment of third parties** who are unaware of such information and, consequently, the **undermining** of the **integrity** of financial markets and **investor confidence**. Consequently, the prohibition against insider dealing should apply where a person who is in possession of inside information takes unfair advantage of the benefit gained from that information by entering into market transactions in accordance with that information by acquiring or disposing of, by attempting to acquire or dispose of, by cancelling or amending, or by attempting to cancel or amend, an order to acquire or dispose of, for his own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates.'

18 The characteristic of the prohibition of trading on the basis of inside information is that the insider has an information advantage (inside information) and he profits from this advantage to the detriment of a third party.[54] The rationale for a strict insider trading law is to be seen in the goal of ensuring the functions of securities markets.[55] Insider bans are necessary to protect investor and market confidence, though there are no empirical studies to support the assumption that investors leave the capital market or are deterred from investing due to a loss of confidence.[56] However, there is at least anecdotal evidence that professional as well as private investors consider it unfair if individual investors can exploit their information advantages.[57] Loss of confidence results in a decline in investment[58] and in the worst case investors leave capital markets. Investor confidence[59] ensured by insider trading prohibitions is therefore a prerequisite for liquid and well-functioning capital markets.[60]

[52] Recital 1 MAR.

[53] J. Hansen, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 8 para. B.8.42: 'the essence of insider dealing as that of being in an advantageous position by possessing information that is not available to the counterparty of the relevant transaction, that is, the parties are not on an equal footing.'; ibid B.8.67 'informational advantage and that advantage is defined by the concept of inside information.'

[54] ECJ of 23 December 2009 – Case C-45/08 (Spector), ECR I-12073 para. 48, NZG (2010), 107; J. Hansen, ECFR (2017), 367, 378.

[55] Cf. K. Hopt and M. Will, *Europäisches Insiderrecht*, 49 ff.; P. Mennicke, *Sanktionen gegen Insiderhandel*, 98 ff.

[56] Cf. P. Mennicke, *Sanktionen gegen Insiderhandel*, 102.

[57] The First Quotation Board of the Frankfurt Stock Exchange was closed in 2012 due to numerous cases of fraud and manipulation. In Japan and Frankfurt, insider trading led to a massive drop in turnover on the stock exchanges in 1991. Cf. P. Mennicke, *Sanktionen gegen Insiderhandel*, 103.

[58] Cf. A. Hienzsch, *Das deutsche Insiderhandelsverbot in der Rechtswirklichkeit*, 41, 184; P. Mennicke, *Sanktionen gegen Insiderhandel*, 99 ff.

[59] See R. Veil § 2 para. 11 f.

[60] Cf. G. Bachmann, *Das europäische Insiderhandelsverbot*, 20 f.; L. Klöhn, 177 ZHR (2013), 349, 372 f.

IV. Concept of Inside Information

1. Definition and Interpretation of Inside Information under the MAD 2003 Regime

The concept of inside information is the key element of various rules in capital markets law. It constitutes a **requirement** for all three **prohibitions** of insider dealings described in the MAR and CRIM-MAD and for the **ad hoc disclosure obligation**, also provided for by the MAR. Issuers of financial instruments are required to inform the public as soon as possible of inside information which directly concerns said issuer.[61] The concept of inside information also plays an important role regarding the rules on market manipulation.[62] 19

The definition of the term inside information was one of the most strongly disputed issues during the reform of market abuse law. The European Commission originally wanted to define an inside information following the British definition for the prohibition of insider dealings (so-called RINGA concept).[63] It was, however, not able to assert itself with this proposal. The Council and the European Parliament agreed that the MAR should contain the same definition as the MAD 2003 had, the reason behind this being that the ECJ had based its decision in the case *Daimler/Geltl* on exactly this definition and interpreted the term in a convincing manner. The European legislator approved the ECJ's approach to this case and saw no need to introduce a different concept on inside information. An understanding of the ECJ's interpretative principles under the old MAD 2003 regime is therefore essential for an analysis of the term inside information provided for in Article 7 MAR. 20

Facts (abridged):[64] In its meeting on 28 July 2005, the supervisory board of DaimlerChrysler AG decided at 9.50 a.m. that the CEO Schrempp should retire from the board as of 31 December 2005 and be replaced by board member Zetsche. A few minutes later DaimlerChrysler AG published an ad hoc notification with this information and its share price rose considerably. Schrempp had already discussed his retirement with the chairman of the supervisory board at length on 17 May 2005 and informed two other members of the supervisory board on 1 June 2005. DaimlerChrysler's communication manager and the executive secretary, who had been informed on 6 July 2005, had been working on the press release, an external statement and a letter to the employees since 10 July 2005. On 27 July 2005 the presiding committee of the supervisory board had decided to recommend a decision on the early retirement of Schrempp and his successor to the supervisory board the following day. Investors who had disposed of shares before the ad hoc information was published claimed a total of € 5,500,000 in damages from DaimlerChrysler AG for these events. 21

[61] Art. 17(1) MAR. See R. Veil § 19 para. 24.

[62] See R. Veil § 15 para. 18.

[63] Cf. Art. 6(1)(e) MAR-COM: 'information not falling within paragraphs (a), (b), (c) or (d) relating to one or more issuers of financial instruments or to one or more financial instruments, which is not generally available to the public, but which, if it were available to a reasonable investor, who regularly deals on the market and in the financial instrument or a related spot commodity contract concerned, would be regarded by that person as relevant when deciding the terms on which transactions in the financial instrument or a related spot commodity contract should be effected'. Cf. for a critical analysis H. Krause and M. Brellochs, 8 CMLJ (2013), 283, 295–299.

[64] Cf. OLG Stuttgart of 22.4.2009 – 20 Kap 1/08, ZIP (2009), 962 and BGH of 25.2.2008 – II ZB 9/07, ZIP (2008), 639.

22 In *Daimler/Geltl* the courts had to deal with the concept of inside information. The BGH first ruled that the intent or deliberation of a CEO to retire early from his position by mutual agreement with the supervisory board is price-sensitive information and could thus be subject to the provisions on inside information. Until the supervisory board has agreed to the retirement, the information will, however, only be classifiable as inside information if the board's consent is sufficiently probable. According to the BGH, such an overwhelming probability can be assumed if the chances of the supervisory board consenting are over 50%.[65] The Oberlandesgericht (OLG, higher regional court) Stuttgart, again presented with the case after the decision of the BGH,[66] ruled that the supervisory board's consent became sufficiently probable on 27 July 2005 when a committee of the supervisory board came to an unanimous agreement.[67] However, the plaintiffs appealed the decision and argued this interpretation did not comply with the regulatory aims of the MAD. The case was therefore submitted to the BGH a second time, the BGH now coming to a different conclusion and therefore presenting the question, whether in a multi-stage process an intermediate step can be classed as inside information, to the ECJ for a preliminary ruling.[68]

23 In **multi-stage processes**, such as capital increases or mergers, it is either possible to refer to the individual process—eg the process of fixing the stock's issue price in the case of a capital increase or fixing the share exchange ratio in merger cases—or to the process as a whole, ie the final result. The BGH reasoned that in a protracted set of facts, the individual steps that have taken place could also constitute 'precise information' in the sense of the MAD and Article 1(1) Directive 2003/124/EC.[69] A preliminary ruling was necessary as the two approaches (the intermediate step or the final event constitutes an inside information) do not necessarily come to the same results.[70]

24 The ECJ answered the question in the light of the aims of the MAD 2003:

> 'An interpretation of the terms 'set of circumstances' and 'event' which disregards the intermediate steps in a protracted process risks undermining the objectives [to protect the integrity of the European Union financial markets and to enhance investor confidence in those markets]. To rule out the possibility that information relating to such a step in a protracted process may be of a precise nature for the purposes of point 1 of Article 1 of Directive 2003/6 would remove the obligation, provided for in the first subparagraph of Article 6(1), to disclose that information, even if it were quite specific and even though the other elements making up inside information […] were also present. In such a situation, certain parties who possessed inside information could be in an advantageous position vis-à-vis other investors and be able to profit from that information, to the detriment of those who are unaware of it. The risk of such a situation occurring is all the greater given that it would be possible, in certain circumstances, to regard the outcome of a specific process as an intermediate step in another, larger process. Consequently, **information relating** to an **intermediate step** which is part of a protracted process may be **precise information**. It should be

[65] BGH ZIP of 25.2.2008 – II ZB 9/07, (2008), 639.
[66] The BGH reversed the OLG Stuttgart's decision and referred the case back to a different civil division of the court in Stuttgart.
[67] OLG Stuttgart of 22.4.2009 – 20 Kap 1/08, ZIP (2009), 962, 966 ff.
[68] BGH of 22.11.20210 – II ZB 7/09, ZIP (2011), 72.
[69] Ibid.
[70] Ibid, 72, 74.

> noted that this interpretation does not hold true only for those steps which have already come into existence or have already occurred, but also concerns […] steps which may reasonably be expected to come into existence or occur.'[71]

This interpretation is convincing. The wording of the resp. provisions permitted both interpretations. Particular note must therefore be taken of the regulatory aim. The prohibitions on insider dealings constituted the centrepiece of the MAD 2003 and it was the explicit aim of the European legislature to effectively prevent insider dealings.[72] The understanding of the concept of inside information must therefore also focus on this aim of ensuring that the prohibitions are as effective as possible.[73] This aim is most suitable attained if the individual steps are also regarded as possible inside information. It must then be determined from case to case whether an intermediate step—such as the decision to resign from the position of the chairman of the management, etc.—or the final event—such as the cancellation agreement as in the case *Daimler/Geltl*—is likely to have a significant effect on the prices of the financial instruments.[74] 25

The BGH further asked the ECJ to clarify how the requirement has to be interpreted that **'circumstances/events** which **may reasonably** be **expected** to **come into existence'** may be considered as inside information. There are two possible approaches to interpretation. The first is to require a predominant probability, ie over 50%, the second a high probability. 26

The ECJ opted for a broad interpretation of the terms 'may reasonably be expected': 27

> 'Article 1(1) of Directive 2003/124, in using the terms 'may reasonably be expected', cannot be interpreted as requiring that proof be made out of a high probability of the circumstances or events in question coming into existence or occurring. To restrict the scope of [the provision] in respect of future circumstances and events to such a degree of probability would undermine the objectives […] to protect the integrity of the European Union financial markets and to enhance investor confidence in those markets. In such a scenario, insiders would be able to derive undue benefit from certain information which, under such a restrictive interpretation, would be held not to be precise, to the detriment of others who are unaware of it. However, in order to ensure legal certainty for market participants, including issuers, […] precise information is not to be considered as including information concerning circumstances and events the occurrence of which is implausible. Otherwise, issuers could believe that they are obliged to disclose information which is not specific or is unlikely to influence the prices of their financial instruments. It follows that, in using the terms 'may reasonably be expected', Article 1(1) of Directive 2003/124 refers to **future circumstances** or **events** from which it appears, on the basis of an overall assessment of the factors existing at the relevant time, that there is a **realistic prospect** that they will **come into existence or occur**.'[75]

A further possibility is to determine the degree of probability by the effects the event will have on the issuer: events that are particularly likely to have a significant effect on the security price need only be of slight probability,[76] whilst a higher probability is required for events less likely to have a significant effect. This second approach is also called **probability/magnitude-formula**.[77] 28

[71] ECJ of 28 June 2012, Case C-19/11 (*Daimler/Geltl*), para. 35–38.
[72] See para. 5.
[73] On the *effet utile* as a method of interpretation in European law see R. Veil § 5 para. 45.
[74] Cf. L. Klöhn, NZG (2011), 166, 170.
[75] ECJ of 28 June 2012, Case C-19/11 (*Daimler/Geltl*), para. 46–49.
[76] Cf. BGH of 22.11.20210 – II ZB 7/09, ZIP (2011), 72, second question referred for a preliminary ruling.
[77] Cf. L. Klöhn, NZG (2011), 166, 168.

29 The Advocate General argued for the second approach:

> 'It follows that, where the potential of that information for affecting share prices is significant, it is sufficient that the occurrence of the future set of circumstances or event, albeit uncertain, be not impossible or improbable. In making that assessment, the extent of the consequences for the issuer will be of relevance inasmuch as that will form part of the information available *ex ante*, given that a reasonable investor will base his decisions on the anticipated impact of the information in the light of the totality of the related issuer's activity, the reliability of the information source and every other market variable which might, in the circumstances, affect the financial instrument in question or the related derivative financial instrument.'[78]

30 The ECJ, however, did not follow the Advocate General in this regard: 'The question whether the required probability of occurrence of a set of circumstances or an event may vary depending on the magnitude of their effect on the prices of the financial instruments concerned must be answered in the negative.'[79] This interpretation appears favourable, the Advocate General's approach causing legal uncertainty for investors and issuers.

31 With its decision, the ECJ has provided clarity in some respects. The '**realistic prospect**' required by the ECJ for future circumstances is to be understood in the sense of an overwhelming probability (of more than 50%).[80] According to the ruling, both occurred and future intermediate steps of a protracted process can qualify as inside information. In the case *Daimler/Geltl* inside information could thus already have existed on 17 May 2005.[81] Whether this was actually the case depends on the possible effect of the information (the intermediate step) on the prices of the financial instruments.

2. Implementation in the MAR

32 The MAR provides for **four types** of **inside information** in Article 7(1). The first category under **lit. a)** covers information that relates to an issuer or a financial instrument. This term is essential for the securities markets and is therefore explained in more detail in this section. The category regulated in **lit. b**) concerns information relating to commodity derivatives and the category specified in **lit. c)** information relating to emission certificates. For example, in the case of derivatives on pigs, the fact of epidemics may qualify as inside information. The same applies to derivatives on potatoes with regard to changes in subsidy policy.[82] The European legislature further wanted to tackle the practice known as front running, ie stockbrokers executing orders on a security for their own account while taking advantage of advance knowledge of pending orders from its customers. Therefore, **lit. d)** MAR provides that 'for persons charged with the execution of orders concerning financial instruments', inside information should also mean 'information conveyed by a client and relating to the client's pending orders in financial instruments, which is of a precise nature, relating

[78] Cf. Opinion of Advocate General Mengozzi, delivered on 21 March 2012, Case C-19/11, para. 106–107.
[79] ECJ of 28 June 2012, Case C-19/11 (*Daimler/Geltl*), para. 50.
[80] Cf. G. Bachmann, DB (2012), 2206, 2209; L. Klöhn, ZIP (2012), 1885, 1889, 1892; H. Krause and M. Brellochs, AG (2013), 309, 313; M. Ventoruzzo and C. Picciau, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 7 para. B.7.38.
[81] Cf. BGH of 23.4.2013 – II ZB 7/09, ZIP (2013), 1165, 1168.
[82] BaFin, Issuer Guideline, Module C, p. 23.

directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments, the price of related spot commodity contracts, or on the price of related derivative financial instruments. Not every order of a client has a significant effect on the price. Front running must, however, be assumed, if the large volume of the client's order gave rise to an incentive for the person executing the order to acquire or dispose of the respective financial instruments, for example.[83]

Article 7(1)(a) MAR provides the same definition of inside information as the MAD 2003. 33
The term is defined as 'information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.'[84] The requirement of a precise information is defined in Article 7(2) MAR. It must be taken into account that, according to Article 7(3) MAR, an intermediate step can also be considered as inside information, provided that it fulfils the criteria for inside information in itself. A further specification is made in Article 7(4) MAR with regard to the price relevance of an information.

The individual elements are examined in more detail below. In particular, the supervisory 34
practice in Europe is taken into account. **BaFin** has commented in detail on the interpretation of the concept of insider information in the issuer guide.[85] In France, **AMF** has provided information on its administrative practice in a guide.[86] **Consob** has also published guidelines on administrative practice in Italy.[87] These are legally non-binding interpretative guidelines. Nevertheless, they are of outstanding importance in practice for issuers.

(a) Information which has Not been Made Public

The information is considered to be non-public when the public at large could not have 35
this knowledge. Thus, gathering public information is legal. It provides an incentive to create value via analysis, which is vital for the proper functioning of capital markets. It is irrelevant how the public at large became aware of the information. When interpreting the term 'non-public', it must be taken into account that European insider law aims to ensure equal informational opportunities for investors. Therefore, information is only publicly known if all investors can take note of it.[88] This is to be affirmed if the publication is made through an electronic information dissemination system, which is prescribed by law for ad hoc announcements.[89] This system ensures a Europe-wide dissemination of information. Information in the local press, through social media, at a general meeting or at a press conference of the issuer is not sufficient.[90]

[83] Cf. BaFin, Issuer Guideline, Module C, p. 24.
[84] Cf. Art. 7(1) MAR.
[85] Cf. BaFin, Issuer Guideline, Module C, p. 9 ff.
[86] Cf. AMF, Guide de l'information permanente et de la gestion de l'information privilégiée, 26 October 2016.
[87] Cf. Consob, Gestione delle informazioni privilegiate, October 2017.
[88] M. Ventoruzzo and C. Picciau, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 7 para. B.7.54.
[89] See R. Veil § 19 para. 41–43
[90] BaFin, Issuer Guideline, Module C, p. 10; Consob, Gestione delle informazioni privilegiate, October 2017, 4.3.2.

(b) Information of a Precise Nature

36 The 'information of a precise nature' is specified in the same way as under the former MAD 2003 regime. 'Information shall be deemed to be of a precise nature if it indicates a set of circumstances which exists or which may reasonably be expected to come into existence, or an event which has occurred or which may reasonably be expected to occur, where it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of the financial instruments or the related derivative financial instrument, the related spot commodity contracts, or the auctioned products based on the emission allowances.'[91]

(aa) Circumstances and Events

37 First of all, it should be noted that circumstances or events that have occurred as well as future circumstances or events can constitute inside information. This regulation was already provided for in the MAD 2003. In addition, Article 7(2) sentence 2 MAR now stipulates, following the ECJ ruling in *Daimler/Geltl*, that 'in the case of a **protracted process** that is intended to bring about, or that results in, particular circumstances or a particular event, those future circumstances or that future event, and also the intermediate steps of that process which are connected with bringing about or resulting in those future circumstances or that future event, may be deemed to be precise information.' Consequently, the (future) final event does not preclude an intermediate step from being examined as a possible inside information.[92]

38 Example: The merger of two listed stock corporations is a process that takes place over a long period of time and involves numerous intermediate steps, such as the agreement of the boards of directors on an exchange ratio of the shares, the amount of an additional cash payment, agreements of the boards of directors on the closure of locations, the signing of the merger agreement, the approval of the merger agreement by the supervisory board and, finally, the approval of the general meetings of both companies and the entry of the resolutions in the commercial registers. Under insider trading law, firstly, the final event, ie the merger, could qualify as inside information. For these purposes, it must be examined whether the entry of the merger in the commercial register (a future event) can reasonably be expected. Secondly, however, each individual intermediate step may also constitute inside information. Thus, it must be examined whether the negotiations on the exchange ratio (an event that has occurred and constitutes an intermediate step) 'in itself fulfils the criteria for inside information' (cf. Article 7(3) MAR).

39 There is no legal definition of what is meant by an intermediate step. Recital 17 MAR gives the following **examples**: 'the state of contract negotiations, terms provisionally agreed in contract negotiations, the possibility of the placement of financial instruments, conditions under which financial instruments will be marketed, provisional terms for the placement of financial instruments, or the consideration of the inclusion of a financial instrument in a major index or the deletion of a financial instrument from such an index.' Of course, these are not exhaustive examples. Strictly speaking, every event arises through numerous intermediate steps. This is also recognised by the BGH, which understands an intermediate step

[91] Cf. Art. 7(2) sentence 1 MAR.
[92] Cf. M. Kiesewetter and M. Parmentier, BB (2013), 2371, 2373; K. Langenbucher, NZG (2013), 1401, 1404.

as '**each individual event** on the **way** to an **intended event**'.[93] In addition, each individual intermediate step is initially a future one until it occurs and is followed by a further, future intermediate step that occurs until the final event has finally occurred. The ECJ explicitly recognised this in the *Daimler/Geltl* case[94] and the legislator has adopted this interpretation with the provision in Article 7(2) sentence 2 and (3) MAR.[95]

Circumstances can above all be defined as **facts**, ie past or present external procedures or situations that can be proven.[96] Whether knowledge of internal plans and intentions of a person can also be classed as inside information was discussed controversially at length in Germany, being of relevance especially for so-called cases of scalping.[97] The BGH ruled that the intention to later sell the recommended securities could not be classed as inside information.[98] The concept of information imperatively requires a connection to a third party. A person cannot therefore be regarded as informed about his own intentions.[99] Under MAR, scalping is still to be understood as market manipulation. However, it follows from Article 9(5) MAR that, in principle, internal facts, such as the decision to buy or sell securities, can also constitute inside information. This becomes particularly relevant in stakebuilding. The decision of an investor to acquire further shares can be inside information.[100] 40

Circumstances which may **reasonably be expected** to come into **existence**, might constitute inside information. This is the case, with the words of the ECJ, when 'it appears, on the basis of an overall assessment of the factors existing at the relevant time, that there is a realistic prospect that they will come into existence or occur.'[101] Where inside information concerns a process which occurs in stages, each stage of the process as well as the overall process could constitute inside information.[102] This is now explicitly clarified in the MAR: 'In the case of a protracted process that is intended to bring about, or that results in, particular circumstances or a particular event, those future circumstances or that future event, and also the **intermediate steps** of that process which are connected with bringing about or resulting in those future circumstances or that future event, may be deemed to be precise information'.[103] 41

The ECJ rejected the *probability/magnitude*-formula arguing it would lead to legal uncertainty. This is also the understanding of the European legislator. It follows from Recital 16 of the MAR, that the notion of inside information should not be interpreted as meaning that the magnitude of the effect of that set of circumstances or that event on the prices of the financial instruments concerned must be taken into consideration.[104] The European 42

[93] BGH of 23.4.2013 – II ZB 7/09, ZIP 2013, 1165.
[94] ECJ of 28 June 2012, Case C-19/11 (*Daimler/Geltl*), para. 15.
[95] H. Krause, in: Meyer et al. (eds.), *Handbuch Marktmissbrauchsrecht*, § 6 para. 71.
[96] Cf. H. Krause, in: Meyer et al. (eds.), *Handbuch Marktmissbrauchsrecht*, § 6 para. 31 f.
[97] See R. Veil § 15 para. 50.
[98] On *scalping* as a form of market manipulation see R. Veil § 15 para. 52.
[99] BGH of 6.11.2003 – 1 Str 24/04, BGHSt 48, 373.
[100] See on legitimate behaviours para. 74.
[101] See above para. 27.
[102] Cf. recital 16 MAR.
[103] Cf. Art. 7(2) sentence 2 MAR.
[104] However, the magnitude of the effect may be taken into account when determining the price relevance. See below para. 58.

legislator made clear that 'an intermediate step in a protracted process shall be deemed to be inside information if, by itself, it satisfies the criteria of inside information'.[105]

43 In the example (see para. 38), a probability of occurrence of at least 50% is to be used as a basis when examining whether the entry of the merger in the commercial register can reasonably be expected. The probability of occurrence cannot be determined with mathematical accuracy. In order to assess it, all known circumstances and information must be taken into account.[106] For the assessment of the probability, it must be considered, for example, how far the merger process has already progressed, ie whether the contract has already been concluded. BaFin also takes into account how the company has proceeded in similar cases.[107]

44 Value judgements, forecasts and recommendations can in any case be inside information if they have a factual element.[108] In addition, the judgement, forecast or recommendation must be specific enough to allow a conclusion to be drawn about the security price. It is conceivable that the factual element itself also qualifies as inside information.

(bb) Specific

45 A circumstance is precise if it is specific enough to allow a conclusion to be drawn about the possible effect of the circumstance on the price of the security. Strictly speaking, this requirement is superfluous because it is already covered by the requirement of price relevance. A reasonable investor does not buy or sell on the basis of non-specific information.[109] In practice, the requirement plays a role above all in the assessment of information that is ambiguous. Only vague or general information does not, according to the administrative practice of the supervisory authorities, allow a conclusion to be drawn regarding its possible impact on the price of the financial instruments in question.[110]

46 *Facts (abridged)*:[111] While working as an auditor, Mohammed obtained knowledge of the fact that an industrial enterprise which was being audited by his auditing company was planning to sell the electronics sector of the company. When this information was later disclosed, the shares prices rose about 19%. Mohammed, who had bought shares on the ground of this information, justified himself with the fact that before the notification of the sale rumours of this had already existed on the market and the information had therefore no longer been inside information. The Tribunal did not share this point of view, arguing that one must distinguish between information that has been made public and is sufficiently precise and information that exists only as a rumour.[112] Furthermore, the progression of the share prices after the disclosure of the information indicated that the rumours had not yet influenced the share prices and could therefore not be regarded as publicly available. The Tribunal did not support Mohammed in the point that the decision to sell

105 Cf. Art. 7(3) MAR.
106 BaFin, Issuer Guideline, Module C, p. 10.
107 BaFin, Issuer Guideline, Module C, p. 10.
108 H. Krause, in: Meyer et al. (eds.), *Handbuch Marktmissbrauchsrecht*, § 6 para. 35.
109 See R. Veil § 6 para. 31.
110 BaFin, Issuer Guideline, Module C, p. 10.
111 *Arif Mohammed/Financial Services Authority* (2005), The Financial Services Markets Tribunal, para. 12. This is the first decision of the Tribunal regarding sec. 118 FSMA, which was, however, still based on the old insider rules which applied the 'relevant information not generally available test' now contained—as described above—in sec. 118(4) FSMA as a catch-all clause.
112 Cf. *James Parker/Financial Services Authority* (2006), The Financial Services Markets Tribunal, para. 37.

had not been specific and precise information, as he had not had any information on the modalities of the sale.[113] The Tribunal regarded an information as sufficiently precise once the insider has more or less certain knowledge of the future sale of the sector, independent of the fact whether the details of the transaction were known to him.

The former CESR stated in its Guidelines that it did not regard rumours to be sufficient to constitute inside information: 'CESR considers that in determining whether a set of circumstances exists or an event has occurred, a key issue is whether there is firm and objective evidence for this as opposed to rumours or speculation.'[114] This interpretation is still valid under the current market abuse regime (cf. Article 17(7) MAR). A **rumour** is characterised by the fact that the truth of the information is uncertain. The subject matter can be an event that has occurred, but it can also refer to a future event. If the rumour is based on a factual element, a rumour can be inside information. If the rumour is based on an event that has occurred, the reliability of the information is important; if it refers to a future event, the probability of occurrence of this factual element is decisive.[115] 47

The **Lafonta** case concerned **information** for which it had been **impossible** to **predict** whether it would have a **positive** or **negative effect** on the price of the shares. The ECJ held: 'in order for information to be regarded as being of a precise nature for the purposes of those provisions, it need not be possible to infer from that information, with a sufficient degree of probability, that, once it is made public, its potential effect on the prices of the financial instruments concerned will be in a particular direction.'[116] 48

The ECJ first justified this interpretation with the broad **wording** and then referred to the **systematic structure** of the **MAD 2003** regime. Lafonta argued 'that information is precise, for the purposes of that provision, only if it allows the person in possession of that information to anticipate how the price of the security concerned will change when that information is made public. He argued that only information that enables the person in possession of it to predict whether the price of the security concerned is going to increase or decrease allows that person to know whether he should buy or sell and, accordingly, grants him an advantage as compared with all the other actors on the market, who are unaware of that information.' The ECJ was not convinced by this interpretation. According to the court, the respective provision of the MAD 2003-regime 'does not require that the information make it possible to determine the direction of change in the prices of the financial instruments concerned. A particular item of information can be used by a reasonable investor as one of the grounds for his investment decision […], even though it does not make it possible to determine the movement in a given direction of the prices of the financial instruments concerned' (para. 34). Finally, the ECJ argued with the purpose of insider trading law: „As regards the purpose of Directive 2003/6, it should be observed that […] to confine the scope of point (1) of Article 1 of Directive 2003/6 and Article 1(1) of Directive 2003/124 solely to information which makes it possible to anticipate the direction of a change in the prices of those instruments risks undermining the objectives [the MAD 2003]. The increased complexity of the financial markets makes it particularly difficult to evaluate accurately the direction of a change in the prices of those instruments […]. In those circumstances—which can lead to widely differing assessments, 49

[113] Para. 73 ff. of the judgment.
[114] CESR, Level 3—second set of CESR guidance and information on the common operation of the Directive to the market, July 2007, CESR/06-562b, No. 1.15.
[115] H. Krause, in: Meyer et al. (eds.), *Handbuch Marktmissbrauchsrecht*, § 6 para. 55.
[116] ECJ of 11 March 2015, Case C-628/13 (*Lafonta*), para. 38, ZIP (2015), 627.

depending on the investor—if it were accepted that information is to be regarded as precise only if it makes it possible to anticipate the direction of a change in the prices of the instruments concerned, it would follow that the holder of that information could use an uncertainty in that regard as a pretext for refraining from making certain information public and thus profit from that information to the detriment of the other actors on the market' (para. 35 and 36).

(cc) Reference to an Issuer or to Financial Instruments

50 The concept of inside information further requires that the information relates either to the *issuer* of a financial instrument or to a *financial instrument* itself. This requirement has no independent significance because information that does not relate to the issuer or financial instrument cannot be price-sensitive.

51 Most circumstances relevant for price developments, such as profit drops, the discovery of a new oilfield or the resignation of the management board's chairman, refer to the issuer. As opposed to this, the case *Georgakis* dealt with information relating to an issuer's financial instruments.[117]

Facts (abridged):[118] Georgakis and members of his family were major shareholders of Parnassos and Atemke, two stock corporations whose shares were admitted to trading on the Greek stock market. On recommendation of their financial consultant, Georgakis and further members of the family decided to support Parnassos' shares price when a decline in prices became apparent, by buying, selling and buying back Parnassos and Atemke shares amongst each other. The ECJ ruled that the decision of the members of the Georgakis group concerning the support of Parnassos shares established a common position within the group regarding the transactions to be effected between its members, with the aim of causing an artificial increase in the price of Parnassos' transferable securities. For those who participated in its adoption, knowledge of the existence of such a decision and of its content constitutes inside information, being information of a precise nature which has not been made public and relates to transferable securities.[119] Whilst the ECJ's decision was still based on the former Insider Directive, the Court's considerations can be applied analogously to the interpretation of the notion of inside information as defined in the former MAD[120] and in the existing MAR.

52 The MAR's definition of inside information also encompasses information which relates indirectly to issuers or financial instruments.[121] However, such information is not subject to the disclosure obligation under Article 17(1) MAR. Information diretly concerning the issuer is also descried as corporate information, in contrast to market information.[122] The former CESR had compiled a list of examples of such information, which includes inter alia future publications of rating agencies' reports and antitrust authority's decisions concerning a listed company.[123]

[117] The term financial instrument is defined in Art. 3(1)(1) MAR by referring to Art. 4(1)(15) MiFID II; see on the term 'financial instrument' R. Veil § 13 para. 16.

[118] Cf. ECJ of 10 May 2007, Case C-391/04 (*Georgakis*) [2007] ECR I-3741.

[119] Cf. ECJ of 10 May 2007, Case C-391/04 [2007] ECR I-3741, para. 33.

[120] Cf. D. Moalem and J. Hansen, 19(5) EBLR (2008), 949, 957 ff.

[121] The issuer is only required to disclose inside information that concerns the issuer directly. See R. Veil § 19 para. 32.

[122] Cf. C. Di Noia and M. Gargantini, 4 ECFR (2012), 484, 493; M. Ventoruzzo and C. Picciau, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 7 para. B.7.58.

[123] CESR/06-562b (fn. 114).

(c) Price Relevance

53 Article 7(4) MAR states that 'information which, if it were made public, would be likely to have a significant effect on the prices of financial instruments, derivative financial instruments, related spot commodity contracts, or auctioned products based on emission allowances shall mean **information** a **reasonable investor would be likely to use** as **part** of the basis of his or her **investment decisions**.' Recital 14 MAR sets out the principles according to which a reasonable investor makes his decisions: 'Reasonable investors base their investment decisions on information already available to them, that is to say, on ex ante available information. Therefore, the question whether, in making an investment decision, a reasonable investor would be likely to take into account a particular piece of information should be appraised on the basis of the ex ante available information.' Furthermore, recital 14, in line with the interpretative principles of the ECJ in *Daimler/Geltl*,[124] states that 'such an assessment has to take into consideration the anticipated impact of the information in light of the totality of the related issuer's activity, the reliability of the source of information and any other market variables likely to affect the financial instruments […] in the given circumstances.'

54 Practice and academia debate above all whether the reasonable investor should be determined on the basis of characteristics (knowledge of the capital market, critical ability, investment motives, professionalism) or whether he should be understood as a collective, namely as a personification of the market.[125] The courts tend to determine a 'prototype investor'.[126] The BGH ruled on securities prospectus law that a reasonable investor is an attentive reader of a prospectus who understands a balance sheet but does not have above-average expertise.[127] He knows the conditions and practices of capital markets; however, he is not necessarily familiar with all the details of the relevant regimes, such as accounting law.[128] The XI Senate of the BGH followed up on these interpretations and held in the IKB case that a reasonable investor has to **take into account irrational reactions** of **other market participants**, such as herd behaviour.[129]

55 *Example*: The OLG Düsseldorf[130] had to determine whether the IKB-Bank had been affected by the subprime mortgage crisis in the United States due to its investment history. The OLG Düsseldorf classed the information on subprime-based instruments held by the IKB-Bank and its special-purpose entities as a specific information. It ruled, however, that the information was not able to influence significantly the IKB-Bank's share price on 27 July 2007. According to the predominant understanding at the time, subprime-based instruments in the company's portfolio were not particularly significant for investment decisions, the ratings received by rating agencies being deemed far more relevant in determining credit risks.[131] The BGH came to a different conclusion, arguing that the potential of inside information to influence the share price must be determined by way of

[124] ECJ of 28 June 2012, Case C-19/11 (*Daimler/Geltl*), para. 55.

[125] Cf. M. Ventoruzzo and C. Picciau, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 7 para. B.7.66 ff.; C. Kumpan and R. Misterek, 184(2) ZHR (2020), 180 ff.

[126] Expression used by C. Kumpan and R. Misterek, 184(2) ZHR (2020), 180, 204.

[127] Cf. BGH of 12 July 1982 – II ZR 175/81, NJW (1982), 2823, 2824.

[128] See R. Veil § 17 para. 34.

[129] BGH of 13 December 2011 – XI ZR 51/10 (IKB), BGHZ 192, 90, 107 f. para. 44; dissenting opionion: L. Klöhn, AG (2012), 345, 349; id., 177 ZHR (2013), 349, 380 ff.

[130] OLG Düsseldorf of 4.3.2010 – I-6 U 94/09, 6 U 94/09, AG (2011), 31, 34.

[131] Ibid., 31, 35.

an ex ante prognosis.[132] The court determined that the subprimes were downgraded by the rating agencies in the middle of July 2007 and there were rumours according to which IKB was subject to a considerable risk due to its involvement with the US subprime market. Due to the fact that at the same time the share price of IKB had decreased considerably, a reasonable investor who is required to also take into account the irrational reactions of other market participants, would have associated a considerable influence on the share price on the highly sensitive market from the middle of July 2007 onwards, taking into account the subprime share of 38.5% IKB held in its own investments and the 90% subprime share in its special purpose vehicles.[133]

56 The concept of inside information should be interpreted with regard to the purpose of insider trading law. A reasonable investor acts behaves in rational way[134] on the basis of **fundamental value-related information**[135] and does not base his decision on irrational market reactions even if these are likely to be profitable.[136] The literature discusses whether a reasonable investor acts on the basis of ecologically sustainable information.[137] This interpretation is not convincing. Ecological aspects do not play a role for the reasonable investor unless they affect the fundamental value of the security, which can be the case with sustainability risks, for example.

57 BaFin refers to the fact whether the respective information will encourage an investor to acquire or dispose of shares and whether this appears profitable to a reasonable investor. A transaction is already profitable if the expected return minus transaction costs exceeds the opportunity costs, ie the return that an investment in financial instruments with comparable risk would achieve.[138] In a first step BaFin examines, from an ex ante point of view, whether the event itself could potentially be price sensitive in a significant way according to general experience.[139] This must be assumed, for example, for an important cooperation, the acquisition or disposal of major holdings and if the issuer has liquidity problems. In a second step the BaFin takes into account the existing or foreseeable specific aspects of the case at hand that may reduce or increase price sensitivity, paying special attention to the question whether the respective information was already known and taken into consideration on the capital market. Investors will, for example, often already have taken the issuer's results into account for their investment or divestment. The information in question may already have been assessed by market participants. For example, investors have often already taken the issuer's business performance into account in their investments and disinvestments. However, if the information is already reflected in the price of the security, it may not be likely to have a significant impact on the price of the financial instruments. Finally, the impact of information must also be measured in terms of the issuer's overall business, the reliability of the information source and other market variables. In particular, the volatility of the market, especially of comparable financial instruments (from issuers in the same industry), must be taken into account. The effects of information must also be considered in the light of the issuer's overall activity, the reliability of the information's source and other market variables,

[132] BGH of 13.12.2011 – XI ZR 51/10, BGHZ 192, 90, 106 para. 41.

[133] Ibid., 90, 107 ff. para. 44.

[134] M. Ventoruzzo and C. Picciau, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 7 para. B.7.67.

[135] L. Klöhn, 177 ZHR (2013), 349, 366 ff.; M. Ventoruzzo and C. Picciau, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 7 para. B.7.67; C. Kumpan and R. Misterek, 184(2) ZHR (2020), 180, 203 ff.

[136] Cf. also M. Sustmann, in: Kämmerer and Veil (eds.), *Übernahme- und Kapitalmarktrecht in der Reformdiskussion*, 230, 251: 'rational and non-speculative acting person'.

[137] The question is being raised by P. Mülbert and A. Sajnovits, ECFR (2021), 256, 287 f.

[138] Cf. BaFin, Issuer Guideline, Module C, p. 12.

[139] Cf. also OLG Düsseldorf of 4.3.2010 – I-6 U 94/09, 6 U 94/09, AG (2011), 31, 34.

such as the volatility of the market, especially with regard to comparable financial instruments of other issuers in the same industry.

58 According to the wording of Article 7 MAR, the reasonable investor is 'likely' to use the information as part of the basis of his investment decision. This means on the one hand that the mere possibility is not sufficient; and on the other hand that a degree of probability close to certainty is not required.[140] Theoretically, it is irrelevant for the price relevance whether an inside information actually has an effect on the price. Nevertheless, this aspect plays a major role in practice. The supervisory authorities attach indicative importance to an actual change in the share price after the inside information has become known.[141] According to Recital 15 MAR, **ex post information** can be used to check the presumption that the ex ante information was price sensitive, but should not be used to take action against persons who drew reasonable conclusions from ex ante information available to them.

59 In the case of intermediate steps, the price relevance shall be determined with regard to the principles of interpretation set out in the third sentence of Recital 14. Consequently, the potential to influence the price is to be determined with regard to, among other criteria, the relevance of the final event for the security price.[142] Intermediate steps may therefore be price-relevant (and constitute inside information) even if the final event is not predominantly likely, provided the final event has a particularly high impact on the issuer and thus on the share price.

60 In the example of the merger of two listed stock corporations (see para. 38), when examining whether the negotiations on the exchange ratio of the shares (an event that has occurred, which is precise and therefore constitutes an intermediate step) 'in itself fulfils the criteria for inside information' (cf. Article 7(3) MAR), it may have to be taken into account that the merger is likely to have tremendous synergy effects and therefore will have a particularly strong impact on the stock exchange price. Even if at the time of the occurrence of the intermediate step (agreement on the exchange ratio) the final event (entry of the merger in the commercial register) is not yet predominantly probable, the intermediate step may already be relevant to the share price because of the enormous impact of the final event.

61 BaFin distinguishes between intermediate steps that derive their quality as inside information from themselves and those intermediate steps that derive their price relevance from the future final event.[143] In the latter case, BaFin assumes that the more significant and probable the final event is, the more likely it is that the price will be influenced and that an overall consideration of the past and future circumstances, taking into account the respective market situation, suggests that a reasonable investor would already use this intermediate step for his own benefit.[144]

62 Ultimately, it will be a question of each individual case whether certain information may have a significant effect on the prices of financial instruments. There is currently no uniform European understanding in this regard with ESMA not yet having published any guidelines

[140] Consob, Gestione delle informazioni privilegiate, October 2017, 4.3.5.
[141] BaFin, Issuer Guideline, Module C, p. 12.
[142] Highly controversial; in line with the author L. Klöhn, ZIP (2012), 1885, 1891; A. Schall, ZIP (2012), 1286, 1288; A. Bingel, AG (2012), 685, 690 ff.; dissenting opinion: H. Krause and M. Brellochs, AG (2013), 309, 314.
[143] Cf. BaFin, Issuer Guideline, Module C, p. 13 f.; J. Vetter et al., AG (2019), 160, 164 ff.
[144] Cf. BaFin, Issuer Guideline, Module C, p.14.

on this topic.[145] It is thus only possible to present the approaches taken by individual supervisory authorities.

63 Some national supervisory authorities have published their administrative practice.[146] BaFin and Consob provide the most detailed information on how they assess the price relevance of forecasts, business figures, dividends, capital measures, significant extraordinary income or expenses, mergers & acquisitions, personnel decisions and insolvencies.[147] Furthermore, they explain numerous examples where there is usually a considerable potential to influence the share price.

64 The BaFin's interpretative notes on financial figures are particularly detailed. BaFin determines price relevance according to whether the information in question deviates materially from the relevant benchmark.[148] In the important case that the issuer in its forecast has indicated a corridor, a significant potential to influence the share price shall as a rule be affirmed if the business figures are outside the corridor. For business figures that lie within the corridor, the following principle applies: the narrower the corridor is defined, the more likely it is that there is no potential to significantly influence the share price. Conversely, this also means that the business figures can have a significant potential to influence the share price if the forecast corridor is very wide and the results are close to the upper or lower edge of the corridor. If, on the other hand, the issuer has only stated a minimum expectation in its forecast, this does not exclude the potential to influence the share price simply because the upper forecast range was formulated in an open manner. In such a case, the issuer has to determine how the forecast statement has been perceived in the market.[149]

V. Prohibitions

1. Overview

65 The MAR 'establishes a common regulatory framework on insider dealing [and] the unlawful disclosure of inside information […] to enhance investor protection and confidence in

[145] However, the former CESR had established guidelines how NCAs should determine the price relevance. It argued that the potential influence on the price of financial instruments should be determined ex ante. The CESR also commented on the difficult question of the degree of probability required for a significant price effect to be expected. Whilst the mere possibility that a piece of information will have a significant price effect is not enough to trigger a disclosure obligation, a degree of probability close to certainty could also not be required. Quantitative criteria alone, such as specific thresholds (2 or 5%), were not a suitable means for determining the significance of price movement, due to the fact that the volatility of 'blue-chip' securities of larger companies is typically less than that of smaller, less liquid stocks. The CESR named three criteria that should be taken into consideration when determining whether a significant effect is likely to occur: (i) whether the type of information is the same as information which has, in the past, had a significant effect on prices; (ii) whether pre-existing analyst research reports and opinions indicate that the type of information in question is price sensitive; and (iii) whether the company itself has ever treated similar events as inside information. Cf. CESR/06-562b (fn. 114), No. 1.12–1.14.

[146] Cf. AMF, Guide de l'information permanente et de la gestion de l'information privilégiée, 26 October 2016, 18 f. (*avertissement sur résultats*).

[147] Cf. BaFin, Issuer Guideline, Module C, p. 15 ff.; Consob, Gestione delle informazioni privilegiate, October 2017, 4.6.7.

[148] Cf. BaFin, Issuer Guideline, Module C, p. 16; equally Consob, Gestione delle informazioni privilegiate, October 2017, 4.6.7.5.

[149] Cf. BaFin, Issuer Guideline, Module C, p. 16 with numerous further interpretative notes on the assessment of financial figures under insider law.

those markets' (Art. 1 MAR). To that end, it prohibits insider dealing and the unlawful disclosure of inside information.[150] The prohibitions are further defined in Article 8 (insider dealing) and Article 10 (unlawful disclosure of inside information) MAR. The prohibitions correspond nearly entirely with the requirements the MAD 2003 laid down. It is therefore justified to refer to the interpretational principles developed by the ECJ with regard to the prohibitions in the former MAD, unless the specific provisions on legitimate behaviour (Article 9 MAR) and market soundings (Article 11 MAR) require otherwise.

2. Prohibition of the Acquisition or Disposal of Financial Instruments

(a) Foundations

A person may not engage or attempt to engage in insider dealing.[151] Insider dealing occurs, when a **person possesses inside information** and **uses** that **information** by directly or indirectly **acquiring** or **disposing of financial instruments** to which that information relates, for its own account or for the account of a third party.[152] The MAR has widened the scope of this prohibition, the use of inside information by cancelling or amending an order concerning a financial instrument to which the information relates and the order was placed before the person concerned possessed the inside information, also being considered an insider dealing.[153] If the insider trading is committed by a legal person, the prohibition applies 'to the natural persons who participate in the decision to carry out the acquisition, disposal, cancellation or amendment of an order for the account of the legal person concerned.'[154] 66

This prohibition is to ensure the integrity of the financial markets and enhance investor confidence, at the same time ensuring more equality between contracting parties in market transactions.[155] In the abovementioned case *Georgakis*[156] all contracting parties of the transactions had access to the same information and no one had been able to benefit from having more information than the others. The ECJ therefore correctly ruled that Georgakis and the members of his family had not breached the rules prohibiting the use of inside information by acquiring or disposing of financial instruments.[157] 67

(b) Acquisition and Disposal of Financial Instruments

The prohibition requires an **acquisition** or **disposal of financial instruments**.[158] An acquisition or a sale already takes place with the validly concluded legal transaction under the law 68

[150] Art. 14 MAR.
[151] Cf. Art. 14(a) MAR.
[152] Art. 8(1) MAR.
[153] Cf. Art. 8(1) sentence 2 MAR.
[154] Art. 8(5) MAR.
[155] Cf. ECJ of 10 May 2007, Case C-391/04 [2007] ECR I-3741 on Art. 2 of the former Insider Directive 89/592/EEC; J. Hansen, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 8 para. B.8.47 and B.8.50.
[156] See above para. 51.
[157] The aim was to fix artificially and simultaneously the prices of certain securities. This constitutes a type of market manipulation as prohibited by the MAR. See R. Veil § 15 para. 32 ff.
[158] Insider dealing must relate to financial instruments. The term is not defined in MAR. Rather, Art. 3(1) No. 1 MAR refers to Art. 4(1) No. 15 of Directive 2014/65/EU (MiFID II). This provision refers with regard to the term financial instrument to the instruments listed in Annex I Section C MiFID II, which in turn are partly defined in Art. 4(1) No. 17, No. 44, No. 45, No. 46, No. 47, No. 48, No. 49 and No. 50 MiFID II, partly by reference to Regulation (EU) No. 600/2014 (MiFIR).

of obligations.[159] This interpretation is required by the meaning and purpose of the norm, because an insider already engages in harmful arbitrage through the transaction under the law of obligations, ie obtains an unjustified advantage.[160] The typical case of an acquisition or sale is the purchase contract. Furthermore, an acquisition based on a donation may also be covered by the prohibition.[161] Furthermore, insider trading requires that a person **directly** or **indirectly acquires** or **sells** financial instruments for **his own account** or for the **account of a third party**. The offence is broadly defined in order to avoid any circumvention of the law. It covers the case that the insider himself is a party to the contract and concludes the transaction for his own account or for the account of a third party (eg as a commission agent), as well as the case that the insider acts as a proxy. Acting in another's name and for another's account occurs, for example, in the case of the repurchase of own shares by the executive board of the company, furthermore in the case of front running for the benefit of a customer or in the case of asset management for which the bank has a power of attorney.

(c) Use of Inside Information and Legitimate Behaviours

69 Under the MAD 2003 regime, literature and courts argued that there must—at least additionally to other factors—be a chain of causation between the acquisition or disposal of the financial instruments to the inside information. This can, for example, become relevant if the target company passes on inside information to an investor in the course of a due diligence proceeding. If the investor is only strengthened in her decision to acquire a financial instrument of the respective company a breach of the prohibition of acquisitions of financial instruments cannot be assumed.[162] As opposed to this, the rules prohibiting the use of inside information are breached if the investor makes additional purchases on the stock market.[163] These questions were also subject to the ECJ's ruling in *Spector*[164] in which the court examined the prohibition closely and gave concrete details on how the European rules are to be interpreted.

70 *Facts (abridged)*: Spector, a listed company under Belgian law, offered a programme via which employees could acquire shares in the company, which Spector planned to acquire on the market. On 21 May 2003 Spector informed Euronext Brussels of its plan to acquire a certain number of its own shares. On 11 and 13 August 2003 board member van Raemdonck acquired 19,773 shares at an average price of € 9.97 for Spector. The price for exercising the acquisition option laid at € 10.45. Subsequently Spector disclosed the company's business results and company policy, leading to a price increase up to € 12.50. The Belgian supervisory authority (CBFA) imposed fines of € 80,000 and € 20,000 on Spector and van Raemdonck, respectively, for the acquisition of the shares.

[159] K. Hopt and C. Kumpan, in: Schimansky et al. (eds.), *Bankrechts-Handbuch*, § 107 para. 63; F. Schäfer, in: Marsch-Barner and Schäfer (eds.), *Handbuch börsennotierte AG*, § 14 para. 39.

[160] Cf. J. Hansen, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 8 para. B.8.81: 'any transaction that may produce a detriment to third parties'.

[161] K. Hopt and C. Kumpan, in: Schimansky et al. (eds.), *Bankrechts-Handbuch*, § 107 para. 65.

[162] Cf. H. Assmann, in: Assmann and Schneider (eds.), *Kommentar zum WpHG*, § 14 para. 45; M. Kemnitz, *Due Diligence und neues Insiderrecht*, 67 ff.

[163] Cf. BaFin, Issuer Guideline, Module C, p.37–38; H. Diekmann and M. Sustmann, NZG (2004), 929, 931; on Austrian law S. Kalss et al., *Kapitalmarktrecht I*, § 21 para. 37; dissenting opinion: P. Mennicke, in: Fuchs (ed.), *Kommentar zum WpHG*, § 14 para. 75.

[164] ECJ of 23 December 2009, Case C-45/08 (*Spector*) [2009] ECR I-12073.

The court, having to decide on the legality of the fines, submitted a number of questions to the ECJ for a preliminary ruling, especially regarding the requirement of making use of inside information.

The ECJ ruled that the fact that a **primary insider** 'in **possession of inside information**, **acquires** or **disposes of**, or tries to acquire or dispose of, for his own account or for the account of a third party, either directly or indirectly, the **financial instruments** to which that information relates **implies** that that *person* has '**used that information**' within the meaning of that provision, but without prejudice to the rights of the defence and, in particular, to the right to be able to rebut that presumption. The question whether that person has infringed the prohibition on insider dealing must be analysed in the light of the purpose of that directive, which is to protect the integrity of the financial markets and to enhance investor confidence, which is based, in particular, on the assurance that investors will be placed on an equal footing and protected from the misuse of inside information.'[165] 71

The ECJ established a rebuttable presumption.[166] The court listed a number of examples for which the assumption does not apply—the most practically relevant being the circumstance of a public takeover bid and a merger proposal. In these cases, the use of the inside information 'should not in itself be deemed to constitute insider dealing. The operation whereby an undertaking, after obtaining inside information concerning a specific company, subsequently launches a public take-over bid for the capital of that company at a rate higher than the market rate cannot, in principle, be regarded as prohibited insider dealing since it does not infringe on the interests protected by that directive.'[167] 72

The **MAR** now provides detailed rules on 'legitimate behaviour'.[168] These provisions are **based on** the **assumption** that a **person** who **possesses inside information** and **acquires** or **disposes** of financial **instruments** to which that information relates **has used that information**.[169] This shall, however, 'not be deemed' to be a use of information and engagement in insider dealing, provided that the requirements laid down in Article 9(1)–(5) MAR are fulfilled. The European legislator has thus implemented into the MAR the examples developed by the ECJ in the *Spector* case, according to which the use of inside information can be refuted, rendering the rules developed by the ECJ more precise and extending them. It is important to underline the fact that it is now also recognised that adequate compliance measures can ensure that a legal person is not held liable for insider dealings of its employees (compliance as a defence measure).[170] 73

The ECJ has not yet had the opportunity to clarify the legal nature of Article 9. Correctly, it should not be seen as an exemption but as a **delineation** of **behaviour** that is **legitimate**.[171] Thus, Article 9 should not be subject to a narrow interpretation.[172] The provisions ensure legal certainty, whilst at the same time giving rise to a number of new questions. The first relates to Article 9 MAR according to which an infringement of the prohibition of insider 74

[165] Ibid., para. 62.
[166] J. Hansen, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 8 para. B.8.158.
[167] Ibid., para. 59.
[168] Cf. Art. 9 MAR.
[169] Cf. Recital 24 MAR.
[170] Cf. Art. 9(1) MAR.
[171] J. Hansen, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 8 para. B.9.07 and 9.09.
[172] Ibid., para. B.914.

dealing set out in Article 14 MAR may still be deemed to have occurred if the NCA establishes that there was an illegitimate reason for the orders to trade, transactions or behaviours concerned. This exception gives rises to legal uncertainty and it is doubtful whether it is sufficiently precise from a constitutional point of view. The scope of application of Article 9 MAR is also problematic, as there may be further situations in which it appears justified to refute the assumption that an insider made use of inside information. In cases in which the interests appear comparable, the provision should be applied by way of analogy, as it is not apparent that the legislator intended the definition of legitimate behaviour to be exhaustive.

75 The so-called master plan theory[173] concerns situations in which an insider (in possession of inside information) carries out a securities transaction after having obtained information through a due diligence. The theory states that the insider does not use the inside information if he has already taken the decision to enter into the transaction beforehand. If the investor obtains negative inside information and then refrains from acquiring the shareholding, he does not use the information either. If he obtains positive inside information and acquires securities as originally planned, he does not violate the prohibition because he had already decided to buy and does not use the inside information. The situation is different if the investor acquires the securities at a different price after obtaining the inside information. In this case, use of the inside information can be affirmed. The master plan theory does not apply if the insider makes changes to the previous plans, for example is only prepared to pay a lower price.[174] The same applies if the insider carries out additional securities transactions (not covered by the master plan), regardless of whether they take place on or off a market (so-called alongside purchases).

76 The trading prohibition does not apply if buyer and seller have the same level of knowledge, as equal informational opportunities of the investors are not impaired. The ECJ had already taken this into account in the Georgakis case: 'Thus, where, in a case such as that in the main proceedings, all of the contracting parties have the same information, they are on an equal footing and the information ceases to be inside information for them in the context of the implementation of the decision adopted within the group. Against this background, since none of them is in a position to derive an advantage over the others, the transactions effected between the members of the group on the basis of that information do not constitute taking advantage, with full knowledge of the facts, of inside information.'[175] These principles of interpretation can also be applied to insider trading law under the MAR.[176] In practice, this can be particularly relevant in face-to-face transactions, for example in the context of a capital increase, acquisition financing or a Stakebuilding prior to a public takeover.[177]

3. Unlawful Disclosure of Inside Information

77 A person shall not unlawfully disclose inside information.[178] Such disclosure arises where a person possesses inside information and discloses that information to any other person,

173 Cf. BaFin, Issuer Guideline, Module C, p. 60.
174 See also K. Hopt and C. Kumpan, in: Schimansky et al. (eds.), *Bankrechts-Handbuch*, § 107 para. 98.
175 Cf. ECJ of 10 May 2007, Case C-391/04 (*Georgakis*) [2007] ECR I-3741, para. 39.
176 C. Seibt and B. Wollenschläger, AG (2014), 593, 598; S. Sieder, ZFR (2017), 171, 178; L. Bühren, NZG (2017), 1172, 1175.
177 See C. Seibt and B. Wollenschläger, AG (2014), 593, 598.
178 Cf. Art. 14(c) MAR.

except where the disclosure is made in the normal exercise of an employment, a profession or duties.[179] This prohibition was already laid down in the former Insider Directive and the MAD 2003 and was refined by the ECJ's decision in *Grøngaard/Bang*.[180] It aims at preventing insider trading.[181]

(a) Disclosure

78 Inside information is disclosed if the recipient is enabled to obtain knowledge of the inside information without significant effort.[182] This can be done by action,[183] but also by omission. It follows from the reference to Article 8(4) MAR that the prohibition applies to both primary and secondary insiders.

79 The provision only prohibits the unlawful disclosure of inside information. The wording (unless it 'is made in the normal exercise of an employment, a profession or duties') has remained unchanged compared to the provisions of the Insider Dealing Directive and the MAD 2003, so that the ECJ jurisprudence in the Grøngaard/Bang case issued on the predecessor rules can be applied for the interpretation of Article 10 MAR.[184]

80 *Facts (abridged)*: Bang was chairman of the Finansforbund, a trade union in the financial sector. Grøngaard, who had been appointed by the employees, was a member of the administrative board of the company RealDanmark, a relatively large listed financial institution. Subsequent to an extraordinary administrative board meeting of RealDanmark, Grøngaard passed on information to Bang on 28 August 2000, regarding the planned merger negotiations with the Danske Bank, another large Danish financial institution. Between 28 August and 4 September 2009 Bang consulted with his two deputies and one of his employees in the administration of the Finansforbund and passed the information he had received from Grøngaard on to them. On 2 October 2000 the merger between RealDanmark and Danske Bank was made public and RealDanmark's shares price rose by 65%. Grøngaard and Bang were criminally prosecuted under section 36(1) of the Danish Securities Trading Act (vædipapirhandelslov) for disclosing inside information. The Københavns Byret decided to stay the proceedings and made reference to the ECJ for a preliminary ruling.

81 The ECJ examined in particular the fact that the prohibition of disclosing inside information does not apply unconditionally. The provision is not applicable if the insider passes on the information in the normal course of the exercise of his employment, profession or duties. According to the ECJ, this exemption clause must be treated restrictively, and can only be justified if there is a **close link between** the **disclosure** and the **exercise** of the **employment**, **profession** or duties and the **disclosure** of such information is **strictly necessary** for the **exercise thereof**.[185] Particular care is required with regard to sensitive information. In these cases, the disclosure is manifestly capable of

[179] Cf. Art. 10(1) MAR.
[180] ECJ of 22 November 2005, Case C-384/02 (*Grøngaard/Bang*) [2005] ECR I-9939.
[181] C. Mosca, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 10 para. B.10.27.
[182] BaFin, Issuer Guideline, Module C, p. 62; A. Meyer, in: Meyer et al. (eds.), *Handbuch Marktmissbrauchsrecht*, § 8 para. 4.
[183] Cf. C. Mosca, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 10 para. B.10.14: written message, sharing access codes or passwords that make inside information available to others.
[184] A. Meyer, in: Meyer et al. (eds.), *Handbuch Marktmissbrauchsrecht*, § 8 para. 11; C. Mosca, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 10 para. B.10.71 (the exemption should be applied narrowly).
[185] ECJ of 22 November 2005, Case C-384/02 (*Grøngaard/Bang*) [2005] ECR I-9939. The High Court of Denmark ruled that a member nominated by the employees has the possibility to discuss a merger that would have a considerable effect on the employees with the chair of his union. The defendants in *Grøngaard/Bang* were therefore exempted from liability. Cf. Højesteret Kopenhagen, ZIP (2009), 1526, 1527.

significantly affecting the price of the transferable securities in question. The ECJ stated that inside information relating to a merger between two companies quoted on the stock exchange is an example of such particularly sensitive information.

82 Whether the exception from the prohibition can be assumed must, according to the ECJ, be determined by the national court in the light of the applicable national laws. What is to be regarded as coming within the normal ambit of the exercise of an employment, profession or duties, depends to a large extent, in the absence of harmonisation in that respect, on the rules governing those questions in the various national legal systems.[186] In particular, the underlying legal concepts in national labour and company law must therefore be taken into account in order to determine whether a member of the board of directors or the supervisory board was permitted to pass on inside information on the company to a major shareholder or whether a representative of the employees on the supervisory board may pass on information to 'his' union. Under consideration of these facts, as part of its examination, 'a national court must, in the light of the applicable national rules, take particular account of: the fact that that exception to the prohibition of disclosure of inside information must be interpreted strictly, the fact that each additional disclosure is liable to increase the risk of that information being exploited for a purpose contrary to [the market abuse regime], and the sensitivity of the inside information'.[187]

83 For the question of whether the disclosure is strictly necessary, it may have to be taken into account whether the recipient makes a declaration of confidentiality or the insider points out to the recipient that the information is inside information (with the consequence that the recipient becomes a secondary insider and is therefore subject to the disclosure obligation pursuant to Article 10 MAR).[188] Irrespective of this, the issuer must include the recipient in the insider list (Article 18 MAR).

84 The prohibition of disclosure becomes relevant in the case of acquisitions of a **block of shares** if the board of directors grants the prospective buyer access to information in the course of a due diligence. The board of directors is authorised to pass on inside information if this is necessary to secure a concrete acquisition intention. Particularly in the case of the acquisition of significant shareholdings, both the economic interest of the issuer and that of the acquirer justify greater transparency than is the case with ordinary share purchases on the stock exchange. For this reason, disclosure by the issuer's management board is made in the normal exercise of a profession or duties, if the prospective buyer wants to acquire a block of shares of more than 3%.[189]

85 Examples for further cases, in which the disclosure is allowed, however, include the possibility for members of the supervisory board to disclose inside information to a major shareholder outside the general shareholders' meeting if this may heighten the chances of a certain measure, such as a capital increase, being adopted by the shareholders' meeting.[190] As opposed to this, the members of the supervisory board are not permitted to disclose inside information regarding upcoming business and personnel policy measures to individual

[186] ECJ of 22 November 2005, Case C-384/02 (*Grøngaard/Bang*) [2005] ECR I-9939, para. 39–40.
[187] Cf. ibid., para. 48.
[188] Cf. BaFin, Issuer Guideline, Module C, p. 63.
[189] A. Meyer, in: Meyer et al. (eds.), *Handbuch Marktmissbrauchsrecht*, § 8 para. 35.
[190] Cf. for a discussion of reasons to disclose C. Mosca, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 10 para. B.10.57 ff.

shareholders. These cases may again have to be treated differently when the issuer is a subsidiary of a parent company. The members of the supervisory board must in these circumstances take the controlling company's interest in a unified management of the whole group into consideration. The disclosure of inside information to the controlling company can therefore be permissible.[191]

(b) Market Sounding

MAR privileges market soundings (also called testing the waters in the US) because they are 'a highly valuable tool to gauge the opinion of potential investors, enhance shareholder dialogue, ensure that deals run smoothly, and that the views of issuers, existing shareholders and potential new investors are aligned. They may be particularly beneficial when markets lack confidence or a relevant benchmark, or are volatile. Thus the ability to conduct market soundings is important for the proper functioning of financial markets and market soundings should not in themselves be regarded as market abuse.'[192] It is a **widespread** market **practice** to **determine** the **interest of investors** in a capital markets transaction (such as an offer of securities) **prior to the transaction**, with the aim of assessing its prospects of success. The market sounding is usually not carried out by the issuer itself, but rather by lawyers or investment bankers retained by the issuer for carrying out the transaction. Prior to the enactment of the MAR, rules on market sounding only existed in France. The procedure is now laid down uniformly for the whole of Europe. 86

The persons involved in a market sounding are (i) the issuer, (ii) the disclosing market participant (DMP) and the person receiving the market sounding (market sounding beneficiaries = MSB). Disclosure of inside information made in the course of a market sounding is deemed to be made in the normal exercise of a person's employment, profession or duties where the DMP complies with Article 11(3) and (5) MAR (cf. Article 11(4) MAR). 87

Market sounding is defined in Article 11(1) MAR. It comprises the communication of information prior to the announcement of a transaction, in order to gauge the interest of potential investors[193] in a possible transaction and the conditions relating to it, such as its potential size or pricing, to one or more potential investors.[194] This is usually carried out only few hours before the publication of the transaction. The transaction may then be regarded as inside information—provided the intermediate steps are already price relevant. The feedback from the investors is important for the issuer, as it enables it to assess the transaction's prospects of success. The DMP informs potential investors (MSBs) of the key features of the planned capital market transaction if they agree to the transmission of the information (wall crossing). In most cases, this information does not yet qualify as inside information. However, there may already be an intermediate step which in itself fulfils the requirements of inside information.[195] The disclosure of other inside information, such as 88

[191] Cf. B. Singhof, ZGR (2001), 146, 162; R. Veil, 172 ZHR (2008), 239, 268.
[192] Recital 32 MAR.
[193] They are also described as market sounding recipients (MSR).
[194] Cf. also Art. 11(2) MAR about market sounding in the course of a takeover bid.
[195] See para. 37.

the decision of a board member to resign from the board, is generally not privileged under Article 11(4) MAR. Only such information may be communicated which, from the point of view of the DMP, is necessary to explore the interest of potential investors in the capital market transaction.[196]

89 Article 11(3)–(5) MAR provide numerous obligations for a DMP, which are put into more concrete terms by Commission Delegated Regulation (EU) No. 2016/960 of 17 May 2016.[197] ESMA has furthermore issued guidelines for persons receiving market soundings.[198] These need, however, not be covered in more detail herein. These rules are intended to facilitate the supervisory authority's monitoring of compliance with the prohibitions on insider trading. The prerequisite for the privileged treatment is merely that the DMP complies with the rules provided for in Article 11(3) and (5) MAR. In addition, the DMP is subject to further obligations, which, however, are not sanctioned. Of practical importance is above all the so-called **cleansing**: If information is disclosed in the course of a market sounding and, in the DMP's opinion, loses its status as inside information, the DMP must inform the recipient immediately.[199]

4. Recommending or Inducing

90 A person may not recommend to another person to engage in insider dealing or induce another person to engage in insider dealing.[200] This prohibition is a catch-all clause, to which the ECJ has not yet referred to. It has the aim of preventing an insider from using a third party or acting collusively with him, in order to circumvent the prohibitions applying to the insider dealing himself by recommending the deals to the third party.

