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High-Level Response to the European Commission´s Targeted Consultation on the Listing Act

More Courageous and Balanced Steps are Needed!

By Prof. Dr. Rüdiger Veil, Marc Wiesner and Moritz Reichert

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Executive Summary

I. Strategies for Overcoming Fragmentation

1. The Transparency Directive 2004/109/EC (TD) should be replaced with a regulation, based on Article 114 TFEU. It should aim to fully harmonise the rules on the disclosure of major holdings and financial instruments.
2. It should be considered to create a 'Single European Market' through an optional '28th regime', which would be a sub-segment of the regulated markets in the EU and would be supervised by ESMA.
3. Enforcement of European capital markets law should generally be tackled by the European legislature instead of the Member States. Irrespective of whether public enforcement is left with the National Competent Authorities or assigned to ESMA, it should be ensured that the enforcement authority is sufficiently authorised, financed, and independent of undue political influence.

II. Deregulating Disclosure as an Opportunity to Foster the European IPO Market

1. Mandatory disclosure requirements should only be scaled back after a thorough cost-benefit analysis, including input from asset-pricing experts as well as issuers.
2. Before further extending exemptions to the mandatory disclosure regime, the Commission should first gather more evidence on whether qualified investors – absent further regulation

– can actually direct issuers towards a socially optimal information level in private placements.

3. Here, as in general, the discussion on legal transplants from the US system should take into account that the US enforcement is particularly effective. This reduces the need to regulate *ex ante*, since courts provide an important regulatory failsafe function.

III. Improving Access to Capital Markets for SMEs

1. In addition to the already established SME Growth Markets (SGM), the European legislator should consider an IPO On-Ramp, similar to the US-model but with temporary exemptions focused on the board composition and renumeration requirements of the SRD II.
2. A key task for the European legislator in SGM is to ensure adequate protection of individual investors.
3. Suggestions to introduce dual class shares as well as multiple voting rights have merit, if the prospectus adequately informs about them at the time of the IPO.
4. Although full adherence to corporate governance codes should not be required for SMEs, EU law should provide minimum requirements for effective management control in SGM.
5. In creating a balanced disclosure regime for SGM, the European legislator should consider strengthening rules on disclosure obligations for major shareholdings as well as stipulating a more flexible disclosure obligation for inside information.

IV. Prospectus Disclosure

1. The European legislator should decide on the most sensible approach to regulating secondary issuances – Recovery Prospectus or initial simplified disclosure regime – by inquiring with investors about their information needs.
2. A Targeted Consultation on secondary issuances should also be used to debate the optimal approach for regulating the interaction between periodic disclosure and prospectus law.
3. Inconsistency between the Universal Registration Document and the simplified disclosure regime as regards the required information level for periodic disclosure should be avoided.
4. The regulatory idea of specifying a certain page limit for a prospectus should not be further pursued.

V. Market Abuse

1. Inside information should be more clearly defined. However, while it makes sense to assess the price relevance from the perspective of a rational, fundamental value-oriented investor, the definition should not include a reference to long-term fundamental value nor to ESG information *per se*.
2. A preliminary analysis of the ad hoc disclosure obligation points to flaws in the current design. A more rule-based regulatory approach promises greater legal certainty and lower costs for issuers. Such an approach could take the form of a two-step system, in which inside information is subject to insider trading prohibition but would not have to be disclosed by the issuer until a later point in time. However, a thorough cost-benefit analysis of the ad hoc disclosure obligation should first be carried out as a basis for further discussions on regulatory changes.

VI. Enforcement

1. Enforcement of European capital markets law should be dealt with on a European level. The optimal enforcement approach should be developed on a case-by-case basis, weighing the pros and cons of private and public enforcement against the background of the regulatory goal of the violated duty.

2. Prospectus law is most efficiently enforced through a mix of private and public enforcement mechanisms.

3. It makes sense to engage in a European discussion on how private law can be used to provide for meaningful incentives to generate a socially optimal level of secondary market disclosure.

4. If a thorough analysis suggests that a specific duty under European capital markets law should be enforced through a combination of public and private enforcement instruments, the European legislature should address the question of how to balance them.

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to the European Commission's Targeted Consultation on the EU Listing Act

More Courageous and Balanced Steps are Needed!

Introduction

The European Commission is requesting feedback for its Consultation on the Listing Act to explore how public capital markets can be made more attractive for EU companies and how SME's access to capital can be improved.[1] The Consultation builds on recommendations by the CMU High Level Forum,[2] the Technical Expert Stakeholder Group (TESG)[3] and ESMA's Reports on MiFID II[4] and MAR[5].

The reform proposals put forward by the expert groups have not yet been discussed in depth by academia.[6] This high-level paper therefore starts by providing input on fundamental reform issues for EU securities markets regulation, such as more ambitious strategies for overcoming fragmentation and policies for a reform of disclosure regimes for both issuers listed on regulated markets and SME Growth Markets. The paper then considers specific consultation questions which refer to essential elements of EU capital markets law. These concern secondary issues in EU prospectus law, the reform of ad hoc disclosure under the market abuse regime and the concept of inside information. Finally, the paper examines policies for a reform of public and private enforcement on the European level.

I. Strategies for Overcoming Fragmentation

The macro- and microeconomic effects of capital market integration are extensive.[7] The reforms of prospectus and market abuse law through regulations were important steps on the way to ensuring a level playing field and thus contributing to resolution of fragmentation. This approach should be consistently pursued in the context of the Capital Markets Union (CMU) project by converting further directives into regulations, to the extent that this is permissible under the TFEU.[8]

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[1] *EC*, Targeted consultation on the listing act: making public capital markets more attractive for EU companies and facilitating access to capital for SMEs, 19 November 2021, available at https://ec.europa.eu/info/consultations/finance-2021-listing-act-targeted_en. The underlying policy goal of facilitating the allocative efficiency of the European financial system by trying to add more capital market based financing to the total financing mix of European companies, particularly SMEs, as well as further integrating European capital markets is sound. See for a balanced assessment e.g. *Buch*/*Bremus*, Capital Markets Union and Beyond, 29 et seqq., who also highlight some drawbacks of the approach; *ECB*, Financial Integration in Europe 2018, 67; *Langfield*/*Pagano*, 31 Econ. Pol. (2016), 51, 94 et seqq.; *Bats*/*Houben*, 114 J. Bank. Fin. (2020), 105776.

[2] Final report of the High Level Forum on the Capital Markets Union – A new vision for Europe's capital markets, June 2020.

[3] *Technical Expert Stakeholder Group (TESG) on SMEs*, Final Report, Empowering EU Capital Markets for SMEs, May 2021.

[4] ESMA, MiFID II Report on the functioning of the regime for SME growth markets, ESMA70-156-4103, 25 March 2021.

[5] ESMA, Final Report MAR Review, ESMA70-156-2391, 23 September 2020.

[6] The book by *Busch/Avgouelas et al.*, Capital Markets Union in Europe (2018) looks at the CMU from 2014-2019 (*Juncker* administration). A debate on the EU's CMU strategy under Commission President *von der Leyen* has hardly taken place so far. The proposals by the High Level Forum are put in context by *Langenbucher*, 17 ECFR (2020), 601 et seq. (recommending a 'top-down legislative intervention').

[7] Cf. *Brüggemeier*, Harmonisierungskonzepte im europäischen Kapitalmarktrecht, 81, with reference to studies according to which an internal capital market reduces the capital costs of a listed company by an average of 0.467%.

[8] This has already been proposed for the CMU project under the Juncker administration, cf. *Ringe*, 9 LFMR (2015), 5, 7.

1. Unification of EU Law

Above all, the European legislature should replace the Transparency Directive 2004/109/EC (TD) with a regulation, based on Article 114 TFEU. The TD already contains full harmonisation rules to a large extent. This applies in particular to the rules on the disclosure of major holdings and financial instruments.[9] However, some essential elements of the regime are still minimum harmonized,[10] such as the reporting thresholds,[11] rules on the attribution of voting rights and the process and timing for notification. As a consequence, investors are confronted with the 'existing fragmentation' of disclosure obligations.[12] The European legislature has justified the minimum harmonization approach in these areas of the TD on account of 'existing differences in ownership concentration' and has also pointed out to differences in corporate governance structures.[13]

The first argument is no longer convincing. It is true that in some Member States stock corporations controlled by families or other block holders are dominant, while in other Member States dispersed ownership structures are common.[14] However, these differences do not justify different rules on thresholds, attribution of voting rights and notification requirements for major holdings. Above all, different corporate governance systems – one-tier- vs. two tier system – do not require different rules on the attribution of voting rights. For example, it is entirely possible to joint action by activist financial investors[15] with abstract concepts, regardless of whether investors approach the board of directors or a supervisory board to influence business policy and regardless of whether shareholders in a public limited company have rights of instruction vis-à-vis the management.[16] Differences in company law can be taken into account in level 3 guidelines.[17] Finally, with regard to the thresholds required under the TD, we suggest that national regulatory options be provided, as this is already the case in the MAR and PR. There is no valid reason why disclosure of financial instruments is fully harmonized, but disclosure of major holdings only partially.

Finally, there is another argument supporting the unification of ongoing disclosure under the TD. The exemptions from the principle of maximum harmonisation raise the difficult question of Member States' legislative competences. The TD allows them to apply 'laws, regulations or administrative provisions

[9] Cf. Chapter III Section I Directive 2004/129/EC providing rules about "ongoing information".

[10] Cf. Art. 3 (1a) subsec. 4 TD.

[11] Member States may provide for both lower and additional thresholds for notification of voting rights, and to require equivalent notifications in relation to thresholds based on capital holdings. Cf. Art. 3 (1a) TD.

[12] Cf. *Pietrancosta*, Transparency of Stock Corporations in Europe, 2019, 109, 122.

[13] Cf. Recital 10 Directive 2013/50/EU.

[14] Until the 1990s, major differences existed in ownership and control structures of listed companies. Cf. *Moearland*, 10 Review of Industrial Organization (1995), 443, 462. In 2021, the OECD considers the increase in institutional ownership as one of the most important developments in respect of corporate ownership. According to the OECD concentration of ownership is similar in most EU countries, although the concentration in the Nordic countries is lower than in Southern European countries (least ownership concentration in Finland, largest concentration in Lithuania and Portugal). Cf. OECD, Corporate Governance Factbook 2021, figure 1.9., 25. According to a study by *Achleitner/Braun et al.*, between 2009 and 2018, around 40 per cent of listed companies in Germany were family businesses. Cf. *Achleitner/Braun et al.*, Stiftung Familienunternehmen, 25 et seq.

[15] The attribution of voting rights due to acting in concert is limited to 'concerted exercise of the voting rights', cf. Art. 10 lit. a) TD. This concept, which the European legislator had already provided for in 1988 (cf. Art. 7 Directive 88/627/EEC of 12 December 1988; Art. 92 lit. c) Directive 2001/34/EC), no longer reflects today's shareholder activism.

[16] Interestingly, Member States providing for both systems for stock corporations did not introduce specific rules on the attribution of voting rights due to acting in concert.

[17] An example of a differentiating assessment can be found in the ESMA Guidelines on the Delay in disclosure of inside information (ESMA 2016/1478), which take into account that legitimate interests of an issuer in the delay of insider information should be assessed with regard to the governance of the issuer (para. 8 lit. c) Guidelines).

adopted in relation to takeover bids, merger transactions and other transactions affecting the ownership or control of companies, supervised by the authorities appointed by Member States pursuant to Article 4 Takeover Bids Directive'. This compromise adopted in the trialogue[18] raises questions of interpretation that have not yet been clarified.[19] As a consequence of a different understanding of the opening clause of the TD, the attribution of voting rights within a group of companies[20] and due to acting in concert[21] are regulated differently across the EU,[22] without it being clear whether these rules are even permissible under EU law. The ECJ's decision on the scope of Member State legislative competences[23] has contributed little to assess whether these more stringent national provisions are in line with EU law.

It is certainly true that the underlying (disparate) company laws of the Member States will always be an obstacle to a uniform application of disclosure obligations on major holdings.[24] Nevertheless, uniform European rules would ensure a higher degree of legal certainty for both investors and issuers[25] and be another important step towards overcoming fragmentation.

2. Creation of a 'Single European Market'

A further more ambitious strategy for overcoming fragmentation would be to create a Single European Market through an optional 28th regime, which would be a sub-segment of the regulated markets in the EU and would be supervised by the ESMA.[26] The optional character would allow issuers to use the harmonised regime when it is advantageous for them. They could opt for the Single European Market either when going public or later, while other issuers would simply retain their existing status.

The 28th regime would come with two main features: First, it would create a more uniform set of rules; and second, it would improve the quality of the European regulatory framework in crucial respects. The 28th regime would go far beyond the status quo in the harmonisation of capital markets law for the issuers admitted to it: directives such as the TD that have been implemented by the Member States in different ways would be applied in the 28th regime in a completely harmonised form. Financial reporting would be exclusively in accordance with IFRS, and only in English. Issuers using the 28th regime should be obliged to allow shareholders to participate in general meetings through purely digital channels rather than physical presence. The rules for financing transactions, especially capital increases, could be better coordinated with the relevant capital market law rules, for example by extending possibilities for a

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[18] Cf. *Veil*, 10 ECFR (2013), 32 et seq.

[19] In German and Austrian literature, this question is discussed controversially. Cf. for a broad interpretation *Parmentier*, AG 2014, 15, 18; *Veil*, ZHR 177 (2013), 427, 434; *Seibt/Wollenschläger*, ZIP 2014, 545, 548 et seq.; *Fidler*, ZFR 2017, 222, 227. Other authors, however, argue for a narrow interpretation. Cf. *Hitzer/Hauser*, NZG 2016, 1365, 1368; *Burgard/Heimann*, WM 2015, 1445, 1448 et seq.; *Kraack*, AG 2017, 677, 679 et seqq.

[20] Cf. Art. 10 lit. e) TD.

[21] Cf. Art.- 10 lit. a) TD.

[22] Cf. In more detail *Veil*, European Capital Markets Law, § 20 para. 52–69.

