

The Foundations of Securities Law

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Introduction

How does the law address topics such as the sale and trade of securities and the regulation of stock exchanges and investment firms? Given the growing importance of capital markets,¹ securities law is highly relevant, but unfortunately also quite complicated. This complexity is also reflected in its literature; reading about securities law, one may relate to Brian Cheffins' chess analogy: Since everyone is expected to be familiar with the first fifty moves, authors often just write about the end game.² Therefore, there is a need to explain the 'first fifty moves', ie the very foundations of securities law. For example, how did securities markets evolve? Why do we need them? What exactly are securities and where are they traded? Who regulates securities law? Should it be harmonised, and to what extent has this already taken place?

This article endeavours to answer these questions. Part I explains when and how securities markets evolved. Part II discusses the relationship between market and bank financing. Parts III and IV outline which types of securities and stock exchanges exist. Part V addresses how (and to what extent) securities law has been harmonised, in particular in the European Union. Part VI concludes.

I. A Brief History of Securities Markets

Securities law has two branches. The first is companies (or the state) issuing different types of securities in order to raise money. Second, these securities are traded on a market, making it easier to attract investors in the first place. Historically, these two elements did not emerge at the same time. Rather, it took some time until the issuing of securities and the development of markets connected.

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¹ See e.g. E Ferran, *Building an EU Securities Market* (Cambridge CUP 2004) 15–21; N Moloney, *EC Securities Regulation* (Oxford OUP 2002) at 79.

² See BR Cheffins, *Company Law* (Oxford OUP 1997) at v, who used this analogy to explain the use of economic theories in company law scholarship.

A. *Pre-history*

The first type of business entity was the partnership, for instance the *societas* in Rome. Usually, partnerships are not associated with securities markets because the partners run and own the business themselves. In two respects, however, the partnership was modified in ways which linked it to securities markets. On the one hand there was (and is) the limited partnership: first in Rome (*societates publicanorum*), then in medieval Italy (*commenda*), and later in other European countries (*société en commandite*,³ *Kommanditgesellschaft*, etc.). This type of partnership enables financial investment because the limited partners – in contrast to the general partners – only provide capital. In medieval Italy these limited partnerships were initially mainly about financing single maritime voyages, but later, they were also used for other forms of trade.⁴ On the other hand the ordinary (or general) partnership changed; from the 14th century, the Florentine type (*compagnia*) provided an opportunity for investment. The partners of the *compagnia* could make financial contributions, in addition to the official capital of the partnership. This *sopracorpo* can be regarded as a predecessor of debt investment because the partner earned interest on the investment rather than on the profits.⁵

Another line of development which paved the way to securities markets was the desire of the state not to depend solely on taxation. In the 11th century Venice and Genoa started to issue debt instruments, and in the following centuries this practice spread to other Italian cities, Germany, Switzerland, and the Low Countries. Some of these debt instruments were compulsory so that they resembled taxation. Gradually, this changed and secondary markets for these debt instruments developed.⁶ In Genoa the development went even further. The Genoese Republic, in 1407, issued *luoghi* of the quasi-public Casa di San Giorgio to fund public debt. These *luoghi* were quite similar to shares in that they could be freely traded and provided a right to a variable dividend.⁷

B. *First Joint-Stock Companies and Securities Markets*

From the 16th century many European countries were keen on establishing colonies and trade with other parts of the world. Some countries, such as Spain and Portugal,

³ Recognized by Colbert in the Ordonnance 1673.

⁴ See CP Kindleberger, *A Financial History of Western Europe* (Oxford OUP 2nd edn 1993) 190; H Hansmann, R Kraakman, and R Squire, 'Law and the Rise of the Firm' (2006) 119 *Harvard L Rev* 1333 at 1372.

⁵ See JB Baskin and PJ Miranti, *A History of Corporate Finance* (Cambridge CUP 1997) at 38–9, 52.

⁶ See M Fratianni and F Spinelli, 'Italian City-States and Financial Evolution' (2006) 10 *European Rev of Economic History* 257; Baskin and Miranti, above n 5 at 8, 52, 94; F Allen and D Gale, *Comparing Financial Systems* (Cambridge Mass MIT Press 2000) at 27.

⁷ Fratianni and Spinelli, above n 6; Baskin and Miranti, above n 5 at 60.

organised and funded this endeavour through the state.⁸ In England, by contrast, joint-stock companies – financed by private investors – emerged in order to trade with other countries or exploit the colonies. The first was the Muscovy Company, chartered in 1555 for trade with Russia, followed by the Eastland Company in 1579 for trade with the Baltic states, and the Levant Company in 1581 for trade with Turkey.⁹

However, the most important date is 1600 when the British East India Company was chartered. Like the earlier companies, its investment was first only about single voyages, specific ships, and short periods of time (between one and three years); however, this soon changed. From 1613 the period of investment was extended (between eight and fifteen years), and from 1642 the East India Company adopted a permanent structure. The consequence of this new structure was that the capital was no longer divided at the end of the voyage. Rather, the shareholders primarily received dividends from their investment.¹⁰ Thus, the East India Company is usually regarded as the first joint-stock company.

In other European countries similar companies were established. This first happened in the Low Countries with the Dutch East India Company (1602) (with perpetual existence since 1623) and in Denmark with the Danish East India Company (1616), followed in France with the *Compagnie des Îles de l'Amérique* (1635), the *Compagnie des Indes Orientales* (1664), and the *Compagnie d'Occident* (1717). Lastly, these were followed in Germany with the *Deutsch-Ostafrikanische Gesellschaft* (1884) and in Portugal with the *Companhia de Moçambique* (1888) and the *Companhia do Niassa* (1891). In the course of time, other projects were pursued in the form of joint-stock companies. The first of these companies was The Governor and Company of the New River which was chartered in 1619 and supplied London with fresh drinking water until 1904.¹¹

The secondary market of shares also became more important and sophisticated. As companies adopted a permanent structure, the possibility of leaving the company by selling shares became more vital. Moreover, there were already secondary markets for other types of financial instruments. Companies issued tradable debt securities, such as bonds;¹² traders could also buy futures and options.¹³ Still, more important was the market in government securities. In order to finance wars and to alleviate the burdens of taxation, many countries issued debt securities. As these

⁸ See Hansmann et al, above n 4 at 1376.

⁹ See Kindleberger, above n 4 at 190–1.

¹⁰ See R Harris, *Industrializing English Law* (Cambridge CUP 2000) at 25; Baskin and Miranti, above n 5 at 64, 69; C Chapman, *How the Stock Markets Work* (London Random House 9th edn 2005) at 18.

¹¹ See B Rudden, *The New River: A Legal History* (Clarendon Oxford 1985).

¹² See Kindleberger, above n 4 at 156; Baskin and Miranti, above n 5 at 72, 81.

¹³ See Baskin and Miranti, above n 5 at 96, 98.

securities were usually standardised, a secondary market in these securities soon emerged.¹⁴

There is some doubt where and when the first stock exchange was established. It is sometimes said that it was either in Bruges (1409) or Antwerp (1531).¹⁵ Yet, this is based on a mistranslation because these exchanges were just ‘bourses’ (*beurs* in Dutch) and not *stock* exchanges. For instance, at the bourses in Bruges and Antwerp merchants traded bills of exchange, foreign currencies, and debt claims. The first stock exchange, however, was in Amsterdam.¹⁶ The shares of the Dutch East India Company (1602) were heavily traded which led to a growing demand for a specialised trading place, and thus, the first stock exchange in 1611. The advantage of this kind of centralised trading platform is that it provides liquidity and uniform pricing.¹⁷ Thus, this idea spread to other places, such as Copenhagen (1619), Paris (1724), Vienna (1771), London (1773), and New York (1792). Yet, it should be noted that even before the formal establishment of the stock exchange, trading of securities had become more commonplace. In London brokers were already meeting in coffee houses to trade even before Jonathan’s Coffee House was converted into a stock exchange in 1773.¹⁸

Despite this positive general trend, the development was not always favourable to securities markets. Bubbles, bankruptcies, and political events led to some backlashes. For instance, with respect to the Low Countries, reference can be made to the Tulip Mania (1636–1637)¹⁹ and the collapse of the Dutch East India Company in the late 18th century. In the United Kingdom (UK), the major drawback was the South Sea Bubble (1720) and the Bubble Act of the same year which restricted the formation of the joint-stock company until 1825.²⁰ In France the Mississippi Bubble (1720) slowed the development, and the French revolution led to a temporary prohibition of joint-stock companies and the stock exchange (1791–1793).²¹

Moreover, the even bigger challenge was that up until the end of the 18th century, one of the main drives of securities markets was to finance the state, rather than private companies. Government securities dominated the markets. Additionally, joint-stock companies were not genuine private entities because they required

¹⁴ See Baskin and Miranti, above n 5 at 80, 90, 101; Allen and Gale, above n 6 at 31; Kindleberger, above n 4 at 160–1, 171.

¹⁵ See http://en.wikipedia.org/wiki/Stock_exchange (for Bruges); K. Weber and G. Davis, ‘The Global Spread of Stock Exchanges 1980–1998’ Working Paper 2000 at 28, available at <http://www.wdi.umich.edu/files/Publications/WorkingPapers/wp341.pdf> (for Antwerp).

¹⁶ See also DF Vagts, ‘Securities Regulation – An Introduction’ in A. Conard (ed) *International Encyclopaedia of Comparative Law* (Tübingen Mohr Siebeck 2000) at Ch 10 para 3.

¹⁷ For details see IV B 1 below.

¹⁸ See R. Michie, *The London Stock Exchange, A History* (Oxford OUP 1999); Baskin and Miranti, above n 5 at 70–1.

¹⁹ See Baskin and Miranti, above n 5 at 96.

²⁰ See Baskin and Miranti, above n 5 at 113.

²¹ See <http://www.euronext.com/editorial/wide/editorial-1989-EN.html>.

state authorisation and, in exchange, were often conveyed public-law rights.²² All this, however, began to change in the 19th century.