91 The prohibition is further specified in Article 8(2) MAR. Recommending or inducing another person to engage in insider dealing occurs where the **person possesses inside information** and (i) **recommends**, on the basis of that information, **another person to acquire** or **dispose of financial instruments** to which that information relates, or induces that person to make such an acquisition or disposal. It further occurs (ii) where such a person recommends that **another person cancel** or amend an **order** concerning a financial instrument to which that information relates or induces that person to make such a cancellation or amendment.

92 'Induce' can be defined as any means of influencing the will of a third party. It is sufficient if the insider suggests a specific transaction to a third party, irrespective of whether or not it explicitly discloses the inside information. The prohibition requires causation between the insider's information and the offender's recommendation, ie the offender must recommend the acquisition or disposal of shares based on his/her inside knowledge.

[196] ESMA, Final Report, Draft technical standards on the Market Abuse Regulation, 28 September 2015, ESMA/2015/1455, p. 23; N. Kubesch, *Marktsondierung nach dem neuen Marktmissbrauchsrecht*, 196 ff.; A. Meyer, in: Meyer et al. (eds.), *Handbuch Marktmissbrauchsrecht*, § 8 para. 91.

[197] Cf. also ESMA, Final Report, Draft technical standards on the Market Abuse Regulation, 28 September 2015, ESMA/2015/1455, p. 21–33 with further interpretational remarks.

[198] Cf. ESMA, Final Report, Guidelines on the Market Abuse Regulation – market soundings and delay of disclosure of inside information, 13 July 2016, ESMA/2016/1130.

[199] Art. 11(6) MAR.

[200] Cf. Art. 14(b) MAR.

5. Exemptions

The European legislature admits that in certain circumstances and for economic reasons the stabilisation of financial instruments or trading in own shares in buy-back programmes can be legitimate, and therefore should not in itself be regarded as market abuse.[201] The prohibition should thus not apply to trading in own shares in 'buy-back' programmes or to the stabilisation of a financial instrument provided such trading is carried out in accordance with Article 5(1)–(5) and the RTS developed by ESMA and endorsed by the Commission.[202] 93

Trading in own shares under buy-back programmes is privileged if it has the purpose of reducing an issuer's capital, meeting obligations arising from a debt instrument that can be converted into equity capital (example: convertible bond) or meeting obligations arising from an employee share scheme. Certain procedural requirements must also be met. The details of the programme must be fully disclosed, trades must be reported to the regulator as part of the repurchase programme and subsequently publicly announced, appropriate limits on price and volume must be observed and trading must be conducted in accordance with the specified conditions. 94

Similar restrictions apply to price stabilisation transactions. This means any purchase or offer to purchase relevant securities and any transaction in comparable linked instruments that investment firms or credit institutions undertake as part of a significant offering of those securities for the sole purpose of supporting the market price of those securities when there is selling pressure on those securities. The insider trading prohibitions do not apply if the price stabilisation measures are limited in time, properly reported and subject to reasonable limits in relation to the price.[203] 95

VI. Supervision

1. Tasks and Powers of National Authorities (NCAs)

The prohibition on insider dealings must be supervised by the national authorities.[204] 96
The European legislature regarded it as imperative that a single competent authority of an administrative nature, guaranteeing its independence of economic actors and avoiding conflicts of interest, be designated in each Member State to supervise compliance with the provisions. It further regarded a common minimum set of effective tools and powers for the competent authority of each Member State necessary in order to guarantee supervisory effectiveness. The national authorities' powers had differed greatly between the Member States,[205] which is why the European legislature approached this aspect in such detail.

[201] Cf. recital 12 MAR.
[202] Commission Delegated Regulation (EU) No. 2016/1052 of 8 March 2016 supplementing Regulation (EU) No. 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the conditions applicable to buy-back programmes and stabilisation measures, OJ L 173, 30 June 2016, p. 34–41.
[203] Cf. Art. 5(4) MAR.
[204] Art. 22 ff. MAR.
[205] See R. Veil § 12 para. 6.

ESMA has no market surveillance powers. The law does not specify how national authorities are to exercise supervision.

97 The nature of supervision is rooted in national administrative law and culturally shaped by national administrative practice. Nevertheless, certain trends can be identified in Europe. In a more **risk-based approach**, the authority takes into account the significance of the matter for the integrity of the capital market and prioritises matters where there are clear indications of market abuse.[206] Challenges arise from the (digital) evolution of markets[207] and the difficulty of accessing information in cross-border transactions.[208] Empirically proven patterns of insider trading are helpful in analysing the vast data sets.[209]

98 In Article 23, the MAR lays down that the competent authorities must be given all supervisory and investigatory powers that are necessary for the exercise of their functions,[210] including at least the right to (a) have **access** to any **document** and **data** in any form, and to receive a copy of it; (b) **require** or demand **information** from any person, including those who are successively involved in the transmission of orders or conduct of the operations concerned, as well as their principals, and if necessary, to summon and question any such person with a view to obtain information; (c) in relation to commodity derivatives, to request information from market participants on related spot markets, obtain reports on transactions, and have direct access to traders' systems; (d) carry out **on-site inspections**; (e) **enter** the **premises** of natural and legal **persons** in order to seize documents and data; (f) to **refer matters** for **criminal investigations**; (g) require existing recordings of telephone conversations, electronic communications or data traffic records; (h) to require existing data traffic records held by a telecommunications operator; (i) to **request** the **freezing** or sequestration of **assets**; (j) **suspend trading** of the financial instruments concerned; (k) to require the temporary cessation of any practice that the NCA considers contrary to the MAR; (l) to impose a **temporary prohibition** on the exercise of **professional activity**; and (m) to take all necessary measures to ensure that the public is correctly informed, inter alia, by correcting false or misleading disclosed information etc.[211]

99 Additionally, the MAR provides detailed rules for the NCAs on cooperation with ESMA[212] and with each other,[213] obliging NCAs render assistance to NCAs of other Member States, especially by exchanging information and cooperating in investigation activities. In addition, there is a worldwide exchange of information and mutual assistance in cross-border cases on the basis of a 'Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information'.[214]

[206] Cf. BaFin, Annual Report 2019, p. 92, 95.
[207] The FCA is addressing this challenge through a Digital Evidence Unit, where a team of technologically savvy specialists examine computers, smartphones and other electronic devices of suspected offenders. Cf. E. Swan and J. Virgo, *Market Abuse Regulation*, para. 1.45.
[208] Cf. J. Austin, *Insider Trading and Market Manipulation*, 255.
[209] Cf. K. Ziehl, *Kapitalmarktprognosen und Insider-Trading*, 48 ff.
[210] Cf. Art. 23(3) MAR.
[211] Art. 23(2)(a)–(m) MAR.
[212] Cf. Art. 24 MAR.
[213] Art. 25 MAR.
[214] Cf. J. Austin, *Insider Trading and Market Manipulation*, 184 ff.

(a) Insider Lists

100 Under the MAD 2003, the Member States had to ensure that issuers, or persons acting on their behalf or for their account, draw up a list of those persons working for them, under a contract of employment or otherwise, who have access to inside information.[215] Though former Commission Directive 2004/72/EC put these requirements into more concrete terms, national differences in regard to data to be included in those lists imposed unnecessary administrative burdens on issuers.[216] In order to reduce costs, the MAR unifies data fields required for insider lists.

101 Article 18 MAR requires issuers or other persons acting on their behalf or on their account to draw up a list of all **persons** who have **access** to **inside information** and who are **working for them** under a contract of employment, or otherwise performing tasks through which they have access to inside information, such as advisers, accountants or credit rating agencies.[217] They must provide the insider list to the NCA as soon as possible upon its request. The insider list must include at least the identity of any person having access to inside information, the reason for including that person in the list, the date and time at which that person obtained access to inside information and the date on which the insider list was drawn up.

102 The extensive content of insider lists is explained against the background that insider lists are considered an important tool for NCAs when investigating possible market abuse.[218] Moreover, insider lists may serve issuers to control the flow of inside information and thereby help manage their confidentiality duties.[219]

103 Issuers and persons acting on their behalf or for their account must regularly update this list and transmit it to the competent authority whenever the latter requests it.[220] There is thus no obligation for an issuer to spontaneously provide its insider list to the competent authority or inform it of updates to the list if the competent authority has not requested it from the issuer.[221] The lists of insiders must be promptly updated whenever there is a change in the reason why any person is already on the list, whenever any new person has to be added to the list or if any person already on the list no longer has access to inside information.[222]

104 A central element of the supervision of insiders through the use of insider lists is the **duty to inform insiders** of their obligations: the persons required to draw up lists of insiders shall take reasonable steps to ensure 'that any person on the insider list acknowledges the legal and regulatory duties entailed and is aware of the sanctions applicable to insider dealing and unlawful disclosure of inside information'.[223] This provision aims to make the respective person aware of its behaviour regarding the dissemination of inside information.

215 Art. 6(3) MAD.
216 Cf. Recital 56 MAR.
217 Cf. BaFin, Issuer Guideline, Module C, p. 88 f.
218 Cf. Recital 56 MAR.
219 Cf. Recital 57 MAR.
220 Art. 18(1)(b) and (c) MAR.
221 CESR/06-562b (fn. 114).
222 Art. 18(4)(a)–(c) MAR.
223 Cf. Art. 18(2) MAR.

105 According to the former CESR, the supervision of insider lists has proven very successful.[224] This has, however, not hindered ESMA to examine national supervisory practices regarding the handling of insider lists. ESMA's peer review came to the conclusion that four Member States had to be considered as not applying sufficient supervisory practices.[225] Meanwhile, ESMA has found the NCAs fully compliant with the requirements regarding insider lists.[226]

(b) Notification Obligations and Whistleblowing

106 Further central elements regarding the prevention and detection of market abuse are organisational requirements and notification obligations. **Market operators** and **investment firms** that **operate** a **trading venue** are required to establish and maintain effective arrangements, systems and procedures aimed at preventing and detecting insider dealing, market manipulation and attempted insider dealing and market manipulation. They must further report orders and transactions, including any cancellation or modification thereof, that could constitute insider dealing, market manipulation or attempted insider dealing or market manipulation to the competent authority of the trading venue without delay.[227]

107 The same obligations apply to '**any person professionally arranging or executing transactions**'.[228] They are required to establish and maintain effective arrangements, systems and procedures to detect and report suspicious orders and transactions. Where such a person has a reasonable suspicion that an order or transaction in any financial instrument, whether placed or executed on or outside a trading venue, could constitute insider dealing, market manipulation or attempted insider dealing or market manipulation, the person must notify the competent authority without delay.[229]

108 These notification obligations constitute a central aspect of the supervision of insiders, enabling the supervisory authorities to examine cases of market abuse and strengthen the market participants' understanding of the fact that market integrity is essential for the functioning of capital markets. The European Commission has therefore laid down detailed rules on the arrangements, systems and procedures for persons to comply with requirements under Article 16(1) and (2) MAR and the content of such a notification and on the procedure to be followed when notifying the national authorities.[230]

109 Any other persons than those professionally arranging or executing transactions are not obliged to inform NCAs about possible insider trading and market manipulations.

[224] Cf. CESR, Level 3—Third Set of CESR Guidance and Information on the Common Operation of the Directive to the Market, May 2009, CESR/09-219.

[225] Cf. ESMA, Supervisory Practices under MAD. Peer Review and Good Practices, 1 July 2013, ESMA/2013/805, para. 14.

[226] Cf. ESMA, Peer Review on Supervisory Practices against Market Abuse. Follow-up Report, 22 December 2015, ESMA/2015/1905, p. 4.

[227] Cf. Art. 16(1) MAR.

[228] This category is defined in Art. 3(1)(28) MAR. See also ESMA, Question and Answers on the Market Abuse Regulation, 20 May 2016, ESMA/2016/738 Section 1 (regarding the definition of 'person professionally arranging or executing transactions').

[229] Cf. Art. 16(2) MAR.

[230] Cf. Commission Delegated Regulation (EU) No. 2016/957 of 9 March 2016 supplementing Regulation (EU) No. 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the appropriate arrangements, systems and procedures as well as notification templates to be used for preventing, detecting and reporting abusive practices or suspicious orders or transactions, OJ L 160, 17 June 2016, p. 1–14.

Whistleblowers may, however, bring new information to the attention of competent authorities which assists them in detecting and imposing sanctions in cases of insider dealing and market manipulation.[231] The European legislature therefore considered measures regarding whistleblowing necessary to facilitate detection of market abuse and to ensure the protection and the respect of the rights of the whistleblower and the accused person.[232] The most important question, however, is subject to national legislation: Member States are free with regard to the question whether they provide for financial incentives to persons who offer relevant new information about potential infringements that results in the imposition of an administrative or criminal sanction.[233]

2. Supervisory Convergence

Little is known about the way in which the NCAs supervise the securities markets. The 110
peer reviews published by ESMA,[234] however, show that the approaches vary considerably throughout Europe. This relates primarily to the question whether procedures are examined on a regular or a risk-based basis. The annual reports further show that some supervisory authorities, such as BaFin, follow empirically proven typical patterns of insider trading.[235] The exchange of information between NCAs plays a very important role.

VII. Sanctions

1. Overview

The MAD 2003 contained no provisions on possible sanctions for breaches of the pro- 111
hibitions. The Member States could therefore decide individually whether they wished to impose criminal sanctions.[236] They had, however, to ensure that 'in conformity with their national law, the appropriate administrative measures can be taken or administrative sanctions be imposed'.[237] The details were once again left to the national legislatures: 'The Member States shall ensure that these measures are effective, proportionate and dissuasive.'[238] This demand, also to be found in the other framework directives enacted 2003 and 2004,[239] was to ensure that the European legal framework against market abuse was sufficient.[240]

[231] Cf. Recital 74 MAR.
[232] Cf. Recital 74 and Art. 32 MAR.
[233] Cf. Art. 32(4) MAR. Cf. on the US regulatory model T. Pfeifle, *Finanzielle Anreize für Whistleblower im Kapitalmarktrecht*.
[234] ESMA/2013/805 (fn. 225).
[235] Cf. K. Ziehl, *Kapitalmarktprognosen und Insider-Trading*, 48 ff.
[236] Cf. Art. 14(1) MAD: 'Without prejudice to the right of Member States to impose criminal sanctions […]'.
[237] Art. 14(1) MAD.
[238] Art. 14(1) MAD.
[239] See R. Veil § 1 para. 21 ff.
[240] Recital 38 MAD.

112 The Market abuse regime under the MAR aims to achieve **further harmonisation** and requires **stricter sanctions** for infringements of the prohibitions laid down in Article 14 MAR. The possible sanctions are also described in detail and range from 'temporary prohibition of an activity' to 'administrative pecuniary sanctions' and 'suspend trading of the financial instrument'. The supervisory authorities are further required to make public any measures and sanctions unless such publication would seriously jeopardise the stability of the financial markets. The MAR then continues by listing the circumstances which the supervisory authority must take into account when determining the type of administrative measures and sanctions to be applied.[241] These requirements were introduced due to the insight that the national authorities made very different use of their sanctioning powers in the past.

2. Administrative Measures and Pecuniary Sanctions

113 The national supervisory authorities must be empowered to **impose fines** of at least **three times** the amount of **profits** obtained or **losses avoided** because of the infringement.[242] This can become relevant in particular in cases of prohibited insider trading. Pecuniary sanctions constitute the core of all administrative sanctions. The MAR provides for a nominal minimum rate of the maximum fine of € **5 million** for natural persons in case of breaches of the prohibitions on insider trading. With regard to legal persons, administrative pecuniary sanctions of up to **15%** of the **total annual turnover** in the preceding business year are possible.[243] In its report on sanctioning practices in the Member States for 2019, ESMA states that almost all NCAs did not impose administrative sanctions for a breach of MAR insider trading prohibitions.[244]

114 Competent supervisory authorities shall publish any decision to impose an administrative sanction or administrative measure in relation to a breach of MAR on their website without undue delay. At a minimum, the nature and character of the breach and the identity of the persons responsible shall be disclosed.[245] If disclosure would be disproportionate, or jeopardise ongoing investigations or the stability of financial markets, the NCA will defer publication, make it anonymous or refrain from it altogether.[246]

115 Naming and shaming has a repressive and general preventive effect, because the publication of violations makes it clear to market participants that violations will be sanctioned. Thus, the public announcement can be qualified as an administrative sanction.[247]

241 Cf. Art. 32(1) MAR.

242 See in more detail R. Veil § 12 para. 18–20.

243 Cf. Art. 30(2)(j) subsec. 2 MAR; see in more detail R. Veil § 12 para. 20.

244 Cf. ESMA, Annual Report on administrative and criminal sanctions and other administrative measures under MAR, ESMA70-156-2005, 12 December 2019. An exception is Belgium, where the supervisory authority imposed administrative sanctions in 7 cases.

245 Art. 34(1) MAR.

246 Art. 34(2) MAR.

247 Cf. P. Koch, *Naming and shaming im Kapitalmarktrecht*, 140 ff.

3. Criminal Sanctions

According to the CRIM-MAD, the Member States are also required to introduce criminal sanctions for the most serious market abuse offences. They only have to sanction intentional offences.[248] Furthermore, Member States are obliged to ensure that legal persons can be held liable.[249] They are, however, not obliged to provide criminal sanctions. It follows from recital 18 CRIM-MAD, that 'non-criminal sanctions or other measures which are effective, proportionate and dissuasive, for example those provided for in' the MAR are sufficient. 116

4. Investor Protection through Civil Liability

The MAR contains no provisions requiring the introduction of a civil liability, leaving this to the choice of the Member States. In many Member States, such as France, Germany, Spain and Sweden, no specific provisions exist granting investors the right to claim damages from insiders. Such claims are therefore subject to the general civil law provisions. French courts see the possibility of an investor's damages being compensated in cases of insider dealings. In *Sidel*, shareholders claimed compensation in criminal proceedings which both the Tribunal correctionnel and the Cour d'appel awarded on the merits, based on Articles 1382 and 1384 Code civil (Cc, French Civil Code). However, the proof of actual damage was not possible, the insider dealing only affecting 30,000 shares, whilst during the relevant period a total of more than 3 million shares were being traded. The courts therefore concluded that the information was not price sensitive.[250] 117

VIII. Conclusion

Insider trading law has evolved in Europe over three decades. The unification of the law in 2014 was an important step to prevent harmful regulatory arbitrage. Moreover, legal unification helps to reduce transaction costs for investors and issuers. Nevertheless, the MAR is far from a comprehensive codification. This is mainly due to the fact that the legislator essentially limited itself to adopting the regulations of the MAD 2003, which aim at a minimum harmonisation, and the case law of the ECJ. The regimes are designed in a non-systematic way, so that regulatory gaps occur. Questions of interpretation are difficult to assess. 118

Another point of criticism concerns the notion of inside information. With the concept of intermediate steps as inside information, first the ECJ and then the European legislator have gone beyond the limits of what is justifiable. This concept raises numerous questions 119

[248] Cf. Art. 3(1), 4(1) and 6(1) CRIM-MAD.
[249] Cf. Art. 8 CRIM-MAD.
[250] T. corr. Paris, 11e ch., 1re sect., of 12 September 2006, no. 0018992026; CA Paris, 9e ch., sect. B, of 17 October 2008, no. 06/09036.

of interpretation that it can hardly be handled with legal certainty. The attempts of national supervisory authorities to provide more legal certainty through case groups are laudable. However, the guidelines are legally non-binding interpretations. In the absence of a uniform Europe-wide understanding of the concept of the reasonable investor, central legal questions are answered differently by supervisory authorities and courts. This problem arises with the insider trading prohibitions, but also with the ad hoc disclosure obligation under Article 17 MAR.

120 A central goal of the 2014 reform was to improve the sanctions regime. The stricter administrative sanctions should have a deterrent effect. However, it is still too early to assess this reliably, as only a few cases reach the courts. The probability of detection remains low. There is therefore a need to improve access to information by the supervisory authorities through a functioning whistleblower system. The supervisory authorities must also keep pace with new technologies.

§ 15

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I. Introduction

1 The aim of every market manipulation is to steer the present market price towards positive results for the manipulator, ie increasing the price before sales and lowering it before acquisitions. Prices can be influenced by information-based as well as transaction-based manipulations.[1] Manipulations most commonly occur on illiquid markets with only little regulation; these markets have the least stringent transparency rules and therefore the largest informational asymmetries between the manipulators and other market participants. In these cases, manipulators can exert particular influence on the amount of information available to the public regarding a certain financial instrument. Additionally, each individual order is potentially more likely to cause price movements on relatively illiquid markets.[2] This can particularly effect emerging markets, which do not yet have sufficient liquidity and efficiency.[3] Within the European Union, market segments below the threshold of regulated markets, eg the *Freiverkehr* (open market) in Germany or the *Alternative*

[1] R. Aggarwal and G. Wu, 79. J. Bus. (2006), 1915.
[2] R. Aggarwal and G. Wu, 79. J. Bus. (2006), 1915, 1917.
[3] R. Aggarwal and G. Wu, 79. J. Bus. (2006), 1915, 1918, quoted studies referring to China and Pakistan.

Investment Market (AIM) in the United Kingdom, remain most likely to be subject to manipulation.

Manipulated prices impair the proper **functioning of the market** and must therefore be prohibited.[4] Investors could lose confidence in a manipulated market and eventually exit the market, a move which would adversely affect the market mechanism. The United States, therefore, introduced comprehensive prohibitions on market manipulation as early as the 1930s. In Europe, a community-wide approach was only adopted in 2003. The former MAD 2003 was intended to ensure a uniform framework throughout the Community,[5] because some Member States had not prohibited such manipulations. The directive's rules for the Member States thus aimed to protect the reliability and accuracy of price formation. 2

The **MAR 2014 regime**,[6] consisting of a Regulation (**MAR**) and a Directive (**CRIM-MAD**), maintains the regulatory approach of the MAD 2003 to **prohibit** both **information-based** and **transaction-based manipulation**. The new rules fill gaps in relation to new trading platforms and OTC instruments, ie instruments traded over the counter, as well as benchmarks, and create a single regulatory framework to avoid regulatory arbitrage. CRIM-MAD also aims at providing greater deterrence and preventing misconduct through stricter sanctions. The objectives have remained unaltered.[7] Investors must be able to rely on a price that has evolved through supply and demand and not through manipulation. 3

II. Foundations

1. Regulatory System

A person shall not engage in or attempt to engage in market manipulation.[8] The concept of market manipulation is specified in Article 12 MAR. This provision provides **four definitions** of **market manipulation**[9] and also offers **five** practically relevant **examples** of these core definitions.[10] The fourth core definition (benchmark manipulation) is new and was introduced in reaction to the LIBOR scandal (cf. Recital 44 MAR). However, the MAR exempts certain activities from the ban on market manipulation. These include the trading in own shares in 'buy-back' programmes and the stabilisation of a financial instrument, provided such trading is carried out in accordance with certain requirements.[11] Secondly, the prohibition does not apply to activities if the person has legitimate reasons 4

[4] Recitals 2, 7 and 47 MAR; cf. H. McVea, in: Moloney et al. (eds.), *The Oxford Handbook of Financial Regulation*, 638; recital 14 of the MAD 2003 aimed to prevent terrorism financing but recitals of the MAR do not mention this purpose anymore.

[5] Recitals 11, 12 MAD 2003; cf. also Communication from the Commission on implementing the Financial Services Action Plan, 11 May 1999, COM(1999) 232 final.

[6] See R. Veil § 1 para. 42 und R. Veil § 13 para. 2.

[7] Recital 3 MAR.

[8] Art. 15 MAR.

[9] Art. 12(1)(a)–(d) MAR.

[10] Art. 12(2)(a)–(d) MAR.

[11] Art. 5 MAR.

and the transaction, order or activity is in accordance with accepted market practice.[12] The MAR additionally contains organisational requirements necessary for detecting market manipulation. Market operators and investment firms that operate a trading venue are required to 'establish and maintain effective arrangements, systems and procedures aimed at preventing and detecting insider dealing, market manipulation and attempted insider dealing and market manipulation'.[13] It also establishes a reporting obligation for securities transactions to enable national supervisors to better monitor compliance with the prohibitions.[14]

5 The broadly phrased prohibitions and exemptions were implemented under the former MAD 2003 regime through three Implementing Directives. These have been repealed by Commission Delegated Regulation (EU) No. 2016/908[15] on accepted market practices and Commission Delegated Regulation (EU) No. 2016/1052[16] on buy-back programmes and stabilisation measures. Annex I of the MAR also provides a list of indicators of prohibited practices.[17]

6 The former CESR had published guidelines that set out its views on the requirements for determining acceptable market practices[18] and explained various manipulative activities and the application of the safe harbour rules.[19] ESMA has not yet issued guidelines on the application of the prohibition of market manipulation. However, it has already issued several opinions on accepted market practices.[20] In addition, some national supervisory authorities (NCAs) have published guidance documents and circulars setting out their administrative practices to prohibit market manipulation.[21]

2. Direct Effect in the Member States

7 The direct effect of the MAR in all Member States makes most national substantive law obsolete. With the exception of the sanctioning regime, all prohibitions on market manipulation are now European law. Member States only need to pass or amend legislation with regard to the MAR's provisions on administrative sanctions and the CRIM-MAD's provisions on criminal sanctions.

[12] Art. 13 MAR.

[13] Art. 16(1) MAR.

[14] Art. 4 MAR.

[15] Commission Delegated Regulation (EU) No. 2016/908 supplementing Regulation (EU) No. 596/2014 of the European Parliament and of the Council laying down regulatory technical standards on the criteria, the procedure and the requirements for establishing an accepted market practice and the requirements for maintaining it, terminating it or modifying the conditions for its acceptance, OJ L153, 10 June 2016, p. 3–12.

[16] Commission Delegated Regulation (EU) No. 2016/1052 supplementing Regulation (EU) No. 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the conditions applicable to buy-back programmes and stabilisation measures, OJ L173, 30 June 2016, p. 34–41.

[17] Art. 12(3) MAR.

[18] CESR, Level 3 – First Set of CESR Guidance and Information on the Common Operation of the Directive to the Market, CESR/04-505b, Oktober 2008.

[19] CESR, Level 3 – Third Set of CESR Guidance and Information on the Common Operation of the Directive to the Market, CESR/09-219, May 2009.

[20] Legal basis for such opinions is Art. 13(4) MAR. The opinions are available at ESMA's website.

[21] Cf. BaFin, Emittentenleitfaden (issuer guideline), Module C, Chapter Market Manipulation.

III. Scope of Application of the MAR

1. Personal Scope

The prohibition of market manipulation **generally applies to all market participants**, regardless of whether they are natural or legal persons.[22] If a member of a company issues a false press release, he or she may be the perpetrator, but also the board member who signed the press release. Where information is prepared, however, for the purpose of **journalism** or other form of expression in the media, the 'disclosure or dissemination of information shall be assessed taking into account the rules governing the freedom of the press and freedom of expression in other media and the rules or codes governing the journalist profession, unless those persons [...] derive, directly or indirectly, an advantage or profits from the disclosure dissemination of the information in question or the disclosure or the dissemination is made with the intention of misleading the market [...]'.[23] 8

2. Material Scope

The **MAR considerably extends** the material scope of the rules on market manipulation compared to the former MAD 2003. The scope is **no longer limited to financial instruments** traded on **regulated markets**.[24] The MAR also applies to financial instruments traded on **MTFs**, admitted to trading on an MTF or for which a request for admission to trading on an MTF has been made[25] and to financial instruments traded on an **OTF**.[26] Financial instruments include in particular shares, bonds and derivatives.[27] 9

The MAR also applies to any related financial instruments traded **OTC**, which depend on or can have an effect on the covered underlying market (eg credit default swaps [CDSs]).[28] The reasoning behind this extension is to avoid regulatory arbitrage among trading venues and to ensure investor protection throughout the European Union.[29] The prohibition of market manipulation in the MAR also covers the interlinkages between spot commodity markets and related financial markets, ie manipulative strategies which use financial instruments to influence spot commodity contracts and vice versa.[30] In this context, the regulation excludes monetary and public debt management as well as climate policy activities from its scope.[31] Emission allowances are classified as financial instruments, thus subjecting financial instruments relating to wholesale energy products to the provisions on market abuse.[32] The MAR 10

[22] Cf. Art. 12(4) MAR.
[23] Art. 21 MAR.
[24] Art. 2(1)(a) MAR; cf. H. McVea, in: Moloney et al. (eds.), *The Oxford Handbook of Financial Regulation*, 646.
[25] Art. 2(1)(b) MAR.
[26] Art. 2(1)(c) MAR.
[27] See R. Veil § 8 para. 2 ff.
[28] Recital 10 and Art. 2(1)(d) MAR.
[29] Recital 8 MAR.
[30] Recital 20 and Art. 2(2)(a)–(c) Commission Proposal for a Regulation of the European Parliament and of the Council on insider dealing and market manipulation (market abuse), 20 October 2011, COM 2011(651) final.
[31] Art. 6 MAR.
[32] Recital 15 and Art. 3(1)(2) MAR refer to Art. 4(1)(15) and Annex I Section C (11) of Directive 2014/65/EU.

further covers emission allowances that are auctioned on an auction platform pursuant to Regulation (EU) No. 1031/2010, even when auctioned products are not financial instruments. This ensures that the MAR constitutes a single rule book of market abuse measures for the entirety of primary and secondary markets in emission allowances.[33]

11 The market manipulation prohibitions also apply if the activity takes place outside the EU (**extraterritoriality**).[34] This applies irrespective of whether a similar prohibition exists in the third country.

IV. Prohibitions

1. Regulatory System

12 Market manipulation prevents the market from being fully and properly transparent. The European legislature is of the opinion that full and proper market transparency is a prerequisite for all economic actors to be able to participate in integrated financial markets.[35] The MAR and CRIM-MAD distinguish transaction-based and information-based manipulations as well as benchmark manipulations.[36]

13 ***Transaction-based*** manipulations[37] are based on the possibility of giving false or misleading signals as to the supply of, demand for or price of financial instruments through an actual order or transaction. ***Information-based*** manipulation requires the dissemination of false or misleading information.[38] The third type is a combination of both types of manipulation, which must be assumed if transactions or orders to trade employ fictitious devices or any other form of deception or contrivance.[39] Annex I to the MAR specifies the requirements of both (i) transaction-based manipulations and (ii) manipulations through fictitious devices by establishing non-exhaustive *indicators* that shall be taken into account when investigating manipulative behaviour.[40] However, these indicators do not allow the automatic conclusion that the behaviour in question constitutes market manipulation. ***Benchmark manipulations***, a subset of information-based manipulations, occur when a person transmits false or misleading information or input to a benchmark and that person knows or ought to have known about that the information or input was false. The most prominent benchmarks are interest rate benchmarks such as LIBOR and EURIBOR, that determine interest payments under a very large number of financial instruments.[41]

[33] Recital 37 and Art. 2(1)(2) MAR.
[34] Cf. Art. 2(4) MAR and R. Veil § 13 para. 19.
[35] Cf. Recital 7 MAR.
[36] The distinction between 'trade-based' and 'information-based' was established by F. Allen and D. Gale, 5 Rev. Fin. Stud. (1992), 503.
[37] Art. 12(1)(a) MAR.
[38] Art. 12(1)(c) MAR.
[39] Art. 12(1)(b) MAR.
[40] Art. 12(3) MAR; Annex I is identical to the former Art. 4 and 5 of repealed Directive 2003/ 124/EC.
[41] Art. 12(1)(d) MAR.

The MAR further provides ***specific types*** of manipulative behaviour, which it derives from the core definitions.[42] These types are also non-exhaustive. Article 12(2)(c) MAR now specifically mentions algorithmic and high-frequency trading. Even if none of these provisions apply, the respective behaviour can still be considered manipulative if such behaviour meets the conditions set out in Article 12(1)(a), (b), (c) or (d) MAR.[43] If one of the instances does, however, apply, the respective behaviour definitely constitutes market manipulation; hence, the instances are not merely indicators within the meaning of Annex I MAR. 14

The MAR thus generally maintains the former MAD 2003 approach, but also prohibits attempted market manipulation; examples of attempted manipulations include all cases where 'the activity is started but is not completed, for example as a result of failed technology or an instruction to trade which is not acted upon.'[44] In prohibiting attempted market manipulation, the MAR considerably broadens the scope of the prohibition. The European legislator found this necessary to enable the supervisory authorities to impose sanctions for attempted manipulations.[45] This conclusion seems somewhat circular and the European legislator does not point to any empirical evidence that would render it necessary to prohibit attempted manipulations. One can safely predict an in-depth discussion and extensive case law on the threshold between 'regular', ie allowed, behaviour and 'prohibited' behaviour, ie attempts to manipulate. Often, inner circumstances, such as a person's intentions, will play a role in determining the exact contours of the prohibition. A more factual question is whether supervisory authorities will be able to reliably detect attempted manipulations and enforce the prohibition. 15

Manipulations are further no longer limited to transactions or orders to trade but also **include any other behaviour**.[46] The European legislature refers to 'behaviour which occurs outside of a trading venue'[47] but provides no specific examples. The MAR includes 'other behaviour' in an attempt to cover as many forms of manipulations as possible. This approach comes at a price—legal certainty for market participants suffers from the broader wording. This is even more important when criminal sanctions are at stake. Constitutional laws of some Member States require that behaviours leading to criminal sanctions are specifically outlined by the law before the act is committed. 16

2. Information-based Market Manipulation

The European legislature considers information-based market manipulation to be particularly dangerous for investors and the proper functioning of markets. It has made this impressively clear in Recital 47: 17

'The spreading of **false** or **misleading information** can have **a significant impact** on the **prices** of financial instruments in a relatively short period of time. It may consist in the 18

[42] Art. 12(2) MAR.
[43] Recital 38 of the MAR explicitly opens the MAR to 'new' forms of manipulation as they may arise in the future.
[44] Recital 41 and Art. 15 MAR.
[45] Recital 41 MAR.
[46] Art. 2(3) MAR.
[47] Recital 46 MAR.

invention of manifestly false information, but also the wilful omission of material facts, as well as the knowingly inaccurate reporting of information. That form of market manipulation is **particularly harmful to investors**, because it causes them to base their investment decisions on incorrect or distorted information. It is also harmful to issuers, because it reduces the trust in the available information related to them. A lack of market trust can in turn jeopardise an issuer's ability to issue new financial instruments or to secure credit from other market participants in order to finance its operations. Information spreads through the market place very quickly. As a result, the harm to investors and issuers may persist for a relatively long time until the information is found to be false or misleading, and can be corrected by the issuer or those responsible for its dissemination. It is therefore necessary to qualify the spreading of false or misleading information, including rumours and false or misleading news, as being an infringement of this Regulation.'

(a) Dogmatics

19 Information-based manipulation is the **dissemination** of '**information** through the **media**, including the Internet, or by any other means, which

- **gives**, or is likely to give, **false** or **misleading signals** as to the **supply** of, **demand** for, or **price**', or
- 'secures, or is likely to secure, the price at an abnormal or artificial level'

of **a financial instrument**, a related spot commodity contract or an auctioned product based on emission allowances. This includes the dissemination of rumours, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading'.[48]

20 There are therefore two prerequisites for market manipulation: (i) the dissemination of false or misleading information, which (ii) gives false or misleading signals as to supply, demand or price of a financial instrument. The ECJ has not yet commented on these concepts. In the absence of coordinating guidelines from ESMA, it is quite conceivable that there are different interpretations in Europe, as national supervisory authorities and courts are likely to rely on the findings of the old market abuse law.

21 With regard to the first requirement, it should be noted that information does not only include facts, forecasts and prognosis, but also rumours. Where, how and to whom information is given is irrelevant for the application of the prohibition. In particular, it is not necessary for the information to be announced to a large audience, for example in a daily newspaper or in social media. The information can be disseminated via traditional communication channels and the Internet, but also in anonymous blogs, by email, etc. Information is incorrect if it does not correspond to the actual facts (because it is untrue or incomplete). Misleading information is correct in terms of content, but its presentation gives the recipient of the information a false idea of the facts described. Information-based manipulation may, among other ways, be achieved by publishing incorrect balance sheets, incorrect ad hoc notifications about inside information, incorrect notices about major shareholdings, or by incorrect statements in the media, eg during press conferences dealing with a company's financial statements or in internet chat rooms.

[48] Art. 12(1)(c) MAR.

22 The MAR requires that the **information** be **disseminated**. It is doubtful whether this can be done by omission. This question arises for all disclosure obligations under capital markets law. Where an investor is obliged to make a notification of changes in voting rights and fails to make such a notification, the failure to do so could also constitute market manipulation. The same applies to an issuer who fails to disclose an inside information immediately. In implementing the MAD 2003, national laws of Member States provided that market manipulation can also occur if someone withholds information contrary to existing legal obligations. The MAR does not explicitly provide for such an offence. However, some interpret the MAR in such a way that even an omission can constitute a market manipulation.[49] The interpretation is based on the argument that under Article 2(4) the MAR also applies to omissions. However, this provision only describes the territorial scope of the MAR.[50] It is also argued that a criminal liability arises from the national criminal codes. However, these rules cannot be applied because of the maximum harmonising character of the MAR. It is therefore no longer possible to commit market manipulation by concealing information contrary to existing legal obligations.[51] The European legislator should extend the ban on information-based market manipulation accordingly in the course of the MAR review.

23 Significant problems of interpretation arise from the requirement that the information must be relevant. In insider trading law, this is defined by the criterion of price relevance: information must be likely to significantly influence the price of the financial instrument. In the case of information-based market manipulation, on the other hand, it is stated that the information 'gives false or misleading signals as to the supply or price of a financial instrument or the demand for it'. It is even sufficient if 'this is likely'. Finally, it suffices that the information 'will lead to an abnormal or artificial price level of a financial instrument' or that 'this is likely'. First it can be noted, that price relevant information is subject to the information-based prohibition of market manipulation.[52] It is sufficient, however, that the information is likely to give false or misleading signals about supply, demand or price. A probability of more than 50% is generally sufficient—the suitability of the signal effect must be assessed from the perspective of a reasonable investor.[53] A price level is artificial if it does not reflect the true economic circumstances or the market price.[54] Legal doctrine develops groups of cases in which it can be assumed that they regularly give a signal with a suitability to influence the price.[55] These include (i) significant cooperations, (ii) liquidity problems and indebtedness, (iii) significant inventions, (iv) important litigation, (v) changes in key personnel positions and (vi) strategic corporate decisions.

24 BaFin determines false or misleading signals by an objective ex-post evaluation. A signal effect is to be affirmed if a reasonable market participant would (probably) take the information into account when making an investment decision because the information (probably) influences supply and demand. It is irrelevant in which direction the supply and demand could be influenced, ie whether the information was suitable to move the price up or down or to keep it.

[49] Cf. Begr. RegE, BT-Drucks. 18/7482, 64 (explanatory notes); H. Brinckmann, in: Meyer et al. (eds.), *Handbuch Marktmissbrauchsrecht*, § 15 para. 36; S. de Schmidt, 6 RdF (2016), 4, 5.

[50] See para. 11.

[51] Cf. P. Mülbert, in: Assmann et al. (eds.) *Kommentar zum Wertpapierhandelsrecht*, Art. 12 MAR para. 58, 180; M. Nietsch, 74 WM (2020), 717 ff.; A. Sajnovits, 71 WM (2017), 1189, 1193 ff.; L. Teigelack, in: Meyer et al. (eds.), *Handbuch Marktmissbrauchsrecht*, § 13 para. 28 ff.

[52] Cf. L. Teigelack, in: Meyer et al., (eds.) *Handbuch Marktmissbrauchsrecht*, § 13 para. 43.

[53] Cf. P. Mülbert, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, Art. 12 MAR para. 187; L. Teigelack, in: Meyer et al. (eds.), *Handbuch Marktmissbrauchsrecht*, § 13 para. 46.

[54] Cf. P. Mülbert, in: Assmann et al., (eds.) *Kommentar zum Wertpapierhandelsrecht*, Art. 12 MAR para. 187.

[55] Cf. P. Mülbert, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, Art. 12 MAR para. 192 ff.

(b) Legal Practice

25 The prohibition of information-based market manipulation is particularly important for issuers. It applies not only when issuers are legally obliged to provide information, but also becomes relevant in the case of voluntary reporting by issuers or by investors.

26 *Example*: In Germany the 'Porsche case' made headlines with the accusation of information-based market manipulation. **Porsche Automobil Holding SE** was accused of intentionally hiding its intent to take over Volkswagen AG (VW).[56] In September 2005 Porsche, which then held 20% of VW's shares, publicly denied any intention of taking over VW. In the following months, Porsche increased its stake in VW, resulting in a holding of more than 30% of the shares by March 2007. Porsche submitted a mandatory takeover offer pursuant to the WpÜG (German Takeover Act) and its supervisory board permitted the acquisition of a majority shareholding in March 2008. In a press release published a week later, Porsche publicly denied any intention of extending its shareholding to a total of 75%. In October 2008 Porsche's CEO announced the plan to acquire further shares to reach a total of 75% and thus cross the threshold needed to enter into a domination and profit/loss transfer agreement.[57] In November 2009 a letter by Porsche's General Counsel was published, stating that Porsche had already 'run through' the possibility of a complete takeover of VW during the first acquisition of VW shares in 2005. Several hedge funds filed claims against Porsche in the United States and in Germany demanding billions in damages, claiming information made public by Porsche would be false and misleading. The funds lost in the US and in Stuttgart and Braunschweig.[58]

27 *Example*: An already closed criminal case that received thorough media attention in Germany is that of the former CEO of **IKB Deutsche Industriebank AG**. In a press release of 20 July 2007, the defendant stated that the risks of dealing with US subprime mortgages would have 'practically no influence' on IKB. The depreciation would not exceed a seven-figure sum. On the day of publication, the price of IKB shares outperformed that of the MDAX,[59] where IKB was listed. One week later it became apparent that the depreciation would run to billions rather than millions. The court ruled that the former CEO had knowingly misled investors by creating the impression (through a press release) that IKB Bank AG had not been materially influenced by the subprime problems, although further analyses of banks and rating agencies showed that the opposite was true.[60]

28 *Example*: In the United Kingdom, the FCA fined the Canadian company formerly carrying on business as **Swift Trade Inc** £8 million for *layering*, a type of trade-based market manipulation.[61] The former FSA further imposed a fine of £17 million on Shell for continually having delivered

[56] Cf. OLG Stuttgart of 26.3.2015 – 2 U 102/14, 60 AG (2015), 404.

[57] This agreement (cf. § 291 AktG—German Stock Corporation Act) allows a parent company to give binding instructions to the board of the subsidiary and to obtain the profits gained by the subsidiary.

[58] OLG Stuttgart of 26.3.2015 – 2 U 102/14, 60 AG (2015), 404; LG Braunschweig of 9.6. 2013 – 5 O 552/12, 10 NZKart (2013), 380.

[59] The MDAX Index is part of the Prime Standard Segment of the Frankfurt Stock Exchange (FWB). It includes the 50 shares from classical sectors excluding technology that rank immediately below the companies included in the DAX index.

[60] BGH of 20.7.2011 – 3 StR 506/10, 56 AG (2011), 702.

[61] FCA, Final Notice, 7722656, Canada Inc formerly carrying on business as Swift Trade Inc, 24 January 2014; layering is the 'practice of entering relatively large orders on one side of an […] order book without the genuine intention that the orders will be executed […] while they nevertheless [move] the price of the relevant share as the market adjusts to the fact that there has been an apparent shift in the balance of supply and demand […] The movement is followed by […] a trade on the opposite side of the order book which takes advantage of […] that movement. This trade is in turn followed by a rapid deletion of the large orders […]', cf. the decision of the Upper Tribunal (Tax and Chancery Chamber) of 23 January 2013, ref. no. FS/2011/0017, 0018 (*Swift Trade*) 3.

incorrect information regarding the reserves of a certain natural resource, thus influencing the share price.[62]

Rumours and false information occur frequently and quickly lead to price changes, with the result that investors buy securities at artificial prices. *Examples*: Shares of the social network Twitter briefly gained 7 % following a fake Bloomberg article conveying takeover rumours in July 2015.[63] The same happened to Avon Products in June 2015 when the SEC's online database was abused to enter false filings for takeover bids.[64] In 2014, British security company G4S took a plunge following a false statement about accounting problems.[65] Shares of American car-maker Tesla rose by 0.75 % following an April fools' joke in 2015 announcing the release of a watch in a tweet.[66] 29

(c) Digression: Behavioural Finance

Any information-based manipulation aims to influence the perception of other market participants. Whether information potentially gives incorrect or misleading signals depends not only on the information itself, but also to a large extent on how the information is understood by the recipient. If investors have persistent problems understanding or processing certain information correctly, a clever manipulator can take advantage of this fact.[67] The literature on behavioural finance has proven that humans generally tend to overestimate their abilities. This phenomenon of ***overconfidence*** also arises on financial markets, as studies on financial analysts,[68] CEOs with regard to takeovers and dividend policies,[69] and private investors with online trading accounts[70] have shown. The result of such overconfidence can be that people do not fall for the manipulator because they believe him, but rather because they believe they can still control events.[71] The human assessment of risks furthermore changes, depending on whether information is framed as a possibility to make profits or prevent losses (***framing effect***), the inclination to take risks being larger when trying to prevent losses. Similarly, humans tend to choose safe profits over possible, but uncertain, higher profits, even if the expected utility in both cases is the same.[72] Finally, humans take in information more easily the more prominently it is presented (***availability bias***). 30

[62] FSA, Final Notice, Shell Transport and Trading Company, plc and The Royal Dutch Petroleum Company NV, 24 August 2004 (this judgment was made prior to the introduction of the new regime and is now viewed as a sanction for information-based manipulation).

[63] www.nytimes.com/2015/07/15/business/dealbook/twitter-shares-jump-after-fake-bloomberg-report.html?r=0.

[64] http://fortune.com/2015/05/15/sec-enables-avon-stock-scam-and-doesnt-seem-to-care/.

[65] www.wsj.com/articles/g4s-hit-by-elaborate-hoax-after-fake-statement-released-1415816334.

[66] http://blogs.wsj.com/moneybeat/2015/04/01/tesla-stock-moves-on-april-fools-joke/.

[67] L. Teigelack, *Finanzanalysen und Behavioral Finance*, 182, concerning the use of information resulting from a research report. For a recent overview of research in behavioural finance see J. Huang et al., 12 Int. J. of Managerial Finance (2016), 92; see also R. Veil § 6 para. 20–29.

[68] G. Friesen and P. Weller, 9 Journal of Financial Markets (2006), 14; O. Stotz and R. von Nitzsch, 15 ZBB (2003), 106 ff.; see also Q. Chen and W. Jiang, 19 Rev. Fin. Studies (2006), 319, 339, 350.

[69] U. Malmendier and G. Tate, 89 Journal of Financial Economics (2008), 20; S. Deshmukh et al., 22 Journal of Financial Intermediation (2013), 440.

[70] B. Barber and T. Odean, 21 Rev. Fin. Studies (2008), 785; B. Barber and T. Odean, 55 J. Fin. (2000), 773.

[71] Cf. L. Teigelack, *Finanzanalysen und Behavioral Finance*, 143.

[72] In general D. Kahneman and A. Tversky, 47 Econometrica (1979), 263, 268–269; A. Tversky and D. Kahneman, 59 J. Bus. (1986), 251, 260.

This can lead to the problem that certain information is not acknowledged, simply because of the way it is presented, eg disclaimers on possible conflicts of interest of the manipulator or information on particular risks.[73]

31 These examples show how much influence human weaknesses in processing information can have on investment decisions. However, the MAR-regime does not take behavioural finance into account. It rather builds on the concept of a *reasonable investor*[74] who bases his decision on all available information.[75] It has not yet been considered that this reasonable investor may make mistakes when coming to an investment decision. Accepting this danger would lead to new problems, as one can hardly predict which person will make which mistake in processing information in any given situation. The concept of a reasonable investor must therefore be regarded as a deliberate decision of the legislature not to want to protect incorrect investment decisions.[76]

3. Transaction-based Market Manipulation

(a) Definition and Indicators

32 The MAR further prohibits **transaction-based market manipulations**, ie any transactions or orders to trade

— which give, or are likely to give, false or misleading signals as to the supply of, demand for, or price of a financial instrument, a related spot commodity contract or an auctioned product based on emission allowances, or
— which secure the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances at an abnormal or artificial level.[77]

33 Annex I Section A of the MAR specifies these broadly phrased definitions. Certain non-exhaustive **indicators**, which do not necessarily in themselves constitute market manipulation, are taken into account when transactions or orders to trade are examined by market participants and competent authorities.

34 The indicators are, among other things:

— the extent to which orders to trade given or transactions undertaken represent a significant proportion of the daily volume of transactions in the relevant financial instrument, related spot commodity contract or auctioned product based on emission allowances in particular when those activities lead to a significant change in their prices;
— the extent to which orders to trade given or transactions undertaken by persons with a significant buying or selling position in a financial instrument, related spot commodity contract or auctioned product based on emission allowances lead to significant changes in the price of

[73] L. Teigelack, *Finanzanalysen und Behavioral Finance*, 131, 143–144.
[74] See R. Veil § 6 para. 31 and § 14 para. 53.
[75] Cf. Recital 14 MAR, recital 1 of the MAD 2003 and CESR, CESR's Advice on Level 2 Implementing Measures for the Proposed Market Abuse Directive, August 2003, CESR/02–89d, p. 10; overview in R. Veil, 18 ZBB (2006), 162 ff.; L. Teigelack, *Finanzanalysen und Behavioral Finance*, 83 ff.
[76] R. Veil, 18 ZBB (2006), 162, 171; L. Teigelack, *Finanzanalysen und Behavioral Finance*, 86–87.
[77] Art. 12(1)(a) MAR; the ECJ has ruled that 'securing' the price at an abnormal level requires no minimum time period. Even very short-lived distortions constitute trade-based manipulation (Case C-445/09 *(IMC Securities)*).

that financial instrument, related spot commodity contract or auctioned product based on emission allowances;

— whether transactions undertaken lead to no change in beneficial ownership of a financial instrument, related spot commodity contract or auctioned product based on emission allowances;[78]
— the extent to which orders to trade given or transactions undertaken or orders cancelled include position reversals in a short period and represent a significant proportion of the daily volume of transactions in the relevant financial instrument, related spot commodity contract or auctioned product based on emission allowances;
— the extent to which orders to trade given or transactions undertaken are concentrated within a short time span in the trading session and lead to a price change which is subsequently reversed;
— the extent to which orders to trade are given or transactions are undertaken at or around a specific time when reference prices, settlement prices and valuations are calculated and lead to price changes which have an effect on such prices and valuations.[79]

Annex II Sections 1 and 2 of Commission Delegated Regulation (EU) No. 2016/522 supplement MAR with regard to the indicators in Annex I.[80] Annex II section 1 gives a good overview of possible forms of trade-based market manipulations. **Wash sales** are a prominent example: if an investor sells shares to a company that it owns, the economic ownership of the security does not change and this may be considered trade-based manipulation. **Marking the close** can happen, if transactions are intentionally entered into at the close of the market, so that investors trading on the basis of the closing price pay a higher price. **Spoofing** describes the procedure in which a manipulator who holds a *long position* submits one or more orders to buy, thus achieving the incorrect impression of a high demand. Shortly thereafter (before executing the order) the manipulator cancels the order, hoping that other market participants submit buy orders due to the seemingly higher demand. The manipulator then sells his securities at this higher price. **Improper matched orders** are orders placed by different parties at basically identical conditions. However, the parties have previously agreed on placing these orders, so that an unnatural strike price can result. Market participants could be **colluding in the after-market of an Initial Public Offer** if they buy positions in the secondary market after a placement in the primary market to post the price to an artificial level and generate interest from other investors. The **creation of a floor/ceiling in the price pattern** means creating obstacles to prices falling below or rising above a certain level. **Ping orders** are small orders that are intended to ascertain the level of hidden orders and to assess what is resting on a hidden platform. Uncovering orders of other market participants through own transactions or orders and then taking advantage of this information is referred to as **phishing**. An **abusive squeeze** lies in taking advantage of the significant influence over supply of, or demand for, or the delivery mechanism of financial instruments etc. in order to distort prices. **Inter-trading venues manipulation** aims 35

[78] This refers to so-called wash sales; see para. 35.
[79] Annex I Section A MAR.
[80] Commission Delegated Regulation (EU) No. 2016/522 supplementing Regulation (EU) No. 596/2014 of the European Parliament and of the Council as regards an exemption for certain third countries public bodies and central banks, the indicators of market manipulation, the disclosure thresholds, the competent authority for notifications of delays, the permission for trading during closed periods and types of notifiable managers' transactions, OJ L88, 5 April 2016, p. 1–18.

to influence the price of financial instruments etc. on one trading venue through transactions or orders to trade on another venue. **Cross-product manipulation** aims to achieve the same goal through transactions or orders to trade in another product. **Concealing ownership** relates to breaches of disclosure obligations in order to conceal the true ownership of financial instruments etc. **Pump and dump** and **trash and cash** concern the dissemination of false or misleading positive or negative information to benefit a long or short position. **Quote stuffing** can create uncertainty among other market participants by entering a large number of trades, cancellations or updates. This can slow down other market participants or camouflage one's own trading strategy. **Momentum ignition** describes the orders or series of orders designed to start or exacerbate a trend in the behaviour of other market participants to move the price in a certain direction. **Layering and spoofing** means placing multiple or large orders to trade on one side of the order book to be able to execute a trade on the other side. Once the actual trade has taken place the unwanted orders are removed. **Placing orders with no intention of executing them** and then removing these orders before execution can mislead other market participants as to the actual supply or demand. **Excessive bid-offer spreads** are maintained if a market participant (ab)uses its power through orders that (likely) bypass trading safeguards such as price/volume limits and thus causes an artificial spread. **Advancing the bid** happens when orders are entered at prices that will increase the bid or decrease the offer and thus move prices. **Smoking** means attracting slower trades by posting orders and then rapidly reversing these orders in a less favourable direction for the slower traders. **Distorting costs associated with a commodity contract** (insurance or freight) can lead to the settlement price of a financial instrument to be set at an artificial level.

36 If the parties disclose the exceptional circumstances before the transaction, their behaviour does not constitute market manipulation. In these cases, the reliability of the price formation does not need to be protected, as the market is informed of the special circumstances beforehand, and thus cannot be misled.

(b) Exceptions

37 No trade-based manipulation within the meaning of Article 12(1)(a) MAR occurs if the person entering into a transaction or placing an order to trade or engaging in any other behaviour can establish that such transaction, order or behaviour has been carried out for **legitimate reasons** and conform with an **accepted market practice** established in accordance with Article 13 MAR.[81] The MAR phrases the exception as a reversal of the burden of proof. The behaviour is therefore prohibited, unless the person who entered into the transaction can submit a legitimate reason and show that the transaction conforms to an accepted market practice. There is an intensive discussion in the legal literature as to the legitimate reasons and accepted market practices; however, this largely remains *law in the books*.

38 The MAR contains no information as to what constitutes a **legitimate reason**. Additionally, ESMA has not made any statement in this respect. There does not appear to be any jurisprudence on this question as yet. Legitimate reasons can, for example, be assumed if the

[81] Cf. Recital 42 MAR.

transaction is based on a legal or supervisory obligation towards a third party. As opposed to this, a legitimate reason is less likely if the transaction was performed in order to give incorrect or misleading signals.

The MAR defines **Accepted Market Practices** (AMPs) as 'a specific market practice that is accepted by a competent authority in accordance with Article 13'.[82] Article 13 MAR has replaced Directive 2004/72/EC in setting forth the criteria that national supervisory authorities may take into account in establishing a market practice and outlines the consultation process for acceptance. ESMA drafted regulatory technical standards with regard to AMPs,[83] and the Commission passed Delegated Regulation (EU) No. 2016/908 on Level 2 signing ESMA's draft into law. The national competent authorities, such as AMF, BaFin, CNMV, CONSOB, etc., may take into account several aspects, such as the level of transparency of the relevant market practice to the market as a whole, the need to safeguard the operation of market forces and the proper interplay of the forces of supply and demand, the risk inherent in the relevant practice for the integrity of related markets, the structural characteristics of the relevant market (ie the type of market participants and the extent of retail investor participation), and the outcome of any investigation of the relevant market practice by any other competent authority.[84] Commission Delegated Regulation (EU) No. 2016/908 specifies these criteria.[85] 39

4. Other Forms of Market Manipulation

Entering into a transaction, placing an order to trade or any other activity or behaviour which affects or is likely to affect the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances, which employs **fictitious devices or any other form of deception** or contrivance is also prohibited.[86] This serves as a **catch-all clause** for all market manipulations that are not covered by the other two definitions, in order to prevent any behaviour that ought to be prohibited from remaining unsanctioned. Annex I Section B MAR provides for indicators that must be taken into account when trying to determine whether behaviour is to be considered manipulative: 40

— whether orders to trade given or transactions undertaken by persons are preceded or followed by dissemination of false or misleading information by the same persons or by persons linked to them;[87]
— whether orders to trade are given or transactions are undertaken by persons before or after the same persons or persons linked to them produce or disseminate research or investment recommendations which are erroneous or biased or demonstrably influenced by material interest.

[82] Art. 3(9) MAR; cf. N. Moloney, *EU Securities and Financial Markets Regulation*, 750 ff., for a detailed description of the AMP rules.
[83] According to Art. 13(7) MAR.
[84] Art. 13(2)(a)–(g) MAR.
[85] Art. 3–9 Commission Delegated Regulation (EU) No. 2016/908.
[86] Art. 12(1)(b) MAR.
[87] This can only refer to information that is not already likely to give false or misleading signals, as this form of information is already included in the core definition in Art. 12(1)(c) MAR.

41 Annex II Section 2 to Commission Delegated Regulation (EU) No. 2016/522 specifies these two indicators. With regard to the first indicator ESMA describes several forms of behaviour, such as disseminating false or misleading positive information after taking a long position and then selling out the position when the price is at an artificially high level (*pump and dump*) or vice-versa (*trash and cash*)[88] and moving empty cargo ships.[89] With regard to the second indicator ESMA also mentions *pump and dump* and *trash and cash*.[90]

5. Benchmark Manipulation

42 Following public reports on the manipulation of reference rates, such as LIBOR in particular, the Commission's proposal of the MAR (published in 2011) was amended in 2012 to prevent such behaviour in the future. The MAR aims to protect investor confidence and also mentions damages to individual investors and potential setbacks to the real economy.[91] It therefore prohibits '**transmitting false** or **misleading information** or providing false or misleading inputs in **relation to a benchmark** where the person who made the transmission or provided the input knew or ought to have known that it was false or misleading, or any other behaviour which manipulates the calculation of a benchmark.'[92]

43 The term benchmark is defined broadly and means 'any rate, index or figure, made available to the public or published that is periodically or regularly determined by the application of a formula to, or on the basis of the value of one or more underlying assets or prices, including estimated prices, actual or estimated interest rates or other values, or surveys, and by reference to which the amount payable under a financial instrument or the value of a financial instrument is determined.'[93] This could have also applied to the alleged influencing of the Foreign Exchange Rates. Several large banks are facing litigation in the US for allegedly distorting the WM/Reuters fix. The 'fix' is based on actual transactions occurring in a certain window of time and is used to determine the 'official' exchange rate between currencies. The allegations are that banks deferred customers' transactions into this window of time to distort the 'fix' in their own favour.[94] Another example could be the influencing of the settlement prices for gas futures on the European Energy Exchange that followed a similar pattern.[95]

44 The indicators in Annex I to the MAR **do not** apply **to benchmark manipulation**, and ESMA considers it premature to provide specific examples or practices of benchmark manipulation.[96]

[88] Annex II sec. 2(1)(c) Regulation (EU) No. 2016/522.
[89] Annex II sec. 2(1)(g) Regulation (EU) No. 2016/522.
[90] Annex II sec. 2(2)(b) Regulation (EU) No. 2016/522.
[91] Recital 44 MAR; cf. N. Moloney, *EU Securities and Financial Markets Regulation*, 744 ff., for a detailed description of benchmark measures.
[92] Art. 12(1)(d) MAR; see in more detail M. Wundenberg §§ 35, 36.
[93] Art. 3(1)(29) MAR.
[94] United States District Court for Southern District of New York, Case 1:13-cv-07789, In re Foreign Exchange Benchmark Rates Antitrust Litigation; UK and US regulators also took action, cf. FCA, Final Notice, Deutsche Bank, 23 April 2015.
[95] BaFin, Jahresbericht 2014 (annual report), p. 220.
[96] ESMA, Final Report, Technical Advice on possible delegated acts concerning the Market Abuse Regulation, 3 February 2015, ESMA/2015/224, para. 13.

6. Specific Types of Market Manipulation

(a) Dominant Market Position

45 The first example of market manipulation is conduct by a person, or persons acting in collaboration, to secure a dominant position over the supply of or demand for a financial instrument, related spot commodity contracts or auctioned products based on emission allowances which has or is likely to have the effect of fixing, directly or indirectly, purchase or sale prices or creates or is likely to create other unfair trading conditions.[97] Strictly speaking, this example does not refer to a manipulation on the ground of the information accessible for market participants. Having a dominant market position does not entail misleading other market participants. This is rather an **antitrust issue**, affecting market fairness.[98] The reason why the dominant market position was still introduced as part of the definition of market manipulation may be that monopolies are likely to weaken investors' trust in the market.

46 According to the MAR, **any conduct** to secure a dominant position is to be prohibited, irrespective of whether the person intends to abuse this position.[99] The dominant position must, however, have the effect of fixing, directly or indirectly, purchase or sale prices or creating other unfair trading conditions.[100] Such manipulation can occur if many uncovered short sales have taken place, and the securities of the respective company are thus in great demand on the market.[101]

47 *Example*: In Germany, the case of VW shares, which briefly soared to a price of over € 1,000, making VW the world's most valuable company for a short time, has proven controversial. At the same time as declaring Porsche's intention to acquire a total of 75% of VW's shares,[102] Porsche's CEO had informed the public of already having raised its holdings to 43%, with an additional 31% in 'options' as a forward cover. These were *cash-settled equity swaps* that did not have to be disclosed at the time.[103] As a result, short sellers and index funds had to acquire further VW shares. However, the supply of ordinary VW shares was extremely low at this time, as large numbers of the available shares were held by Porsche itself or by its contractual counterparties via option contracts. The counterparties had acquired shares in order to hedge the risks resulting from the option contract. The federal state of Lower Saxony held a little more than 20% of the shares, so that a supply of merely 6% of available shares was met by 13% of shorted shares. However, the prohibition of cornering does not grant investors a claim under section 823(2) of the German Civil Code (Bürgerliches Gesetzbuch – BGB). The courts have therefore dismissed claims for damages.[104] Irrespective of this, Porsche is unlikely to have had a dominant position on the market.[105]

97 Art. 12(2)(a) MAR.
98 P. Mülbert, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, Art. 12 MAR para. 226.
99 Cf. H. Fleischer and E. Bueren, 34 ZIP (2013), 1253, 1256.
100 Art. 1(2)(a) MAR.
101 Cf. H. Fleischer and E. Bueren, 34 ZIP (2013), 1253, 1256.
102 See para. 26.
103 In more detail see R. Veil § 20 para. 93.
104 OLG Braunschweig of 12.1.2016 – 7 U 59/14, 61 AG (2016), 290; OLG Stuttgart of 26.3.2015 – 2 U 102/14, 60 AG (2015), 404; H. Fleischer and E. Bueren, 34 ZIP (2013), 1253 f.
105 Cf. A. Anschütz and M. Kunzelmann, in: Meyer et al. (eds.), *Handbuch Marktmissbrauchsrecht*, § 14 para. 30.

(b) Transactions at the Close of the Market

48 A second example of market manipulation is the so-called ***marking the close***.[106] The MAR defines this as 'the buying or selling of financial instruments at the opening or closing of the market which has or is likely to have the effect of misleading investors acting on the basis of the prices displayed, including the opening or closing prices.'[107] This can be especially profitable when further transactions are concluded on the basis of an upwards distorted closing price.

(c) Certain Means of Algorithmic and High-Frequency Trading (HFT)

49 Algorithmic trading and HFT are **not prohibited per se**. Certain forms are rather classified as *trade-based* market manipulations. In general, sending orders to a trading venue without an intention to trade is prohibited if the order is placed with the intention of disrupting or delaying the functioning of the venue's trading system, making it more difficult for others to identify genuine orders (so-called *layering* or *quote stuffing*) or creating a false or misleading impression about the supply and demand for a financial instrument.[108] The enumeration is non-exhaustive because the MAR **aims** to **provide adaptable measures against market manipulation in the face of rapidly changing forms of trading.**[109]

(d) Abusing Access to the Media

50 A further example of market manipulation refers to 'taking advantage of occasional or regular access to the traditional or electronic media by voicing an opinion about a financial instrument, related spot commodity contract or an auctioned product based on emission allowances (or indirectly about its issuer) while having previously taken positions on that financial instrument, related spot commodity contract or an auctioned product based on emission allowances and profiting subsequently from the impact of the opinions voiced on the price of that instrument, related spot commodity contract or an auctioned product based on emission allowances without having simultaneously disclosed that conflict of interest to the public in a proper and effective way'.[110] This is also called ***scalping*** and might, for example, involve spam e-mails, which promise considerable increases in the share price of specific issuers. Before sending the e-mail, the sender buys shares in the generally illiquid titles, enabling them to profit from the subsequent price movement. Successful *scalping* requires that the opinion of the scalper can influence the share price. It therefore usually happens with regard to illiquid shares for which even slight trading activities can lead to price movements.[111]

51 *Example*: In Germany the BGH had to deal with a criminal case on scalping in 2003. The defendant was the editor of a money magazine and appeared in stock market programmes on television

[106] See above para. 35.
[107] Art. 12(2)(b) MAR.
[108] Art. 12(2)(c) MAR; The FCA fine of £ 8 million mentioned in para. 19 was for layering.
[109] Recital 38 MAR.
[110] Art. 1(2)(d) MAR.
[111] Cf. R. Aggarwal and G. Wu, 79. J. Bus. (2006), 1915, 1917; one of the most commonly cited examples from the United States is the case *SEC v. Lebed*, 73 SEC Docket 741, 20 September 2000, in which a teenager earned a few hundred thousand dollars through scalping on the Internet.

issuing investment recommendations. He had obtained the reputation of being an opinion maker in the 'new market' (Neuer Markt) and had entered into consultancy contracts with two funds. These usually followed his recommendations without any further enquiries. The defendant and an accomplice raised funds, before acquiring new economy stock and then recommending these to the two funds without, however, indicating that he was holding respective shares himself. Due to the high order volume the prices of the securities rose and the defendant sold his shares at a higher price.