[23] ECJ of 9 September 2021, C-605/18 (Adler Real Estate AG and Others v Finanzmarktaufsichtsbehörde (FMA)

[24] Cf. *Pietrancosta*, Transparency of Stock Corporations in Europe, 2019, 109, 122.

[25] Issuers would also benefit from further unification of the rules. Since issuers in most Member States have to make public investor notifications about major holdings, they usually have to check whether the notifications are correct. In addition, shareholders lose their voting rights if they are not compliant with the notification requirements. The issuer must check whether an investor has lost its rights because otherwise the shareholder is not entitled to vote at a general meeting.

[26] The idea of a 'Single European Market" was developed by *Balthasar* and *Veil*, Frankfurter Allgemeine Zeitung, issue 80 of 7 April 2021, 29.

simplified exclusion of subscription rights. As regards insolvency law, uniform standards would be created for insolvency filing obligations, the ranking of claims and avoidance rights of insolvency administrators. Issuers in the 28th regime would be supervised by the ESMA, which would also be responsible for the approval of securities prospectuses, the enforcement of insider trading law and disclosure obligations.

The concept of a '28th regime' would complement the top down approach of EU capital markets law. For investors, the European segment would remove hurdles that exist today due to different regulatory regimes. Issuers could address a broader investor base through a EU-wide uniform set of rules and reduce the administrative burden associated with redundant structures. Above all, the EU could develop a blueprint for a more far-reaching CMU, while the Member States would retain competences in line with the principle of subsidiarity. In this model, ESMA could deepen its supervisory expertise.

3. Efficiently Enforcing European Capital Markets Law on a European Level

Another fundamental aspect relates to the enforcement of European capital markets law. Proper enforcement has been a point of interest for the European legislature ever since the recommendations of the so called *de Larosière*-Report in 2009.[27] We are generally convinced that the Report was right in claiming that enforcement in European capital markets law should be tackled by the European legislature instead of the Member States.[28]

The arguments for and against harmonisation through European law have long been the subject of controversial debate, with a wide range of opinions emerging.[29] We think that four arguments can be made in favour of (further) harmonisation: *First*, transaction costs for issuers would be reduced, while at the same time legal certainty would be ensured for injured investors.[30] *Second*, the design of the enforcement of capital markets law obligations poses the risk of harmful regulatory competition among Member States rather than an opportunity to promote innovation. In particular, it must be taken into account that the enforcement mechanism *de facto* determines the effectiveness and scope of the obligations for capital market participants. Therefore, a deviation of (national) enforcement from the optimal level of enforcement affects the practical effectiveness of European law. Additionally, we have doubts whether Member States have sufficient incentives to adopt the most efficient system of enforcement.[31] *Third*, it is difficult to imagine that an efficient level of enforcement can be ensured if the

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[27] In very broad strokes, the report *first* recommended that the European legislature should make every effort to achieve maximum harmonisation of core rules. *Second*, it drew attention to the absence of consistent enforcement regimes of Member States, which were seen as weak and would, inter alia, allow harmful regulatory arbitrage. See *The High-Level Group on Financial Supervision in the EU,* Report, 25. 2. 2009 (*de Larosière* -Report), para. 109, 201.

[28] On a more fundamental level the significance of an efficient enforcement is self-evident. It is the declared goal of the European legislature to strengthen capital market-based financing due to the associated macroeconomic benefits. A balanced design of the enforcement mechanism is therefore necessary to meet the expectations of issuers but also of investors. This is by no means a simple regulatory challenge as a legislator – in order to establish an optimal level of enforcement – must have some rough idea of the social costs arising from violations of capital markets law. In our view, this delicate task is best left in the hands of the European legislator, who should develop a fundamental enforcement concept. On this basis, a proposal can then be made for a proportionate and efficient enforcement framework for SME.

[29] For further detail see *Gerner-Beuerle*, 7 CMLJ (2012), 317 with further references in Fn. 5; *Wundenberg,* ZGR 2015, 124, 151 with further references in Fn. 133; for the comparable discussion in US law cf. *Romano*, 107 Yale L.J. (1998), 2359; *Choi*, 41 Va. J. Int´l L. (2001), 815.

[30] Efficient enforcement lowers the incentive of investors to verify the issuer's information and thus reduces information costs of the capital market. In this respect, an efficient enforcement regime strengthens investor confidence. A unified (efficient) enforcement mechanism may also help to overcome investors' home bias. For further details see *Veil,* Enforcing Consumer and Capital Markets Law, 2019, 405, 419; *Brüggemeier*, Harmonisierungskonzepte im europäischen Kapitalmarktrecht, 2018, 89.

[31] For a more detailed assessment see *Brüggemeier*, Harmonisierungskonzepte im europäischen Kapitalmarktrecht, 30 et seqq., 158 et seqq. The reasons which make us doubt the desirability of regulatory competition between the Member States can

legislation is not uniform but is designed partly by the Member States and partly by the European legislature. *Fourth*, where it becomes necessary to coordinate and balance private and public enforcement this can be better implemented by one (European) regulator.

A question apart from this is whether public enforcement of duties under European capital markets law should be left to National Competent Authorities or whether further centralisation to ESMA is sensible. We offer no general opinion on this complex issue. Either way it should be ensured that National Competent Authorities or ESMA are sufficiently authorised, financed, and are independent from undue political influence.

II. Deregulating Disclosure as an Opportunity to Improve the European IPO Market

The Consultation is inspired by the idea that the requirements of European capital markets law, especially under EU prospectus law, are too cumbersome for issuers, in particular SMEs, and should potentially be scaled back or, at least in some cases, abandoned altogether in order to facilitate capital market financing.[32] Although there is some evidence on an unfavourable long-term development of the IPO market in the EU compared to overall GDP development,[33] we argue that further cuts in the present system of mandatory disclosure should be supported by a thorough cost-benefit analysis. Regrettably, the current focus of the Consultation does not live up to this standard. Additionally, we caution the Commission against light heartedly expanding exemptions from the current system of mandatory disclosure.

1. Thorough Cost-Benefit Analysis as a Requirement for Further Scaling Down Mandatory Disclosure Requirements

While the Consultation focusses predominately on the costs of the regulatory regime to issuers, significantly less attention is paid to the fact that mandatory disclosure is a necessary precondition for a well-functioning IPO market, irrespective of the size of the issuer.[34] If investors are not provided with socially optimal, i.e. cost efficient amount of information relevant to the value of the securities on offer, their information costs[35] incurred when valuing securities will not be sufficiently reduced, at the very least deterring an optimal level of investment in issuers with the highest risk-adjusted returns and eventually resulting in a suboptimal level of companies receiving funding.[36] Providing investors with less information at the time of a public offering might therefore result in a situation in which – contrary to what a reduction in mandatory disclosure requirements purports to achieve – the costs for going public

mostly be traced back to the discussion on the overall attractiveness of “issuer choice” as a regulatory strategy in global capital markets. See for the initial idea especially *Romano*, 107 Yale L. J. (1998), 2359; *Romano*, 2 Theor. Inq. L. (2001), 387; for the comparable idea of “portable reciprocity” see *Choi/Guzman*, 65 Fordham L. Rev. (1997), 1856; for a convincing critique *Fox*, 85 Va. L. Rev. (1999), 1335; *Langevoort*, 63 Law & Contemp. Probl. (2000), 46, 50.

[32] *EC*, Targeted Consultation, 6, 10 et seq., 14 et seq., 16 et seqq.; see further *EC*, A Capital Markets Union for People and Businesses, 7 et seq.; *High Level Forum CMU*, A New Vision for Europe’s Capital Markets, 68; *TESG*, Empowering EU Capital Markets for SMEs, 7.

[33] *Oxera*, Primary and secondary equity markets in the EU, 12 notes a decline in listings of 12% between 2010 and 2018 in the European Union compared to GDP growth over the same period of 24%. There are some signs that the trend might have reversed in 2021. *EY*, Global IPO Trend Report 2021, 21 reports 154% more IPOs in numbers in Europe compared to 2020. See *Stulz*, 36 Oxford Rev. Econ. Pol. (2020), 275, 276 et seqq. for data on the development in the US.

[34] See for arguments why issuers – left to their own devices – will choose a suboptimal level of disclosure in primary and secondary markets, *Enriques/Gilotta*, Oxford Hdb. of Financial Regulation, 511, 520 et seqq.

[35] We make use of the taxonomy on information costs developed by *Gilson/Kraakman*, 70 Va. L. Rev. (1984), 549, 594 et seqq. They distinguish between three different types of information cost: (i) acquisition costs, describing the costs to acquire value relevant information in the first place, (ii) processing costs, meaning costs incurred in understanding information, and finally, (iii) verification costs, defining the costs to make sure that an issuer is reliable and that the information presented is true and fair.

[36] See for an instructive explanation, *Fox*, Capital Markets Union in Europe, para. 13.20 et seqq.

actually increase.[37] A reduction in the allocative efficiency of the European capital market becomes problematic for the welfare of the European economy as soon as some companies, incapable of going public, do not receive funding through different channels.[38] In short, reducing mandatory disclosure requirements has the potential to cause more harm than benefits to the European economy.

This analysis is further reinforced by the fact that there is no clear-cut case connecting increased regulatory burdens in capital markets law to declining IPO activity. Instead, the recent reduction of companies "taking the public route" might at least partially be attributable to market developments, which make it more attractive to remain private for longer or sell out to a larger company via the "M&A route" than to go public.[39]

Where does this discussion leave us? The market-making function of mandatory disclosure does not imply that there is no room to manoeuvre and cut back on disclosure mandates *per se*. After all, owing to the persistent information problems of the legislator[40] and the fact that the idea of a two-tiered disclosure system, differentiating between SMEs and larger issuers, has only recently come into regulatory focus, we are not certain whether the current regime provides for an efficient level of issuer disclosure. This might be particularly true for SMEs. For instance, looking at the cost side first, SMEs might be disproportionally affected by the high fixed cost of disclosure.[41] They might also face higher proprietary costs if they are forced to disclose, since their business operations are usually not as diversified as those of larger competitors, making disclosure potentially more harmful to their competitive position.[42] Focussing on the benefits of disclosure, SMEs are also less complex than larger companies, resulting in less of a need to lower the information costs of investors. Additionally, although we also have to bear in mind that small offerings entail a higher probability of being used as a vehicle for fraud,[43] disclosure failures of SMEs typically produce less negative externalities.[44]

Instead of merely focussing on what costs of compliance specific line items of disclosure produce, the European legislator should only scrape those disclosure requirements that generate more costs than they save. In doing so it should remain conscious about two facts: First, the fixed cost of a public offering implies that there is a certain size threshold under which an initial public offering will continue to remain an unattractive option for smaller firms, even if substantial deregulation has taken place.[45] Second, the

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[37] For instance, *Chaplinsky/Weiss Hanley et al.*, 55 J. Acc. Res. (2017), 595 et seqq. analysis of the consequences of the deregulating provisions of the JOBS Act shows that the indirect costs of going public increased as a consequence of scaling back mandatory disclosure requirements.

[38] Internal financing and bank-based financing provide other important funding channels for companies. Bank-based financing, however, can fail to produce an optimal level of funding if new technologies with uncertain future outlooks seek for financing or if the company is unable to provide for collateral due to its focus on human capital. Additionally, – as the aftermath of the financial crisis in the EU has shown – banks are prone to so called credit crunches potentially hampering growth, see for more details on this e.g. *Allen*/*Gale*, Comparing Financial Systems, 406 et seq.; *Langfield*/*Pagano*, 31 Econ. Pol. (2016), 51, 62. For an empirical assessment see *ECB*, Financial Integration 2018, 85 et seqq., 90 et seqq.; *Fox*, 5 Capital. Soc. (2010), 1, 39 et seqq.

[39] For a deep dive on this see *Kesten*, The Oxford HdB of IPOs, 2019, 28, 41 et seqq.; for a comprehensive framework on the going-public decision see *Stulz*, 36 Oxford Rev. Econ. Pol. (2020), 275 et seqq.

[40] The basic idea that a rule maker might not have an optimal amount of information to optimally regulate a certain field dates back to *v. Hayek*, 35 Am. Econ. Rev. (1945), 519.

[41] *Oxera*, Primary and secondary equity markets in the EU, 79.

[42] *Enriques*/*Gilotta*, Oxford HdB of Financial Regulation, 2015, 511, 529 and fn. 94.

[43] For an analysis on this see *Schwartz*, 39 J. Corp. L. (2014), 347, 370 et seqq.

[44] This not only relates to the fact that market confidence might not be shattered in the same way, *Oxera*, Primary and secondary equity markets in the EU, 84, but also that products, goods and service markets might not be as negatively affected, see *Velikonja*, 54 Wm. & Mary L. Rev. (2013), 1887, 1924.

[45] *Fox*, Capital Markets Union in Europe, para. 13.109.

apparent long-term decline in IPO activity seems to be at least partially driven by changing economic conditions, making it unlikely that regulatory action will provide for a significant difference.[46] Moving forward, a potentially better way to think about reforming the disclosure system would therefore be to gather information from asset-pricing experts on which information mandates of the current regime are considered to be essential and which ones are unnecessary[47] and compare this input with the answers given by issuers in the Consultation. In that regard, it also seems sensible to look more closely into the welfare effects of the EU Growth and EU Recovery Prospectus before introducing any further changes to the current regime.

2. Exempting More Transactions from the Mandatory Disclosure Regime as an Option to Foster Capital-Market Based Financing?

