Financial Law Institute

Working Paper Series

The Harmonisation of Securities Regulation in Europe in the New Trading Environment

Eddy WYMEERSCH

WP 2000-16

July 2000

UNIVERSITEIT GENT

The **Financial Law Institute** is a department within the Law School of the Ghent University, Belgium. The research activities undertaken within the Institute focus on various issues of company and financial law, including private and public law of banking, capital markets regulation, company law and corporate governance.

The **Working Paper Series**, launched in 1999, aims at promoting the dissemination of the research results of different researchers within the Financial Law Institute to the broader academic community. The use and further distribution of the Working Papers is allowed for scientific purposes only. Working papers are published in their original language (Dutch, French, English or German) and are provisional.

For more information and a full list of available working papers, please consult the **homepage** of the Financial Law Institute at:

http://www.law.rug.ac.be/fli

© Financial Law Institute, Universiteit Gent, 2000

The Harmonisation of Securities Regulation in Europe in the New Trading Environment

Eddy WYMEERSCH

Abstract

The integration of the securities markets in Europe is gaining momentum: Euronext has been in operation for several months now, while after the iX failure new ways are being investigated to structure anew the securities trading business. In July 2000, a few days before the iX proposal was announced, this paper was presented at a Cambridge UK Conference. It attempts to identify the main lines of development which harmonisation has followed in Europe, reviewing the policies underlying the directives, the need for a European SEC and finally the conflict issues that are likely to pop up in any type of cross border integration of the market organisation. Although written with the iX model in mind, the issues that are analysed will have to be addressed in any market structure. The conflict rules contained in the 13th Directive are also analysed, as these probably will have to be adapted to an integrated cross border trading environment.

Comments to the Author:

Eddy.Wymeersch@rug.ac.be

© Financial Law Institute, Universiteit Gent, 2000

Cambridge July 7th 2000

Regulating European Markets

The Harmonisation of Securities Regulation in Europe in the New Trading Environment

Eddy Wymeersch
Univ. Ghent

1. The present state of the regulation of securities markets in the EU

a - short historical background

1. An analysis of the harmonisation efforts in the field of securities regulation in the European Union can best be started with a short overview putting developments in a historical perspective.

Looking back on the developments over the last thirty years, e.g. taking as a starting point the publication of Segré Report[1] - which is November 1966 -, one cannot but admit that considerable progress has been made: capital markets have been fully liberalised, and access entirely freed, regulations in all of the 15 European states are more or less harmonised, investment products and services circulate freely all over Europe under the European passport, all that resulting in a truly European capital market, carried on in a single currency, at least in the core EU states. The movement has been more than liberalisation and integration. Most jurisdictions have considerably upgraded their regulations and practices: it is often forgotten that even in the mid 1970 many jurisdictions did not have an organised supervision on prospectuses, while I still remember the days that even leading market representatives denied the existence of any insider trading, and therefore the need for any regulation.

This longer historical view is needed to put recent dissatisfaction with the present stage of regulation and development in its right historical perspective: what has been achieved is far from negligible, but it could have been more and certainly it should have been better. Dissatisfaction presently stems mainly from the poor state of integration of the markets themselves, resulting in an equally deficient state of regulatory harmonisation. One must admit that for the last seven years, i.e. after ISD[2], nothing substantial has been achieved (the take-over directive being left unmentioned)[3].

2. The main cause of discontent lies at the level of the poor integration of the securities markets, especially of the stock exchanges. Here also some historical perspective is useful. The first attempts to better organise the markets date back to the mid 1980s: earliest was one of these long defunct projects, to which the commission contributed even financially, but that finally run ashore on the unwillingness of the existing exchanges to wake up to the challenges of the new times. Schemes for linking the existing markets or opening access to traders from the other states were circulated, but

---

1 CEE-Commission, *Le développement d'un marché européen des capitaux, Brussels*, November 1966, 400 p.

2 Investment Services Directive, 93/22/EEC of 10 May 1993, OJEC, L 141, of 11 June 1993, 27-46.

3 In 1999, the Commission disclosed its new action programme.

© *Financial Law Institute, Universiteit Gent, 2000*

fell on deaf ears[4]. Competition was kept low and profitable. Protected behind the high walls of monetary division, markets could more or less live at a pace of their own.

This state of affairs has changed: new competitors, especially the American and Japanese traders have entered the scene, while the stock exchanges of which there still are something like 23 in Europe - have been challenged by the presence of new trading systems, such as Nasdaq, Easdaq, Tradepoint, Instinet and the likes. Also competition between the exchanges has considerably increased, leading to vast changes in trading patterns. The winners of yesterday are not necessarily those topping the league table today, and even less tomorrow.

On the background of these developments, regulation has also become under increasing pressure: deregulation, liberalisation, globalisation are the buzz words, less investor protection, prudential regulation, curbing market manipulation and insider dealing. With the new affluence, would investors have become less risk averse?

b- the present state of regulation

3. The regulation of the securities business in Europe presents a highly scattered picture. Each of the 15 jurisdictions has its own regulations. Although a large part of these regulations has been based on the same EU rules, and use a common core of definitions, concepts and ideas (among which the central concept of "mutual recognition"), the implementation of the Community rules in the national legal systems present considerable differences, some of which have an undeniable influence on business decisions.