Before this case, the prevailing view in legal literature held that the acquisition of securities by a *scalper* prior to the public recommendation thereof violated the rules on insider dealings, the knowledge of the *scalper* of the ensuing recommendation being regarded as inside information. The BGH did not follow this understanding, arguing that personally created facts did not constitute inside information requiring that the information have a connection to a third party and not only exist in the mind of the *scalper*.[112] 52

Under the MAR regime, a self-generated fact can also be inside information.[113] However, European law understands scalping as market manipulation, so that insider trading law is not applicable. 'Positions' are not only securities, but also derivatives and short positions (of a short seller).[114] Ultimately, lack of transparency is penalised. For a 'proper and effective' disclosure of the conflict of interest, it is not necessary to disclose the size of the position.[115] The prohibition does not require that the scalper's statement is false or misleading or that the recommendation is factually untenable. However, statements of a scalper which contain false or misleading signals may constitute market manipulation according to Article 12(1)(c) MAR. The *scalper's* recommendation needs not in itself be incorrect or misleading. Recommendations of a *scalper* that give false or misleading signals in the sense of the core definition already constitute market manipulation for this reason. 53

(e) Emission Allowances

The acquisition or sale of emission allowances or related derivatives on the secondary market prior to the auction under Regulation (EU) No. 1031/2010 is to be considered market manipulation, if it has the effect that the auction clearing price is fixed at an abnormal or artificial level or if bidders are misled.[116] 54

V. Safe-Harbour Rules

1. Introduction

The MAR stipulates **two exceptions from the prohibition of market manipulation**. The prohibitions do not apply to trading in own shares in '**buy-back**' programmes and the 55

[112] BGH of 06.11.2003 – 1 StR 24/03, BGHSt 48 (2003), 373.
[113] See R. Veil § 14 para. 51.
[114] Cf. L. Teigelack, in: Meyer et al. (eds.), *Handbuch Marktmissbrauchsrecht*, § 13 para. 62 ff.
[115] Cf. L. Teigelack, in: Meyer et al. (eds.), *Handbuch Marktmissbrauchsrecht*, § 13 para. 74, 79; P. Mülbert, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, Art. 12 MAR para. 249.
[116] Art. 12(2)(e) MAR.

stabilisation of a financial instrument, provided such trading is carried out in accordance with the procedure laid down in the MAR and the applicable RTS.[117] Buy-back programmes and stabilisation measures are of considerable practical importance. Commission Delegated Regulation (EU) No. 2016/1052 takes the place of repealed Regulation (EC) No. 2273/2003 in specifying conditions for buy-back programmes and stabilisation measures.

2. Buy-Back Programmes

56 The acquisition of own shares by a company can help signal to the market that the securities are not undervalued. The incentive to buy caused by the company can lead to a stabilisation or increase of the share price. A company may also buy back shares as currency for acquisitions, to prevent takeovers or to meet obligations arising from employee share option programmes or exchangeable bonds. Once the share price deviates from the securities' 'real value', one enters the realm of market manipulation, because the **price is no longer determined by the free interaction of market forces**, but rather by the company steering the market. Nevertheless, buy-back programmes for own shares (not bonds) are exempted from the prohibition of market manipulation under certain conditions due to their great importance for issuers.

57 The exemption applies only to outright trading in own **shares**, however. The issuer may not use derivatives anymore to acquire own shares. The MAR mentions the term 'associated instruments' in connection with stabilisation measures but not in the context of buy-back programmes.[118] Buy-back programmes that meet the requirements established by the regulation are exempt from the prohibition of market manipulation and insider dealing. However, the obligations to disclose inside information[119] and major shareholdings[120] remain applicable.[121] The issuer also has to meet the EU corporate law requirements regarding share buy-backs.[122]

(a) Aim of the Programme

58 **Legitimate objectives** for buy-back programmes **only** include the **reduction** of an **issuer's capital** (in value or in number of shares), **meeting obligations** arising from debt financial instruments exchangeable into equity instruments or employee share option programmes, or **other allocations** of **shares** to employees or to members of the administrative, management or supervisory bodies of the issuer or of an associate company.[123] Calls to include buy-back programmes for acquisition financing into the *safe harbour* can be heard regularly in legal practice. The former CESR rebuffed this demand, although not all supervisory

117 Art. 5 MAR.

118 Recital 2 Commission Delegated Regulation (EU) No. 2016/1052; using derivatives was explicitly allowed by former Regulation (EC) No. 2273/2003 (recital 8).

119 Art. 17(1) MAR; see R. Veil § 19.

120 Art. 9 and 10 TD; see R. Veil § 20.

121 P. Mülbert, in: Assmann et al., *Kommentar zum Wertpapierhandelsrecht*, Art. 5 MAR para. 13, 14.

122 A buy-back programme is defined as trading in own shares in accordance with Art. 21 to 27 of Directive 2012/30/EU.

123 Art. 5(2)(a)–(c) MAR.

authorities of the Member States shared this opinion.[124] France, for example, has declared the acquisition of own shares to finance the acquisition of a company on Euronext an *accepted market practice*.[125] The Greek competent authority did not evaluate the aim of the programme at all as long as the trading conditions were met.[126] ESMA describes the purposes listed in the MAR as the 'sole legally allowed' purposes[127] thus making them factually binding outside of grandfathered Accepted Market Practices.

(b) Disclosure Obligations

In order to profit from the *safe-harbour* rule, an issuer must comply with certain disclosure obligations, both prior to and after implementing the buy-back. Full details of the programme must be adequately disclosed to the public, *prior* to the start of trading.[128] The 'adequate disclosure' of information is defined in Commission Delegated Regulation (EU) No. 2016/1052 and will not be described in any further detail herein.[129] Trades must be reported as being part of the buy-back programme to the competent authority of the trading venue and subsequently disclosed to the public.[130] The issuer must report each transaction relating to the buy-back programme to the competent authority of the trading venue on which the shares have been admitted to trading or are traded, including certain information specified in Regulation (EU) No. 600/2014.[131] 59

(c) Trading Conditions

The buy-back programme must follow the procedure laid down in the MAR and in Commission Delegated Regulation (EU) No. 2016/1052. The provisions on trading conditions are to ensure that the acquisition of own shares by the company does not lead to an artificial price increase by higher acquisition prices or a shortage of shares on the free market.[132] The MAR therefore calls for adequate limits with regard to price and volume to be complied with.[133] Commission Delegated Regulation (EU) 2016/1052 contains detailed provisions on trading conditions. Shares shall be purchased on a trading venue where the shares are admitted to trading or are traded.[134] The issuer may not pay a higher price for the shares than the highest price of the last independent trade/bid on the respective trading venue.[135] A shortage of shares on the market is to be prevented by the fact that 60

[124] CESR, CESR's response to the Commission call for evidence on the review of the Market Abuse Directive, July 2009, CESR/09-635, 7.

[125] Cf. www.cesr-eu.org/popup2.php?id=3379.

[126] V. Tountopoulos, 22 EWS (2012), 449, 454.

[127] ESMA, Final Report, Draft Technical Standards on the Market Abuse Regulation, 28 September 2015, ESMA/2015/1455, para. 12; cf. also N. Moloney, *EU Securities and Financial Markets Regulation*, 753.

[128] Art. 5(1)(a) MAR.

[129] Art. 1(b) Commission Delegated Regulation (EU) No. 2016/1052.

[130] Art. 5(1)(b) MAR.

[131] Art. 5(3) MAR refers to Art 25(1) and (2) Art 26(1), (2) and (3) of Regulation (EU) No. 600/2014; Art. 2 Commission Delegated Regulation (EU) No. 2016/1052 contains details on the disclosure obligations.

[132] P. Mülbert, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsgesetz*, Art. 5 MAR para. 52.

[133] Art. 5(1)(c) MAR.

[134] Recital 4 and Art. 3(1)(a) Commission Delegated Regulation (EU) No. 2016/1052.

[135] Art. 3(2) Commission Delegated Regulation (EU) No. 2016/1052.

'issuers shall not […] purchase more than 25% of the average daily volume of the shares in any trading day on trading venue on which the purchase is carried out'.[136]

(d) Restrictions

61 Additionally, the issuer is subject to a number of restrictions, which are to ensure fairness and transparency of the buy-back programme.[137] The issuer may not sell own shares for the duration of the programme and may not trade at all during certain, so-called 'closed' periods, or where the issuer has decided to delay the public disclosure of inside information.[138] *Closed* in the sense of the MAR are periods during which the issuer's board members are prohibited to trade in the issuer's shares. The RTS point to the MAR's definition of closed periods in the context of managers' transactions (30 calendar days before the mandatory publication of a financial report).[139]

62 The restrictions on trading do not apply if the issuer is an investment firm or credit institution and has established effective information barriers (*Chinese walls*) between those responsible for the handling of inside information and those responsible for any decision relating to the trading of own shares.[140] They also do not apply if the issuer has a time-scheduled buy-back programme in place or the buy-back programme is managed by an investment firm or a credit institution with sole discretion as to the transactions.[141] A *time-scheduled* programme sets out the dates and quantities of securities to be traded during the period of the programme at the time of the public disclosure of the buy-back programme.[142] The disadvantage of these programmes is that the issuer can no longer react flexibly to the actual market conditions.[143] At the same time, they guarantee transparency and independence, thus exempting the issuer from the prohibitions.

3. Price Stabilisation

63 So-called stabilisation activities constitute a second safe harbour. The MAR defines stabilisation as a **purchase** or offer to purchase **securities**, or a transaction in associated instruments equivalent thereto, which is undertaken by a **credit institution** or an investment firm in the context of a significant distribution of such securities **exclusively for supporting** the **market price** of those securities for a **predetermined period of time**, **due** to a **selling pressure** in such securities.[144] These measures are privileged, because stock offerings are often accompanied by numerous disposals of shares by short-term traders. Some investors also subsequently sell as many shares as necessary to cover their costs of acquiring the newly issued shares (so-called *flipping*). The resulting selling pressure reduces the price of the

[136] Art. 3(3) Commission Delegated Regulation (EU) No. 2016/1052.
[137] P. Mülbert, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, Art. 5 MAR para. 66.
[138] Art. 4(1)(c) Commission Delegated Regulation (EU) No. 2016/1052.
[139] Art. 4(1)(c) Commission Delegated Regulation (EU) No. 2016/1052.
[140] Art. 4(3) and (4) Commission Delegated Regulation (EU) No. 2016/1052.
[141] Art. 4(2) Commission Delegated Regulation (EU) No. 2016/1052.
[142] Art. 1(a) Commission Delegated Regulation (EU) No. 2016/1052.
[143] P. Mülbert, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, Art. 5 MAR para. 69.
[144] Art. 3(2)(d) MAR.

financial instruments. This is regarded as contrary to market interests, and the regulation thus aims to prevent such price drops.[145] Since stabilisation activities lead to an artificial price level, adequate public disclosure is necessary in order to ensure the investors' trust in the market mechanisms.[146]

As with buy-back programmes, the safe harbour for stabilisation measures only exempts an issuer from the prohibition of market manipulation and insider trading. Ad hoc disclosure obligations and the general rules governing investment firms and credit institutions still apply, as only these institutions are allowed to carry out stabilisation measures. 64

(a) Scope of Application

Only investment firms and credit institutions are permitted to undertake stabilisation activities under the MAR.[147] The safe harbour is open to significant distributions defined as an *initial* and *secondary* offer of securities that is distinct from ordinary trading both in terms of the amount in value of the securities to be offered and the selling method to be employed.[148] This also includes the placement of shares after a capital increase.[149] So-called *block trades*, in which large shareholdings are traded between individual persons, generally do not fall within the scope of the exemption. The Commission, however, leaves a door open for 'negotiated transactions that do not contribute to price formation.'[150] 65

The *safe-harbour* rule further does not apply to a decline in stock prices resulting from the poor economic situation of an issuer. Additionally, stabilisation may under no circumstances 'be executed above the offering price'.[151] Stabilisation may only aim to stabilise the price, not, however, to increase it. According to ESMA, sales also do not fall within the scope of the directive, as only the purchase of shares can stabilise the price.[152] 66

(b) Period of Stabilisation

The MAR only exempts stabilisation activities from the market manipulation provisions if these activities were limited to a certain time period in advance.[153] The activities must furthermore have an immediate relation to an offering. In an **initial public offering** of shares and other securities equivalent to shares, the **period begins on the date of commencement of trading and ends no later than 30 calendar days thereafter.**[154] The *safe harbour* is therefore not open for transactions during the *bookbuilding* phase. In a secondary offering, the relevant period begins on the date of adequate public disclosure of the final price of the relevant securities and ends no later than 30 calendar days after the date of allotment.[155] 67

[145] Recital 6 Commission Delegated Regulation (EU) No. 2016/1052.
[146] Recital 8 Commission Delegated Regulation (EU) No. 2016/1052.
[147] Art. 3(2)(d) MAR.
[148] Art. 3(2)(c) MAR.
[149] P. Mülbert, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, Art. 5 MAR para. 78.
[150] Recital 4 Commission Delegated Regulation (EU) No. 2016/1052.
[151] Art. 7(1) (shares or other securities equivalent to shares) and accordingly 7(2) (securitised debt convertible or exchangeable into shares) Commission Delegated Regulation (EU) No. 2016/1052.
[152] Recital 11 Commission Delegated Regulation (EU) No. 2016/1052.
[153] Art. 5(4) MAR.
[154] Art. 5(1)(a) Commission Delegated Regulation (EU) No. 2016/1052.
[155] Art. 5(1)(b) Commission Delegated Regulation (EU) No. 2016/1052.

Special rules exist for bonds and other forms of debt securities, because the quotation of prices usually does not begin immediately after the issuance of the securities.[156]

(c) Disclosure and Organisational Obligations

68 As for buy-back programmes, European law also demands disclosure of stabilisation activities. Before the opening of the offer period of the relevant securities, adequate public disclosure[157] is required. The person appointed to do so[158] must make public the fact that stabilisation may or may not be undertaken and that it may be stopped at any time. The disclosure must further contain information on the beginning and end of the period during which stabilisation may occur and on the conditions under which a so-called *greenshoe* option may be exercised.[159]

69 Within one week after the end of the stabilisation period, certain details of the transactions or the fact that no stabilisation was undertaken are to be adequately disclosed and the competent authority is to be informed.[160] The responsible person is additionally obligated to record each stabilisation order or transaction, ensuring a better supervision by the competent authority.[161]

(d) Ancillary Stabilisation

70 'Ancillary stabilisation' means 'the **exercise** of an **overallotment facility** or of a ***greenshoe*** **option** by investment firms or credit institutions, in the **context** of a **significant distribution of securities**, exclusively for **facilitating stabilisation activity**.'[162] In the offering, a greater number of securities is allotted than originally offered. This measure serves to mitigate any potential demand surplus. The additional securities are usually provided by one or more securities loans. If the market price of the instrument declines after the offering, the underwriting bank (or banks) acquires securities on the market in order to stabilise the instrument's price, and 'repays' the securities loans with these shares. If the market price increases or remains stable, the underwriting bank or banks can acquire the shares lent to it at the issue price and sell them with a profit in the market. A conflict of interest may occur if the bank acquires too many shares through the *greenshoe* option, and now wants to sell those shares.[163]

71 The former CESR and now ESMA are of the opinion that neither the disposal of securities that were acquired through stabilisation measures nor the subsequent purchase of such papers (*refreshing the greenshoe*) fall within the scope of the safe harbour. The MAR defines

[156] P. Mülbert, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsgesetz*, Art. 5 MAR para. 87; cf. Art. 5(2) and (3) Commission Delegated Regulation (EU) No. 2016/1052.
[157] Art. 6(1) Commission Delegated Regulation (EU) No. 2016/1052.
[158] Art. 6(3) Commission Delegated Regulation (EU) No. 2016/1052.
[159] Art. 6(1)(a)–(f) Commission Delegated Regulation (EU) No. 2016/1052.
[160] Art. 6(3), (4) Commission Delegated Regulation (EU) No. 2016/1052.
[161] Art. 6(4) Commission Delegated Regulation (EU) No. 2016/1052.
[162] Art. 1(e) Commission Delegated Regulation (EU) No. 2016/1052; on the concept of overallotment and *greenshoe* options see Art. 2(13), (14) Regulation (EC) No. 2273/2003 and A. Meyer, in: Marsch-Barner and Schäfer (eds.), *Handbuch börsennotierte AG*, § 8 para. 63 ff.
[163] P. Mülbert, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsgesetz*, Art. 5 MAR para. 101.

stabilisation measures as measures supporting the market price of securities due to selling pressure in such securities. This can only be achieved through buy orders.[164]

Ancillary stabilisation depends on additional prerequisites. An overallotment of securities is only permitted during the subscription period and only at the issue price. The *greenshoe* option can only be exercised in the context of an overallotment, it must be exercised during the stabilisation period, and it may not amount to more than 15% of the original offer. An overallotment of shares that is not covered by the *greenshoe* is only allowed up to 5% of the original offer. Further disclosure obligations apply after the completion of the offering.[165] 72

VI. Supervision

Even the best rules against market abuse require an effective level of supervision and enforcement. Market manipulation in particular has been said to be especially difficult to police.[166] However, enforcement activity seems to be on the rise across the EU and other continents.[167] 73

1. Supervisory Mechanisms

Each Member State shall designate a competent authority (NCA) for the purposes of the MAR.[168] The MAR makes supervision possible through general notification obligations for all transactions and special notification obligations for suspicious transactions.[169] The supervisory authorities employ increasingly sophisticated methods of IT monitoring to determine deviations from normal order behaviour with the help of algorithms and statistical tests.[170] 74

The MAR further introduces a whistleblowing mechanism.[171] Member states must 'ensure that competent authorities establish effective mechanisms that enable reporting of […] infringements'.[172] The MAR outlines several key measures that Member States must introduce, such as data protection and employment protection for the whistleblower and the alleged perpetrator.[173] 75

[164] Recital 11 Commission Delegated Regulation (EU) 2016/1052; CESR, Level 3—Third Set of CESR Guidance and Information on the Common Operation of the Directive to the Market, May 2009, CESR/09-219, 12.

[165] Art. 8 Commission Delegated Regulation (EU) No. 2016/1052; ESMA, Final Report, Draft Technical Standards on the Market Abuse Regulation, 28 September 2015, ESMA/2015/1455, para. 53 ff.

[166] N. Moloney, *EU Securities and Financial Markets Regulation*, 754.

[167] H. McVea, in: Moloney et al. (eds.), *The Oxford Handbook of Financial Regulation*, 651.

[168] Art. 22 MAR; for a detailed account of supervisory mechanisms and cooperation cf. N. Moloney, *EU Securities and Financial Markets Regulation*, 755, 763.

[169] Art. 16 MAR for suspicious transaction reporting; Art. 26 MiFIR for general transaction reporting obligations; cf. N. Moloney, *EU Securities and Financial Markets Regulation*, 755 ff.

[170] Report on CESR Members' Powers Under The Market Abuse Directive and its Implementing Measures (07-380), 27 ff.; H. McVea, in: Moloney et al. (eds.), *The Oxford Handbook of Financial Regulation*, 653.

[171] Art. 32 MAR.

[172] Art. 32(1) MAR.

[173] Art. 32(2) MAR.

2. Investigatory Powers

76 The MAR contains detailed provisions on the minimum powers of supervisory authorities. These powers include the **right** to have **access** to any **document** and to receive copies, **demand information** from any person, and if necessary, to summon and hear any such person, to carry out **on-site inspections**, to require existing telephone and existing data traffic records, to require the cessation of any practice that is contrary to the MAR, to suspend trading in the respective financial instrument, to request the freezing and/or sequestration of assets, to request temporary prohibition of professional activity, and to enter the premises of natural or legal persons with prior judicial authorisation.[174] Member States must implement these powers into their national laws.

77 The MAR is open to Member States granting more powers to their NCA.[175] It further makes it clear that the provision of information to a competent authority will not breach any (data protection) law, any contractual non-disclosure obligation or any other restriction on the provision of information; no person will be held liable for providing information to the competent authority.[176] This clarification can be especially important for banks providing customer-related information (banking secrecy).

VII. Sanctions

1. Administrative and Criminal Sanctions

(a) Administrative Sanctions

78 The Commission had reached the conclusion that the framework under the former MAD 2003 was insufficient.[177] In a remarkable change from the former MAD 2003 regime, the MAR therefore now contains detailed requirements for the Member States to adhere to in developing their administrative sanctioning systems.[178] The MAR generally leaves it to the Member States to provide 'for competent authorities to have the power to take appropriate administrative sanctions or other administrative measures' for at least certain infringements, including market manipulation.[179] The Member States may only refrain from laying down administrative sanctions where, under national law, criminal sanctions already apply to the infringements in question.[180] This is partly relevant for market manipulation because the Member States had to impose criminal sanctions for several forms of severe market manipulation under the CRIM-MAD.

[174] Art. 23(2) MAR.
[175] Art. 23(3) MAR.
[176] Art. 23(4) MAR.
[177] See recital 70 MAR and recitals 3–5 CRIM-MAD; N. Moloney, *EU Securities and Financial Markets Regulation*, 762; M. Faure and C. Leger, 9 Brook. J. of Corp., Fin. & Comm. Law (2015), 417, criticise this approach as empirically unfounded.
[178] Art. 30(2) MAR.
[179] Art. 30(1)(1) MAR.
[180] Recital 72 and Art. 30(1)(2) MAR.

The MAR further describes measures and sanctions that can be imposed.[181] Member States must, among other measures, specify maximum pecuniary sanctions but the MAR establishes a floor for the maximum amounts. It calls for **pecuniary sanctions** of at least three times the amount of profits gained or losses avoided where these can be determined.[182] For natural persons, Member States must impose maximum pecuniary sanctions of at least € 5 million for market manipulation.[183] For legal persons, Member States must impose maximum pecuniary sanctions of at least € 15 million or 15% of last year's annual (consolidated, if applicable) turnover for market manipulation.[184] 79

Unlike the former MAD 2003 regime, the MAR now generally requires **supervisory authorities to publish** all **administrative sanctions** or **measures** imposed, excluding investigatory measures, and make the publications available on their website for at least five years.[185] This so-called naming and shaming can be considered an administrative sanction.[186] It can lead to considerable reputational damage[187] and enhance transparency by disclosing to the market all the sanctions imposed. 80

The MAR grants the NCAs a certain degree of discretion but non-publication is only the last resort. Rather, if a NCA considers publication disproportionate or hazardous to the stability of the financial markets, it shall choose between deferred or anonymous publication. Only if both of these options still jeopardised the stability of the financial markets or be disproportionate can the competent authority not publish the decision.[188] 81

(b) Criminal Sanctions

The Member States must also ensure that market manipulation is a **criminal offence at least in serious cases and when committed intentionally**.[189] The Commission was restricted to the instrument of a directive, as the European Union does not have the powers to harmonise criminal law by way of a regulation.[190] The scope of the directive is identical to the scope of the regulation with the exception that a transaction, order or other behaviour on a spot commodity market must have an actual effect on the price or value of a related financial instrument and vice-versa.[191] The CRIM-MAD excludes buy-back programmes, stabilisation measures and behaviour in pursuit of monetary and other public policies by reference to the MAR.[192] 82

Market manipulation is separately defined for the purposes of the CRIM-MAD.[193] The definition is almost identical to that of the MAR. However, the CRIM-MAD does not include 83

[181] Art. 30(2) MAD.
[182] Art. 30(2)(h) MAR.
[183] Art. 30(2)(i)(i) MAR.
[184] Art. 30(2)(j), 30(2)(3) MAR.
[185] Recital 73 and Art. 34(1) MAR.
[186] R. Veil, 45 ZGR (2016), 305, 308, 318 ff.
[187] CESR, Review Panel Report, MAD Options and Discretions, March 2010, CESR/09-1120, 115.
[188] Art. 34(1)(3) MAR.
[189] Recital 10 and Art. 5(1) CRIM-MAD.
[190] Art. 83(1) TFEU; cf. M. Faure and C. Leger, 9 Brook. J. Corp., Fin. & Comm. Law (2015), 389. See also R. Veil § 13 para. 12.
[191] Art. 1(4)(a), (b) CRIM-MAD.
[192] Art. 1(3) CRIM-MAD.
[193] Art. 5(2) CRIM-MAD.

auctioned products based on emission allowances and only applies if false signals are actually given and prices are actually secured or affected. Unlike under the MAR, it is not sufficient that false signals are likely to be given or prices are likely to be secured.[194] Like the MAR, the CRIM-MAD does not explicitly mention omissions but only applies to orders, etc. and other 'behaviour'.[195]

84 The CRIM-MAD considers cases of market manipulation to be serious where the impact on market integrity, the actual or potential profits gained or loss avoided, the level of damage caused to the market, the level of actual alteration of the value of a financial instrument etc. or the amounts of funds originally used is high. Cases are also serious where the manipulator comes from within the financial sector or a supervisory authority.[196] Member States must also impose criminal sanctions for inciting, aiding and abetting and attempting market manipulation as defined for the purposes of the CRIM-MAD.[197]

85 Criminal penalties for **natural persons** committing market manipulation must be 'effective, proportionate and dissuasive'. Member States must provide for a maximum term of imprisonment of at least four years for market manipulation.[198] Inciting, aiding and abetting and attempted market manipulation must only be punishable as a criminal offence. The Member States must also provide for **criminal penalties against legal persons** when market manipulation was committed for the benefit of a legal person by any person acting individually or as part of an organisation of the legal person. The acting person must have a leading position within the legal person based on certain defined criteria.[199] The Member states must also ensure that a legal person can be held liable where the lack of supervision or control by one of the persons in a leading position has made it possible for a subordinate to commit market manipulation for the benefit of the legal person.[200] Criminal sanctions against legal persons do not shield the acting natural persons from (parallel) criminal liability.[201]

86 Recently, the European Courts of Human Rights (ECHR) held that in an Italian case the possibility to accumulate criminal and administrative sanctions for the same behaviour (market manipulation) violates the European Convention of Human Rights because it creates a **double jeopardy**.[202]

(c) Enforcement Practices

87 In its report on sanctions practice in the Member States for 2019, ESMA states that almost all NCAs have imposed administrative sanctions for breach of the ban on market manipulation in very few cases.[203] No information on criminal sanctions is included in the report.

[194] Art. 5(2) CRIM-MAD.
[195] See para. 22.
[196] Recital 12 CRIM-MAD.
[197] Art. 6 CRIM-MAD.
[198] Art. 7(1) and (2) CRIM-MAD.
[199] Art. 8(1) CRIM-MAD.
[200] Art. 8(2) CRIM-MAD.
[201] Art. 8(3) CRIM-MAD.
[202] ECHR of 4 March 2014 (application No. 18640/10, 18647/10, 18663/10, 18668/10 and 18698/10), *Grande Stevens et. al. v. Italy*, cf. M. Ventoruzzo, 16 EBOR (2015), 145.
[203] Cf. ESMA, Annual Report on administrative and criminal sanctions and other administrative measures under MAR, ESMA70-156-2005, 12 December 2019. An exception is Sweden, where Finansinspektionen has imposed administrative sanctions in 29 cases.

Different experiences with enforcement practice by supervisory authorities are reported from Member States. The FCA in the UK has adopted a strategy of strict enforcement, 'if necessary', ie if the specific facts of a prohibition are not met, it reverts to the High Level Standards and Principles of the FCA Handbook, which enable it to impose drastic fines.[204]

2. Private Enforcement

88 Market manipulation results in investors buying or selling securities at distorted prices. This raises the question of whether investors can claim damages from the manipulator. Unlike the Prospectus Regulation[205] the MAR is silent on civil liability as a means of investor protection. Commentators have argued that the Member States are required to introduce civil liability to ensure the practical effectiveness of the market abuse prohibitions (*effet utile*).[206] Whether the ECJ follows this interpretation can, of course, hardly be assessed. One argument against this interpretation is that the European legislator has established a comprehensive system of supervision with extensive powers of investigation and administrative and criminal sanctions, thus providing an effective system of enforcement.

89 In Austria, the Supreme Court has recognised **liability for damages** in **favour of investors**. The court argues that the prohibition of information-based market manipulation is aimed at protecting the individual investor, who relies on information disseminated by professionals or through the media when making investment decisions.[207] Liability under private law is also possible in other jurisdictions. French, Greek and Italian law can be construed to allow private enforcement; Portuguese, Irish and Cyprus laws explicitly allow for it.[208] In Germany, on the other hand, the possibility of private enforcement has been denied by the courts, arguing that the aim of the prohibition of market manipulation is only to ensure the functioning of the markets at a macro-level.[209]

90 The recitals to the MAR emphasise that misinformation to capital markets harms investors and causes damages. A liability of the manipulator should therefore be recognised by that legislature. Ideally, this issue should be subject to a coordinating directive of the EU, ensuring liability also for grossly negligent misinformation of market participants.

VIII. Conclusion

91 The rules against market manipulation follow the same mechanism as under the former MAD 2003 regime. The MAR generally prohibits market manipulation and explains the prohibition through core definitions and a number of instances. Buy-back programmes and stabilisation measures are exempted under identical conditions as they were under the

204 Cf. E. Swan and J. Virgo, *Market Abuse Regulation*, para. 5.37.
205 See R. Veil § 17 para. 73.
206 See R. Veil § 12 para. 24.
207 Cf. OGH, 8 Ob 104/12b; OGH, 6 Ob 28/12d, 5.2 ff; S. Kalss et al., *Kapitalmarktrecht I*, § 22 para. 72.
208 V. Tountopoulos, 11 ECFR (2014), 304.
209 BGH of 19.07.2004 - II ZR 218/03, BGHZ 160, 134, 139–140; confirmed in BGH of 13.12.2011 - XI ZR 51/10 (*IKB*), BGHZ 192, 90; BVerfG of 24.09.2002 - 2 BvR 742/02, 23 ZIP (2002), 1986.

MAD 2003. The MAR's aim to expand the prohibition beyond the scope of the MAD 2003 is, however, clearly visible. More trading venues are included, manipulation is prohibited even across markets and products and attempts as well as 'any behaviour' not expressly mentioned in the MAR are covered. As a result of the Libor scandal, the European legislature has introduced a fourth extremely broad core example of market manipulation. However, the numerous technical provisions of the MAR and the Delegated Regulation reflect the difficulty of precisely describing manipulative behaviour that has a harmful effect.

92 After five years of practical experience with the MAR regime, it can be positively noted that hardly any relevant regulatory gaps have occurred. This is also due to the fact that the material scope of application of the prohibitions has been extended and the elements of the prohibitions are broadly defined. However, there is a need for reform in the case of information-based market manipulation. It should be expressly regulated that market manipulation can also take place by concealing information.

93 MAR and CRIM-MAD aim to ensure market integrity and a high level of investor protection. It is difficult to assess whether these regulatory objectives have been achieved. This is mainly because little is known about enforcement practices in the Member States. In particular, it is unclear whether NCAs and public prosecutors have the necessary expertise to judge and prosecute complex cases of market manipulation. In addition, the civil law liability for damages of manipulators is still terra incognita.

4

Disclosure System

§ 16

Foundations

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I. Introduction

1 The legal framework for an efficient capital markets law essentially requires mandatory disclosure rules in order to supply the market with the necessary information on issuers. This was pointed out as early as 1966 by the Segré Committee in its Summary Report, thus

preparing the ground for the development of a disclosure system in the European Member States. The Segré Committee underlined the fact that disclosure is a necessary prerequisite for the viability of a harmonised European capital market. It considered a pan-European minimal framework of mandatory disclosure rules to be a fundamental measure in improving investor information through capital-seeking issuers.[1] Subsequently, disclosure provisions became one of the central regulatory instruments of European capital markets law. This regulatory concept was inspired by the US Securities Regulation which has always followed a disclosure philosophy for regulating capital markets.[2]

Justice *Louis D. Brandeis* described the disclosure philosophy applied by the US Securities Regulation as follows: 'Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.'[3] *Louis Loss* and *Joel Seligman* highlighted the importance of mandatory disclosure rules in capital markets law in a similarly simple way: 'Then, too, there is the recurrent theme throughout these statutes of disclosure, again disclosure, and still more disclosure.'[4] 2

The recognition that mandatory disclosure rules play an important role in the viability of capital markets as proclaimed by the Segré Committee is not an exclusively legal one. The necessity for a mandatory system of disclosure can also be examined from an economic point of view. Theoretical studies on capital markets and economic models are of essential importance for the regulation of capital markets and are regarded as the justification for the disclosure philosophy in US capital markets law.[5] Therefore, the following short introduction into the underlying economic principles is necessary for understanding the disclosure system in European capital markets law. 3

II. Transparency and Capital Market Efficiency

The statements of *Louis D. Brandeis*, *Louis Loss* and *Joel Seligman* in the previous paragraphs emphasise the idea of mandatory disclosure being an instrument to manage a conflict of interests. But, furthermore, mandatory disclosure is also seen as essential for investors to make optimal investment decisions. In economics the connection between disclosure and its influence on the behaviour of investors on the one hand and capital markets on the other hand is examined under the benchmark of efficiency. In general, one distinguishes three different types of efficiency: allocational, institutional and operational.[6] 4

[1] European Commission, The Development of a European Capital Market, Report of a Group of experts appointed by the EEC Commission, November 2006 ('Segré Report'), p. 225 ff.

[2] L. Klöhn, 177 ZHR (2013), 349, 350–351; K. Hopt, 140 ZHR (1976), 201, 204 ff.; K. Hopt, 141 ZHR (1977), 389, 415.

[3] L. Brandeis, *Other People's Money and How the Bankers Use It*, 92.

[4] L. Loss and J. Seligman, *Securities Regulation*, 29.

[5] Cf. K. Hopt, 140 ZHR (1976), 201, 205; T. Möllers, 208 AcP (2008), 1, 5.

[6] Cf. H.-D. Assmann, in: Nörr (ed.), *Rechtsentwicklung*, 251, 263–264; H. Kohl et al., 138 ZHR (1974), 1, 16 ff.; M. Oulds, in: Kümpel et al. (eds.), *Bank- und Kapitalmarktrecht*, para. 11.57 ff.; N. Vokuhl, *Kapitalmarktrechtlicher Anlegerschutz*, 179 ff. See also R. Veil § 2 para. 8–10.

1. Allocational Efficiency

5 Allocational efficiency describes the main function of the capital markets as allocating scarce investable financial resources to investment opportunities.[7] Disclosure is regarded as having a positive influence on the reduction of information asymmetries between investors and issuers. Informational deficits of investors regarding important aspects of pricing and the quality of the issuers' investment offers can cause market failure or at least influence market efficiency decisively. The 'Market for Lemons' described by *Akerlof* is a well-cited model in this context.[8]

(a) Akerlof and the 'Market for Lemons'

6 *Akerlof* chose the market for used cars as an example of the problem of quality uncertainty.[9] If the quality of the product is uncertain, the customer can no longer distinguish between good and bad quality by looking at the price. In this case the buyers' behaviour is determined by 'adverse selection' and 'moral hazard'. In consequence sellers of good-quality products are at a disadvantage. They are unable to obtain a high enough price to make selling their products worthwhile. The higher costs of production cannot be passed on to the buyer as due to the uncertainty the buyer has to make deductions and will only be willing to pay an average price which therefore replaces the competitive price. These uncertainties are thus only advantageous for sellers of low-quality products, ie 'lemons'. Therefore, more and more sellers of products of above-average quality are squeezed out of the market. This finally leads to a complete market collapse.[10]

(b) Fama and the Efficient Capital Market Hypothesis (ECMH)

7 In addition to *Akerlof*'s 'Market for Lemons' the 'Theory of Informational Efficiency of Capital Markets'[11] proposed by *Fama* has also gained wide influence regarding the determination of the implications and effects of information on the markets. Originally this theory was developed for the securities analysis. It soon, however, also found its way into general theories on capital markets. Nevertheless the theory's informative value regarding the allocational mechanism is only indirect, as the theory of informational efficiency does not refer to the actual market processes but rather to procedures prior to these. It explores the relationship between information and market prices, or, in other words, the messages communicated by certain prices.[12] The main assertion of the theory of informational efficiency is that a capital market is efficient if the stock prices immediately and fully reflect the

[7] L. Enriques and S. Gilotta, in: Moloney and Ferran (eds.), *Financial Regulation*, 513; T. Möllers, 208 AcP (2008), 1, 7; P. Mülbert,177 ZHR (2013), 160, 172.

[8] G. Akerlof, 84 Q. J. Econ. (1970), 488 ff.

[9] See R. Veil § 2 para. 26.

[10] Cf. for this concept also H. Fleischer, *Informationsasymmetrie im Vertragsrecht*, 121 ff.; N. Moloney, *EU Securities and Financial Markets Regulation*, 56, argues with the 'Market for Lemons' model in favour of mandatory disclosure in the primary market.

[11] E. Fama, 25 J. Fin. (1970), 383 ff.

[12] W. Beaver, *Financial Reporting*, 127, 134–135.

available information.[13] The primary aim of the theory is to establish the actual degree of informational efficiency on the capital markets in order to be able to determine the amount of information already reflected in the prices. If, for example, the stock prices already reflect all existing information, trading decisions based solely on existing information do not yield abnormal returns as the relevant securities are not mispriced.[14]

The stipulations made by the theory of informational efficiency can only be proven for the very restrictive condition of market equilibrium as it is imperative that the adjustment process takes place immediately, that there are zero transaction costs, the market participants have homogeneous investor expectations and that they behave strictly rationally regarding all new information.[15] If the theory of informational efficiency requires such restrictive conditions in order to have a significant explanatory power, it is as such very imprecise and useless for empirical analysis. For this reason *Fama* amended his theory with the **efficient capital market hypothesis (ECMH)**.[16] 8

The ECMH describes three forms of informational efficiency on capital markets depending on the degree to which the market price ideally reflects different information: a weak informational efficiency means that the market price only reflects historical information, such as past prices or return sequences.[17] In a semi-strong form of informational efficiency, the market prices reflect all publicly available information. Strong informational efficiency implies that the market prices instantly reflect all price relevant information, ie not only all publicly available information, but also all hidden 'inside information'.[18] 9

(c) Discussion on the Scope of a Legal Reception of the ECMH

There are dissenting opinions as to what extent binding parameters for the development of a legal disclosure regime can be deduced from the ECMH.[19] In 1988 the US Supreme Court established the **fraud-on-the-market doctrine** by adopting the semi-strong form of the ECMH into its jurisprudence. In *Basic Inc. v Levinson* the court applied a presumption of reliance for investors who wanted to recover damages for misrepresentation from the issuer and who had to prove that they had relied on such misrepresentations. The court held that the investors could satisfy this reliance requirement by invoking a presumption that the price of stock traded in an efficient market reflects all public material information—including material misrepresentations.[20] 10

By justifying its fraud-on-the-market doctrine with the ECMH in *Basic* the US Supreme Court took an active part in the process of transforming the ECML from an academic 11

[13] E. Fama, 25 J. Fin. (1970), 383.

[14] S. Kress, *Effizienzorientierte Kapitalmarktregulierung*, 40; R. West, 31 Fin. Analysts J. (1975), 30. For a description of the market model which the ECMH is based on, cf. L. Klöhn, 177 ZHR (2013), 349, 354 ff.

[15] E. Fama, 25 J. Fin. (1970), 383, 387; R. West, 31 Fin. Analysts J. (1975), 30.

[16] E. Fama, 25 J. Fin. (1970), 383.

[17] E. Fama, 25 J. Fin. (1970), 383, 388, 414.

[18] Cf. also Z. Bodie et al., *Investments and Portfolio Management*, ch. 11 (p. 371 ff.).

[19] N. Moloney, *EU Securities and Financial Markets Regulation*, 57. See also H. Brinckmann, *Kapitalmarktrechtliche Finanzberichterstattung*, 61–62, in detail.

[20] *Basic Inc. v Levinson* [1988], 485 U.S., 224: 'Because most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations may be presumed […]'.

theory into a broad ideological justification for preferring market outcomes over regulation, beginning in the 1970s and influencing regulatory policy mainly in the United States for over thirty years since then.[21] Due to the overstatement of its implications the ECMH was always exposed to strong criticism, especially by insights derived from behavioural finance.[22] After the financial crisis some critics even went so far as to hold the ECMH responsible for this worldwide collapse of financial markets.[23] The increasing criticism also reached the jurisprudence of the US Supreme Court. In *Halliburton Co. v. Erica John Fund, Inc.* the court confirmed its presumption of reliance established in *Basic* by the conclusion that 'Halliburton has not identified the kind of fundamental shift in economic theory that could justify overruling a precedent on the ground that is misunderstood, or has since been overtaken, by economic realities'.[24] But three dissenting judges argued that *Basic* should be overruled by referring to new economic insights that called the implications of the ECMH for the fraud-on-the-market doctrine into question.[25]

12 The criticism on the ECMH makes clear that it should not be overstated by assuming a convergence of informational and fundamental efficiency. As fundamental efficiency means that investors get the 'correct price', informational efficiency only means that stock prices respond quickly to the release of new public information.[26] Having this in mind an essential observation that can be deduced from the semi-strong form of the ECMH is that if information is made public, the capital markets are capable of reflecting this publication in the prices[27] and informational efficiency and price accuracy are increased.[28]

2. Institutional Efficiency

13 Institutional efficiency outlines the criteria necessary for capital markets to function as markets. It is generally measured in terms of free market access for investors and traders, the range of products offered and the depth of financial capital available on the market.[29] Others consider investor confidence to be the main criteria for institutional efficiency. From this more politico-economic point of view, the main priority of capital markets law is to strengthen the level of investor confidence in the integrity and stability of the markets.[30] However, these diverging approaches only result in variations regarding terminology and

[21] Cf. R. Gilson and R. Kraakman, 100 Va. L. Rev. (2014), 313, 315 ff., state that the ECMH was 'hijacked by a powerful political cliente'.

[22] Cf. D. Daeniker, GesKR 2014, 396, 398; see also below para 31.

[23] Cf. D. Daeniker, GesKR 2014, 396, 398; R. Gilson and R. Kraakman, 100 Va. L. Rev. (2014), 313 ff. with further references.

[24] *Halliburton Co. v. Erica John Fund, Inc.* [2014], 573 U.S., Opinion of the Court, 10.

[25] *Halliburton Co. v. Erica John Fund, Inc.* [2014], 573 U.S., Thomas, J., concurring in judgment, 7 ff.

[26] Cf. R. Gilson and R. Kraakman, 100 Va. L. Rev. (2014), 313.

[27] M. Brellochs, *Publizität und Haftung*, 169–170.

[28] L. Enriques and S. Gilotta, in: Moloney and Ferran (eds.), *Financial Regulation*, 519; N. Moloney, *EU Securities and Financial Markets Regulation*, 57.

[29] Cf. K. Hopt, *Gutachten G 51. Dt. Juristentag*, G 49; M. Oulds, in: Kümpel et al. (eds.), *Bank- und Kapitalmarktrecht*, para. 11.58 ff.; N. Vokuhl, *Kapitalmarktrechtlicher Anlegerschutz*, 180.

[30] M. Oulds, in: Kümpel et al. (eds.), *Bank- und Kapitalmarktrecht*, para. 11.85; N. Vokuhl, *Kapitalmarktrechtlicher Anlegerschutz*, 180.

reasoning while the specifications concerning the content of institutional efficiency are the same. Institutional efficiency is measured in liquidity and volatility.[31]

14 Disclosure can positively or negatively influence an investor's decision to enter or exit the market and therefore have a direct impact on **liquidity**. If a market participant is uncertain about the accuracy of public information or is not able to compare investment possibilities sufficiently with the help of the disclosed information, this may restrain him from participating, thus resulting in a reduction of liquidity on the markets.[32] Disclosure can, if standardised and reliable, prevent this effect and thus have a positive effect on liquidity.[33] The influence of disclosure on the **volatility** of the market can be determined similarly. When new information is published, the market prices adapt accordingly, thus increasing volatility.[34] A certain volatility may even be seen as necessary with regard to informational efficiency in order for the prices to be able to adjust to the appearance of new information.[35] Similarly, when requesting an increase of liquidity one has to consider that in a situation of total liquidity, ie if an additional supply or demand will lead to no change in the equilibrium price, the price will not adjust to new information.[36] The market mechanisms can thus only function correctly if a certain level of volatility is accompanied by some degree of illiquidity.

3. Operational Efficiency

15 Operational efficiency describes a process-orientated examination of capital markets involving aspects of time and transaction costs.[37] Insufficient disclosure may not necessarily lead to market migration, but will certainly lead to higher costs for an investor to make an informed investment decision. The informational efficiency of capital markets depends on the extent to which the information has spread. The circulation of information will in turn be higher the lower the informational costs are and vice versa.[38]

16 One can distinguish between three types of **information costs**: costs of acquisition, verification and processing.[39] Disclosure primarily reduces the costs for investors to acquire information. Additionally, requiring a specific content of the information to be disclosed and effective quality control can reduce the costs of verification and processing. The auditor's certificate attained through the audit of financial statements, for example, can be seen as an instrument ensuring the quality of the information, enabling investors to rely on it and thus

[31] Cf. S. Kress, *Effizienzorientierte Kapitalmarktregulierung*, 59 ff.

[32] R. Schmidt, 34 ZfbF (1982), 728, 741.

[33] C. Meier-Schatz, *Wirtschaftsrecht und Unternehmenspublizität*, 216–217; H. Merkt, *Unternehmenspublizität*, 345.

[34] S. Kress, *Effizienzorientierte Kapitalmarktregulierung*, 65.

[35] Y. Amihud and H. Mendelson, 3 J. Acc., Aud. Finance (1988), 369, 374; S. Kress, *Effizienzorientierte Kapitalmarktregulierung*, 66.

[36] S. Kress, *Effizienzorientierte Kapitalmarktregulierung*, 64.

[37] S. Kress, *Effizienzorientierte Kapitalmarktregulierung*, 44; N. Vokuhl, *Kapitalmarktrechtlicher Anlegerschutz*, 181.

[38] R. Gilson and R. Kraakman, 70 Va. L. Rev. (1984), 549, 593.

[39] R. Gilson and R. Kraakman, 70 Va. L. Rev. (1984), 549, 593 ff.: 'The lower the cost of particular information, the wider will be its distribution, the more effective will be the capital market mechanism operating to reflect it in prices, and the more efficient will be the market with respect to it.'

reducing their costs of verification.[40] Operational efficiency can be increased if the effects of provisions on disclosure are seen as a whole: by burdening the issuers with mandatory disclosures instead of leaving the acquisition of information up to the investors the total transaction costs on the market are minimised.[41]

III. Disclosure Provisions as Part of the Regulation of Capital Markets

1. The Importance of Legal Disclosure Provisions from an Economic Point of View

17 Economics is often confronted with the task of having to find binding parameters for the development of legal disclosure provisions.[42] The benchmark of full market efficiency could work as such a standard for the regulation of capital markets,[43] but Economics does not provide clear parameters that can be used to design a system of mandatory disclosure and its necessary content for achieving full market efficiency.[44] Rather, the findings can only be understood in a model theoretical context giving no more than an indication for the legislator of how to shape the system of mandatory disclosure.[45] In Economics the reference model and benchmark is usually an allocationally efficient market and all deviations from this which occur in reality are immediately classed as market failure. Market failure thus becomes the criterion to describe a market that is unable to fulfil its allocational task. In order to counteract market failure, regulatory intervention is regarded necessary.[46]

(a) Reduction of Information Asymmetries to Prevent Market Failure

18 **Market failure** may result from an asymmetrical distribution of information[47] between market participants which can be prevented or reduced by legal disclosure provisions.[48]

(aa) Social Value of Public Information

19 The theory of the social value of public information, which can be traced back to *Fama/Laffer*[49] and *Hirshleifer*,[50] supports this concept, especially with regard to capital

[40] F. Easterbrook and D. Fischel, 70 Va. L. Rev. (1984), 669, 674–675; H. Merkt, *Unternehmenspublizität*, 470–471.
[41] Cf. R. Veil, 167 ZHR (2003), 365, 379–380.
[42] Cf. C. Meier-Schatz, *Wirtschaftsrecht und Unternehmenspublizität*, 161 ff.; H. Merkt, *Unternehmenspublizität*, 212 ff.
[43] Cf. J. Wüstemann et al., in: Hopt et al. (eds.), *Kapitalmarktgesetzgebung*, 11 and passim.
[44] L. Enriques and S. Gilotta, in: Moloney and Ferran (eds.), *Financial Regulation*, 525.
[45] L. Enriques and S. Gilotta, in: Moloney and Ferran (eds.), *Financial Regulation*, 525.
[46] L. Enriques and S. Gilotta, in: Moloney and Ferran, (eds.) *Financial Regulation*, 526.
[47] In more detail H. Fleischer, *Informationsasymmetrie im Vertragsrecht*, 121 ff.; R. Fülbier, *Regulierung der Ad-hoc-Publizität*, 176 ff.
[48] N. Moloney, *EU Securities and Financial Markets Regulation*, 54; R. Fülbier, *Regulierung der Ad-hoc-Publizität*, 179.
[49] E. Fama and A. Laffer, 44 J. Bus. (1971), 289 ff.
[50] J. Hirshleifer, 61 Am. Econ. Rev. (1971), 561 ff.

markets law. It shows that if information is merely obtained privately this can be disadvantageous for an allocationally efficient market mechanism. The costs of obtaining information constitute a use of resources by each market participant without any advantage for society as a whole. An excessive amount of information is produced as market participants generate the same information parallel to one another.[51] That is why the production of public information through a legal disclosure obligation is regarded as economically advantageous, substituting private procurement of information and reducing the loss of resources associated with an information surplus.[52] However, this cannot lead to the conclusion that mandatory legal regulation of disclosure is necessary. It must be noted that investors have collective means of forcing issuers to necessary disclosure measures. These means include risk surcharges, discounts[53] and influencing shareholder meetings.[54]

(bb) Reduction of Agency Costs and Signal Theory

Some argue that economic incentives are sufficient to provide the necessary level of disclosure. The asymmetric distribution of information between issuers and investors results in so-called **agency costs**. These describe the costs for the investors to minimise the information advantages of the issuers.[55] The issuer's management has a large interest in keeping the agency costs low. The reduction in share price and manager remuneration as a result of the asymmetry of information lead directly to economic disadvantages for the management. Thus, the necessary information is voluntarily disclosed in order to reduce asymmetries of information.[56] 20

The **signal theory** generalises this idea by stating that anyone having better information will signal this if he can gain economic advantages therefrom.[57] Similarly, there can be an incentive to disclose negative company data, as reluctance to do so will provoke scepticism in the investors. This scepticism may cause more of the investors to sell off their shares than would the disclosure of the negative information itself.[58] These incentives for voluntary disclosure resulting from agency costs and the signal theory are, however, put into perspective when compared to opposing incentive systems. In particular, *Verrecchia*'s concept of 'proprietary costs'[59] exemplifies how a company may be dissuaded from voluntary disclosure by the ensuing negative externalities. 21

(b) Information and the Public Good Problem

A different line of argumentation focuses on the nature of information as a public good. Public goods can lead to market failure due to the so-called **free-rider** 22

[51] E. Fama and A. Laffer, 44 J. Bus. (1971), 289, 292; J. Hirshleifer, 61 Am. Econ. Rev. (1971), 573.

[52] L. Enriques and S. Gilotta, in: Moloney and Ferran (eds.), *Financial Regulation*, 512.; R. Fülbier, *Regulierung der Ad-hoc-Publizität*, 177–178.

[53] R. Fülbier, *Regulierung der Ad-hoc-Publizität*, 178.

[54] R. Ewert, BFuP (1989), 245, 261.

[55] In more detail R. Richter and E. Furubotn, *Neue Institutionenökonomie*, 176–177.

[56] H. Merkt, *Unternehmenspublizität*, 212–213.

[57] C. Meier-Schatz, *Wirtschaftsrecht und Unternehmenspublizität*, 164; M. Rehberg, in: Eger and Schäfer (eds.), *Ökonomische Entwicklung*, 314.

[58] H. Merkt, *Unternehmenspublizität*, 213; J. Köndgen, in: Ott and Schäfer (eds.), *Ökonomische Analyse*, 128, 152, takes a more restrictive point of view by stating that disclosure provisions have to be at least partly mandatory.

[59] R. Verrecchia, 5 J. Acc. Econ. (1983), 179, 181.

effect.[60] The free-rider effect describes a situation in which anybody can gain access to public goods without costs so that the market price of these public goods is reduced to zero. As a result, there is no longer any incentive to offer public goods on the market and a shortage may occur.[61] Yet whilst economic studies assume all information to be a public good,[62] thereby enabling disclosure to prevent market failure, this approach is too general: the nature of information changes, taking on the characteristics of a private good during the period of production and developing the character of a mixed good during distribution. Only when fully distributed can information then be classed as a public good.[63] There is proof of this understanding with regard to the capital markets: according to the ECMH, additional returns can be attained on semi-strong capital markets by making use of inside information.[64] As a result share prices will adjust to the new level of information and no further returns will be attained by making use of the inside information— the information has been exhausted.[65] Information therefore must be classed as a hybrid good,[66] thus preventing a general statement on the necessity of mandatory disclosure.

23 Market failure can further result from the monopoly which exists regarding information. Corporate information in particular is usually subject to the monopoly of the issuer who will mostly be the only one with access to internal company data—or at least the one whose access involves the lowest costs.[67] A disclosure obligation could prevent the issuer from exploiting his monopoly.[68] However, once again the above-mentioned incentives of voluntary disclosure militate against the understanding that a regulatory intervention is inevitable. They are said to ensure sufficiently that the issuer will not abuse his monopoly on corporate information.[69]

(c) Mandatory Disclosure and the Theory of Transaction Costs

24 By contrast, the **transaction cost theory** promises considerable insight,[70] stipulating that disclosure provisions are not absolutely but only relatively mandatory from an economic point of view, provided the legislative disclosure rules contribute to a reduction

[60] A public good is defined by two aspects: firstly, that no rivalry exists regarding its consumption—even when one consumer makes use of public information it remains available for others; secondly, the fact that one cannot be excluded from the use of the good when not paying for it, R. Fülbier, *Regulierung der Ad-hoc-Publizität*, 172.

[61] Cf. L. Enriques and S. Gilotta, in: Moloney and Ferran (eds.), *Financial Regulation*, 521; Meier-Schatz, *Wirtschaftsrecht und Unternehmenspublizität*, 166–167; H. Merkt, *Unternehmenspublizität*, 219.

[62] The immaterial nature of information proves that the amount of existing information cannot be reduced by the fact that an individual makes use of it, N. Gonedes and N. Dopuch, Supplement to 12 J. Acc. Res. (1974), 48, 65, ie the use of information by one person does not exclude others from using it, N. Gonedes, 31 J. Fin. (1976), 611, 617.

[63] C. Meier-Schatz, *Wirtschaftsrecht und Unternehmenspublizität*, 170 ff.

[64] Cf. L. Klöhn, 177 ZHR (2013), 349, 354 ff., on information traders who try to gain extra returns by comparing market prices with the fundamental value of the company.

[65] C. Meier-Schatz, *Wirtschaftsrecht und Unternehmenspublizität*, 171; R. Fülbier, *Regulierung der Ad-hoc-Publizität*, 175.

[66] C. Meier-Schatz, *Wirtschaftsrecht und Unternehmenspublizität*, 172; H. Merkt, *Unternehmenspublizität*, 219.

[67] E. Fama and A. Laffer, 44 J. Bus. (1971), 289, 292; N. Gonedes, 31 J. Fin. (1976), 611, 618; T. Möllers, 208 AcP (2008), 1, 8.

[68] R. Fülbier, *Regulierung der Ad-hoc-Publizität*, 181.

[69] Cf. R. Fülbier, *Regulierung der Ad-hoc-Publizität*, 182.

[70] For details cf. R. Richter and E. Furubotn, *Neue Institutionenökonomie*, 53 ff.

of transaction costs on the market. This can be determined by drawing up a balance in order to determine and compare the transaction costs with and without the respective disclosure provisions. A mandatory disclosure regime must be regarded as necessary if the overall level of the transaction costs improves under legislative disclosure provisions compared to without them.

In cases of information asymmetries regarding internal company data it must be kept in mind, that issuers have much easier and cheaper access to these than investors. The issuers can thus often be seen as the *cheapest cost avoiders*,[71] thus justifying placing them under the obligation of disclosure. Especially regarding capital markets, it has been suggested to lower transaction costs by introducing fixed standards that must be adhered to when providing information.[72] Legislative provisions which improve the content and quality of information and standardise the methods of disclosure hold many advantages over a concept relying on the market process.[73] It is less cost-intensive, improves the possibilities of comparing the information provided and reduces the processing costs.[74] Yet one must bear in mind that standardising the disclosure mechanisms requires a consensus. In order to achieve this, opposing interests have to be assessed.[75] This usually results in a compromise which entails that mostly only minimum standards will be achieved.[76] 25

(d) Conclusion

Altogether, various incentives can be found that may lead an issuer to disclose information voluntarily, thus reducing the lack of transparency. In other words: 'A world without mandatory disclosure would not be completely in the dark'.[77] But it has not been clearly determined to date whether voluntary disclosure is sufficient or whether legislative intervention remains necessary. Economic research findings remain unclear on this.[78] 26

2. Disclosure Provisions as Part of Investor Protection

Economic theories have produced only a few clear parameters that can be applied to the disclosure systems of European capital markets. Therefore the development of a disclosure system can be seen more as a reaction to regulatory concerns[79] that have occurred or been identified than as the implementation of economic theories guaranteeing ideal 27

[71] T. Möllers, 208 AcP (2008), 1, 10–11; L. Stout, 87 Mich. L. Rev (1988), 613, 705; R. Veil, 167 ZHR (2003) 365, 379–380; N. Vokuhl, *Kapitalmarktrechtlicher Anlegerschutz*, 181.

[72] See also, especially regarding the disclosure of accounting, J. Wüstemann et al., in: Hopt et al. (eds.), *Kapitalmarktgesetzgebung*, 11–12, 16.

[73] Cf. L. Enriques and S. Gilotta, in: Moloney and Ferran (eds.), *Financial Regulation*, 524–525, 531.

[74] L. Enriques et al., in: Kraakman et al. (eds.), *The Anatomy of Corporate Law*, 244, 246; R. Walz, ZfbF Sonderheft 32 (1993), 85, 94–95; R. Fülbier, *Regulierung der Ad-hoc-Publizität*, 192; M. Rehberg, in: Eger and Schäfer (eds.), *Ökonomische Entwicklung*, 314 ff.; N. Vokuhl, *Kapitalmarktrechtlicher Anlegerschutz*, 172.

[75] Cf. R. Walz, ZfbF Sonderheft 32 (1993), 85, 95.

[76] R. Fülbier, *Regulierung der Ad-hoc-Publizität*, 193.

[77] L. Enriques and S. Gilotta, in: Moloney and Ferran (eds.), *Financial Regulation*, 525.

[78] L. Enriques and S. Gilotta, in: Moloney and Ferran (eds.), *Financial Regulation*, 525.

[79] O. Ben-Shahar and and C. Schneider, U. Pa. L. Rev. (2011), 645, 680; L. Enriques and S. Gilotta, in: Moloney and Ferran (eds.), *Financial Regulation*, 512–513.

conditions for the functioning of the market. Legislative measures will usually be based on the justification that pan-European provisions are necessary to ensure **investor protection**.[80] It is generally argued that an adequate investor protection increases the investors' confidence in the market and deters them from withdrawing their financial capital from capital markets which would have a disastrous consequence for the entire economic system.[81]

(a) Principle of Investor Protection through Information Disclosure

28 Investor protection in capital markets law is generally based on the overall principle of an investor making its decisions autonomously, ie free of governmental paternalism.[82] This also includes an investor's freedom to act irrationally[83] even though such behaviour is not the benchmark for the legislator's regulation. Following this liberal approach, the European model of investor protection is like the US Securities Regulation based on the concept of a **reasonable investor** who makes rational decisions on the capital markets.[84]

29 Although Economic theory in general does not provide a precise guidance for the legislator and its task to regulate capital markets, the ECMH had a huge impact on this concept of investor protection in capital markets law, beginning with the US Securities Regulation and when the European capital markets law followed the US approach.[85] Deficits in the level of investor protection are countered with further information, helping investors to make reasonable decisions.[86] This approach can best be described as an '**information paradigm**'.[87] The core function of mandatory disclosure provisions is therefore to provide investors with information on the issuers to help them make better decisions,[88] meaning that such decisions shall be based on the disclosed information. According to the insights of the semi-strong form of the ECMH, informational efficiency and price accuracy shall be increased in respect to the disclosed information. Mandatory disclosure thereby has the effect of controlling investors' decisions and the reasonable investor works as a purely functional, normative model, making capital markets more informationally efficient.[89]

[80] Cf. M. Deckert and J. v. Rüden, EWS (1998), 46, 49 ff.; P. Mülbert, WM (2001), 2085, 2092, 2100.

[81] L. Enriques and S. Gilotta, in: Moloney and Ferran (eds.), *Financial Regulation*, 514.

[82] P. Buck-Heeb, ZHR 177 (2013), 310, 326–327; P. Mülbert, 177 ZHR (2013), 160, 206.

[83] P. Buck-Heeb, ZHR 177 (2013), 310, 327; P. Mülbert, 177 ZHR (2013), 160, 173.

[84] Cf. L. Klöhn, 177 ZHR (2013), 349, 369 ff.; R. Veil, ZBB (2006), 162 ff.

[85] Cf. N. Moloney, *EU Securities and Financial Markets Regulation*, 55; L. Klöhn, 177 ZHR (2013), 349, 350–351, 363 ff.

[86] P. Buck-Heeb, ZHR 177 (2013), 310, 326–327; J.-U. Franck and K. Purnhagen, *Homo Economicus, Behavioural Sciences, and Economic Regulation: On the Concept of Man in Internal Market Regulation and Its Normative Basis*, 5; N. Moloney, *EU Securities and Financial Markets Regulation*, 771.

[87] Cf. J.-U. Franck and K. Purnhagen, *Homo Economicus, Behavioural Sciences, and Economic Regulation: On the Concept of Man in Internal Market Regulation and Its Normative Basis*, 7, 9. In Germany, the notion of an 'information model' is used to describe this approach, cf. P. Buck-Heeb, 177 ZHR (2013), 310, 326; P. Mülbert,177 ZHR (2013), 160, 184; W.-G. Ringe, in: Lehmann and Kumpan, *European Financial Services Law*, Art. 1 TD para. 2.

[88] L. Enriques and S. Gilotta, in: Moloney and Ferran (eds.), *Financial Regulation*, 512; 515; see also N. Moloney, *How to Protect Investors*, 46.

[89] J.-U. Franck and K. Purnhagen, *Homo Economicus, Behavioural Sciences, and Economic Regulation: On the Concept of Man in Internal Market Regulation and Its Normative Basis*, 6 ff.; L. Klöhn, 177 ZHR (2013), 349, 383 ff.

(b) Discussion on the Scope of Investor Protection

30 The extent to which investor protection is achieved through disclosure provisions has been subject to extensive legal discussions.[90] Some argue that disclosure provisions are crucial for an efficient capital market, are based on economic insights and thus only aim to achieve a supra-individual level of investor protection.[91] Others purport that the disclosure provisions are rather orientated towards the protection of the individual investor.[92] The European provisions alone do not provide a clear answer to this dispute. Most disclosure provisions are laid down in directives which require implementation into the national laws of the Member States, granting them discretion with regard to the exact wording of the provisions. On an abstract level it can only be said that disclosure provisions are primarily based on economic parameters to control investors' decisions[93] as a whole.[94] The protection of an individual investor would be better achieved by information rights of the investors or notification obligations of the issuers.[95] The protection of the individual investor is also an objective of European capital markets law.[96] But, in general terms, it cannot be said that European disclosure provisions aim to achieve investor protection by ensuring that an individual investor can claim for civil liability.

(c) Criticism of the Information Paradigm and Complementing Measures for Investor Protection

31 The idea of a rational investor has more and more frequently been questioned due to new insights derived from **behavioural finance**.[97] Problems of bounded rationality and information overload[98] can impair the ability of individual investors to handle and correctly process the information available at the market and may keep them from making optimal decisions.[99] The insights from behavioural finance have therefore questioned the concept of investor protection being based on a system of 'disclosure, again disclosure, and still more disclosure'.[100,101] As a consequence, the information paradigm and the principle of investor

[90] N. Moloney, *EU Securities and Financial Markets Regulation*, 55. For an overview on the German discussion cf. H. Brinckmann, *Kapitalmarktrechtliche Finanzberichterstattung*, 76 ff.; H. Merkt, *Unternehmenspublizität*, 301 ff.

[91] Cf. M. Deckert and J. v. Rüden, EWS (1998), 46, 49; L. Klöhn, 177 ZHR (2013), 349, 384; P. Mülbert, 177 ZHR (2013), 160, 172–173.

[92] Cf. T. Möllers, ZGR (1997), 334, 336 ff.