As to our latter suggestion, we initially note that the idea of *mandatory* disclosure sits uneasily with any approach exempting offerings directed at a larger audience from its purview and leaving them to private ordering instead. It might nevertheless be justified to exempt a limited number of transactions from the regime[48] for cost-benefit reasons.[49] We argue, however, that we possess limited knowledge on the desirability of raising capital private, making significant expansions to the current system – potentially modelled after the more extensive US-system[50] or suggestions raised in the UK Listing Review – a risky gamble.[51]

More to the point, there is already a lack of evidence on whether the current approach – exempting offers only directed at qualified investors from mandatory disclosure – is conceptually sound when viewed against the backdrop of the goal of an allocatively efficient financial system. The Commission should therefore hold structured interviews to assess whether qualified investors can truly "fend for themselves"[52] and if, in fact, they should. Since an allocatively efficient capital market relies on a socially

[46] A case in point are the effects of JOBS Act on IPO activity in the US. *Stulz*, 36 Oxford Rev. Econ. Pol. (2020), 275, 289 reports that although the number of IPOs increased in the two years following the act, in the years after that total IPOs in each year were below the numbers from 2004 to 2007.

[47] Cf. *Oxera*, Primary and secondary equity markets in the EU, 86.

[48] We could think about reforming the current definition of "qualified investors" to make it easier for "professional" retail investors to qualify, as there is – apart from the advantages of division of labour within institutional investors – no *a priori* reason why sophisticated retail investors should not be able to reach a qualification comparable to institutional investors. Allowing them to participate in such offerings might expose them to returns otherwise unavailable to them. See for suggestions on further developing the regime e.g. *TESG*, Empowering EU Capital Markets for SMEs, 62 et seq. Deeper questions loom here as well. Even if the Commission were to conclude that private ordering of professional investors, third parties and issuers can create a socially optimal level of issuer disclosure, it should bear in mind that being a public company generates positive externalities for society and the rest of the economy. They could deteriorate if less companies go public because of a too attractive private-placement market. For an overview on the positive externalities, including the stock market being a good indicator for the development of the economy as well as public information enabling authorities to adapt their regulatory strategies, see *De Fontenay*, 68 Hastings L. J. (2017), 445, 486 et seq.; *Schön*, 6 J. Corp. L. Stud. (2006), 259, 273 et seq.

[49] Currently, the Prospectus Regulation allows for exemptions in Art. 1 para. 4 and 5, Art. 3 para. 2.

[50] In any case, the exemption is criticized in the US-literature, as it has not been adjusted for inflation, see *Sjostrom*, 36 Seattle U. L. Rev. (2013), 1143, 1157 et seq. See for an overview on recent adjustments to the US system, *Greene/Gabor et al.*, Col. Bus. L. Rev. (2021), 714, 769 et seq.

[51] Most relevant to the US-System are Regulation D, 17 C.F.R. § 230.506, and Regulation A, Securities Act § 3(b)(2). Regulation D permits securities offers without a prospectus to so called "accredited investors", a term also encompassing somewhat wealthy individuals without any financial sophistication. In contrast, the European approach, defining "qualified investors" in Art. 1 para. 4, 2 lit. e) Prospectus Regulation in conjunction with Annex II MiFiD II is more restrictive, as it necessitates – at least to a certain extend – financial or trading experience of the investor. Regulation A even makes it possible to raise up to fifty million dollars from non-accredited investors – further SEC rules apply – within a twelve-month period without publishing a prospectus, while the EU only allows Member States to exclude offers not exceeding eight million euros within a period of twelve months from the Prospectus Regulation. In the United Kingdom, the UK Listing Review, 34 also proposes expanding exemptions from the duty to publish a prospectus.

[52] *SEC v. Ralston Purina Co.*, 346 U.S. 119, 123, 125 (1953).

optimal level of issuer disclosure, this depends on whether qualified investors – absent further regulation – can actually direct issuers towards a socially optimal information level in private placements.[53] In that regard it should also be kept in mind that the information level in private placements in the US is not solemnly achieved through private ordering. Instead, it is influenced by investors in private placements still being able to bring claims under Rule 10b-5 of the Securities Exchange Act of 1934[54].[55] European capital markets law currently lacks such a catch-all anti-fraud provision, which should make us even more cautious about transplanting the US-approach without further ado.

III. Improving Access to Capital Markets for SMEs

1. Fundamental Regulatory Strategies

Improving access to finance for SMEs is a key component of the EU's CMU project. The European legislation aims to facilitate IPOs for SMEs by having an appropriate legal framework and enabling early-stage investors to exit these companies.[56] However, there are further reasons to make public capital markets more attractive for SMEs. Usually, private investors do not have access to private equity markets, while these markets have become an important element of portfolio diversification for professional investors.[57] In the US, this aspect plays a major role in the debate on improving access to finance for SMEs. Recent recommendations by US stakeholders to help more companies go public and stay public are inspired by the idea that "public offerings allow 'Main Street' investors to own a direct economic stake in the success of American enterprises."[58] Of course, this also applies to Europe's citizens, who should have the chance to benefit from the success of European-based companies.

What is the best way to make capital markets more attractive for SMEs? We have already outlined that the problems are multifaceted and that reforms of the regulatory framework are only partially effective at improving access to capital markets. Keeping this in mind, any proposals for reform have to consider that Europe has chosen to provide the SME Growth Market (SME GM) as an alternative for SMEs seeking funding through public equity. However, a SME only benefits from facilitations if its shares are listed on a SME GM. According to ESMA, SME GMs have seen an important growth in 2020 and could represent a feasible avenue for SMEs willing to raise funds through equity markets. Nevertheless, they still account for less than 15% of total SME trading.[59] Thus, most SMEs are not listed at a SME GM!

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[53] There are some theoretical arguments pointing in the direction that professional investors are capable to do so, even if we assume the arguments for mandatory disclosure to remain sound. This is because in private placements issuers might be reasonably confident to confide certain proprietary information to a limited audience, thereby reducing incentives to disclose at suboptimal level. Nevertheless, the agency-cost justification for mandatory disclosure remains valid in private placements, suggesting that professional investors might fail to extract a socially optimal amount of information from issuers. In any case, the Commission should be cautious to infer from the costs of capital in private placements being comparable to public markets that private-capital raisings result in the same degree of allocative efficiency. This is because the disclosure generated in public markets might lead to spillover effects, allowing investors to better value securities offered in exempted transactions, since they can infer the adequate price by looking at the price comparable companies offering securities in public markets can obtain, *De Fontenay*, 68 Hastings L. J. (2017), 445, 490 et seqq.

[54] 15 U.S.C. §§ 78a-78pp.

[55] The Supreme Court has decided that section 12(a)(2) Securities Act, a negligence based liability regime, does not apply to private placements, Gustafson v. Alloyd Co., 513 U.S. 561 (1995). Additionally, some states might apply the tort of negligent misrepresentation, *Langevoort*, 63 Law & Contemp. Probl. (2000), 46, 69.

[56] Cf. TESG, final Report, 5.

[57] Capital Markets Modernization Taskforce, Final Report, January 2021, 7.

[58] American Securities Association et al, Expanding the On-Ramp, 2018, 3.

[59] ESMA, EU Securities Markets. Annual Statistical Report 2021, 17 December 2021, ESMA50-165-2004.

This finding raises the question of whether European legislation should also provide regulatory facilitations for SMEs interested in listing on a regulated market.[60] These issuers are also confronted with the problem that European securities regulation is complex, thus causing disproportionate costs. The complexity results from the number of regimes and their level of detail. Furthermore, it is particularly challenging for SMEs that the numerous Single Rulebooks governing access to equity markets and market conduct (PR; MAR; TD and SRD, the latter two transposed into national laws) are not aligned with each other.

Proportionality is not only essential in banking regulation, but also in European securities regulation. However, a more balanced permanent regime for SMEs listed on a regulated market would dilute the concept of a SME GM under MiFID II. Consequently, SMEs would have few incentives to have their shares listed on a SME GM. One possible strategy, however, is to establish an IPO On-Ramp, following the model of the US.

In the US, this strategy has shown some success in reviving the IPO market.[61] The idea is simple and at the same time captivating: Emerging growth companies are exempt for a period of up to five years from some requirements of US corporate and accounting law that were perceived as particularly costly by issuers and the finance industry.[62] This strategy is also of interest for Europe, although the exemptions from regulatory requirements in Europe will be different from those in the US.

We recommend a temporary exemption from those rules in particular that are not absolutely necessary for effective investor protection and the proper functioning of the capital markets. Board composition and remuneration requirements serve (important!) socio-political concerns under the SRD II, are, however, dispensable, at least for a transitional period, if this helps to make it easier for companies to go public. The results of an expert survey suggest that such requirements are relevant for the decision on whether to go public or not, as compliance can be particularly burdensome and costly.[63]

Companies would benefit for a period of three to five years from regulatory facilitations. During this time, the management can become familiar with securities regulation and further requirements under accounting law. We therefore suggest that the Commission considers an IPO On-Ramp as a further alternative for SMEs seeking a listing on a regulated market.

2. Specific Reform Proposals

In order to assess the reforms proposed by the TESG and taken up by the Commission in the Targeted Consultation, it should first be kept in mind that a large part of the trading of securities on SME GMs is

[60] SMEs whose shares are traded on a "simple" MTF are not considered here.

[61] The JOBS Act has led to a steady increase in IPOs (from 124 in 2011 to 226 in 2013 and 291 in 2014). Cf. *Ernst&Young*, The JOBS Act 2015 mid-year update, p. 2. However, in the long-run, the IPO On-ramp 'has not opened the floodgates to the U.S. public markets', cf. *Ryan*, IPO 'On-Ramp' a Qualified Success (only 105 IPOs in 2016, down 38% from 2015 due to 'explosion in private investment capital').

[62] The JOBS Act provides emerging growth companies (EGCs) with, among other things, facilitations in the regime on executive compensation, accounting-related facilitations in registration, facilitations in the audit of the internal control system, more flexibility in the communication with investors and the possibility of a confidential pre-registration with the SEC. The reform was a reaction to the perception that many requirements introduced in US law by the Sarbanes Oxley Act were considered too costly by companies. Cf. *Cunningham*, The JOBS Act, 22. The IPO Task Force, Rebuilding the IPO On-Ramp, 19 estimated that the reform would lead to savings of 30-50% in compliance costs.

[63] Cf. *Veil*, Kapitalmarktzugang für Wachstumsunternehmen, 120-127.

done by private investors.[64] For institutional investors, an investment in such issuers is often not attractive due to the small volume of listed shares and disproportionate costs.[65]

In order to foster participation of retail investors to SME markets, it should be borne in mind that market manipulation and insider trading have a particularly damaging effect in a rather illiquid market. The spectacular fraud cases in Germany (former Neuer Markt) and Spain (former Mercado Alternativo Bursátil) cast a spotlight on the importance of private enforcement as a mechanism to protect trust in the integrity of market participants.[66] However, European legislation leaves it up to the Member States to provide for liability rules. This is not convincing for a market with a 'European seal' (SME GM).[67]

Market operators and EU legislation will have to face a further challenge. Private investors are investing less and less in individual shares, but rather in funds. This macro development also impacts liquidity of SME markets.[68] Consequently, the incentives for institutional investors to invest in SMEs should be improved. The establishment of a EU fund[69] is an interesting idea for promotion SME IPOs and listing, as investments by a EU fund could help to make investments in SME IPOs more cost-effective.[70]

Keeping the policies in mind, key proposals of the TESG for reforming the legal framework for SME Growth Markets (SGM) have merit. This applies in particular to the introduction of dual class shares and multiple voting rights,[71] provided that the prospectus adequately informs about these special features at the time of the IPO. These instruments make it easier for start-ups and family-owned companies to access capital markets as they can retain control over the company.

The TESG also rightly draws attention to improving corporate governance mechanisms for issuers listed on a SME GM. On the one hand, it is not necessary to oblige board members of SMEs to explain whether they comply with recommendations of a corporate governance code. The main reason for this is that such codes hardly take into account the specificities of SMEs.[72] Instead, the recommendations are tailored to large issuers. However, minimum requirements for effective management control should be provided under European law. These measures will contribute to the protection of investors and are necessary to ensure the proper functioning of a SME GM.

We also agree with the intention to create a balanced disclosure regime. The TESG has put forward a number of important ideas, following up on the High-Level Forum's recommendations. The reforms should go in two directions. On the one hand, it will be necessary to strengthen the disclosure regime through additional obligations for investors about changes in major shareholdings. The existing

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[64] Cf. *LSE*, A Guide to AIM, 2010, p. 58, 65 ("much of the daily volume in AIM companies is brought about by these small private investors"); *Veil*, Kapitalmarktzugang für Wachstumsunternehmen, 63; TESG, final Report, 60.

[65] Cf. *Perrone*, Capital Markets Union in Europe, para. 13.31.

[66] Cf. *Perrone*, Capital Markets Union in Europe, para. 13.51 (however, focusing only on public enforcement by a single supervisor).

[67] Cf. on the signalling effect *Veil/Di Noia*, Regulation of the EU Financial Markets. MiFID II and MiFIR, para. 13.49.

[68] Cf. *Fleming*, Speech 9 May 2017.

[69] It may therefore make sense to create an EU fund that invests in SME securities. Cf. Commission, A Public-Private Fund to Support the EU IPO Market for SMES. Final Report, October 2020.

[70] Cf. Commission, A Public-Private Fund to Support the EU IPO Market for SMEs. Final Report, October 2020, 101.

[71] Cf. TESG, Final Report, 32 et seq.

[72] This can be exemplified by the German Corporate Governance Code, which does not differentiate between large companies and SMEs in any of its recommendations.

notification obligations are still subject to the divergent corporate laws of the Member States, with the consequence being that in some Member States it is possible for investors to creep up on issuers listed. On the other hand, we encourage the Commission to consider a more flexible disclosure obligation for inside information. The current regime under Art. 17 MAR might be too burdensome for SMEs.[73]

IV. Prospectus Disclosure

The Consultation further inquiries about useful suggestions to scale back regulation on so-called secondary issuances of issuers already listed.[74]

1. The Role of Regulation in Secondary Issuances

While we generally agree with the goal to distinguish between initial offerings and secondary issuances as the investors' information needs differ, we caution against taking this approach too far. At the outset, it has to be borne in mind that although TD and MAR feed the market with information, they cannot provide investors with information, which only come into existence by virtue of the transaction itself.[75] Moreover, the fact that issuers and their managers have incentives not to disclose at a socially optimal level,[76] suggests a role for mandatory disclosure in these transactions as well. It follows that although investors in secondary issuances generally do not require the same amount of information as in initial offerings, it is ill-advised to abolish mandatory disclosure for secondary issuances altogether.[77]

Moving on to the most sensible approach to catering to the informational demands of investors in secondary issuances, we do not purport to be in the best position to judge whether the Recovery Prospectus[78] suffices or whether the market also needs the information stipulated in the initial simplified disclosure regime[79]. The Commission should answer this by asking those who know best: investors investing in secondary issuances. As in the United Kingdom,[80] this could be done through a Targeted Consultation for regulating secondary issuances or – at the very least – by making use of the results gathered there.