C. The Growing Importance of Securities Markets in the Last 200 Years

The industrialisation of the 19th century increased the need for capital. The building of railways and canals and the operation of mines were the main reasons why companies issued more securities and capital markets became more important.²³ This was accompanied by legal changes which made it easier to establish companies. The French Code de Commerce of 1807 already regulated the institution of the joint-stock company in abstract rules, and on its model the charter system was replaced by the concession system. The next step was the free registration system which guaranteed founders a legal entitlement to an entry in the commercial register. This came into place in the UK in 1844, France in 1867, Germany in 1870, and the United States (US) in 1875.²⁴ Additionally, the concept of limited liability became firmly established in the course of the 19th century which also fostered investment in shares.²⁵

Yet, capital markets did not develop in a straight-forward way in all countries. For instance, it is often said that in continental Europe companies have relied more on bank financing than on capital markets. The ownership of companies has therefore not been dispersed; rather, shares are held by other companies, banks, or families. This is said to be different in countries like the UK and the US where capital markets are seen as more developed, so that interest in shares has been broader and shareholder ownership has been more dispersed.²⁶ However, if one examines the development in more detail, various nuances emerge. Julian Franks et al found that in Germany between 1860 and 1950, 'financial markets look[ed] remarkably similar to their UK counterparts. There were a large number of firms listed on German stock markets and firms raised large amounts of equity finance.' The only difference was that unlike in the UK other companies and banks emerged as the main holders of shares.²⁷ According to Raghuram Rajan and Luigi Zingales, in 1913 by most indicators France was financially more developed than the US. However, after

²² See J Hill, 'Public Beginnings, Private Ends – Should Corporate Law Privilege the Interest of Shareholders' in F Macmillan (ed), *International Corporate Law, Volume 1* (Oxford Hart 2001) at 17 at 18 et seq.

²³ See R Rajan and L Zingales, *Saving Capitalism from the Capitalists* (New York Crow Business 2003) 36; Kindleberger, above n 4 at 192–6.

²⁴ See M Siems, *Convergence in Shareholder Law* (Cambridge CUP 2008) 18–20; IG MacNeil, *The Law on Financial Investment* (Oxford Hart 2005) at 35.

²⁵ See Siems, above n 24 at 69–70; MacNeil, above n 24 at p 35.

²⁶ See J Coffee, 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control' 111 Yale L J 1; Allen and Gale, above n 6 at 35–7; Chapman, above n 10 at 121.

²⁷ J Franks, C Mayer, and HF Wagner, 'The Origins of the German Corporation – Finance, Ownership and Control' (2006) 10 Rev of Finance 537.

World War I came the ‘great reversal’: Relationship capitalism became more important in continental Europe (although, it is now weakening again).²⁸ Finally, it should be noted that in the UK personal capitalism (rather than US-style market capitalism) prevailed for a long time.²⁹ It is also not entirely clear when dispersed shareholder ownership actually emerged in the UK: Was it during the 1980s or had it already emerged during the early part of the 20th century?³⁰

There is also an intensive debate as to why there are differences among countries. Some emphasise the importance of legal rules (law matters thesis), particularly in company and securities law,³¹ as well as the differences between legal families.³² The counterview objects that actual development precedes the legal development (history matters thesis³³ or law follows thesis³⁴).³⁵ Instead it is suggested that the strength of capital markets depends on other aspects, such as politics,³⁶ geography and natural resources,³⁷ culture and religion,³⁸ the education system, monetary policy, product competition,³⁹ active investment banks,⁴⁰ the existence of investment and pension funds, and other institutional investors.⁴¹

²⁸ Rajan and Zingales, above n 23 at 191–196, 201–225, 245, 247–271; R Rajan and L Zingales, ‘The Great Reversals: The Politics of Financial Development in the Twentieth Century’ (2003) 69 J of Financial Economics 5.

²⁹ See AD Chandler, *Scale and Scope: The Dynamics of Industrial Capitalism* (Cambridge Mass Belknap 1990).

³⁰ See BR Cheffins, ‘History and the Global Corporate Governance Revolution: The UK Perspective’ (2001) 43/4 Business History 87 at 89–91. And see also BR Cheffins, *Corporate Ownership and Control: British Business Transformed* (Oxford OUP 2008).

³¹ See e.g. R La Porta et al, ‘Law and Finance’ (1998) 106 J of Political Economy 1113; R La Porta et al ‘What Works in Securities Law?’ (2006) 61 J of Finance 1.

³² Coffee, above note 26 at 49 et seq, 78–9. See also A Pekmezovic, ‘Determinants of Corporate Ownership: The Question of Legal Origin’ (2007) 18 ICCLR 97 an 147.

³³ K Heine and W Kerber, ‘European Corporate Laws, Regulatory Competition and Path Dependence’ (2002) 13 Eur J of Law and Economics 47 at 53.

³⁴ H Hansmann and R Kraakman, ‘The End of History for Corporate Law’ (2001) 88 Georgetown L J 439 at 454–5.

³⁵ Eg BR Cheffins, ‘Does Law Matter? The Separation of Ownership and Control in the United Kingdom’ (2001) 30 J of Legal Studies 459; Coffee, above n 26.

³⁶ MJ Roe, *Political Determinants of Corporate Governance* (Oxford OUP 2003); M Pagano and P Volpin, ‘The Political Economy of Finance’ (2001) 17 Oxford Rev of Economics 502

³⁷ D Acemoglu et al, ‘Reversal of Fortune: Geography and Institutions in the Making of the Modern World Income Distribution’ (2002) 117 Q J of Economics 1231.

³⁸ RM Stulz and R Williamson, ‘Culture, Openness, and Finance’ (2003) 70 J of Financial Economics 313; AN Licht et al, ‘Culture, Law, and Corporate Governance’ (2005) 25 International Review of Law and Economics 229.

³⁹ See DB Branson, ‘The Very Uncertain Prospect of ‘Global’ Convergence in Corporate Governance’ (2001) 34 Cornell International LJ 321 at 329–30; BH McDonnell, ‘Convergence in Corporate Governance – Possible, but not Desirable’ (2002) 47 Villanova L Rev 341 at 380.

⁴⁰ See Baskin and Miranti, above n 5 at 120, 135.

⁴¹ MJ Roe, ‘Political Preconditions To Separating Ownership from Corporate Control’ (2000) 53 Stanford L Rev 539 at 585 (but not primarily); see also Branson and McDonnell above n 39.

There is no easy solution to these questions. The causal relation between legal and economic development cannot be simply answered in one direction or another, and there is no single reason which can explain the strengths and weaknesses of capital markets in all countries.⁴² Instead it is more fruitful to identify a mixture of legal and institutional preconditions for strong capital markets, such as effective regulators, prosecutors and courts, financial disclosure, reputational intermediaries, company and insider liability, market transparency, culture, and other informal institutions.⁴³

Furthermore, it has to be noted that the legal, economic, and institutional differences among countries are increasingly blurred. In the European Union securities law is to a large extent harmonised.⁴⁴ Economically, capital markets have recently become more important in continental Europe which has led to some dispersion of shareholder ownership in the direction of the ownership structures in the US and the UK.⁴⁵ This development is fostered by the fact that there are now institutional investors (such as investment or pension funds) in all countries and that these institutions increasingly invest across borders.⁴⁶ Finally, the stock exchanges themselves have changed. They have become private and competitive institutions which often do not operate on one market only and even merge with other stock exchanges.⁴⁷

II. Bank and Market Finance

The history of securities markets has shown that this development responded to the need for fresh capital. This requires further explanation. The easiest way to obtain capital may be to use retained earnings.⁴⁸ This means that the company draws on its internal funds earned over time, minus any proportion of profit put in reserve funds and dividends distributed to shareholders. Details depend on company law which will not be explained here. In contrast to this, external financing is a topic of both banking and securities law. The core activity of commercial banks is taking deposits from savers and other finance providers and lending funds to companies and other borrowers (Figure 1). Financing companies through loans is also called 'indirect finance'. Conversely, 'direct financing' does not depend on the role of banks as intermediaries. Here, companies issue shares, bonds, or other securities

⁴² See Siems, above n 24 at 231–233.

⁴³ BS Black, 'The Legal and Institutional Preconditions for Strong Securities Markets' (2001) 48 UCLA L Rev 781.

⁴⁴ See V C below.

⁴⁵ Siems, above n 24 at 281–288.

⁴⁶ Siems, above n 24 at 288–290.

⁴⁷ See IV B 3 below.

⁴⁸ See e.g. E Ferran, *Company Law and Corporate Finance* (Oxford OUP 1999) at 69–70; R Burgess, *Corporate Finance Law* (London Sweet and Maxwell 1992); MacNeil, above n 24 at 208; S Valdez and J Wood, *An Introduction to Global Financial Markets* (Hampshire Palgrave 4th edn 2003) at 9.

to investors on the capital market and in return get the funds they need. This is a core topic of securities law.⁴⁹ Finally, there can be mixed forms of direct and indirect finance. For instance, companies may not issue their securities to investors directly; rather they may be distributed to investors via banks. It is also possible for investment funds to buy securities and for investors to acquire units of these funds.⁵⁰ These topics are also part of securities law.

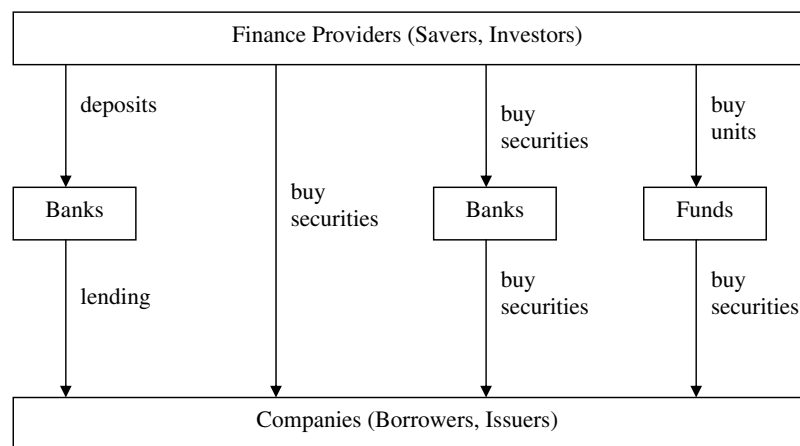


Figure 1

There are a number of reasons why countries should not only rely on bank financing.⁵¹ First, market financing reduces the danger of bank-driven crises, for instance when a major bank fails because of bad loans. Secondly, a reduction of bank dependency can be useful because strong banks not only control the corporate finance of companies, but they may be major shareholders as well, and this can lead to self-dealing problems. Thirdly, capital markets can be advantageous because they provide companies with additional funding opportunities. For instance, they may make it easier to attract venture capitalists or foreign investors, and they may also be useful if banks are too slow, risk-averse, or inflexible. Fourthly, capital markets can lead to an efficient allocation of capital. This means that the capital market will channel investment to the companies which can make the best use of them.⁵²

⁴⁹ Additionally, companies which issue shares have to take company law into account, for instance, the maintenance of capital and pre-emptive rights; see Second Council Directive 77/91/EEC of 13 Dec 1976, OJ 1977 L 26/1.

⁵⁰ In the UK and Ireland these may also be trusts; see e.g. MacNeil, above n 24 at 116, 121. Other types of collective investments, such as pension funds and life insurance, are outside the scope of this article.