[93] For the idea of controlling people's decisions through disclosure provisions see L. Enriques and S. Gilotta, in: Moloney and Ferran (eds.), *Financial Regulation*, 512; C. Meier-Schatz, *Wirtschaftsrecht und Unternehmenspublizität*, 106–107; H. Merkt, *Unternehmenspublizität*, 338 ff.

[94] H. Brinckmann, *Kapitalmarktrechtliche Finanzberichterstattung*, 82 ff.

[95] H. Brinckmann, *Kapitalmarktrechtliche Finanzberichterstattung*, 86.

[96] See R. Veil § 2 para. 11, K. Follak, in: Dauses (ed.), *Handbuch des EU-Wirtschaftsrechts*, F.III para. 6.

[97] N. Moloney, *EU Securities and Financial Markets Regulation*, 57 ff. For an overview on the behavioural finance-research see R. Veil § 6 para. 20–29.

[98] Cf. T. Paredes, 81 Wash. U. L. Q. (2003), 417, 434 ff.

[99] P. Buck-Heeb, 177 ZHR (2013), 310, 327–328; L. Enriques and S. Gilotta, in: Moloney and Ferran (eds.), *Financial Regulation*, 515, 528; N. Moloney, *EU Securities and Financial Markets Regulation*, 773; P. Mülbert, 177 ZHR (2013), 160, 169 ff., 187 ff.

[100] Cf. L. Loss and J. Seligman, *Securities Regulation*, 29.

[101] Cf. L. Enriques and S. Gilotta, in: Moloney and Ferran (eds.), *Financial Regulation*, 528; N. Moloney, *EU Securities and Financial Markets Regulation*, 55; L. Klöhn, 177 ZHR (2013), 349, 358 ff. See also O. Ben-Shahar and C. Schneider, U. Pa. L. Rev. (2011), 645, 679 ff.

protection through mandatory disclosure are complemented by different, rather paternalistic regulative measures, such as the prohibition of an execution-only transaction for certain investment products[102] or even the prohibition of certain investment products[103] or forms of transactions[104] in general.[105] These measures follow the realisation that investors are unable to make rational—meaning optimal—decisions even if provided with sufficient information.[106] Investor protection is therefore adjusted through the principle of **consumer protection**[107] justifying a higher level of governmental paternalism und limited autonomy of the individual.

32 The critics of the information paradigm can rely on the accepted findings of behavioural finance. Nevertheless, other regulative measures for investor protection should only be applied very rarely in capital markets law.[108] The reason is that a renunciation of the information paradigm and a higher level of governmental paternalism would mean jeopardising the basic social approach of individual freedom and free capital markets.[109] The information paradigm accepts these premises and stems from the idea of free markets and the goal to reach market efficiency. Behavioural finance still describes and systemises irrational behaviour on the market more than actually presenting a comprehensive alternative model for capital markets regulation.[110] The information paradigm is therefore still without a viable alternative that could ensure better investor protection. In other words: The information paradigm is not without weaknesses but it still seems to be the best regulative approach for investor protection as long as other approaches have not been proven to be better than this second best choice.[111]

3. Disclosure Provisions as an Instrument to Foster Sustainable Finance

33 Since 2015, the Paris Agreement on climate change[112] and the UN 2030 Agenda for Sustainable Development[113] highly accelerated governmental measures for more sustainability. In the area of financial market regulation, the concept of **sustainable finance** summarises measures in this respect. The Commission's Action Plan 'Financing Sustainable

[102] Art. 25(4) MiFID II.

[103] Cf. Art. 40 ff. MiFIR.

[104] Cf. Art. 12 ff. Regulation (EU) No. 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps, OJ L 86, 24 March 2012, 1–24.

[105] Cf. P. Buck-Heeb, 177 ZHR (2013), 310, 330; N. Moloney, *EU Securities and Financial Markets Regulation*, 771 ff.; P. Mülbert, 177 ZHR (2013), 160, 198 ff.

[106] With criticism P. Mülbert, 177 ZHR (2013), 160, 207.

[107] Cf. P. Buck-Heeb, ZHR 177 (2013), 310, 340; N. Moloney, *How to Protect Investors*, 40; N. Moloney, *EU Securities and Financial Markets Regulation*, 773; P. Mülbert, 177 ZHR (2013), 160, 178, 180–181.

[108] Cf. P. Buck-Heeb, 177 ZHR (2013), 310, 342.

[109] O. Ben-Shahar and C. Schneider, U. Pa. L. Rev. (2011), 645, 681; L. Enriques and S. Gilotta, in: Moloney and Ferran (eds.), *Financial Regulation*, 512, 513; P. Buck-Heeb, 177 ZHR (2013), 310, 328–329.

[110] P. Buck-Heeb, 177 ZHR (2013), 310, 329–330.

[111] Cf. N. Moloney, *EU Securities and Financial Markets Regulation*, 58; L. Klöhn, 177 ZHR (2013), 349, 363.

[112] Paris Agreement under the United Nations Framework Convention on Climate Change, 12 December 2015, available at: https://unfccc.int/sites/default/files/english_paris_agreement.pdf.

[113] Resolution adopted by the General Assembly of the United Nations, Transforming our world: the 2030 Agenda for Sustainable Development, 25 September 2015, available at: www.un.org/ga/search/view_doc.asp?symbol=A/RES/70/1&Lang=E.

Growth' of 2018[114] marked the starting point for a comprehensive set of European regulatory initiatives to implement this political agenda. The Commission pointed out that sustainability and the transition to a low-carbon, more resource-efficient and circular economy are key in ensuring long-term competitiveness of the European economy.[115] Thus, the sustainable finance framework aims to reorient capital flows towards sustainable investments meaning the provision of funding for economic activities taking longer-term interests on environmental, social and governance (ESG) considerations into account.[116]

In order to achieve these objectives, the European legislator focused its regulatory measures on two main aspects.[117] This is first the establishment of an European classification system for sustainable activities, so called '**EU Taxonomy**'.[118] Since 2020, the Taxonomy Regulation sets out the conditions an economic activity has to meet in order to qualify as environmentally sustainable.[119] Besides, the European legislator also identified **disclosure obligations on sustainability issues** as a key instrument to reorient capital flows towards sustainable investments.[120] In the Commission's view fostering corporate transparency on sustainability issues will enable investors and stakeholders to assess companies' long-term value creation and their sustainability risk exposure.[121] The legislative transposition took place (i) by Regulation (EU) 2019/2088[122] on sustainability-related disclosures in the financial services sector (SFDR), laying down sustainability disclosure obligations for manufacturers of financial products and financial advisers toward end-investors[123] and also (ii) by integrating the already existing non-financial reporting stipulated by Directive 2014/95/EU[124] amending the Accounting Directive as regards disclosure of non-financial and diversity information by certain large undertakings and groups (NFRD) into the sustainable finance agenda.[125] 34

By using mandatory disclosure for its strategy on sustainable finance, the European legislator refers again to the characteristics of disclosure provisions as a control instrument for the decisions of capital market participants.[126] The legislator justified its approach of fostering transparency on sustainability issues by deficits revealed in the existing framework of corporate disclosure.[127] Sustainable investments would require a long-term orientation 35

[114] Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, Action Plan: Financing Sustainable Growth, 8 March 2018, COM(2018) 97 final (Sustainable Finance Action Plan 2018).

[115] Commission, Sustainable Finance Action Plan 2018, p. 1.

[116] Commission, Sustainable Finance Action Plan 2018, p. 2.

[117] Cf. R. Veil, in: FS Hopt, 1321, 1322.

[118] European Commission, Sustainable Finance Action Plan 2018, p. 3 ff.

[119] See R. Veil § 1 para. 59 and § 2 para. 22.

[120] Cf. R. Veil, in: FS Hopt, 1321, 1322 ff.

[121] Commission, Sustainable Finance Action Plan 2018, p. 3 ff.

[122] Cf. Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability- related disclosures in the financial services sector, OJ L 317, 9 December 2019, p. 1–16 (SFDR).

[123] Cf. R. Veil, in: FS Hopt, 1321, 1327 ff.

[124] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, OJ L 330, 15 November 2014, p. 1–9 (NFRD).

[125] Cf. F. Möslein and A.-C. Mittwoch, WM (2019), 481, 487 ff. See also H. Brinckmann § 18 para. 16 ff. On problems with the connection between these two disclosure regimes cf. R. Veil, in: Tountopoulos and Veil (eds.), *Transparency of Stock Corporations in Europe*, 129, 138.

[126] See above para. 29.

[127] Cf. European Commission, Sustainable Finance Action Plan 2018, p. 4.

whereas the current framework was seen as focusing on the production of high returns over a short timeframe.[128] This can been explained by the increasing degree of uncertainty when it comes to predict a company's performance over a longer period of time. Although capital markets law refers to financial accounting information for its system of periodic disclosure assuming that such information provide the best instrument for a prognosis on future companies' performance business economics has developed so far,[129] nonetheless, the more the prognosis goes into the future even financial accounting information are losing their capacity as a prognosis tool. As the European legislator tries to reorient capital flows towards long-term (meaning sustainable) investments, disclosure provisions need to supply the market with information on these sustainability issues. As they are intended to open investment decisions for a long-term perspective, they bear a higher degree of uncertainty as eg financial accounting information. However, by requiring companies to report on sustainability issues these companies are forced to integrate environmental, social and governance concerns in their business operations and in their interaction with their stakeholders.[130] In this way disclosure obligations on sustainability issues act as an **instrument of permanent self-control**.[131]

IV. Development of a Disclosure System in European Capital Markets Law

36 In the beginning, the European legislator did not follow an overall concept for the development of a disclosure system. The first directives[132] referred to limited aspects of capital markets law[133] and only contained provisions for issuers whose securities were admitted to the official listing of a stock exchange. Meanwhile the European Union has enlarged its regulatory activity.[134] This led to the development of an overall disclosure regime.

[128] Cf. Commission, Sustainable Finance Action Plan 2018, p. 3, 10; R. Veil, in: Tountopoulos and Veil (eds.), *Transparency of Stock Corporations in Europe*, 129, 141.

[129] See H. Brinckmann § 18 para. 7 ff. with further references.

[130] Cf. Commission, Sustainable Finance Action Plan 2018, p. 3; R. Veil, in: Tountopoulos and Veil (eds.), *Transparency of Stock Corporations in Europe*, 129, 137 ff.

[131] Cf. J. Hennrichs, ZGR (2018), 206, 209.

[132] These were Council Directive 79/279/EEC of 5 March 1979 coordinating the conditions for the admission of securities to official stock exchange listing, OJ L 66, 16 March 1979, 21–32 (Securities Admission Directive); Council Directive 80/390/EEC of 17 March 1980 coordinating the requirements for the drawing up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing, OJ L 100, 17 April 1980, p. 1–26 (Securities Admission Prospectus Directive) and Council Directive 82/121/EEC of 15 February 1982 on information to be published on a regular basis by companies the shares of which have been admitted to official stock-exchange listing, OJ L 48, 20 February 1982, p. 26–29 (Half-Yearly Report Directive).

[133] M. Brellochs, *Publizität und Haftung*, 26.

[134] Initially, the European disclosure system which was based mainly on European directives followed a concept of a system of five concentric circles, P. Mülbert, WM (2001), 2085, 2094–2095. Since regulated and non-regulated markets have been consolidated, cf. M. Brellochs, *Publizität und Haftung*, 50–51, the distinction between the different market areas which used to be laid out in the legislative regulation has been reduced. For a systematic presentation of European capital markets law see M. Brellochs, *Publizität und Haftung*, 26 ff.; H. Merkt, *Unternehmenspublizität*, 140 ff.; P. Mülbert, WM (2001), 2085, 2094–2095.

37 A company's disclosure obligations can be divided into three categories, depending on the company's stages of market participation.[135] The first disclosure obligations arise when a company makes a public offering. According to the Prospectus Regulation the issuer then has to publish a prospectus.[136] Activities on secondary markets are accompanied by further periodic and ad hoc disclosure obligations. Periodic disclosure ensures that the market is continually supplied with the company's relevant financial accounting and—to some degree—non-financial information. The Transparency Directive requires the regular publication of financial reports to these means.[137] Additionally there are various obligations on disclosure for a company during market participation, the most important being the disclosure of inside information,[138] changes of major shareholdings,[139] control over a target company[140] and directors' dealings.[141] A mandatory disclosure upon market exit does not exist at a European level.

38 Studies trying to develop an overall concept of corporate disclosure[142] came to the conclusion that disclosure correlates with market participation: The more capital an issuer raises on the market, the more its disclosure obligations grow. The same applies with regard to the mandatory disclosure on capital markets. From the perspective of capital markets law, an issuer's relevance to the overall market increases with the amount of capital it raises on the market.[143] The more capital the issuer raises, the more important the issuer becomes regarding the protection of the investors and the institutional efficiency of the capital markets as a whole. It also increases its impact on the overall allocational efficiency of the markets, making an effective and correct pricing mechanism for the issuer's securities more important. The correct pricing conveys the allocational potential of an issuer. It becomes more important the more capital is bound to it. Economically a misallocation of large amounts of capital entails more ineffectual real investments of this issuer than would be the case for an issuer with a lower market capitalisation. The amount of capital bound by an issuer thus indicates its economic importance for the market.[144]

V. Dissemination Procedure and Access to Regulated Information

39 Economic insights have shown that legislative provisions standardising content and procedure for the information provision can have a positive effect for the regulation of capital

[135] Overview in: Brinckmann, *Kapitalmarktrechtliche Finanzberichterstattung*, 91 ff.; M. Brellochs, *Publizität und Haftung*, 30 ff.

[136] See R. Veil § 17 para. 5.

[137] See H. Brinckmann § 18 para. 32–47.

[138] See R. Veil § 19 para. 24.

[139] See R. Veil § 20 para. 23.

[140] See R. Veil § 28 para. 5, § 39 para. 2.

[141] See R. Veil § 21 para. 12.

[142] Cf. H. Merkt, *Unternehmenspublizität*, 332 ff. and passim; on the periodic disclosure system H. Brinckmann, *Kapitalmarktrechtliche Finanzberichterstattung*, 138 ff.

[143] H. Brinckmann, *Kapitalmarktrechtliche Finanzberichterstattung*, 139 ff.

[144] This approach is confirmed by the European law. Issuers are exempted from disclosure if certain capital related minimum thresholds are not reached by the issuer, cf. Art. 1(2)(h) PD, Art. 8(2) TD, or the issuer only affects a small group of investors due to a high denomination per unit set for the issued securities, cf. Art. 8(1)(b) TD.

markets.[145] With the legislative aim of mandatory disclosure provisions to increase capital markets informational efficiency,[146] legal requirements have to secure the investors' immediate and cost-efficient access to the relevant information.[147]

1. Development of Harmonised Requirements for the Access to Regulated Information

40 In the beginning European capital markets law followed a separate approach regarding the requirements on the disclosure procedure. Every single directive—meaning the Securities Admission Directive, Securities Admission Prospectus Directive and the Half-Yearly Report Directive and their successors[148]—laid down their own provisions on the disclosure procedure regarding the disclosure obligation contained in each directive. At that time the legislator mainly relied on a publication in printed newspapers in order to ensure fast access to such information throughout the relevant Member State.[149]

41 The European legislature realised the high importance of a harmonised access to information for the functioning of the capital markets and, therefore, follows a more integrated and unified approach since the TD of 2004. The TD contains more specific requirements regarding the (i) **disclosure procedure** and the (ii) **storage of information**. The TD and the Implementing Directive 2007/14/EC[150] laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, require the disclosure and storage of '**regulated information**'. This term refers to all information which the issuer is required to disclose under the TD, ie notifications on major holdings[151] and financial reports,[152] and under any super-equivalent disclosure obligation adopted by the Member States under Article 3(1) TD.[153] But as far as issuers of financial instruments which are traded on a regulated market are concerned, the term also refers to inside information[154] and directors' dealings[155] under the MAR.[156] This shows the overarching approach of the European legislator in the respect.

145 See above para. 25.
146 See above para. 29.
147 See above para. 25.
148 See R. Veil § 1 para. 24.
149 Cf. Art. 17 Securities Admission Directive; Art. 20 et. seq. Securities Admission Prospectus Directive; Art. 7 Half-Yearly Report Directive.
150 Commission Directive 2007/14/EC of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, OJ L 69, 9 March 2007, p. 27–36.
151 See R. Veil § 20 para. 39.
152 See H. Brinckmann § 18 para. 58–60.
153 Cf. Art. 2(1)(k) TD.
154 See R. Veil § 19 para. 41–43.
155 See R. Veil § 21 para. 19.
156 Cf. Art. 2(1)(k) TD. References to the MAD in this provision shall be construed as references to the MAR in accordance with the correlation table set out in Annex II MAR: Art. 37 MAR. See also W.-G. Ringe, in: Lehmann and Kumpan (eds.), *European Financial Services Law*, Art. 21 TD para. 4.

(a) Requirements on the Dissemination of Regulated Information

Under the TD the Member States must ensure that an **issuer discloses regulated information** in a **manner** ensuring **prompt access** to such information on a **non-discriminatory basis**.[157] It must be disseminated in a manner that ensures it is capable of being disseminated to as wide a public as possible.[158] The issuer must refer to such media as may reasonably be relied upon for the effective dissemination of information to the public throughout the Community.[159] These requirement can realistically only be met by use of the Internet, which is why the European legislature explicitly allows the information to be published on the issuer's website, provided this publication is then announced to the media.[160] These requirements illustrate a development for the dissemination procedure in two areas. This is first that today issuers are required to use such media that ensure effective dissemination throughout the European Union and not only throughout the relevant Member State.[161] Secondly, the legislator respects past technical developments and opens the media to be used for dissemination from print to electronic means, primarily the Internet. 42

Although inside information and directors' dealings are covered by the term 'regulated information' in the TD, the disclosure of this information by issuers is also regulated by the MAR.[162] The reason for this is that the scope of the MAR is wider; Article 17(1) and Article 19(1) MAR also require issuers of financial instruments traded on MTFs and OTFs to make public the respective information. That is why the MAR empowers the Commission to endorse implementing technical standards submitted by ESMA[163] with regard to the public disclosure of inside information.[164] The provisions of the Commission Implementing Regulation (EU) No. 2016/1055 (ITS)[165] are directly applicable in the Member States, whilst the disclosure requirements of the TD (relevant for issuers whose securities are admitted to trading on a regulated market) have to be implemented into national law of the Member States. 43

Under the MAR the issuer must ensure fast access and a complete, correct and timely opportunity for assessment by the public.[166] These requirements are further specified in Article 2 ITS, which does not explicitly refer to the terms of the TD. Nevertheless, ESMA has developed compatible requirements and standards to those set out in the TD to establish a level playing field between regulated markets and MTFs and OTFs.[167] 44

[157] Cf. Art. 21(1) sentence 1 TD.
[158] Cf. Art. 12(2) Directive 2007/14/EC.
[159] Cf. Art. 21(1) sentence 3 TD.
[160] Art. 12(3) Directive 2007/14/EC.
[161] Cf. W.-G. Ringe, in: Lehmann and Kumpan (eds.), *European Financial Services Law*, Art. 21 TD para. 9.
[162] Cf. Art. 17(1) sentence 2 MAR; Art. 19(3) MAR.
[163] Cf. ESMA, Final Report, Draft technical standards on the Market Abuse Regulation, 28 September 2015, ESMA/2015/1455, Annex XII.
[164] Cf. Art. 17(10) MAR; Art. 19(3) sentence 1 MAR.
[165] Cf. Commission Implementing Regulation (EU) No. 2016/1055 of 29 June 2016 laying down implementing technical standards with regard to the technical means for appropriate public disclosure of inside information and for delaying the public disclosure of inside information in accordance with Regulation (EU) No. 596/2014 of the European Parliament and of the Council, OJ L 173, 30 June 2016, p. 47–51.
[166] Cf. Art. 17(1) sentence 2 MAR; Art. 19(3) MAR.
[167] Cf. ESMA/2015/1455 (fn. 163), p. 43.

(b) *Officially Appointed Mechanism (OAM)*

45 The Member States must further ensure that the issuer makes the regulated information available to an '**officially appointed mechanism**' (OAM),[168] ie to a database responsible for the central storage of the regulated information, which complies with minimum quality standards of security and certainty as to the information source and guarantees easy access by end users.[169] As a result, each Member State established or appointed an OAM.[170]

46 The storage of inside information and directors' dealings is also regulated by the MAR.[171] Only if the information disclosed under the MAR is also 'regulated information' as defined by the TD, the issuer has to make the information available to an OAM.[172] This means, that there is no obligation for issuers of financial instruments traded on an MTF and OTF to make the inside information and directors' dealings available to an OAM, unless the Member States establish such an obligation.

(c) *Implementation in the Member States*

47 Aside from the requirements concerning the OAMs, the requirements in the TD are limited to the general foundations of disclosure and storage of regulated information. Each Member State is responsible for the details thereof, such as the exact media to be employed. The individual Member State must determine whether a dissemination of the information in daily newspapers or via the Internet is sufficient. As a consequence, the European legal requirements for the access to regulated information have led to a strong divergence (i) in the disclosure procedures as well as (ii) to the central storage mechanisms within the Member States.[173] As a consequence access to regulated information still follows a national not a European approach.[174]

(d) *European Electronic Access Point (EEAP) and European Single Access Point (ESAP)*

48 Albeit the recommendation of the Actica Feasibility Study to replace all national OAMs and to establish one central OAM,[175] the reform of the Level 1 acts has not abolished the existence of national databases. Instead, after its revision in 2013,[176] the TD only requires

[168] Cf. Art. 21(1) sentence 1 TD.
[169] Cf. Art. 21(2) TD.
[170] ESMA provides a list of OAMs, available at: www.esma.europa.eu/access-regulated-information.
[171] Cf. Art. 17(1) sentence 2 MAR; Art. 19(3) MAR.
[172] Cf. Art. 17(1) sentence 2 MAR; Art. 19(3) sentence 2 MAR.
[173] For more details on the transposition in the Member States, see H. Brinckmann § 18 para. 58 ff. See also 2nd edn. (2017), R. Veil, § 22 para. 8 ff.
[174] Cf. W.-G. Ringe, in: Lehmann and Kumpan (eds.), *European Financial Services Law*, Art. 21a TD para. 2.
[175] Cf. Actica, Feasibility Study for a pan-European storage system for information disclosed by issuers of securities—Final Report, 18 October 2011, available at: https://ec.europa.eu/info/sites/info/files/report-storage-system-18102011_en.pdf, p. 53.
[176] Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC, OJ L 294, 6 November 2013, p. 13–27 (ADTD).

ESMA to establish and operate a '**European electronic access point**' (EEAP) to connect the national OAMs.[177] The EEAP shall facilitate pan-European access to regulated information[178] by allowing to access and search the national databases centrally, using unique identifiers for each issuer. The technical requirements of the EEAP are specified by Level 2 legislation. The RTS on the EEAP have been developed by ESMA in 2015[179] and published in 2016.[180] However, ESMA realised at the end of 2016 that work on this project was more ambitious than initially planned, especially with respect to cost.[181]

Looking for a technical solution for the EEAP, the Commission started a pilot project for a European financial transparency gateway (EFTG)[182] that is based on the distributed ledger technology.[183] But before it even started, the EEAP seems to merge into the new project of a **European single access point (ESAP)**. In 2020, the Commission presented its new action plan for a capital markets union[184] based on the report of a high-level forum on the capital markets union.[185] In order to make companies more visible to cross-border investors, better integrate national capital markets and facilitate their access to market funding, the Commission wants to tackle the lack of accessible and comparable company data for investors. Therefore, the Commission aims to set up the ESAP as an EU-wide platform that provides investors with seamless access to financial and sustainability related company information.[186] The ESAP shall built on the EFTG pilot project but follow a broader approach than the EEAP as it shall also improve the availability and accessibility of sustainability-related data.[187] In this context, further amendments to the TD can be expected.[188] 49

2. Conclusion

The legal requirements on the access to regulated information under European capital markets law go in the right direction but, however, are still far away from the target. The TD contains harmonised requirements on the disclosure and central storage of regulated information under the TD as well as under the MAR. Thereby, the European legislator follows an overarching approach, releasing from focusing on separate legislative acts. It is also 50

[177] Cf. Art. 21a(1) TD.

[178] Recital 15 ADTD.

[179] ESMA, Final Report on Draft Regulatory Technical Standards on European Electronic Access Point (EEAP), 25 September 2015, ESMA/2015/1460.

[180] Commission Delegated Regulation (EU) 2016/1437 of 19 May 2016 supplementing Directive 2004/109/EC of the European Parliament and of the Council with regard to regulatory technical standards on access to regulated information at Union level, OJ L 234, 31 August 2016, p. 1–7.

[181] Cf. W.-G. Ringe, in: Lehmann and Kumpan (eds.), *European Financial Services Law*, Art. 21a, para. 9.

[182] The EFTG is available at: https://eftg.eu/.

[183] Commission, Governance for a DLT/Blockchain enabled European Electronic Access Point (EEAP), Final Report, available at: https://op.europa.eu/en/publication-detail/-/publication/98da7b74-38db-11ea-ba6e-01aa75ed71a1.

[184] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, A Capital Markets Union for people and businesses-new action plan, 24 September 2020, COM(2020) 590 final (New CMU Action Plan).

[185] Final Report of the High Level Forum on the Capital Markets Union 'A new vision for Europe's capital markets', available at: https://ec.europa.eu/info/sites/info/files/business_economy_euro/growth_and_investment/documents/200610-cmu-high-level-forum-final-report_en.pdf.

[186] Commission, New CMU Action Plan. p. 7.

[187] Commission, Annex to the New CMU Action Plan. p. 1.

[188] Commission, Annex to the New CMU Action Plan. p. 1.

important that the scope of the MAR includes MTFs and OTFs as it improves the internal market and facilitates the competition between regulated markets and MTFs/OTFs. But the approach to provide different legal sources for issuers whose financials instruments are admitted to trading on a regulated market on the one side and MTF/OTF-issuers on the other side is not convincing. This might lead to unnecessary differences in the disclosure and storage of information and thereby makes the access to price relevant information more difficult and costly. The same applies to other disclosure obligations, especially the obligation to disclose a prospectus[189] which is not available via OAM but via the website of the competent authority.[190] A unified system of access to information is necessary. The EEAP is on the starting block and will reduce the costs of information about issuers from other Member States, thereby improving the internal market and market efficiency.[191] To replace all national OAMs by a central European OAM would probably be the best but also most difficult solution. It remains to be hoped that a gateway based on distributed ledger technology will be able to operate the EEAP or ESAP in a way as if all national OAMs have been merged into one central European OAM.

189 See. R. Veil § 17 para. 58.
190 Cf. Art. 21(5) PR.
191 Cf. W.-G. Ringe, in: Lehmann and Kumpan (eds.), *European Financial Services Law*, Art. 21a para. 8.

§ 17

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I. Introduction

1 The Prospectus Regulation (EU No. 2017/1129 – PR) aims to protect investors by providing information. Recital 3 expresses this concisely as follows: '**Disclosure** of **information** in cases of **offers** of securities to the public or **admission** of **securities** to **trading** on a regulated market is vital to **protect investors** by removing asymmetries of information between them and issuers. Harmonising such disclosure allows for the establishment of a cross-border passport mechanism which facilitates the effective functioning of the internal market in a wide variety of securities.' Recital 7 adds that the PR also intends to 'to ensure investor protection and market efficiency, while enhancing the internal market for capital.' The obligation to publish information about the issuer and the securities is based on the idea to enable all investors to make an informed investment decision. The appropriate way to make this information available is to publish a prospectus.

2 The rules on prospectus disclosure are based on the recognition that securities are so-called credence products.[1] Unlike with so-called search goods, an investor cannot reduce uncertainties by obtaining information about the product prior to acquisition, or realistically assess securities at acceptable information costs due to their complexity and the duration of capital investments. The investor must therefore rely upon the promised quality of the securities. This confidence can only be based on reliable information.[2] Primary markets do not bear the characteristics of strong-form efficiency in terms of the ECMH,[3] resulting in an asymmetric distribution of information between issuers and investing market participants.[4] These deficits are to be reduced through prospectus disclosure.

3 Professional investors usually do not need the information provided by a securities prospectus. They can obtain relevant information easily and cost-efficiently from the issuer, through individual discussions with the investor relations department and the management as well as in the context of roadshows. Prospectus disclosure is primarily intended to

[1] See R. Veil § 2 para. 12.

[2] Cf. L. Burn, in: Panasar and Boeckmann (eds.), *European Securities Law*, para. 1.39; H. Fleischer, *Gutachten F 64. Dt. Juristentag*, F 23; N. Moloney (ed.), *EU Securities and Financial Markets Regulation*, 55–56.

[3] See on the Efficient Capital Market Hypothesis R. Veil § 2 para. 29 and H. Brinckmann § 16 para. 8–9.

[4] Cf. H.-D. Assmann (ed.), *Prospekthaftung*, 292 ff.; N. Vokuhl, *Kapitalmarktrechtlicher Anlegerschutz*, 176.

enable **retail investors** to make an informed investment decision.[5] European prospectus law determines who is to be understood as a qualified investor. Conversely, it follows that information asymmetries are to be assumed for all other investors, which are to be countered by a securities prospectus. Information should be adapted to the level of knowledge and expertise of retail investors.[6]

For the issuer, the prospectus is not only the legal prerequisite for the offer of the securities and their admission to listing, but also a **sales document** with which it attracts investors (dual function of the prospectus).[7] The marketing function becomes particularly relevant when shares or bonds are offered to the public for the first time (IPO). An issuer will then have particular cause to highlight the advantages of the business strategy or the attractiveness of its products. The European prospectus regime takes account of the marketing aspect by imposing requirements on advertising that are intended to ensure the fairness and truthfulness of advertising in the prospectus in the interest of retail investors.[8] 4

II. Foundations

1. Disclosure Obligation

At the centre of the prospectus regime is the obligation to publish a prospectus. Securities may only be offered to the public after prior publication of a prospectus (also referred to as an **offering prospectus**).[9] Furthermore, a prospectus obligation also exists for the admission of securities to trading on a regulated market (also referred to as **admission prospectus**).[10] The regime (preparation, content and presentation) is identical for both prospectuses. 5

There are numerous exceptions to the prospectus requirement where there is no need for investors to be informed by means of prospectus publication because the information asymmetries are balanced out by market forces or other information documents. For example, if a public offer is directed exclusively at qualified investors, an offer prospectus does not need to be published.[11] If the securities are to be admitted to trading, however, a prospectus must be prepared and published because retail investors also acquire the securities via the secondary market. 6

The securities prospectus is subject to **ex ante control** by the **supervisory authority**. It may only be published after the competent authority has approved it.[12] The supervisory 7

[5] Cf. M. Gruber (ed.), *EU-Prospektrecht*, 16.
[6] Cf. recital 7 Regulation (EU) No. 2019/980.
[7] Cf. H.-D. Assmann, *Prospekthaftung*, 218; G. Kastelein and T. Reutelingsperger, in: Busch et al. (eds.), *Prospectus Regulation and Prospectus Liability*, 14.04; A. Meyer, in: Habersack et al. (eds.), *Unternehmensfinanzierung am Kapitalmarkt, Rn.* 36.13; M. Schlitt, in: Habersack et al. (eds.), *Handbuch der Kapitalmarktinformation*, § 3 Rn. 2.
[8] Cf. Art. 20 PR.
[9] Cf. Art. 3(1) PR.
[10] Cf. Art. 3(3) PR.
[11] Cf. Art. 1(4)(a) PR.
[12] Cf. Art. 20(1) PR.

authority shall verify that the prospectus is complete, comprehensive and consistent.[13] It does not check whether the content of the prospectus is correct. This could hardly be done by an authority and would prolong the procedure. Therefore, administrative sanctions and civil enforcement mechanisms in the form of prospectus liability are needed to ensure that the issuer provides correct information.

2. Accompanying Regimes

8 The disclosure obligations of the PR concern the primary market. The information of investors required on the secondary market is ensured by other disclosure obligations. The Market Abuse Regulation (MAR) requires issuers of financial instruments to **disclose inside information** without delay.[14] In addition, the Transparency Directive (TD)[15] requires Member States to provide for the publication of an **annual and half-yearly financial report**[16] and require investors to make public **changes** in **major holdings** in issuers.[17]

9 The dense regime of investor information on the secondary market justifies imposing lower requirements on the content of the securities prospectus in case of a secondary issuance.[18] The premise of the simplified disclosure rules is that, due to the secondary market obligations (on a Regulated Market and on the SME Growth Market), information-efficient securities prices are achieved, which make publication of the information already reflected in the securities price through a prospectus unnecessary.

3. Legal Sources

(a) European Level

10 The obligation to publish a prospectus was first introduced by the European legislature in 1979. Since then, it has been subject to a number of reforms.[19] For 'reasons of consistency', the legislature regrouped the provisions in 2003, making extensive amendments. The **Prospectus Directive** (PD 2003) constituted an instrument essential to the achievement of the internal market.[20] In 2010, the PD was amended by Directive 2010/73/EU,[21] ensuring

[13] Cf. Art. 20(4) PR.
[14] Cf. Art. 17 MAR. See R. Veil § 19.
[15] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (TD), p. 38 ff. (TD).
[16] See H. Brinckmann § 18 Rn. 41 ff.
[17] See R. Veil § 20.
[18] Cf. Art. 14 PR.
[19] See R. Veil § 1 para. 5–6, 10 and 24; more details on historical aspects in N. Moloney, *EU Securities and Financial Markets Regulation*, 71 ff.; P. Schammo, *EU Prospectus Law*, 74 ff.
[20] Cf. recital 4 PD.
[21] Directive 2010/73/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, OJ L327, 11 December 2010, p. 1–12.

a more effective investor protection and facilitating cross-border offers. The 2017 reform built on this and pursued the goal of reducing the administrative burden for companies on the one hand, and making the prospectus a more valuable source of information on the other hand.[22]

11 The Prospectus Regulation (PR)—a Level 1 measure of the European legislature—is an essential step towards the completion of the Capital Markets Union[23] and counters the divergent approaches of the PD 2003/2010, which resulted in a fragmentation of the internal market.[24] The choice of the form of a regulation (instead of a directive) is justified by the fact that in the 'absence of a harmonised framework to ensure uniformity of disclosure and the functioning of the passport in the Union it is therefore likely that differences in Member States' laws would create obstacles to the smooth functioning of the internal market for securities. Therefore, to ensure the proper functioning of the internal market and improve the conditions of its functioning, in particular with regard to capital markets, and to guarantee a high level of consumer and investor protection, it is appropriate to lay down a regulatory framework for prospectuses at Union level.'[25]

12 Most of the provisions of the PR aim at a **full harmonisation** of prospectus law. However, with regard to individual aspects, Member States have regulatory options (see para. 68). Moreover, the provisions on supervision and sanctions are directive-like regulatory mandates. Finally, the disclosure requirements of the PR do not affect the right of a Member State, a competent authority or a stock exchange (by means of its stock exchange rules) to lay down further specific requirements in connection with the admission of securities to trading on a regulated market, in particular in relation to corporate governance. Such requirements should not directly or indirectly restrict the drawing up, the content and the dissemination of a prospectus approved by a competent authority.[26] Of practical importance, for example, is the admission requirement to organise analyst conferences annually.

13 The PR is supplemented by a Level 2 regime developed by ESMA and endorsed by the Commission. **Delegated Regulation** (EU) No **2019/979** governs a number of technical aspects (key financial information in the summary of the prospectus, the publication and classification of prospectuses, the advertising of securities, supplements to the prospectus and the notification portal). **Delegated Regulation** (EU) No **2019/**980 concerns the presentation, content, scrutiny and approval of the prospectus. It is a huge set of rules. The detailed provisions reflect the aim of the European legislator and the Commission to establish a uniform legal situation in the EU. The more detailed the European regulations are, the lower the risk of divergent interpretations by national supervisory authorities.

14 In order to promote consistent supervisory practice by national competent authorities, the former CESR published a document with recommendations on how to interpret the requirements of the European disclosure regimes and a document with questions

[22] Cf. M. Gruber (ed.), *EU-Prospektrecht*, 20.
[23] Cf. recital 1 PR.
[24] Cf. recital 4 PR.
[25] Cf. recital 4 PR.
[26] Cf. recital 8 PR.

and answers on the common positions agreed by CESR members. **ESMA** has continued this approach and publishes updates of these documents accordingly. The **guidelines**[27] are intended to ensure uniform interpretation and application of the rules. The **Q&A document**[28] is a practical convergence tool that provides interpretation and guidance to market participants. Finally, ESMA's guidelines on alternative performance measures (so-called APM guidelines)[29] are relevant for securities prospectuses.

(b) National Level

15 The provisions of the PR are directly applicable in the Member States; they therefore do not need to be transposed into national law. However, the PR provides for regulatory options for the Member States (see para. 68). Thus, Member States may facilitate the public offer of securities through crowd-funding. National laws also regulate prospectus liability and the powers of national supervisory authorities.

III. Prospectus Requirement According to the Prospectus Regulation

1. Scope of Application

16 Offers of securities to the public as well as the admission of securities to trading on a regulated market that fall within the PR's scope of application are generally subject to the publication of a prospectus.[30] The scope of application is thus defined through the terms '**admission of securities to a regulated market**' and '**offers of securities to the public**'.

17 In Article 2(1)(a), the PR defines 'securities' as all transferrable securities with the exception of money market instruments having a maturity of less than 12 months.[31] The definition of the term in MiFID II is applicable.[32] The term includes dividend-paying securities (especially shares, convertible bonds and bonds with warrants) and debt securities (especially bonds).[33] This distinction is important for the preparation and content of a prospectus. For lack of fungibility, registered bonds, time deposits, savings bonds, shares in a limited liability company or a limited partnership are not securities.[34] The PR also does not apply to unit certificates issued by an investment fund or a capital management company.[35]

[27] ESMA, Guidelines on Risk Factors under the Prospectus Regulation, 1. 10. 2019, ESMA31-62-1293.
[28] ESMA, Questions and Answers, Prospectuses, ESMA/2019/ESMA31-62-1258, Version 10, last updated on 27 July 2021.
[29] ESMA, Guidelines on Alternative Performance Measures (APM), 5.10.2015, ESMA 2015/1415.
[30] Cf. Art. 1 PR.
[31] See R. Veil § 8 para. 4.
[32] See R. Veil § 8 para. 9.
[33] Cf. Art. 2(b) and (c) PR.
[34] See R. Veil § 8 para. 20.
[35] Cf. Art. 1(2)(a) PR. The obligation to publish a prospectus results from UCITS/AIFMD.

The term '**offer** of **securities to** the **public**' means a communication to persons in any form and by any means, presenting sufficient information on the terms of the offer and the securities to be offered, in order to enable an investor to decide to purchase or subscribe to these securities.[36] This solves the problem that used to arise from the fact that the Member States had differing views on whether an offer requires a prospectus publication, resulting in a possible obligation to publish a prospectus in one Member State whilst the offer or the admission of the same security in a different Member State was possible without a prospectus.[37] 18

An '**offer**' does not require a legally binding declaration of intent. Already the invitation to submit an offer (invitatio ad offerendum) is to be regarded as an offer. Whether an offer is **public** is not determined by whether it is addressed to a certain number of investors. According to the meaning and purpose of prospectus law, the requirement of publicity is not to be determined quantitatively, but qualitatively.[38] An offer is public if it is addressed to an indefinite group of investors. Private placements are not regarded as public. In doing so, the issuer specifically addresses investors who are known to it and who are not in need of protection due to their knowledge.[39] 19

The **admission** of **securities** to **trading** on an MTF does not give rise to an obligation to publish a prospectus under EU law. This is only the case for an admission to trading on a Regulated Market.[40] If an issuer offers shares only to qualified investors[41] and applies for admission of the shares to trading on an SME growth market (for example Scale of the FWB) which is not a Regulated Market but an MTF,[42] there is no obligation to publish a prospectus under the PR. However, the rules and regulations of the trading venue may provide that a prospectus or other information document must be published for admission to trading. With regard to the SME Growth Market Scale, the issuer shall prepare an 'inclusion document' which shall be published on the website of Deutsche Börse AG.[43] 20

2. Exemptions from the Obligation to Publish a Prospectus

(a) Exceptions for Offers of Securities

The PR exempts **offers** of securities addressed solely **to qualified investors** from the obligation to publish a prospectus.[44] The term 'qualified investors' primarily refers to all professional investors such as credit institutions, investment firms, financial institutions and insurance companies. These investors do not require protection due to their level of expertise and better access to information.[45] 21

[36] Art. 2(d)(1) PR. This definition also applies to the placement of securities by financial intermediaries (Art. 2(d)(2) PR).
[37] P. Schammo, *EU Prospectus Law*, 80.
[38] M. Schlitt, in: Habersack et al. (eds.), *Handbuch der Kapitalmarktinformation*, § 3 para. 32.
[39] A. Meyer, in: Habersack et al. (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, para. 36.5.
[40] Cf. Art. 2(j) PR i.V.m. Art. 4(1) No. 21 MiFID II.
[41] An offer prospectus does not need to be published then, Art. 1(4)(a) PR.
[42] See R. Veil § 7 para. 11 and 16.
[43] Cf. § 17(1)(b),(3)(b), Annex 2, General Terms and Conditions of Deutsche Börse AG for the Open Market on the Frankfurt Stock Exchange, 9.12.2019.
[44] Art. 1(4) PR.
[45] Cf. P. Schammo, *EU Prospectus Law*, 126 ff.

22 The PR further contains an exception for an offer of securities addressed to fewer than 150 natural or legal persons per Member State, other than qualified investors, which is aimed at facilitating **private placements**. If the offer has a high minimum denomination or amount, it can be assumed that retail investors are either not addressees or have sufficient assets to bear the risks.

23 If the obligation to draw up a prospectus is to be avoided when submitting an offer for securities, use will generally be made of this last exemption in practice. Securities with a minimum consideration of € 100,000 per investor are offered publicly with a minimum denomination of € 100,000 (or full € 1,000 above € 100,000) or with a minimum denomination of € 1,000 (whereby only securities with a minimum consideration of € 100,000 or full € 1,000 above € 100,000) may be transferred. This exemption is of particular relevance in practice, as the issuer itself can assure adherence to the prerequisites, without having to rely on the banks. Nevertheless issuing banks will generally declare in their contract with the issuer to submit the offer only under the preconditions described above, ie only to qualified investors or less than 150 investors. In addition, the persons acquiring the securities must confirm that they are qualified in the sense of the PR. This so-called '*belt and suspenders*' strategy is of outstanding importance in practice.

24 The obligation to publish a prospectus does not apply to offers to the public for certain types of securities. The exemptions refer to cases in which the securities are offered as substitutes for existing securities or in connection with certain transactions. In these cases investors have already been supplied with the necessary information at an earlier point.[46] Shares issued as substitutes for shares of the same class already issued does not therefore need to be accompanied by a prospectus if the issuing of such new shares does not involve any increase in the issued capital. Similarly, securities offered in connection with a takeover or a merger by means of an exchange offer do not require a prospectus to be published provided that a document is available containing information which is regarded as being equivalent to that of a prospectus by the competent authority. This requirement will usually be fulfilled by the offer document in takeovers and the merger report.

(b) Exemptions for Certain Issuances for the Admission to the Regulated Market

25 The obligation to publish a prospectus is also not applicable to the admission to trading certain types of securities on a regulated market.[47] The cases are similar to those mentioned above, with the addition of exemptions, such as that for securities already admitted to trading on *another* regulated market, provided certain conditions ensuring investor protection are fulfilled. The admission of shares resulting from the conversion or exchange of other securities or from the exercise of the rights conferred by other securities to the regulated market is also not subject to the publication of a prospectus, provided that said shares are of the same class as the shares already admitted to trading on the same regulated market.

[46] C. Seibt et al., AG (2008), 565 ff.; R. Veil and M. Wundenberg, WM (2008), 1285 ff.
[47] Art. 1(5) PR.

3. Format and Structure of a Prospectus

(a) Single or Separate Documents and Base Prospectus

The PR provides the possibility to draw up the prospectus as a single document or separate documents. **Separate documents** must divide the required information into a **registration document** (including information on the issuer), a **securities note** and a **summary note** (which is divided into four sections). In these cases, the registration document can be published in advance and remains valid for 12 months after its publication (cf. Article 12 Abs. 1 PR) for numerous offers to the public or admissions to trading on a regulated market (of course, a securities note and a summary note have to be published for each offer). It is especially suited to the needs of issuers that regularly place offers of securities to the public, such as banks.[48] As opposed to this, the single document appears more suited to the issuance of shares.[49] 26

With the modernisation of prospectus law, the European legislature intended to give **frequent issuers** the opportunity to reduce their cost of compliance with the PR and enable them to swiftly react to market windows.[50] For this purpose, it has created a specific regime, inspired by the US shelf registration.[51] Every financial year, any issuer whose securities are admitted to trading on a regulated market or an MTF may draw up a registration document in the form of a **universal registration document** describing the company's organisation, business, financial position, earnings and prospects, governance and shareholding structure.[52] This form requires the approval of the authority. If it has been approved in two consecutive financial years (the issuer is then granted the status of a frequent issuer),[53] uniform registration forms can be filed in future without prior approval.[54] When market conditions are favourable for a public offer of securities, the issuer can use the universal registration document and draw up a prospectus by adding a securities note and a summary note. Finally, the issuer also benefits from shorter approval periods.[55] 27

For offers of certain non-equity securities (bonds) the prospectus can consist of a **base prospectus**[56] which must contain the same 'relevant information' on the issuer and the securities as a single or separate document, with the exception of the final terms of the offer.[57] The issuer announces the specific terms and conditions of each offer only immediately prior to the commencement of the relevant offer period. The base prospectus may also 28

[48] Cf. R. Panasar et al., in: Panasar and Boeckmann (eds.), *European Securities Law*, para. 2.72.
[49] Cf. M. Schlitt et al., BKR (2005), 251, 251; A. Meyer, in: Habersack et al. (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, para. 36.17; M. Schlitt, in: Habersack et al. (eds.), *Handbuch der Kapitalmarktinformation*, § 4 para. 5.
[50] Cf. recital 39 PR.
[51] Cf. D. Fischer-Appelt, in: Busch et al. (eds.), *Prospectus Regulation and Prospectus Liability*, para. 13.67.
[52] Cf. Art. 9(1) PR.
[53] Cf. Art. 9(11) subsec. 2 PR.
[54] Cf. Art. 9(2) subsec. 2 PR.
[55] Cf. Art. 9(2) subsec. 2 PR.
[56] Cf. Art. 9(11) PR.
[57] Art. 2(s) PR.

be prepared as a single document or in several individual documents.[58] The final terms shall be published at the latest on the day of the respective public offer.

29 In practice, the base prospectus plays a major role. It is mainly used for offering programmes (such as Medium Term Notes – MTN programmes) or for structured products (such as certificates).[59] The final conditions shall be set out in a separate document.[60] If the final terms are neither included in the base prospectus nor in a supplement, the issuer shall make them available to the public and file them with the competent authority as soon as possible after the offer of securities to the public or the admission to trading on a regulated market.[61]

(b) Preparation, Content and Presentation

30 European prospectus law is characterised by the **principle** of **investor protection through information**. A prospectus shall 'contain the necessary information which is material to an investor for making an informed assessment of a) the assets and liabilities, profits and losses, financial position, and prospects of the issuer and of any guarantor; b) the rights attached to the securities; and c) the reasons for the issuance and its impact on the issuer.'[62]

31 The **materiality** of the information to an investor is central to the preparation of a prospectus.[63] However, the law does not explicitly specify which investor the EU prospectus law has in mind as the addressee of the prospectus. Is it a professional investor who has extensive specialist knowledge, a retail investor who has no specialist knowledge and is easily misled, or an average investor who can at least be said to have a minimum of expertise. Furthermore, what are the investment objectives of this investor? Is he profit-oriented or does he (also) make his decisions with regard to ecological and social concerns?

32 In a 1982 decision regarding a listing prospectus, the BGH focused on the attentive reader and average investor who understands a balance sheet but does not have above-average expert knowledge. An average investor does not necessarily need to be familiar with the key language used in professional circles.[64] With regard to an offering prospectus, the BGH came to a different interpretation 30 years later: 'The question of whether a securities prospectus is incorrect or incomplete must be based on the recipient's horizon, whereby the understanding of the interested parties addressed by the prospectus is decisive. If a sales prospectus for securities that are not to be traded on the stock exchange is explicitly addressed to the uninformed and stock market inexperienced public, the average (small) investor addressed cannot be expected to be able to read a balance sheet. In these cases, the recipient's horizon is therefore determined by the abilities and knowledge of an average (retail) investor who informs himself about the investment solely on the basis of the information in the prospectus and does not have any special knowledge.'[65]

[58] Art. 8(6) PR.
[59] Cf. R. Panasar et al. in: Panasar and Boeckmann (eds.), *European Securities Law*, para. 2.73; W. Kullmann and J. Metzger, WM (2008), 1292, 1296; P. Schammo (ed.), *EU Prospectus Law*, 96 ff.
[60] Art. 8(4) subsec. 1 PR.
[61] Art. 8(5) subsec. 1 PR.
[62] Art. 6(1) subsec. 1 PR.
[63] Cf. V. de Seriére, in: Busch et al. (eds.), *Prospectus Regulation and Prospectus Liability*, para. 9.13.
[64] BGH of 12. 7. 1982 – II ZR 175/81, NJW 1982, 2823, 2824.
[65] BGH of 18. 9. 2012 – XI ZR 344/11, BGHZ 195, 1.

The principles of interpretation concern prospectus liability, which is largely subject to the national laws of the Member States.[66] For the interpretation of Union supervisory law, the principles are nevertheless helpful because they shed light on the various facets of the potential addressees of a prospectus and the legal issues associated with the investor concept. Should it be an inexperienced and unsophisticated investor, particularly high demands are to be made on the scope and presentation of the information in a prospectus. 33

For an answer, it should first be noted that a prospectus is not exclusively aimed at institutional investors, because an issuer does not need to prepare a prospectus for an offer to them. The guiding principle is therefore a **retail investor**, both for the offering prospectus and for the admission prospectus. It must also be taken into account that prospectus law provides for requirements regarding the comprehensibility of the information contained in a securities prospectus. These requirements are based on the assumption of a reasonable investor who has knowledge of financial products and the capital market. This can in any case be derived from the requirement that the information in a prospectus must be written and presented in an easily analysable, concise and comprehensible form.[67] A special need for protection due to lack of knowledge does not come up in these requirements. The requirements for the summary are different: it must be 'easy to read', 'characters of readable size' must be used, and the language must be 'clear, non-technical, concise and comprehensible'. Thus, the guiding principle of an inexperienced, uninformed and easily misled investor is to be used as addressee of the summary. However, it cannot be applied to the entire EU securities prospectus law. For the remaining prospectus content, the guiding principle of the reasonable investor applies.[68] In this respect, an attentive reader with average professional knowledge is to be assumed for both offer and admission prospectuses.[69] This investor is profit-oriented. Prospectus law does not assume, as does financial services law, that retail investors pursue additional purposes, such as social or environmental objectives, in addition to the investment objective of financial returns.[70] 34

The **content** and **format** of a prospectus shall be determined pursuant to Article 13 PR in accordance with the provisions of Delegated Regulation 2019/980 of the European Commission. The Level 2 legal act requires that the prospectus has a certain structure. The schedules and modules of the Level 2 regime specify the information to be provided by the respective issuers and for the issuance of the securities concerned (so-called building block approach). 35

Schedule means a list of minimum disclosures tailored to the specific nature of the different securities and issuers, whereas a module means a list of additional disclosures not included in the schedules. By combining the relevant annexes in each case, the information necessary for the preparation of the prospectus can be identified for the specific securities offered by the issuer. The Delegated Regulation not only specifies the intended use of each schedule and module, but also determines the 'possible' combinations of the schedules and modules. 36

[66] Cf. Art. 11 PR.

[67] Cf. Art. 6(2) PR.

[68] Cf. V. de Seriére, in: Busch et al. (eds.), *Prospectus Regulation and Prospectus Liability*, para. 9.22–9.31.

[69] See para. 80 on the question of whether this guiding principle is also decisive for prospectus liability law.

[70] This aspect becomes particularly relevant in the case of prospectus liability. Whether a statement in the prospectus is material is determined by the decision-making preferences of a reasonable investor. See para. 81.

37 The **minimum information** to be included in a prospectus for certain securities is set out in the Annexes to Delegated Regulation 2019/980. For example, in the case of a **share issue**, Annex I (equity securities) provides for minimum information to be included in the share registration document and Annex XI provides for minimum information to be included in the share securities note. On the one hand, information must be provided about the issuer, such as risk factors, the business and financial position, the capital resources, the corporate bodies and senior management, the major shareholders, and the assets and liabilities, financial position and profit and loss of the issuer. On the other hand, specific information must be provided on the respective 'share', in particular on security-related risk factors, the issuer's capital, the securities, the terms and conditions of the offer as well as on the admission to trading and any dilution resulting from the offer.

38 A much quoted stock market saying is that the future is traded on the stock exchange. Therefore, two minimum disclosures of a prospectus in a share issue are of particular importance for investors. The first is the **Operating and Financial Review** (Annex I, Section 7; comparable to the Management's Discussion and Analysis of Financial Condition and Results of Operation (MD&A) in the US). The prospectus must include 'a fair review of the development and performance of the issuer's business and of its position for each year and interim period for which historical financial information is required, including the causes of material changes.' The review shall also give an indication of the issuer's likely future development and activities in the field of research and development.

39 Secondly, EU prospectus law seeks to counter the danger of unreliable statements about company profits.[71] The prospectus of a share issue must also contain trend information (section 10) and provide information on earnings forecasts or estimates (section 11) if the issuer has published one. Where an issuer chooses to include a new profit forecast or a new profit estimate, or a previously published profit forecast or a previously published profit estimate (which is often done for marketing reasons),[72] the profit forecast or estimate shall be clear and unambiguous and contain a statement setting out the principal assumptions upon which the issuer has based its forecast, or estimate. An audit of profit forecasts and estimates by an independent auditor with subsequent reporting (audit report on profit forecasts and estimates) is no longer required under the PR regime. This is the most controversial new provision of the 2017 reform, because the external audit can be valuable information for investors.[73] The European legislator has abolished it for cost reasons.

40 A prospectus contains the **terms** and **conditions** of the **offer**. As a rule, the final issue price and the final issue volume are not yet precisely determined when the prospectus is published. Both will be determined later if the issue takes place in the bookbuilding process.[74] It is then sufficient if the prospectus states either the maximum price and/or the maximum issue volume or the valuation methods and criteria.[75] The final price and the final issue volume shall be filed with the competent authority and published.[76]

[71] Cf. G. Strampelli, in: Busch et al. (eds.), *Prospectus Regulation and Prospectus Liability*, para. 8.64.
[72] Cf. M. Schlitt and C. Landschein, 31 ZBB (2019), 103, 106.
[73] Cf. G. Strampelli, in: Busch et al. (eds.), *Prospectus Regulation and Prospectus Liability*, para. 8.78.
[74] See R. Veil § 7 para. 38.
[75] Art. 17(1) PR.
[76] Art. 17(2) PR.

(c) Structure

41 A prospectus must contain a table of contents, a summary, the risk factors and the contents of the schedules and modules of Regulation 2019/980. The requirements for the summary and risk factors are discussed below. The requirements for the schedules and modules are not presented here (for an overview of the minimum disclosures for a share issue, see para. 37–39).

(aa) Summary

42 The prospectus shall include a summary that provides the key information investors need in order to understand the nature and the risks of the issuer, the guarantor and the securities that are being offered or admitted to trading on a regulated market.[77] It should 'aid investors when considering whether to invest in such securities'.[78] The summary takes into account the limited knowledge of retail investors who are often overwhelmed by reading the financial information of a prospectus.[79] In addition, the sometimes-daunting size of the prospectus discourages retail investors from reading it.[80]

43 The summary must be prepared in a uniform format to facilitate comparison with similar securities. European law prescribes a detailed structure and gives clear instructions on how the document is to be drafted. In formal terms, the summary must be concise and presented in a manner that is easily understandable. In terms of language and style, it must be drawn up in such a way as to facilitate the understanding of the information, in particular by using language that is clear, precise and generally understandable to investors.

44 The summary must be divided into **four sections**: a) an introduction, containing warnings; b) key information on the issuer; c) key information on the securities; d) key information on the offer of securities to the public and/or the admission to trading on a regulated market.[81] Further content requirements are also provided for each section. Of particular importance are the warnings which, among other things, inform the investor that the summary is to be understood as an introduction to the prospectus and that the investor should rely on the prospectus as a whole when deciding to invest in the securities.[82]

45 The regime on the summary of a prospectus has undergone a fundamental change through the 2003, 2010 and 2017 reforms. The guiding principle of the summary is an inexperienced, uninformed and easily misled investor (see para. 34). In terms of content, the summary now covers all aspects that an investor needs for an investment decision. The summary has become a 'prospectus within a prospectus', even if it is expressly provided that it is written as a short document and printed out in a maximum length of seven A4 pages.[83] However, the legislature still maintains that an investor should make his decision

[77] Art. 7(1) subsec. 1 hs. 1 PR.
[78] Art. 7(1) subsec. 1 hs. 2 PR.
[79] Cf. R. ten Have, in: Busch et al. (eds.), *Prospectus Regulation and Prospectus Liability*, para. 12.06.
[80] Cf. M. Gruber (ed.), *EU-Prospektrecht*, 99.
[81] Art. 7(3) PR.
[82] Art. 7(5)(2)(a) and (b) PR.
[83] Art. 7(3)(1) PR.

on the basis of the entire prospectus. This is made clear to investors in the warning notices. In addition, liability under civil law due to incorrect information exclusively in the summary is generally excluded.[84]

(bb) Risk Factors

46 Risk factors are an essential element of a securities prospectus. The risks of a capital investment are explained by the peculiarities of a security and the difficulty to forecast issuer's earnings. The issuer is in the best and most cost-effective position to counter such information asymmetries. However, given the liability risks arising from a prospectus, an issuer may be inclined to provide too much information that is ultimately irrelevant to the investment. The regime on risk factors (consisting of the requirements set out in Article 16 PR and standards issued by ESMA in guidelines)[85] seeks to address this problem through quantitative and qualitative requirements.

47 The **qualitative requirements** aim to ensure that the reader learns about the specific and material risks. Thus, Article 16(1) PR stipulates that the risk factors featured in a prospectus shall be limited to **risks** which are **specific** to the **issuer** and/or to the **securities** and which are **material** for taking an informed investment decision, as corroborated by the content of the registration document and the securities note. Recital 54 PR adds that a prospectus should not contain risk factors which are generic and only serve as disclaimers, as those could obscure more specific risk factors that investors should be aware of, thereby preventing the prospectus from presenting information in an easily analysable, concise and comprehensible form. To determine materiality, the PR follows a procedural approach. An issuer has to assess the likelihood of the risk factor occurring and the expected magnitude of the negative impact.

48 The ESMA guidelines divide the risk factors into categories.[86] With regard to risk factors which are **specific** and **material** to the **issuer**/guarantor, ESMA recommends the following categories (Guidelines para. 35): Risks related to the issuer's financial situation; risks related to the issuer's business activities and industry; legal and regulatory risk; internal control risk; environmental, social and governance risks. Risk factors which are **specific** and **material** to the **securities** could be divided into the following categories (Guidelines para. 36): risks related to the nature of the securities; risks related to the underlying; risks related to the guarantor and the guarantee; risks related to the offer to the public and/or admission of the securities to trading on a regulated market.

49 The **quantitative requirement** aims at not letting the section of the prospectus get out of hand. An absolute number would be too schematic a requirement. It is therefore foreseen that the risk factors shall be presented in a limited number of categories depending on their nature. In each category the most material risk factors shall be mentioned first.[87] This restriction articulates the concern that investors could be overwhelmed with too much information (information overload).[88] ESMA Guideline 9 requires that the number of

[84] Art. 11(2) subsec. 2 PR.
[85] ESMA, Guidelines on risk factors under the Prospectus Regulation, 1.10.2019, ESMA31-62-1293.
[86] Cf. R. ten Have, in: Busch et al. (eds.), *Prospectus Regulation and Prospectus Liability*, para. 12.41: 'useful, but still are (and can only be) generic in nature'.
[87] Art. 16(1) subsec. 4 PR.
[88] See on the problem of information overload R. Veil § 6 para. 33.

categories and subcategories included in the prospectus should not be disproportionate to the size/complexity of the transaction and risk to the issuer/guarantor.

The guiding principle for the section on risk factors is the **reasonable investor**.[89] Each risk factor shall be adequately described, explaining how it affects the issuer or the securities being offered or to be admitted to trading. The assessment of the materiality of the risk factors provided for in the second subparagraph may also be disclosed by using a qualitative scale of low, medium or high.[90] 50

(d) Incorporation by Reference

Information may be incorporated by reference in a prospectus where it has been previously or simultaneously published electronically, drawn up in a language fulfilling the requirements of Article 27 and where it is contained in one of the documents, specified in Article 19(1) PR. In practice, the reference is mainly used for information from balance sheets, transaction documents (eg in the case of a merger), audit opinions and financial statements, the company's articles of association or from already approved prospectuses, but predominantly for the issuance of debt instruments. The incorporation of information by reference is intended to facilitate the issuer's preparation of the prospectus; however, with this technique it is not intended to reduce the information.[91] 51

(e) Language

The need to translate the prospectus into the language of the host Member State for mutual recognition had previously proved to be a serious obstacle.[92] In order to facilitate the cross-border raising of capital, the European legislature amended this requirement in the PD. Article 19 PD distinguished between four scenarios, the cross-border cases being of particular practical relevance. Where an offer to the public was made or admission to trading on a regulated market was sought in one or more Member States excluding the home Member State, the prospectus could be drawn up 'in a language customary in the sphere of international finance'.[93] The competent authority of each host Member State could only require that the summary be translated into its official language.[94] With the reform of prospectus law in 2017, the legislator adopted these requirements in Art. 27 PR. 52

Where an **offer** of securities to the public is made or **admission** to **trading** on a regulated market is sought only in the **home Member State**, the prospectus shall be drawn up in a language accepted by the competent authority of the home Member State.[95] Where an offer of securities to the public is made or admission to trading on a regulated market is sought 53

89 Cf. V. de Serière in: Busch et al. (eds.), *Prospectus Regulation and Prospectus Liability*, para. 9.26.

90 Art. 16(1) subsec. 3 PR.

91 Cf. S. Lenz and M. Heine, NZG 2019, 766, 767.

92 Cf. C. Crüwell, AG (2003), 243, 248; U. Kunold and M. Schlitt, BB (2004), 501, 508.

93 For a list of the languages accepted for prospectus review and the translation of the summary in case of passporting, cf. R. Panasar et al., in: Panasar and Boeckmann (eds.), *European Securities Law*, para. 2.124.

94 Art. 19(2) PD.

95 Cf. Art. 27(1) PR.

in one or more Member States excluding the home Member State, the prospectus shall be drawn up either in a language accepted by the competent authorities of those Member States or in a language customary in the sphere of international finance, at the choice of the issuer, the offeror or the person asking for admission to trading on a regulated market.[96] As a rule, such a prospectus will be drawn up in the English language.[97]

4. Approval and Publication

(a) Foundations

54 A prospectus shall not be published unless the relevant competent authority has approved it.[98] European law provides for an **ex ante control mechanism**. In this respect, it is stricter than US law, which allows so-called well-known seasoned issuers to make a public offering of securities without prior approval of a securities prospectus in order to take advantage of favourable times for an offering as quickly as possible. In the USA, a strict prospectus liability regime and an effective enforcement mechanism in the form of class action ensue a high level of investor protection. Such a system does not exist in Europe. Therefore, it makes sense for Europe to stick to ex ante approval by NCAs.

55 'Approval' means the positive act at the outcome of the scrutiny by the home Member State's competent authority of the completeness, the consistency and the comprehensibility of the information given in the prospectus.[99] It follows that the national authorities do not merely check completeness of a prospectus.[100] By coherence is meant that the prospectus has no inconsistencies. The requirements for comprehensibility differ, depending on whether it is the summary (see paras. 25, 43) or the other parts of the prospectus (see paras. 36 ff.). An authority does not check the accuracy of the content or the issuer's business model.