2. Specific Comments on Regulating Secondary Issuances

Apart from that, our input here is limited to one fundamental and two more specific comments on optimally regulating secondary issuances.

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[73] Cf. *Veil/Di Noia*, Regulation of the EU Financial Markets. MiFID II and MiFIR, para. 13.34 et seq.; *Kumpan*, ZGR 2016, 2, 31; in more detail see below VI.2.

[74] *EC*, Targeted Consultation, 24 et seqq.

[75] This is true for information about how the proceeds of the transaction will be used and the potential impact of the transaction on its *debt-equity ratio*, *Coffee*, 52 Wash. & Lee L. Rev. (1995), 1143, 1166 et seqq.; *Langevoort*, 63 Law & Contemp. Probl. (2000), 45, 51 fn. 29.

[76] Agency costs, leading to suboptimal disclosure decisions, might even be particularly pronounced in the context of secondary issuances, if managers fear being ousted in case of negative disclosure, see *Gulati*, 46 UCLA L. Rev. (1999), 675, 696 et seqq; *Langevoort*, 63 Law & Contemp. Probl. (2000), 45, 54.

[77] Cf. Question 24 Option 1.

[78] Art. 14a Prospectus Regulation.

[79] Art. 14 Prospectus Regulation.

[80] See Call for Evidence: UK Secondary Capital Raising Review.

a) Regulating Secondary Issuances as an Opportunity to Think About Conceptualizing the Interaction Between Periodic Disclosure and Prospectus Law

Secondary issuances raise the general question of how to best conceptualise the interaction between periodic disclosure and prospectus law in European capital markets law. In very general terms, the European legislature has two potential avenues for regulatory action at its disposal. Either, following the US example,[81] it further dedicates itself to building an integrated system of mandatory disclosure. The fundamental task for policymakers then becomes to ensure that relying on periodic disclosure in order to reduce prospectus disclosure does not lead to a suboptimal information level for secondary issuances.[82]

Alternatively, it can leave the periodic disclosure regime untouched and assign the main task for ensuring an informed investor decision to prospectus law. Assuming that the TD (and MAR) currently does not provide for a socially optimal level of issuer disclosure,[83] the European legislature is left with comparatively less latitude to trim mandatory disclosure for secondary issuances. This is because the prospectus has to make up for the suboptimal information level generated by periodic disclosure.

It is our impression that – at least in Europe – there has not been a sufficiently rigorous debate to date on whether either one of these policy choices or a third one should be pursued.[84] Hence, it seems sensible for the Commission to use the proposed Targeted Consultation on secondary issuances to also facilitate a broader discussion on which approach is considered desirable.

In any case, the success of tying together periodic and prospectus disclosure for the sake of secondary issuances will be determined by ensuring that the information taken into account by investors when deciding whether to invest in a secondary issuance is as properly verified as in an initial public offering. Since investors investing in secondary issuances will use value relevant information provided by periodic disclosure this depends heavily, albeit not entirely,[85] on whether one can confidently assume that the system of enforcement for periodic disclosure is effective enough.[86] There might be reasons to doubt

[81] See for instance *Loss/Seligman et al.*, Fundamentals of Securities Regulation Vol. 1, 244 et seqq. *Palmiter*, Securities Regulation, 21 et seq., 131.

[82] At least in the case of the simplified disclosure regime it might be argued that the recent cut backs have led to a suboptimal information level mandated for secondary issuances. This is because capital-market practitioners note that the information provided in pursuance with the TD does not live up to the standards of the – often particularly relevant – Operating and Financial Review or the Section on Capital Resources included in the regular prospectus, *Berrar*/*Wiegel*, CFL (2012), 97, 105. See Section 7 and 8 Delegated Regulation 2019/980.

[83] This seems to be the position of the European legislator. The Universal Registration Document, Art. 9 Prospectus Regulation, is modelled after the registration document for equity securities and provides for more extensive disclosure than the TD. See Annex 2 Delegated Regulation 2019/980. By using the Universal Registration Document issuers are able to fulfil the obligations of the TD regarding the annual and half-yearly financial report, Art. 9 para. 12 Prospectus Regulation.

[84] We offer no opinion on this here. On a theoretical level one could for instance argue against a system of fully integrated mandatory disclosure that, in order to keep a listing attractive, elevated duties to inform investors should only fall on listed companies which actually issue securities instead of all listed companies. In favor of a fully integrated system of mandatory disclosure speaks that it significantly reduces going-to-market-time, since most of the information required is already available through periodic disclosure. Additionally, it might also facilitate informational efficiency in the secondary market. Another option, currently pursued by means of the Universal Registration Document, would be to offer fully integrated mandatory disclosure as an option issuers relying on regular issuances can opt in to.

[85] At least with larger issuers financial analysts, the financial press coverage, and short shellers do their part in creating incentives to disclose truthfully, see for instance *Langevoort*, 63 Law & Contemp. Probl. (2000), 46, 52.

[86] Of course, it is also possible to reduce verification costs for secondary issuances through incorporation by reference, i.e. incorporating periodic disclosure into the prospectus. The problem with this lies in the fact that the resulting additional due diligence, of course depending in its extend on the implemented liability standard, for the incorporated documents prolongs going-to-market-time, the most prominent advantage of an integrated disclosure regime, see *Cox*, 63 Law & Contemp. Probl. (2000), 11, 19. Also suggesting that integrated disclosure requires shoring up of incentives to properly verify periodic disclosure, *Fox*, 70 Va. L. Rev. (1984), 1005, 1033 et seq.

this, since MAR and TD (predominately) focus on public enforcement.[87] We therefore suggest that the Commission approaches proper enforcement for secondary issuances holistically, taking both into account: the efficient enforcement of prospectus law as well as of periodic disclosure.

b) Avoiding Inconsistency Between the Universal Registration Document and the Simplified Disclosure Regime

Taking a closer look at the currently implemented regime, we note that the approach the European legislator takes in regulating secondary issuances is inconsistent. The dominant options the Prospectus Regulation provides for equity secondary issuances are the Universal Registration Document on the one hand, and the simplified disclosure regime[88] on the other hand. Only the former requires companies to add to the information level mandated by TD and MAR, while in the context of the latter TD and MAR are considered to be sufficient to inform investors. We argue that this inconsistency should be avoided in the future, since there is no good reason for investors to receive different amounts of information depending on the kind of regulatory-relief-mechanism used by the issuer. The Commission should therefore decide which information level for periodic disclosure – Universal Registration Document or TD and MAR – it deems cost efficient, instead of allowing for two different models with divergent quality in the information provided.

c) A Comment on Specifying a Certain Page Limit for a Prospectus

Finally, we are sceptical about the apparently increasingly popular regulatory technique of specifying a certain page limit for a prospectus.[89] Although it makes sense to try reducing the total number of pages of a prospectus,[90] issuers are generally still required by European law and national liability rules to provide investors with all information necessary to make an informed investment decision. A page limit for prospectuses would only increase the liability exposure for companies forced to make cuts on disclosure, while also risking that the prospectus – at least of companies difficult to value – provides for a suboptimal level of issuer disclosure. This might lead to fewer companies considering access to capital markets to be attractive. We think that a better approach to reducing the length of a prospectus would be to scale back line items currently mandated in the Delegated Regulations.

V. Market Abuse

The Consultation addresses a number of different topics with respect to MAR. Of these, two fundamental issues of the regime will be discussed here in more detail: (i) the definition of inside information and (ii) the relationship of insider trading law and ad hoc disclosure. Although both insider trading law and ad hoc disclosure share the same regulatory goal of capital market efficiency, they work differently and generate different costs and benefits for capital market participants. The characteristic feature of European law is that both regimes are linked to the same trigger: inside information[91]. The

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[87] Cf. Art. 28b TD, Art. 30 MAR.

[88] Artt. 14, 14a Prospectus Regulation.

[89] It is currently being used in Art. 14a para. 4 Prospectus Regulation and the *TESG*, Empowering EU Capital Markets for SMEs, 23 recommends to apply if to prospectuses of SMEs in general.

[90] The fear of too long prospectuses and, as a consequence, deteriorating investor decisions should not be overblown though. At least for professional investors, to whom prospectus disclosure should be directed to, there is limited, if any, evidence on them facing an information overload as a consequence of too long mandatory disclosure documents, cf. *Georgiev*, 64 UCLA L. Rev. (2017), 602, 671 et seq.; *Gerding*, 90 Tul. L. Rev. (2016), 1143, 1150; *Harper Ho*, 65 Vill. L. Rev. (2020), 67, 127: "In general, investors do not believe themselves to be burdened by the costs of immaterial information generated by current risk disclosure requirements in the MD&A and elsewhere. [Footnote omitted]".

[91] Art. 7 MAR.

concept of inside information must therefore not only meet the needs of both regimes, any change or clarification of the definition of inside information also has far-reaching consequences.

The fact that the Commission addresses the definition of inside information in the Consultation is nevertheless reasonable. *First*, a clarification of the vague definition contributes to a uniform interpretation within the Member States and therefore makes perfect sense with regard to the aim of establishing the Capital Markets Union.[92] *Second*, a concretisation of the legal obligations is also useful from a liability point of view. Legal uncertainty[93] in the case of secondary market liability exacerbates the already existing risk of *overdeterrence*[94] (at least with regard to ad hoc disclosure violations).

1. The Definition of Inside Information

According to the Commission's idea for a possible reform, inside information with a significant price effect shall mean *"information a rational investor would be likely to consider relevant for the long-term fundamental value of the issuer and use as part of the basis of his or her investment decisions"*.[95] The proposal addresses the criterion of price relevance and highlights three aspects by means of which price relevance is to be tested: the relevance of the information for the investment decision of a *rational* investor who bases his investment decision on the *fundamental value* of the information and only takes into account *long-term* impacts on the fundamental value. This clarification of the concept of inside information is useful as it can help to reduce legal uncertainties.[96] The proposed wording is convincing

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[92] On the economic significance of the Capital Markets Union, see above fn. 1.

[93] Economic analysis shows that uncertainty can lead to excessive levels of compliance – see *Shavell*, Economic Analysis of Accident Law, 1987, 79 et seqq.; *Calfee/Craswell*, 70 Va. L. Rev. (1984), 965; *Craswell/Calfee*, 2 Journal of Law, Economics & Organization (1986), 279; in the context of capital markets law *Schäfer/Ott*, Lehrbuch der ökonomischen Analyse, 2020, 363 et seqq. In the standard economic model, it is irrelevant whether legal uncertainty stems from vague legal criteria or enforcement deficits. Any reduction of uncertainty makes sense in principle. However, the study of *Feldman/Teichman*, 84 NYU Law Rev. (2009), 980 showed, that (especially in criminal law) uncertainties in the interpretation of substantive law lead to a lower level of compliance than mere enforcement deficits. One could conclude, therefore, that reducing the first type of uncertainty is a particularly worthwhile goal for legislatures.

[94] The problem of *overdeterrence* in the case of secondary market disclosure violations has been discussed for years – cf. *Easterbrook/Fischel*, 52 Chi. L. Rev. (1985), 611; *Alexander*, 48 Stan. L. Rev. (1996), 1487; *Gelter,* Kapitalmarkthaftung und Gesellschaftsrecht, 2013, 83. *Overdeterrence* in this case arises from the fact that civil liability compensates for pure economic losses*.* Some investors profit from a violation of disclosure obligations, while others lose. If the issuer has to compensate the losing investors for their losses, this results in a misalignment of behavioural incentives. However, this picture is incomplete because distorted stock market prices also cause real economic distortions. Without naming these exhaustively, distorted secondary market prices give rise to a number of social harms: disruption of the market for corporate control, failure of the secondary market as an instrument of external corporate governance, disincentives for investors by increasing the cost of information acquisition and verification, higher volatility at the expense of risk-averse investors and distorted feedback for the primary market (esp. in case of secondary emissions) with the consequence of an adverse effect on the allocation efficiency of the primary market (*Fox*, 109 Colum. L. Rev. (2009), 237, 252 et seqq.; *Posner*, 54 Geo. Wash. L. Rev. (1986), 159, 170; *Velikonja*, 54 Wm. & Mary Law Rev. (2013), 1887). The proper design of the liability rule thus becomes a legislative challenge. Higher compliance costs because of *overdeterrence* reduce the attractiveness of capital markets and may lead issuers to avoid them. For further details on the economic relevance of capital market-based financing see fn. 1.

[95] Question 53 (b) (b).

[96] A detailed statement by *BaFin* on the interpretation of the concept of price relevance/reasonable investor can be found in the Issuer Guidelines (cf. *BaFin*, Issuer Guidelines, Modul C, I.2.1.4). The understanding of *BaFin* is consistent with the rulings of the *Bundesgerichtshof* (BGH of 13 December 2011 – XI ZR 51/10 (IKB), BGHZ 192, 90). Even with this guidance from the supervisory authority, however, not all doubtful questions can be answered for practice and discussions will continue in academic literature. In contrast, in its recently published MAR review, ESMA argued against changing or amending the definition of inside information (*ESMA*, MAR Review report, 2020, ESMA70-156-2391, 55 et seq.). ESMA justifies its cautious approach with the risk of undesirable consequences, in particular for investor protection and investor confidence (*ibid*, 56). This objection of ESMA is certainly justified. Nevertheless, we believe that the advantages of a conceptual clarification of inside information might be significant and therefore should be discussed. This is all the more urgent as the interpretation of the criterion of price relevance varies widely in Europe. For further details cf. *Securities and Markets Stakeholder Group*, Advice to ESMA – SMSG Position Paper

with regard to the assessment of price relevance from the perspective of a rational, fundamental value-oriented investor. In contrast, a further narrowing of this standard to information relevant to long-term fundamental value creates the risk of considerable distortions of insider trading law and ad hoc disclosure.

a) The Rational, Fundamental Value-oriented Investor

The rationality of the reasonable investor has already been assumed in academic literature. It has been derived from recitals 14 and 15 MAR, according to which reasonable investors draw *reasonable* conclusions from the *ex ante* information available when assessing the price relevance of specific information.[97] Codification of investor rationality in the legislative text, as discussed by the Commission in the Consultation, would confirm this understanding. A rational investor acts to maximize his own utility and bases his investment decision on factors which are consistent, free of contradictions, transitive, and invariant.[98] He has the ability to collect information, analyse and process it in a "perfect" way without systematic errors.