⁵¹ See Black, above n 43 at 832–834.

⁵² Of course, in reality capital markets are not completely efficient; see e.g. R Gilson and R Kraak-

However, strong reliance on capital markets can also be risky. Bank financing has the benefit of stability. It escapes the potentially unhealthy short-termism of capital markets.⁵³ Furthermore, shareholders who perceive themselves as having an active part in the monitoring of the company, as opposed to being investors only, may contribute to a more stable shareholder structure.⁵⁴ For transition and developing countries in particular, an open capital market may also lead to the risk that international investors collectively withdraw their capital. This danger of free flow of capital was exemplified in the Asian financial crisis in the late 1990s and is also acknowledged by the supporters of free markets.⁵⁵

A similar dichotomy can be seen at the firm level. Bank and market financing have both advantages and disadvantages. This is complicated by the fact that the issuing of debt securities⁵⁶ has similarities with both the issuing of shares and the taking of loans. Thus, it is best to start with the basic question of whether a company should issue equity (ie, ordinary shares) or take a loan. On the one hand issuing equity to the public has certain advantages, such as giving the founders (or venture capitalists)⁵⁷ an opportunity to exit the company, the capital does not have to be paid back, and for a listed company, it may be easier to recruit the best managers and acquire other companies.⁵⁸ On the other hand a simple bank loan may be advantageous as the company may be able to renegotiate the lending terms if problems arise, does not face the risk of a public takeover, and does not have to comply with the various disclosure, reporting, and trading requirements of securities law.⁵⁹

The issuing of debt securities also entails the fulfilment of certain requirements. Companies may see it, however, as an advantage that debt securities do not provide investors with control rights in the company. This, as well as the fact that investors are entitled to fixed payments, is similar to loans.⁶⁰ It may therefore be preferable to rely highly on debt (ie, to be 'highly geared'). Nevertheless, the famous theorem by Franco Modigliani and Merton Miller holds that the choice between debt and equity finance does not affect the firm's average cost of capital.⁶¹ This was, however, based on the assumption that there was an efficient market with

man, 'The Mechanisms of Market Efficiency Twenty Years Later' (2003) 28 J of Corporation Law 718.

⁵³ See Ferran above n 48 at 76.

⁵⁴ See Black, above n 43 at 784–5.

⁵⁵ J Bhagwati, *In Defense of Globalization* (Oxford OUP Press 2004) at 199–207.

⁵⁶ Such as bonds, debentures or commercial papers; see III B 1 below.

⁵⁷ See e.g. RJ Gilson, 'Engineering a Venture Capital Market: Lessons From the American Experience' (2003) 55 Stanford L Rev 1067 at 1075, 1091.

⁵⁸ See LD Soderquist and TA Gabaldon, *Securities Law* (New York Foundation Press 2nd edn 2004) at 25–28; Valdez and Wood, above n 48 at 182.

⁵⁹ See Soderquist and Gabaldon, above n 58 at 28–30; Ferran, above n 48 at 459.

⁶⁰ See III B below.

⁶¹ F Modigliani and MH Miller, 'The Cost of Capital, Corporation Finance and the Theory of Investment' (1958) 48 American Economic Rev 261. See also F Modigliani and MH Miller, 'Corpo-

neither taxes, nor insolvency costs, nor asymmetric information. In this case it is indeed plausible that there is a link between debt and equity; for instance, an investor who wants to buy shares can borrow the necessary cash and thus substitute personal borrowing for that of a company. In the real world, of course, markets are not entirely efficient and there are taxes, insolvency costs, and asymmetric information. Thus, it is an important theme of finance to analyse which debt to equity ratio companies should have.⁶²

III. Types of Securities

The previous two sections have already mentioned the distinction between shares and debt securities. There are also hybrids between these two types. Shares, debt securities, and hybrids are all used by companies (and with respect to debt securities, by the state) in order to raise capital.⁶³ They will be explained in this section. Additionally, there are futures, options, and swaps which are not about corporate finance, but about hedging and speculation, and further, there are units in investment funds which enable investors to diversify their investment. These special instruments are not covered in this article.

The terminology of European Union (EU) securities law is that ‘financial instruments’ is the overall term for all instruments mentioned in the previous paragraph.⁶⁴ The term ‘securities’ is only used for shares, long and medium term debt securities, and hybrids between these two types.⁶⁵ Short term debt securities are called ‘money-market instruments’.⁶⁶ Futures, options, swaps, and units of investment funds are only (other) financial instruments. This is different from US terminology where the term ‘securities’ is defined in a broader way.⁶⁷

A. Shares

Ordinary shareholders provide the firm with equity capital and receive in return, at the latest with the dissolution of the company, an entitlement to the yield remaining after deduction of contractual liabilities. Furthermore, as providers of equity capital they share in the supervision of the company through their voting rights.⁶⁸ These

rate Income Taxes and the Cost of Capital: A Correction’ (1963) 53 *American Economic Rev* 433; Ferran, above n 48 at 61–2.

⁶² For details see e.g. FR Kaen, *Corporate Finance* (Cambridge Mass Blackwell 1995) at 429–540.

⁶³ The exception are covered warrants; see C below.

⁶⁴ Directive 2004/39/EC of 21 Ap 2004 (MiFiD) OJ 2004 L 145/1, Art 4(1)(n 17) and Annex I.

⁶⁵ Directive 2004/39/EC of 21 Ap 2004 (MiFiD) OJ 2004 L 145/1, Art 4(1)(n 18).

⁶⁶ Directive 2004/39/EC of 21 Ap 2004 (MiFiD) OJ 2004 L 145/1, Art 4(1)(n 19).

⁶⁷ See US Securities Act 1933, s 2(a).

⁶⁸ See e.g. BR Cheffins, above n 2 at 54; Vagts, above n 16 at para 10–2; Ferran, above n 48 at 48–9.

typical elements of shareholder ownership also point towards the advantages and disadvantages of an investment in ordinary (or common) shares. Its main advantages are that shareholders have the chance to influence the way the company is run and to participate in the company's growth. Its main disadvantage is that a financial return is not certain: the share price may fall, dividends may not be distributed, and in case of insolvency, shares are the last to be paid.

Various modifications are, however, possible. For instance, in some countries companies can issue shares with multiple or no voting rights.⁶⁹ In the latter case it is usually required that shareholders be granted preferential rights to a dividend.⁷⁰ A more recent phenomenon is tracking stocks. These are shares with dividend rights extending only to a part of the whole company so as to reach investors interested specifically in these parts.⁷¹ Details about differences in shareholders rights are a part of company law, rather than securities law. Company law is about the functionality of internal company affairs whereas securities law is about the functionality of the market on which securities are traded.⁷² A further difference is that securities law is only about joint-stock companies because shares of private companies are not tradable on the capital market.

There is no easy answer to the question of which shares investors should invest in, as much depends on one's personal preferences. This concerns, first, the type of shares. For instance, preference shares without voting rights or tracking stocks attract investors who want to target their investment more specifically than ordinary shareholders. Secondly, the amount of investment is important. Small shareholders usually see themselves as just investors because they have hardly any chance to influence the running of the company whereas larger blockholders may be more able to act as if they were the owners of the company.⁷³ Thirdly, it matters in which company to invest. The specific return to investors can, on the one hand, derive from dividends. In this respect, the crucial figure is the dividend yield of a share, calculated as follows: the dividend divided by the market price of the share, multiplied by 100.⁷⁴ On the other hand, similar to other types of investment, shareholders can try to sell their shares at a price higher than which they had bought it. Both the dividends and the change in price are taken into account in the beta coefficient (β) of a stock. This figure indicates the volatility of a share with high

⁶⁹ See Siems, above n 24 at 112–117. For an empirical account see ISS Europe, ECGI, Shearman & Sterling, *Report on the proportionality principle in the European Union* (2007), available at http://ec.europa.eu/internal_market/company/docs/shareholders/study/final_report_en.pdf.

⁷⁰ See Siems, above n 24 at 116.

⁷¹ See Siems, above n 24 at 76–77.

⁷² See Vagts, above n 16 at para 10.1. This relates to the dichotomy between 'voice' and 'exit'. See generally AO Hirschman, *Exit, Voice and Loyalty* (Cambridge Mass Harvard University Press 1970).

⁷³ On these different models see Siems, above n 24 at 60–64.

⁷⁴ See A Davidson, *How the City Really Works* (London Kogan 2006) at 41–2; Ferran, above n 48 at 69.

risk shares having a β higher than one and shares with low risks having a β between zero and one.⁷⁵

B. Debt Securities

Like a loan, a debt security is a simple credit contract. Therefore it only confers to its holder a creditor's right against the issuer, but – in contrast to a shareholder – he or she does not become part of the corporate governance of a company. Investors in debt securities usually have no control rights and do not share in the issuer's growth. However, debt securities have the advantage that, in general, investors know what they will get back, namely the principal upon the maturity date (the face value, par value, or nominal value of the debt security) and periodic interest payments (the coupons). Furthermore, in case of insolvency of the issuer, they rank above shareholders for repayment.⁷⁶

1. Types of Debt Securities

Apart from these general features, there are, however, various kinds of debt securities. First, in contrast to shares, they can be issued not only by companies but also by the state and international organisations (eg, the World Bank).⁷⁷ Debt securities issued by the state often have special names, such as gilts in the UK and Ireland, *Bunds* in Germany, and treasuries in the US.⁷⁸ For the state the main advantage in issuing government debt securities is that this can be faster, more flexible, and less contentious than a raise in the tax rate.⁷⁹

Second, there are distinctions based on the duration of debt securities. Short term debt securities of up to one year are called 'money market instruments'. Examples include treasury bills (for government securities) and commercial papers (for corporate securities). These money market instruments are traded on the money market and often follow different rules than other types of financial instruments.⁸⁰ Medium and long term debt securities are called 'bonds' and are traded on the capital market. Usually, the duration of bonds is fixed. However, there can also be 'callable bonds' which can be redeemed by the issuer prior to maturity.

Third, there are differences in the way the interest is calculated. The normal situation is that the interest is fixed from the outset. However, it is also possible for

⁷⁵ For the method of calculation see JH Stock and MW Watson, *Introduction to Econometrics* (Boston Addison Wesley 2003) at 102; Ferran, above n 48 at 58.

⁷⁶ Ferran, above n 48 at 52.

⁷⁷ Chapman, above n 10 at 7 (in 2005 world's financial assets \$ 119 trillion; \$ 33.1 trillion shares; \$ 31.5 trillion corporate debt securities; \$ 21.2 trillion government bonds).

⁷⁸ For an overview of government debt securities in the EU Member States see http://ec.europa.eu/economy_finance/efc/efc_market_en.htm.