The overall picture of securities regulation at the EU level is a partial body of common concepts and regulatory patterns, while a large part of the field remains uncovered, and considerable differences subsist in the rules ultimately applicable, each state having translated the European rules more or less according to it own fancy.

This rather depressing view is brightened by the "mutual recognition principle": although the overall system continues to show a lack of a central policy and direction, the regulators are not any more standing in each other way. At least in theory: in practice the possibility for national regulators to broaden the scope of the "general interest clause" constitutes in certain fields a pretext for restricting and sometimes barring cross border transactions[5].

Mutual recognition essentially aims at avoiding double regulation and supervision, the situation that existed in the 1970's and which was so heavily criticised in the Segré report. In the early directives, the leading idea was to enact similar regulation, which would necessarily be very detailed so that double vetting of the prospectus and other disclosure documents would become unnecessary. This proved unworkable. Therefore mutual recognition was introduced: the first directive in which it was used is the 1985 Ucits directive[6].

---

4 See among the early proposals WYMEERSCH, "Quelques réflexions sur l'interconnection des marchés européens de valeurs mobilières", *Rivista delle Società, 1982*, 1214-1255; also: "From harmonization to integration in the European securities markets", *3 Journal of Comparative Corporate Law and Securities Regulation*, 1981, 1-29.

5 See also the contribution by Gilles THIEFFRY at this conference.

6 Directive 85/611/EEC of 20 December 1985, OJEC, L 375 of 31 December 1985, 3-18.

Apart from reducing interstate barriers, mutual recognition has other definite advantages: it creates some competition between regulations and between regulators. Overly cautious regulators are prevented from enacting excessive regulation under the threat to loose their supervisory business, from which often they receive a large part of their income. The success of some market centres is partly based on differences in regulatory burdens: if its stays within limits of overall prudence, this is not necessarily an evil feature.

As an increasing number of issues becomes cross border, mere mutual recognition was considered insufficient. Especially in the fields of prudential supervision on financial conglomerates, supervisors are co-ordinating their actions by entering into Memoranda of Understanding. Specific agreements between supervisors deal with organising multi-state and multi-subject supervision, to be exercised on groups containing banks, insurance companies, investment advisers, brokers and so on, most of these operating in numerous jurisdictions. Multiplicity of supervision therefore co-exists with a certain forms of co-ordination. A whole body of rules and practices has sprung from this approach, leading to new forms of "contractually" organised supervision, that clearly go beyond the minimum norms laid down in the directives and in the regulations of the states involved.

No similar developments have been witnessed the core fields of securities regulation, especially the regulation and supervision on of the stock exchanges. In addition, there is a need for further streamlining of the existing regulations, probably through is more strictly enforced system of "mutual recognition".

c- Towards a European SEC?

4. It cannot be denied that the present state of regulation and supervision in Europe presents certain flaws and undeniable drawbacks.

But one should also view the advantages of this pattern of regulation. It is a clear expression of subsidiarity, a notion that has become dear to many citizens in our, in all respects so diverse, but culturally so rich part of the world. Furthermore, it stimulates competition between regulations, a considerable guarantee[7] for the citizens not to be burdened by unnecessary, over-restrictive rules. It allows firms to innovate, to launch new financial products, or create new trading mechanisms. Competition between the markets and their participants avoids costly outlyers, both in regulation and supervision. But the consequence inevitably is that regulations present greater diversity, causing costs in terms of compliance and oversight.

The major difficulty in actual practice derives precisely from this diversity of regulation: cross borders transactions have to take account of the numerous regulatory systems which they could possibly affect. More harmonisation is called for. Several solutions can be imagined: some prefer more flexibility in the regulatory system, others a "de facto" co-ordination while the maximalists plead for a fully fledged European SEC. These issues have been on the table for a long time. With recent developments in the market structure they may be calling for a new analysis[8].

---

[7] In some respects comparable to some sort of Habeas corpus.

[8] See the Lamfalussy group's assignment: "Création du comité de sages pour les marchés boursiers, blocage à propos de la lutte contre le blanchissement de capitaux", Agence Europe, 18 July 2000.

The present regulatory process at the EU level is too slow, and too cumbersome. The average time for adopting a directive is closer to ten than to five years. Once adopted, a directive cannot be changed, except with considerable efforts and after lengthy negotiations: some rules are obsolete, others that were not so well justified from the outset, were adopted as a political compromise. These rules cannot be revised, removed nor updated. The EU Commission has started a simplification exercise called SLIM (Simpler legislation for the Internal Market): however, the securities field has not benefited from the blessings of SLIM.

There always has been a need for a monitoring body supervising the implementation and interpretation of the directives: this body, known as the Contact Committee, has been provided for in the admission directive of 1979[9]. But being a mere advisory body, its rulings are not binding except after having been laid down in a directive. There are good arguments for further reinforcing the functioning of this committee, e.g. by rendering its recommendations and opinions public, and giving some binding force to its interpretations of the existing rules (e.g. on a comply or explain basis).