This behavioural model has been challenged by the findings of *behavioural economics* research;[99] for the purposes of capital markets law, it is nevertheless convincing to retain it in principle.[100] *First*, with regard to ad hoc disclosure, this is supported by the fact that the adaptation of disclosure obligations to *behavioural biases* is an error-prone and by no means easy task.[101] *Second*, it is unclear to what extent investors' cognitive biases are to be given any legal consideration at all. This is because every normative adjustment of the disclosure obligations incurs costs again on the part of the issuers and, in the worst case, even reduces the efficiency of the capital market.[102] And *third*, the legal uncertainty associated with an alternative behavioural model also argues in favour of the normative assumption of rational behaviour in the case of insider trading.

According to the Commission's proposal the rational investor takes into account only information relevant to fundamental value. In neo-classical corporate finance theory, the fundamental value is determined by the underlying cash flows of a financial instrument and the associated risk.[103] Neither the

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Regarding ESMA´s Work on MAR Level 3-Measure, ESMA/2015/SMSG/025, 21.9.2015, para. 34; *Langenbucher,* AG 2016, 417, 419 et seqq.

[97] Cf. *Veil*, European Capital Markets Law, 2022, § 14 para. 56; *Klöhn*, in Klöhn, Marktmissbrauchsverordnung, 2018, Art. 7 para. 274; *Ventoruzzo/Picciau*, in Ventoruzzo/Mock, Market Abuse Regulation, 2017, Art. 7 para. B.7.67.

[98] *Hastie/Dawes*, Rational Choice in an Uncertain World, 2010, 237 et seqq.; *Schäfer/Ott*, Lehrbuch der ökonomischen Analyse, 2020, 107 et seqq.; *Kirchgässner*, Homo Oeconomicus, 2013, 14 et seqq. One could also relate the concept of reasonable investor to that of *homo oeconomicus*. The requirement of rationality does not prevent the consideration of ESG factors in the context of investment decisions (*Mülbert/Sajnovits,* 18 ECFR (2021), 256, 285).

[99] For an overview cf. *Schäfer/Ott*, Lehrbuch der ökonomischen Analyse, 2020, 118 et seqq.; *Englerth/Towfigh*, in Towfigh/ Petersen et al., Ökonomische Methoden im Recht, 2017, § 8.

[100] Suggestions as to how the insights of *behavioural economics* research can be made fruitful for the interpretation of the concept of the reasonable investor can be found in the US literature. There too, the discussion about the characteristics of the reasonable investor is intense (for an overview *Rose*, 43 J. Corp. L. (2017), 77). For further details see *Huang*, 13 Sup. Ct. Econ. Rev. (2005), 99, 112.

[101] *Choi/Pritchard*, 56 Stan. L. Rev. (2003), 1, 61; *Langevoort*, 97 Nw. U. L. Rev. (2002), 135, 138; *Langevoort*, 52 Stan. L. Rev. (1999), 87, 109.

[102] *Choi/Pritchard*, 56 Stan. L. Rev. (2003), 1, 50, 61; *Langevoort*, 52 Stan. L. Rev. (1999), 87, 111; *Huang*, 13 Sup. Ct. Econ. Rev. (2005), 99, 111.

[103] *Brealey/Myers et al.*, Principles of Corporate Finance, 2019, Chap. 4; *Berk/DeMarzo*, Corporate Finance, 2020, Chap. 3.3-3.5. The fundamental value can be calculated by discounting all future cash flows (*discounted cash flow method*). The future cash flows for shares depend on the future earnings potential of the company in question. There are different methods to determine

legal text of MAR nor the recitals so far allow the conclusion that only information relevant to fundamental value is subject to insider trading prohibition and ad hoc disclosure.[104] There is a wide range of opinions, with one side supporting a strict focus on fundamental value[105], while others want to see irrational market reactions[106] or ESG information[107], independent of fundamental value impact, captured by the concept of inside information.

To understand why it is appropriate to base the assessment of price relevance on the impact of information on fundamental value, it is important to discuss two separate questions. The first step is to clarify in general terms what information an efficient capital market needs (= fundamental value-relevant information). Second, it is important to ask how much the regulation of insider trading law and ad-hoc disclosure must take into account actual market conditions that deviate from the ideal capital market (= consideration of information with actual price-influencing potential independent of the fundamental value).[108] This should only be done if real market conditions permanently compromise the efficiency of the capital market and regulation can help to prevent this. However, we do not see any need for a regulatory adaptation at present.

The objective of capital market regulation is to create an efficient market (in terms of fundamental value).[109] An efficient market is not an end in itself; rather, its legal protection stems from the economic significance of the capital market as an institution. In simple terms, the value of an efficient secondary market consists in the information and signalling function of securities prices. Fundamental value-efficient prices ensure allocative efficiency in the capital market as well as in product and labour markets. Securities prices become efficient through the trading of informed investors (so called

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the future cash flows (*dividend discount mode, total pay-out* and *free cash flow valuation model* – for further detail see *Berk/DeMarzo*, Corporate Finance, 2020, Chap. 9.1, 9.2). The discount factor corresponds to the cost of capital (or rather the expected rate of return demanded by investors) (*Brealey/Myers et al.*, Principles of Corporate Finance, 2019, 83, 231). It can be calculated using the *capital asset pricing model* (CAPM) (*Brealey/Myers et al.*, Principles of Corporate Finance, 2019, 232 and 213 et seqq. concerning alternative models such as the *arbitrage pricing theory* (APT) or the *Fama-French multi-factor model*).

[104] Recital 24 MAR declares the principle of equal access to information as a regulatory aim, building on the case law of the ECJ. However, this in itself does not answer the question to which information equal access should be ensured. In other words, Recital 24 describes the aim but not the reason for regulating inside information.

[105] *Veil*, European Capital Markets Law, 2022, § 14 para. 56; *Ventoruzzo/Picciau*, in Ventoruzzo/Mock, Market Abuse Regulation, 2017, Art. 7 para. B.7.67; *Klöhn,* ZHR 177 (2013), 349, 383 et seqq.; *Klöhn*, in Klöhn, Marktmissbrauchsverordnung, 2018, Vor Art. 7 para. 75 et seqq., Art. 7 Para. 271; *Kumpan/Misterek*, in Schwark/Zimmer, KapMR-Kommentar, 2020, Art. 7 para. 147 et seqq.

[106] *BGH* of 13 December 2011 – XI ZR 51/10 (IKB), BGHZ 192, 90 para. 44; *BaFin*, Issuer Guidelines, Modul C, I.2.1.4.1; *BaFin*, Art. 17 MAR – Veröffentlichung von Insiderinformationen (FAQ), 29.5.2019, Kap. III. 4.b; *Assmann*, in Assmann/Schneider et al., Wertpapierhandelsrecht, 2019, Art. 7 para. 84.

[107] *Mülbert/Sajnovits*, 18 ECFR (2021), 256, 284 et seqq.

[108] Similiar *Langenbucher*, AG 2016, 417, 419 et seq. More recently, a distinction has been made in German academic literature between an individual view and a collective perspective (cf. *Kumpan/Misterek,* ZHR 184 (2020), 180, 189; *Kumpan/Misterek*, in Schwark/Zimmer, KapMR-Kommentar, 2020, Art. 7 para. 128 et seqq.; *Mülbert/Sajnovits*, 18 ECFR (2021), 256, 281 et seqq.; *Klöhn*, in Klöhn, Marktmissbrauchsverordnung, 2018, Art. 7 para. 271). This contrast obscures the actual issue. Even on the basis of a collective view (reasonable investor as the embodiment of the ECMH), further concretisation is required. This is because "the market" acts only through the investors, so that ultimately the collective view is, in effect, the standard of an "ideal" information trader, who takes only fundamental considerations into account when making his investment decision (implicitly acknowledging this point *Klöhn*¸ in Klöhn, Marktmissbrauchsverordnung, 2018, Art. 7 para. 272). The crucial question is rather to what extent regulation derived from an ideal of an efficient market must be adapted to real market conditions.

[109] In detail, we have to distinguish between information-efficient and fundamental value-efficient markets. An information-efficient market price is characterized by the fact that it is unbiased meaning it is as likely to be below the share's actual value as above. In contrast, a market price that accurately forecasts the underlying cash flows and risk of the financial instrument is fundamentally efficient. An information-efficient market is thus a necessary precondition for a fundamental value-efficient market. For further detail cf. *Klöhn*, in Klöhn, Marktmissbrauchsverordnung, 2018, Vor Art. 7 para. 77 et seq.

information traders). This is referred to as the information arbitrage model and the market mechanism.[110] The strategy of information traders is to detect arbitrage opportunities by comparing the current security price with what they believe to be the fundamental value.[111] Consequently, they buy undervalued and sell overvalued financial instruments.[112] Their trading causes security prices to change and the current market price to converge to the efficient market price. Uninformed investors contribute to market efficiency by providing liquidity. An efficient market serves their interests by leading to lower trading costs[113] and reducing the risk of being exploited by other market participants.[114] By diversifying their portfolio, they can hedge against the unsystematic risk[115] and possible mispricing of shares.[116]

In light of the above, the Commission's proposal makes perfect sense. If the market is supplied with fundamental value-relevant information through ad hoc announcements, informed traders can benefit from this in several ways, in particular by reducing costs for the acquisition and processing of the information.[117] A similar argument can be made for insider trading law.[118] If information relevant to fundamental values is not subject to a prohibition of insider trading, (outside) information traders trade against insiders. They systematically lose out to insiders and, in the worst case, leave the market.[119] This result is undesirable from an economic perspective, because the trading of insiders is, compared to the trading of outside information traders, a much weaker mechanism to incorporate new information into prices.[120]

As mentioned above, we do not consider it necessary to extend the concept of inside information to non-fundamental value-relevant information in order to reflect real market conditions. Admittedly, there may be a favourable arbitrage opportunity for the insider in some cases as well. However, this does not change anything for ad hoc disclosure. If information unrelated to the fundamental value had to be published, this would disrupt the activities of information traders, who would first have to check the

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[110] *Grossman/Stiglitz*, 70 Am. Econ. Rev. (1980), 393; *Gilson/Kraakman*, 70 Va. L. Rev. (1984), 549. For an overview cf. *Klöhn*, in Klöhn, Marktmissbrauchsverordnung, 2018, Vor Art. 7 para. 84 et seqq.

[111] For further details *Goshen/Parchomovsky*, 55 Duke L.J. (2006), 711, 723; *Harris*, Trading & Exchanges, 2003, 226 et seqq.; *Klöhn*, ZHR 177 (2013), 349, 354 et seqq.; *Klöhn*, in Klöhn, Marktmissbrauchsverordnung, 2018, Vor Art. 7 para. 84 et seqq.

[112] *Goshen/Parchomovsky*, 55 Duke L.J. (2006), 711, 726 et seqq.

[113] Information asymmetries increase bid-ask spreads and thus trading costs – cf. Goshen/Parchomovsky, 55 Duke L.J. (2006), 711, 728 et seq.

[114] *Goshen/Parchomovsky*, 55 Duke L.J. (2006), 711, 726 et seqq.; *Easterbrook/Fischel*, 70 Va. L. Rev. (1984), 669, 694; *Klöhn*, ZHR 177 (2013), 349, 358.

[115] See *Brealey/Myers et al.*, Principles of Corporate Finance, 2019, 178 et seqq.

[116] *Goshen/Parchomovsky*, 55 Duke L.J. (2006), 711, 727.

[117] In addition, the risk of insiders and noise traders is reduced. For further details cf. *Goshen/Parchomovsky*, 55 Duke L.J. (2006), 711, 737 et seqq.; *Georgakopoulos*, 16 Int´l Rev. L. & Econ. (1996), 417, 424; *Klöhn*, ZHR 177 (2013), 349, 375.

[118] *Goshen/Parchomovsky*, 55 Duke L.J. (2006), 711, 733 et seqq.; *Klöhn*, ZHR 177 (2013), 349, 372 et seqq.; *Klöhn*¸ in Klöhn, Marktmissbrauchsverordnung, 2018, Vor Art. 7 para. 108 et seqq.

[119] *Fox/Glosten et al.*, 43 J. Corp. L. (2018), 817, 851.