56 A variety of competent authorities in Member States, with different responsibilities, might create unnecessary costs and overlapping of responsibilities without providing any additional benefit. In each Member State, a single competent authority should be designated to approve prospectuses and to assume responsibility for supervising compliance with this Regulation.[101] The competent authority shall be the authority in the issuer's home Member State.[102] It shall be independent from market participants.[103]

57 For the approval, the Authority shall have a maximum period of 10 working days after receipt of the draft prospectus;[104] in the case of an initial offer of securities, the time limit shall be 20 working days.[105] If information is submitted subsequently, the deadlines shall

[96] Cf. Art. 27 (2) subsec. 1 PR.
[97] R. Panasar et al. in: Panasar and Boeckmann (eds.), *European Securities Law*, para. 2.121.
[98] Art. 20(1) PR.
[99] Art. 2(r) PR.
[100] Cf. C. Crüwell, AG (2003), 243, 250; U. Kunold and M. Schlitt, BB (2004), 501, 509; C. Sandberger, EWS (2004), 297, 300; L. Burn, in: Panasar and Boeckmann (eds.), *European Securities Law*, para. 1.100 f.
[101] Recital 71 PR.
[102] Cf. on the concept of home Member State, the legal definition in Art. 2(m) PR.
[103] Art. 31(1) PR.
[104] Art. 20(2) PR.
[105] Art. 20(2) PR.

only apply from that point in time.[106] The timing of a public offering of securities may become unpredictable for the issuer or offeror.[107] In legal practice it is therefore not uncommon to agree on a time plan with a number of dates for the submission of documents with the supervisory authority. The supervisory authority can then comment on the documents that have been provided and notify the issuer as to what further information is required. The issuer will often submit multiple drafts of the prospectus to the authority.[108]

Once approved, the prospectus shall be made available to the public by the issuer, the offeror or the person asking for admission to trading on a regulated market at a reasonable time in advance of, and at the latest at the beginning of, the offer to the public or the admission to trading of the securities involved.[109] **Publication** on a **website** of the **issuer**, the offeror or the person asking for admission to trading shall be sufficient.[110] A prospectus shall be valid for 12 months after its approval for offers to the public or admissions to trading on a regulated market, provided that it is completed by any supplement.[111] 58

(b) European Passport

The introduction of the European passport for cross-border offerings and a multiple listing was an important milestone in European capital markets legislation in 2010. The regime has basically proven its worth, although a significant increase in pan-European offerings cannot be observed to date.[112] 59

From a legal point of view, a cross-border public offer or admission to trading in a Member State other than the home Member State requires that the competent authority of the host Member State is informed by means of a 'certificate of approval' pursuant to Article 25 PR (so-called notification).[113] The notification may be accompanied by a translation of the summary.[114] The competent authorities of the host Member States[115] may not carry out their own approval procedure.[116] 60

Passporting allows issuers to offer or admit to trading securities in any Member State without the need for multiple approvals of the prospectus.[117] It replaces the previous concept of mutual recognition, which had proven to be incomplete and too complex. The European Passport Mechanism aims to ensure the widest possible access to investment capital on a Community-wide basis.[118] 61

[106] Art. 20(4)(2) PR.
[107] Cf. C. Crüwell, AG 2003, 243, 251; U. Kunold and M. Schlitt, BB 2004, 501, 509.
[108] Cf. M. Schlitt, in: Habersack et al. (eds.), *Handbuch der Kapitalmarktinformation*, § 5 para. 18.
[109] Cf. Art. 21(1) PR; L. Burn, in: Panasar and Boeckmann (eds.), *European Securities Law*, para. 1.114.
[110] Cf. Art. 21(2) PR.
[111] Cf. Art. 12(1) PR.
[112] Cf. M. Schlitt, in: Habersack et al. (eds.), *Handbuch der Kapitalmarktinformation*, § 5 para. 36.
[113] Cf. Art. 24 PR.
[114] Cf. Art. 24(1) subsec. 2 PR.
[115] Art. 2(n) PR.
[116] Art. 24(1)(2) PR.
[117] *L. Burn*, in: Panasar and Boeckmann (eds.), *European Securities Law*, para. 1.106 f.
[118] Cf. recital 3 PR.

(c) Supplement to the Prospectus

62 A prospectus, whether a single document or consisting of separate documents, shall be valid for 12 months after its approval for offers to the public or admissions to trading on a regulated market, provided that it is completed by any supplement.[119] The obligation to update by means of supplements is provided for in Article 23 (1) PR: 'Every **significant new factor**, **material mistake** or **material inaccuracy** relating to the information included in a prospectus which may affect the assessment of the securities and which arises or is noted between the time when the prospectus is approved and the closing of the offer period or the time when trading on a regulated market begins, whichever occurs later, shall be mentioned in a supplement to the prospectus without undue delay.' The duty to supplement also includes updating the summary and any translations.[120]

63 The supplement shall not be published until it has been approved by the competent authority. The approval period shall not exceed five working days.[121] The supplement to an offering prospectus is associated with a right of withdrawal for investors. Investors who have already committed to purchase or subscribe for the securities before the supplement is published have the right to withdraw their commitments within two days of the publication of the supplement.[122] In practice, this right has not played a major role so far.

64 The provision has been criticised many times,[123] especially with regard to the period within which an investor can revoke his commitment.[124] In this respect, the European legislator has already taken the criticism into account by amending the Prospectus Directive 2010. At the time, he did not address the criticism that investors are entitled to a right of revocation even if the subsequently provided information does not have a negative impact on the investment decision.[125] Neither did the PR established in 2017 change the legal situation. An investor can therefore withdraw from the investment if he comes to the conclusion that he has made a 'bad' deal due to negative market developments.[126]

5. Special Regimes

65 Issuers can make use of the simplified disclosure rules for **secondary issuances** under certain conditions.[127] The simplified prospectus requires that securities of the issuer have been admitted to trading on a regulated market or SME growth market for at least 18 continuous months. Under these conditions, the issuer is obliged to disclose periodic financial reports and ad hoc price-sensitive information. Due to secondary market disclosure, lower requirements may be imposed on primary market disclosure. However, the securities

[119] Cf. Art. 12(1) PR.
[120] Art. 23(1) subsec. 2(2) PR.
[121] Art. 23(1) subsec. 2(1) PR.
[122] Art. 23(2) subsec. 1 PR.
[123] Cf. U. Kunold and M. Schlitt, BB (2004), 501, 510; W. Kullmann and J. Metzger, WM (2008), 1292, 1297.
[124] Cf. P. Schammo, *EU Prospectus Law*, 105.
[125] Cf. P. Schammo, *EU Prospectus Law*, 104.
[126] Cf. W. Kullmann and J. Metzger, WM (2008), 1292, 1297; M. Schlitt, in: Habersack et al. (eds.), *Handbuch der Kapitalmarktinformation*, § 5 para. 30.
[127] Cf. Art. 14 PR in connection with Art. 4 and Annex 3 and 12 Delegated Regulation 2019/980.

have to be fungible with existing securities which were previously issued. The regime of a simplified prospectus is used in particular for the issue of subscription rights.[128] It is based on the idea of the ECMH that security prices reflect publicly available information. However, it is yet unclear whether the new simplified regime will play a role in practice.[129]

A proportionate regime is also provided for **small and medium-sized enterprises** (SMEs) and for issuers listed on a SME growth market in the form of the EU growth prospectus.[130] The regime is intended to facilitate SMEs' access to the capital market.[131] It lies 'in the middle ground' between exemption from disclosure obligations under the PR and the 'fully fledged application of the standard regime'.[132] Some interesting privileges are provided, such as limiting the obligation to include historical financial information to the last two financial years.[133] 66

Member States may exempt small offers of securities from the obligation to publish a prospectus.[134] For **micro-issues** with a total consideration of less than € 1 million, there is generally no prospectus requirement under EU law. Member States may also not provide for such a requirement.[135] Prospectus disclosure is disproportionate in these cases, as it is costly and a high level of investor protection through supervision is not strictly necessary. 67

IV. Supervision

The Prospectus Regulation requires a competent administrative authority to be responsible for supervising the adherence to the prospectus obligations.[136] These competent authorities (NCAs) are to be completely independent from all market participants.[137] The most important task of an NCA is to review and approve the prospectus. In addition, it has to detect and sanction violations of the law. ESMA limits itself to coordinating the practices of NCAs and determining best practices in prospectus approval. 68

Ideally, national supervisory authorities have the same practices and apply the law consistently. However, the authorities of the Member States are still far from having an essentially consistent supervisory culture. The peer reviews conducted by ESMA reveal different approaches among supervisors, ranging from the question of how many authority staff are involved in the approval process, to the fundamental question of whether a risk-based approach is followed.[138] Divergences are explained by different financial resources of the authorities, but may also reflect supervisory arbitrage. Finally, national 69

[128] Cf. M. Schlitt, in: Habersack et al. (eds.), *Handbuch der Kapitalmarktinformation*, § 4 para. 118; M. Gruber, *EU-Prospektrecht*, 180 ff.
[129] Cf. P. Horsten, in: Busch et al. (eds.), *Prospectus Regulation and Prospectus Liability*, 11.59.
[130] Cf. Art. 15 PR in connection with Art. 28 ff. Delegated Regulation 2019/980.
[131] See R. Veil § 1 para. 58 und § 7 para. 23.
[132] Cf. A. Perrone, in: Busch et al. (eds.), *Prospectus Regulation and Prospectus Liability*, 10.17.
[133] Cf. M. Schlitt, in: Habersack et al. (eds.), *Handbuch der Kapitalmarktinformation*, § 4 para. 122.
[134] Cf. Art. 3(2) PR.
[135] Cf. Art. 1(3) PR.
[136] Art. 21(1) PD.
[137] Cf. Art. 31 PR.
[138] Cf. ESMA, Peer Review on Prospectus Approval Process. Peer Review Report, 30 June 2016, ESMA/2016/1055.

supervisory practice always reflects the jurisprudence of national administrative courts and national courts.[139] Finally, any liability of supervisory staff may also lead to a bureaucratic approach.[140]

70 Each competent authority shall have all the powers necessary for the performance of its functions, the powers upon receipt of an application for approving a prospectus and in connection with the securities admitted to trading on a regulated market being described in detail.

V. Administrative and Criminal Sanctions

71 Under the regime of the Prospectus Directive 2003/2010, the legal situation and practice in Europe was disparate. In particular, there were considerable differences in the administrative sanctions.[141] Most Member States had maximum amounts for fines. The amounts varied; in Denmark, fines could be imposed up to € 1,350, while the maximum amount in France was € 2.5 million and the United Kingdom had no upper limit.[142] Criminal sanctions played a minor role. However, a considerable number of 20 states had established special legal offences.[143] In addition, the general provisions of criminal law were applicable, which were quite important in practice.[144]

72 The reform of prospectus law in 2017—as well as the reforms of transparency and market abuse law—harmonised the sanction regimes of the Member States and strengthened them.[145] Recital 74 PR emphasises that the sanctions should have a deterrent effect. The administrative pecuniary sanctions to be provided for by the Member States are high and are based on the models of the TD and MAR.[146] Member States do not need to introduce criminal sanctions.

VI. Private Enforcement

1. Requirements under European Law

73 The PR requires Member States to provide for liability under private law: 'Member States shall ensure that **responsibility** for the information given in a prospectus, and any

139 Cf. C. Di Noia and M. Gargantini, in: Busch et al. (eds.), *Prospectus Regulation and Prospectus Liability*, 16.88.
140 Cf. C. Di Noia and M. Gargantini, in: Busch et al. (eds.), *Prospectus Regulation and Prospectus Liability*, 16.88.
141 Cf. CESR, Report on Members' Powers under the Prospectus Directive and its Implementing Measures, CESR/07-383, Juni 2007, p. 65 ff.; ESMA, Report: Comparison of liability regimes in Member States in relation to the Prospectus Directive, 30 May 2013, ESMA/2013/619, p. 17 ff.
142 Sec. 91 (1A) FSMA; R. Veil and M. Wundenberg, *Englisches Kapitalmarktrecht*, 37 f.
143 Cf. ESMA, Report: Comparison of liability regimes in Member States in relation to the Prospectus Directive, 30 May 2013, ESMA/2013/619, p. 22.
144 Cf. about Sweden: *Högsta domstolen*, NJA 1992, 691 ff. (Leasing Consult).
145 See R. Veil § 12 para. 10 ff. on the EU's sanctions strategy.
146 Art. 38(1) PR.

supplement thereto, attaches to at least the **issuer** or its **administrative, management or supervisory bodies**, the **offeror**, the **person asking for the admission to trading** on a regulated market or the guarantor, as the case may be. The persons responsible for the prospectus, and any supplement thereto, shall be clearly identified in the prospectus by their names and functions or, in the case of legal persons, their names and registered offices, as well as declarations by them that, to the best of their knowledge, the information contained in the prospectus is in accordance with the facts and that the prospectus makes no omission likely to affect its import.'[147] Thus, liability is not imposed on any particular person. However, Member States must ensure that their laws, regulations and administrative provisions apply to the persons responsible for the information contained in a prospectus.[148] Finally, liability for incorrect information in a summary is limited.[149] The conditions for prospectus liability are, moreover, left to the discretion of the Member States.

The **applicability** of **national law** governing prospectus liability in **cross-border situations** 74
has not yet been clarified by the courts. The ECJ has so far only commented on the international jurisdiction in a prospectus liability action.[150] It can at least be deduced from this that the ECJ qualifies a prospectus liability claim as a non-contractual claim.[151] As a consequence, the Rome II Regulation is applicable. According to Article 4(2) Rome II Regulation, the law of the state in which the damage occurred applies. Academics argue this would be the place of the market (so-called market principle). They put forward that prospectus disclosure would aim at ensuring the proper functioning of capital markets. Thus, the law of the market at which the securities are listed is to be applied.[152] This means that French prospectus liability law is applicable to the issue of a security in France. This also applies to investors domiciled abroad and whose securities account is located abroad.

2. National Law

The civil liability for the publication of an incorrect prospectus could not differ more 75
throughout the EU. Some European Member States have introduced special provisions thereon, and may additionally apply general civil law provisions, other Member States rely solely on their general concepts under torts law. Whilst Germany,[153] Spain,[154] Italy[155] and Austria,[156] for example, have introduced special provisions thereon, and may additionally apply general civil law provisions, other Member States, such as France[157] and Sweden,[158] rely

[147] Cf. Art. 11(1) PR.

[148] Cf. Art. 11(2) subsec. 1 PR.

[149] Cf. Art. 11(2) subsec. 2 PR.

[150] Cf. EuGH of 28. 1. 2015 – Rs. C-375/13 (Kolossa), NJW (2015), 1581, 1583.

[151] Cf. B. Singhof and O. Seiler, in: Berrar et al.(eds.), *WpPG*, Vor § 21 ff. para. 17.

[152] Cf. R. Freitag, WM (2015), 1165; W. Groß, *Kapitalmarktrecht*, § 9 WpPG para. 72b; M. Habersack, in: Habersack et al. (eds.), *Handbuch der Kapitalmarktinformation*, § 28 para. 57; B. Singhof and O. Seiler, in: Berrar et al., *WpPG*, Vor § 21 ff. para. 26. Dissenting opinion A. Hellgardt and W.-G. Ringe, 173 ZHR (2009), 802, 826 ff.

[153] Cf. §§ 8 ff. WpPG.

[154] Cf. Art. 38(3) LMV.

[155] Cf. Art. 94(8) and (9) TUF.

[156] Cf. § 22 KMG.

[157] Cf. Art. 1382 Cc.

[158] An issuer may be held liable on the legal basis of the Kapitel 29, § 1(1)(2), (2)(2) ABL and the general rules of tort law, cf. R. Veil and F. Walla, *Schwedisches Kapitalmarktrecht*, 25 ff.

solely on their general civil law liability concepts. The national regimes are well researched in comparative literature.[159] The details in the European jurisdictions will not be discussed here. Some central problems regarding prospectus liability should, however, be examined more closely at the example of German law: which deficiencies result in prospectus liability? What must be considered regarding the other requirements of a prospectus liability, such as causation between the incorrect publication and the transaction, responsibility, the capacity to sue and the legal consequences of prospectus liability?

(a) Deficiencies of the Prospectus

76 A prospectus is regarded as deficient if it contains **incorrect** or **insufficient information**. Information is incorrect if it does not relate to the facts. A prospectus contains insufficient information if it does not include all the information required by the Prospectus Regulation. Common examples are the reference to an incorrect or manipulated balance sheet in the prospectus or the omission of the fact that an action for annulment is pending against the capital increase resolution. A prospectus can further be deficient if it **reflects** an **unrealistic picture** of the **issuer** or his financial situation or **profit expectations**.[160]

77 *Facts (abridged and simplified)*:[161] The Beton- und Monierbau AG (BuM) was experiencing liquidity problems that could only be cleared with the help of a loan, guaranteed by the federal state of North Rhine-Westphalia. When new financial difficulties arose a short time later the company applied for a federal guarantee which was granted under the premise of a capital increase. After the prospectus was published, an investor acquired new shares from the capital increase. Less than six months later, bankruptcy proceedings were instituted against BuM. The Bundesgerichtshof (BGH—German Federal Court of Justice) ruled that when determining whether a prospectus contains incorrect or insufficient information it is not sufficient to examine the presented facts individually. One must rather also take into account the impression these facts give as a whole. In the case at hand, the general picture conveyed did not sufficiently indicate that the shares had to be classed as high-risk investments of a highly speculative nature. The prospectus rather attempted to give the impression that the difficulties were merely temporary and the capital increase was intended to consolidate the company's budget, indicating that the financial results would improve compared with those of previous year.

78 In Germany, Italy and Austria the rules on liability require that the prospectus has to be **incorrect** in an aspect **material** for the **evaluation** of the **security**. This can be assumed, if the relevant aspect is taken into account for an investment decision of a **reasonable investor**. The prevalent understanding in Germany is that a reasonable investor must be

[159] Cf. the country reports on France, Germany, Italy, Spain, the Netherlands, Luxembourg and the United Kingdom. in: Busch et al. (eds.), *Prospectus Regulation and Prospectus Liability*, sec. III; see also: K. Hopt and H.-C. Voigt (eds.), *Prospekt- und Kapitalmarktinformationshaftung*, 2004; R. Veil and M. Wundenberg, *Englisches Kapitalmarktrecht*, 24 ff.; R. Veil and P. Koch, *Französisches Kapitalmarktrecht*, 29 ff.; R. Veil and F. Walla, *Schwedisches Kapitalmarktrecht*, 20 ff.; C. Gerner-Beuerle, 23 Temp. Int'l & Comp. L. J. (2009), 317, 344–372.

[160] BGH of 06.05.1982 – III ZR 18/91, NJW (1982), 2823 ff. (described in further detail in the example below); cf., however, OLG Frankfurt of 15.05.2012 – 23 Kap 1/26, ZIP (2012), 1240 ff., which held that a prospectus is not incorrect, if the valuation of the real estate owned by the issuer is overstated by 12%, as such deviation still ranges within the acceptable margin.

[161] BGH of 06.05.1982 – III ZR 18/91, NJW (1982), 2823 ff.

able to read and understand a balance sheet without, however, having above-average expert knowledge.[162]

Example: In the case *Beton- und Monierbau AG (BuM)* the prospectus contained the information that the company's financial results would improve considerably in 1978, compared to 1977 when the company suffered severe losses. The BGH ruled that no reasonable investor would have got the overall impression that this improvement could still mean overall losses—albeit reduced compared to the year before. An average investor need not understand the terminology common to insiders. 79

The BGH developed the principles of interpretation at a time when the European legislature had issued minimum harmonising directives for the first time. In the meantime, prospectus law has been unified by the Prospectus Regulation. This raises the question (already intensively discussed in financial services law)[163] whether national liability law is determined by the requirements of EU prospectus law: Is the reasonable investor the one under the Prospectus Regulation 2017/1129?[164] This interpretation is supported by the fact that stricter liability law requirements for the content and design of a prospectus would lead to legal uncertainty and would result in considerable transaction costs for issuers. 80

The concept of the reasonable investor under EU law (see para. 33) is important in two respects. Firstly, it is relevant for the way in which the prospectus is presented: What level of knowledge of the investor can be assumed? Can he be easily misled (see para. 34)? Secondly, the guiding principle of a reasonable investor also determines the content of a prospectus, in particular the question of which facts must be included in the prospectus. In this context, it is also significant whether the reasonable investor is profit-oriented and/or makes his decisions according to ESG criteria. 81

It is particularly difficult to determine whether a prospectus is incorrect with regard to statements referring to future events and prognoses. In Germany, incorrect statements are also subject to prospectus liability. **Statements** on **future events** are regarded as **incorrect** if they are **not** reasonable or are **not based** on actual **facts.**[165] France treats the problem of a liability for an incorrect prognosis similarly, all statements on future developments requiring a verifiable foundation.[166] If this is not the case and the prognosis is based on intentions (eg future acquisition of a company) or estimations (eg future profits), this must be made clear in the prospectus. A prognosis based on facts must be accompanied by information on how it was established. A number of examples put the content of prognoses into more concrete terms.[167] 82

Example: In *BuM* the BGH ruled that the wording of the provisions on prospectus liability did not include facts in the term 'information' but also evaluative statements on the economic situation of the company and its future developments, as these could not always be clearly distinguished. 83

[162] Cf. BGH of 06.05.1982 – III ZR 18/91, NJW (1982), 2823, 2824; OLG Frankfurt am Main of 10.07.2005 – 5 U 182/03, AG (2005), 851, 852; OLG Frankfurt am Main of 01.02.1994 – 5 U 213/92, WM (1994), 294, 295; OLG Stuttgart of 07.08.1984 – 6 U 51/84, WM (1984), 586, 592.

[163] See R. Veil § 30 para 62.

[164] P. Mülbert, in: FS Bergmann, 529, 539; M. Habersack, in: Habersack et al. (eds.), *Handbuch der Kapitalmarktinformation*, § 28 para. 15.

[165] BGH of 06.05.1982 – III ZR 18/91, NJW (1982), 2823, 2824; OLG Frankfurt am Main of 01.02.1994 – 5 U 213/92, WM (1994), 291, 295; LG Frankfurt am Main of 10.10.1997 – 3/11 O 77/97, WM (1998), 1181, 1184.

[166] Cf. Art. 212-14–212-16 RG AMF.

[167] Cf. H.-J. Puttfarken and A. Schrader, in: Hopt and Voigt (eds.), *Prospekt- und Kapitalmarktinformationshaftung*, 600–601.

An investor must therefore be able to rely on the evaluative statements to be conclusions deduced from the facts on the basis of a thorough analysis. Accordingly, the issuer of the prospectus could not be held liable for the incorrectness of the statements, his liability rather depending on whether the prognosis is commercially justifiable on the basis of the underlying facts.

(b) Claimant and Opposing Party

84 In Germany, France and Austria it is not only **investors** still holding securities who are **entitled** to assert **claims**, but also investors who have already disposed of the respective securities. Under German law this right exists for the acquisition of securities within six months of the prospectus publication, irrespective of whether the securities were acquired on the primary or secondary market.[168] Spain[169] also provides for compensation claims for investors who have acquired respective securities on the secondary market within a certain time frame after the prospectus was published.

85 The PR does not specify against whom the claim is to be brought. It is thus hardly surprising that the Member States have not answered this question uniformly. In general it can be said that Germany, France, Italy, Austria and Spain all assume the **issuer** to be **held liable**.

86 In **Germany**, the action for prospectus liability can further be brought against any person responsible for the drawing up and publication of the prospectus,[170] ie the **issuer** and the **banks** issuing the securities, as well as against any person upon whose initiative the publication is based.[171] The latter is any person with an economic interest in the issuance, such as **major shareholders** or banks participating in the issuance of shares by a smaller and less solvent issuing company. German legal literature does not assume any liability of lawyers who only participate in drawing up parts of the prospectus without any personal economic interest in the issuance.[172]

(c) Causation

87 An essential element of prospectus liability is the question as to whether the claimant actually based his investment decision on the incorrect information. Germany has eased the **burden** of **proof of causation**,[173] whilst France, Italy and Sweden do not provide any rules easing the burden of proof for the investor.

88 In Germany, the courts formerly ruled that a general disposition towards the acquisition of shares, initiated through publications in the media or investment consulting, was sufficient for the assumption of causation between the prospectus and the investor's decision to acquire the securities (so-called *Anlagestimmung*).[174] The investor was assumed to have

[168] Cf. § 9(1) WpPG.

[169] Cf. M. Iribarren Blanco, *Responsabilidad civil por la información divulgada por las sociedades cotizadas*, 47 ff.; M. Grimaldos García, 102 RDBB (2006), 271, 278–279.

[170] § 9(1) No. 1 WpPG.

[171] § 9(1) No. 2 WpPG.

[172] M. Habersack, in: Habersack et al. (eds.), *Handbuch der Kapitalmarktinformation*, § 28 para. 30.

[173] Cf. on the legal situation in Austria S. Kalss et al., *Kapitalmarktrecht I*, § 12 para. 79.

[174] Cf. BGH of 14.07.1998 – XI ZR 173/97, BGHZ 139, 225, 233; BGH of 06.05.1982 – III ZR 18/91, NJW (1982), 2827, 2828.

indirectly gained knowledge of the content of the prospectus through information that was publicly available. The BGH ruled that the investor need not have read the prospectus or gained knowledge of it, ruling that it was sufficient if the report was decisive for the assessment of the security amongst experts and had thus helped to create a general disposition towards its acquisition.[175] The legislature finally adopted this understanding in § 12(2) no. 1 WpPG, which now contains a **legal assumption of causation**: The claim is unsubstantiated if the decision to acquire the respective securities was not based on the information in the prospectus. The defendant must prove this missing causation. It depends on the investor's individual motives that are decisive for the acquisition decision.[176]

(d) Responsibility (Fault)

All jurisdictions require responsibility for prospectus liability, **negligence** sufficing in Spain, France, Italy and Sweden, whilst in Austria the required standard of fault depends on the person who is to be held liable.[177] Germany has the most restrictive rules concerning responsibility.[178] Pursuant to § 12(1) WpPG, a person is exempt from liability if he can prove that he did not know that the prospectus contained incorrect or insufficient information and that his lack of knowledge was not based on gross negligence. Burden of proof is thus reversed: The opposing party must exculpate himself. A person acts with gross negligence if he fails to exercise reasonable care in a particularly serious way,[179] ie if he failed to make the most obvious deliberations.[180] The standard can vary, as the personal and expert knowledge of a person must be taken into consideration when determining whether it acted with gross negligence. The **issuer** has particularly high due diligence responsibilities because it has the relevant information at its disposal, has the legal means to obtain it (also from subsidiaries) and is in a position to assess its accuracy. In contrast, the banks managing the issue of securities usually do not have the necessary information from their own knowledge. Their due diligence obligations concern the verification of the information provided by the issuer.[181] This includes a plausibility check of the completeness and consistency of the information. In principle, the banks do not have to check the accuracy of the information. However, this is to be assessed differently if there are any indications that the information is incorrect or incomplete.[182] 89

(e) Legal Consequences

The Member States attach different legal consequences to the liability for incorrect prospectus information which can be divided into two categories. In some jurisdictions, investors may claim the **difference** between the **acquisition price** and **disposal price** for 90

[175] BGH of 14.07.1998 – XI ZR 173/97, BGHZ 139, 225, 233.
[176] Cf. BGH of 15.12.2020 – XI ZB 24/16, ZIP 2021, 508, 515 para. 87.
[177] Cf. § 22 (1) KMG.
[178] Cf. C. Gerner-Beuerle, 23 Temp. Int'l & Comp. L.J. (2009), 317, 374.
[179] Cf. BGH of 11. 5. 1953 – IV ZR 170/52, BGHZ 10, 14, 17; BGH of 5. 2. 1983 – II ZR 252/82, BGHZ 89, 153, 161.
[180] Cf. OLG Düsseldorf of 5. 4. 1984 – 6 U 239/82, WM (1984), 586, 595.
[181] Cf. M. Habersack, in: Habersack et al. (eds.), *Handbuch der Kapitalmarktinformation*, § 28 para. 41; O. Mülbert and B. Steup, in: Habersack et al. (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, para. 41.113.
[182] Cf. O. Mülbert and B. Steup, in: Habersack et al. (eds.), *Unternehmensfinanzierung am Kapitalmarkt*, para. 41.111.

the shares or the actual value of the security as damages. Other Member States additionally provide the possibility to rescind the contract or claim compensation by restoration of the previous situation (**restitution in kind**).

91 In Germany, an investor can demand specific performance, ie the return of the securities against reimbursement of the acquisition price, pursuant to § 9(1) WpPG. If an investor has meanwhile disposed of the securities he can alternatively demand the difference in price between the acquisition and disposal, including all costs related thereto, such as the broker's commission paid to the issuing bank or a stockbroker and all costs attached to the exercise of subscription rights.

92 It has been discussed controversially whether **payments** the **issuer** must **make** to the investors based on the rules of prospectus liability **comply with** the (European) **capital maintenance regime**. Literature and courts tend to purport that the rules on prospectus liability comply with the principles on capital maintenance,[183] arguing that the respective stock exchange law provisions came into force after the rules on capital maintenance (*lex posterior* rule). The highest civil court in Austria (Oberste Gerichtshof) also ruled that the provisions on prospectus liability would override the rules on capital maintenance.[184] It appears doubtful, however, whether this interpretation complies with European company law.[185]

93 The ECJ, however, rejected this argument: 'In those circumstances, a payment made by a company to a shareholder because of irregular conduct on the part of that company prior to or at the time of the purchase of its shares does not constitute a distribution of capital within the meaning of Article 15 of the Second Directive and, consequently, such a payment ought not to be subject to the conditions stated in that article.'[186] The Court argued that 'liability of the company concerned to investors, who are also its shareholders, by reason of irregular conduct on the part of that company prior to or at the time of the purchase of its shares, does not derive from the memorandum and articles of association and is not directed solely at the internal relations of that company. The source of the liability at issue in such a case is the share purchase contract.'[187] According to the ECJ, the 'establishment of […] a liability regime is therefore within the discretion conferred on the Member States and is not contrary to European Union law.'[188]

VII. Conclusion

94 With the enactment of the PD in 2003, the European legislature aimed to ensure the largest possible access to investment capital at a European level. The aims of the provisions further

[183] Cf. W. Bayer, WM (2013), 961, 966; S. Gebauer, *Börsenprospekthaftung und Kapitalerhaltungsgrundsatz*, 190 ff.; distinguishing between acquisition on the primary markets (liability is restricted to free assets) and acquisitions on the secondary markets (no restriction on liability, cf. § 57 AktG); cf. also BGH of 09.05.2005 – II ZR 287/02 NZG (2005), 672; OLG Frankfurt am Main of 11.10.2000 – 7 U 203/98, AG (2000), 132, 134.

[184] Cf. OGH of 30.03.2011 – 7 Ob 77/10i, GesRZ (2011), 193.

[185] Cf. N. Vokuhl (ed.), *Kapitalmarktrechtlicher Anlegerschutz*, 46 ff.; E.-M. Wild (ed.), *Prospekthaftung einer Aktiengesellschaft unter deutschem und europäischem Kapitalschutz*, 183 ff.

[186] ECJ of 19 December 2013, Case C 174/12 (*Hirmann*), para. 32.

[187] ECJ of 19 December 2013, Case C 174/12 (*Hirmann*), para. 29.

[188] ECJ of 19 December 2013, Case C 174/12 (*Hirmann*), para. 44.

include investor protection and market efficiency. These aims have largely been achieved. The reform of the Prospectus Directive in 2010 brought about further harmonisation of the requirements for the preparation and content of a prospectus when securities are offered to the public or admitted to trading. Nevertheless, the EU was still far from a level playing field. The 2017 reform was therefore an important step in the context of the Capital Markets Union project.

Since European prospectus law has undergone a high degree of maturity within four decades, the European legislator could simply transfer a large part of the regime of the EU directive into a EU regulation. Modernisations on Level 1 were implemented within the existing framework. The European legislature has not adopted completely new regulatory approaches, such as the transition from ex ante to ex post supervision by NCAs for well-known seasoned issuers. Though flexibilisation of EU prospectus law is inspired by reforms of the US Securities Regulation, it is plausible that the EU has not taken more ambitious steps for a reform. In the USA, flexibility in supervisory law can be provided for because the federal law on securities regulation provides for strict prospectus liability and, as an accompanying measure, effective mechanisms of collective redress in the form of class action. The legal situation in the EU is fundamentally different. Prospectus liability is regulated differently in the EU, a preventive effect of private enforcement being doubtful in all EU countries. Class actions or other types of action are only recognised in some Member States and have not been tested there either. Whether representative actions in the sense of Directive 2020/1828 will enable effective collective protection cannot yet be assessed. Against this background, it is not surprising that EU supervisory law is developing in small steps. 95

A fundamental question of European capital markets regulation also arises in prospectus law: Who is the addressee of capital market information? In market abuse law, the reasonable investor is protected. This figure is also found in prospectus law. Since the 2017 reform, European supervisory law has been characterised by a dichotomy. On the one hand, the summary of a prospectus must be oriented towards the inexperienced and easily misled investor; on the other hand, the other contents are directed towards a self-responsible investor with average knowledge of the capital market. The Member States may not apply stricter standards in this respect. Although the 2017 reform has infiltrated EU supervisory law with consumer protection considerations in a central area, the traditional figure of the reasonable investor continues to determine civil liability. 96

§ 18

Periodic Disclosure

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I. Introduction

1. Development of a System of Periodic Disclosure

1 Periodic disclosure is defined as the continual supply of the capital market with information on the issuer. The concept can first be found in the Directive 79/279/EEC[1] coordinating the conditions for the admission of securities to official stock exchange listing (Securities Admission Directive) of 1979.[2] It required companies and undertakings, whose shares and debt securities, respectively, were admitted to a stock exchange's official listing, to immediately make their annual accounts and annual report available to the public. The directive provided the possibility for group companies to publish additionally or alternatively

[1] Council Directive 79/279/EEC of 5 March 1979 coordinating the conditions for the admission of securities to official stock exchange listing, OJ L 66, 16 March 1979, p. 21–32 (Securities Admission Directive).

[2] See R. Veil § 1 para. 6. For the legislative history of the TD cf. W.-G. Ringe, in: Lehmann and Kumpan (eds.), *European Financial Services Law*, Art. 1 TD para. 12 ff.

a consolidated account.[3] This marked the beginning of an annual mandatory disclosure under stock exchange law.

The disclosure obligation provided for by the European legislature with the Securities Admission Directive was restricted to annual accounts and annual reports which had already been harmonised with the Fourth Directive 78/660/EEC[4] on the annual accounts of certain types of companies (Fourth Directive) and which were thus already subject to disclosure requirements.[5] The provisions of the Securities Admission Directive thus built upon the already existing structures and stipulated an additional disclosure obligation. This resulted in a **dualistic regulatory concept**, in which the obligation to disclose and the content thereof were regulated separately. 2

In 1982, the Securities Admission Directive was complemented by the Directive 82/121/EEC[6] on information to be published on a regular basis (Half-Yearly Report Directive) which required companies, whose shares were admitted to official listing on a stock exchange, to publish a half-yearly report on the activities, profits and losses of the company during the first six months of each financial year.[7] The directive constituted the European legislature's reaction to the recommendations in the Segré Report for the introduction of the requirement for a continuous flow of information for companies on capital markets.[8] Unlike the commonly known methods of annual accounts and annual reports that could be referred to in the Securities Admission Directive, the half-yearly reports were until then an unknown reporting format. Therefore, the Half-Yearly Report Directive had to contain provisions on the content of the half-yearly report, in addition to laying down the disclosure obligation for it.[9] 3

In 1999, the Commission defined the measures necessary to fulfil the aim of a single market for financial services in its Financial Services Action Plan and underlined the importance of a directive to improve the rules on transparency.[10] In trying to comply with its time scale for the legislative reforms of the financial market, the Commission adhered to the Lamfalussy Report,[11] which recommended a more effective legislative process on four levels. 4

[3] Art. 4(2) in conjunction with Annex III Schedule C 4, Annex IV Schedule D A. 3 Securities Admission Directive. These provisions were later adopted, without amendments in Art. 67, 80 Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities, OJ L 184, 6 July 2001, p. 1–66 (New Securities Admission Directive).

[4] Fourth Council Directive 78/660/EEC of 25 June 1978 based on Art. 54 (3) (g) of the Treaty on the annual accounts of certain types of companies, OJ L 222, 14 August 1978, p. 11–31 (Fourth Directive).

[5] Art. 47(1) Fourth Directive.

[6] Council Directive 82/121/EEC of 15 February 1982 on information to be published on a regular basis by companies the shares of which have been admitted to official stock-exchange listing, OJ L 48, 20 February 1982, p. 26–29 (Half-Yearly Report Directive).

[7] Art. 1(1), Art. 2 Half-Yearly Report Directive, later adopted without amendments in Art. 70 New Securities Admission Directive.

[8] Commission, The Development of a European Capital Market, Report of a Group of experts appointed by the EEC Commission, November 2006 ('Segré Report'), p. 228–229.

[9] Art. 5 Half-Yearly Report Directive, later adopted without amendments in Art. 73 New Securities Admission Directive.

[10] Cf. recital 3 TD.

[11] Final Report of the Committee of Wise Men on Securities Markets Regulation, 15 February 2001, available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/lamfalussy_report.pdf; see R. Veil § 1 para. 18.

Based on this, the **Transparency Directive (TD)** was enacted as the fourth framework directive in 2004. It contains framework measures and general principles on the transparency requirements regarding information about issuers whose securities are admitted to trading on a regulated market. In 2007, the TD was followed by the Level 2 Directive 2007/14/EC[12] laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, containing more detailed rules on the requirements described in the TD.

5 The TD essentially refined the system of periodic disclosure on the basis of financial reporting. It revoked existing provisions[13] and, at first, introduced a total of four reporting formats: the annual financial report, the half-yearly financial report, the quarterly financial report and the interim management statement. But already at the time of its adoption, the TD provided for a critical review and required the Commission to present a report to the European Parliament and to the Council until 30 June 2009 on the operation of the TD.[14] As a result of this review, Directive 2013/50/EU[15] amending the TD (ADTD) was enacted in 2013. Member States had to implement the new rules into their national laws until the end of November 2015.[16] The ADTD provided for substantial changes to the original concept of the TD: The interim management statement has been abolished only a few years after its introduction[17] and the annual and half-yearly financial report became largely subject to the concept of maximum harmonisation.[18] As a consequence, today Member States may only require issuers to publish additional periodic financial information besides annual and half-yearly financial reports under very limited conditions.[19]

6 All financial reports are based on financial accounting information and subject the latter to a capital markets law disclosure obligation. This, however, did not apply to the former interim management statement. The interim management statement had a pure narrative content and, therefore, presented a disruptive factor within the system of financial reporting. It is thus to be welcomed that the interim management statement has been abolished.

[12] Commission Directive 2007/14/EC of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, OJ L 69, 9 March 2007, p. 27–36.

[13] Art. 32(5) TD.

[14] Cf. Art. 33 TD. Pursuant to Art. 33 TD, Commission published the Report on the Operation of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, 27 May 2017, COM(2010) 243 final, and the Commission Staff Working Document, 27 May 2010, SEC(2010) 611.

[15] Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC, OJ L 294, 6 November 2013, p. 13–27 (ADTD); see R. Veil § 1 para 43. On the Commission's proposal for the ADTD, 25 October 2011, COM(2011) 683 final, cf. H. Brinckmann, 67 BB (2012), 1370 ff.

[16] Cf. Art. 4(1) ADTD.

[17] Cf. Art. 1(5) ADTD replacing former Art. 6 TD.

[18] Cf. Art. 1(2) ADTD amending former Art. 3 TD; cf. also H. Brinckmann, 67 BB (2012), 1370, 1371 ff.

[19] See below para 54 ff. Cf. also R. Veil, 66 WM (2012), 53, 54.

2. Financial Accounting Information as the Basis of Financial Reporting

Periodic disclosure meets the capital market's continual need for information. Yet the determination of the exact need for information is difficult. An empirical study on all information required or used by investors for their investment decisions would probably bring to light a very complex picture: whilst professional investors mainly rely on economic data and indicators, such as sales figures, sales revenues and profits, as well as the analysis of charts and past share prices,[20] other investors will often only rely on the recommendations of investment advisors or follow investment decisions or insider tips of supposed stock market gurus.[21] All these methods have in common that they give a basis for a prognosis[22] on future market developments,[23] which will, however, always be accompanied by a certain amount of uncertainty.[24] 7

Whilst no method can completely eliminate this uncertainty, it can nevertheless be assumed that some information will be more suitable than others as the basis for predicting future market developments. Financial accounting information is an established[25] and well-tried prognosis instrument and has been proven at least to reduce the uncertainties regarding future developments.[26] Although market reactions resulting from natural disasters or terrorist attacks cannot be taken into account, information on capital reserves, liabilities and pension provisions will give an insight into the future chances and risks of a company.[27] Therefore financial accounting information must be regarded as the best prognosis instrument business economics has so far developed.[28] 8

[20] On the two different approaches of securities analysis—the fundamental and the technical one—and information processing through investors cf. S. Sehgal and M. Gupta, 32 Decision (2005), 91, 93; R. Levy, 23 FAJ (1967), 69; G. Franke and H. Hax, *Finanzwirtschaft des Unternehmens und Kapitalmarkt*, 402 ff.

[21] The high importance of future-oriented information for investors describes the US Court of Appeals in *Wielgos v. Commonwealth Edison Company*, 892 F.2d 509 (7th Cir. 1989): 'Investors value securities because of beliefs about how firms will do tomorrow, not because of how they did yesterday. If enterprises cannot make predictions about themselves, then securities analysts, newspaper columnists, and charlatans have protected turf'; cf. also H. Fleischer, 45 AG (2006), 2.

[22] On the importance of prognosis by management cf. L. Enriques et al., in: Kraakman et al. (eds.), *The Anatomy of Corporate Law*, 244, 250; T. Hazen, *The Law of Securities Regulation*, § 3.8[4], 147 ff.; on prognosis in capital markets law in general cf. R. Veil, 45 AG (2006), 690 ff.

[23] Cf. W. Beaver and J. Demski, 12 J. Acc. Res. (1974), 170, 171. Before an investor makes a decision regarding an investment or divestment it must make a prognosis as to which investments promise the highest returns in the future. If it decided correctly the price will adapt accordingly and thus correctly reflect where there is a scarcity of capital, cf. J. Ronen, in: Bicksler (ed.), *Handbook of Financial Economics*, 415, 431 ff.; L. Enriques et al., in: Kraakman et al. (eds.), *The Anatomy of Corporate Law*, 244, 249 ff.; R. Walz, 45 ZfbF Sonderheft 32 (1993), 85, 102.

[24] H. Brinckmann, *Kapitalmarktrechtliche Finanzberichterstattung*, 197.

[25] Cf. L. Enriques et al., in: Kraakman et al. (eds.), *The Anatomy of Corporate Law*, 244, 252; W. Beaver, 136 JOA (1973), 49, 51; W. Busse von Colbe, 45 ZfbF Sonderheft 32 (1993), 11, 15; J. Ronen, in: Bicksler (ed.), *Handbook of Financial Economics*, 415, 437 ff. On the problem of 'information overload' cf. T. Paredes, 81 Washington University Law Quarterly (2003), 417, 448–449.

[26] Cf. W. Beaver, 136 JOA (1973), 49, 50 ff.; J. Campbell and R. Shiller, 43 J. Fin. (1988), 661, 675; J. Ekkenga, *Anlegerschutz, Rechnungslegung und Kapitalmarkt*, 75–76; H. Brinckmann, *Kapitalmarktrechtliche Finanzberichterstattung*, 194 ff. On the relationship between capital markets and financial accounting information cf. also H.-J. Böcking, 50 Zfbf Sonderheft 40 (1998), 17, 23 ff.

[27] Cf. J. Ronen, in: Bicksler (ed.), *Handbook of Financial Economics*, 415, 435 ff.

[28] On the reporting obligations of financial accounting information in the United States cf. T. Hazen, *The Law of Securities Regulation*, § 9.3, 328 ff.

9 The European legislature's recourse to financial accounting information for a periodic disclosure to the capital markets can be justified by the fact that it is a common prognosis instrument and is, in general, price sensitive.[29] For this reason, **financial accounting information** is the **substantial part** of financial reporting regarding **periodic capital market information**. Although investors may continually demand information not contained in the financial reports,[30] the European legislature's aim is still to control the investors' market behaviour mainly by supplying them with information gained from corporate accounting.

10 The fact that the information is to be used on the capital market influences the evaluation of the financial accounting information itself, as its primary aim is to inform investors.[31] This requires the most exact description possible of the issuer's economic situation. Thus, the European regime on disclosure of financial accounting information results in investor control based on real economic performance indicators. It ensures that share prices can periodically adjust to the company's fundamental value, limiting the effects speculations had on the share price.

3. The Growing Importance of Non-financial Information within the System of Periodic Disclosure

11 Even though the predominance of financial accounting information for the system of periodic disclosure is not called into question, however, it can be seen that non-financial information became constantly of more importance within this regime. This development has probably not reached its end as it is part of the still very active discussion on **sustainable finance**.[32] By integrating non-financial information into the system of periodic disclosure the legislator follows the same aim as for financial accounting information: investors' market behaviour shall be controlled and the allocation of capital guided to those companies that are preferable in the legislator's view.

(a) The Disclosure of Environmental Issues as the Beginning of Non-financial Reporting

12 First approaches to supplement the disclosure of financial accounting information by a non-financial reporting go back to the early 1990s. Resulting from the growing importance of the environmental protection movement in the second half of the twentieth century, the

[29] Empirical studies have proved that financial accounting information has influence on the share price, cf. W. Beaver, 136 JOA (1973), 49, 51; W. Busse von Colbe, 45 ZfbF Sonderheft 32 (1993), 11, 16; F. Wagner, 34 ZfbF (1982), 749, 758 ff.; cf. also L. Enriques et al., in: Kraakman et al. (eds.), *The Anatomy of Corporate Law*, 244, 246 ff.

[30] The German Bundesgerichtshof (BGH—German Federal Court of Justice) underlined that apart from stock exchanges it cannot be expected that investors are able to fully understand and interpret a company's financial statement, BGH of 18.9.2012 – XI ZR 344/11, BGHZ 195, 1.

[31] Therefore, investors get better information under a reporting regime that consequently follows a 'fair-value-approach' like the 'Anglo-Saxon' model or the IFRS, L. Enriques et al., in: Kraakman et al. (eds.), *The Anatomy of Corporate Law*, 244, 252 ff.; H. Brinckmann, *Kapitalmarktrechtliche Finanzberichterstattung*, 190 ff. and passim. On the development of the different financial reporting models cf. Alibhai, Salim et al., *Wiley 2020: Interpretation and Application of International Financial Reporting Standards*, 1 ff.

[32] See H. Brinckmann § 16 para 33 ff.

concept of environmental protection also became part of European policies. In 1993, the Commission published its strategy and policy for the environment and sustainable development within the European Community.[33] In that analysis, the Commission identified a failure in companies' accounting information to fully reflect their environmental impact. To improve awareness of environmental issues, the Commission provides for an initiative in the area of company accounting to foster reporting on financial aspects relating to the environment.[34]

The implantation of this initiative took place in 2001 when the Commission adopted a recommendation on European accounting law[35] to strengthen a better recognition and measurement of environmental issues in annual accounts and—as well—better disclosure of environmental issues in annual reports.[36] The European legislator had recognised a very low level of voluntary disclosure on environmental issues by the companies, notwithstanding an increasing demand by investors and other stakeholders for such information.[37] The environmental information disclosed by companies was often seen inadequate or unreliable for investors.[38] Therefore, the legislator wanted to allow for higher comparability and consistency of the environmental information presented and recommended the disclosure of environmental issues with the annual and consolidated annual reports or in the notes to the annual and consolidated accounts.[39] 13

This marked the beginning of a non-financial reporting becoming part of European accounting law and—due to its regulatory concept—also of the system of periodic disclosure. At this early stage, non-financial reporting was based on a Commission's recommendation and, therefore, a non-binding, **purely descriptive element** that was limited in frequency to annual reports and in its content to **environmental issues**. 14

(b) Development of Non-financial Reporting by Initiatives on Corporate Social Responsibility

Already two years later, the legally non-binding recommendation has been transferred into binding European law. Directive 2003/51/EC amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of 15

[33] Commission, Towards Sustainability—European Community programme of policy and action in relation to the environment and sustainable development, COM(1992) 23, OJ C 138, 17 May 1993, p. 5–98 (Towards Sustainability 1993).

[34] Commission, Towards Sustainability 1993, p. 71.

[35] Commission Recommendation of 30 May 2001 on the recognition, measurement and disclosure of environmental issues in the annual accounts and annual reports of companies, OJ L 156, 13 June 2001, p. 33–42 (Recommendation 30 May 2001).

[36] The 'annual report' has later been renamed into 'management report' when Art. 46 Fourth Directive and Art. 36 Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Art. 54 (3) (g) of the Treaty on consolidated accounts, OJ L 193, 18 July 1983, p. 1–17 (Seventh Directive), have both been consolidated in Art. 19 and 29 Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, OJ L 182, 26 June 2013, p. 19–76 (Accounting Directive).

[37] Cf. recital 4 Recommendation 30 May 2001.

[38] Cf. recital 4 Recommendation 30 May 2001.

[39] Annex 4 Recommendation 30 May 2001.

companies, banks and other financial institutions and insurance undertakings[40] amended the European accounting law and integrated the obligation to report on non-financial information relating to **environmental and some social (employee) matters** into the company's annual report.[41] Directive 2003/51/EC stipulated for the first time the obligation to report on environmental as well as social (employee) matters.

16 The reason for the extension of environmental by social matters can be explained by the debate on **corporate social responsibility (CSR)** that included ideas on environmental protection and sustainability towards the end of the twentieth century.[42] When the Commission presented its first CSR-initiative in 2001 by the Green Paper on promoting a European framework for CSR,[43] it already specified CSR as concept whereby companies integrate social and environmental concerns in their business operations.[44] With respect to the disclosure of non-financial information in companies' annual reports, the Green Paper referred to the existing disclosure of environmental issues based on the Commission's recommendation and empathised the development of further environmental and social reporting.[45]

17 In 2011, the Commission presented a renewed strategy on CSR.[46] In it, the Commission concluded that the economic crisis has damaged confidence in enterprises and focused public attention on their social and ethical performance. Therefore, the Commission aimed to create conditions favourable to sustainable growth, responsible business behaviour and durable employment generation by a renewed strategy on CSR.[47] And although progress was made, the Commission observed many companies in the EU had not sufficiently integrated social and environmental concerns into their operations.[48] The Commission therefore extended the scope of CSR by a new definition meaning, very broadly, the responsibility of enterprises for their impacts on society,[49] and announced new legislative action to improve company disclosure of social and environmental information.[50]

18 As a result, Directive 2014/95/EU[51] amended the Accounting Directive as regards disclosure of non-financial and diversity information by certain large undertakings and groups (NFRD). The NFRD introduced an **independent reporting element** for non-financial

[40] Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings, OJ L 178, 17 July 2003, p. 16–22.

[41] Recital 9, Art. 1(14)(a), Art. 2(10)(a) Directive 2003/51/EC.

[42] Cf. J. Hennrichs, 47 ZGR (2018), 206, 208.

[43] Commission, Green Paper—Promoting a European framework for corporate social responsibility, 18 July 2001, COM(2001) 366 final (Green Paper CSR).

[44] Commission, Green Paper CSR, p. 6.

[45] Commission, Green Paper CSR, p. 17.

[46] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee of the Regions—A renewed EU strategy 2011–14 for Corporate Social Responsibility, 25 October 2011, COM(2011) 681 final (CSR Strategy 2011).

[47] Commission, CSR Strategy 2011, p. 4.

[48] Commission, CSR Strategy 2011, p. 5.

[49] Commission, CSR Strategy 2011, p. 6.

[50] Commission, CSR Strategy 2011, p. 11.

[51] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, OJ L 330, 15 November 2014, p. 1–9 (NFRD).

information within the management report and the consolidated management report in the form of the non-financial statement and the consolidated non-financial statement, but limits their application to large public-interest companies (eg listed companies, banks, insurance companies)[52] with more than 500 employees.[53] To help companies disclose relevant non-financial information in a more consistent and more comparable manner, the Commission published Guidelines on non-financial reporting[54] and Supplementing Guidelines on reporting climate-related information.[55]

(c) Upcoming Developments of Non-financial Reporting by its Integration into the Sustainable Finance Agenda

The upcoming awareness of climate change in recent years has highly accelerated governmental measures for more sustainability with the objective of combating further consequences of climate change. In the area of financial market regulation, the concept of sustainable finance summarises measures in this respect. The Commission's Action Plan 'Financing Sustainable Growth' of 2018[56] took up the existing level of non-financial reporting reached by the NFRD und integrated it into further initiatives under its sustainable finance strategy. In this regard, the Commission acknowledged that the NFRD already requires large public interest entities to disclose material information on key environmental, social and governance aspects and announced an evaluation of the non-financial reporting according to sustainability aspects.[57] In 2019, the Commission finally committed to a review of the NFRD in its Communication on the European Green Deal.[58] This review will be aimed at increasing companies' and financial institutions' disclosure on climate and environmental data so that investors are fully informed about the sustainability of their investments.[59] 19

(d) Conclusion

Non-financial information became continuously of more importance within the system of periodic disclosure and developed into an **important supplement** to financial accounting information. Currently, it is still limited in frequency to the annual financial report in so far as only the management report and the consolidated management report contain a 20

[52] Art. 2(1) Accounting Directive.

[53] Art. 1(1) and (3) NFRD. This covers approximately 6,000 large companies and groups across the European Union, cf. J. Hennrichs, 47 ZGR (2018), 206, 209; this figure is also mentioned by the Commission, cf. https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_de.

[54] Communication from the Commission, Guidelines on non-financial reporting methodology for reporting non-financial information, OJ C 215, 5 July 2017, p. 1–20.

[55] Communication from the Commission, Guidelines on non-financial reporting: Supplement on reporting climate-related information, OJ C 209, 20 June 2019, p. 1–30.

[56] Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, Action Plan: Financing Sustainable Growth, 8 March 2018, COM(2018) 97 final (Sustainable Finance Action Plan 2018).

[57] Commission, Sustainable Finance Action Plan 2018, p. 9 ff.

[58] Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, The European Green Deal, 11 December 2019, COM(2019) 640 final (The Green Deal).

[59] Commission, The Green Deal, p. 17.

disclosure obligation for non-financial information;[60] the interim management report of the half-yearly financial report does not contain the requirement to disclose non-financial information.[61] Together with the corporate governance statement, which is also an element of the management report and the consolidated management report,[62] the content of non-financial reporting refers to **environmental, social and governance matters** relevant to the reporting entity.

21 As it is a pure **descriptive element** withing the annual financial report, non-financial information can be presented in a less integrated and less consistent way compared to financial accounting information. As a result, issuers are less comparable on matters included in their non-financial reporting. Investors focusing on non-financial information for their investment decisions will, therefore, have to accept greater uncertainty when it comes to predict future performance and market valuation of that issuer. For a legal framework of the integration of non-financial information within the system of periodic disclosure it should be observed that due to their greater scope of interpretation, the extent of non-financial information within financial reports has to remain low and should only supplement financial accounting information where necessary.

II. Regulatory Concepts

1. Requirements under European Law

(a) The Financial Report as a Unified Reporting Standard for Periodic Disclosure

22 Since the enactment of the TD, the periodic supply of the capital market with information is ensured by an obligation for the issuer to publish financial reports. All reporting formats—annual financial report and half-yearly financial report—are referred to as 'financial reports', showing the European legislature's efforts to introduce a unified standard of reporting for periodic information about the capital market. The TD of 2004 also contained references to the quarterly financial report by comparing it with the interim management statement.[63] But since the interim management statement has been abolished[64] the quarterly financial report is no longer subject of the TD. Nevertheless, the history of the quarterly financial report as a former additional reporting format within the system of financial reporting supports the European approach of having 'financial reports' as a unified reporting standard for the periodic supply of the capital market with information on the issuers.

23 Financial reporting can be regarded as the disclosure of financial accounting under capital markets law. **Periodic statements** by the **issuer** are a central element of this—a

[60] Cf. Art. 19(1) and 29(1) Accounting Directive.
[61] Cf. Art. 5(4) TD.
[62] Cf. Art. 20 and 29 Accounting Directive.
[63] Cf. recital 16, Art. 6(2) TD of 2004.
[64] The former interim management statement, which was introduced by the TD of 2004, stood outside the periodic disclosure system based on financial reports. Therefore, the abolishment of the interim management statement in 2013 has also removed a disruptive factor out of the system of periodic disclosure.

financial statement is contained in the annual financial report and a condensed financial statement is included in the half-yearly financial report.[65]

24 The reason why the European legislator recourses to financial accounting information for the periodic disclosure can directly be deduced from the functions connected to financial accounting.[66] Financial accounting has the role of a monitoring mechanism by which the company's stockholder can control and the company's management have to account for the management of the entrusted resources.[67] Financial reporting addresses the disclosure of financial accounting information to investors on capital markets, who shall process the financial accounting information and orientate their investment decisions respectively. The underlying legal and political objective behind this concept is that the investors shall be in a position to control the issuer's economic activities by their investment decisions. Additionally, financial reporting improves transparency of, and thereby confidence in, the capital markets.

25 Additionally, the annual financial report also contains—to some extent—non-financial information as a supplement to financial accounting information.[68] The European legislator integrates this non-financial reporting into periodic disclosure mainly to follow a political agenda and foster **sustainable investments**.[69] This follows the rationale that pure financial accounting information have deficits when it comes to predict a company's long-term performance.[70] Therefore, non-financial reporting within the system of periodic disclosure aims at strengthening investors' long-term perspective as it is much too focused on short-term financial performance.[71] By the disclosure of environmental, social and governance matters within annual financial reports, the European legislator tries to control the investors' market behaviour and guide financial resources to issuers with a more sustainable business than others.

(b) Correlation with European Accounting Law as a Reflection of the Dualistic Regulatory Concept

26 The dualistic regulatory concept first addressed in the Securities Admission Directive[72] has since intensified in the European law about financial reports. Whilst originally elements of accounting law were only referred to regarding the annual disclosure obligations of annual accounts and reports, leaving the half-yearly report largely independent of these rules, the

[65] Art. 4(2)(a), 5(2)(a) TD. Although the TD of 2004 did not stipulate any detail regarding the elements of a quarterly financial report, referring to it as a 'financial report', much can be said for subjecting the quarterly report to the same requirements as the annual and half-yearly financial reports, especially requiring it typically to have a structure characteristic of a (condensed) financial statement, cf. H. Brinckmann, *Kapitalmarktrechtliche Finanzberichterstattung*, 179–180.

[66] Cf. H. Brinckmann, *Kapitalmarktrechtliche Finanzberichterstattung*, 181 ff.; J. Ronen, in: Bicksler (ed.), *Handbook of Financial Economics*, 415, 417 ff.

[67] Cf. R. Bushman and A. Smith, 9 Economic Policy Review (2003), 65, 67 ff.; J. Ronen, in: Bicksler (ed.), *Handbook of Financial Economics*, 415, 417.

[68] See above para. 11 ff.

[69] Commission, The Green Deal, p. 17.

[70] Cf. R. Veil, in: Tountopoulos and Veil (eds.), *Transparency of Stock Corporations in Europe*, 129, 141.

[71] Commission, The Green Deal, p. 17.

[72] See above para. 1.

European legislature now refers to accounting law more extensively.[73] Hence, the obligation to disclose is an element of capital markets law, whilst the content of the disclosure takes into consideration the objects of accounting law.

27 Similar can be said of the auditing obligation regarding financial statements. It is also subject to the provisions of European accounting law,[74] whilst the obligation to declare a balance sheet oath is an element related to the content developed by the European legislature exclusively for the area of financial reporting, based on the similar provision in the US *Sarbanes-Oxley Act*.[75] The balance sheet oath is an instrument to strengthen the personal responsibility for the financial accounting within the issuer. This character of the balance sheet oath also becomes apparent in the fact that the persons responsible within the issuer must submit a statement containing their name and function in which they declare that the financial statement and management report comply with the 'true and fair view principle' as laid down in the applicable set of accounting standards.[76] A balance sheet oath must be made for all annual and half-yearly financial reports.[77]

28 The references to accounting law in the financial reporting framework still provide scope for an individual design of the financial reporting information presented by an issuer. Depending on different sectors or a special economic situation of the issuers it might be necessary to adjust the information of a financial report as far as this is permitted by the applicable accounting law and as long as this is without giving the financial report a misleading character. One example for the possible adjustment of financial reporting information are **Alternative Performance Measures (APM)**. An APM can be described as a financial measure of historical or future financial performance, financial position, or cash flows, other than a financial measure defined or specified in the applicable financial reporting framework.[78] APMs like, eg the EBITDA are very common and can be very useful to present a better description of the issuer than financial measures contained in the applicable accounting law framework. Since 2015 a European harmonisation of APMs has been reached by ESMA Guidelines.[79]

(c) Addressee of the Disclosure Obligation

29 The annual financial report must be made public by all issuers[80] and the half-yearly report by all issuers of shares and debt securities.[81] The TD defines the term 'issuer' as a natural person or a legal entity governed by private or public law, including a state, whose securities

[73] Only the former interim management statements had no connection to accounting provisions.

[74] Cf. Art. 4(4) TD. The TD refers in Art. 4(4) to provisions of the former Fourth Directive and the Seventh Directive, which have both been consolidated in Art. 34 and 35 Accounting Directive.

[75] Sec. 302(a) Sarbanes-Oxley Act 2002, cf. H. Chang et al., 81 TAR (2006), 1, 3–4; T. Hazen, *The Law of Securities Regulation*, § 9.3[1], 333–335; H. Fleischer, 28 ZIP (2007), 97–98.

[76] Art. 4(2)(c), 5(2)(c) TD explicitly refers to the concept of true and fair view in its English version; cf. also N.-C. Wunderlich, in: Habersack et al. (eds.), *Handbuch der Kapitalmarktinformation*, § 9 para. 88; W.-G. Ringe, in: Lehmann and Kumpan (eds.), *European Financial Services Law*, Art. 4 TD para. 14.

[77] Art. 4(2)(c), 5(2)(c) TD.

[78] Cf. ESMA, Guideline on Alternative Performance Measures, 5 October 2015, ESMA/2015/1415en, para. 17.

[79] ESMA/2015/1415en (fn. 78).

[80] Art. 4(1) TD.

[81] Art. 5(1) TD.

are admitted to trading on a regulated market.[82] The provisions thus exempt certain public bodies, especially states, regional or local authorities of a state, the ECB, EFSF and the Member States' national central banks, from the rules on financial reporting.[83] Legal entities governed by public law are therefore only partly required to oblige with the rules on financial reporting. The TD also exempts an issuer of debt securities admitted to trading on a regulated market, the denomination per unit of which is at least € 100.000, from the obligation to publish a financial report.[84]

The addressees of the provisions are further defined by the criteria 'regulated market' and 'securities'. Both terms are defined in MiFID II.[85] Put briefly, this entails that annual reports are required on all regulated securities markets and half-yearly reports are additionally necessary on all regulated markets for shares and debt securities. 30

2. Implementation in the Member States

The disclosure obligation for financial reports is part of the Members States' national laws. The Commission monitors the transposition measures taken by each Member State.[86] The requirements on financial reporting stipulated by the TD have mostly been adopted by the Member States one-to-one into their national law so that the national provisions comply with the European requirements.[87] Thus, the national provisions on financial reporting shall not be presented in detail at this point. 31

III. Annual Financial Report

1. Overview

The TD requires the issuer to make public its annual financial report at the latest four months after the end of each financial year.[88] The annual financial report comprises the **audited financial statement** (lit. a) and **management report** (lit. b) as well as a **statement** made by the **persons responsible** within the issuer whose names and functions shall be clearly indicated to the effect that, to the best of their knowledge, the financial statements prepared in accordance with the applicable set of accounting standards give a true and fair view of the assets, liabilities, financial position and profit or loss of the issuer and the undertakings included in the consolidation taken as a whole. The management report must 32

[82] Art. 2(1)(d) TD.
[83] Art. 8(1)(a) TD.
[84] Art. 8(1)(b) TD.
[85] See R. Veil § 1 para 44. For more details on the concept of a regulated market see R. Veil § 7 para. 11–15 and on the term 'security' R. Veil § 8 para. 4–5.
[86] An overview is available at: https://eur-lex.europa.eu/legal-content/DE/NIM/?uri=CELEX:32004L0109.
[87] Cf. W.-G. Ringe, in: Lehmann and Kumpan (eds.), *European Financial Services Law*, Art. 1 TD para. 14.
[88] Art. 4(1) TD.

include a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face (lit. c).[89]

33 This statement by the persons responsible within the issuer is termed the '**balance sheet oath**'. The TD does not make sufficiently clear who the 'persons responsible' are, this being a problem that has transferred itself to the Member States' implementations. Those Member States that adopted the directive's provisions one-to-one must therefore deal with this question in their national laws.

34 A particularity can be found in German law where the TD's provisions on the balance sheet oath are connected with the provisions in the HGB (German Commercial Code) on accounting law[90] by making reference to the latter.[91] As a consequence of this, the obligation to make the respective statement is addressed to the legal representatives of a corporation, in a German stock corporation this being the board members (and not the members of the supervisory board). This only appears consistent when one considers that the accounting law in the German HGB generally calls upon all legal representatives regarding the obligation to compile annual accounts and annual reports,[92] thus expressing the principle of joint responsibility which underlies all German corporate law.[93] This connection between the balance sheet oath and the HGB accounting provisions, however, leads to problems with regard to foreign companies[94] if their home countries follow other principles regarding legal responsibility than that of joint responsibility.[95] Countries that follow the concept of a single-tier system for the board of a stock corporation will often provide for differing competencies of the directors.[96] In the United States, for example, only the CEO and CFO are obliged to make a balance sheet oath.[97]

2. Financial Accounting Information

(a) Consolidated and Individual Accounts

35 The information to be made public in the annual financial report was not developed by the European legislature specifically for the TD. The TD rather refers to the harmonised provisions on accounting law which require a distinction between consolidated and

[89] Art. 4(2) TD.

[90] § 264(2), § 289(1), § 297(2) and § 315(1) HGB.

[91] For annual reports § 114(2)(3) WpHG and for half-yearly reports § 115(2)(3) WpHG state that the reports must contain a statement as described in § 264(2), § 289(1) HGB. For corporate group companies these provisions are referred to in § 117(1) WpHG.

[92] Cf. § 264(1) HGB.

[93] H. Fleischer, 28 ZIP (2007), 97, 100, with further references.

[94] The German concept of so-called domestic issuers may also subject foreign issuers to the German rules on financial reporting.

[95] In more detail H. Brinckmann, *Kapitalmarktrechtliche Finanzberichterstattung*, 273 ff.

[96] Cf. § 141(a) Delaware General Corporation Law (DGCL); on the legal situation in the United States cf. G. Henn and J. Alexander, *Laws of Corporations*, 564, 593 ff.; H. Merkt and S. Göthel, *US-amerikanisches Gesellschaftsrecht*, 327 ff.; G. Rehm, in: Eidenmüller (ed.), *Ausländische Kapitalgesellschaften im deutschen Recht*, § 11 para. 41.