⁷⁹ Furthermore, the issuing of government bonds has a monetary effect. See e.g. R Lipsey and A Crystal, *Economics* (Oxford OUP 11th edn 2007) at 464–6.

⁸⁰ See already III preamble above.

the interest to be linked to the interest rate of the market. These debt securities are called 'floating rate notes' (FRN). Further, there can be 'zero bonds' (or 'zero coupon bonds') for which no interest is paid at all. Here, the incentive to invest derives from the fact that the zero bonds are issued at discount to par value.

Fourth, it can be distinguished based on the extent to which the business risk of the issuer is born by the investor. The starting point is that the risk depends only on the financial strength of the issuer, and the investor may therefore lose the investment if the issuer becomes insolvent. However, on the one hand it is possible to intensify this risk. For instance, government debt securities may be 'revenue bonds' where the principal and interest are only repaid from the earnings generated by a particular project. On the other hand the risk can be reduced by collaterals. This is relevant for corporate bonds. An example of these secured debt securities are 'mortgage bonds' for which the debt obligation is backed by mortgages on specific properties. With respect to secured and unsecured bonds, a note on terminology is necessary. In the UK secured debt securities are sometimes called 'debentures' and unsecured debt securities 'loan stock'.⁸¹ The problem with this, however, is that in the US debentures are unsecured securities and stock usually refers to shares. Thus, it is better to avoid these terms, as is done in the European directives and regulations on securities law.

Fifth, debt securities may be issued on either a domestic or foreign market. When they are issued abroad, it is further possible that they are issued in either the currency of the country where they are issued or in another currency. In the latter case debt securities are called 'Eurobonds'. This term needs further explanation because Eurobonds are not necessarily associated with the Euro or the European Union. The 'Euro-term' originated after World War II when wealthy citizens from Eastern European countries sought to open dollar accounts – but not in the US, because they feared that their assets may be seized for political reasons. As a consequence, they held 'Eurodollar' accounts in Western European countries. In the 1960s the prefix 'Euro' was extended to bonds which were denominated in a foreign currency. The major driving force for these Eurobonds was US tax law because it discouraged investment in foreign debt issuers.⁸² Today, there can be various reasons why Eurobonds are used. For instance, they may be advantageous because the issuer prefers or needs a particular currency, or because the issuer targets the international investment community interested in Eurobonds.

2. *Asset Backed Securities (ABS)*

ABS are a special type of debt securities. In contrast to the previous types, the special features derive not primarily from its legal characteristics but from its economic function. The starting point is that a financial institution (the 'originator';

⁸¹ See Ferran, above n 48 at 50; MacNeil, above n 24 at 101.

⁸² See generally Davidson, above n 74 at 93; Valdez and Wood, above n 48 at 133, 135–9, MacNeil, above n 24 at 104.

see Figure 2) owns risky assets, typically loan debts or other receivables. Next, the originator establishes a separate company (the ‘special purpose vehicle’ or SPV) and sells the risky assets to it. The SPV issues bonds to investors which are backed by its assets (therefore, ‘asset backed securities’),⁸³ and the surplus of the ABS is transferred to the originator. This entire process is called securitisation because it transforms receivables into tradable securities.⁸⁴

Securitisation can also take place if a non-financial company wants to dispose of risky assets. Here too financial institutions are involved. They act as sponsors or finance arrangers of the securitisation. This means they have either an assisting role only, or they buy the assets from the non-financial institution and transfer them to the SPV. Apart from that, the securitisation is as depicted in Figure 2.

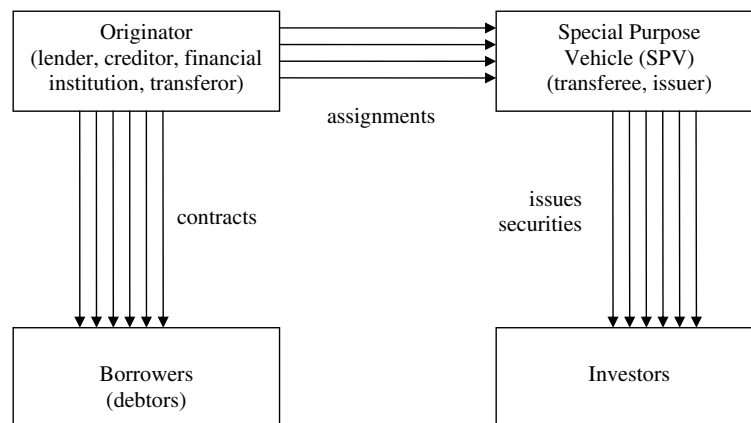


Figure 2

Why does securitisation take place? The first advantage is that it enables the originator to dispose of risky assets. This is particularly important for financial institutions because the removal of risky assets from the balance sheet makes it easier to

⁸³ Less common is that the SPV issues shares. However, this is also possible. See HS Scott, *International Finance: Law and Regulation* (London Sweet and Maxwell 2004) at 342; Commission Regulation 2009/204 of 29 Ap 2004 implementing Directive 2003/71/EC (Prospectus Directive), OJ 2004 L 215/33, Art 2(5): ‘Asset backed securities’ means securities which: (a) represent an interest in assets, including any rights intended to assure servicing, or the receipt or timeliness of receipts by holders of assets of amounts payable there under; or (b) are secured by assets and the terms of which provide for payments which relate to payments or reasonable projections of payments calculated by reference to identified or identifiable assets’.

⁸⁴ See generally on ABS and securitisation M Graziadei and U Mattei, *Commercial Trusts in European Private Law* (Cambridge CUP 2005) at 505–531; C Paul and G Montagu, *Banking & Capital Markets Companion* (Exeter Law Matters Publishing 2006) at 126–154; Scott, above n 83 at 336–359; Valdez and Wood, above n 48 at 131–3.

comply with capital adequacy requirements.⁸⁵ Secondly, securitisation is a flexible source of funding. It transforms receivables, which previously only entitled the originator to future income streams, into freely tradable securities. There is also demand for these securities from institutional investors because they regard it as an advantage that the securitised assets are insulated from the general business risk of the originator.

Both in the EU and in the US, lengthy reports have discussed the various regulatory problems of ABS.⁸⁶ For instance, ABS relate to both company and insolvency law because there has to be a true sale of the asset in order to insulate the SPV from the general business risk of the originator. Further, bank secrecy rules matter because originators are usually financial institutions. If loans are secured by way mortgages, ABS are also called Mortgage Backed Securities (MBS). However, with MBS it may be a problem that the assets are constantly changing, and therefore, the real estate register may need to be changed too.⁸⁷ Finally, the treatment of ABS in accounting and tax law plays an important role.⁸⁸

3. *Investment in Debt Securities*

As with shares,⁸⁹ the question of which debt securities investors should invest in has no easy answer because a lot depends on one's personal preferences. This concerns, first, the decision of which type of debt securities in which to invest. For instance, depending on their time horizon, investors may choose between short, medium, and long term debt securities; and depending on their risk preferences, they may choose between secured and unsecured ones.

Second, the investment decision depends on the default risk of the specific debt security. Here, credit rating agencies (mainly Moody's, Standard & Poor's, Fitch and Dominion) play an important – and controversial – role. Based on their own criteria they rate bonds with letters such as 'AAB', 'A-', etc. Since a 'rating can make the difference between life and death',⁹⁰ the International Organization of Securities Commissions (IOSCO), the EU, and the US-Securities Exchange Commission (SEC) have recently examined whether there is a need to regulate these rating agencies;⁹¹ however, none have come to a definitive conclusion.

⁸⁵ For an example see Valdez and Wood, above n 48 at 34. See also Directive 2006/48/EC of 14 Jun 2006 (Credit Institutions Directive), OJ 2006 L 177/8, Arts 4(36–44), 94–101, Annex IX.

⁸⁶ For the EU see study from Nov 2004, available at http://ec.europa.eu/enterprise/entrepreneurship/financing/docs/report_en.pdf (112 pages). For the US see SEC-Rules on ABS from Dec 2004, available at <http://www.sec.gov/rules/final/33-8518.pdf> (495 pages).

⁸⁷ See Graziadei and Mattei, above n 84 at 514 (for Germany).

⁸⁸ See e.g. Scott, above n 83 at 343–347.

⁸⁹ See A above.

⁹⁰ Financial Times 'Lex: Credit Rating Agencies' (13 Feb 2005).

⁹¹ The Technical Committee of the International Organization of Securities Commissions, Code of Conduct Fundamentals for Credit Rating Agencies, Dec 2004, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD180.pdf>; Directive 2003/125/EC of 22 Dec 2003 implementing Directive 2003/6/EC (Market Abuse Directive), OJ 2003 L 339/73, rec. 10; Communication of 23 Dec 2005 from the

Third, the yield of a debt security matters. When an investor buys a newly issued debt security, the yield is only the interests which are paid per year. For a later purchase, however, it has to be taken into account that the face value of a debt security usually differs from its market price. At first sight this may seem surprising; it is the very feature of a debt security as a securitised loan that an investor should know exactly what he or she will get back. However, the market price can vary, for instance, because of the default risk of the issuer or a change in the prevailing interest rate in the economy. Thus, the current yield has to be calculated as follows: the annual interest payment divided by its market price, multiplied by 100.⁹²

C. *Hybrids*

The first types of hybrids are mere modifications of shares or debt securities. For instance, preference shares without voting rights forgo the participation rights of ordinary shareholders in favour of preferential dividend rights.⁹³ With respect to bonds it is, for example, possible to provide the following: that the interest is not fixed but depends on the profits of a project,⁹⁴ that bondholders have contractual rights to participate in the running of the company,⁹⁵ and that bonds are subordinated to other forms of debt in case of insolvency.⁹⁶

Second, convertible bonds (or convertible preference shares) provide a temporal combination of two types of investment. They are bonds which can be converted into shares. Thus, on the one hand the investor has the advantage that he or she can always decide to keep the investment safe in a debt security; on the other hand he or she can also participate in the growth of the company by converting the bonds into shares.

Third, there are different types of warrants.⁹⁷ A traditional warrant is issued together with bonds (or preference shares) as a 'sweetener' to the former securities. It allows its holder to buy a specified amount of shares at a fixed price. Thus, in contrast to convertibles, the investor can always keep the bonds.

The purchase of shares on the basis of the warrant is not equivalent to a simple acquisition of shares on the market because the warrant guarantees the investor that he or she does not pay more than the fixed price. This is also the function of 'naked

Commission on Credit Rating Agencies (2006/C 59/02); EU Commission, Consultation on (i) a draft Directive / Regulation with respect to the authorisation, operation and supervision of credit rating agencies (CRAs) and (ii) on policy options to address the problem of excessive reliance on credit ratings of 31 July 2008; SEC documents available at <http://www.sec.gov/divisions/marketreg/ratingagency.htm>.