[120] *Gilson/Kraakman*, 70 Va. L. Rev. (1984), 549, 630 et seq.; *Klöhn*¸ in Klöhn, Marktmissbrauchsverordnung, 2018, Vor Art. 7 para. 109; *Fox/Glosten et al.*, 43 J. Corp. L. (2018), 817, 852. See also *Lee/Piqueria*, 52 J. Emp. Finance (2019), 56 (finding that insiders are not able to predict future returns and are prone to behavioural biases, notwithstanding their access to private information).

relevance of the information for the fundamental value.[121] It also creates the risk of legal uncertainty, which, aggravated by hindsight bias on the part of courts, increases the risk of *overdeterrence*. In the case of the insider trading prohibition, it can be argued that no protection of information traders is required in this respect. If they interpret the actions of insiders correctly as noise because they are not related to the fundamental value, they are doing exactly what justifies the legal protection of their trading: adjusting the market price to the fundamental value.[122] A broad understanding of the concept of inside information would rather lead to legal uncertainty, as the scope of insider trading prohibition would then be difficult to predict. Moreover, an extension of the insider trading provisions is not necessary to protect uninformed investors.[123]

More recently, it was discussed to what extent these arguments also apply to ESG information.[124] This specifically concerns ESG information for which the impact on fundamental value is not obvious.[125] Despite the potential relevance of ESG information on real economic allocation efficiency, taking into account any ESG information in the context of inside information would lead to legal uncertainty[126] and unclear implications for market efficiency. Special consideration of ESG information does not seem appropriate, at least at present, due to the lack of robust empirical research demonstrating a defraudation of other market participants by insiders based on ESG information, which investors may perceive as unfair. Moreover, the relevance of the topic is likely to diminish by itself over time as ESG issues will have an increasingly large, immediate impact on corporate cash flows due to advancing climate change and greater internalization of externalities through environmental and socio-political regulation. Therefore, there is currently no need for further legislative action.

b) Long-term Fundamental Value Orientation

The Commission's proposal, however, does not stop at identifying price-relevant information as information relating to fundamental value. Rather, only information that a rational investor would consider relevant for *long-term* fundamental value should have a “significant price effect”. The meaning of this additional criterion remains unclear, and it should not be included in the MAR, because either it is redundant or there is a risk of insider trading law and ad hoc disclosure failing. To understand this conclusion, one should be aware that there are at least three possible approaches to interpreting the term "long-term", none of which is convincing.

First, the criterion could be a redundant remark. Fundamental value is determined by the discounted future cash flows of a financial instrument. Only information that has a (long-term) impact on these future cash flows has an impact on the fundamental value. Short-term fluctuations are reflected to a comparatively lesser extent in the fundamental value unless they also include information on future cash

[121] *Kumpan/Misterek*, ZHR 184 (2020), 180, 208; *Klöhn*, ZHR 177 (2013), 349, 380 et seq.; *Klöhn*, in Klöhn, Marktmissbrauchsverordnung, 2018, Art. 7 para. 276, 286. In the worst case, market efficiency is adversely affected by *information overload*. For further details concerning i*nformation overload* cf. *Paredes*, 81 Wash. U. L. Q. (2003), 417. In addition, learning effects of the market are threatened to be slowed down and coordination problems with the rules of market manipulation arise (*Klöhn*, ZHR 177 (2013), 349, 380 et seq.; *Klöhn*, in Klöhn, Marktmissbrauchsverordnung, 2018, Art. 7 para. 287).

[122] *Klöhn*, ZHR 177 (2013), 349, 380 et seqq.; *Klöhn*, in Klöhn, Marktmissbrauchsverordnung, 2018, Art. para. 287.

[123] *Goshen/Parchomovsky*, 55 Duke L.J. (2006), 711, 726 et seqq.; *Kumpan/Misterek*, ZHR 184 (2020), 180, 209 et seqq.

[124] *Mülbert/Sajnovits*, 18 ECFR (2021), 256, 284 et seqq.

[125] For more details on the (potential) influence of ESG information on fundamental value, see *Mülbert/Sajnovits*, 18 ECFR (2021), 256, 272 et seqq.

[126] For a different opinion see *Mülbert/Sajnovits*, 18 ECFR (2021), 256, 286.

flows. In other words, a long-term perspective is inherent in the fundamental value assessment.[127] Redundant criteria should be avoided, though, because of the risk of legal uncertainty.

However, the criterion of long-term could also have a different meaning. Long-term could, *second*, be equivalent to sustainability, or, *third*, be understood as the opposite of short-termism. In academic debate, a clear distinction is often not made between sustainability and long-/short-termism. Even the European Commission conflates the two terms.[128] Short-termism is the myopic, inefficient focus on short-term gains at the expense of larger losses in the longer term.[129] Sustainability, by contrast, addresses aspects of negative externalities and distributive considerations.[130] Aligning investment behaviour with sustainability considerations may be preferable to choosing a short-term investment project in a specific case. If the sustainable investment project is also the long-term profitable investment project, sustainability and long-termism go hand in hand.[131] Both topics, though, are to be differentiated from the perspective of intellectual history and economics. In any case, neither interpretation is convincing from a normative-theoretical perspective. First, they create legal uncertainty (What is sustainable information? How far into the future does information have to extend before it can be said to have a long-term influence on the fundamental value?). Such uncertainty is problematic both with regard to liability for disclosure violations due to the risk of *overdeterrence* and with regard to the enforcement of the insider trading prohibition, especially since European law mandates criminal sanctions. Second, the purpose of insider trading law and ad hoc disclosure conflicts with a restriction to long-term, fundamental value-relevant information. This is because the disadvantages described above arise in the case of information that is not relevant to sustainability but is relevant to fundamental values: There is a decrease in the activity of information traders, resulting in a decrease of market efficiency. In the worst-case scenario, a market failure is imminent (*lemon market*).[132] However, no advantage is evident that could compensate for these potential disadvantages. Moreover, with respect to the third interpretation of the long-term criterion, it is not clear to what extent short-term information should have a detrimental effect on issuer behaviour[133], nor how the interests of issuers or

[127] This seems to be the understanding of the *TESG*: *„The introduction of the "long-term fundamental value of the issuer" would allow short-term investments, which often follow different investment logics than those underlying the notion of inside information, to be disregarded. Moreover, this would help foster harmonisation taking into account that some Member States focus on fundamental value and others include incentives for short-term volatility when assessing the impact on stock prices.*" (*TESG*, Empowering EU Capital Markets for SMEs, 2021, 75).

[128] *EC*, Action Plan: Financing Sustainable Growth, COM(2018) 97 final, 3 (*„Sustainability and long-termism go hand in hand. Long-termism describes the practice of making decisions that have long-term objectives or consequences. Investments into environmental and social objectives require a long-term orientation."*). Similar *EY*, Study on Directors´ Duties and Sustainable Corporate Governance: Final Report, 2020, vi, viii. But see Final Report of the High-Level Expert Group on Sustainable Finance, 2018, 45 et seqq.

[129] *Roe/Spamann et al.*, 38 Yale J. Reg. Bulletin (2021), 133, 136; *Roe/Shapira,* Law Working Paper No. 554/2020 2020, 15 et seqq.; *Bueren,* ZGR 2019, 813, 819; Final Report of the High-Level Expert Group on Sustainable Finance, 2018, 45.

[130] *Roe/Spamann et al.*, 38 Yale J. Reg. Bulletin (2021), 133, 136.

[131] On the other hand, choosing an investment project that damages the environment and leads to the exploitation of workers may not be sustainable, but may secure high cash flows for the company in the long term (*Bueren*, ZGR 2019, 813, 819 et seq.).

[132] *Akerlof*, 84 Quarterly J. Econ. (1970), 488; for an application of the "lemon market" to the capital market see *Myers/Majluf*, 13 Fin. Econ. (1984), 187; *Black*, 48 UCLA Law Rev. (2001), 781, 786 et seqq.

[133] It is difficult to draw an argument from the discussion of the usefulness of quarterly reporting. It is true that the abolition of quarterly reporting was explained by the danger of short-termism (cf. Recital 4 TD 2013/50/EU). However, it is highly controversial theoretically and empirically whether harmful short-termism arises due to quarterly reporting (for further details *ESMA*, Report Undue short-term pressure on corporations, 2019, ESMA30-22-762 para. 323; *Park*, 10 U.C. Irvine L. Rev. (2020), 991; *Roe*, 68 Bus. Law. (2013), 977). At best, the current level of research allows the conclusion that specific information, such as profit forecasts and profit figures, can lead to short-termism. On the other hand, continuous and timely disclosure serves other corporate governance aspects such as management control. Restricting the flow of information may therefore solve one

investors are served by reducing the flow of information. As a result, it seems convincing to assess price relevance solely on the basis of the impact of the information on the fundamental value. For market efficiency, the time horizon of the information is not decisive.[134] The efficient capital market rather reflects it accurately in the security price.

2. The Relationship Between Insider Trading Prohibition and Ad Hoc Disclosure

European law follows a one-step model. Under this regulatory approach, trading in possession of inside information is prohibited (insider trading prohibition) and the issuer must disclose the inside information as soon as possible. In such a system, ad hoc disclosure serves as a preventive instrument against insider trading in addition to its information function.[135] The resulting broad scope of ad hoc disclosure is mitigated by the possibility of delay under Art. 17 (4) MAR, provided that the issuer has legitimate interests in keeping inside information confidential.

The Consultation discusses two aspects of the current system. *First*, the obligation to disclose intermediate steps is addressed. The Commission asks whether it should be clarified that inside information relating to a multi-stage process need only be made public once the end stage is reached, unless a leakage has occurred.[136] *Second*, the Commission is considering the possibility of separating the ad hoc disclosure obligation from insider trading law and creating a two-step system. While inside information would continue to be subject to the insider trading prohibition, the ad hoc disclosure obligation would only be triggered upon the occurrence of predefined, price-relevant events.[137] In order to assess these considerations, it is first necessary to evaluate the costs and benefits of the current legal regulation of ad hoc disclosure. We will then discuss reform options and present a recommendation for the way forward.

a) Cost-Benefit Analysis of the Current Ad Hoc Disclosure Regime

The *benefit* of ad hoc disclosure consists in the reduction of information asymmetries between issuers and investors. The faster the market (or rather the information traders) are provided with price-relevant information, the faster market prices will approximate fundamental value. Fundamental efficient market prices protect uninformed investors and contribute to real economic allocation efficiency. Although empirical studies on MAR are lacking so far, older studies suggest that ad hoc announcements have an impact on capital market prices.[138] These findings are explicitly interpreted by some authors as evidence

problem but create another. Crucially, however, there has been no discussion at all to date of whether information subject to ad hoc disclosure can also lead to short-termism. This is by no means a matter of course.

[134] *Kumpan/Misterek*, ZHR 184 (2020), 180, 219.

[135] *Veil*, European Capital Markets Law, 2022, § 19 para. 2.

[136] Question 53 (b) (c).

[137] Question 54. The Commission had already made a similar proposal of different definitions of inside information for the purposes of insider trading prohibition and ad hoc disclosure obligation in the MAR proposal cf. *EC*, Proposal for a Regulation of the European Parliament and of the Council on insider dealing and market manipulation (market abuse), COM(2011) 651 at 12(3).

[138] *Nowak,* ZBB 2001, 449 (finding that only a part of the ad hoc announcements in a sample of German issuers proved to be statistically price-sensitive); *Muntermann/Guettler*, 17 J. Int. Fin. Markets, Institutions and Money (2007), 1 (finding that stock prices react within 30 min after the ad hoc disclosures); *Baule/Tallau,* working paper 2012, 1 (finding significant abnormal returns on the day of publication of ad hoc announcements); *Dettenrieder/Theissen,* working paper 2012, 1 (finding significant price changes, increased trading volumes and increased bid-ask spreads after the publication of an ad hoc announcement); *Bank/Baumann*, 29 Financ. Mark. Portf. Manag (2015), 173 (finding abnormal returns). See also *Leibfried/Spinner,* IRZ 2012, 163 (finding significant abnormal returns for ad hoc announcements pursuant to the disclosure obligation of the Schweizer Börse SIX and concluding that the ad hoc disclosure enhances market efficiency).

of an improvement in market efficiency.[139] On the other hand, there is to date no convincing empirical evidence that the disclosure obligation of the intermediate steps doctrine (Art. 7 (2) MAR) provides significant informational benefits to investors.

This (potential) benefit of ad hoc disclosure must be compared with the *costs* incurred at the same time by the mandatory disclosure regime. Costs can arise for the issuer but also for investors. We are unable to make any quantitative statement regarding the *costs incurred by issuers* in complying with the ad hoc disclosure obligation.[140] In this respect, it is also difficult for us to assess the impact of the ad hoc disclosure obligation on the incentives of SMEs to seek capital market-based financing.[141] Nevertheless, two aspects seem worth mentioning. *First*, the number of delayed ad hoc announcements is steadily increasing.[142] This finding could indicate a problem, as the mitigation of the broad ad hoc disclosure obligation via the provision of Art. 17 (4) MAR is in any case associated with costs for the issuer,[143] whereas such costs are avoided by limiting the substantive disclosure obligation. The problem is exacerbated by the difficulties in interpreting Art. 17 (4) MAR[144], which lead to legal uncertainty and thus to higher compliance costs for issuers. *Second*, a first descriptive empirical analysis suggests that ad hoc announcements are often released after a transaction has been completed and inform about events, which have already occurred.[145] Although disclosure can help to reduce information asymmetries, an inadequately designed disclosure obligation can diminish this informational advantage. If information is presented incompletely or in a way that is difficult to understand, the period of information processing takes longer or incurs additional *costs for informed investors*.[146]

Existing empirical research does not allow a clear conclusion regarding the efficiency of the current regime of ad hoc disclosure. If the informativeness of ad hoc announcements is emphasized on the basis of measured, statistically significant price reactions[147], however, this does not allow us to draw comparative conclusions for a potentially better design of ad hoc disclosure. By contrast, a textual analysis of recent ad hoc announcements has shown that the specific information content of ad hoc

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[139] *Bank/Baumann*, 29 Financ. Mark. Portf. Manag (2015), 173, 196; *Dettenrieder/Theissen*, working paper 2012, 21 (arguing that investors view ad hoc announcements as valuable).

[140] Theoretically, a further distinction can be made between direct costs associated with compliance with the ad hoc disclosure obligation and indirect costs that arise because other persons also benefit from the issuer's disclosure – for further detail cf. *Klöhn*, in Klöhn, Marktmissbrauchs-verordnung, 2018, Vor Art. 17 para. 74 et seqq.

[141] The current regime acknowledges the needs of SMEs with respect to the disclosure obligation. Art. 17 (9) MAR allows inside information relating to SME issuers to be disclosed on the market´s website in some circumstances. However, this is just a minor concession with regard to the dissemination of the inside information.