[97] Sec. 302(a) Sarbanes-Oxley Act 2002. On the impact of the balance sheet oath in the United States cf. H. Chang et al., 81 TAR (2006), 1, 5 ff.

individual accounts. Where the issuer is required to prepare consolidated accounts according to the Accounting Directive,[98] the audited financial statements must comprise a consolidated account drawn up in accordance with the Regulation (EC) No. 1606/2002[99] on international accounting standards[100] (IAS/IFRS Regulation) as well as an annual account of the parent company drawn up in accordance with the national law of the Member State in which the parent company is incorporated.[101] Where the issuer is not required to prepare consolidated accounts, the audited financial statement must comprise the accounts prepared in accordance with the national law of the Member State in which the company is incorporated.[102]

The accounting standards regarding annual financial accounts differ greatly between the Member States. In Ireland the issuer has the option to prepare not only the consolidated account but also the annual financial account in accordance with the IAS/IFRS.[103] In Austria,[104] France, Germany, Spain and Sweden, on the other hand, the annual financial account must be prepared in accordance with national accounting law. 36

Example: The home Member State of issuer A is Ireland. Issuer A is required to prepare consolidated accounts. Issuer B is also required to prepare consolidated accounts. Its home Member State is Germany. Issuer A has to prepare his consolidated account in accordance with IAS/IFRS and—to save costs—will probably also prepare his annual financial account in accordance with IAS/IFRS, which is permitted in Ireland. Hence, the information made public by issuer A in his annual financial report is developed on a consistent accounting standard. Issuer B also has to prepare his consolidated account in accordance with IAS/IFRS, but will prepare his annual financial account in accordance with German accounting law, Germany not allowing annual financial accounts to be based solely on IAS/IFRS. Accounts compiled on this basis must rather simultaneously comply with German accounting law. As a consequence, the information disclosed by issuer B in his annual financial report will be based on two different accounting standards and will therefore not be consistent.

The European requirements regarding annual financial reports depend strongly on whether the report refers to an individual company or a group company, the respective provisions being from different legal fields.[105] This dualistic regulatory concept depends strongly on accounting law. A uniform standard of accounting throughout Europe has so far only been achieved by the IAS/IFRS Regulation[106] for consolidated accounts.[107] The regulation is 37

[98] With respect to the obligation to prepare consolidated accounts, Art. 4(3) TD still refers to the Seventh Directive. After the Seventh Directive has been repealed and consolidated in the Accounting Directive, Art. 4(3) TD has to be read as reference to the obligation to prepare consolidated accounts according to the Accounting Directive.

[99] Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, OJ L 243, 11 September 2002, p. 1–4 (IAS/IFRS Regulation).

[100] On the process of IFRS standard setting cf. Alibhai, Salim et al., *Wiley 2020: Interpretation and Application of International Financial Reporting Standards*, 4–5.

[101] Art. 4(3) TD.

[102] Art. 4(3) TD.

[103] Sec. 272(2) Companies Act 2014.

[104] Cf. S. Kalss et al. (eds.), *Kapitalmarktrecht I*, § 15 para. 25.

[105] Cf. W.-G. Ringe, in: Lehmann and Kumpan (eds.), *European Financial Services Law*, Art. 4 TD para. 9.

[106] On the road to the IAS/IFRS Regulation cf. N. Moloney, *EU Securities and Financial Markets Regulation*, 153 ff.

[107] On the international distribution of IAS/IFRS cf. I. Iordache, 18 Audit Financiar (2020), 568, 571 ff.

applicable to the consolidated accounts of publicly traded companies since the financial year starting 1 January 2005.[108] The annual accounts are still subject to the Member States' national provisions, a uniform level only being attained within the limits of the Accounting Directive. So far it is not foreseeable when and if the IAS/IFRS must also be made applicable to annual accounts Europe-wide. Annual accounts have further reaching functions in the Member States than solely informational purposes: they play an important role for determining the dividend payout[109] and as the basis for tax assessment, thus preventing a stronger unification at a European level. In consequence, the provisions on annual financial reports contain different requirements for individual companies and group companies, resulting in difficulties when trying to compare the different annual financial reports.

(b) Management Report

38 The management report contained in annual financial reports is also subject to the accounting laws. It is governed by Article 19 of the Accounting Directive and, should the issuer be required to prepare consolidated accounts, also by Article 29 of the Accounting Directive.[110] It is a descriptive reporting element in order to provide further analysis of both, financial and also non-financial information relevant for an understanding of the issuer's development, performance or position.[111]

39 The management report of issuers with more than 500 employees is also subject to the provisions of the NFRD stipulating higher reporting requirements for non-financial information by a '**non-financial statement**'.[112] The non-financial statement creates an independent reporting element of the management report and requires non-financial reporting in more detail as the issuer shall report on the undertaking's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.[113] By requiring issuers that do not pursue policies in relation to these matters to provide a clear

[108] Art. 4 IAS/IFRS Regulation.

[109] When calculating the dividends the annual accounts are taken as the basis for determining the company's profits that can be distributed. According to Art. 17 and 18 of Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Art. 54 of the Treaty on the Functioning of the European Union, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent, OJ L 315, 14 November 2012, p. 74–97, the distribution of profits is limited by the purpose of capital maintenance. A study published by KMPG on behalf of the European Union in 2008 showed that IAS/IFRS annual accounts were used as the basis for profit distribution in 17 of the 27 Member States in 10 of which the IFRS accounting profits are not modified for this, cf. KPMG, *Feasibility study on an alternative to the capital maintenance regime established by the Second Company Law Directive 77/91/EEC of 13 December 1976 and an examination of the impact on profit distribution of the new EU accounting regime*, available at: https://ec.europa.eu/docsroom/documents/42762/attachments/1/translations/en/renditions/native, 1.

[110] Cf. Art. 4(5) TD, which refers to the repealed Art. 46 Fourth Directive and Art. 36 Seventh Directive for the content of the management report. But pursuant to Art. 52 Accounting Directive references to the repealed Fourth and Seventh Directives shall be construed as references to the Accounting Directive and shall be read in accordance with the correlation table in Annex VII of the Accounting Directive.

[111] Cf. Art. 19(1) Accounting Directive.

[112] Cf. Art. 19a Accounting Directive.

[113] Cf. Art. 19a(a) Accounting Directive.

and reasoned explanation for not doing so ('comply or explain') the European legislator tries to force the relevant issuers to take care and to create a greater awareness of these matters.[114]

(c) Auditing of the Annual Financial Report

European law stipulates an obligation that annual financial reports have to be audited in accordance with Article 34, 35 Accounting Directive.[115] The TD refers to the harmonised European accounting law for the requirements on auditing annual financial reports. The auditing has to be completed by an audit report,[116] which has to be disclosed in full to the public together with the annual financial report.[117] The audit reports therefore proofs the reliability of the—financial as well as non-financial—information disclosed in the annual financial report. 40

(d) Single Electronic Reporting Format (ESEF)

Since its revision in 2013, the TD provided for a greater harmonisation of the format of annual financial reports. Since 1 January 2020 all annual financial reports shall be prepared in a **single electronic reporting format (ESEF)**.[118] The European legislator is of the opinion that a harmonised electronic format for reporting is very beneficial for issuers, investors and supervisory authorities, since it makes reporting easier and facilitate accessibility, analysis and comparability of annual financial reports.[119] Following preparations by ESMA[120] the Commission laid down further details and technical specifications of the ESEF by Level 2 Delegated Regulation (EU) 2019/815[121] supplementing the TD with regard to regulatory technical standards on the specification of a single electronic reporting format (ESEF DR). From 1 January 2020, issuers on EU regulated markets shall prepare their entire annual financial reports in Extensible Hyper Text Markup Language (XHTML) format.[122] Where annual financial reports contain IAS/IFRS consolidated financial statements, these shall be labelled by using the Inline XBRL markup language, which makes the labelled disclosures structured and machine-readable.[123] 41

[114] Cf. J. Hennrichs, 47 ZGR (2018), 206, 209.

[115] Cf. Art. 4(4) TD, which refers to the repealed Art. 51, 51a Fourth Directive and Art. 37 Seventh Directive. But pursuant to Art. 52 Accounting Directive references to the repealed Fourth and Seventh Directives shall be construed as references to the Accounting Directive and shall be read in accordance with the correlation table in Annex VII of the Accounting Directive.

[116] Cf. Art. 35 Accounting Directive.

[117] Art. 4(4) TD.

[118] Art. 4(7) TD.

[119] Recital 26 ADTD. Cf. W.-G. Ringe, in: Lehmann and Kumpan (eds.), *European Financial Services Law*, Art. 4 TD para. 27.

[120] ESMA, Final Report on the RTS on the European Single Electronic Format, 18 December 2017, ESMA32-60-204.

[121] Commission Delegated Regulation (EU) 2019/815 of 17 December 2018 supplementing Directive 2004/109/EC of the European Parliament and of the Council with regard to regulatory technical standards on the specification of a single electronic reporting format, OJ L 143, 29 May 2019, p. 1–792 (ESEF DR).

[122] Art. 3 ESEF DR. Cf. W.-G. Ringe, in: Lehmann and Kumpan (eds.), *European Financial Services Law*, Art. 4 TD para. 26.

[123] Art. 4(4) and 6 ESEF DR.

IV. Half-yearly Financial Reports

1. Overview

42 The half-yearly financial report is structured parallel to the annual financial report and covers the first six months of the financial year. An issuer of shares or debt securities shall make public a half-yearly financial report covering the first six months of the financial year as soon as possible after the end of the relevant period, but at the latest three months thereafter.[124] The half-yearly financial report must comprise a **condensed set of financial statements** (lit. a), an **interim management report** (lit. b) and a **balance sheet oath** comparable to that of the annual financial report (lit. c).[125]

2. Financial Accounting Information

(a) Consolidated and Individual Accounts

43 The condensed set of financial statements is not a question of harmonised European accounting law. Rather, its content was first defined by the TD and follows the concept of the annual financial report. Once again one must distinguish between consolidated and individual accounts.

44 Where the issuer is required to prepare consolidated accounts, the TD requires that the condensed set of financial statements must be prepared in accordance with the IAS/IFRS applicable to **interim financial reports**.[126] The relevant standard for interim reports is described in IAS 34.[127] According to IAS 34, a condensed set of financial statements must include, at a minimum, a statement of financial position, income statement, statement showing all changes in equity, cash flow statement—all in condensed form—and selected explanatory notes.[128] For publicly traded companies the explanatory notes must contain segment information.[129]

45 Where the issuer is not required to prepare consolidated accounts, the TD stipulates own requirements for the condensed set of financial statements. It must at least contain (i) a condensed balance sheet, (ii) a condensed profit and loss account and (iii) explanatory

[124] Art. 5(1) TD. The TD of 2004 provided for a deadline of two months for publishing half-yearly financial reports. In 2013 the ADTD extended this deadline to three months in order to provide additional flexibility and thereby reduce administrative burdens. By the extension of the deadline, small and medium-sized issuers' reports were expected to receive more attention from and become more visible for the market participants, cf. recital 6, Art. 4 ADTD.

[125] Art. 5(2) TD.

[126] Art. 5(3) TD.

[127] On the objectives of interim financial reporting under IAS 34 cf. Alibhai, Salim et al., *Wiley 2020: Interpretation and Application of International Financial Reporting Standards*, 899 ff.

[128] IAS 34.8; Alibhai, Salim et al., *Wiley 2020: Interpretation and Application of International Financial Reporting Standards*, 903 ff.

[129] IAS 34.16A(g), IFRS8.2.

notes on these accounts.[130] However, about half of the Member States require all condensed financial statements to be prepared in line with IAS/IFRS which permitted under Article 3(1) TD.[131] In preparing the condensed balance sheet and profit and loss account, the issuer must follow the same principles for recognising and measuring as when preparing annual financial reports.[132] Further minimum requirements regarding the content of the condensed set of financial statements can be found in the Directive 2007/14/EC. According to this, the condensed balance sheet and profit and loss account must show each of the headings and subtotals included in the most recent annual financial statements of the issuer.[133] Additional line items shall be included if, as a result of their omission, the half-yearly financial statements would give a misleading view of the assets, liabilities, financial position and profit or loss of the issuer.[134] In addition, the condensed account must include a comparative balance sheet and a comparative profit and loss account of the preceding financial year.[135] The explanatory notes must include sufficient information to ensure the comparability of the condensed half-yearly financial statements with the annual financial statements and sufficient information and explanations to ensure a user's proper understanding of any material changes in amounts and of any developments in the half-year period concerned, which are reflected in the balance sheet and the profit and loss account.[136]

(b) Interim Management Report

The interim management report must include at least an indication of **important events** that have occurred during the first six months of the financial year, and their impact on the condensed set of financial statements, together with a description of the principal risks and uncertainties for the remaining six months of the financial year. For issuers of shares, the interim management report must also include major **transactions** of **related parties**.[137] This includes related parties' transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or the performance of the enterprise during that period and any changes in the related parties' transactions described in the last annual report that could have a material effect on the financial position or performance of the enterprise in the first six months of the current financial year.[138] Thus, the interim management report must be regarded as an independent part of the half-yearly financial report which was developed without any reference to accounting law.[139] A reporting of non-financial information is no mandatory element of the interim management report. 46

[130] Art. 5(3) TD.
[131] Cf. W.-G. Ringe, in: Lehmann and Kumpan (eds.), *European Financial Services Law*, Art. 5 TD para. 19.
[132] Art. 5(3) TD.
[133] Art. 3(2) Directive 2007/14/EC (fn. 12).
[134] Art. 3(2) Directive 2007/14/EC (fn. 12).
[135] Art. 3(2) Directive 2007/14/EC (fn. 12).
[136] Art. 3(3) Directive 2007/14/EC (fn. 12).
[137] Art. 5(4) TD.
[138] Cf. Art. 4 Directive 2007/14/EC (fn. 12).
[139] For companies subject to the German accounting standards of the DRSC, DRS 16 contains further information on the interim report. Cf. T. Strieder and O. Ammedick, 60 DB (2007), 1368 ff.

(c) Auditing of the Half-yearly Financial Report

47 Unlike for the annual financial report, European law contains no obligation regarding the auditing of the half-yearly financial report. If the half-yearly financial report has been audited by choice, however, the audit report must be reproduced in full. The same must apply in the case of an auditors' review.[140] If the half-yearly financial report has not been audited or reviewed by auditors, the issuer must make a statement to that effect in its report.[141] The Member States national laws mostly provide that the auditing of half-yearly reports is optional.[142]

V. Quarterly Periodic Financial Reports

1. The Question of a Sufficient Supply of Capital Markets with Information on Issuers

48 One of the most controversial issues for the system of periodic disclosure is the frequency for an obligation to publish information on issuers. Currently, it is the opinion of the European legislator that an obligation to publish annual and half-yearly financial reports with information on the assets, financial positions and profit and losses is sufficient for the continual supply of the capital market.[143] For that reason, Member States may require issuers to publish **additional periodic financial information** on a more frequent basis than annual and half-yearly financial reports only under **very limited conditions**.[144] But at this point, the TD has passed through a significant change since its enactment in 2004.

(a) Concept of a Quarterly Reporting Obligation in the TD 2004

49 In its initial proposal for the TD in 2003, the Commission followed the idea that the key data required under former Community law for half-yearly reporting should in future be published as quarterly financial information.[145] The Commission's proposal for the TD therefore contained the provision that for issuers whose shares are admitted to trading on the regulated market quarterly financial information should be mandatory for the first and third quarter of a financial year.[146] As with the former half-yearly reports, the quarterly financial information was to contain the consolidated figures, presented in table form, indicating the net turnover and the profit or loss before or after deduction of tax as well as an

[140] Art. 5(5) TD.
[141] Art. 5(5) TD.
[142] Germany merely provides that the condensed set of financial statements and the interim management report *may* be reviewed by auditors, cf. § 115(5) WpHG.
[143] Cf. Art. 3(1) TD.
[144] Cf. Art. 3(1a) TD.
[145] Cf. Commission, Proposal for a Directive of the European Parliament and of the Council on the harmonisation of transparency requirements with regard to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, 26 March 2003, COM(2003) 138 final, p. 16 ff.
[146] COM(2003) 138 final (fn. 145), Art. 6 TD-Proposal, p. 12 ff.

explanatory statement relating to the issuer's activities and profits and losses during the relevant three-month period. Furthermore, the issuer was to choose whether it wanted to publish an indication of the likely future development for itself and its subsidiaries.

The Commission justified the shorter intervals with a comparison of the information standards in the Member States and the necessity to strengthen the European stock markets as compared with the US market where such quarterly financial reporting has been required since 1946.[147] In this context the Commission explained that quarterly financial information would provide more structured and reliable information thus enhancing the stock market performance and investor protection.[148] Before the TD was enacted in 2004, only eight Member States, including Austria, France, Italy and Spain, required the publication of quarterly financial reports. In other Member States, such as Germany, quarterly financial reporting rules existed only on the basis of stock exchange rules.[149] 50

The Commission's suggestion on quarterly financial reporting as the new concept regarding periodic disclosure in Europe was not greeted warmly. After the report of the Committee on Economic and Monetary Affairs[150] the concept of quarterly financial reports threatened to be deleted altogether until a Council compromise proposal was accepted by the European Parliament. The negative attitude towards the requirement to disclose quarterly reports was mainly justified by the substantial additional costs for issuers and the danger of a focus on short-term earnings performance rather than on a company's longer-term strategy.[151] As a result the Commission's proposal was reduced to the format of so-called **interim management statements** which had lower requirements regarding their content than the quarterly financial information. 51

(b) Content of Interim Management Statements

The TD of 2004 stipulated that issuers whose shares are admitted to trading on a regulated market must make public a statement by its management during the first six-month period of the financial year and another one during the second six-month period of the financial year.[152] It had to contain an explanation of material events and transactions that have taken place during the relevant period and their impact on the financial position of the issuer and its controlled undertakings; and a general description of the financial position and performance of the issuer and its controlled undertakings during the relevant period.[153] The interim management statements as such had no relation to the financial statements, rather constituting an independent reporting format in the TD of 2004. Their content was very similar to that of management reports. 52

[147] Cf. COM(2003) 138 final (fn. 145), p. 14 ff.
[148] Cf. COM(2003) 138 final (fn. 145), p. 14 ff.
[149] Cf. COM(2003) 138 final (fn. 145), p. 14 ff.
[150] Cf. Report by the Committee on Economic and Monetary Affairs on the proposal for a European Parliament and Council directive on the harmonisation of transparency requirements, A5/2004/79 final, available at: PreLex COD/2003/45, p. 38 ff.
[151] Explanatory Statement of the European Committee on Economic and Social Affairs on the Proposal for a TD, OJ C 80, 30 March 2004, p. 87–88. Also seen critically by the European Central Bank, OJ C 242, 9 October 2003, p. 6, 8, that favours minimum disclosure obligations for issuers.
[152] Art. 6(1) TD of 2004.
[153] Art. 6(1) TD of 2004.

(c) Quarterly Financial Reports under the TD of 2004

53 The TD of 2004 also introduced the **non-binding** format of a **quarterly financial report** by stating that issuers which, under either national legislation or the rules of the regulated market or of their own initiative, publish quarterly financial reports in accordance with such legislation or rules are not required to make public the aforementioned interim management statements.[154] The European legislature did not make any statements on the structure and content of the quarterly financial reports, rather referring to the fact that the requirements can be dictated and defined by national regulation or the rules of the stock exchange. The quality requirements to be met were also not defined in the directive. But the quarterly financial report was approximated to the annual and half-yearly financial report by the term 'financial report', making it seem only logical that the quarterly financial report had to contain the same periodic statement that is essential in the other two reports.[155] The transposition of the TD of 2004 confirmed this point of view, showing similarities in the quarterly and half-yearly financial reports in many Member States, although most of the Member States did not introduce a legal obligation to make public quarterly financial reports.[156]

2. Concept of Additional Periodic Disclosure after the Reform of 2013

54 During the **revision** of the TD[157] the provisions on interim management statements as well as any reference to quarterly financial reports have been abolished in the TD.[158] Instead of the interim management statement the Commission introduced a new report on payments to governments into the TD.[159] But this report on payments to governments follows a different approach compared to financial reporting and is therefore not part of the system of periodic disclosure.[160] The Commission justified its rethinking for interim management statements with the argument that the administrative burden linked to the preparation of such statements is too high especially for small and medium-sized issuers. Additionally, interim management statements foster pressure on issuers to focus on short term results instead of encouraging long-term investments. Therefore and unlike at the time of the initial enactment of the TD in 2004 the publication of quarterly information is no longer considered necessary by the European legislator for investor protection.[161]

55 After the revision of the TD, Member States are exceptionally permitted to require issuers to publish additional periodic financial information other than annual and half-yearly

[154] Art. 6(2) TD of 2004.

[155] H. Brinckmann, *Kapitalmarktrechtliche Finanzberichterstattung*, 127–128.

[156] Cf. 1st edn. (2013), H. Brinckmann, § 18 para. 54.

[157] Cf. R. Veil § 1 para. 43.

[158] Art. 1(5) ADTD.

[159] The new Art. 6 TD contains an obligation for issuers active in the extractive or logging of primary forest industries to prepare annual reports on payments made to governments.

[160] The report pursuant to Art. 6 TD intends to make governments accountable for the use of their resources and to promote good governance, cf. Commission, Proposal for a Directive of the European Parliament and of the Council amending Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and Commission Directive 2007/14/EC, 25 October 2011, COM(2011) 683 final (TD-II-COM), p. 8 ff.

[161] TD-II-COM, p. 5, 7, 11 (recital 4).

financial reports if (i) such a disclosure obligation does not constitute a disproportionate financial burden, in particular for the small and medium-sized issuers concerned, and (ii) the content of the additional periodic financial information required is proportionate to the factors that contribute to investment decisions by the investors in the Member State concerned.[162] Before taking a decision requiring issuers to publish additional periodic financial information (or keeping a requirement already in place after the revision of the TD), Member States have to examine (i) whether such additional requirements may lead to an excessive focus on the issuers' short-term results and performance and (ii) whether they may impact negatively on the ability of small and medium-sized issuers to have access to the regulated markets.[163] With these restrictions for the Member States the revision of the TD in 2013 implemented the concept of maximum harmonisation at least for the annual and half-yearly financial reporting of small and medium-sized issuers.[164]

Originally, the Commission intended to go even further and completely prohibit Member States from requiring issuers to publish periodic information other than annual and half-yearly financial reports.[165] This would have led to a maximum harmonisation of annual and half-yearly financial reporting and Member States would have been prohibited from introducing (or keeping) any quarterly reporting obligation into their national law.[166] But this very strict approach of the Commission has been significantly moderated during the legislative process. Within the limits laid down in Article 3(1a) TD, Member States are permitted to have additional periodic disclosure obligations beside annual and half-yearly financial reports in their national law. But Member States hardly make use of this scope for implementation. When implementing the ADTD most of the Member States abolished the legal obligation to publish interim management statements so that most of the Member States do no longer contain any quarterly reporting obligation in their national legislation. But the limits for additional periodic disclosure set by the TD do not apply to stock exchanges or market operators who are able to require issuers to publish periodic financial information on a more frequent basis than annual and half-yearly financial reports.[167] The additional periodic disclosure beside the requirements set by the TD is therefore part of the self-regulation by the markets. 56

As an example, the German stock exchange in Frankfurt requires issuers listed in the subsegment 'Prime Standard' to disclose quarterly statements beside annual and half-yearly financial reports.[168] These quarterly statements are very similar to the former interim management statements as required by the TD of 2004 and do therefore not provide the same quality of financial information as annual and half-yearly financial reports. 57

[162] Art. 3(1a) TD.
[163] Art. 3(1a) TD.
[164] W.-G. Ringe, in: Lehmann and Kumpan (eds.), *European Financial Services Law*, Art. 3 TD para. 6.
[165] TD-II-COM, p. 7, 16 (Art. 1(2)).
[166] H. Brinckmann, 67 BB (2012), 1370 ff.; R. Veil, 66 WM (2012), 53, 54.
[167] Recital 5 ADTD; TD-II-COM, p. 7; H. Brinckmann, 67 BB (2012), 1370 ff.; R. Veil, 66 WM (2012), 53, 54; W.-G. Ringe, in: Lehmann and Kumpan (eds.), *European Financial Services Law*, Art. 5 TD para. 41; dissenting opinion: C. Seibt and B. Wollenschläger, 51 AG (2012), 305, 308.
[168] § 53 Exchange Rules for the Frankfurter Wertpapierbörse (effective as of 18 March 2016), available at: https://www.xetra.com/resource/blob/31802/c5112b158d9f72e3fb6c2b9405d63a27/data/2020-11-23-Exchange-Rules-for-the-Frankfurter-Wertpapierb-rse.pdf.

VI. Disclosure Procedures

1. Requirements under European Law

58 European law only stipulates two requirements regarding the disclosure of financial reports. The first being that the disclosure must take place through media ensuring that financial reports will be disseminated to as wide a public as possible in all Member States.[169] This can realistically only be met by use of the Internet.[170] The European legislature explicitly allows the information to be published on the issuer's website, provided this publication is then announced to the media.[171] The Internet is therefore the primary publication medium for financial reports. The second requirement is that the Member States must supply an **officially appointed mechanism (OAM)** for the central storage of financial reports.[172]

2. Transposition in the Member States

59 These very general rules under European law have led to a strong divergence in the disclosure procedures within the Member States. In Germany, prior to making the financial reports publicly available for the first time, any company which issues securities as a domestic issuer must make a pan-European publication concerning when and on which website the financial reports will be publicly available in addition to their availability in the company register. Simultaneously with the publication of such announcement, the company must notify the supervisory authority thereof.[173] Only after the publication of the announcement is the actual financial report disclosed—usually on the issuer's website[174]—and transmitted to the company register in order to be stored there.[175] German law partially deviates from the TD's provisions and exempts issuers that are already subject to the obligation to disclose the respective accounting documents under commercial law from the obligation to disclose an annual financial report.[176] This exemption only applies to German corporations,[177] whilst foreign companies must still make public an annual financial report.[178] The German legislature sought to relieve the German corporation from a double burden.[179] The result of this exemption is, however, that the disclosure procedure regarding annual financial reports differs for national and foreign issuers.[180]

[169] Art. 21(1) TD, Art. 12(2) Directive 2007/14/EC (fn. 12).
[170] See H. Brinckmann § 16 para. 42.
[171] Art. 12(3) Directive 2007/14/EC (fn. 12).
[172] Art. 21(2) TD. See also H. Brinckmann § 16 para. 43 ff.
[173] § 114(1), § 115(1) WpHG, § 8b(3)(2) HGB.
[174] § 114(1), § 115(1) WpHG, This is not, however, mandatory, cf. N. Kumm, 64 BB (2009), 1118, 1119.
[175] § 114(1), § 115(1) WpHG, § 8b(3)(2) HGB.
[176] § 114(1) WpHG.
[177] Cf. § 325 HGB.
[178] H. Hönsch, in: Assmann et al. (eds.), *Kommentar zum WpHG*, § 114 para. 14; M. Zimmermann, in: Fuchs (ed.), *Kommentar zum WpHG*, § 37v para. 7.
[179] Begr. RegE TUG, BT-Drucks. 16/2498 (explanatory notes), p. 43.
[180] For more details cf. H. Brinckmann, *Kapitalmarktrechtliche Finanzberichterstattung*, 283 ff. On possible conflicts resulting from this, cf. P. Mülbert and S. Steup, 10 NZG (2007), 761, 763 ff.

The information requested by the TD is so-called 'regulated information', which, in Ireland shall be made public by means of a Regulatory Information Service (RIS).[181] Such a RIS is provided by the Irish stock exchange.[182] The Central Bank of Ireland has to be notified simultaneously when a financial report has been send to a RIS for its dissemination and publication.[183] If no RIS is open for business, the issuer shall without delay disseminate and make public regulated information through two newswire services or other media that ensure dissemination and making public of regulated information, and a RIS, for release, as soon as one reopens.[184] The Irish stock exchange also operates the OAM for the central storage of financial reports. In Sweden, the FI's website gives access to a database in which all financial reports are stored.[185] 60

3. Outlook: Access to Financial Reports via a Central European Access Point

The strong divergence in the disclosure procedures within the Member States also applies to the central storage mechanisms of regulated information. As a result of the TD 2004, each Member State established or appointed an OAM.[186] But access to these information still follows a national not a European approach. 61

Example: An institutional investor from the US is interested in investing into different European insurance companies. It shall be his first investment in Europe. So far, he only has some names of potential companies, but he wants to deeper analyse and compare the performance of the companies by going through their last financial reports. To find the relevant financial reports, first, he must find out the home state of the company. Then, second, he must find out the relevant OAM of that Member State to search for the information he is looking for. To compare with the other companies he has to repeat the same procedure for every company.

During the revision of the TD in 2013, the Commission concluded that the access to financial information on listed companies on a pan-European basis is burdensome because interested parties have to go through 27 different national databases in order to search for information.[187] This leads to the fact that cross-border access to financial reporting information is highly limited across the European Union. To facilitate pan-European access to regulated information, the network of the Member State's appointed storage mechanisms shall be enhanced and greater harmonised.[188] A web portal shall be developed and operated by ESMA serving as a **European electronic access point (EEAP)**. Interested parties shall have access to information in the central storage mechanisms of every Member State via the EEAP.[189] Currently, the Commission is 62

[181] Regulation 6(1) S.I. No. 366 of 2019, Central Bank (Investment Market Conduct) Rules 2019.
[182] Available at: https://direct.euronext.com/#/rispublication.
[183] Regulation 6(2)(3) S.I. No. 366 of 2019, Central Bank (Investment Market Conduct) Rules 2019.
[184] Regulation 7(1) S.I. No. 366 of 2019, Central Bank (Investment Market Conduct) Rules 2019.
[185] The information is available at: https://fiapplfinanscentralen.fi.se/FinansCentralen/search/Search.aspx.
[186] ESMA provides a list of OAM, available at: https://www.esma.europa.eu/access-regulated-information.
[187] TD-II-COM, p. 8.
[188] Recital 15 ADTD.
[189] Cf. Art. 21a(1) TD.

looking for a technical solution for the EEAP and envisages to merge the EEAP into the new project of a '**European single access point (ESAP)**' which shall follow a broader approach than the EEAP as it shall also improve the availability and accessibility of sustainability-related data.[190]

VII. Enforcement of Financial Information

63 After the occurrence of numerous major corporate accounting scandals since the 1990s the Member States as well as the European Union have gradually become convinced that a system of sanctions and civil liability alone does not provide for issuers' consistent compliance with the relevant financial reporting framework. This conclusion might result from the fact that provisions on criminal and administrative sanctions or civil liability in the Member States (still) need further development until they force issuers to comply with the relevant accounting law. But the reason may also lie in the financial reporting itself. Any misstatement published by an issuer in its financial report has spread in the capital market long before a system based on sanctions and liability will be able to force the issuer to publish a revised statement and to correct its misleading financial report.

64 Member States have taken different measures and established new mechanisms to ensure the compliance of financial statements with the relevant legal framework.[191] These measures and mechanisms are generally defined as the '**enforcement**' of financial information, meaning (i) examining the compliance of financial information with the relevant financial reporting framework and (ii) taking appropriate measure where infringements are discovered.[192]

65 The European requirements on enforcement are very limited. The IAS/IFRS Regulation states in its recitals that '*a proper and rigorous enforcement regime is key to underpinning investors' confidence in financial markets*' and requires Member States '*to take appropriate measures to ensure compliance with international accounting standards*'.[193] The TD stipulates that Member States shall ensure the competent authority being empowered (i) to examine that information referred to in the TD is drawn up in accordance with the relevant reporting framework and (ii) to take appropriate measures in case of discovered infringements.[194] Thus, under European law Member States are required to establish an enforcement regime[195] but the European legislator has not set any parameters for the specific organisation of such a regime so that the Member States are free to establish their enforcement system based on self-regulation, supervision or a mixture of both.

190 See H. Brinckmann § 16 para. 49.

191 For an overview of models in different countries cf. H. Hirte and S. Mock, in: Hirte and Möllers (eds.), *Kölner Kommentar zum WpHG*, § 37n para. 26 ff.

192 Cf. ESMA, Guidelines on enforcement of financial information, 4 February 2020, ESMA32-50-218, p. 11 (Enforcement Guidelines).

193 Recital 16 IAS/IFRS Regulation.

194 Recitals 28, Art. 24(4)(h) TD.

195 S. Kalss et al. (eds.), *Kapitalmarktrecht I*, § 15 para. 47.

A European harmonisation of enforcement exists in the form of a coordination of European enforcement institutions.[196] European enforcers coordinate a consistent application of the European IAS/IFRS accounting framework through the European Enforcers Coordination Session (EECS), a network advising ESMA on accounting matters. In 2020 ESMA has also published new Guidelines on enforcement to ensure effective and consistent enforcement within the European Union.[197]

Almost all Member States have given a supervising authority the responsibility of enforcement of financial information. An exception can be found in Germany and Austria where a procedure of dual enforcement has been established. To exemplify the Member State's different approaches in the area of enforcement the dual-enforcement as it only exists in Germany and Austria[198] as well as the enforcement in Ireland shall be presented. 66

1. Dual-enforcement in Germany and Austria

In 2005 Germany, followed by Austria in 2013, established a system of dual-enforcement. The characteristic of the dual-enforcement can best be described as a two-tier enforcement regime involving a private and a supervisory enforcement institution.[199] The first tier involves the private enforcement institution, in Germany the **Financial Reporting Enforcement Panel (FREP)** and in Austria the **Austrian Financial Reporting Enforcement Panel (AFREP)**. FREP or AFREP will initiate an examination (i) with cause if there are concrete indications of an infringement of financial reporting requirements or (ii) on a random sampling basis.[200] In Germany the FREP also has to initiate proceedings on request of BaFin.[201] 67

Subject to examination is the most recently adopted annual or half-yearly financial report of capital market oriented companies.[202] The examination procedure of FREP and AFREP is based on cooperation. If a company is not willing to cooperate, FREP or AFREP will notify the supervisory authority (BaFin resp. FMA) to initiate a formal examination proceeding. 68

Basically, the supervisory authority participates in the enforcement proceedings at the second tier level only if a company does not participate willingly in the examination or does not agree with the findings of FREP or AFREP or has substantial doubts about whether the findings of FREP or AFREP are correct or whether the examination was conducted properly. The relevant supervisory authority, the BaFin in Germany and the FMA in Austria, is entitled to decide on the infringement of financial reporting requirements by order and also to order the publication that the financial statement was incorrect. 69

[196] For a list of European enforcers see: ESMA, Report Enforcement and regulatory activities of European enforcers in 2019, 2 April 2020, ESMA32-63-846, p. 64 (Annex 2).

[197] ESMA, Enforecment Guidelines, p. 8.

[198] Cf. European Parliament, Study Requested by the ECON committee [external authors K. Langenbucher et al.]—What are the wider supervisory implications of the Wirecard case?, November 2020, PE 651.385, 20, available at: https://www.europarl.europa.eu/RegData/etudes/STUD/2020/651385/IPOL_STU(2020)651385_EN.pdf (Wirecard Study).

[199] Cf. N.-C. Wunderlich, in: Habersack et al. (eds.), *Handbuch der Kapitalmarktinformation*, § 9 para. 104.

[200] § 342b(2) HGB, § 2(1) RL-KG.

[201] § 342b(2) HGB.

[202] § 342b(2) HGB, § 1(1), § 2 RL-KG.

70 The supervisory authorities in Germany and Austria are only entitled to decide on the infringement of financial reporting requirements by order in cases of *material* infringement. In Germany the OLG Frankfurt ruled that the BaFin is only entitled to decide on the infringement by order if accounting law provisions have been *materially* infringed.[203] Relevant for the question whether infringements reach the level of materiality shall be the perspective of an investor on the capital markets.[204] The same criteria also apply in Austria although they have not been confirmed by a court decision so far.[205]

71 Recently, the potential accounting fraud of the German **Wirecard AG** called the German dual-enforcement regime into question. Over years, neither the auditors nor examinations of FREP were able to reveal that financial accounting information have possibly been manipulated although concrete indications had been made public and brought to the attention of BaFin.[206] The modifications of the German system of dual-enforcement are still under discussion. As one consequence, German government terminated the contractual relationship with FREP. The termination becomes effective as of the end of 2021.[207] ESMA conducted a fast-track peer review focusing on the application of the ESMA Guidelines on enforcement by BaFin and FREP and on impediments to the effectiveness of the German system of dual-enforcement in the specific context of the Wirecard case. In its report[208] ESMA identified, among other, various deficiencies in the effectiveness of the German enforcement system, mainly with respect to the cooperation of BaFin and FREP regarding the exchange of information, competences and speed.[209] Due to a first legal proposal[210] for improvements of the German enforcement system, the BaFin shall obtain more powers for own examinations and investigations in cases of suspected infringements of financial reporting requirements.[211]

2. Enforcement in Ireland by the Financial Reporting Supervision Unit (FRSU)

72 In Ireland, the Irish Auditing and Accounting Supervisory Authority (IAASA) has been designated as the competent authority for the purposes of Article 24(4)(h) TD[212] and is therefore responsible for examining affected issuers' compliance with the financial reporting framework requirements and for taking appropriate action where non-compliance is

[203] OLG Frankfurt of 22.01.2009—WpÜG 1/08 and 3/08, 30 ZIP (2009), 368, 369.
[204] OLG Frankfurt of 22.01.2009—WpÜG 1/08 and 3/08, 30 ZIP (2009), 368, 371.
[205] S. Kalss et al. (eds.), *Kapitalmarktrecht I*, § 15 para. 65.
[206] An overview on the facts and the timeline of the Wirecard case can be found in: European Parliament, Wirecard Study, 30 ff. (Appendix A).
[207] Cf. European Parliament, Wirecard Study, 32 (Appendix A).
[208] ESMA, Fast Track Peer Review on the Application of the Guidelines on the Enforcement of Financial Information (ESMA/2014/1293) by BaFin and FREP in the Context of Wirecard, Peer Review Report, 2 November 2020, ESMA42-111-5349 (Wirecard Report).
[209] ESMA, Wirecard Report, p. 13 ff.
[210] Draft legislation for a Gesetz zur Stärkung der Finanzmarktintegrität (Finanzmarktintegritätsstärkungs gesetz—FISG), BR-Drucks. 9/21.
[211] Cf. M. Schüppen, 56 DStR (2021), 246, 251 ff.
[212] Regulation 36(2) and 42(2) S.I. No. 277 of 2007, Transparency (Directive 2004/109/EC) Regulations 2007.

identified. At the IAASA its **Financial Reporting Supervision Unit (FRSU)** has taken over this task.

FRSU follows a risk-based approach to the selection of financial reports for examination. This risk-based approach considers (i) the risk of material misstatement in issuers' financial reports and (ii) the potential impact of such a misstatement on the users of financial reports.[213] The FRSU tries to find out in cooperation with the examined issuer whether relevant accounting or reporting requirements have been breached and—if this is the case—tries to reach an agreement with the company on the corrective or clarificatory action.[214] There is considerable pressure on the issuers to cooperate with the FRSU during the examination. Since the amendment of the IASSA's competences in 2015,[215] it has wider discretion in terms of publication of its financial reporting enforcement findings than heretofore and may even bring its examination to the attention of the public.[216] Nevertheless, the FRSU enjoys substantial rights on information vis-à-vis the issuer, its directors, managers, employees or the auditors.[217] It may also appoint authorised officers with substantial powers to carry out an investigation.[218] 73

VIII. Sanctions

The TD originally did not lay down a well-differentiated concept regarding the sanction for breaches of financial reporting duties. The revision of the TD in 2013 led to more detailed requirements for administrative sanctions but it is still in the power of the Member States to take the necessary measures. 74

1. Liability for Incorrect Financial Reporting

The TD requires Member States to ensure the necessary penalties for breaches of financial reporting duties. In this context the Member States must ensure that responsibility for drawing up the information and making this public lies at least with the issuer or its administrative, management or supervisory bodies, and that the national laws, regulations and administrative provisions on liability are applicable to the issuers, their bodies or the persons responsible within the issuers.[219] Whilst the European regulations remain vague and leave a large margin of appreciation to the Member States in the transposition 75

213 Cf. IAASA FAQs in financial reporting supervision, available at: http://www.iaasa.ie/FAQs/FRS.
214 Cf. IAASA FAQs in financial reporting supervision, available at: http://www.iaasa.ie/FAQs/FRS.
215 Regulation 43(3) S.I. No. 277 of 2007, Transparency (Directive 2004/109/EC) Regulations 2007, as amended by Regulation 2(d) S.I. No. 44 of 2015, Transparency (Directive 2004/109/EC) (Amendments) Regulations 2015.
216 IAASA, Policy Paper on Publication of IAASA's Financial Reporting Enforcement Findings, 17 July 2015, p. 2, available at: http://www.iaasa.ie/getmedia/815203c6-a917-4ee6-985e-036508400053/IAASA_FRSU_Publications_July2015.pdf.
217 Regulation 43(1) S.I. No. 277 of 2007, Transparency (Directive 2004/109/EC) Regulations 2007.
218 Regulation 53 and 54 S.I. No. 277 of 2007, Transparency (Directive 2004/109/EC) Regulations 2007.
219 Art. 7 TD.

of the directive,[220] it still becomes clear that a specific liability for incorrect financial reporting is required;[221] otherwise, the European legislature would not try to ensure that Member States take the necessary measures. General rules on liability will often be insufficient, as they do not achieve the specific level of protection required in financial reporting; in particular, the liability may not be restricted to cases of wilful action.[222] The European concept allows the liability rules to be addressed either solely to the issuer or also to the responsible bodies within the issuer.[223]

76 Due to the very restrictive European requirements, the civil liability for incorrect financial reporting is still very inconsistent between the Member States.[224] Most Member States, such as Austria, German and Sweden, even have by no means implemented the requirements of Article 7 TD into their national rules on civil liability. As a result, no specific liability for incorrect financial reporting exists and the question arises (i) as to whether incorrect financial reporting is subject to the general rules on civil liability of that Member State and (ii) whether these rules comply with the requirements of Article 7 TD.[225]

2. Sanctions under Criminal and Administrative Law

77 The TD requires Member States to lay down rules on sanctions only with respect to administrative measures and sanctions. They shall be effective, proportionate and dissuasive.[226] The TD clarifies that this requirement is without prejudice to the right of Member States to provide for and impose criminal sanctions,[227] but the TD does not lay down any further requirements for criminal sanctions. Where obligations apply to legal entities, Member States shall ensure that in the event of a breach, sanctions can be applied to the members of administrative, management or supervisory bodies of that legal entity and to other individuals who are responsible for the breach under national law.[228]

78 After the reform in 2013, the TD stipulates requirements for administrative measures and sanctions in much more detail. If an issuer fails to make public its annual or half-yearly financial report, the competent authority shall have the power to impose a whole range of sanctions, in particular, a public statement indicating the natural or the legal entity responsible and the nature of the breach, in case of a legal entity fines (i) up to € 10,000,000 or 5% of the total annual turnover or (ii) up to twice the amount of the profits gained or losses avoided because of the breach, whichever is higher.[229] The new European rules also lay

[220] Cf. recital 17 TD.
[221] Cf. also P. Mülbert and S. Steup, 59 WM (2005), 1633, 1653; R. Veil, 18 ZBB (2006), 162, 168–169.
[222] R. Veil, 18 ZBB (2006), 162, 169.
[223] M. Brellochs, *Publizität und Haftung*, 95; H. Fleischer, 60 WM (2006), 2021, 2027; R. Veil, 18 ZBB (2006), 162, 168.
[224] For more details on different concepts of civil liability rules in the Member States, cf. 2nd edn. (2017), H. Brinckmann, § 18 para. 68 ff.
[225] Cf. 2nd edn. (2017), H. Brinckmann, § 18 para. 70 ff., for examples presented in more detail.
[226] Art. 28(1) TD.
[227] Art. 28(1) TD.
[228] Art. 28(2) TD.
[229] Art. 28b(1)(c) TD.

down criteria for the determination of the type and the level of administrative measures and sanctions.[230]

Even though the requirements of the TD for sanctions under criminal or administrative law have reached a higher level of harmonisation with the ADTD, Member States still follow very different approaches as to whether incorrect financial reporting shall be subject to criminal and/or administrative law and to what extend sanctions apply.[231] 79

IX. Conclusion

The capital markets must continually be supplied with information on the issuers in order to ensure an adequate price formation for securities. Capital market regulation must enable investors to compare different issuers and allow them to trust the information disclosed. The European legislature had this in mind when it enacted the TD. This Directive also takes into account that according to economic studies, only the company's accounting can provide a regular informational basis for investors. It therefore integrates the rules on company accounting into the regulatory concept of capital markets law. The rules on company accounting include financial accounting information and—as a necessary complement—non-financial information regarding environmental, social and governance matters. 80

Legal developments in the area of periodic disclosure are not yet complete. It can be expected that shaping the precise concept for non-financial reporting within the system of periodic disclosure will soon become even more important for the European legislator as it is decisive for an efficient implementation of sustainable finance. 81

Further improvement is also necessary with regard to the fact that financial reports are not the only possible format for periodic disclosure. Although the former interim management statement has been abolished with the revision of the TD in 2013 and thereby a disruptive factor within the system of European periodic disclosure has been eliminated, the Commission's original target of a maximum harmonisation of annual and half-yearly financial reports has not been reached. As a consequence, Member States are under certain conditions[232] still permitted to establish additional periodic disclosure obligations beside annual and half-yearly financial reports in their national law and there are no requirements of the European law on these additional reporting formats. This may result in a serious fragmentation of reporting obligations in the Member States and a pan-European harmonisation of periodic disclosure regime is far from being established. 82

Another open task can be found when looking at the investors' access to financial reporting information. The TD only provides for general standards and requires the Member States to establish one OAM for the central storage of this information.[233] From an investor's perspective, the current pan-European access to financial reporting information requires searching 83

[230] Art. 28c(1) TD.
[231] See 2nd edn. (2017), H. Brinckmann, § 18 para. 74 ff., for examples presented in more detail.
[232] Cf. Art. 3(1) TD.
[233] Art. 21(2) TD.

through 27 different national databases and therefore forms a significant barrier to the investors' access to this information. A first step to increase harmonisation in this respect is in sight: The European access point (EEAP) will provide much easier access and searching through different databases in form of the OAMs. This alone will improve comparability of the financial reports of issuers from different Member States. The same applies to the ESEF for annual financial reports which increases comparability of the reports covered.

84 A solution must also be found for the fact that financial reports rely on accounting law which is still mainly in the hands of the Member States. The information in the financial reports is thus not subject to any uniform accounting standards, although it is becoming increasingly apparent that the IAS/IFRS may become such internationally accepted standards.[234]

85 The requirements of the TD on sanctions and liability in cases of an incorrect financial reporting are probably the last essential part within the system of periodic disclosure that needs to be revised in order to achieve a better harmonisation in the future. The revision of the TD by the ADTD already led to more detailed requirements for administrative sanction but, however, this does not seem to be enough to ensure an equally high quality of financial reports in all Member States. For the next revision of the TD, more detailed requirements for civil liability are vitally necessary as well as minimum standards for the Member States' enforcement systems. Only an effective law enforcement regime that includes public and private measures will be able to safeguard that issuers fully comply with the rules on financial reporting and supply investors with reliable information.

[234] IFRS are the dominant global financial reporting standard, N. Moloney, *EU Securities and Financial Markets Regulation*, 152.

§ 19

Disclosure of Inside Information

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I. Introduction

1. Regulatory Goals

The obligation to publish inside information has a long tradition in European capital markets law.[1] Directive 79/279/EEC already stipulated that an issuer must make such information available to the public. These were 'any major new developments in [the] sphere of activity [of the issuer] which are not public knowledge and which may, by virtue of their effect on its assets and liabilities or financial position or on the general course of its business, lead to substantial movements in the prices of its shares.'[2] The purpose of this requirement was to improve the **efficiency** of **markets**. 1

The next reform was the Insider Dealing Directive 89/592/EEC of 13.11.1989.[3] The legislative act provided that the ad hoc disclosure obligation also applied to companies and undertakings the transferable securities of which are admitted to trading on a market which is regulated and supervised by authorities, operates regularly and is accessible directly oder indirectly to the public. More importantly, ad hoc disclosure of inside information could for the first time be understood as a **preventive measure** under **insider trading law**. The European legislature consistently continued this approach in 2003. The legal basis for the ad 2

[1] A. Pietrancosta, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 17 para. B.17.16 points to the 1966 Segré Report.

[2] Art. 17 (1), Schedule C no. 5 a Council Directive 79/279/EEC of 5 March 1979 coordinating the conditions for the admission of securities to official stock exchange listing, OJ L66, 16. March 1997, p. 21 ff.

[3] Council Directive 89/592/EEC of 13 November 1989 coordinating regulations on insider dealing of 13. 11. 1989, OJ. L334, 18. November 1989, p. 30 ff.

hoc disclosure obligation was now to be found in the Market Abuse Directive (MAD 2003).[4] Both regimes—the **insider trading prohibitions** and the **disclosure obligation**—provided for the **same concept** of **inside information**. Consequently, the legislature understood the duty to disclose inside information as an important instrument to combat insider trading. This was also reflected in recital 24 MAD 2003: 'Prompt and fair disclosure of information to the public enhances market integrity'.

3 On the other hand, it must be recognised that the publication of price-sensitive information improves the information efficiency of the markets. In interaction with the **periodic disclosures**, market participants obtain the **information** necessary to **evaluate** the **fundamental value** of the issuer. Thus, the disclosure obligation has a dual function.[5] The ad hoc disclosure obligation is not only intended to counter insider trading, but also to protect the pecuniary interest of investors with regard to achieving 'correct' prices as well as their freedom of decision.[6]

4 If one focuses on the preventive nature of disclosure obligations regarding insider dealings, it appears reasonable to require the same conditions when prohibiting insider trading and when requiring disclosure. Both concepts can then apply the same notion of inside information. This was taken into account by the European legislator who understood the disclosure obligations as a complement to the prohibitions on insider trading (MAD 2003 regime).

5 From the perspective of transparency and efficient price formation on markets, the close link of the disclosure obligation with the insider trading prohibition is not strictly necessary, as disclosure can have a detrimental effect on the issuer.[7] The issuer may have a legitimate interest in not disclosing inside information without delay. This had already been recognised by Directive 79/279/EEC. At the time, the 'competent authorities' could exempt an issuer from the disclosure obligation, if the disclosure of particular information is such as to prejudice the legitimate interests of the company. Now the issuer itself decides on the delay of publication. This right is of great importance in practice because the ECJ has interpreted the concept of inside information of the MAD 2003 regime broadly (with an insider law justification) and the European legislator has taken up these principles with the Market Absue Regulation (MAR) 2014.[8] This means that—to put it briefly—uncertain events must also be disclosed. However, an issuer may have a variety of legitimate interests in keeping such information secret.

6 With the proposal for a Market Abuse Regulation published in 2011, the European Commission pursued the aim of decoupling the prohibitions on insider trading and the ad hoc disclosure obligation. This should be done with a new category of inside information that should not be subject to disclosure. However, the Commission was not able to assert itself with this proposal in the trialogue. Yet the proposal made perfect sense, as current practice shows that the one-tier concept (synchronisation of insider trading prohibitions and ad hoc dislosure) has not proven its worth

[4] Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), OJ L96, 12 April 2003, p. 16 (MAD 2003).

[5] Cf. H.-D. Assmann, in: Assmann/Schneider/Mülbert (eds.), *Kommentar zum Wertpapierhandelsrecht*, Art. 17 MAR para. 7–9; P. Buck-Heeb, *Kapitalmarktrecht*, para. 459; Kalss/Hasenauer, in: Kalss et al. (eds.), *BörseG/MAR*, Art. 17 MAR para. 5.

[6] BGH of 23.4.2013 – II ZB 7/09, ZIP 2013, 1165, 1170 para. 34.

[7] Cf. J. Payne, in: Tountopoulos/Veil (eds.), *Transparency of Stock Corporations in Europe*, 89, 106.

[8] See R. Veil § 14 para. 19–31.

(see para. 44). This gives rise to the research question whether the ad hoc disclosure obligation should be redesigned.

A reform should be discussed with a view to the US Securities Regulation, which does not provide for a similar ad hoc disclosure obligation of inside information.[9] Instead, an issuer in the U.S. has to report on current events according to section 13(a)(1) SEA. This disclosure obligation is supplemented by numerous specific disclosure obligations and the disclose-or-abstain rule. The SEC's detailed disclosure requirements on current events (Rule 13a-11 and Form 8-K) relate to circumstances described in abstract terms, such as 'financial information', 'matters related to accountants and financial statements' or 'corporate governance and management', which the SEC has defined in very precise terms. The circumstances are characterised by the fact that they have already occurred. Consequently, an issuer is not obliged to publicly announce uncertain events, such as in the case of Geltl/Daimler the intention of the chairman of the board to resign from office.[10] There is therefore far greater legal certainty for issuers, and disclosure costs are likely to be considerably lower for issuers compared to the European regime. Empirical capital market research also teaches that the disclosure requirement makes a significant contribution to overcoming information asymmetries.[11] Not every piece of information that can be used for insider trading must also be disclosed. 7

The US Securities Regulation also pursues **corporate governance purposes** with disclosure requirements. It is sometimes argued that this is even one of the main goals of mandatory disclosure rules.[12] The recitals of MAR do not comment on this.[13] However, some scholars in Europe qualify ad hoc publicity of inside information (also) as a norm under company law that contributes to effective corporate governance.[14] It is true that issuers may be obliged to immediately disclose legal violations within the company, provided that this information is relevant to the share price. The capital markets react to such compliance-relevant information with price reductions. The obligation of ad hoc disclosure can therefore have a disciplinary effect on business managers and reduce agency costs. In addition, shareholders are enabled to assert shareholder rights through access to compliance-relevant information. However, these interdependencies do not justify qualifying Article 17 MAR as a norm under company law and making this aspect useful for questions of interpretation. According to the recitals of MAR, the European legislature pursues other purposes with the obligation to disclose inside information.[15] The interpretation of Article 17 MAR should be based on the two traditional purposes. 8

[9] Comparative analyses of both regimes by J. Payne, in: Tountopoulos/Veil (eds.), *Transparency of Stock Corporations in Europe*, 89, 91 ff.

[10] See R. Veil § 14 para. 21.

[11] Empirical research indicates abnormal returns of 8-K notices. Cf. A. Lerman and J. Livnat, 15 Review of Accounting Studies (2010), 752 ff.

[12] Cf. L. Gullifer and J. Payne, Corporate Finance Law, 548 with reference to US-American literature; M. B. Fox, 109 Colum. L. Rev. (2009), 237, 253 ff.

[13] A. Hellgardt, in: Assmann/Schneider/Mülbert (eds.), *Wertpapierhandelsrecht*, §§ 97, 98 WpHG para. 34 argues, it would follow from recital 55 MAR that the disclosure obligation would also have a corporate governance function. However, recital 55 only stipulates that the disclosure requirement would increase investor confidence in SME issuers.

[14] Cf. A. Hellgardt, *Kapitalmarktdeliktsrecht*, 407 ff.; L. Klöhn, in: Klöhn (ed.), MAR, Art. 17 para. 11; A. Hellgardt, in: Assmann/Schneider/Mülbert (eds.), *Wertpapierhandelsrecht*, §§ 97, 98 WpHG para. 34. Dissenting opinion M. Habersack, in: Klöhn/Mock (eds.), Festschrift 25 Jahre WpHG, 217, 226 f.; L. Gullifer and J. Payne, *Corporate Finance Law*, 548, 580 (acknowledging a governance function for periodic disclosure, rejecting it for ad hoc disclosure of inside information).

[15] This is different for transparency of major shareholdings (see R. Veil § 20 para. 4) and disclosure of related party transactions (see R. Veil § 22 para. 33).

9 In summary, the MAR 2014 pursues two goals with the obligation to publish inside information. Firstly, the disclosure obligation is intended to prevent insider trading and, secondly, to improve price efficiency. The overall objective is to protect investors and their confidence in issuers. Private investors, in particular, also benefit from immediate publication, because they benefit in any case from the fact that professional market participants (analysts, brokers, portfolio managers and other arbitrageurs) evaluate the information without delay, so that the information is immediately reflected in the prices of securities.[16] However, the addressee of the notification is not only the professional market participant: the issuer must ensure that the inside information is published in a way that allows the public, ie investors of any kind to access it quickly and to make a complete, accurate and timely assessment of it.[17]

2. Practical Relevance

10 Little is known about how many **inside information** issuers admitted to the regulated market or on an MTF **discloses** each year. Most supervisory authorities in the Member States do not provide information about this in their activity reports and on their websites. Figures are known for Germany. The number of publications rose to 5,421 in the early 2000s.[18] Thereafter, the number decreased steadily (2008: 3,037; 2009: 2,657; 2010: 2,207; 2011:2,002; 2012 1,818).[19] It remains at this level today (2018: 2,069; 2019: 1,977).[20] At first glance, these facts about a decline in ad hoc disclosures[21] do not reflect the fact that the ECJ's case law (taken up with MAR) on the concept of inside information has not only extended the prohibitions on insider trading, but also the disclosure requirements. However, to evaluate the figures, it must be taken into account that issuers used ad hoc notifications as a marketing tool in the early 2000s until the legislature banned this practice. Furthermore, there were far more listed companies than today.

11 **Delay** of **disclosure** has become increasingly important over the past 20 years. Prior to the implementation of MAD in 2003, delay hardly played a role. In Germany, only 26 requests for approval of a delay were submitted in 2002, of which 18 were granted.[22] This changed with the MAD 2003 regime. In Germany, there were a total of 244 delays in 2012 (2011:202; 2010: 177; 2009: 240; 2008: 209), often in multi-stage decision-making processes, for example when a decision still required the approval of the supervisory board.[23] The number has nearly tripled to date (2018: 532; 2019: 557).[24] The delay is of great practical significance primarily because the ECJ has interpreted the concept of inside information in a broader

16 Cf. J. Payne, in: Tountopoulos/Veil (eds.), *Transparency of Stock Corporations in Europe*, 89, 91.
17 See para. 42.
18 BaFin, *Annual Report* 2002, p. 75.
19 BaFin, *Annual Report* 2012, p. 189; BaFin, *Annual Report* 2011, p. 211.
20 BaFin, *Annual Report* 2019, p. 96.
21 The development in Austria is similar, cf. S. Kalss and C. Hasenauer, in: Kalss et al. (eds.), BörseG/MAR, Art. 17 MAR para. 8. In 2019, 373 ad hoc notifications were published, cf. FMA, Annual Report 2019, p. 100.
22 Cf. BaFin, Annual Report 2002, p. 75.
23 Cf. BaFin, Annual Report 2012, p. 189; BaFin, Annual Report 2011, p. 210; BaFin, Annual Report 2009, p. 189.
24 BaFin, Annual Report 2019, 96.

way, with the consequence that uncertain events must also be disclosed.[25] In its report on the MAR Review, ESMA states that national supervisors were notified of a delay in publication in approximately 14,000 cases between July 2016 and June 2019. Significant differences can be observed in the Member States.[26]

3. Empirical Studies

Empirical research makes use of event studies to determine the influence of unanticipated price-relevant events on the value of companies with the help of security prices.[27] These financial statistical methods are based on the assumption that capital markets are semi-strong information efficient in the sense of the ECMH.[28] Accordingly, liquid capital markets reflect all publicly available price-relevant information at all times. Under this assumption, all public information, such as news published ad hoc by companies, is immediately reflected in the prices of securities. Event studies can be used to determine how strongly and in which direction company share prices react to published events. The influence of an event is called abnormal return. To determine this, an event window is defined. For each day of this period, the normal (ie expected) return corrected for market influences is subtracted from the actual return. Then, the calculated abnormal returns are aggregated over the period of the event window. This cumulative abnormal return indicates the influence of the event under investigation with respect to the entire event window. Finally, the statistical significance of the abnormal return is determined using appropriate tests. 12

Empirical research already exists on the early phase of European securities regulation. A study published in 2001 came to the conclusion that even with highly statistically significant average stock market reactions, never more than one-third of the individual announcements in a sample proved to be statistically price-sensitive.[29] A few years later, an article suggested that security prices had responded within 30 minutes to ad hoc published inside information. The larger the company, the smaller the statistically significant abnormal returns.[30] 13

Empirical research on the MAD 2003 regime is limited, but agrees on the basic finding that there are statistically significant abnormal returns on the day of publication of ad hoc announcements. One paper demonstrates this for earnings.[31] Two recent research papers show post-release adjustments in security prices.[32] One of these papers concludes that the ad hoc disclosure requirement is an effective means of improving market efficiency, whilst the other finds that investors would view ad hoc disclosures as valuable.[33] Event studies on the MAR regime have not been published to date. 14

[25] See R. Veil § 14 para. 39 ff.

[26] ESMA, MAR Review Report, ESMA70-156-2391, 23 September 2020, para. 192.

[27] Cf. for an explanation of event studies J. Y. Campbell/A. W. Lo/A. C. MacKinley, *Econometrics of Financial Markets* (1997), Chapter 4.

[28] See on the ECMH R. Veil § 2 para. 29 and H. Brinckmann § 16 para. 7.

[29] Cf. E. Nowak, JBB (2001), 449, 465.

[30] Cf. A. Muntermann and J. Güttler, 17 Journal of International Financial Markets, Institutions and Money (1) 2007, 1 ff. (Analysis of 2,705 notifications in the period from 1. 8. 2003 to 31. 8. 2004).

[31] R. Baule and C. Tallau, *Market Response to Ad Hoc Disclosures and Periodic Financial Statements*, Chapter 4.

[32] M. Bank and R. Baumann, 29 Financ Mark Portf Manag (2015), 173, 196; D. Dettenrieder and E. Theissen, *The Market Reaction to Corporate Disclosure*, Chapter 4.

[33] D. Dettenrieder and E. Theissen, *The Market Reaction to Corporate Disclosure*, Chapter 4.

15 None of the aforementioned research differentiates between certain and uncertain information. This would require analysing every ad hoc disclosure. A legal analysis of 244 personnel-related ad hoc announcements in 2017 has shouldered this task.[34] Only 13.52% of the notifications disclosed uncertain information. In many cases, notifications were made after multiple transactions and the market was thus only informed about transactions that had been completed (from the issuer's point of view). The information content of a relevant portion of ad hoc announcements was at least doubtful, so that it may have been difficult for investors to recognise the inside information at all. A conclusion on the price relevance is often made difficult by the fact that either no information is given on the subject or the ad hoc announcement contains various information.

II. Regulatory Concepts

1. Requirements under European Law

(a) Disclosure Obligations under the MAR

16 The obligation to disclose inside information is laid down in Article 17(1) MAR. The European legislature primarily understands this obligation as an instrument to **prevent insider dealings** (see para. 9), the MAR's (as the former MAD's) aim being to ensure the integrity of EU financial markets.[35] The obligation to disclose inside information is essential to avoid insider dealing and ensure that investors are not misled.[36] This is also the ECJ's view.[37]

17 Article 17(1) MAR requires **issuers** to **disclose** as soon as possible **inside information** which **directly concerns** that **issuer**. The term 'inside information' is defined in Article 7 MAR,[38] the definition applying both to the rules prohibiting insider dealings and to those requiring the disclosure of inside information. The European Commission's plans to introduce a new category of inside information that would not have been subject to the disclosure obligations have been abandoned.[39]

18 Article 17(4) MAR allows an issuer to **delay** the public **disclosure** of inside information at its own responsibility, provided that (i) immediate disclosure is likely to prejudice his legitimate interests, (ii) the delay of disclosure is not likely to mislead the public and (iii) the issuer is able to ensure the confidentiality of that information. In the case of a protracted

[34] Cf. R. Veil et al., ZGR (2020), 2 ff.
[35] Cf. Recital 2–4 MAR.
[36] Cf. Recital 49 MAR.
[37] ECJ of 28 June 2012, Case C-19/11 (*Daimler/Geltl*), para. 33. The ECJ also highlighted the importance of legal certainty and systematic coherence, see ibid., para. 48, 52. Confirmed in ECJ of 11 March 2015, Case C-628/13 (*Lafonta*), EuZW (2015), 387 ff. On the foregoing ruling of the Cour de cassation, see T. Bonneau, Bull. Joly Bourse (2014), 15 ff.
[38] See R. Veil § 14 para. 32.
[39] Cf. Art. 6(1)(e) and Art. 12(3) Proposal for a Regulation of the European Parliament and of the Council on Insider Dealing and Market Manipulation (Market Abuse), 20 October 2011, COM(2011) 651 final; on these plans P. Koch, BB (2012), 1365 ff.; see also para. 6.

process that occurs in stages and that is intended to bring about, or that results in, a particular circumstance or a particular event, an issuer may on its own responsibility delay the disclosure of inside information relating to this process.[40] As a lesson of the financial crisis, Article 17(5) and (6) MAR provide a second possibility to delay the disclosure of inside information if the issuer is a credit or financial institution and the disclosure of the inside information entails a risk of undermining the financial stability of the issuer and of the financial system. Unlike the 'general delay' (under Article 17 (4) MAR), this delay is granted in the public interest and is subject to the competent authority's prior consent.

Article 17 MAR is supplemented by the Implementing Regulation (EU) 2016/1055[41] and the Delegated Regulation (EU) 2016/522[42] (Level 2 legal acts). Furthermore, ESMA has issued MAR guidelines to ensure a uniform application of certain rules.[43] 19

(b) Relationship to Other Disclosure Rules

The MAR does not determine the relationship between the disclosure obligation for inside information and other disclosure obligations under EU und national law. This question is of outstanding importance. In particular, this is true for the relationship between the TD rules on **periodic disclosure** (financial reports) and those on the disclosure of inside information. Generally speaking, both regimes are **simultaneously applicable and independent** from each another, the disclosure of inside information not only being an addition to the rules on periodic disclosure but also an independent instrument aimed at combating insider dealing.[44] Information subject to the rules on periodic disclosure may thus also have to be made public as inside information prior to its disclosure in the financial reports if it is publicly unknown and price-relevant. The upcoming publication of a financial report does not release the issuer from its duty to disclose inside information as soon as possible and does not constitute a legitimate interest for the issuer to delay the disclosure of the inside information.[45] 20

In general, the obligation to disclose inside information is also independent from all other rules of transparency and the time limits for their disclosure. This especially refers to the rules on disclosure regarding major shareholdings under Article 9 and 10 TD, for example.[46] Changes in the structure of shareholdings can have a direct effect on the issuer even before the thresholds regarding control have been reached. If the investor intends to intervene in 21

[40] Art. 17(4) subsec. 2 MAR.