⁹² See Davidson, above n 74 at 90; Valdez and Wood, above n 48 at 110–1.

⁹³ See A above.

⁹⁴ See B 1 above (on revenue bonds).

⁹⁵ For the UK see Gore-Browne on Companies (Jordan 2003), Update 64 para 21[8].

⁹⁶ See also Ferran, above n 48 at 54 (on subordinated debt in general).

⁹⁷ See e.g. MacNeil, above n 24 at 107–8.

warrants'. They are naked because they are issued without an initial bond (or preference share). The investor therefore only receives the opportunity to buy a specified share at a fixed price.

Naked warrants can be issued not only by the issuer of the underlying share but by financial institutions as well. In the latter case they are called 'covered warrants'. Here, one may expect that the financial institution (which is not the issuer of the underlying share) has to buy the shares on the market if the investor makes use of the warrant. The term 'covered' would therefore mean that the financial institution actually possesses or buys the shares. However, it is more common that covered warrants provide for cash settlement. For instance, when an investor buys a covered warrant that gives him or her the right to acquire a share for €80 in the next two years, and after one year the share price is €100, the investor will get €20 in cash. In these cases the term 'covered' only refers to the fact that the financial institution will often cover its risk by acquiring other financial instruments or other forms of insurance.

The cash settlement of covered warrants is not only of technical importance. So far, it has been assumed that warrants always grant the right to buy shares (call warrants). However, with cash settlement it is also possible to buy warrants which grant the right to sell shares (put warrants) because it does not matter whether the investor owns or is able to acquire these shares. Furthermore, there can be warrants on intangible things, for instance, index warrants, where the cash settlement is determined by the value of an index (Dow Jones, FTSE 100, DAX, etc.).⁹⁸ Functionally, these covered warrants are different from the other securities, which have been described in this section, because they are not used in order to raise capital. Rather, they are similar (but not identical) to financial options, which are not addressed in this article.⁹⁹

IV. Securities markets and Stock Exchanges

The previous section has explained which types of securities exist. The second branch of securities law is that securities are issued and traded on a market.¹⁰⁰ Here too, various differentiations need to be addressed, for instance, between public and private offers, first and secondary listings, primary and secondary markets, and stock exchanges and other trading platforms.

A. Public Offers and Trading

Most parts of securities law are only applicable if shares or debt securities are or have been offered to the public. In contrast to this, private placements concern of-

⁹⁸ See Chapman, above n 10 at 49.

⁹⁹ See already III preamble above.

¹⁰⁰ See I preamble above.

fers to a limited number of persons. Public offers can be first or second offers. A first offer denotes the situation in which an issuer offers securities to the public for the first time. If this concerns shares (and not debt securities), this is also called 'going public' or 'initial public offering' (IPO). Second offers (or secondary offerings) take place when an issuer, who has already offered securities to the public, issues new securities. Legally, this distinction matters because second offers do not have to comply with standards as strict as those for first offers.¹⁰¹

Another distinction is between primary and secondary markets. Primary markets are those where securities are created and investors purchase them from the issuers. Thus, all types of public offers concern primary markets. In contrast to this, secondary markets are those where investors buy and sell securities to each other after a public offer.

B. Stock Exchanges

*1. Rationale*¹⁰²

Public offers and trading often take place at stock exchanges. Why is this the case? From the issuers perspective the admission to a stock exchange has the advantage of enhancing the liquidity of an issue.¹⁰³ This follows from the fact that the willingness of investors to buy securities increases if the securities are traded on a stock exchange. There are various reasons why investors feel attracted to these securities. First, the admission and trading requirements of exchanges often protect investors beyond the general rules of securities law, for instance, because there may be additional minimum capitalisation or disclosure requirements. Secondly, major stock exchanges have a reputational advantage because investors may take the view that only high quality securities are traded at these exchanges. Thirdly, and most importantly, exchanges enhance the possibility to sell the securities again. On the one hand this is just a natural consequence of the fact that stock exchanges provide trading venues where buyers and sellers meet. On the other hand a number of institutional features foster the functionality of stock exchanges. For instance, exchanges usually provide mechanisms for price formation, clearing and settlement, and monitoring of trading. Furthermore, it is possible that so called 'market makers' will 'enhance the liquidity of an exchange by using their own capital to trade against the market when the trading is light, in order to buffer price swings due to

¹⁰¹ See Ferran, above n 48 at 73.

¹⁰² Soderquist and Gabaldon, above n 58 at 25–28; Moloney, above n 1 at 83–84; AM Fleckner, 'Stock Exchanges at the Crossroads' (2006) 73 *Fordham L Rev* 2541 at 2545–2551; JR Macey and M O'Hara, 'Regulation Exchanges and Alternative Trading Systems: A Law and Economic Perspective' (1999) 28 *J of Legal Studies* 17 at 37–42; EW Kitch, 'Regulation of the Securities Market' in B Bouckaert and G De Geest (eds), *Encyclopaedia of Law and Economics* (Cheltenham Edward Elgar 2000) at 817–8.

¹⁰³ See also Ferran, above n 48 at 74.

the fewness of offers rather than to changes in underlying market values'.¹⁰⁴ Finally, stock exchanges also have a public function. The reasons outlined above not only benefit issuers and investors but also improve the allocation of capital. This means that the capital market channels investment to the companies which can make best use of them.¹⁰⁵ This fosters financial development which – according to the predominant view – also leads to economic growth.¹⁰⁶

2. Types of Stock Exchanges

In the terminology of EU securities law, there are listed, regulated, and other markets. The term 'listed market' (or first-tier market) refers to the Member States' main securities market with the most difficult access and maximum investor protection. Other regulated markets (or second-tier markets) provide lighter requirements and may be better suited for smaller or growing companies. However, most parts of EU securities law apply to all 'regulated markets'. As it is therefore important to know which exchanges are regulated markets, the EU Commission publishes a list of all regulated markets in the EU.¹⁰⁷ This list is also interesting from a terminological perspective because Member States use different names for their second regulated markets, for instance: 'semi-official market' in Austria, 'unofficial market' in Bulgaria, 'parallel market' in Poland, and 'free market' in Slovenia. Finally, there are exchanges which are not regulated markets. This does not mean that these exchanges are not subject to any national regulations. With very few exceptions the directives and regulations of EU securities law are not applicable. For instance, the Alternative Investment Market (AIM), which belongs to the London Stock Exchange (LSE), is one of these non-regulated markets for smaller growing companies.¹⁰⁸

The rationale of stock exchanges, as stated above, is most clearly fulfilled for listed markets. However, there are also benefits in choosing other regulated or even non-regulated markets. It may be cheaper and faster to be admitted to these markets, and the ongoing costs and regulatory burdens are usually lower. Thus, for companies which only need some external capital, it can be a rational decision to forgo the liquidity of listed markets for the lower costs of secondary or unregulated markets.

¹⁰⁴ *Board of Trade of the City of Chicago v Securities and Exchange Commission* 923 F.2d 1270, 1272 (1991) per R Posner. For the European law see Directive 2004/39/EC of 21 Ap 2004 (MiFiD) OJ 2004 L 145/1, Art 4(1)(n 8).

¹⁰⁵ See already n 52 above.

¹⁰⁶ For a discussion of this position see Rajan and Zingales, above n 23 at 108–125; Ferran, above n 1 at 8–11.

¹⁰⁷ Available at http://ec.europa.eu/internal_market/securities/isd/mifid_en.htm. This is based on Directive 2004/39/EC of 21 Ap 2004 (MiFiD) OJ 2004 L 145/1, Art 4(1)(n 14).

¹⁰⁸ http://www.londonstockexchange.com/en-gb/products/companyservices/ourmarkets/aim_new/AIM.

3. *Recent Developments*

Traditionally, stock exchanges were non-profit mutual associations which held an uncontested monopoly in a particular country. The stock exchange was not owned by investors but rather by insiders such as brokers, dealers, banks, and possibly also the state. Structurally, it was described as a private golf club: 'The assets of the golf club (the course and clubhouse) correspond to the assets of the exchange. The playing members correspond, say, to large financial institutions; the social members correspond, say, to smaller brokers.'¹⁰⁹

A process called demutualization has changed this structure, and stock exchanges have gradually become ordinary listed companies.¹¹⁰ The starting point was the 1987 listing of the Swedish Options Exchange (*OptionsMäklarna*) which had already been a public company from the outset (OM AB). In 1992 the Stockholm Stock Exchange (SSE) was transformed into a company, and in 1993 it was taken over by the holding company of the Swedish Options Exchange (OM *Gruppen* AB). In 1998 the SSE merged into OM *Gruppen* AB, which in 2003 became part of the Nordic-Baltic stock exchange OMX, which is also listed.¹¹¹ Recently, most other major stock exchanges have become listed companies too, such as the London Stock Exchange, Euronext, and *Deutsche Börse* in 2001, and the NYSE in 2005.¹¹²

This development has had various consequences. First, it has reduced the regulatory role of stock exchanges. In the past stock exchanges often had the main responsibility to decide about listing rules, ongoing disclosure requirements, and monitoring of trading. There are indeed some arguments in favour of self-regulation of stock exchanges. The profits of stock exchanges increase if they attract a greater volume of securities. Thus, stock exchanges have incentives to provide and enforce legal rules which protect both issues and investors, whereas the government may be sheltered from competitive pressures. It could therefore be argued that regulatory competition between stock exchanges leads to a 'race to the top'.¹¹³

¹⁰⁹ O Hart and J Moore, 'The Governance of Exchanges: Members' Cooperatives Versus Outside Ownership' (1996) 12 *Oxford Rev of Economic Policy* 53 at 58. See also M Blair and G Walker, *Financial Markets and Exchanges Law* (Oxford OUP 2007) para 1.220 (distinction between non-profit and profit generating mutual entities).

¹¹⁰ See e.g. Regulatory Issues Arising From Exchange Evolution – Final Report, Report of the Technical Committee of IOSCO, Nov 2006, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCO-PD225.pdf>; Fleckner, above n 102 a 2554–2566; Ferran, above n 1 at 239–243; A Mendiola and M O'Hara, 'Taking Stock in Stock Markets: The Changing Governance of Exchanges' Working Paper 2003, available at <http://ssrn.com/abstract=431580>; AN Licht, 'Stock Exchange Mobility, Unilateral Recognition, and the Privatization of Securities Regulation' (2001) 41 *Virginia J of International Law* at 589–592.

¹¹¹ See generally <http://www.nasdaqomx.com/aboutnasdaqomx/milestones/milestonesomx/>.