[142] The development can be traced in *BaFin's* annual reports. While in 2002 approval was granted for only 18 ad hoc announcements (in response to 27 requests) (*BaFin*, Annual Report, 2002, 75), *BaFin* reported 496 delays for 2020 (Annual Report 2020, 91), while issuers published a total of 2,397 ad hoc disclosures in 2020. *Consob* reports similar figures for the Italian capital market. In 2020, 323 ad hoc announcements were delayed (*Consob*, Annual Report, 2020, 40). In its MAR Review ESMA states that approximately 14.000 cases of use of delayed disclosure of inside information were recorded by the national supervisors from 2016 to 2019 (Final Report MAR para. 192).

[143] Although it is not entirely clear, it is likely that at least a decision by the management board itself will be required. See *Veil*, European Capital Markets Law, 2022, § 19 para. 66 et seqq.; *BaFin*, Issuer Guidelines, Modul C, I.3.3.1.1.

[144] *ESMA*, MAR Review Report, 2020, ESMA70-156-2391, 62 et seqq.

[145] *Veil/Gumpp et al.,* ZGR 2020, 2, 31 (analysing 244 personnel-related ad hoc disclosures in 2017 and finding that only 13,52% of the announcement concerned future events).

[146] *Gilson/Kraakman*, 70 Va. L. Rev. (1984), 549, 566 et seqq.

[147] *Dettenrieder/Theissen*, working paper 2012, 21.

announcements is at least doubtful in a not negligible number of cases.[148] Although the considerations presented here certainly do not cover all relevant aspects for the cost and benefit analysis, they do indicate that ad hoc disclosure in its current form should be reconsidered.

b) Reform Options

The potential flaws of the current regulation can be traced back to the one-step model of MAR, which combines insider trading law and ad hoc disclosure via the definition of inside information. As a comparative analysis of US securities markets law shows, a synchronization of insider trading law and disclosure obligations is not the only conceivable model. For US law, there is no general duty to disclose new, price-relevant information[149] unless (i) the facts meet one of the predefined disclosure items[150] or (ii) the issuer has disclosed information in the past that now proves to be misleading in light of the new information, which is why, according to some courts, there should be a duty to update[151]. Although the US system has evolved to some extent into a continuous disclosure system in legal practice[152], it follows a rule-based approach in principle. Empirical research suggests that the information published on the basis of the mandatory, event-based disclosure obligation in the form of current reports (Form 8-K) contributes to market efficiency.[153] However, this empirical research does not allow conclusions to be drawn for the European regulatory system.

The advantages and disadvantages of rule- and standard-based regulatory approaches have already been discussed in detail.[154] While standards struggle with the problem of uncertainty, rules can be under- and over-inclusive, such that the compliance achieved may deviate from what is socially optimal. With regard to a reform of the ad hoc disclosure under MAR, there are basically two options. *First*, one could stick to the existing system and try to improve it by specifying the definition of inside information (Art. 7 MAR) and the possibility of delay (Art. 17 para. 4 MAR). An additional reform step could be a more detailed design of the form and content of ad hoc announcements.[155] The result would be a small and probably less effective reform. Compliance costs for companies could only be partially reduced this way. *Second*, a two-step system could be established by separating ad hoc disclosure and insider trading law. The discussion on the merits of a one-step or two-step system has already been conducted with regard to

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148 *Veil/Gumpp et al.*, ZGR 2020, 2, 32.

149 *Klöhn*, in Klöhn, Marktmissbrauchsverordnung, 2018, Vor Art. 17 para. 3; *Steinberg*, 22 U. Pa. J. Int´l Econ. L. (2001), 635, 657 et seq. The rules of the stock exchanges partly provide for ongoing disclosure (e.g. New York Stock Exchange Listed Company Manual § 202.05). However, these are not enforced with equal intensity (*Horwich,* 71 Bus. Law. (2016), 1113, 1128 et seq.; *Ventoruzzo,* 11 ECFR (2014), 554, 571 et seq.).

150 Issuers are required to file a current report under Sec. 13 or 15(d) of the SEA 1934 in the form of Form 8-K (17 CFR 249.308). Form 8-K contains guidance from the SEC consisting of "*General Instructions*" and specific instructions regarding the "*information to be included in the report*". The items triggering a reporting obligation are exhaustively named in Form 8-K.

151 *Klöhn*, in Klöhn, Marktmissbrauchsverordnung, 2018, Vor Art. 17 para. 7.

152 *Enriques/Hertig et al.,* The Anatomy of Corporate Law, 2017, 243, 252; *Payne,* Transparency of Stock Corporations in Europe, 2019, 89, 93; *Haazen*, The Law of Securities Regulation, 2017§ 9.3 = 330; *Oesterle*, 20 Cardozo Law Rev. (1998), 135.

153 *Lerman/Livnat*, 15 Rev. Acc. Stud. (2010), 752 (examining the impact of the new SEC mandated disclosure requirements in 2004 and finding that all disclosed items (old and new) are associated with abnormal volume and return volatility); *McMullin/Miller et al.*, 24 Rev. Acc. Studies (2019), 1 (finding that the 2004 mandated disclosure requirements led to more efficient price formation).

154 For further details *Kaplow*, 42 Duke L. J. (1992), 557; *Ehrlich/Posner*, 3 J. Legal Stud. (1974), 257.

155 For example, in the event of a resignation of a director pursuant to Item 5.02 (a)(1) Form 8-K, there is a duty to notify if this is due to a "*disagreement with the registrant*". This obviously increases the information content of the announcement (*Veil/Gumpp et al.*, ZGR 2020, 2, 33).

the Commission's earlier proposal.[156] If one wants to design a two-step system that provides for an ad hoc disclosure obligation for price-relevant information that begins at a later point in time, the only option is to add specific disclosure provisions to the principle-based Art. 17 MAR[157] or (following US law) to design the ad hoc disclosure as a rule in principle.[158] This appears to be the best way to limit the disclosure obligation to final events of multi-stages processes, as discussed by the Commission, and to reduce compliance costs for issuers. The two-step system is based on an understanding of the ad hoc disclosure as an instrument to reduce information asymmetries between issuer and investor and not at as a preventive instrument to stop insider trading. This appears to be coherent: While the negative consequences of insider trading argue for a comprehensive ban on trading price-relevant information, the ad hoc disclosure obligation generates different costs and benefits for the issuer and market participants. [159] This is because the insider trading prohibition and the disclosure obligation operate differently. However, it must be recognized that in the event of a fundamental change in the disclosure regime, the risk of insider trading that would then exist[160] must be countered by additional regulation and enforcement.[161] In particular, more intensive *ex post* enforcement will be required and liability for voluntary, misleading information must be discussed and implemented.

VI. Enforcement

The advanced harmonisation of public enforcement in MAR, PR and TD raises the question of the role of private enforcement in capital markets law. To date, civil liability has only been outlined to a limited extent in the European legislative acts, which has led to disparate implementation of civil law enforcement instruments in the Member States. This situation may not have been so worrisome in the past, as capital markets law tended to be underenforced. As enforcement increases and with the goal of a CMU, discussing this question is now becoming increasingly important. The Commission should take the Consultation as an opportunity to analyse what allocation of enforcement authority between public and private actors is the best way to prevent violations of capital markets law.

The debate about the merits of private or public enforcement has long been conducted on a theoretical[162] and empirical[163] level. This discussion will not be recapitulated here. We do not believe that relying solely on public enforcement for core rules such as the information obligations on the primary and secondary market is a promising approach. Legal practice, the comparison with US securities

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156 *Krause/Brellochs,* AG 2013, 309, 335 et seqq.; *Krause/Brellochs*, 8 CMLJ (2013), 283, 295 et seqq.; *Veil,* ZBB 2014, 85, 89; *Merkner/Sustmann,* AG 2012, 315, 319 et seqq.

157 This means that for particularly relevant types of cases, the legislature defines the final event that shall be solely subject to the disclosure obligation. Intermediate steps on the way to this final event would then be exempt from the disclosure obligation. For all other inside information, the general disclosure obligation would remain applicable.

158 The ECJ has already pointed out the difficulty of a normative distinction between an intermediate step and a final event in the current system (see *ECJ*, Case C-19/11 (Geltl/Daimler) para. 37: *"it would be possible, in certain circumstances, to regard the outcome of a specific process as an intermediate step in another, larger process."*).

159 *Payne,* Transparency of Stock Corporations in Europe, 2019, 89, 106.

160 See also *Ventoruzzo*, 11 ECFR (2014), 554, (arguing that the broad scope of ad hoc disclosure might explain the differences in the enforcement of insider trading prohibition between the US and Europe).

161 In this respect, US law is available as a possible source of ideas (e.g. *disclose or abstain rule; half-truth doctrine*).

162 For an overview cf. *Jackson/Zhang,* Oxford HdB of Corporate Law and Governance, 2018, 928; *Klöhn,* Compensation of Private Losses, 2011, 179; *Wagner,* FS Köndgen, 2016, 649.

163 *La Porta/Lopez-de-Silanes et al.*, 61 J. Fin. (2006), 1; *Jackson/Roe*, 93 J. Fin. Econ. (2009), 207; *Coffee*, 156 U. Pa. L. Rev. (2007), 229.

market law and the developments in antitrust law[164] support the view that only an enforcement mix can offset the specific weaknesses of the private and public enforcement mechanisms and ensure the necessary level of enforcement. However, we also do not believe that there is a one-size-fits-all solution for all duties under capital markets law. Rather, the advantages and disadvantages of private liability and public enforcement must be assessed from a functional perspective and with respect to the goal of the specific duty. Economic analysis has already outlined the relevant considerations for this required analysis. These include, for example, the possibility of detecting the violation and the offender, the available sanctions with the associated deterrent effect, and the enforcement incentives.[165]

In the following section, as an example of a comprehensive study yet to be done, it is shown that, at least for the Prospectus Regulation, an enforcement mix proves superior. We further argue that civil liability for the enforcement of disclosure obligations in the secondary market seems appropriate and suggest that the Commission puts the issue on its agenda. However, our comments are limited to some general considerations. Assessing enforcement of capital markets law also raises the question of how to balance private and public enforcement. Additional (national) civil liability might increase the compliance costs of issuers and create competitive distortions.[166] If the cumulative sanction exceeds the net harm[167], there is a danger of *overdeterrence*. Therefore, a balanced design of public and private enforcement becomes necessary.

1. Case Study: Private Enforcement of the Prospectus Regulation

We think that an effective and harmonised prospectus liability regime would be a reasonable step to ensure an efficient level of enforcement for the primary market. To quickly recap, the initial push for full harmonisation in the legislative process of the Prospectus Directive did not fail because of disagreement in principle but rather due to a lack of knowledge on the details of the liability regimes of the Member States.[168] We can now ascertain that this deficit has been remedied by the international comparative literature.[169] Critically, the same research has also documented that we are still left with widely differing prospectus liability regimes in the Member States.[170] We think that putting an end to this through further harmonisation offers at least four advantages.[171]

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164 Directive 2014/104/EU of the European Parliament and of the Council of 26 November 2014 on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union.

165 *Shavell*, Foundations, 2004, 571 et seqq.; *Klöhn,* Compensation of Private Losses, 2011, 179; *Wagner,* FS Köndgen, 2016, 649; for a discussion of the suitable enforcement approach in the case of market manipulation cf. *Klöhn,* Gesellschafts- und Kapitalmarktrecht, 2014, 230.

166 *Veil,* Enforcing Consumer and Capital Markets Law, 2019, 405, 419.

167 On the concept of net harm in more detail *Schäfer/Ott*, Lehrbuch der ökonomischen Analyse, 2020, 363; *Easterbrook/Fischel*, 52 Chi. L. Rev. (1985), 611, 618 et seqq.

168 *Hopt*/*Voigt*, Prospekt- und Kapitalmarktinformationshaftung, VI.

169 *Veil*, Europäisches und deutsches Kapitalmarktrecht, § 17 para. 84. Relevant contributions include: *Busch et al.*, Prospectus Regulation and Prospectus Liability, Section III; *Conac*/*Gelter*, Global Securities Litigation and Enforcement, *passim*; *ESMA*, Comparison of liability regimes in Member States, *passim*; *Hopt*/*Voigt*, Prospekt- und Kapitalmarktinformationshaftung, *passim*; *Veil*/*Koch*, Französisches Kapitalmarktrecht, 29 et. seqq.; *Veil*/*Walla*, Schwedisches Kapitalmarktrecht, 20 et. seqq.; *Gerner-Beuerle*, 23 Temp. Int'l & Comp. L. J. (2009), 317, 344 et. seqq.

170 *Busch et al.*, Prospectus Regulation and Prospectus Liability, para. 1.33: *Hopt*/*Voigt*, Prospekt- und Kapitalmarktinformationshaftung, 1, 44; *Veil*, Europäisches und deutsches Kapitalmarktrecht, § 17 para. 84.

171 We leave aside the difficult question whether the fact that the prospectus liability regimes of the Member States differ in their intensity of enforcement and – through the differences in the necessary level of care – leads to appreciable distortions of

a) Reduction of Obstacles for International Offerings of Securities

First, harmonising the prospectus liability regimes reduces obstacles for international offerings of securities as issuers do not have to fear differing interpretations of national courts when a prospectus is considered to be deficient, nor would they need to inquire about different practices of national courts.[172] This would feed into one the key underlying goals of the CMU – to foster an integrated European capital market.[173]

b) Further Alignment of the Information Costs of European Investors

Second, harmonising the prospectus liability regimes of the Member States marks an efficient regulatory strategy to further align the information costs of investors, thereby combating the home bias of European investors.[174]

When deciding whether to invest into domestic or international securities, investors face additional verification costs if they cannot assume that effective investor protection mechanisms are in place that ensure that the information presented by issuers from other Member States is true and fair. This makes international diversification less attractive.[175] Thus, in order to reduce the home bias of European investors[176], the European Union should put mechanisms in place, which ensure that the verification costs of investors are roughly comparable, no matter in which EU security the investor intends to invest

competition between the issuers. While there is no doubt that the intensity of enforcement influences the applied level of care, the resulting higher costs in producing a prospectus might be counterbalanced by smaller risk premiums charged by investors facing lower verification costs. See on the relationship between enforcement and cost of capital generally *Coffee*, 156 U. Pa. L. Rev. (2007), 229.