[41] Commission Implementing Regulation (EU) 2016/1055 of 29.6.2016 laying down implementing technical standards with regard to the technical means for appropriate public disclosure of inside information and for delaying the public disclosure of inside information in accordance with Regulation (EU) No 596/2014 of the European Parliament and of the Council, OJ L173, 30. June 2016, p. 47 ff.

[42] Commission Delegated Regulation (EU) 2016/522 of 17 December 2015 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council as regards an exemption for certain third countries public bodies and central banks, the indicators of market manipulation, the disclosure thresholds, the competent authority for notifications of delays, the permission for trading during closed periods and types of notifiable managers' transactions, OJ L88, 05 April 2016, p. 1 ff.

[43] ESMA, MAR-Guidelines – Delay in the Disclosure of Inside Information, 20.10.2016, ESMA/2016/1478.

[44] See above para. 2–3.

[45] BaFin, Emittentenleitfaden (issuer guideline), Module C, p. 35; H.-D. Assmann, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, Art. 17 MAR para. 9; S. Kalss et al. (eds.), *Kapitalmarktrecht I*, § 16 para. 6. Dissenting opinion: J.L. Hansen, *Say when: When must an issuer disclose inside information?*, p. 27.

[46] See also R. Veil § 20 para. 20.

the business policy, the information about the acquisition of the shareholding may be price relevant.[47] The same applies with regard to the disclosure obligations for managers' transactions (formerly directors' dealings), although these will generally be of indirect concern to the issuer.

2. National Regulation

22 As the European market abuse framework is now laid down in a regulation, the **MAR rules** are **directly applicable** and need no implementation into the Member States' national laws. The unification of the disclosure obligations raises the question if and to what extent the Member States may also adopt further rules under the MAR. Under the MAD 2003 regime, the ECJ had left the question unanswered.[48] As the instrument of the regulation has been chosen to prevent diverging national requirements as a result of the transposition of a directive[49] and the MAR heavily relies on ESMA for further implementation and guidelines, the Member States' room for manoeuvre should be very limited. Even where national rules only specify the applicable European requirements, these national interpretations will be subject to the ECJ's review.[50]

23 Yet, these restrictions do not apply to national provisions on supervision and sanctions,[51] special rules on the liability for incorrect or omitted publications of inside information (see para. 81 ff.) not being affected. Also, the national supervisory authorities may continue to publish further **guidance** as the French (**AMF**),[52] German (**BaFin**)[53] and Italian (**Consob**)[54] authorities do. The NCAs interpretation is not legally binding on the courts. It nevertheless has a large practical relevance for the market participants, the NCA being the competent supervisory authority and as such permitted to impose administrative sanctions.

III. Obligation to Disclose Inside Information (Article 17(1) MAR)

1. Issuers of Financial Instruments

24 The obligation to disclose inside information as laid down in Article 17 MAR is addressed primarily to the issuers (of financial instruments).[55] Article 17(1) subsec. 3 MAR specifies

[47] L. Klöhn in: Klöhn (ed.), *MAR*, Art. 17 para. 406; S. Kalss et al. (eds.), *Kapitalmarktrecht*, § 16 para. 7.
[48] ECJ of 23 December 2009, Case C-45/08 (*Spector*) [2009] ECR I-12073, para. 63–64; also OLG Stuttgart, ZIP (2009), 962, 970.
[49] Cf. Recital 5 MAR.
[50] For more detail see also R. Veil § 5 para. 18.
[51] Cf. Art. 23(2), 30(1) and (2) MAR ('at least').
[52] AMF, Guide de l'information permanente et de la gestion de l'information privilégiée, 26.10.2016.
[53] BaFin, Emittentenleitfaden (issuer guideline), 5th ed. 25.3.2020 (Module C); on the legal nature and practical relevance of the issuer guideline see R. Veil § 5 para. 59.
[54] Consob, Gestione delle informazioni privilegiate, October 2017.
[55] On the term 'financial instrument' see R. Veil § 8 para. 2.

that the obligation applies to all **issuers** who have requested or approved **admission** of their **financial instruments** to trading on a **regulated market** in a Member State or, in the case of instruments only traded on an **MTF** or on an **OTF**, issuers who have approved trading of their financial instruments on an MTF or an OTF or have requested admission to trading of their financial instruments on an MTF in a Member State.

The question as to in which Member State an issuer is subject to disclosure proves technical and difficult to answer but essential for legal practice. Pursuant to Article 21(1) in conjunction with Article 2(1)(i) TD, an issuer is subject to the disclosure provisions in its home Member State. Article 21(3) TD modifies this home Member State rule for cases in which securities are admitted to trading on a regulated market in only one host Member State and not in the home Member State. 25

Situations in which subsidiaries of a company are involved lead to a number of problems with regard to the disclosure of inside information. The MAR and most national laws provide no solution to these problems. Companies in a **corporate group** can then only be subject to disclosure obligations individually, and the parent company, for example, cannot be obliged to disclose information on the listed financial instruments of a subsidiary. 26

Facts (Dieselgate): Volkswagen AG (VW) had provided defeat devices in its vehicles in order to pretend on the test bench that the vehicles complied with the respective emission regulations and standards. VW made this publicly known with the following ad hoc announcement dated 22. 9. 2015: 'Volkswagen is pressing ahead with the clarification of irregularities in the software used in diesel engines. […] Further internal checks to date have shown that the control software in question is also used in other diesel vehicles of the Volkswagen Group. In the majority of these engines, the software has no effect whatsoever. Vehicles with engines of type EA 189 with a total volume of around eleven million vehicles worldwide are in question. Only in the case of this engine type was a conspicuous deviation between test bench values and real driving operation detected. Volkswagen is working at full speed to eliminate these deviations with technical measures. The company is currently in contact with the responsible authorities and the German Federal Motor Transport Authority. To cover necessary service measures and further efforts to regain the trust of our customers, Volkswagen intends to set aside around €6.5 billion in the 3rd quarter of the current financial year, with an impact on earnings. […] The Group's earnings targets for 2015 will be adjusted accordingly.'[56] 27

VW and (also listed) Porsche SE (Porsche), VW's majority shareholder, were sued by investors for compensation. The investors argue that VW had published the inside information too late. This would also apply to Porsche, which had also been obliged to issue an ad hoc announcement because of the event. 28

The court decisions are not yet legally binding. However, the Stuttgart Regional Court has already partially upheld an action against Porsche SE for failure to publish inside information. It assumed that Porsche itself had an obligation to disclose inside information due to the manipulation in its subsidiary. In the case of groups of companies, there would be a double obligation on the part of the parent company and the subsidiary. The court argued that both companies were legally independent persons and that the respective ad hoc notifications addressed different groups of shareholders.[57] 29

[56] The ad hoc announcement was published in German. This translation does not originate from VW.
[57] LG Stuttgart v. 24.10.2018 – 22 O 101/16, JBB (2020), 59 ff. para. 187.

2. Inside Information

(a) Foundations

30 Pursuant to Article 17(1) MAR, issuers must disclose all inside information directly concerning them. In both this context and in the prohibitions on insider dealings the same definition of the term 'inside information' applies.[58] The application of this term had caused difficulties particularly with regard to disclosure obligations in protracted processes, such as multi-stage decision-making processes. This has led the European legislator to clarify the rules for protracted processes in Articles 7(2), (3) and 17(4) subsec. 2 MAR. However, inside information subject to disclosure will always be less than the inside information resulting in prohibitions of insider dealings, as information that only refers to the financial instruments and information only concerning the issuer indirectly need not be made public.[59]

31 In its decision on the investor lawsuit against Porsche (see para. 27),[60] the Regional Court of Stuttgart referred to several intermediate steps, including (i) the decision by an executive of VW to approve the installation of manipulation software in order to activate the defeat device, (ii) the notification of an executive of VW on 28 April 2014 about the financial consequences of the manipulation (penalties and damages) and (iii) the written notification of Prof. Winterkorn, Chairman of the board of directors of VW, by memoranda about the events in the USA in May 2014. The court examined whether these intermediate steps in themselves fulfil the criteria for inside information. This is now expressly regulated in Article 7(3) MAR. The Stuttgart Regional Court affirmed the relevance to the share price, arguing, among other things, that the implementation of the manipulation software had resulted in risks that threatened the existence of the company.

(b) Information Directly Concerning the Issuer

32 The MAR does not offer a definition as to when information 'directly concerns the issuer'. This causes problems in legal practice, where the term needs to be put into more concrete terms in order to be applied correctly. Fulfilling its former role on Level 3 of the Lamfalussy Process,[61] the CESR published a positive list of circumstances which generally directly concern the issuer and a negative list of circumstances that will generally only concern an issuer indirectly.[62] The BaFin's issuer guideline contains a further, more detailed list, although none of these lists can be regarded as final. They must rather be understood as listing the most common cases, the given examples having, however, to be interpreted in the light of the respective situation. Under certain circumstances, a case may thus have to be regarded as concerning the issuer directly although it is listed as generally not doing so, and vice versa.[63]

33 General economic and market data do not fall within the direct concern of the issuer and are therefore not subject to the disclosure obligation. The distinction may, however, prove

[58] On the term 'inside information' see R. Veil § 14 para. 32–64.

[59] See R. Veil § 14 para. 50.

[60] LG Stuttgart of. 24.10.2018 – 22 O 101/16, JBB (2020), 59 ff. para. 227 ff.

[61] See F. Walla § 4 para. 4.

[62] CESR, Market Abuse Directive Level 3—second set of CESR guidance and information on the common operation of the Directive to the market, July 2007, CESR/06-562b, p. 7 ff.; CESR, (amended version of) CESR's Advice on Level 2 Implementing Measures for the proposed Market Abuse Directive, December 2002, CESR/02-089d, p. 12 f.

[63] BaFin, Emittentenleitfaden (issuer guideline), Module C, p. 33.

difficult in individual cases. Similarly, the issuer generally need not disclose changes concerning competitors and the development of commodity prices.

As opposed to this, **circumstances** in the **issuer's sphere of activity** are always **subject** to **disclosure**. These generally constitute the most important group of relevant information to be published and usually refer to measures taken by the management or other bodies of the issuer, business-related activities undertaken by employees and any developments originating within the issuer's business. 34

Yet, the disclosure obligation is not restricted to developments and activities in the issuer's sphere of activity.[64] Takeover offers made by another company, for example, also directly concern the issuer, control over the company not only having an effect on the financial instruments of the company but also on the decision-making process in the general meeting of the target company.[65] The same applies to squeeze-out procedures or to changes in an agency's rating of the company. 35

(c) Attribution of Knowledge

According to the wording of Article 17 MAR, the ad hoc disclosure obligation exists irrespective of whether the issuer is aware of the existence of inside information. The duty could therefore already exist if inside information objectively exists. This interpretation is criticised with the argument that something impossible would be required of the issuer (ultra posse nemo obligatur).[66] However, according to the wording and purpose of Article 17(1) MAR, the disclosure obligation does not require the issuer's knowledge.[67] Knowledge of the existence of inside information becomes relevant at the level of sanctions and legal consequences.[68] In particular, liability for damages on the part of the issuer requires fault. In this context, not only the knowledge of the board members is to be attributed to the issuer, but also the knowledge of employees if the issuer violated its duties to organise knowledge within the company.[69] 36

3. No Offsetting of Information

In the United Kingdom issuers have occasionally argued that negative information could be cancelled out by positive information. If the market's expectations are not changed by the information as a whole, disclosure should not be necessary. The FCA/FSA has repeatedly refuted this approach, eg in its ruling in the case of *Wolfson Microelectronics plc*: 37

Facts (abridged):[70] Wolfson Microelectronics plc was a listed company that produced semiconductors for consumer electronics. On 10 March 2008 a major customer, formerly generating 38

[64] BaFin, Emittentenleitfaden (issuer guideline), Module C, p. 33.
[65] M. Pfüller, in: Fuchs (ed.), *Kommentar zum WpHG*, § 15 para. 245 f.
[66] H.-C. Ihrig, 181 ZHR (2017), 381, 389.
[67] M. Nietsch, ZIP (2018), 1421, 1427.
[68] M. Nietsch, ZIP (2018), 1421, 1427 ff.
[69] H.-C. Ihrig, 181 ZHR (2017), 381, 388.
[70] FSA, Final Notice, 19 January 2009; cf. B. McDonnell, 88 COB (2011), 1, 13–14; R. Veil and M. Wundenberg, *Englisches Kapitalmarktrecht*, 117–118. The FSA also fined *Entertainment Rights plc* on the same day for not disclosing inside information in the mere hope to be able to compensate a loss of profits in the course of the financial year, cf. FSA, Final Notice, 19 January 2009.

approximately 18% of Wolfson's revenue, told Wolfson that they would not be ordering parts for future editions of products A and B, two of the major customer's products. For Wolfson this represented a loss of 8% of its forecast revenue for the year. At the same time, Wolfson was informed that the same major customer would increase its demand for the supply of parts for product C, making Wolfson's overall revenues from the major customer in 2008 equivalent to those of the previous year. On the recommendation of external consultants, Wolfson disclosed the information on the loss of the order for products A and B on 27 March 2008, subsequently suffering an 18% fall in its share price.

39 The FSA ruled that the delay in disclosing information breached the obligation to disclose inside information as soon as possible to conform with DTR 2.2.1 and Listing Principle 4. Offsetting negative and positive news—or cancelling out negative by positive news—is not acceptable. Rather, companies should disclose both types of information and allow the market to determine whether, and to what degree, the positive information compensates for the negative information. Additionally, Wolfson's calculations failed to take the implications for revenues post 2008 into account although the previously anticipated level of 2008 revenues could be achieved. The information was significant for investors with regard to its implications for Wolfson's future status vis-à-vis the major customer.

4. No Combination of Disclosure with Marketing Activities

40 Transparency can be affected not only by price-sensitive information which remains undisclosed but also by a flood of information, impairing the processing of information important for investment decisions. In Spain, the disclosure of future circumstances, which are not yet entirely certain, had been regarded as the most severe risk to transparency regarding inside information. In addition, issuers might use the disclosure as an instrument towards investor relations. Replacing former Article 2(1) subsec. 1 of Directive 2003/124/EC, Article 17(1) subsec. 2 sentence 2 MAR now expressly prohibits to combine the disclosure of inside information with marketing activities.

5. Publication Procedure

41 The issuer must make the **publication** '**as soon as possible**'. Thus, the information must be published immediately (see para. 46). An issuer may, however, take a reasonable period of time to investigate the facts and decide on an exemption, if necessary.[71]

42 Ad hoc announcements must be formulated in such a way that they eliminate information asymmetries with regard to inside information. According to Article 17(1) MAR, the ad hoc notification shall enable **fast access** and **complete**, **correct** and **timely assessment** of the information by the public. Specific requirements on the means of disclosure of inside information are provided for in Article 2 Implementing Regulation (EU) 2016/1055. It must be made unambiguously clear in the announcement that the information communicated is inside information and what the subject matter of the inside information is.[72] The concept

[71] Cf. BGH of 17.12.2020 – II ZB 31/14, ZIP 2021, 346, 361 (*Hypo Real Estate*).
[72] BaFin, Emittentenleitfaden (issuer guideline), Module C, p. 43 ff.

of the public used in Article 17 MAR is not further defined in the Implementing Regulation (EU) 2016/1055. However, recital 1 of Regulation (EC) 2016/1055 states that the 'inside information should be publicly disclosed free of charge, simultaneously and as fast as possible amongst **all categories of investors** throughout the Union'. It can be concluded from this that a private investor is also an addressee of ad hoc notifications.[73] It must be possible for him to assess the price relevance of the disclosed event.[74]

How the publication is to be made is determined by Article 2(1) Implementing Regulation (EU) 2016/1055. Inside information is disseminated (i) to as wide a public as possible on a non-discriminatory basis, (ii) free of charge and (iii) simultaneously throughout the Union. In addition, inside information shall be communicated, directly or through a third party, to the media which are reasonably relied upon by the public to ensure its effective dissemination. The issuer also has to post and maintain on its website for a period of at least five years all inside information. 43

IV. Delay in Disclosure

1. Foundations

The far-reaching disclosure obligation laid down in Article 17(1) MAR, which is based on the ECJ's wide interpretation of the term inside information,[75] requires correction.[76] In some cases, such as mergers or squeeze-outs, the early disclosure of this intent may endanger its success. Article 17(4) MAR therefore provides for a 'general delay' and permits the **issuer** to **delay** the public **disclosure** of inside information under its own responsibility, if (i) immediate disclosure is likely to **prejudice the legitimate interests** of the issuer, (ii) the delay is **not likely to mislead the public** and (iii) the issuer is able to ensure the **confidentiality** of the information. The importance of this possibility of delay in the disclosure regime for inside information cannot be emphasised enough. 44

While Article 17(4) subsec. 2 MAR clarifies that issuers may delay the disclosure of inside information relating to a protracted process that occurs in stages, Article 17(4) subsec. 3 MAR requires an issuer who had delayed the disclosure of inside information to **inform** the **competent authority** of this **delay** immediately after the disclosure. It also has to provide—although not necessarily simultaneously[77]—a written[78] **explanation** unless the Member 45

[73] Cf. R. Veil and A. Brüggemeier, in: Meyer/Veil/Rönnau (eds.), *Handbuch Marktmissbrauchsrecht*, § 10 para. 168 ff.; L. Klöhn, in: Klöhn (ed.), *MAR*, Art. 17 para. 515 ff.

[74] L. Klöhn, in: Klöhn (ed.), *MAR*, Art. 17 para. 523 f.; R. Veil and A. Brüggemeier, in: Meyer/Veil/Rönnau (eds.), *Handbuch Marktmissbrauchsrecht*, § 10 para. 174.

[75] See ECJ of 28 June 2012, Case C-19/11 (*Daimler/Geltl*); ECJ of 11 March 2015, Case C-628/13 (*Lafonta*), EuZW (2015), 387 ff.

[76] Cf. BGH of 23.4.2013 – II ZB 7/09, ZIP (2013), 1165, 1168; G. Bachmann, 172 ZHR (2008), 597, 608. See also S. Gilotta, 13 EBOR (2012), 45 ff. emphasising the issuer's need for secrecy.

[77] Cf. ESMA, Final Report. Draft Technical Standards on the Market Abuse Regulation, ESMA/2015/1455, 28 September 2015, para. 230.

[78] According to Recital 4 Commission Implementing Regulation (EU) 2016/1055, written form means the use of electronic means of transmission accepted by the relevant competent authority.

State has chosen that the explanation depends on a request of the competent authority. Some Member States have made use of this in order to achieve deregulation and reduce the supervisory authority's audit burden.[79]

46 The short period necessary for determining whether a disclosure obligation exists is not regarded as a delay as in these cases the disclosure takes place '**as soon as possible**'.[80] This is all but trivial when the issuer's management itself is surprised by the possible inside information, as may be the case with compliance irregularities (eg in the case of *Volkswagen*) or in corporate groups. It may be tricky to determine to what extent an issuer needs to organise its internal chains of information in order to ensure timely disclosure, and when information which is not available to or even hidden from the management is still attributed to the issuer.

47 After this period a delay is only possible provided the prerequisites under Article 17(4) or (5) MAR are given; in the case that a requirement ceases to exist, the information must be disclosed immediately. The issuer must therefore check continually whether all the requirements for the delay are still given.[81] This means that disclosure may in some cases be delayed indefinitely, as the MAR contains no maximum duration for the delay. In these cases, there is no obligation to inform the competent authority, either.

48 The issuer will then have to disclose the information without undue delay. The relevant date for assessing which information must be disclosed is the time at which the requirements for the delay cease to exist. If by this time the information has lost its character as inside information, it need not be disclosed. This is, for example, conceivable if the issuer has meanwhile abandoned its plans to take certain measures. In these cases, there is no obligation to inform the competent authority of the delay and explain it. According to the unambiguous wording of Article 17(4) subsec. 3 MAR, such obligations are only triggered when inside information is actually disclosed. This has to be seen critically: The information and explanation requirements are conceived as tools to be used in potential insider-dealing investigations[82] and are equally, if not even more important when the inside information is never disclosed.

49 In the wake of the financial crisis, financial institutions (eg Northern Rock and Société Générale) have repeatedly been faced with the duty to disclose inside information where this disclosure risked leading to a bank run and thereby endanger the stability of the financial system. The disclosure regime did not provide a clear legal base to delay disclosure in these cases, however, since it was rather the public interest than a legitimate interest of the issuer which required the delay. Articles 17(5) and (6) MAR therefore provide for a new and **separate**[83] possibility to **delay** the **disclosure** of inside information to preserve the **stability**

[79] Cf. ESMA, MAR Review Report, 23 September 2020, ESMA70-156-2391, para. 195: Austria, Denmark, Finland, France, Greece, Italy, Luxembourg, the Netherlands, Spain, Sweden and the United Kingdom.

[80] Cf. L. Klöhn, AG (2016), 423, 430; S. Kalss et al. (eds.), *Kapitalmarktrecht I*, § 16 para. 48; C. Di Noia and M. Gargantini, ECFR (2012), 484, 507.

[81] Cf. CESR, Market Abuse Directive Level 3—second set of CESR guidance and information on the common operation of the Directive to the market, July 2007, CESR/06–562b, p. 11.

[82] Cf. ESMA/2015/1455 (fn. 77), para. 232 ff.

[83] As Art. 17(6) subsec. 4 MAR clarifies, issuers that are credit or financial institutions are free to choose the 'general' delay mechanism in these cases. It appears doubtful if the requirement of the issuer's legitimate interests can be met, however.

of the financial system, especially for inside information concerning a temporary liquidity problem or the need to receive temporary liquidity assistance.[84] It applies only to issuers which are **credit** or **financial institutions**. The following conditions, which according to ESMA are to be interpreted narrowly,[85] have to be met: (i) the disclosure risks to undermine the financial stability of the issuer and of the financial system, (ii) it is in the public interest to delay the disclosure, (iii) the confidentiality of the information can be ensured, and (iv) the competent authority has consented to the delay. Article 17(6) MAR specifies the procedure for these delays.

Confidentiality may also exist for other legal reasons. The **obligation** to **publish** inside information is **excluded by law** if the **personal rights** of a natural person **outweigh** the **interest** of the **capital markets** in publishing the information. The legal basis is the general right of personality pursuant to Article 7 and 8 of the Charter of Fundamental Rights of the European Union.[86] In practice, this has so far mainly become relevant in the case of a serious illness of a football player. The disclosure can be omitted without the issuer taking a delay decision pursuant to Article 17(4) MAR.[87] Furthermore, the exclusion of the obligation to publish is justified in literature by the principle of **nemo tenetur**.[88] If internal investigations revealed suspicions of compliance violations, the issuer could refer to the principle that no one was obliged to incriminate himself. This prohibition of self-incrimination is based on Article 6(1) of the European Convention on Human Rights. 50

2. Delay Pursuant to Article 17(4) MAR

(a) Legitimate Interests

The issuer's 'legitimate interests' that may justify a delay in disclosure are a key element of the disclosure regime. It is therefore essential to put this abstract concept into more concrete terms. Whilst the European legislator did not define the term 'legitimate interests', it assigned ESMA to issue a guideline to establish a non-exhaustive indicative list of such legitimate interests[89] and included two examples of legitimate interests in Recital 50 of the MAR which mirror former Article 3(1) of Directive 2003/124/EC. These are: 51

— ongoing negotiations, or related elements, where the outcome or normal pattern of those negotiations would be likely to be affected by public disclosure. In particular, in the event that the financial viability of the issuer is in grave and imminent danger, although not within the scope of the applicable insolvency law, public disclosure of information may be delayed for a limited period where such a public disclosure would seriously jeopardise the interest of

[84] On this delay cf. L. Klöhn, AG (2016), 423, 432; P. Koch, BB (2012), 1365, 1367; N. Moloney, *EU Securities and Financial Markets Regulation*, 731, 734.

[85] Cf. ESMA/2015/1455 (fn. 77), para. 251; L. Klöhn, AG (2016), 423, 432.

[86] Cf. H.-D. Assmann, in: Assmann/Schneider/Mülbert (eds.), *Kommentar zum Wertpapierhandelsrecht*, Art. 17 MAR para. 74; *Klöhn*, in: Klöhn (ed.), *MAR*, Art. 17 para. 379 ff.

[87] Cf. H.-D. Assmann, in: Assmann/Schneider/Mülbert (eds.), *Kommentar zum Wertpapierhandelsrecht*, Art. 17 MAR para. 75.

[88] Cf. H.-D. Assmann, in: Assmann/Schneider/Mülbert (eds.), *Kommentar zum Wertpapierhandelsrecht*, Art. 17 MAR para. 76 ff.

[89] Art. 17(11) MAR.

existing and potential shareholders by undermining the conclusion of specific negotiations designed to ensure the long-term financial recovery of the issuer;

— decisions taken or contracts made by the management body of an issuer which need the approval of another body of the issuer in order to become effective, where the organisation of such an issuer requires the separation between those bodies, provided that public disclosure of the information before such approval, together with the simultaneous announcement that the approval remains pending, would jeopardise the correct assessment of the information by the public.

52 In its guidelines, ESMA has put both cases into more concrete terms and split the first case into the two independent examples of **ongoing negotiations** and a **danger** to the **financial viability** to an **issuer**. The guidelines comprise three further situations which largely perpetuate the CESR's examples.[90] These are (i) the development of a product or an invention; (ii) plans to buy or sell a major holding in another entity (but negotiations have not yet started); and (iii) deals or transactions previously announced and subject to a public authority's approval. The former case of impending developments that could be jeopardised by premature disclosure is suppressed for being too generic.[91] The listed examples are non-exhaustive; even in the listed cases the issuer has to carry out a case-by-case assessment whether its interests are legitimate.[92]

53 It is highly controversial if the term 'legitimate interests' has to be construed generously or narrowly. While the SMSG suggested a generous interpretation, ESMA expressly refused this approach and calls for a narrow interpretation.[93] This reflects the discussion on the scope of the disclosure duty. Since the legislator embraced a far-reaching understanding of the term inside information, opponents of an extensive duty to disclose argue for an enhanced need for possibilities to delay disclosure—mostly from a transparency-oriented perspective. Supporters fear that the delay could be abused to thwart the disclosure obligation and argue from both a transparency-oriented and a insider trading preventive point of view.[94] Whilst the legislator's decision may obviously not be reversed by admitting legitimate interests too extensively, there is **no need for a narrow interpretation**, either.[95] Article 17(4) MAR recognises the need for delay and provides for confidentiality in order to prevent insider dealing during the delay. In particular, Article 17(4) subsec. 2 MAR expressly allows delay to the disclosure of intermediate steps subject to the same conditions as any other inside information, but does not generally justify the delay. In any event, an issuer may not delay the disclosure of 'uncertain' inside information based on an alleged risk of misleading the public by this disclosure.[96]

54 An abstract specification of the legitimate interests causes problems because there is no '**interest of a company**' or 'interest of an issuer'. Moreover, this concept is probably

[90] Cf. CESR, Market Abuse Directive, Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market, July 2007, CESR/06-562b.

[91] ESMA, Final Report. Guidelines on the Market Abuse Regulation – market soundings and delay of disclosure of inside information, ESMA/2016/1130, 13 July 2016, para. 50.

[92] Cf. Recital 50 MAR; ESMA/2016/1130 (fn. 91), para 52 ff.; Annex IV, para. 113; Annex V, para. 88, 94.

[93] ESMA/2016/1130 (fn. 91), para. 52; Annex III, para. 24 (SMSG's response to ESMA's CP).

[94] Cf. G. Bachmann, DB (2012), 2206, 2210.

[95] C. Kumpan, DB (2016), 2039, 2043.

[96] Dissenting opinion: J.L. Hansen, *Say when: When must an issuer disclose inside information?*, 26, 28: 'Correctness and completeness trumps haste'.

understood differently among Member States.[97] In order to ensure a common understanding in the EU, the interests of the company should be interpreted on the basis of what interests shareholders typically have.[98] This interpretation is supported by the 50th recital of MAR, which refers to the interests of existing and potential shareholders.

A legitimate interest of the issuer exists in principle if the shareholders are threatened with disadvantage by the publication. This disadvantage manifests itself in expected negative effects on the fundamental value of the share.[99] Even if the wording of Article 17(4) MAR does not contain any further requirements, the purpose of ad hoc disclosure requires that the disadvantage is of such intensity that the capital market's interest in information is to be assessed as lower. The issuer has no discretion as to the existence of legitimate interests.[100] 55

Legitimate interests of the issuer may exist in negotiations the outcome of which would likely be jeopardised by immediate public disclosure.[101] ESMA gives the following non-exhaustive examples: mergers, acquisitions, splits and spin-offs, purchases or disposals of major assets or branches of corporate activity, restructurings and reorganisations. 56

Recital 50 MAR addresses financial problems of the issuer: 'In the event that the financial viability of the issuer is in grave and imminent danger [...], public disclosure of information may be delayed for a limited period where such a public disclosure would seriously jeopardise the interest of existing and potential shareholders by undermining the conclusion of specific negotiations designed to ensure the long-term financial recovery of the issuer'. The wording of ESMA's guideline is almost identical: 'the financial viability of the issuer is in grave and imminent danger, although not within the scope of the applicable insolvency law, and immediate public disclosure of the inside information would seriously prejudice the interests of existing and potential shareholders by jeopardising the conclusion of the negotiations designed to ensure the financial recovery of the issue.' 57

In the context of multi-stage decision-making processes, the individual intermediate steps may already constitute inside information subject to publication (see para. 30). In particular, if a decision taken by the board of directors or the conclusion of a contract is still dependent on the approval of the supervisory board, this may constitute a legitimate interest for a delay. However, waiting for the further necessary decision should not constitute an automatism.[102] According to ESMA's guidance, an issuer may have 'legitimate interests in a delay if the inside information relates to decisions taken or contracts entered into by the management body of an issuer which need, pursuant to national law or the issuer's bylaws, the approval of another body of the issuer, other than the shareholders' general assembly, in order to become effective, provided that (i) immediate public disclosure of that information before such a definitive decision would jeopardise the correct assessment of the information by the public; and (ii) the issuer arranged for the definitive decision to be taken as soon as possible.'[103] 58

[97] A. Pietrancosta, in: Ventoruzzo/Mock (eds.), *Market Abuse Regulation*, Art. 17 para. B.17.81.

[98] BaFin, Emittentenleitfaden (issuer guideline), Module C, p. 38; H.D. Assmann, in: Assmann/Schneider/Mülbert (eds.), *Kommentar zum Wertpapierhandelsrecht*, Art. 17 MAR para. 101; L. Klöhn, 178 ZHR (2014), 55, 73 ff.; L. Klöhn and U. Schmolke, ZGR (2016), 866, 875 f.; P. *Mülbert and A. Sajnovits*, WM (2017), 2001, 2004.

[99] L. Klöhn, 178 ZHR (2014), 55, 80 f. See on the concept of the fundamental value R. Veil § 14 para. 56 and R. Veil § 26 para. 11 f.

[100] Dissenting opinion: L. Klöhn, in: Klöhn (ed.), *MAR*, Art. 17 para. 157 ff.

[101] ESMA/2016/1478 para. 8 lit. a., 4; ESMA/2016/1130 para. 55 f.

[102] ESMA/2016/1130 para. 68.

[103] ESMA/2016/1478 para. 8 lit. c); recital 50 lit. b) MAR.

(b) No Misleading the Public

59 Whether the public may be misled by the delay in disclosure is difficult to determine.[104] Generally speaking, any delay leads to a pricing that does not reflect all the relevant information, the price-sensitive nature of the information being a defining element of the concept of information and therefore a necessary prerequisite for any disclosure obligation. Applying this understanding of the term 'misleading the public' would, however, be absurd.[105] Misleading the public is therefore only to be assumed if the information available to the market gives an impression that is contrary to the actual situation under consideration of the inside information and the issuer's behaviour.[106]

60 ESMA has identified the following three sets of circumstances when the delay is likely to mislead the public; the list is non-exhaustive:[107]

- the inside information whose disclosure the issuer intends to delay is materially different from the[108] previous public announcement of the issuer on the matter to which the inside information refers to;
- the inside information whose disclosure the issuer intends to delay regards the fact that the issuer's financial objectives are likely not to be met, where such objectives were previously publicly announced;
- the inside information whose disclosure the issuer intends to delay is in contrast with the **market's expectations**, where such expectations are based on signals that the issuer has previously sent to the market, such as interviews, roadshows or any other type of communication organized by the issuer or with its approval.

Especially the last example with its reference to the market's expectations was highly controversial.[109] However, it reflects the importance ESMA gives to the disclosure obligation.

(c) Ensuring Confidentiality

61 Article 17 MAR does not specify when an issuer is able to ensure the confidentiality of the information. Two of the three specific duties for issuers formerly contained in Article 3(2) Directive 2003/124/EC[110] can be deduced from Article 4(1)(c) Commission Implementing Regulation (EU) No. 2016/1055 which implicitly requires: (i) **information barriers** to be put in place internally and with regard to third parties to prevent access to inside information by persons other than those who require it for the normal exercise of their functions within the issuer; (ii) **arrangements** to be put in place **to disclose** the relevant **inside information**

[104] Remarkably, Art. 17(5) MAR does not rely on this condition.

[105] Cf. CESR, Market Abuse Directive Level 3—second set of CESR guidance and information on the common operation of the Directive to the market, July 2007, CESR/06-562b, p. 11; OLG Stuttgart of 22.4.2009 – 20 Kap 1/08, ZIP (2009), 962, 970; C. Di Noia and M. Gargantini, ECFR (2012), 484, 506.

[106] OLG Stuttgart of 22.4.2009 – 20 Kap 1/08, ZIP (2009), 962, 970.

[107] ESMA/2016/1130 (fn. 91).

[108] In the draft guidelines, reference was made to 'a' previous public announcement. Now, only the last public announcement concerning the relevant matter is referred to, cf. ESMA/2016/1130 (fn. 91), Annex IV, para. 141.

[109] Cf. C. Di Noia et al., ZBB (2014), 96, 101.

[110] Repealed by Art. 37 MAR.

as soon as possible where the confidentiality is no longer ensured. Furthermore, the issuer needs to appoint persons responsible for ensuring the ongoing monitoring of the conditions for the delay according to Article 4(1)(b)(ii). The third duty under Article 3(2) Directive 2003/124/EC—to take the necessary measures to ensure that any person with access to such information acknowledges the legal and regulatory duties entailed and is aware of the sanctions attached to the misuse or improper circulation of such information—can be found in Article 18(2) MAR.

Under the former regime, any breach of these duties made the delay unlawful—even if the inside information was not leaked. This is still true for the duties implied in Article 4(1)(c) Commission Implementing Regulation (EU) No. 2016/1055 as they are referred to as serving to fulfil the conditions for delay according to Article 17(4) MAR. Issuers must also comply with these duties to make a delay according to Article 17(5) MAR lawful. As the obligation to take all reasonable steps to ensure that the duties ensuing from inside information are acknowledged by any person involved is no longer designed as a part of the delay mechanism, breaches do not result in a breach of confidentiality (but are subject to sanctions under the rules for insider lists). 62

The BGH and the OLG Stuttgart had to examine the obligation to take measures to ensure that the duties ensuing from inside information are acknowledged by any person involved in the case of *Geltl*.[111] The OLG Stuttgart ruled that this obligation also existed towards members of the board even though these were bound to confidentiality through their position. It argued that only persons with a general obligation to confidentiality are allowed access to inside information. The required instruction takes this into account and aims at further information in order to ensure that the insider is reminded of his obligations as an insider and the sanctions for breaches of these obligations. In case the insider is not instructed duly, the issuer may entail **civil liability**, as the BGH—dissenting from the OLG Stuttgart—does not allow the issuer to refer to the fact that even if it had acted correctly, it would only have instructed the respective person, but would not have disclosed the respective information sooner. 63

If inside information is leaked to the public and confidentiality is therefore no longer ensured, the issuer must promptly make a complete disclosure of that information. Although there may be other indicators for a leak, such as unusual developments of the stock exchange price or trade volume, the focus lies on **rumours**. While Article 6 MAD 2003 did not directly address this issue, Article 17(7) subsec. 2 MAR obliges issuers to disclose the inside information immediately—both in cases of a general delay or a delay to preserve the stability of the financial system—where a rumour explicitly relates to that inside information and is sufficiently accurate to indicate that the confidentiality is no longer ensured.[112] ESMA has specified that the disclosure obligation is triggered whether the leak comes from the sphere of the issuer or not. Otherwise, disclosure might be delayed further due to the potentially time-consuming search for the source of the leak.[113] 64

[111] BGH of 23.4.2013 – II ZB 7/09, ZIP (2013), 1165, 1170; OLG Stuttgart of 22.4.2009 – 20 Kap 1/08, ZIP (2009), 962, 969, 972.

[112] On the reform proposal see C. Di Noia and M. Gargantini, ECFR (2012), 484, 521 ff.

[113] ESMA/2015/1455 (fn. 77), para. 243.

65 This puts an end to a long discussion on this point and to the practice in some Member States, such as Germany where the BaFin[114] had a more generous approach towards rumours. When such rumours arise, the issuer can no longer rely on a 'no comment policy' as was widely accepted before.[115] Issuers should therefore reconsider their communication strategy with a view to potential upcoming inside information. As neither the European legislator nor ESMA[116] specify when a rumour fulfils these requirements, especially when it is 'sufficiently accurate', there is a risk that divergent national practices will persist.

(d) Decision by the Issuer

66 Under the MAD 2003 regime, literature discussed the question of whether it was sufficient if the requirements for a delay were given,[117] or whether the issuer additionally had to make a conscious decision to this end.[118] The issuer might in particular fail to make a conscious decision in a protracted process that occurs in stages if it realises too late that certain information qualifies as inside information. In the civil proceedings in *Geltl* the OLG Stuttgart ruled[119] that a delay in disclosure did not necessarily require the issuer's conscious decision. However, the BGH, in its appeal decision, and the OLG Frankfurt, entrusted with the supervisory proceedings in the same case, left the question unanswered.[120]

67 Under the MAR regime, the question must be decided unambiguously. The wording of Article 17(4) subsec. 1 MAR indicates that European law requires a conscious decision: If 'an issuer *may* […] delay' disclosure, this constitutes an action which necessitates an underlying decision.[121] Article 17(4) subsec. 3 MAR also implies a conscious decision: an issuer who is unaware of the fact that it has been delaying disclosure cannot inform the competent authority of the delay and explain it. Article 4(3)(e) Commission Implementing Regulation (EU) No. 2016/1055 now even explicitly requires the issuer to make a conscious decision and inform the competent authority of its date and time. The reason for this is that ESMA considers this information crucial for potential insider-dealing investigations.[122] As European law requires the conscious decision,[123] national laws cannot free issuers from it.

68 The requirements this decision must meet remain somewhat unclear, although ESMA and the Commission provide orientation through their technical standards which specify which information on the delay has to be given to the competent authority—and which further information has to be maintained as evidence in proceedings.[124] While ESMA apparently

[114] Cf. BaFin, Emittentenleitfaden 2013 (issuer guideline), p. 61. In the 5th edition of its issuer guideline, BaFin now confirms this change of practice.

[115] Cf. CESR, Market abuse Directive Level 3—third set of CESR guidance and information on the common operation of the Directive to the market, May 2009, CESR/09-219, p. 14 ff.

[116] ESMA expressly refused to provide more explanation in the draft technical standard (para. 244) and did not come back on the issue in the guidelines.

[117] OLG Stuttgart of 22.4.2009 – 20 Kap 1/08, ZIP (2009), 962, 973.

[118] BaFin, Emittentenleitfaden 2009 (issuer guideline), p. 59.

[119] OLG Stuttgart of 22.4.2009 – 20 Kap 1/08, ZIP (2009), 962 ff.

[120] BGH of 23.4.2013 – II ZB 7/09, ZIP (2013), 1165, 1169.

[121] Cf. C.H. Seibt and B. Wollenschläger, AG (2014), 593, 600.

[122] ESMA/2015/1455 (fn. 77), para. 232, 239. Dissenting opinion: L. Klöhn, AG (2016), 423, 431 (no clear statement from ESMA).

[123] BaFin, Emittentenleitfaden (issuer guideline), Module C, p. 36; R. Veil, JBB (2014), 85, 93; D. Poelzig, NZG (2016), 762, 765.

[124] Cf. Art. 4 Commission Implementing Regulation (EU) 2016/1055.

sees no obligation under European law that the decision be taken by the management board itself,[125] it does not address global or preventive authorisations to this effect.[126] As Article 17(4) subsec. 2 MAR recognises the particular difficulties in the case of a protracted process which occurs in stages, it should be legitimate at least here to **decide preventively** on the **delay** when the issuer itself does not yet consider the information concerned as inside information. Whilst a separate decision is required for each intermediate step, the issuer may make the decision for several intermediate steps at the same time.

3. Delay Pursuant to Article 17(5) MAR

69 Certain issuers have another option to delay the publication of inside information. The regulation in Article 17(5) MAR goes back to experiences from the financial market crisis (see para. 49). Ad hoc announcements by banks sometimes resulted in drastic share price losses, triggering a bank run and threatening the stability of the financial system.[127] **Credit institutions** and other **financial institutions** may now postpone the publication of inside information if there is a **risk** that the **financial stability** of the **financial system** and the **issuer** will be undermined by disclosure, the delay is in the public interest, confidentiality can be ensured and the competent authority agrees to the postponement.

70 A credit or financial institution has the choice whether to delay disclosure under Article 17(4) or (5) MAR. In the latter case, unlike Article 17(4) MAR, it does not matter whether the postponement of disclosure would be likely to mislead the public. According to the European legislature, efficient price formation is less important than the goal of the stability of the financial system.

71 The right to delay publication pursuant to Article 17(5) MAR exists in the case of inside information entailing a risk of undermining the financial stability of the issuer and of the financial system. Recital 52 MAR gives the following examples: 'information pertinent to temporary liquidity problems, where they need to receive central banking lending including emergency liquidity assistance from a central bank where disclosure of the information would have a systemic impact'. In this context, BaFin considers significant outflows of liquid funds or a significant decrease in equity capital.[128] With regard to the threat to the financial stability of the financial system, BaFin takes into account whether the institution is (globally) systemically important.[129]

V. Obligation to Disclose Inside Information (Article 17 (8) MAR)

72 Article 17(8) MAR extends the disclosure obligation to persons acting on behalf or on account of the issuer and who disclose inside information to third parties in the normal

[125] ESMA/2015/1455 (fn. 77), para. 239 ('eg a managing board member or a senior executive director').
[126] Cf. M. Pfüller, in: Fuchs (ed.), *Kommentar zum WpHG*, § 15 para. 474 ff.
[127] Cf. P. Koch, BB (2012), 1365, 1367 f.; L. Klöhn, 181 ZHR (2017), 746, 753 ff.
[128] BaFin, Emittentenleitfaden (issuer guideline), Module C, p. 41.
[129] BaFin, Emittentenleitfaden (issuer guideline), Module C, p. 41.

course of the exercise of their employment, profession or duties. In legal practice, this provision is of little importance.[130] In general, the issuer will in these cases also be subject to a disclosure obligation due to the fact that it can no longer ensure that the information remains confidential.[131] This disclosure obligation is intended to ensure equal access to information for all capital market participants.[132] It may become relevant if the issuer has delayed disclosure due to the existence of legitimate interests pursuant to Article 17(4) or (5) MAR or Article 17(1) MAR is not applicable because the inside information does not directly relate to the issuer.

VI. Supervision

73 One of the main novelties of the MAR regime when compared to the former MAD 2003 are the much more detailed and stricter rules on supervision and sanctions. According to Articles 22 ff. MAR, it is still the national supervisory authorities who are responsible for ensuring that the regulation's provisions are applied correctly. They must follow the same rules as for insider trading.[133]

VII. Sanctions

1. Administrative and Criminal Measures and Sanctions

74 Unlike under Article 14(1) MAD 2003 when Member States were only required to 'ensure, in conformity with their national law, that the appropriate administrative measures can be taken or administrative sanctions be imposed against the persons responsible where the provisions adopted in the implementation of this Directive have not been complied with', Articles 30 ff. MAR contain very detailed rules on administrative sanctions. Uncommonly within a regulation, these rules need to be implemented into national law.

75 Pursuant to Article 30(2)(i)(ii) MAR, the maximum fine for an infringement of Article 17 MAR must be at least € **1 million** in respect of a natural person. For a legal person, the maximum fine must be at least € **2.5 million or 2% of its total annual turnover** according to Article 30(2)(j)(ii) MAR. In the case of corporate groups, the relevant turnover is that of the ultimate parent undertaking, pursuant to Article 30(2) subsec. 3 MAR. Although the level of fines may still vary considerably amongst the different Member States, these rules have brought about major changes for some European countries: In 2008, maximum

[130] Cf. L. Klöhn, WM (2010), 1869 ff.
[131] See para. 61.
[132] L. Klöhn, WM (2010), 1869; H.-D. Assmann, in: Assmann/Schneider/Mülbert, *Kommentar zum Wertpapierhandelsrecht*, Art. 17 MAR para. 285.
[133] See R. Veil § 14 para. 96–110.

sanctions ranged from € 100 in Bulgaria and Finland to € 2.5 million in Ireland, Portugal and Belgium, whilst the United Kingdom[134] did not restrict the level of fines.[135]

Article 34(1) MAR requires the competent authorities to **publish** any **decision** imposing an **administrative sanction** or other administrative measure in relation to an infringement of the MAR on their website immediately after the sanctioned person has been informed of the decision. When the decision is subject to an appeal, it must still be published immediately, as Article 34(2) MAR explicitly addresses this case and limits the sanctioned person's rights to having information on the appeal and its outcome published in the same way. The European legislator put remarkable emphasis on this instrument known as 'naming and shaming'. Under the MAD 2003 regime, such disclosure was left to the competent authorities' discretion—and rarely applied in some Member States. After long debates, the publication of any sanction is now **mandatory** and has to be carried out **immediately**. Due to concerns regarding the proportionality of the publication, especially if natural persons are being sanctioned, Article 34 MAR allows for several exceptions including a delay of the publication and a publication on an anonymous basis. 76

Article 34 MAR does not explain why a decision should be made public. Recital 73 MAR mentions the dissuasive effect and the information of market participants of behaviour which is considered an infringement. This seems to follow the French concept: In France, all sanctions were made public on the AMF's website pursuant to Article L. 621–15-V C. mon. fin., even before the MAD 2003 was enacted. The publication of sanctions has also been recommended with regard to the directives based on the Financial Services Action Plan.[136] In 2007 the Conseil d'État ruled that the disclosure of imposed sanctions constitutes a sanction in itself. It does not require the decision to have full legal effect before it is made public in order to comply with the presumption of innocence.[137] The publication must, however, follow the principles of legality and proportionality. The AMF regards naming and shaming as particularly effective, as a deterrent to others and because it helps market participants understand which behaviour is seen critically. This is exactly the MAR's position. 77

Criminal sanctions and civil liability are not directly addressed.[138] **Member States** are therefore **free** not to sanction breaches by criminal or civil law at all.[139] However, Member States are free to impose stricter sanctions.[140] This means that they may choose to sanction breaches of the disclosure obligations for inside information also by **criminal law**.[141] But criminal sanctions for breaches of the disclosure obligations for inside information play a subordinated role in Europe. Under the MAD 2003 regime, breaches were only sanctioned under criminal law in 9 out of 29 CESR Member States, possible penalties reaching from 78

134 For examples of FSA enforcement action see B. McDonnell, 88 COB (2011), 1, 15 ff.

135 Cf. CESR, Executive Summary to the Report on Administrative Measures and Sanctions and the Criminal Sanctions available in Member States under the Market Abuse Directive (MAD), February 2008, CESR/08-099, p. 5, 10; see also the individual descriptions on p. 34 ff.

136 Cf. P.-H. Conac, 1 RTDF (2006), 128 ff.

137 Cf. G. Roch, Bull. Joly Bourse (2008), 204, 207. Seen critically by N. Rontchevsky, 1 RTDF (2008), 86 ff.

138 The CRIM-MAD does not prescribe to implement criminal sanctions for breaches of the disclosure obligations, either.

139 Dissenting opinion: A. Hellgardt, AG (2012), 154, 162 ff.; sceptically (as herein) K.J. Hopt, WM (2013), 101, 111. See also R. Veil § 12 para. 23–25.

140 See R. Veil § 12 para. 12.

141 Cf. D. Verse, RabelsZ 76 (2012), 893, 896.

fines of € 5,000 in Ireland to a maximum prison sentence of eight years in Italy.[142] Whilst criminal liability does not require a special provision but can rather be based on the general provisions for pecuniary offences, it appears of little importance in legal practice. As the CRIM-MAD does not address breaches of the obligation to disclose inside information according to Article 17 MAR, no major changes are to be expected concerning criminal sanctions.

79 As the (implementing) rules on sanctions and their application into practice continue to fall within the Member States' responsibility, sanctioning breaches of disclosure obligations for inside information is still largely a matter of national law. Member States are able to pursue their national approaches to enforcement which make use of and combine various sanctions under civil, administrative and criminal law in very different ways.

2. Civil Liability

80 The MAR does not provide for any rules on liability for damages on the part of the issuer and/or members of management due to breaches of the ad hoc disclosure obligation. The legal situation in Europe is therefore different.[143] This is also due to the fact that Member States have different traditions and ideas about the purpose of private enforcement. It is seen as problematic, above all, that ultimately the existing shareholders bear the financial burden of incorrect ad hoc disclosure, as they bear the financial disadvantages of a liability claim against the issuer. If liability for damages is to pursue preventive purposes, it should be possible to bring claims against the members of the management. Liability for damages would then have the greatest possible preventive effect. Addressing the claims for damages to the managers would also have the advantage that the existing shareholders, who are typically uninvolved in the breach of the ad hoc obligation, would not suffer any financial damage. However, national legislators are reluctant to do so because external liability could have prohibitive effects and managers could find the office of managing director in listed companies unattractive. Finally, the concept of issuer liability would have to address the risk of over-deterrence. In view of the difficulty in determining ex ante the duties of conduct for issuers, liability for negligence bears the risk of over-enforcement, which would be detrimental to information efficiency. In the United Kingdom, the legislature has therefore set high requirements for issuer liability. Keeping this in mind, it may not be surprising that tort law plays a dominant role in the judicial practice of the Member States.[144]

[142] Cf. CESR, Report on administrative measures and sanctions as well as the criminal sanctions available in Member States under the market abuse directive (MAD), February 2008, CESR/08-099, p. 5, 10; see also the individual descriptions on p. 34 ff.

[143] See on the discussion of whether the principle of effet utile requires recognition of a private right of action by investors, R. Veil § 12 para. 25.

[144] In the Netherlands, a trend has developed to claim damages from issuers and managers. The legal basis lies in tort law. Cf. L. Lennarts and J. Roest, in: Conac/Gelter (eds.), *Global Securities Litigation and Enforcement*, 491 f. In France, courts also apply tort law, cf. P.-H. Conac, in: Conac/Gelter (eds.), *Global Securities Litigation and Enforcement*, 346. Cf. on Italy G. Ferrarini and P. Giudici, in: Conac/Gelter (eds.), *Global Securities Litigation and Enforcement*, 455.

(a) Germany

As there will generally be no contractual relationship between the investor and the issuer or its management, liability for breaches of the obligation to disclose inside information will usually be based on tort law or the special provisions in §§ 119, 120 WpHG. In **tort law**, liability is attached either to the violation of a protected right or interest in § 823(1) BGB, the infringement of a protective law in § 823(2) BGB or an intentional damage contrary to public policy in § 826 BGB. As breaches of the disclosure obligation result in pure economic losses and § 26(3) sentence 1 WpHG excludes the applicability of § 823(2) BGB, tortious liability for incorrect or omitted publications of inside information is usually restricted to § 826 BGB.[145] This provision prescribes compensation for intentional damages: A person who, in a manner contrary to public policy, intentionally inflicts damage on another person is liable to the other person to make compensation for the damage. The case of *Infomatec* is one of the BGH's leading cases on § 826 BGB in which the court set out the basic requirements for a tortious liability for incorrect information. 81

Facts (abridged):[146] Infomatec AG published the information that a mobile telephone network provider had placed an order for wifi hubs and their licences with a total order volume of more than DM 55 million as inside information. In fact, the binding order the customer had placed only had an order volume of DM 9.8 million. Immediately after the publication the share price rose by 20%. Two months later an investor acquired shares at this high share price, which dropped considerably in value after it became public that the information was incorrect. 82

The BGH held the **members** of the **board of directors** liable for the damage suffered, arguing that the **conscious publication** of **incorrect information** was **contrary to public policy** and immoral. The BGH was of the opinion that management had published the information intentionally in order to induce investors to acquire shares at an extortionate price. The BGH justified the immorality on the grounds that the board members had intentionally deceived investors by issuing a grossly inaccurate ad hoc announcement. 83

The BGH developed this line of argumentation towards a tort liability for the publication of incorrect information further in *EM.TV*[147] and *Comroad*.[148] Both the issuer (§§ 826, 31 BGB) and the members of the management board responsible for the disclosure (§ 826 BGB) can be held liable. In legal practice, the personal liability of the members of the management will be more relevant for investors, as the issuer itself will often be insolvent—as in *Infomatec*. 84

Requiring full **proof of causation** between the incorrect information and the investor's decision to acquire the shares is seen particularly critically, as this is usually nearly impossible 85

[145] Cf. M. Brellochs, *Publizität und Haftung*, 109 ff., 144 ff.; A. Hellgardt, *Kapitalmarktdeliktsrecht*; S. Richter, *Schadenszurechnung bei deliktischer Haftung für fehlerhafte Sekundärmarktinformation*; K. Sauer, *Haftung für Falschinformation des Sekundärmarktes*.

[146] BGH of 19.7.2004 – II ZR 218/03, BGHZ 160, 134 ff. (*Infomatec I*); BGH of 19.7.2004 – II ZR 402/02, BGHZ 160, 149 ff. (*Infomatec II*).

[147] BGH of 9.5.2005 – II ZR 287/02, NZG (2005), 672 ff. (*EM.TV*).

[148] BGH of 28.11.2005 – II ZR 80/04, NZG (2007), 345 f.; BGH of 28.11.2005 – II ZR 246/04, NZG (2007), 346 f.; BGH of 26.6.2006 – II ZR 153/05, NZG (2007), 269 ff.; BGH of 4.6.2007 – II ZR 147/05, NZG (2007), 708 ff.; BGH of 4.6.2007 – II ZR 173/05, NZG (2007), 711 ff.; BGH of 7.1.2008 – II ZR 229/05, NZG (2008), 382 ff.; BGH of 7.1.2008 – II ZR 68/06, NZG (2008), 385 f.; BGH of 3.3.2008 – II ZR 310/06, NZG (2008), 386 ff.(*Comroad I-VIII*).

for the investor. The BGH nonetheless grants no alleviation of the burden of proof, arguing that the decision to acquire shares requires the decision of an individual person and cannot be generalised.[149] The BGH further does not accept the US 'fraud on the market theory', according to which the general deception of investor confidence in the integrity of market prices constitutes liability, purporting that this would lead to an interminable applicability of § 826 BGB.[150] As opposed to this, the issuer may be held liable if an investor has abstained from disposing of his shares on the basis of incorrect information resulting from a breach of the disclosure obligation.[151]

86 The nature of claimable damages was also unclear. Specific performance pursuant to § 249 BGB, ie the reimbursement of the acquisition price and the return of the shares or—should the shares meanwhile have been disposed of—payment of the difference between the acquisition and disposal price, subjects the defendant to the risk of all price fluctuations. It would therefore appear more reasonable to restrict the damages to the difference between the acquisition price and the price that would have developed if the information had been disclosed correctly. The BGH, however, sees the damage in any detriment to a legitimate interest or exposure to an undesired legal obligation, allowing restitution and therefore not restricting the investor's claims to the difference between the actual and the hypothetical acquisition price. If the investor only claims the latter, the exact amount of damages must be determined according to the methods of modern finance. In this procedure the damages are determined on the basis of the difference in price after the true facts have become known. According to the BGH, the judge will in certain cases have to estimate the damages on the legal basis of § 287 Zivilprozessordnung (ZPO—German Civil Procedure Code).[152]

87 Restitution must further be seen critically with regard to the provisions on capital maintenance in §§ 57 ff. AktG and the restricted possibilities of an issuer to acquire his own shares, pursuant to § 71 AktG. Yet the BGH has given restitution priority over the special rules on company law in cases of intentional damage contrary to public policy, arguing that the investor may not be treated differently from a third-party creditor of the issuer if it acquired the shares on the secondary market. The issuer's liability could therefore not be restricted to the issuer's free assets. The acquisition of the shares by the issuer only takes place more or less by chance if the issuer decides not to dispose of the shares to a third party and claim the difference in price from the issuer, but rather to claim the full amount from the issuer.[153] Equally, the ECJ has stated that such priority to restitution is compatible with the Capital Maintenance Directive 77/91/EEC.[154]

88 In 2002 the German legislator further introduced **special rules** on the **liability** for **incorrect** or **omitted inside information** in §§ 37b, 37c WpHG (later transferred into §§ 119, 120 WpHG), which have meanwhile led to a number of proceedings.[155] § 119 WpHG constitutes a liability for the omission to disclose inside information, whilst § 120 WpHG applies to the publication of incorrect inside information. The provisions only concern the issuers

[149] Cf. BGH of 19.7.2004 – II ZR 218/03, BGHZ 160, 134, 144 (*Infomatec I*).
[150] BGH of 26.6.2006 – II ZR 153/05, NZG (2007), 269 (*Comroad III*).
[151] BGH of 9.5.2005 – II ZR 287/02, NZG (2005), 672, 675 (*EM.TV*).
[152] BGH of 9.5.2005 – II ZR 287/02, NZG (2005), 672 ff. (*EM.TV*); BGH of 19.7.2004 – II ZR 218/03, BGHZ 160, 134 et ff. (*Infomatec I*).
[153] BGH of 9.5.2005 – II ZR 287/02, NZG (2005), 672, 674 (*EM.TV*); BGH of 26.6.2006 – II ZR 153/05, NZG (2007), 269, 270 (*Comroad III*).
[154] ECJ of 19 December 2013, Case C-174/12 (*Hirmann*), ZIP (2014), 121 ff. with regard to the prospectus disclosure obligations. See R. Veil § 17 para. 93.
[155] Cf. BGH of 17.12. 2020 – II ZB 31/14, ZIP 2021, 346, 366; BGH of 13.12.2011 – XI ZR 51/10 (IKB), BGHZ 192, 90 ff. (*IKB*).

of financial instruments that have been admitted to trading on a domestic stock exchange. The management can be held responsible by the company pursuant to § 93 AktG.

89 According to § 119 WpHG the **issuer** is to be held **liable** if the investor bought the financial instruments after the omission and still owns the financial instruments upon disclosure of the information, ie paid too high a price due to the omission to disclose the negative information. The issuer is further to be held liable if the investor bought the financial instruments before the existence of the relevant inside information and sells them after the omission at too low a price due to the omission to disclose the positive information. § 119 WpHG declares the issuer to be held liable if the investor made the investment decision because it relied on the false information, if the issuer acted with intent or gross negligence and the investor has incurred damages. This can be the case if the investor bought the financial instruments after publication due to the overly positive impression given and still owns the financial instruments at the point in time at which it becomes publicly known that the information was inaccurate. Such is also the case if it bought the financial instruments before publication and sold them at too low a price before it became clear that the information was inaccurate because of the unduly negative impression the information gives.

90 §§ 119(2), 120(2) WpHG exempt the issuer from liability if it can prove that it acted neither with intent nor with gross negligence. A similar reversal of the burden of proof concerning causation[156] between the breach of the disclosure obligation and the investment decision does not, however, exist.[157] As in § 826 BGB, the BGH allows the investor to claim restitution and does not restrict claims to the difference between the actual and the hypothetical acquisition price.[158]

91 During the subprime crisis investors argued that the issuer's involvement in certain securities—directly or via special-purpose vehicles—should have been disclosed as inside information. The BGH[159] shared this view and ruled that the issuer had to reimburse the acquisition price if the investors could prove that they would not have purchased the shares if the issuer had disclosed his involvement in the usual way. If the investors could not prove causation, they could still claim the difference between the actual and the hypothetical acquisition price. At the same time, the BGH argued that §§ 119, 120 WpHG could not be applied analogously to simple press releases as no gap in the law in this respect existed.[160]

(b) Austria

92 The Austrian OGH—unlike the German legislator—regards the obligation to disclose inside information as a **protective rule**, aimed directly at the protection of investors, thereby enabling claims based on § 1311 ABGB (Austrian General Civil Code) in cases of negligence.[161] Damages for the intentional publication of incorrect information can be claimed on the

[156] Cf. on this discussion R. Veil, ZHR 167 (2003), 365, 370 with further references.

[157] BGH of 13.12.2011 – XI ZR 51/10, BGHZ 192, 90, 115 f. (*IKB*).

[158] BGH of 13.12.2011 – XI ZR 51/10, BGHZ 192, 90, 109 ff. (*IKB*).

[159] BGH of 13.12.2011 – XI ZR 51/10, BGHZ 192, 90 ff. (*IKB*).

[160] Confirmed in OLG Braunschweig of 12.1.2016 – 7 U 59/14, ZIP (2016), 414 ff. (*Porsche*); OLG Stuttgart of 26.3.2015 – 2 U 102/14, WM (2015), 875 ff. (*Porsche/Volkswagen*).

[161] OGH of 15.3.2012 – 6 Ob 28/12d, ÖBA 2012, 548, 550; OGH of. 24.1.2013 – 8 Ob 104/12w, ÖBA 2013, 438; S. Kalss et al. (eds.), *Kapitalmarktrecht I*, § 16 para. 99, § 20 para. 16; S. Kalss, ZBB (2013), 126, 131.

basis of § 1300 ABGB and § 1295(2) ABGB, the latter applying to intentional behaviour contrary to public policy.[162] The Austrian approach further understands the obligation to disclose inside information as a special legal relationship between issuer and investor that may lead to a liability for negligent breaches of this obligation on the basis of the concept of *culpa in contrahendo*.[163] Austrian law also accepts the possibility of damages pursuant to § 2 öUWG (Austrian Act against Unfair Practices). Generally, damages cannot be claimed from the issuer's bodies directly; rather the issuer itself is held liable for their behaviour pursuant to § 26 ABGB.[164]

93 Damages may be claimed not only by investors who have acquired of disposed of shares to their detriment, but in some cases also by investors who simply still hold the respective shares.[165] Potential investors that abstained from acquiring the shares due to an incorrect or omitted ad hoc notification only lose the opportunity to make profits. This opportunity is not recoverable.[166]

94 Although the proof of causation in the case of breaches of a protective law is generally facilitated under Austrian law, the breach of the obligation to disclose inside information does not entail any particular alleviation for the investor's proof of causation.[167] Generally, breaches of the modalities of disclosure can also entitle the investor to damages. In these cases causation will, however, be particularly difficult to prove.[168]

95 As in Germany, investors may generally claim specific performance, meaning the reimbursement of the acquisition price in exchange for the return of the shares. Yet, this principle is watered down considerably as the OGH also sees the risk of overcompensation if the general market risk is shifted to the issuer. The OGH therefore deducts any advantages resulting from the contract's unwinding.[169] As in Germany, these claims are not regarded as being contrary to the principle of equal treatment (§ 47a öAktG (Austrian Stock Corporation Act), § 83 BörseG), the prohibition to retransfer capital contributions (§ 52 öAktG) or the prohibition for the issuer to buy back its own shares (§ 65 öAktG).[170]

(c) United Kingdom

96 In the United Kingdom, a legal foundation for investors' claims for damages was introduced into the FSMA on 1 October 2010.[171] Section 90A in conjunction with Schedule 10A establishes a liability of the issuer for any incorrect, misleading or delayed information or the

[162] S. Kalss et al. (eds.), *Kapitalmarktrecht I*, § 20 para. 15.
[163] S. Kalss et al. (eds.), *Kapitalmarktrecht I*, § 16 para. 99.
[164] S. Kalss et al. (eds.), *Kapitalmarktrecht I*, § 20 para. 10; on court decisions in the wake of the financial crisis, cf. S. Kalss, ZBB (2013), 126 ff.
[165] S. Kalss et al. (eds.), *Kapitalmarktrecht I*, § 19 para. 24–25.
[166] S. Kalss et al. (eds.), *Kapitalmarktrecht I*, § 19 para. 27.
[167] S. Kalss et al. (eds.), *Kapitalmarktrecht I*, § 20 para. 23 ff.
[168] S. Kalss et al. (eds.), *Kapitalmarktrecht I*, § 20 para. 11.
[169] OGH of 15.3.2012 – 6 Ob 28/12d, ÖBA (2012), 548, 552; on this see K.J. Hopt, WM (2013), 101, 107; S. Kalss, ZBB (2013), 126, 131 ff.
[170] OGH, ÖBA (2012), 548, 549, 552.
[171] The amendments were implemented by the Financial Services and Markets Act 2000 (Liability of Issuers) Regulations 2010; for more detail see L. Gullifer and J. Payne, *Corporate Finance Law*, 586–592; K.J. Hopt, WM (2013), 101, 105; D. Verse, RabelsZ 76 (2012), 893 ff.

omission to publish the information.[172] Any person who possesses, acquired or disposed of shares based on the belief that the published information was complete and correct is entitled to claim damages pursuant to this provision.[173] The burden of proof has not been facilitated for investors—in particular the US 'fraud on the market theory' is not applicable. A further requirement in cases of incorrect or incomplete information is that the issuer intentionally or recklessly failed to disclose the information correctly. If the publication was omitted entirely, the issuer is only held liable for intent.[174]

As a result, the hurdles for civil liability are high, which is justified by the trust in effective enforcement through the public authorities.[175] The reservations about private enforcement can also be explained by concerns about opportunistic lawsuits and disruptive developments for companies, as well as the observation that secondary market liability would ultimately only mean a transfer of wealth from the company to the shareholders bringing the lawsuit (pocket shifting).[176] 97

(d) Other Member States

In other Member States civil liability towards investors appears to play a less important role.[177] None of the other Member States seems to provide a special legal foundation for damages based on a breach of disclosure obligations or to have published court decisions on this matter. The legal literature gives little attention to this question, although in general the possibility to claim damages under tort law appears to be accepted.[178] 98

In Spain, a liability under tort law is possible pursuant to Article 1902 CC (Spanish Civil Code), although in legal practice the claim will be met by strict requirements and the outcome will usually be uncertain.[179] Whilst the general rule on a liability for torts in France, Article 1382 C. civ. (French Civil Code), would also be applicable to these circumstances, it has not as yet played any role in legal practice.[180] In both states the discussion is mostly combined with that on a liability for breaches of the periodic disclosure obligations, ie under the generic term of a liability for incorrect information on the secondary market.[181] Whilst 99

[172] Cf. L. Gullifer and J. Payne, *Corporate Finance Law*, 587; R. Veil and M. Wundenberg, *Englisches Kapitalmarktrecht*, 112. The scope of application is much larger, though, cf. D. Verse, RabelsZ 76 (2012), 893, 902 ff.; M. Wundenberg, ZGR (2015), 124, 145.