¹¹² See general overview IOSCO, above n 110 at 2.

¹¹³ See PG Mahoney, 'The Exchange as Regulator' (1997) 83 *Virginia L Rev* 1453; FH Easterbrook and DR Fischel, *The Economic Structure of Corporate Law* (Cambridge Mass Harvard University Press 1991) at 294–5; SJ Choi and A Guzman, 'Portable Reciprocity: Rethinking the International Reach

However, counter-arguments are also possible. The extent of competitive pressures on stock exchanges could be doubted because most people primarily invest in their home country. Furthermore, the transformation of stock exchanges into ordinary companies may have the consequence that they should only compete over the commercial efficiency of their operations. Involvement in regulatory issues may lead to conflicts of interests, and further, stock exchanges lack democratic accountability and public enforcement mechanisms. Finally, statutory law can be supported by the argument that the state has a general interest in the functioning of financial markets.¹¹⁴ As a result, statutory law and the powers of public authorities have now by and large substituted the former involvement of stock exchanges in legislation and supervision.¹¹⁵

Secondly, the demutualization of stock exchanges makes regulatory responses necessary. These changes are summarised in a report of the Technical Committee of IOSCO.¹¹⁶ For instance, this report discusses which governance arrangements may be used, such as independent board members and ‘Chinese walls’, in order to maintain a balance between the commercial and public interests of stock exchanges. Another point that is addressed is that countries may provide rules on the ownership of stock exchanges. For example, there may be restrictions on shareholder ownership as well as disclosure and notification requirements. With respect to the supervision of stock exchanges, it can be a problem that many stock exchanges are listed on the exchange’s own market, and therefore special oversight arrangements against a potential conflict of interest may be needed.

Thirdly, the transformation of stock exchanges into for-profit entities has increased competition among them. Stock exchanges are motivated to improve their electronic trading systems¹¹⁷ in order to provide fast and cheap trading services. Moreover, competition has led to a number of cross-border alliances, for example, in Europe OMX (Stockholm, Helsinki, Riga, Tallinn, Vilnius, Copenhagen) and Euronext (Paris, Brussels, Amsterdam, Porto, Liffe), and now also the emerging transatlantic alliances NYSE Euronext and NASDAQ OMX.¹¹⁸ There have also been ongoing attempts to take over the London Stock Exchange.¹¹⁹ These alliances do not lead to single entities; rather they only provide holding structures or joint

of Securities Regulation’ (1998) 71 Southern California L Rev 903 at 945–947; Macey and O’Hara, above n 102 at 37–45; R Romano, ‘Empowering Investors: A Market Approach to Securities Regulation’ (1998) 107 Yale L J 2359 at 2399–2401; Ferran, above n 1 at 243–254.

¹¹⁴ See 1 above.

¹¹⁵ See e.g. Directive 2003/71/EC of 4 Nov 2003 (Prospectus Directive), OJ 2003 L 345/64, Art 21 and Directive 2003/6/EC of 28 Jan 2003 (Market Abuse Directive), OJ 2003 L 96/16, Art 11 which refer to ‘competent authorities’.

¹¹⁶ See above n 110.

¹¹⁷ For instance, Xetra (for the Deutsche Boerse), SETS (for the LSE), and NCS (for Euronext).

¹¹⁸ On the market of stock exchanges see in particular the statistics and publications of the World Federation of Exchanges, available at <http://www.world-exchanges.org/WFE/home.Asp>.

¹¹⁹ First by OMX, then Deutsche Boerse, and then NASDAQ. See Blair and Walker, above n 109 at paras 1.223–4.

ventures with common information and trading systems, marketing, and – as far as possible – legal rules.¹²⁰ Therefore, even with these international stock exchanges, companies have to choose a point of entry in one specific country.

C. Securities Trading Outside Exchanges

Stock exchanges face increased competition not only from other exchanges but also from other forms of trading. Trading of securities outside exchanges has the disadvantage that it provides less liquidity. However, this may be counterbalanced by the fact that trading outside exchanges can be cheaper, faster, more confidential, and less constrained by regulation than trading on an exchange.

In detail, there are different forms of trading outside exchanges. First, trading ‘over the counter’ (OTC) means that securities are traded directly between two parties. These parties are often professionals, such as financial institutions or financial investors. Securities which are usually traded OTC are money market instruments and Eurobonds.¹²¹ Secondly, Alternative Trading Systems (ATS), which in the EU are also called Multilateral Trading Facilities (MTF),¹²² go further because they offer a ‘quasi-exchange’ for multiple parties. Typically, ATS provide a real-time, computerised, automatic order matching system, but – in contrast to stock exchange – no infrastructure (such as market makers)¹²³ that facilitates liquidity.¹²⁴ Similar to OTC, ATS are mainly used by institutional and professional investors for trading in debt securities. Thirdly, by contrast, ‘internalisation’ primarily concerns transactions by retail investors. Internalisation takes place if a bank or investment firm executes an order which it had received by one of its client without involvement of a stock exchange. For instance, this can be the case when a client of a bank orders the acquisition of a security and a second client of that same bank orders the sale of the same type of security. Furthermore, it is possible that a bank executes a client order by buying or selling the securities itself.

Securities-trading outside exchanges is not without problems.¹²⁵ The dispersal of trading away from stock exchanges leads to a fragmentation of markets. Thus, there is the danger that the markets in securities become more shallow and illiquid. Further, price formation can become less efficient and price volatility can increase. Finally, internalisation in particular can lead to a conflict of interest; for instance, when a bank gets a sell order from one of its customers and then executes

¹²⁰ See NJ Clausen and KE Sorensen, ‘Competition and Co-operation between Stock Exchanges – Legal Aspects and Challenges’ (2002) EBLR 371; Licht, above n 110 at 591–3; Ferran, above n 1 at 256–257.

¹²¹ See III B 1 above.

¹²² See Directive 2004/39/EC of 21 Apr 2004 (MiFiD) OJ 2004 L 145/1, Art 4(1)(n 15).

¹²³ See B 1 above.

¹²⁴ See generally Macey and O’Hara, above n 102; MacNeil, pp 293–5.

¹²⁵ See e.g. Proposal for a Directive on Investment Services and Regulated Markets and Amending Directives 85/611/EEC, 96/6/EEC and 2000/12/EC of 19 Nov 2002, COM(2002) 625 final at 8–12.

this order by buying these securities from the customer. Possible regulatory responses include the extension of the requirements of stock exchanges to ATS¹²⁶ and the prohibition of internalisation.¹²⁷ However, the EU does not follow these ‘radical approaches’ but provides more nuanced rules, in particular requiring transparency.¹²⁸

V. The Internationalisation and Europeanisation of Securities Law

Who should regulate securities law? It has already been mentioned that today it is primarily legislators, rather than stock exchanges, who are responsible for the regulation of securities markets.¹²⁹ This leads to further questions of whether legislation should be left to the nation states or whether some kind of global, or at least European, securities law is necessary, and to what extent this internationalisation and Europeanisation has already taken place.

A. *The Rationales for Unifying Securities Law*

The reasons for international (or European) uniformity are threefold.¹³⁰ First, harmonisation benefits issuers because issuers who offer securities across countries face fewer regulatory differences which lead to lower transactions costs and reduced costs of capital. Secondly, uniform rules reduce the transaction costs to investors. They can more easily compare investment opportunities from different countries, therefore investments in foreign countries become less risky. Thirdly, uniform ‘rules of the game’ create a ‘level playing field’. If different countries cannot undercut each other and national lobbies cannot bring about over-regulated laws, then all issuers have equal opportunities, and in the international competition for investors, only their economic performance counts.

¹²⁶ For the US see Regulation ATS 1998 of the SEC.

¹²⁷ This used to be the case in some Member States of the EU. See Proposal for a Directive on Investment Services and Regulated Markets and Amending Directives 85/611/EEC, 96/6/EEC and 2000/12/EC of 19 Nov 2002, COM(2002) 625 final at 6–8.

¹²⁸ Directive 2004/39/EC of 21 Apr 2004 (MiFiD) OJ 2004 L 145/1, Arts 27–30.

¹²⁹ See IV B 3 above.

¹³⁰ U Geiger, ‘The Case for Harmonization of Securities Disclosure Rules in the Global Market’ (1997) *Columbia Business L Rev* 241; U Geiger, ‘Harmonization of Securities Disclosure Rules in the Global Market – A Proposal’ (1998) 66 *Fordham L Rev* 1785. For the discussion see also EJ Pan, ‘Harmonization of U.S.-EU Securities Regulation: The Case For a Single European Securities Regulator’ (2003) 34 *Law and Policy in International Business* 499 at 504–510; MB Fox, ‘The Securities Globalization Disclosure Debate’ (2000) 78 *Washington University L Q* 567 at 593–595; HE Jackson, ‘Centralization, Competition, and Privatization in Financial Regulation’ (2001) 2/2 *Theoretical Inquiries in Law* 4 at 6–15.

Like harmonisation in other areas of law,¹³¹ criticism here is also possible. It can be said that uniform rules disregard national differences in culture, language, and business practices. They could also be disadvantageous because international law making is usually more burdensome and slow, and perhaps also counter to regulatory innovations.¹³² Moreover, there is a line of criticism based on the advantages of regulatory competition.¹³³ In a non-harmonised system of securities law, issuers and investors can choose where to sell and buy securities. This may lead to competition among regulators for the best law and thus a 'race to the top'. Alternatively, it could be emphasised that different issuers and investors have different preferences, for instance regarding the risk they are willing to take. Thus, non-uniformity could be advantageous because it offers more choices to issuers and investors.

Yet, there are valid counter-arguments against this criticism. The first is that harmonisation need not necessarily disregard differences in culture, language, and business practices if countries kept some room for manoeuvre. Secondly, the problems of 'petrification' and unresponsive law-making can be addressed by innovative law making procedures, as already seen with financial regulation in the EU.¹³⁴ Thirdly, regulatory competition in securities law can be problematic. The starting point of this critique is that the directors and managers of the issuer may choose to offer securities under the law of a country which only provides lax rules. Thus, a 'race to the bottom' may be threatening. The belief that investors will spot this managerial opportunism and refuse to invest in such a company is not entirely realistic. Investors may not have the ability to identify which legal system is best. Furthermore, there is a home bias in investment which means that investors usually invest in their home market, even if the rules of this market are not ideal.¹³⁵ Finally, regulatory competition assumes that law makers readily respond to external pressures. However, as exemplified in the discussion between the public choice and the public interest theory,¹³⁶ the behaviour of governments and parliaments cannot easily be equated with that of private actors. As a result, there is a case for at least some harmonisation.

¹³¹ For company law see Siems, above n 24 at 375–377.