[172] See for instance *Ferran*, 4 ECFR (2007), 461, 482 et seqq.

[173] The growing presence of international institutional investors in the European markets, which can be addressed by issuers through additional private placements, has made it less pressing to facilitate "traditional" international offerings, see for this development *Armour/Bengtzen et al.*, Securities Market Issues for the 21st Century, 2018, 381, 395. This does not, however, make international offerings and dual listings obsolete. Only international offerings allow companies to also tap the retail markets of the entire European Union. Dual listings remain a relevant option for companies interested in benchmarking themselves against a peer group in a different Member State. Additionally, through the publicity they create, they can support a market entry in a different Member State and make the issuer more attractive to employees in said Member State. Moreover, as long as the intensity of enforcement differs between the Member States, they allow issuer to bond themselves to a more effective system of enforcement. Finally, international offerings remain an attractive option for issuers operating in a Member State in which less international institutional investors are active. For a summary on the benefits of international offerings and dual listings, see *Oxera*, Primary and secondary equity markets in the EU, 100; *PWC/Baker & McKenzie*, Equity Sans Frontières, 18 et seq. For an assessment of the "bonding hypothesis" in the European context see *Roosenboom*/*Van Dijk*, 33 J. Bank. & Fin. (2009), 1898 et seq. For the initial idea see *Coffee*, 93 Nw. U. L. Rev. (1999), 641, 691 et seq.

[174] If investors can be certain that no matter in which offering they invest in the EU they are protected by the same effective liability mechanism, this might also increase the trust of investors to invest internationally, see *Moloney*, How to Protect Investors, 90. The relationship between regulation and the somewhat elusive concept of trust is, however, uncertain. It might also be the case that further regulation "crowds out" trust if people are made attentive to the riskiness of certain actions through new regulation being introduced. Thus, we do not put a focus on it here. For an empirical assessment of the relationship between trust and regulation, which can only find positive effects of regulation in countries with low social capital, see *Carlin et al.*, 92 J. Fin. Econ. (2009), 321, 323.

[175] For the relationship between differing information costs and home bias, see *Brüggemeier*, Harmonisierungskonzepte im europäischen Kapitalmarktrecht, 89. For empirical evidence highlighting that the home bias of US-investors is less pronounced for countries with high quality disclosure obligations and enforcement mechanisms, see *Eichler*, 31 J. Intern. Mon. Fin. (2012), 1008. There might be other reasons for investors facing higher information costs in analysing foreign companies, such as language barriers or the relative ease of gathering local information, which are hard to even out through regulation. See for an in-depth analysis, *Fox*, 95 Mich. L. Rev. (1997), 2498, 2514.

[176] For evidence on the still persisting home bias of European investors, see *EC*, European Financial Stability and Integration Review 2020, 17 et seq.; is it said that the home bias is particularly pronounced with less experienced investors, *Goetzmann*/*Kumar*, 12 Rev. Fin. (2008), 433; *Grinblatt*/*Keloharju*, 55 J. Fin. Econ. (2000), 43; *Karlsson*/*Nordén*, 31 J. Bank. Fin. (2007), 317.

in. Surely, the minimum harmonisation effectuated in the public enforcement domain contributes to this goal as well.[177] We, however, think that an argument can be made that it is an efficient regulatory strategy to add an effective private enforcement regime to it.[178] This is because it offers advantages which cannot be replicated by further developing the existing public enforcement regime.[179]

First of all, when two effective enforcement mechanisms are in place, it becomes more difficult for issuers with incentives to work towards a suboptimal level of disclosure and enforcement[180] to effectuate a deregulatory capture of the enforcement regime.[181]

Besides, adding effective private enforcement to the European enforcement mix helps to ensure that the incentives to abide the law remain consistent over time. While enforcement authorities, which are financed through the budget of the state and/or fees of the market participants, generally face difficulties in quickly adapting their budgets during times when "securities fraud" increases significantly, private parties can rapidly add more resources, thereby guaranteeing that cases will also be pursued if they happen more often.[182] Thus, a dualistic enforcement system ensures that issuers are constantly incentivized to inform markets at a socially optimal level.[183]

In addition, an effective prospectus-liability regime could enable the courts to further develop the disclosure regime, thereby providing an important safeguard against the ever-looming danger of regulatory failure. Rule makers in capital markets typically face an information problem on how to regulate in a cost-effective way because – unlike investors and issuers – they do not consider the benefits and costs of certain duties to disclose on a regular basis.[184] They might also be prone to *deregulatory capture* and, in the EU-context, undue influence by Member States interested to protect their respective "national champions". This creates the risk of both: unduly restrictive duties to disclose and, by contrast, duties to disclose which are too laissez faire.[185] If national courts, ultimately guided by the European Court of Justice, can hear arguments from both sides on the cost and benefits of a duty to disclose and decide for themselves whether a certain alleged deficiency of a prospectus warrants a successful claim, they are able to make use of the knowledge of investors and issuers on what

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177 Art. 38 Prospectus Regulation.

178 Unlike for liability in the secondary market, there is widespread agreement that prospectus liability does not lead to *overdeterrence*, i.e. it does not compensate investors for more than the social costs caused, see for instance *Easterbrook*/*Fischel*, 52 U. Chi. L. Rev. (1985), 611, 637; *Mahoney*, 78 Va. L. Rev. (1992), 623, 632; *Schäfer*, Prospekt- und Kapitalmarktinformationshaftung, 160, 177.

179 The standard we apply here is twofold. *First*, further harmonising the prospectus-liability regimes should only be pursued if it reduces more social costs resulting from breaches of prospectus law than it creates direct and indirect enforcement cost. *Second*, this result should not be achievable through further developing the existing public-enforcement regime. Cf. *Ackermann*, FS Köndgen, 1, 16; *Rose*, 158 U. Pa. L. Rev. (2010), 2173, 2178. Because of the latter condition, we do not dig deeper into potential advantages of private enforcement which – at least in principle – can be replicated by further developing public enforcement. This particularly relates to the compensatory function of private law as well a potential safeguard function against protectionism of "national champions" through national competent authorities.

180 These incentives are the same which lead issuers to disclose at a socially suboptimal level, see *Enriques*/*Gilotta*, Oxford HdB of Financial Regulation, 511, 520 et seqq.

181 *Coffee*, 42 Md. L. Rev. (1983), 215, 227.

182 *Coffee*, Entrepreneurial Litigation, 177.

183 *Coffee*, Entrepreneurial Litigation, 177; *Davies*, Capital Markets Union in Europe, para. 15.03.

184 See generally *Shavell*, 13 J. Legal Stud. (1984), 357, 359 et seq.

185 *Haeberle*/*Henderson*, 85 U. Chi. L. Rev. (2018), 1313, 1328 et seqq.

constitutes a cost-effective duty to disclose.[186] In such a system issuers anticipate that they will only be held to the standard to disclose efficiently in court,[187] which reduces the danger of regulatory failure and makes raising capital potentially more cost effective. Courts can mandate duties to disclose in cases where the written law inefficiently does not provide for one while conversely also denying claims in cases, in which a too restrictive duty to disclose has been prescribed by the regulator.[188] Crucially, to leverage these advantages the European legislator needs to define on a European level how national courts should go about in determining a prospectus mistake.[189]

c) Assurance that EU Prospectus Law is Effectively Enforced *Ex Post* as an Opportunity to Reduce Enforcement *Ex Ante*

Third, once the European legislator puts an EU-wide effective *ex-post* enforcement in place, there will be room to reduce the often time-consuming and typically not very cost-effective[190] enforcement *ex ante* through approval of the prospectus.[191] It would allow us to reconsider whether it is indeed necessary for every prospectus to be checked by a National Competent Authority or whether we can rely on the deterring function of an effective prospectus liability law, thereby reducing going-to-market-time for EU-issuers.[192]

d) Harmonisation of Prospectus Liability Law as a Necessary Precondition for Single European Market Offerings

Finally, while our recommendation to further harmonise the prospectus liability regimes does not depend on the implementation of our suggestion to create a ´Single European Market´,[193] it nevertheless goes hand in hand with it. A fully harmonised prospectus liability regime is a precondition for EU offerings under the auspices of ESMA to work effectively, since issuers would otherwise face 27 different liability regimes when addressing all EU-investors.

2. Enforcing Disclosure Obligations on Secondary Markets

Changing focus from the primary market to the secondary market, we find it regrettable that the Consultation does not inquire about the potential of private law to enforce disclosure obligations on

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186 The general concept we apply here was sketched out by *Shavell*, 13 J. Legal Stud. (1984), 357, 359 et seq.

187 See generally *Shavell*, 13 J. Legal Stud. (1984), 357, 365 et seq.

188 See generally *Shavell*, 13 J. Legal Stud. (1984), 357, 365 et seq.

189 National courts can only help to reduce the danger of regulatory failure if an European approach to prospectus liability allows courts some leeway on deciding whether an alleged deficiency actually constitutes a prospectus mistake instead of prescribing this – e.g. by means of the single rulebook – almost entirely *ex ante*. In order to still safeguard some uniformity in the application and further development of the law, the European legislator should consider defining who the reasonable investor of European prospectus(-liability) law is. For an analysis on the merits of such an approach for the US-securities law see *Rose*, 43 J. Corp. L. (2017), 77, 110 et seqq.

190 *Ex-ante* enforcement which takes effect independently of the actual occurrence of harm is generally less cost effective than an *ex-post* regime which only applies if harm has occurred, see *Shavell*, 42 J. Legal Stud. (2013), 275, 297.

191 For an equally critical assessment of the prospectus approval syste, *Schammo*, 7 EBOR (2006), 501, 517 et seqq.

192 In that regard, we would like to direct the Commission's attention to the following statement by *Fox*, Capital Markets Union in Europe, para. 13.99 which – judged by our discussions with practitioners – also adequately captures the practice of European issuers and their advisors: "[…] while public enforcement can be very effective with the grossest violations, *actors in the public offering process are much more attuned to the possibility of civil damages liability in their choice of their level of care in determining the truth and in assuring that what is discovered is reflected in their disclosures*. [emphasis added]".

193 See above II.2.

secondary markets. Given the fact that an informationally efficient secondary market provides important societal functions[194] and that the advantages of private enforcement outlined above apply in the secondary market context as well, it strikes us as premature to narrow the regulatory debate down to public enforcement from the beginning. Surely, there is less certainty on whether allowing investors to compensate for their losses in secondary-market trades in cases of informational failures of the issuer might lead to *overdeterrence*.[195] Nevertheless, the risk of societal harmful *overdeterrence* can also be reduced by tweaking the respective liability rule, for example, by making sure that issuers can anticipate their duties to disclose with a sufficient degree of certainty.[196] We therefore think that it makes sense to engage in an European discussion on how private law can be used to provide for meaningful incentives to generate a socially optimal level of secondary market disclosure while simultaneously avoiding *overdeterrence*.

3. Balancing Private and Public Enforcement

Finally, if a thorough analysis suggests that a specific duty under European capital markets law should be enforced through a combination of public and private enforcement instruments, the European legislature should address the question of how to balance them. This concerns several points that can only be named here as such: *First*, the danger of *overdeterrence* caused by a (cumulative) sanction that is too high overall must be discussed.[197] This requires a rough idea of the social harm[198] associated with a violation of capital markets law. Admittedly, this is not a simple regulatory challenge. If the legislative aim is to ensure efficient enforcement[199], however, this issue must be addressed. *Second*, potential synergies need to be considered. For example, access to information from public authorities can increase the chances of success for private plaintiffs. However, this advantage must be weighed against a possible reduction in the effectiveness of public enforcement.[200] Synergies can also be generated if courts in subsequent private damages suits are bound by final decisions of the national supervisory authorities or subsequent final judgments (*follow-on suits).*[201] This is familiar from antitrust law.[202] *Third*, the possibility of conflicting interpretations of the same legal provision in the context of private and public enforcement should be prevented.[203] *Fourth*, in addition to coordinating private and public law enforcement, a combination of both enforcement mechanisms can be considered (*hybrid enforcement*).[204] For example,

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[194] See above fn. 94.

[195] See on this heatedly debated topic the literature cited in fn. 94.

[196] *Schäfer*/*Ott*, Lehrbuch der ökonomischen Analyse, 362 et seqq.; *Veil*/*Brüggemeier*, Enforcement im Gesellschafts- und Kapitalmarktrecht 2015, 277, 301.

[197] *Poelzig*, ZGR 2015, 801, 839; *Veil/Brüggemeier,* Enforcement, 2015, 277, 281 discussing the possible problem of double jeopardy.

[198] This refers to the economic consequences resulting from a violation of the obligations under capital markets law. See also the comments above on the real economic consequences of inefficient securities prices in fn. 94. This problem arises irrespective of whether enforcement is public or private.

[199] *Veil/Brüggemeier,* Enforcement, 2015, 277, 279 et seqq.

[200] *Poelzig*, ZGR 2015, 801, 839 et seqq.; *Veil/Brüggemeier,* Enforcement, 2015, 277, 297 et seqq. See also Art. 6 RL 2014/104/EU.

[201] *Veil/Brüggemeier,* Enforcement, 2015, 277, 307 et seq.; *Maume,* ZHR 180 (2016), 358, 388 (with the proposal of a rebuttable presumption to avoid false incentives).

[202] Art. 9 Directive 2014/104/EU.

[203] *Poelzig*, ZGR 2015, 801, 844 et seq.

it is feasible to involve a national supervisory authority in the conduct of civil proceedings or, conversely, to involve private parties in public enforcement (e.g. by means of a right to request an investigation by the national supervisory authority). Inspiration can be found in other areas of law and national jurisdictions.[205]

[204] For further details cf. *Veil/Brüggemeier,* Enforcement, 2015, 277, 302 et seqq.; *Maume*, ZHR 180 (2016), 358, 386 et seqq.

[205] For further details cf. *Veil/Brüggemeier,* Enforcement, 2015, 277, 302 et seqq.

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