[173] Sec. 90A schedule 10A(3) and (5) FSMA.

[174] Sec. 90A schedule 10A(3) FSMA states: 'The issuer is liable in respect of the omission of any matter required to be included in published information only if a person discharging managerial responsibilities within the issuer knew the omission to be a dishonest concealment of a material fact.'

[175] Cf. I. Chiu, in: Conac/Gelter (eds.), *Global Securities Litigation and Enforcement*, 627, 643; D. Verse, RabelsZ 76 (2012), 893, 919; M. Wundenberg, ZGR (2015), 124, 146.

[176] Cf. I. Chiu, in: Conac/Gelter (eds.), *Global Securities Litigation and Enforcement*, 627, 643; L. Gullifer and J. Payne, *Corporate Finance Law*, 591.

[177] The legal situation in the European Union is described in P.-H. Conac and M. Gelter (eds.), *Global Securities Litigation and Enforcement* (2019), Part III.

[178] Cf. on court decisions in France P.-H. Conac, in: Conac/Gelter (eds.), *Global Securities Litigation and Enforcement* (2019), 331, 346.

[179] Cf. G.J. Sastre Corchado, 1 RMV (2007), 253, 254.

[180] Cf. P.-H. Conac, in: Conac/Gelter (eds.), *Global Securities Litigation and Enforcement* (2019), 331, 346 on claims against issuers and 347 ff. on claims against third parties.

[181] Cf. M. Iribarren Blanco, *Responsabilidad civil por la información divulgada por las sociedades cotizadas*, passim.

Italian legal literature also discusses the tort liability of issuers and the management, no legal practice to this regard is apparent.[182] Similarly, Swedish legal literature acknowledges the applicability of the general provisions of tort law, although legal practice has not yet adopted this approach.[183]

VIII. Conclusion

100 Ad hoc disclosure of inside information has had a dual function since the 1989 reform. Conceptually, the unified approach for the prohibitions on insider trading and the disclosure of inside information, orientated towards the term 'inside information', remains critical, not all information relevant for insider trading prohibitions necessarily requiring disclosure obligations. The European legislator missed the chance to extract the disclosure obligation from the market abuse regime and regulate it together with the other transparency obligations. Thus, the link to the insider trading prohibition via the uniform basic concept of inside information remains a weak point of the MAR regime. The expansion of the concept of inside information subject to disclosure has led to issuers increasingly making use of the right to delay publication due to legitimate interests. This gives rise to a fundamental reform of ad hoc disclosure.

101 De lege lata, the concept of inside information requires further clarification. This is already of central importance for the application of insider prohibitions, but also becomes relevant in the case of ad hoc disclsoure. If one accepts that a reasonable investor is willing to take irrational behaviour into account (as jurisprudence does!), the fulfillment of the ad hoc disclosure obligation becomes an almost impossible task for issuers. Furthermore, the right of the issuer to delay disclosure should be put into more concrete terms. In order to achieve more legal certainty, it will be essential to develop an accurate understanding of the issuer's interest. The consequence of diverging interpretations of the basic terms is that a uniform practice throughout Europe is a distant prospect. ESMA's MAR guidelines are in need of improvement and should be further developed.

102 In Europe, ad hoc disclosure is mainly enforced by administrative sanctions imposed by the national supervisory authorities. It is still too early to evaluate the more stringent MAR regime. Whilst private enforcement plays a major role in the US, this is not the case in Europe. Indeed, most Member States do not pursue any particular strategies in this respect, but rely on the general rules of tort law. However, in Austria and Germany private liability of an issuer due to incorrect or omitted publication of inside information is not only inspired by the idea of compensation, but also has a deterrent effect. It is advisable to harmonise the divergent approaches of the Member States and develop a common understanding of private enforcement throughout Europe.[184]

[182] Cf. G. Ferrarini and M. Leonardi, in: Hopt and Voigt (eds.), *Prospekt- und Kapitalmarktinformationshaftung*, 720; on the legal basis G. Ferrarini and P. Giudici, in: Conac/Gelter (eds.), *Global Securities Litigation and Enforcement*, 446, 454 and 464 on the SCI case, establishing a 'disclose or abstain' obligation, based on principles of Italian civil law and European capital markets law.

[183] Cf. R. Veil and F. Walla, *Schwedisches Kapitalmarktrecht*, 87.

[184] Cf. R. Veil, in: Gsell/Möllers, *Enforcing Consumer and Capital Markets Law*, 405 ff.

§ 29

Foundations

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I. Introduction

Investors usually carry out the acquisition and sale of securities with the assistance of banks and other investment firms. For three decades, the EU has pursued the goal of protecting investors who use investment services. The legal framework has grown tremendously during this time. There are many reasons for this. Securities investment is of paramount importance to retail investors, who are increasingly relying on it to provide for their old age. Traditional investments are practically out of the question in a zero-interest environment. Retail investors have a special need for protection because they are often unable to assess the quality of the financial product. They therefore depend on investment services being provided in a way that is in their best interest. Experience shows that this is not always the case. In addition, increasingly complex financial products pose a threat to financial stability.[1] Finally, legal harmonisation for 27 Member States means that the rules are becoming more detailed. 1

Regulatory strategies have become more diverse over the past three decades. Directive 93/22/EEC was limited to requiring investment firms to be authorised by the supervisory authority before the commencement of business. It also provided for rules of conduct that ensured investor protection primarily through information. These rules went into impressive detail in 2004 (with MiFID I replacing Directive 93/22/EEC) and 2014 (with MiFID II replacing MiFID I and the PRIIPs Regulation being adopted). The information model, which has 2

[1] Cf. recital 37 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (MiFID II).

only been successful to a limited extent, is now also supplemented by product governance requirements and product intervention measures.

3 The European legislature implemented reforms regarding this 'cornerstone of financial market integration in Europe' in order to comply with the resolutions passed at the G20 summit in Pittsburgh on 24/25 September 2009 on effective responses to the causes of the financial crisis. The crisis had disclosed weaknesses in the regulation of financial instruments other than shares. Furthermore, financial innovations and the increasing complexity of financial instruments had shown that investor protection needed to be improved. Reforms were also necessary due to the fact that the strongly competitive environment had led to new challenges. Other provisions of MiFID I were outdated due to market and technological developments.[2]

4 The market for investment firms is competitive. The EBA found that, in 2015, there were more than 6,500 investment firms in Europe. However, half of these were from the United Kingdom. With Brexit, the number of authorised firms has therefore decreased significantly. The range of services investment firms typically offer is wide. Investment brokerage, investment advice and asset management are the most important.[3]

II. Legal Framework

1. Supervisory Law

5 The legal foundations for financial services supplied by investment firms are largely supervisory law. Compliance with these rules is supervised by the NCAs, and infringements are subsequently also sanctioned by the NCAs, eg by way of fines. The supervisory provisions themselves are meanwhile to be found more or less entirely at a European level (maximum harmonisation). Supervisory law for investment firms consists of three regimes. The MiFID II regime – in the form of a directive (**MiFID II**)[4] and a regulation (**MiFIR**)[5] as well as numerous Level 2 and 3 measures – provides requirements for the authorisation and activities of investment firms. The body of rules and regulations is enormous: It comprises legal texts of more than 7,000 pages!

(a) The MiFID II Regime

6 **MiFIR** establishes uniform requirements in relation to (i) the disclosure of trade data to the public, (ii) the reporting of transactions to the NCAs, (iii) the trading of derivatives

[2] Cf. Commission, Explanatory Memorandum on the Proposal for a revision of MiFID, 20 October 2011, COM (2011) 656 final, p. 2.

[3] Cf. EBA, Report on Investment Firms, EBA/Op/2015/20, p. 97.

[4] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, OJ L 173, 12 June 2014, p. 349–496.

[5] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012, OJ L 173, 12 June 2014, p. 84–148.

on organised venues, (iv) non-discriminatory access to clearing and to trading in benchmarks, (v) product intervention powers of the NCAs and the ESAs, and (vi) the provision of investment services by third-country firms.[6] MiFIR is a regulation and therefore directly applicable in the Member States. The European legislator has adopted a regulation instead of a directive because this is a more suitable form of action to transfer direct supervisory powers to ESMA and EBA. A regulation is furthermore better able to prevent supervisory arbitrage and ensure uniform competitive conditions.

MiFID II establishes requirements in relation to (i) the authorisation and operating conditions for investment firms, (ii) the provision of investment services by third-country firms, (iii) the authorisation and operation of regulated markets, (iv) the authorisation and operation of data reporting services and (v) supervision, cooperation and enforcement by NCAs.[7] 7

The MiFID II regime (consisting of the MiFIR and MiFID II) applies to investment firms. An **investment firm** is a legal person that provides one or more investment services to third parties and/or performs one or more investment activities on a professional basis in the ordinary course of its business or profession. **Investment services** and activities means any service and activity listed in Section A of Annex I that relates to a financial instrument,[8] namely (1) the reception and transmission of orders, (2) the execution of orders on behalf of clients, (3) dealing on own account, (4) portfolio management, (5) investment advice, (6) the underwriting of financial instruments, (7) the placement of financial instruments, (8) the operation of an MTF, and (9) the operation of an OTF. 8

(b) PRIIPs

The second regime consists of the **PRIIPs Regulation**,[9] which concerns so-called packaged investment products and insurance investment products. The regulation has a 'cross-sectoral approach' because it covers not only traditional financial products but also insurance-linked products.[10] The products offer a maturity value or a surrender value that is fully or partially exposed, directly or indirectly, to market fluctuations. The regime applies to so-called PRIIP manufacturers and persons who advise on or sell PRIIPs. These may be investment firms but also other market participants. 9

The regulatory approach of the PRIIPS Regulation is to require **disclosure**: a basic information sheet (also known as a key information document or KID) must be prepared and made available at the time of the advice or sale. It is intended to enable investors, especially inexperienced and uninformed ones, to understand a (complex!) financial product. For this reason, the regulation provides for detailed requirements regarding the form and content of a basic information sheet. This information document – also referred to as a 'short document' – must be precise, honest and clear and must not be misleading.[11] 10

[6] Cf. Art. 1(1) MiFIR.
[7] Cf. Art. 1(2) MiFID II.
[8] Cf. Art. 4(1) no. 2 MiFID II.
[9] Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products, OJ L 352, 9 December 2014, p. 1–23.
[10] Cf. V. Colaert, in: Busch et al. (eds.), *Capital Markets Union in Europe*, para. 16.25 and 16.84 (who welcomes this approach in principle).
[11] Cf. Art. 6(1) and (4) PRIIPs Regulation.

(c) IFR/IFD Regime

11 The third regime concerns **prudential supervision** of investment firms. Regulation (EU) 2019/2033 (**IFR**) sets out uniform prudential requirements for authorised and supervised investment firms, compliance with which is supervised by national authorities under Directive (EU) 2019/2034 (**IFD**). Large investment firms are subject to the rules of Regulation (EU) 648/2012 (Capital Adequacy Regulation or **CRR**). The IFR regime has its focus on the risks arising from the business activities of investment firms.

12 Investment firms do not accept client funds as deposits and do not grant loans. Their risk profile differs significantly from the risk profile of banks. The **capital requirements** of the IFR/IFD regime are designed to address the firm, client and market risks specific to investment firms. Furthermore, the regime limits concentration risks and counteracts liquidity risks. The new regime is intended to be risk-sensitive. As the supervisory framework is designed to be risk-based, it is not the specific investment service that is the decisive factor, but rather the risk profile that is to be assessed in each individual case on the basis of abstract criteria (so-called K-factors).

13 In addition to initial capital, the IFR/IFD regime also regulates governance aspects that supplement those of MiFID II/CRD IV.[12] Investment firms are subject to a differentiated system of **solvency supervision**, which also includes requirements for internal governance and places obligations on the management board with regard to the company's risk management system and the remuneration policies.

2. Enforcement Mechanisms

14 **Supervisory law** is traditionally enforced by means of administrative law and criminal law. MiFID II and the IFR/IFD regime impose detailed requirements on Member States as to the minimum powers of the national supervisory authorities. They must also ensure that national supervisory authorities can impose fines. In this respect they contain minimum harmonising rules.

15 Additionally, private law applies to financial services, investment advice being rendered on the basis of a contract between the investment firm and the client. The contract determines the mutual rights and obligations. The supervisory authorities are generally not permitted to file claims with regard to clients' rights. Such claims must be asserted by the clients themselves before the national courts. As of yet, the European legislature has not harmonised this field of law. In particular, MiFID II does not contain rules concerning contractual terms and obligations. The legal relationships under private law are therefore determined by the applicable national regimes. They are of paramount importance in practice. Whether the prudential rules also determine the contractual obligations is a fundamental question that is treated differently in the different Member States.[13]

[12] See M. Wundenberg § 34.
[13] See R. Veil § 30 para. 61 ff.

§ 30

Investment Services

Bibliography

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I. Introduction

Many investors lack an overview of financial products as well as the knowledge necessary 1
to assess the (increasingly complex) financial products that may be suitable for them.[1]

[1] Cf. P. Balzer, *Vermögensverwaltung durch Kreditinstitute*, 14.

Investors also have different levels of risk tolerance. They are increasingly dependent on personal recommendations. As a result, they typically use a variety of services when buying or selling securities. An investor may let another person manage his assets (**asset management**); he may obtain advice on the sale and acquisition of financial products (**investment advice**) or on potential contractual partners (**investment brokerage**). In addition, investors are not authorised to close the respective deals.[2] A securities dealer purchases the securities in his own name but for the account of the investor (**commission**). The securities dealer may also acquire the securities for his own account (**proprietary trading**) to then resell them to the investor.

2 The legal framework governing investment services has grown tremendously over the past three decades. This section will cover the regulatory concept of the MiFID II regime in more detail. The focus will be on the requirements for investment firms when manufacturing financial instruments and providing certain investment services, such as investment advice and portfolio management. In addition, this section will examine the obligations under civil law relating to investment advice and asset management.

II. Regulatory Concept of the MiFID II Regime

1. Overview

3 MiFID II applies to investment firms, market operators, data provision services and third-country companies that provide investment services or carry out investment activities through a company branch in the EU.[3] The conditions for the admission and the operation of investment firms, as well as the admission and operation of regulated markets will be discussed in more detail hereinafter.[4]

2. Investment Firms

4 A key condition for the performing of investment services as a regular professional or commercial activity is the prior authorisation by the national supervisory authority.[5] MiFID II stipulates that any such activity is prohibited unless permission is granted. This approval requirement is meant to ensure investor protection and the stability of the financial system.[6]

5 Approval may be granted when the investment firm meets the corporate governance requirements of MiFID II (in particular with regard to the **management body**)[7] and has

[2] At the stock exchanges, investors cannot conduct equity transactions themselves. To enter into a transaction they must mandate someone who is authorised to participate in exchange trading. The details are laid down in the Member States' stock exchange laws.

[3] Cf. Art. 1(1) MiFID II.

[4] Cf. Art. 1(2)(a) and (c) MiFID II.

[5] Cf. Art. 5(1) MiFID II; cf. also M. Lehmann, in: Lehmann/Kumpan (eds.), European Financial Services Law, Art. 5 MiFID II para. 2: 'core principle'.

[6] Cf. recital 37 MiFID II.

[7] Cf. Art. 9 ff. MiFID II. See M. Wundenberg § 34.

sufficient **initial capital**.[8] Furthermore, the investment firm must comply with a wide range of **organisational requirements**[9] ensuring that conflicts resulting from the firm's various activities do not affect the interests of the clients.[10]

6 According to its Annex I, Section A, MiFID II defines **investment services** as (1) the reception and transmission of orders in relation to one or more financial instruments; (2) the execution of orders on behalf of clients; (3) dealing on own account; (4) portfolio management; (5) investment advice; (6) the underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis; (7) the placing of financial instruments without a firm commitment basis; (8) the operation of an MTF; and (9) the operation of an OTF. An investment firm that provides one or more investment services for third parties in the course of its regular professional or commercial activity must comply with the **rules of conduct** of MiFID II provided for in Chapter II when providing these services.

7 In Section B of its Annex I, MiFID II also lists **ancillary securities services**. These are services that are typically related to investment services.[11] In particular, it covers (1) the safekeeping and administration of financial instruments for the account of clients, (2) the granting of credits or loans to an investor to allow him to carry out a transaction in one or more financial instruments, (3) advising companies on capital structure etc., (4) foreign exchange services, (5) investment research and financial analysis and (6) services related to underwriting. When providing these ancillary services, the investment firm must also comply with the MiFID II **rules of conduct**. However, a company does not become an investment firm solely by providing ancillary investment services.

3. Market Operators (Regulated Market)

8 With the notion of a market operator, MiFID II covers people who manage and/or operate the business of a regulated market.[12] A regulated market, like an MTF or OTF, is a trading venue within the meaning of MiFID II.[13] While the operation of an MTF or OTF is covered in MiFID II as an investment service, MiFID II governs regulated markets through an independent regime,[14] which provides for similar regulatory concepts as the regime for investment services. For example, a regulated market requires authorisation.[15] The market operator's management body must comply with certain governance[16] and organisational requirements.[17] Only the aspect of capital resources is regulated relatively liberally.[18]

[8] Cf. Art. 15 MiFID II.
[9] Cf. Art. 16 MiFID II and Art. 25 ff. IFD.
[10] Cf. recital 56 MiFID II.
[11] Cf. C. Kumpan, in: Schwark and Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, § 2 WpHG para. 167.
[12] Cf. Art. 4(1) no. 18 MiFID II; in more detail M. Lehmann, in: Lehmann/Kumpan (eds.), European Financial Services Law, Art. 1 MiFID II para. 9.
[13] See R. Veil § 7 para. 11.
[14] Cf. Title III MiFID II.
[15] Cf. Art. 44 MiFID II.
[16] Cf. Art. 45 MiFID II.
[17] Cf. Art. 47 MiFID II.
[18] Cf. Art. 47(1)(f) MiFID II with the requirement for the admission to listing to continuously have sufficient financial resources.

4. Supervision and Sanctions

9 Compliance with the rules of conduct is supervised by national authorities (NCAs). That is why the rules of conduct are also referred to as supervisory law. MiFID II requires that the authorities have certain powers, in particular the right to inspect documents of all kinds, to request information and to carry out on-site investigations.[19]

10 MiFID II requires the Member States to ensure that administrative sanctions and measures can be imposed in the event of violations of MiFID II.[20] The Member States have to ensure that the authorities consider certain circumstances when exercising their powers, such as the severity and duration of the violation, the degree of responsibility of the person responsible and the person's financial capacity.[21] In addition, the competent authorities must be allowed to immediately make public the decisions imposing an administrative sanction or measure.[22]

III. General Rules of Conduct for Investment Firms

11 MiFID II provides for a specifically tailored regime of obligations when investment firms provide investment services. The rules of conduct take into account the characteristic legal relationships in the various types of investment services. There is a different potential for conflicts with investment advice than there is with asset management. In the case of investment advice, the client makes an investment decision himself, whereas in the case of asset management, the decision is made by the manager. The fiduciary relationship between client and asset manager requires a different regulatory approach. Nevertheless, it makes sense to provide certain basic rules of conduct for all investment services as well as ancillary services. It makes sense generally to stipulate that an investment firm must act carefully and deal appropriately with conflicts of interest.

1. Due Diligence Obligations

12 An investment firm must respect general principles when providing investment and ancillary services. It must act **honestly**, **in good faith** and **professionally in the best possible interests of its clients**.[23] This principle determines the relationship between an investment firm and a client.[24] It is similar with the duties under private law, however, subject to supervision by a public authority. In contrast to civil law, supervisory law does not allow to waive or restrict due diligence obligations.

13 'Honest and in good faith' not only means that an investment company must not commit any pecuniary crimes directly directed at the client's assets,[25] but it must be guided by the model of a prudent businessman who not only strives for profit but also shares a trusting

[19] Cf. Art. 69(2)(a)–(u) MiFID II.
[20] Cf. Art. 70 MiFID II.
[21] Cf. Art. 72 MiFID II.
[22] Cf. Art. 71 MiFID II.
[23] Cf. Art. 24(1) MiFID II.
[24] Cf. K. Rothenhöfer, in: Schwark and Zimmer (eds.), *Kapitalmarkrechts-Kommentar*, § 63 WpHG para. 6.
[25] Cf. K. Rothenhöfer, in: Schwark and Zimmer (eds.), *Kapitalmarkrechts-Kommentar*, § 63 WpHG para. 11.

and loyal relationship with his client.[26] The requirement of professional activity implies that an investment firm must have the necessary expertise,[27] in particular with regard to the financial instruments that are the subject of the investment service.

14 An investment firm must act in the best interests of its client. This does not exclude the investment firm from pursuing its own profit interests.[28] An investment firm can therefore of course ask to be remunerated for its services. But it must ensure that risks for the clients are minimised. The level 1 principles are put into more concrete terms in Articles 58, 64, 65 and 67–69 Delegated Regulation (EU) 2017/565.

15 A central issue when executing orders are the costs and the conditions of the transaction. According to Article 27(1) MiFID II, investment firms shall 'take all sufficient steps to obtain, when executing orders, the best possible result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order.' According to Article 64 Delegated Regulation (EU) 2017/565, these factors are to be determined on the basis of the following criteria: the characteristics of the client including his categorisation as retail or professional; the characteristics of the client order; the characteristics of the financial instruments; the characteristics of the execution venues. However, an investment firm must not ignore the client's ideas; instructions from the clients take priority.[29]

16 The point of reference for the best possible interest is the specific, individual client, rather than an average client. With regard to the client's interest, a variable standard applies.[30] This means that the duty to safeguard interests precisely prohibits an investment firm from disregarding ideas expressed by the customer, even if they are objectively unreasonable.[31] A client does not waive the investment firm's duty to safeguard his interests by insisting on making objectively unreasonable investments. Nevertheless, the client's statements are legally relevant for the firm. The investment firm is obliged to act in accordance with the objectively unreasonable ideas of the client. This is consistent with the fact that the client can choose between a higher and a lower level of protection by opting for a specific client category defined by the asset manager.[32]

2. Obligations in Cases of Conflict of Interest

17 The European legislator has based the rules concerning conflicts of interest on the fact that the increasing range of activities that many investment firms carry out at once has increased the potential for conflicts of interest between these different activities and the clients‘ interests.[33] Article 23(1) MiFID II describes the relationships in which such conflicts can occur: Conflicts of interest can arise between the investment firm—including its management, employees and contractually bound agents, or other persons who are directly or

[26] Cf. I. Koller, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, § 63 para. 17; K. Rothenhöfer, in: Schwark and Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, § 63 WpHG para. 10.

[27] Cf. K. Rothenhöfer, in: Schwark and Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, § 63 WpHG para. 15.

[28] Cf. I. Koller, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, § 63 para. 20.

[29] Cf. Art. 27(1) sentence 2 MiFID and Art. 64(2) Delegated Regulation (EU) 2017/565.

[30] Cf. A. Fuchs, in: Fuchs (ed.), *WpHG*, § 31 para. 35.

[31] Cf. K. Rothenhöfer, in: Schwark and Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, § 63 WpHG para. 35.

[32] Cf. A. Fuchs, in: Fuchs (ed.), *WpHG*, § 31 para. 35.

[33] Cf. recital 56 sentence 1 MiFID II.

indirectly connected to the investment firm—and the firm's clients, as well as between the clients themselves.

18 The exact characteristics of a conflict of interest are not defined by law. In general, it can be stated that there is a conflict of interest when two (or more) parties pursue certain goals, but it is not possible for both parties to do so in full.[34] The MiFID II regime only covers those conflicts that are related to investment services or ancillary services.

19 Conflicts of interest between the client and the investment firm are of a structural nature, especially if the investment firm is a universal bank. The client's interest in executing the order in accordance with his interests may be impaired if the investment firm wants to execute the order itself, ie, from its own portfolio (proprietary trading). It is also in blatant contrast to the client's interests if the investment firm, with knowledge of the customer order, first purchases or sells securities itself (so-called *front running*). It is also problematic if an investment company manufactures securities itself (in-house financial products) and pursues its own sales interest, to which an interest in remuneration is added (hidden benefits).[35]

20 As mentioned, conflicts of interest can also arise between different clients of the same investment firm. It is in the client's interests that his order be carried out on the most favourable terms and at the lowest possible cost. The order of a single client can affect the price formation, so that the following order will be executed at less favourable prices.

21 The MiFID II regime seeks to counter the investment firm's conflicts of interest with **organisational requirements** and **rules of conduct** (two pillars).[36] The first pillar pursues the goal of proactively preventing the occurrence of (avoidable) conflicts of interest and ensuring that the investment firm deals appropriately with the conflicts that do arise. The organisational rules consist primarily of the requirement to take precautions for appropriate measures that prevent conflicts of interest from harming clients' interests.[37] The second pillar of rules of conduct refers to the relationship between the investment firm on the one hand, and the client on the other. It aims to minimise the client's risk exposure by stipulating that conflicts of interest be disclosed.[38] The client should be able to recognise the investment firm's conflict of interest and assess whether and to what extent it may affect the firm's service. Transparency therefore enables the client to make an appropriate investment decision.

IV. Product Approval Process (Product Governance)

1. Overview

22 With MiFID II, the European legislator has introduced a new regulatory approach to achieve a high level of investor protection.[39] The organisational requirements for investment firms,

[34] Cf. I. Koller, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, § 80 para. 14; K. Rothenhöfer, in: Schwark and Zimmer (eds.), *Kapitalmarkrechts-Kommentar*, § 63 WpHG para. 42.

[35] Cf. K. Rothenhöfer, in: Schwark and Zimmer (eds.), *Kapitalmarkrechts-Kommentar*, § 63 WpHG para. 46; *Lerch*, Anlageberater als Finanzintermediäre, passim.

[36] Cf. K. Rothenhöfer, in: Schwark and Zimmer (eds.), *Kapitalmarkrechts-Kommentar*, § 63 WpHG para. 38.

[37] Cf. Art. 18(3) MiFID II. See M. Wundenberg § 33 para. 14.

[38] Cf. Art. 23(2) and (3) MiFID II.

[39] Cf. Art. 4(1) no. 2 in conjunction with Annex 1 Section A MiFID II.

also referred to as product governance, are intended to improve investor protection with regard to investment advice as well as advice-free investment services. The rules are intended to have a preventive effect.[40]

23 The MiFID II approach is twofold. Firstly, investment firms that manufacture financial instruments must ensure that these products are manufactured in such a way that they meet the needs of a specific target market of end customers within the respective customer category (**organisational requirements** for the **manufacturer**). Secondly, investment firms shall take appropriate measures to ensure that the financial instruments are sold to the identified target market and regularly review the identification of the target market and the performance of the products offered (**organisational requirements** for the **sale** of financial products). The main objective of these principles is to ensure that an investment firm avoids conflicts of interest.

24 The principles provided for in MiFID II are specified in the Commission Delegated Directive (EU) 2017/593 of April 7, 2016.[41] Article 9 of this Directive regulates in detail the product monitoring obligations for investment firms that design financial instruments, and Article 10 deals with the distributors' product monitoring obligations. The new regulations of the MiFID II regime (Article 16(3) and 24(2) MiFID II and Article 9 and 10 of the Commission Delegated Directive of April 7, 2016) are not directly applicable. Member States must introduce corresponding provisions in their national laws.

25 ESMA has also issued guidelines to ensure that the rules are applied uniformly.[42] The guidelines are not legally binding. In practice, however, they play an important role, especially considering NCAs have declared that they will apply the guidelines.

2. Scope

26 The rules concerning product governance apply to financial instruments, ie, transferable securities (stocks and bonds), money market instruments, shares in collective investment schemes, options, futures, swaps and other derivative contracts, derivative instruments for the transfer of credit risk and financial speculations on differences.[43] The personal scope includes investment firms[44] that are registered as investment firms under national law.

3. Manufacturers

27 An investment firm that designs financial instruments to sell to clients must maintain, operate and review a **process** for the **approval** of any **financial instrument** and of significant adjustments to existing financial instruments before the instrument can be marketed or

[40] Cf. I. Koller, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, § 80 para. 129; D. Zetzsche, in: Lehmann/Kumpan (eds.), European Financial Services Law, Art. 16 MiFID II para. 17.

[41] Commission Delegated Directive (EU) 2017/593 of April 7 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits, C(2016) 2031 final.

[42] Cf. ESMA, Guidelines on MiFID II Product Governance Requirements, 5 February 2018, ESMA35-43-620 EN.

[43] Cf. Art. 4(1) no. 15 in conjunction with Annex 1 Section C MiFID II.

[44] Cf. Art. 4(1) no. 2 in conjunction with Annex 1 Section A MiFID II.

distributed to clients.[45] This obligation is closely related to the obligation under Article 24(2) MiFID II, according to which investment firms that design financial instruments to sell to clients must ensure that these financial instruments are designed in such a way that they **meet** the **needs** of a specific **target market** of **end customers** within the respective customer type, that the distribution strategy is compatible with the specific target market and that reasonable steps are taken to ensure that the financial instrument is sold to the specific target market. It is of central importance that a target market for end customers is defined for each financial instrument in the product approval process. In particular, all relevant risks for the target market must be assessed.[46]

28 As a rule, manufacturers have no direct customer contact and therefore determine the target market based on their theoretical knowledge and experience with the product. ESMA recommends taking five 'categories' into account.[47] A manufacturer should determine (i) what type of customer the product is targeting, (ii) what knowledge and experience the target clients should have, (iii) the clients' financial loss-bearing capacity, (iv) their risk tolerance and (v) goals and needs.

29 The product approval process is an internal process of the investment firm. The NCA is not involved in the process. However, the NCA monitors whether an investment firm complies with the regulatory requirements. The principle-based requirements of MiFID II are specified in more detail in Article 9 Delegated Directive 2017/593. The extensive regime need not be considered in detail. Only the most relevant requirements for the product approval process will be highlighted.

30 Firstly, an investment firm's processes and measures must ensure that the design of financial instruments meets the requirements for the proper handling of conflicts of interest, including remuneration. Investment firms that design financial instruments must ensure in particular that the design of the financial instrument, including its characteristics, does not have a negative impact on end customers and does not lead to problems with market integrity by enabling the company to reduce its own risks or positions in the underlying assets of the product and/or to dispose of it in case the investment firm already holds the underlying assets for its own account.[48]

31 Financial products can compromise the proper functioning or the stability of the financial markets. Therefore, before deciding to proceed with the launch of a specific product on the market, investment firms are required to check whether the financial investment may represent a threat.[49]

32 The greatest challenge lies in **determining** the **target market**, since it is particularly unclear how exactly it must be determined. MiFID II does not contain any specific requirements in this regard. The Level 2 guideline requires investment firms 'to identify at a sufficiently granular level the potential target market for each financial instrument and specify the type(s) of client for whose needs, characteristics and objectives, including any sustainability related objectives, the financial instrument is compatible. As part of this process, the firm shall identify any group(s) of clients for whose needs, characteristics and objectives the financial instrument is not compatible, except where financial instruments consider sustainability factors. Where investment firms collaborate to manufacture

[45] Cf. Art. 16(3) subsec. 2 MiFID II. Manufacturing encompasses the creation, development, issuance and/or design of financial instruments, cf. Art. 9(1) subsec. 1 Delegated Directive 2017/593.

[46] Cf. Art. 16(3) subsec. 3 MiFID II.

[47] Cf. ESMA, Guidelines on MiFID II Product Governance Requirements, 5 February 2018, ESMA35-43-620 EN, para. 18.

[48] Cf. Art. 9(2) Delegated Directive 2017/593.

[49] Cf. Art. 9(4) Delegated Directive 2017/593.

a financial instrument, only one target market needs to be identified.'[50] Union law acknowledges the principle of **proportionality**. Thus, in the case of a plain vanilla instrument (such as a share or a bond) the target market definition can be relatively simple.[51]

33 However, the Member States must require investment firms to identify the respective potential target market with sufficient precision and to indicate the type(s) of clients for whose needs, characteristics and objectives the financial instrument is suitable.[52] For simpler, more common products, the target market may be determined in less detail, while for complex or less common products, the target market should be determined in more detail.[53]

34 An investment firm must also follow certain rules for carrying out product approval, including a **scenario analysis** of the financial instruments that is intended to assess the risk of poor results as well as under what circumstances these results may occur.[54]

35 A final key point is the question of who should be responsible for the approval process within an investment firm. On the one hand, Article 9(7) of the Commission Delegated Directive 2017/593 provides that **the compliance function** monitors the development and regular review of the product monitoring precautions to avoid any risk that the company does not comply with the provisions set out in this article. Second, the management body of the investment firm must exercise effective control over the firm's product governance process.[55] This is in line with the general compliance requirements under MiFID II.[56]

4. Distributors

36 The rules on product governance also apply to the sale of financial instruments. The investment firm must develop a sales strategy that is consistent with the identified target market.[57] In addition, the investment firm must take reasonable steps to ensure that the financial instrument is distributed to the identified target market.

37 The principles are specified in the Level 2 Directive. The obligation to define the target market for the respective financial instrument is of pivotal importance, even if the target market was not defined by the manufacturer.[58] Investment firms must ensure that they receive adequate and reliable information from manufacturers to ensure that the products are distributed in accordance with the characteristics, objectives and needs of the target market. The investment firms use the information obtained from the manufacturers as well as information about their own clients to determine the target market and distribution strategy. Naturally, when an investment firm acts as both a manufacturer and a trader, only one target market assessment is required.[59]

[50] Cf. Art. 9(9) Delegated Directive 2017/593, amended by Commission Delegated Directive 2021/1269 of 21 April 2021 amending Delegated Directive (EU) 2017/593 as regards the integration of sustainability factors into the product governance obligations.

[51] Cf. D. Zetzsche, in: Lehmann/Kumpan (eds.), European Financial Services Law, Art. 16 MiFID II para. 24.

[52] Cf. Art. 9(9) Delegated Directive 2017/593.

[53] Cf. recital 19 Delegated Directive 2017/593.

[54] Cf. Art. 9(10) Delegated Directive 2017/593.

[55] Cf. Art. 9(6) Delegated Directive 2017/593.

[56] See M. Wundenberg § 33 para. 31–88.

[57] Cf. Art. 16(3) subsec. 3 MiFID II.

[58] Cf. Art. 10(1) subsec. 2 Delegated Directive 2017/593.

[59] Cf. Art. 10(2) subsec. 3 Delegated Directive 2017/593.

38 Investment firms must take compliance measures to ensure that these requirements are met.[60] Finally, they are obliged to regularly review and update their governance arrangements to ensure that they remain robust and fit for their purpose, and take appropriate actions if necessary.[61]

39 In essence, the product governance regime aims to ensure that financial products are only sold within their respective target market. However, there is no legal obligation to do so.[62] In individual cases, it can even make sense to sell a **financial product** to a **customer** who is **outside the target market**. According to portfolio theory,[63] it may be appropriate for this customer to purchase a particularly risky product. The ESMA guidelines (see para. 30) recognise this: 'When providing investment advice adopting a portfolio approach and portfolio management to the client, the distributor can use products for diversification and hedging purposes. In this context, products can be sold outside of the product target market, if the portfolio as a whole or the combination of a financial instrument with its hedge is suitable for the client' (para. 52 ESMA guidelines).

V. Investment Advice

1. Terminology

40 MiFID II understands investment advice to be 'the provision of **personal recommendations** to a **client**, either upon its request or at the initiative of the investment firm, in respect of one or more **transactions** relating to **financial instruments**.'[64] To substantiate, Article 9 Delegated Regulation (EU) 2017/565[65] stipulates that a personal recommendation is a 'recommendation that is made to a person in his capacity as an investor or potential investor, or in his capacity as an agent for an investor or potential investor. That recommendation shall be presented as suitable for that person, or shall be based on a consideration of the circumstances of that person.' In addition, it must 'take one of the following sets of steps: (a) to buy, sell, subscribe for, exchange, redeem, hold or underwrite a particular financial instrument; (b) to exercise or not to exercise any right conferred by a particular financial instrument to buy, sell, subscribe for, exchange, or redeem a financial instrument.' Finally, Article 9 stipulates that a recommendation will not be regarded as a personal recommendation if it is exclusively issued to the public. As a result, advice given in a newspaper, journal, magazine, web article, television or radio does not constitute investment advice within the meaning of MiFID II. Tips in stock market information services and stock market letters also usually do not constitute investment advice.[66]

41 Investment advice is traditionally provided in discussions between employees of an investment firm and the client. The digitisation of business life has meanwhile also produced other forms of

[60] Cf. Art. 10(3) Delegated Directive 2017/593.
[61] Cf. Art. 10(4) Delegated Directive 2017/593.
[62] I. Koller, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, § 80 para. 149.
[63] See R. Veil § 9 para. 17.
[64] Cf. Art. 4(1) no. 4 MiFID II.
[65] This Regulation was amended by Commission Delegated Regulation (EU) 2021/1253 of 21 April 2021 amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms, OJ L 277 of 2.8.2021, p. 1.
[66] Cf. H.-D. Assmann, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, § 2 para. 176.

investment advice (so-called **robo advice**), which, for investors, can be a cost-effective alternative to traditional investment advice. These other forms of investment advice are partially or fully automated systems that function entirely or largely without human interaction. Recommendations are made on the basis of an algorithm that takes into account the client's information, in particular about his investment objectives. This has the advantage of a higher degree of rationality than traditional investment advice given by a human. Digital advice on capital investments does not take place in a legal vacuum. The MiFID II regime is technology-neutral and therefore also applies to digital investment advice.[67]

Investment advice is to be distinguished from **investment brokerage** in particular. This investment service consists of the receipt and transmission of orders relating to one or more financial instruments.[68] This is done by bringing two or more investors together, which enables a business deal to be concluded between these investors.[69] Investment brokerage is provided by anyone who, as a 'messenger', forwards the investor's declaration of intent, which is aimed at the acquisition or sale of financial instruments, to the person with whom the investor wishes to conclude such a deal.[70] The activity must go beyond simply providing evidence of the opportunity to conclude transactions in financial instruments. Cases in which the service is limited to establishing contact between the investor and a seller of financial instruments are not considered investment brokerage.[71] However, in these cases, there is also no advice given, eg about the investment goals and the risk-bearing capacity of the investor, which is characteristic of investment advice.[72] 42

MiFID II differentiates according to whether the investment advice is provided independently or not. **Independent investment advice** is also called fee-based independent investment advice because the consultant demands remuneration from the client (on the basis of a contract). This regime reflects mis-selling problems observed in all European countries under the MiFID I regime.[73] Thus, strict requirements apply. In particular, the investment firm is not permitted to accept or retain any fees, commissions or other monetary or non-monetary benefits from a third party or a person acting on behalf of a third party for the provision of the service to the clients.[74] Payments are made solely by the customer. If the advice is not classified as independent fee-based investment advice, the investment firm can indirectly financially benefit 'through the recommended financial products' by receiving financial inducements from the issuer of the product. 43

2. Rules of Conduct

MiFID II recognises that investment recommendations are of paramount importance to investors and that investment decisions have become complex.[75] It therefore aims to improve client protection through information (so-called information model). The term '**client**' 44

[67] Cf. BaFin, Robo Advice, 19 February 2020.
[68] Cf. Annex I Section A no. 1 MiFID II.
[69] Cf. recital 44 MiFID II.
[70] Cf. BaFin, Notes on Investment Advice (Merkblatt zur Anlageberatung) of 17 May 2011, last amended on 18 February 2019.
[71] Cf. BaFin, Notes on Investment Advice (Merkblatt zur Anlageberatung) of 17 May 2011, last amended on 18 February 2019; H.-D. Assmann, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, § 2 para. 127.
[72] Cf. H.-D. Assmann, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, § 2 para. 129.
[73] Cf. M. Brenncke, in: Lehmann/Kumpan (eds.), *European Financial Services Law*, Art. 24 MiFID II para. 31.
[74] Cf. Art. 24(7)(b) MiFID II.
[75] Cf. recital 70 MiFID II.

means 'any natural or legal person to whom an investment firm provides investment or ancillary services'.[76] This can be either a **professional client** or a **retail investor**.[77] Because of the disparate nature of the multitude of investors, the categories remain vague. This is not to say, however, that the requirements for investment advice are the same with regard to all kinds of investors. The question of whether a financial instrument is suitable for a client depends on the customer's goals and his knowledge, ie it is taken into account when investors are inexperienced and risk-averse.[78] The following paragraphs will deal only with obligations that apply to investment firms providing investment advice to retail investors, taking into account that European legislation has aligned the requirements for investment firms with the **idea** of **sustainability**. First, Delegated Regulation (EU) No. 2021/1253 incorporates sustainability factors, risks and preferences into organisational requirements and conditions for the performance of the activities of investment firms. Second, the disclosure obligations provided for financial advisors in Regulation (EU) 2019/2088 (SFDR) also become relevant. However, the transparency of sustainability risk policies (Article 3), transparency of adverse sustainability impacts at entity level (Article 4), transparency of remuneration policies in relation to the integration of sustainability risks (Article 5) and the transparency of the integration of sustainability risks (Article 6) are not considered in detail below.

(a) Exploration

45 An investment firm is first required to obtain **information** (i) about the client's **knowledge** and **experience** of dealing in certain types of financial instruments or investment services, (ii) about the client's **financial situation**, including his ability to bear losses, and (iii) about his **investment objectives**,[79] including his risk tolerance, so as to enable the investment firm to recommend to the client the services and products that are suitable for the client and, in particular, correspond to his risk tolerance and ability to bear losses. This is also referred to with the words ***'know your customer'***.[80]

46 The general requirements of Art. 25(2) MiFID II are specified in the Delegated Regulation 2017/565.[81] For example, information about the client's financial situation includes information about the origin and amount of the client's regular income, assets, investments and real estate as well as regular financial obligations. With regard to the client's investment objectives, information must be obtained about the period in which the client intends to hold the investment, the client's risk preferences, risk profile and the purpose of the investment. Finally, a client must be asked whether he wants to take **sustainability factors** into consideration in the selection process of financial instruments. This implies, among other things, investing a minimum amount in environmentally sustainable investments.

(b) Information

47 An investment firm must provide its clients with 'all relevant information'.[82] Information requirements have increased steadily over the course of almost three decades. The latest

[76] Cf. Art. 4(1) no. 9 MiFID II.
[77] Cf. Art. 4(1) no. 10 and 11 MiFID II.
[78] Cf., with regard to MiFID I, N. Moloney, 13 EBOR (2012), 169, 179 ff.
[79] See also R. Veil § 23 on the different investment objectives.
[80] Cf. P. Nelson, *Capital Markets Law and Compliance*, para. 14.52.
[81] Cf. Art. 54(2), (5) and (7), Art. 55(1) Regulation 2017/565.
[82] Cf. recital 72 MiFID II.

reform, realised through MiFID II, takes particular account of the fact that financial instruments are highly complex products and that their design is subject to continuous innovation.[83] The regulatory requirements also take into account that investors often have difficulties understanding financial products. **Comprehensibility** is therefore an essential requirement of MiFID II. Furthermore, the rules endeavour to counter the problem of *information overload*[84] by simply limiting the maximum amount of information documents.

The current regime consists of three pillars. The first pillar concerns **general mandatory information** that an investment firm must provide before or when providing investment services. The information relates to the investment firm itself as well as its services, the financial instruments and proposed investment strategies, execution venues and costs as well as ancillary costs. Clients should reasonably understand the types of financial instruments or investment services offered to or requested by them, as well as their respective risks, and be able to make their investment decisions on that basis. The information can also be made available in standardised form. It must be presented in such a way that it can be **understood** by an **average member** of the **group** to whom it is **directed** or by whom it is likely to be received.[85] 48

The second pillar of the information model is specifically tailored to investment advice and requires an investment firm to **disclose** the **nature** and **content** of the **investment advice**. An investment firm that provides investment advice must inform the client comprehensively and well in advance about (i) whether the investment advice is provided independently or not (see para. 43), (ii) whether the investment advice is based on an extensive or rather limited analysis of various types of financial instruments; and (iii) whether the investment firm will regularly provide the client with a suitability assessment concerning the recommended financial instruments. The details of the disclosure obligation are covered by Article 52 Delegated Regulation 2017/562. The information now also includes **sustainability factors**, which are taken into consideration in the selection process of financial instruments.[86] 49

Finally, investment advice must contain **product-specific information**. This is done either by means of a key information sheet (to be drawn up in accordance with the provisions of the PRIIPS Regulation) or by means of a 'short and easily understandable information sheet' or other type of **information document**.[87] An information sheet must contain the essential information about the respective financial instrument, so that the client can assess the type of instrument, how it works, the associated risks, the prospects for returns and capital repayment under different market conditions, as well as the costs associated with the investment, and is able to compare all this to the characteristics of other financial instruments. For non-complex instruments, the maximum size of an information sheet is two A4 pages. 50

[83] Cf. recital 79 MiFID II.
[84] See R. Veil § 6 para. 32.
[85] Cf. Art. 44(2)(d) Regulation 2017/565.
[86] 'Sustainability factors' mean environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters. Cf. Art. 2(9) Delegated Regulation (EU) 2017/565 in connection with Art. 2, point (22) Regulation (EU) 2019/2088 (SFDR).
[87] Cf. ESMA, Guidelines on MiFID II Product Governance Requirements, 5 February 2018, ESMA35-43-620 EN, para 52.

(c) Assessment of Suitability

51 The so-called *suitability doctrine* is at the heart of MiFID II's client protection regime: an investment firm may recommend to its client only those financial instruments and investment services that are suitable for the client based on the information obtained. The details of this process-based regime[88] can be found in Articles 54 and 55 of the Delegated Regulation 2017/565. Looking at the comprehensive and detailed set of rules, it becomes clear what outstanding importance the legislature attaches to suitability testing. The focus is on the individual investor being advised by the investment firm, not on the average customer! For example, a derivative may be suitable for a commercially savvy attorney; it is not, however, for a risk-averse pensioner who wants to invest the money for the long term.

52 A transaction is **suitable** for a client if it (i) **corresponds** to the **investment objectives** of the client in question, also with regard to his willingness to take risks and any **sustainability preferences**, (ii) it is designed in such a way that any **investment risks** associated with the transaction are **financially acceptable** considering the client's investment objectives, and (iii) it is such that the client has the necessary experience and knowledge in order to **understand** the **risks** involved in the transaction or in the management of his portfolio.[89] The suitability test does not require an investment firm to recommend the most suitable financial instrument.[90] The target market determined by the manufacturer or distributor (see para. 27) does not set any limits to the recommendation.[91] However, an investment firm has a special duty of care when it recommends a product to a client who is not included in the product's target market.[92] If an investment firm cannot obtain the necessary information about the client (see para. 45), it must not recommend any investment services or financial instruments to the client (**supervisory prohibition**).[93]

53 An investment firm must provide its retail client with a **statement** on the **suitability** of the financial instrument. It may not make a recommendation if the instruments are not suitable for the client. However, an investment firm shall not recommend financial instruments or decide to trade such instruments as meeting a client's or potential client's **sustainability preferences** when those financial instruments do not meet those preferences.[94] A 'brown' product may therefore be recommended to a client interested in 'green' investments, but the investment firm may not describe it as 'green'. The purpose is to prevent greenwashing.

(d) Execution Only

54 Under certain conditions MiFID II allows an investment firm to not obtain any information from its client.[95] This applies to companies whose investment services only consist of the **execution** of **client orders** or the **receipt** and **transmission** of **client orders** (also referred to as *execution only*). Essentially, this concerns financial transactions on a commission basis,

[88] Cf. M. *Brenncke*, in: Lehmann/Kumpan, European Financial Services Law, Art. 25 MiFID II para. 5.
[89] Cf. Art. 54(2)(a)–(c) Regulation 2017/562.
[90] Cf. *Brenncke*, in: Lehmann/Kumpan, European Financial Services Law, Art. 25 MiFID II para. 12.
[91] Cf. Art. 54(2)(a)–(c) Regulation 2017/562.
[92] Cf. I. Koller, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, § 64 para. 41; M. Brenncke, in: Lehmann/Kumpan (eds.), European Financial Services Law, Art. 24 MiFID II para. 14.
[93] Cf. Art. 54(8) Regulation 2017/562.
[94] Cf. Art. 54(10) Regulation 2017/562, as amended by Delegated Regulation 2021/1253.
[95] Cf. Art. 25(4) MiFID II.

proprietary trading, contract brokerage and investment brokerage. Naturally, this privilege is limited to transactions involving only **non-complex financial instruments**.[96] It is also a prerequisite that the service is provided at the request of the client, that the client is informed about the absence of a suitability assessment, and that the firm complies with the rules on conflicts of interest.[97]

3. Obligations under Private Law

MiFID II does not specify any requirements for legal relationships under private law. In particular, it does not make any explicit statement on the civil liability of an investment firm due to incorrect investment advice. In the absence of a European regulation, it is up to the national legal systems of the individual Member States to determine the contractual consequences of a violation of the rules of conduct.[98] This is a central issue, however: It is indispensable for effective investor protection that investors are compensated for incorrect information they are given.[99] Private enforcement not only has a compensatory but also a preventive function.[100] 55

The legal situation in Europe has so far only been researched in part. Comparative research on English, French, Italian, Dutch and Swedish law shows that the basis for claims lies in contract law and tort law.[101] There are different answers to the question of the relationship between supervisory and civil law, called 'hybridisation of judicial reasoning' by M.W. Wallinga.[102] This will be discussed below using German law as an example. 56

The starting point for the legal development in Germany is the famous ***Bond* decision** of the Federal Court of Justice made in 1993.[103] The Court not only commented on the conditions under which a contract between an investment advisor and a client is concluded, but also set out the obligations an investment advisor has towards his client. 57

Facts: The plaintiffs had been investing their savings (approx. DM 55,000) with the defendant Volksbank for more than 20 years in secure forms of investment (fixed-term deposits, savings balances, federal savings notes). After an amount of over DM 20,000 had become due, a consultation took place about the reinvestment of this amount. The investment advisor presented the plaintiffs with a list of offers from their investment programme, which listed, inter alia, the DM bond of the Australian Bond Finance Ltd. Before taking up this investment recommendation, the defendant had informed itself that the bond had been admitted to official trading on the Frankfurt Stock Exchange shortly beforehand on the basis of a prospectus containing an audit opinion, and had obtained the listing prospectus. The Australian Ratings Agency had already rated the bond 'BB' (speculative 58

96 Cf. Art. 25(4)(a) MiFID II in conjunction with Art. 57 Regulation 2017/565.

97 Cf. Art. 25(4)(b)-(d) MiFID II.

98 Cf., with regard to MiFID I, ECJ of 30 May 2013, Case C-604/11, ZIP (2013), 1417, 1419, para. 57 (Juzgado de Primera Instancia n° 12 de Madrid).

99 Cf. P. Mülbert, ZHR 177 (2013), 160, 194.

100 Cf. C. Kumpan and A. Hellgardt, DB (2006), 1714.

101 Cf. A. Perrone and S. Valente, 13 EBOR (2012), 31, 33; M.W. Wallinga, *EU investor protection regulation and private law*, passim; F. Walla, 22 EBLR (2011), 211, 218–219, with regard to Swedish law.

102 M.W. Wallinga, *EU investor protection regulation and private law*, 393: 'The hybridisation of judicial reasoning as a result of the complementarity model demonstrates the integration of EU investor protection regulation into national private law'.

103 BGH of 6. 7. 1993 – XI ZR 12/93, BGHZ 123, 126.

with below-average coverage) in June 1988 and 'B' (highly speculative with low capital coverage) in December 1988. After the bond's listing on the stock exchange, it was rated 'CCC', indicating the risk of the issuer's bankruptcy. On the basis of the adviser's recommendation, the plaintiffs bought the bond with a nominal value of DM 20,000 from the defendant.

59 The BGH ruled that an advisory contract had been concluded between the investors and Volksbank: 'If a prospective investor approaches a bank or a bank's investment advisor approaches a client in order to be advised or advise on the investment of a sum of money, this constitutes an offer to conclude an investment advisory contract that is tacitly accepted by starting the consultation.'

60 Advice from a bank or an investment advisor must, firstly, be based on whether the intended investment transaction is intended to serve as a safe investment or whether it is speculative in nature. With this objective in mind, the recommended investment must be tailored to the personal circumstances of the client, ie '**investor-appropriate**'.[104] Secondly, the advice must be '**instrument-specific**'. This means that concerning the object of the investment, the advice must relate to those properties and risks that are or can be of material importance for the respective investment decision. A distinction must be made between general risks (economic situation, development of the stock market) and the special risks that result from the individual circumstances of the investment object (price, interest rate and currency risk). The advice given by the bank must be correct and thorough, comprehensible and complete.[105]

61 In the *Bond* decision, the BGH ruled that the defendant had violated its obligations in several ways: First, the defendant's investment advisor's response to the question of the bond's price risk had been misleading. The risk of the proposed investment was the issuer's possible bankruptcy. Such bankruptcy would not only have resulted in the loss of interest payments but also in a decline in the bond issue's market value. Second, the recommendation to buy the bond issue was not 'investor-appropriate'. The defendant had known from their long-term business relationship that the plaintiffs had invested their savings exclusively in secure forms of investment and had so far avoided any risk of loss. They had no experience in corporate bonds. Knowing these circumstances, recommending to buy foreign corporate bonds using a substantial part of the savings, and without a thorough investigation into the creditworthiness of the foreign issuer, was a breach of a duty.[106]

62 The BGH has outlined and further developed advisory obligations in numerous rulings. The *Lehman* decisions represent a milestone. According to the rulings, an investment advisor has to inform customers about the **general issuer risk**:[107] When selling index certificates, the advisory bank is obliged to inform the investor that he will lose all of the invested capital in the event of the issuer's insolvency, even if there is no specific indication of an impending insolvency. However, according to the BGH, if the bank has properly provided information about the general issuer risk, no further information is required.

63 The principles of contractual obligations developed by the BGH in the *Bond* judgment must be specified in more detail in each individual case. In supervisory law, legislature has already regulated a variety of aspects of investor client protection with differentiated obligations. The question therefore arises as to whether the supervisory rules of conduct can be

[104] BGH of 6. 7. 1993 – XI ZR 12/93, BGHZ 123, 126, 129.
[105] BGH of 6. 7. 1993 – XI ZR 12/93, BGHZ 123, 126, 129.
[106] BGH of 6. 7. 1993 – XI ZR 12/93, BGHZ 123, 126, 129 f.
[107] BGH of 27. 9. 2011 – XI ZR 182/10, BGHZ 191, 119, 125 ff.

applied to determine the contractual obligations. This question is highly controversial because when regulating the obligations, the European legislator did not have legal consequences in private law in mind, but rather developed those obligations as behavioural standards that are monitored by a supervisory authority. Nevertheless, some advocate that the supervisory rules are **dual in nature**, that is, those exact rules also apply when it comes to contractual relationships.[108] Others assign at least some kind of impact on private law to the supervisory obligations,[109] in the sense that they indirectly affect the contractual duties of the investment advisor (also called spill-over effect—*Ausstrahlungswirkung*).

The BGH is opposed to the application of supervisory law in private law.[110] The court recognises that the supervisory regulations 'can be of importance for the content and scope of (pre-)contractual information and advice obligations.'[111] However, according to the BGH, the rules are 'exclusively of a public law nature and therefore do not affect the civil law obligation relationship between the investment services company and the client.' According to the BGH, the responsibility lies with the BaFin, which supervises investment firms. The provisions of supervisory law 'cannot justify an independent obligation under the law of obligations to inform the defendant about the profit margin achieved by a securities transaction, not even through a spill-over. The supervisory rules of conduct [. . .], insofar as their objective is investor protection, can be of importance for the content and scope of (pre-) contractual information and advice obligations. However, their scope of protection under private law does not go beyond those (pre-)contractual obligations.'[112] 64

VI. Asset Management

1. Terminology

Asset management is characterised by the fact that a (natural or legal) person manages assets that are economically not attributed to the person, but to a third party.[113] The asset manager is therefore involved in the asset investment affairs of another person. In this respect, he looks after the interests of the other person. He has a certain freedom of action. 65

MiFID II understands portfolio management as 'the **management** of **portfolios** on a **client-by-client basis** with a **margin of discretion** within the scope of the **client's mandate**, provided that these portfolios contain one or more financial instruments.'[114] The regulatory 66

[108] Cf. J. Köndgen, ZBB (1996), 361 f.; N. Lang, ZBB (2004), 289, 295; F. Leisch, *Informationspflichten nach § 31 WpHG*, 85; C. Benicke, *Wertpapiervermögensverwaltung*, 461 ff.; T. Möllers, in: *Kölner Kommentar zum WpHG*, § 31 para. 6 f.

[109] Cf. I. Koller, in: Assmann et al. (eds.), *Kommentar zum Wertpapierhandelsrecht*, § 64 para. 9; R. Sethe, *Anlegerschutz im Recht der Vermögensverwaltung* (2005), 748 ff.

[110] This applies to the XIth Civil Chamber; the issue is handled differently by the IIIrd Civil Chamber. According to J. Forschner, *Wechselwirkungen von Aufsichtsrecht und Zivilrecht*, 203, the two Civil Chambers must therefore call the Grand Senate pursuant to § 132 GVG.

[111] Cf. BGH of 19. 6. 2006 – XI ZR 56/05, WM (2007), 487, 489.

[112] Cf. BGH of 17. 9. 2013 – XI ZR 332/12, NZG (2013), 1226, 1228 para. 20.

[113] F. Schäfer et al., in: Schäfer et al. (eds.), *Handbuch der Vermögensverwaltung*, § 1 para. 8.

[114] Art. 4 (1) no. 8 MiFID II.

term is broad. It covers both trust management as well as administration by way of power of attorney.

67 Trust management (widespread in the Anglo-Saxon region) indicates that the asset manager acquires the securities as property and holds them in trust for the benefit of his clients. The (external) legal power of the asset manager is limited (internally) by the trust agreement. By means of indirect representation, the trustee manages assets that are legally his own but economically the client's.[115] Clients have a contractual right to the proper administration and transfer of the managed assets.[116]

68 In contrast, power of attorney is mainly used in German-speaking countries. The asset manager acts in the name of and for the account of a third party, so that the investor becomes the owner of the securities and other assets.[117] However, the asset manager can also be authorised to dispose of the entrusted assets in his own name.[118]

69 The asset management contract can entitle the asset manager to dispose of the investor's custody account. It is then necessary to make a separate agreement granting the asset manager *in rem* power of disposition.[119] In this case, the asset manager requires a bank power of attorney.

70 The MiFID II regime is not limited to traditional asset management, but also applies to **digital asset management** (MiFID II technology neutrality).[120] Digital asset management indicates that the service is provided on the basis of an algorithm that offers the client a solution based on prior data entry.[121] The agreed upon strategy is implemented in the client's investment portfolio using algorithms. The proposals for a change in composition of the portfolio are also based on an algorithm. The European Commission has rightly made it clear that the investment firm is responsible for the use of the software.[122]

2. Rules of Conduct

71 The obligations for an investment firm are essentially the same as those for investment advice. An investment firm must obtain the relevant **information** about its clients and provide the clients with general (see para. 48) and specific information (see para. 50). Transactions that are carried out in the context of financial portfolio management must, as with investment advice (see para. 51), be suitable for the customer (so-called **suitability assessment**).

72 The European legislature has strengthened the regime for **inducements** (fees, commissions and any monetary or non-monetary benefits paid or provided by any third party)

[115] F. Möslein, in: Langenbucher et al. (eds.), *Bankrechts-Handbuch*, ch. 34 para. 11.
[116] F. Schäfer et al., in: Schäfer et al. (eds.), *Handbuch der Vermögensverwaltung*, § 1 para. 43.
[117] F. Schäfer et al., in: Schäfer et al. (eds.), *Handbuch der Vermögensverwaltung*, § 1 para. 53; F. Möslein, in: Langenbucher et al. (eds.), *Bankrechts-Handbuch*, ch. 34 para. 10.
[118] F. Schäfer et al., in: Schäfer et al. (eds.), *Handbuch der Vermögensverwaltung*, § 1 para. 53.
[119] F. Schäfer et al., in: Schäfer et al. (eds.), *Handbuch der Vermögensverwaltung*, § 1 para. 55; F. Möslein, in: Langenbucher et al. (eds.), *Bankrechts-Handbuch*, ch. 34 para. 10.
[120] Cf. U. Schäfer, in: Assmann et al. (eds.), *Handbuch des Kapitalanlagerechts*, § 23 para. 20.
[121] Cf. M. Brenncke, in: Lehmann/Kumpan, *European Financial Services Law*, Art. 24 MiFID II para. 38.
[122] Cf. Art. 54(1) subsec. 2 Delegated Regulation (EU) 2017/565: 'Where […] portfolio management services are provided in whole or in part through an automated or semi-automated system, the responsibility to undertake the suitability assessment shall lie with the investment firm providing the service and shall not be reduced by the use of an electronic system in making the […] decision to trade.'

taking into account mis-selling practices and poor quality of investment services.[123] Under MiFID II, particularly strict requirements apply to inducements. An investment firm may not accept or retain any inducements from third parties in connection with financial portfolio management. Only minor non-monetary benefits are permitted (*de minimis* exception), provided that they are (i) suitable for improving the quality of the investment service provided to the client, (ii) reasonable and proportionate in terms of their scope and (iii) unambiguously disclosed to the client.

The asset manager has a certain amount of discretion. It therefore makes sense that the client should be regularly informed about how the asset manager has invested the money. The asset manager is therefore obliged to report regularly on the development of the portfolio. At the heart of the **reporting requirement** is a periodic list that includes a fair and balanced review of the measures taken and the performance of the portfolio during the regular reporting period of three months.[124] In addition, the asset manager must inform his client immediately if a loss threshold of 10% of the portfolio is exceeded.[125] 73

VII. Conclusion

The European regime of investment services has now reached a proud age of 30 years. It is characterised by a tremendous depth of detail concerning the rules of conduct. This is due to the objective of creating a uniform legal framework within the EU. This entails considerable regulatory costs for investment firms. In view of the outstanding importance of securities investments for EU citizens' pensions provisions, it was inevitable to create a dense network of rules of conduct that takes into account the information deficits of investors and the various conflicts of interest of investment firms. The complexity of the regulatory levels is of course in need of improvement. The numerous information obligations and other prudential requirements originate from MiFID II, the provisions of which have been implemented in the national legal systems, but are specified in a European regulation (2017/562). This is an unnecessarily complex legal situation. 74

Despite the far-reaching supervisory regulations, the EU is far from having a uniform legal framework. This is mainly due to the fact that the European legal acts do not cover the legal relationships under private law. European legal research on private law obligations in investment advice, asset management and other securities services is still in its early stages. For the time being, we only know that fundamental issues are treated very differently.[126] This applies, for example, to the question of whether the supervisory rules of conduct affect private law obligations or are even directly applicable in private law. In view of this level of knowledge, it should come as no surprise that the discussion about harmonising private law governing investment services is still in its infancy. 75

Over the past 30 years, the content of the rules of conduct under supervisory law has also evolved. The idea remains that investors are able to draw appropriate conclusions for an 76

[123] Cf. Art. 60 Regulation 2017/562.
[124] Cf. Art. 60 Regulation 2017/562.
[125] Cf. Art. 62(1) Regulation 2017/562.
[126] Impressive analyses by M.W. Wallinga, *EU investor protection regulation and private law*.

investment decision from the information provided.[127] However, MiFID II and PRIIPS Regulation now recognise that the majority of investors have no relevant financial knowledge and tend to behave irrationally. The matter has therefore developed into a kind of consumer protection law[128] that operates with paternalistic concepts. The information model complemented by product governance rules is supplemented by product intervention powers of the supervisory authorities, which can be exercised if investor protection cannot be established through information.

77 These developments reflect extensive experience with poor investment advice. Jurisprudence clearly shows that advisors repeatedly recommend unsuitable securities to their clients. It remains to be seen whether the increasing digitisation of investment advice and asset management will help clients invest more appropriately and be less exposed to harmful conflicts of interest.

127 Cf. V. Colaert, in: Busch et al. (eds.), *Capital Markets Union in Europe*, para. 16.77.
128 Cf. C. Vogel, *Vom Anlegerschutz zum Verbraucherschutz*, passim.