¹³² HS Scott, 'Internationalization of Primary Public Securities Markets' (2000) 63 *Law and Contemporary Problems* 71 at 78–80.

¹³³ R Romano, 'The Need for Competition in International Securities Regulation' (2001) 1 *Theoretical Inquiries in Law* at 6–11, 29–60.

¹³⁴ See C 1 below.

¹³⁵ See generally e.g. HS Scott, *International Finance* (New York Foundation Press 12th edn 2005) at 460–1; AG Ahearne et al, 'Information Costs and Home Bias: An Analysis of US Holdings of Foreign Equities' (2004) 62 *J of International Economics* 313; KK Lewis, 'Trying to Explain the Home Bias in Equities and Consumption' (1999) 37 *J of Economic Literature* 571.

¹³⁶ See Siems, above n 24 at 234.

B. International Securities Law

On the international level there has been some promotion for uniformity by the International Organization of Securities Commissions (IOSCO), the International Accounting Standards Board (IASB), and the Committee on Payment and Settlement Systems (CPSS).¹³⁷ IOSCO, founded in 1974, is a private association of securities supervisors with aims to establish informal standards and improve information exchange, monitor securities transactions, and cooperate among national supervisory bodies. For this purpose IOSCO has proposed international objectives, consolidated recently in the Objectives and Principles of Securities Regulation.¹³⁸ The IASB is responsible for uniform accounting standards which are now called International Financial Reporting Standards (IFRS). While these do not apply directly in individual legal systems, it is becoming increasingly accepted for companies to present their accounts in accordance with these international accounting standards.¹³⁹ The CPSS is a committee of the Bank for International Settlements (BIS). Together with IOSCO, the CPSS has drafted Recommendations for Securities Settlement Systems which have the aim to reduce the risks involved in the clearing and settlement of securities.¹⁴⁰ These three documents – the IOSCO Objectives, the IFRS, and the CPSS/IOSCO Recommendations – are also fostered by the International Monetary Fund (IMF) and the World Bank. As part of their Financial Sector Assessment Program (FSAP), it is monitored how well countries observe these international standards.¹⁴¹

C. European Securities Law

1. Development

From 1979 to 1989 the European Community (EC) enacted directives on issuer disclosure, official listing, and insider dealing; and from 1993 to 1998, directives were enacted on investment services, investment funds, and financial institutions.¹⁴² The problem with these directives was that they only harmonised some basic rules, lacked coherency, and were implemented and enforced in different ways. This patchwork approach to European securities law has changed significantly with the Financial Services Action Plan 1999 (FSAP). The overall aim of this plan was to

¹³⁷ See <http://www.iosco.org/>; <http://www.iasb.org.uk/>; <http://www.bis.org/cpss/index.htm>. See also C Bradley, 'Private International Law-Making For the Financial Markets' (2005) 29 Fordham International L J 127.

¹³⁸ Available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>.

¹³⁹ Overview available at <http://www.iasplus.com/country/useias.htm>.

¹⁴⁰ Available at <http://www.bis.org/publ/cpss46.htm>.

¹⁴¹ See <http://www.imf.org/external/np/fsap/fsap.asp>. For the Reports on the Observance of Standards and Codes (ROSCs), available at <http://www.imf.org/external/np/rosc/rosc.asp>.

¹⁴² For details see Moloney above n 1 at 21–25; MG Warren, *European Securities Regulation* (The Hague Kluwer Law International 2003) at 1–8, 57–76.

create a single EU financial market, eliminate market fragmentation, and reduce the costs of raising capital. Its forty-two measures were completed in 2005. Thus, there is now relatively comprehensive EU financial law, particularly in securities law.

It was discussed whether a Financial Services Action Plan II should follow. However, in its White Paper on Financial Services Policy 2005–2010, the Commission took a more moderate approach.¹⁴³ It was recommended that first the existing *acquis communautaire* should be implemented, enforced, and evaluated. Secondly, the remaining barriers to the financial services across the EU should be removed. And thirdly, the Commission should aim at deepening its cooperation with other financial marketplaces, in particular the US.

The FSAP was mainly about reforming substantive law. However, there is the further problem that the traditional EU law-making process was often said to be too slow, rigid, and complex.¹⁴⁴ Thus, in 2001 the Committee of Wise Men, chaired by Baron Alexandre Lamfalussy, produced a report ('Lamfalussy Report') which led to ground-breaking changes to the law-making procedure of EU financial services law.¹⁴⁵ The integration of European financial markets is now carried out in a flexible four-level process (Figure 3 below). At the first level, framework directives or regulations are laid down. At the second level, the Commission, together with new committees, adopts implementing rules in directives or regulations. At the third level, the committees provide recommendations, guidelines, and common stan-

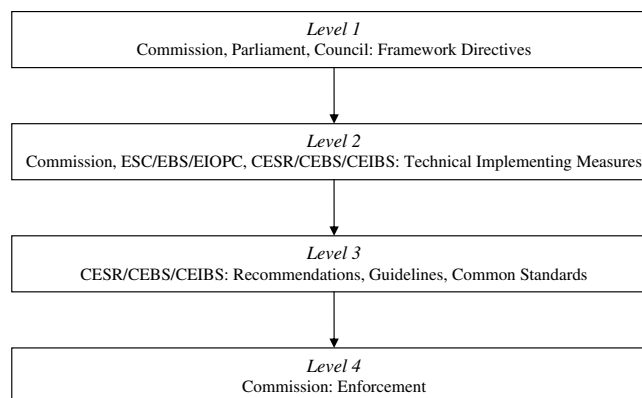


Figure 3

¹⁴³ Available at http://ec.europa.eu/internal_market/finances/docs/white_paper/white_paper_en.pdf.

¹⁴⁴ See e.g. M Siems, 'The Case Against Harmonisation of Shareholder Rights' (2005) 6 Eur Business Organization L Rev 539 at 542.

¹⁴⁵ Final Report of the Committee of Wise Men on the Regulation of the European Securities Markets, 15 Feb 2001. Background is the comitology procedure, see Council Decision 1999/468/EC of 28 Jun 1999 laying down procedures for the exercise of implementing powers conferred on the Commission, OJ 1999 L 184/23.

dards. Finally, at the fourth level, the Commission enforces the – now more detailed – European law.

Two types of committees play a role in this new regulatory structure. The European Securities Committee (ESC) and the European Banking Committee (EBS),¹⁴⁶ comprised of representatives of the Member States, decide about proposed second level measures. The Committee of European Securities Regulators (CESR) and the Committee of European Banking Supervisors (CEBS)¹⁴⁷ are involved in preparing the advice for the Commission at the second level. Furthermore, they have the sole responsibility for the recommendations, guidelines, and common standards at the third level.¹⁴⁸

Was this process successful? The proponent's view can refer to the fact that the FSAP made European harmonisation broader and the Lamfalussy approach also made it deeper. For instance, the Prospectus Directive and the Market Abuse Directive have been accompanied by detailed second level directives and regulations and third level CESR guidelines.¹⁴⁹ Furthermore, the advocate would cite the general benefit that this new approach is 'fast, efficient, and flexible'.¹⁵⁰

However, there has also been criticism. Some of these concerns are based on the fact that at the second and third level, the EU is now very much involved in the details of financial services law. Thus, one can put forward that the EU is going too far because the law is becoming too detailed, technical, abstract, and rigid.¹⁵¹

Furthermore, one could voice democratic concerns because the European Parliament does not decide about second and third level measures. Yet, as most mea-

¹⁴⁶ Commission Decision 2001/528/EC of 6 Jun 2001 establishing the European Securities Committee (ESC), OJ 2001 L 191/45; Commission Decision 2004/10/EC of 5 Nov 2003 establishing the European Banking Committee (EBC), OJ 2004 L 3/36; Commission Decision 2004/9/EC of 5 Nov 2003 establishing the European Insurance and Occupational Pensions Committee (EIOPC), OJ 2004 L 3/34.

¹⁴⁷ Commission Decision 2001/527/EC of 6 Jun 2001 establishing the Committee of European Securities Regulators (CESR), OJ 2001 L 191/43; Commission Decision 2004/5/EC of 5 Nov 2003 establishing the Committee of European Banking Supervisors (CEBS), OJ 2004 L 3/28; Commission Decision 2004/6/EC of 5 Nov 2003 establishing the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), OJ 2004 L 3/30.

¹⁴⁸ Which are published at <http://www.cesr-eu.org/> and <http://www.c-ebs.org/>.

¹⁴⁹ Commission Regulation 809/2004 of 29 Apr 2004 implementing Directive 2003/71/EC (Prospectus Directive), OJ 2004 L 149/1; Commission Directive 2003/124/EC of 22 Dec 2003 implementing Directive 2003/6/EC (Market Abuse Directive), OJ 2003 L 339/70; Commission Directive 2003/125/EC of 22 December 2003 implementing Directive 2003/6/EC (Market Abuse Directive), OJ 2003 L 339/73; Commission Regulation 2273/2003 of 22 Dec 2003 implementing Directive 2003/6/EC (Market Abuse Directive), OJ 2003, L 336/33; Commission Directive 2004/72/EC of 29 April 2004 implementing Directive 2003/6/EC (Market Abuse Directive), OJ 2004, L 162/70.

¹⁵⁰ N Moloney, 'Time to Take Stock on the Markets: The Financial Services Action Plan Concludes as the Company Action Plan Rolls Out' (2004) 53 ICLQ 999 at 1007.

¹⁵¹ G Ferrarini, 'Contract Standards and the Markets in Financial Instruments Directive (MiFID)' (2004) Eur Rev of Contract L 19; N Moloney, 'Innovation and Risk in EC Financial Market Regulation: New Instruments of Financial Market Intervention and the Committee of European Securities Regulators' (2007) 32 ELR 627. For a differentiated view see Ferran, above n 1 at 57, 84–91, 122–126.

asures are adopted by the Council and the Parliament under the co-decision procedure at the first level,¹⁵² the Lamfalussy approach can only work if the European Parliament agrees to it. The Parliament could therefore ensure that the inter-institutional balance is safeguarded. First, the Commission has to inform the Parliament about second level measures.¹⁵³ Secondly, the Commission has to commit itself to not using its powers at the second level where the predominant view of the Parliament is against it.¹⁵⁴ Thirdly, first level measures may contain a ‘sunset clause’ which states that the powers of the Commission at the second level are limited to four years.¹⁵⁵ Fourthly, the Inter-Institutional Monitoring Group (IIMG) – which is composed of six independent experts, two nominated by each institution – assesses the law-making under the Lamfalussy approach.¹⁵⁶

2. *The Harmonised Law*

The result of the FSAP and the Lamfalussy approach is that there are EU directives and regulations on all major aspects of securities law.¹⁵⁷ With respect to primary markets, these are the Prospectus Directive, the Prospectus Regulation, and the Listing Directive.¹⁵⁸ Secondary markets are addressed in the Transparency Directive, the Regulation on International Accounting Standards, the Market Abuse Directive, and the Takeover Directive.¹⁵⁹ Regulation related to the infrastructure of capital markets can be found in the Markets in Financial Instruments Directive (MiFID), the Capital Adequacy Directive, the Investor Compensation Schemes Directive, and the Settlement Finality Directive.¹⁶⁰ Finally, investment funds are, to

¹⁵² Art 251 EC.

¹⁵³ See e.g. Directive 2003/6/EC of 28 Jan 2003 (Market Abuse Directive), OJ 2003 L 96/16, rec 8; Directive 2003/71/EC of 4 Nov 2003 (Prospectus Directive), OJ 2003 L 345/64, rec 25.

¹⁵⁴ European Council resolution on more effective securities market regulation in the European Union – Stockholm, 23 Mar 2001, para 5, available at <http://europa.eu/bulletin/en/200103/p000044.htm>.

¹⁵⁵ See e.g. Directive 2003/6/EC of 28 Jan 2003 (Market Abuse Directive), OJ 2003 L 96/16, Art 17(4); Directive 2003/71/EC of 4 Nov 2003 (Prospectus Directive), OJ 2003 L 345/64, Art 24; Directive 2004/109/EC of 15 Dec 2004 (Transparency Directive), OJ 2004, L 390/38, Art 23. This will change when (or if) the EU Reform Treaty (Treaty of Lisbon) comes into force because the consolidated version of the Treaty will contain a right to revoke the delegation (Art 290(2)).

¹⁵⁶ See http://ec.europa.eu/internal_market/finances/committees/index_en.htm#interinstitutional.

¹⁵⁷ See also G Walker, ‘European Financial Programme: Content, Structure and Completion’ (2004) EBLR 305; Moloney, above n 150.

¹⁵⁸ Directive 2003/71/EC of 4 Nov 2003 (Prospectus Directive), OJ 2003 L 345/64; Commission Regulation 809/2004 of 29 Apr 2004 implementing Directive 2003/71/EC (Prospectus Directive), OJ 2004 L 149/1; Directive 2001/34/EC of 28 May 2001 (Listing Directive), OJ 2001 L 184/1.

¹⁵⁹ Directive 2004/109/EC of 15 Dec 2004 (Transparency Directive), OJ 2004 L 390/38; Regulation 1606/2002 of 19 July 2002, OJ 2002 L 243/1; Directive 2003/6/EC of 28 Jan 2003 (Market Abuse Directive), OJ 2003 L 96/16; Directive 2004/25/EC of 21 Apr 2004 (Takeover Directive) OJ 2004 L 142/12.

¹⁶⁰ Directive 2004/39/EC of 21 Apr 2004 (MiFID), OJ 2004 L 145/1; Directive 2006/49/EC of 14 Jun 2006 (Capital Adequacy Directive), OJ 2006 L 177/201; Directive 97/9/EC of 3 Mar 1997 on inves-

some extent, harmonised in the Directives on undertakings for collective investment in transferable securities (UCITs).¹⁶¹

These legal instruments have a number of common features. First, many topics have been harmonised in a detailed and comprehensive way, sometimes even with maximum harmonisation. The EU therefore does not rely on regulatory competition in order to improve securities regulation. Yet, there is one gap: EU securities law is only applicable to ‘regulated markets’;¹⁶² stock exchanges can decide to set up a non-regulated market and, by doing so, evade the applicability of EU securities law.¹⁶³ However, it is no surprise that all major European stock exchanges are regulated markets because it would scare off investors if, for instance, Euronext or the LSE decided to be ‘unregulated’ only. Furthermore, it has to be noted that ‘regulated market’ is a wide term; the status as a regulated market does not depend on an official listing.¹⁶⁴

Secondly, the conflict-of-law rules are also parallel in many of the EU directives. The main principle is that a particular document or a particular business is authorised by the home Member State, and further that this authorisation is recognised in other Member States. Home state control and mutual recognition therefore leads to a ‘regulatory passport’ because, for instance, a prospectus approved by the authority of one Member State can be used throughout Europe in order to issue securities to the public.¹⁶⁵

Thirdly, there are common principles in substantive law. The main tool of European securities law is disclosure of information,¹⁶⁶ such as prospect requirements, on-going disclosure requirements, and disclosure of inside information.¹⁶⁷ European directives also address the regulation of intermediaries, for instance brokers and dealers, stock exchanges, and investment funds.¹⁶⁸ More generally, the FSAP aimed at strengthening the protection of investors. In particular, this concerns retail investors because EU securities law now frequently distinguishes between retail and professional investors.¹⁶⁹ With respect to enforcement, however, the public purpose of

tor-compensation schemes, OJ 1997 L 84/22; Directive 98/26/EC of 19 May 1998 (Settlement Finality Directive), OJ 1998 L 166/45.

¹⁶¹ Directive 85/611/EEC of 20 Dec 1985, OJ 1985 L 375/3; Directive 2001/107/EC of 21 Jan 2002, OJ 2002 L 41/20; Directive 2001/108/EC of 21 Jan 2002, OJ 2002 L 41/35.

¹⁶² See IV B 2 above.

¹⁶³ L Enriques and M Gatti, ‘Is There a Uniform EU Securities Law After the Financial Services Action Plan?’ Working Paper 2007, available at <http://ssrn.com/abstract=982282>, p 8; Blair and Walker, above 109 at para 10.93.

¹⁶⁴ See IV B 2 above.

¹⁶⁵ Directive 2003/71/EC of 4 Nov 2003 (Prospectus Directive), OJ 2003 L 345/64, Art 17.

¹⁶⁶ See also Ferran, above n 1 at 127–133.

¹⁶⁷ See the Prospectus, Transparency and Market Abuse Directives, above n 158 an 159.

¹⁶⁸ See the MiFiD and the UCITS Directive, above n 160 an 161

¹⁶⁹ See e.g. Directive 2004/39/EC of 21 Apr 2004 (MiFiD), OJ 2004 L 145/1, Art 19(10), Annex II.

securities law¹⁷⁰ is at the fore because the EU directives and regulations mainly address administrative, rather than private enforcement, in some detail.¹⁷¹

Has EU securities law now reached an endpoint? Although there is an impressive *acquis communautaire*, this is not the case. For instance, one can point to the gaps of the European directives and regulations and suggest that a comprehensive 'European Securities Code' may be needed.¹⁷² Further, a number of special topics, such as hedge funds or derivatives, are only partly covered in EU securities law. With respect to enforcement, the diversity of national financial authorities could in the future be substituted by a 'European Securities and Exchange Commission.'¹⁷³ Moreover, private and criminal enforcement are usually only briefly mentioned in the European directives. However, the general counter-argument is that too much centralisation can be problematic: It is against the subsidiarity principle of Article 5 EC, and financial markets in the Member States are in fact still different. Specifically, a central supervisor can be monopolistic and unresponsive.¹⁷⁴ CESR in its Himalaya Report¹⁷⁵ and the Commission in its White Paper¹⁷⁶ have also opposed the idea of a single supervisor and instead rely on increased communication and cooperation.

VI. Conclusion

This article has outlined the foundations of securities law. This has not been an easy task because securities law is characterised by a number of differentiations. History has shown that public and private finance, as well as primary and secondary markets, emerged at different stages throughout the development of securities markets. In the section on corporate finance, the advantages, and disadvantages

¹⁷⁰ See IV B 1 above.

¹⁷¹ For instance, for the Market Abuse Directive (above n 158), see M Siems, 'The EU Market Abuse Directive: A Case-Based Analysis' (2008) 2 Law and Financial Markets Rev 39 at 46.

¹⁷² A Sáinz de Vicuña, 'The Legal Integration of Financial Markets of the Euro Area' (2001) EBLR 223 at 233–4.

¹⁷³ EJ Pan, 'Harmonization of U.S.-EU Securities Regulation: The Case For a Single European Securities Regulator' (2003) 34 Law and Policy in International Business 499; YV Avgerinos and M Andenas (eds), *Financial Markets in Europe: Towards a Single Regulator?* (London Kluwer Law International 2003); GA Hertig and R Lee, 'Four Predictions about the Future of EU Securities Regulation' (2003) 3 J of Corporate Law Studies 359; P-M Boury, 'Does the European Union need a Securities And Exchange Commission?' (2006) 1 Capital Markets L J 184.

¹⁷⁴ Moloney, above n 1 at pp 888–891; Ferran, above n 1 at 119–122.

¹⁷⁵ CESR, Preliminary progress report: Which supervisory tools for the EU securities markets? ('Himalaya Report'), Oct 2004 (ref 04/333f); see also AD van Leeuwen, Chairman of CESR, who explains the name of the report as follows: 'To make this analysis, we created a smaller group of Chairmen who needed high-level staff assistants to help develop solid research and cover some serious "ground". In our vocabulary, we called them "sherpas" and that is how the report got its nickname as the "Himalaya-Report"'.
¹⁷⁶ See 1 above.

between bank and market finance were explained. The section about the different types of securities highlighted the distinctive features of shares, debt securities, and hybrids, as well as their various sub-categories. Further, there are different types of securities markets and stock exchanges depending on the level of regulation and formalisation. Finally, this article turned to the different rationales for harmonisation and the different features of contemporary European securities law.

More implicitly, this article has also demonstrated the international dimension of securities markets and their regulation. It is sometimes claimed that only in Common Law countries securities markets are important and investors well protected.¹⁷⁷ This is, however, too simplistic. The origins of securities markets are partly continental European (namely Italian and Dutch), and there are a number of common trends which concern most countries of the world.¹⁷⁸ Moreover, the foundations of securities law are relatively similar across countries. For instance, it was therefore possible to explain the different types of securities and securities markets in a way which generally did not distinguish between the laws of different countries.¹⁷⁹

A further common theme was that recent developments have shaped the content of securities law. Examples included the growing importance of Asset Backed Securities, the demutualization of stock exchanges, and the rise of new trading platforms (such as Alternative Trading Systems).¹⁸⁰ Moreover, in Europe the level of legislation has shifted from the Member States to the EU. Since the FSAP was completed in 2005, European securities law is now relatively comprehensive. The future will show whether and how this new European law will adapt to the ever-changing dynamics of financial markets.

¹⁷⁷ See I C and II above.

¹⁷⁸ See I A and B above and the references in note 180.

¹⁷⁹ See III and IV above.

¹⁸⁰ See III B 2, IV B 3 and IV C above.