But more should be done: this Committee or any other body to be set up should have the power to initiate new regulations, or at least set the policy guidelines which member states are bound to implement This would at least render the system more vigorous and facilitate integration, especially in the fields not covered by the present directives. But is will not render regulation more harmonised: the deep differences in the legal tradition of the member states will result in even more regulation, leading to even greater differences in the national rules. Also as these European policy guidelines, - as at present the directives - would be regarded as minimum standards to which members states can freely add, at the end of the day, one can expect a new round of regulations.

Therefore and understandably, the cry for an all powerful European SEC has been formulated by several writers in the past. Much depends on what would be the exact meaning one wants to give to this “European SEC”: if it the all powerful, highly centralised body, with extensive powers of investigation and enforcement as we known it from the American experience, the answer in many parts of the EU will certainly be negative.

However, a pattern comparable to the one found in the Maastricht Treaty empowering the European Central bank to set policy guidelines with respect to prudential supervision[10], and have certain powers of verification as to the implementation of its guidelines seems a more workable approach which more closely follows the spirit of the European Union. To extend the power to direct investigations in the members states or even engage in enforcement actions would go beyond the limits of the workable integration patterns in Europe. This does not mean that no further co-ordination measures can be taken, e.g. in organising mutual information on supervision methods, or common training, and in reinforcing the exchange of information in other areas[11].

---

[9] Art. 20 of the directive of 79/279/EEC of 5 March 1979, OJEC, L 66, of 16 March 1979, 21-32.

[10] See art. 105.6 of the EU Treaty; see the ideas developed by Pedro Gustavio Texeira at this conference.

[11] The subject has been extensively dealt with by K. LANNOO, *Does Europe need an SEC? Securities Market Regulation in the EU*, European Capital Markets Institute, November 1999.

2 - Regulation of the markets under the modified trading landscape

5. The major challenge for the regulation of the securities markets in Europe lies in the adaptation to the new trading environment which will be the consequence of the merger of the exchanges.

A couple of months, or even days before more precise details are disclosed on the structure of the new trading environment, to deal with this subject is like looking into a black cristal ball. Therefore, the following analysis will be based on theoretical hypotheses, which later may appear to be realistic, or not.

Two items will be dealt with: the first one deals with a trading scheme as may be introduced in some members states. The second will more specifically deal with the application of the existing regulations to some of the possible schemes.

a. The new trading schemes

6. At present there only sketchy information available about the two new trading schemes. Under the iX scheme, there will be at least two trading platforms, one for seasoned stock, to be linked to the London regulatory sphere, and the one for small caps and technology shares, reportedly to be linked to the Frankfurt regulation.

The Euronext scheme reportedly will contain a comparable subdivision of matters: Paris will be the trading place for the most important stocks, Brussels for the small caps, while Amsterdam will house the derivatives market. There is also some information available on the legal structure of Euronext: it would be based on a Dutch holding company, subject to the Dutch co-determination system, with 100% subsidiaries in Paris, Brussels and Amsterdam, the latter being the operational units, born out of the former stock exchanges. Shares in the former exchanges would be exchanged for shares in the holding company.

7. Previously, exchanges were regarded as public interest organisations, aimed at securing the smooth functioning of the secondary market, and this mainly in light of the interest of the issuers, among which the Treasury counted as the first, and foremost important. On the continent, this function was visible in the regulation up to a few years ago, as is pointed out by some features that go back to napoleontic times and his continuous search for funds to finance the war effort. Exchanges continue to play an important role in support of financing of business firms, a function for which they frequently were criticised as inefficient in attracting funds for the national economies.

Starting from the mid 90s, under the pressure of international competition, but also as a consequence of new, more efficient trading alternatives, exchanges gradually moved away from their public function to become essentially commercial firms, competing with other trading systems (ECN' or PTSs) aimed at maximising profits. As most exchanges combined organisational, regulatory, supervisory and enforcement tasks, it became increasingly apparent that the combination of these tasks with their essentially commercial private business objectives would be incompatible. Several exchanges choose for converting into commercial companies[12], sometimes after difficult demutualisation[13] exercises, while other still retain some of their previous supervisory functions. Exchanges

---

[12] e.g. in Sweden, France, Italy.

[13] See in the UK and in the Netherlands.

have become “market organisers” and compete, on a commercial basis, although not necessarily, with other order execution systems.

8. The main drivers of change are well known: international competition, globalisation of the markets and the formidable facilities offered by the electronic linking of the markets. The stock exchanges as commercial providers of financial services, have no longer a monopoly position: the same services can be provided on a competitive basis by any firm that meets certain requirements, and especially by computer driven electronic networks or ECNs. Competition has replaced the public interest function that dominated the market organisation before. As a consequence, regulation should be adapted to secure access to this market of “securities trading services” to any candidate, provider of financial services that meets the pre-established criteria. Therefore a regulatory framework for the registration of stock exchanges and other market organises should be introduced. The role of the market supervisor consists of registering the candidates on the basis of the criteria set by the legislature, and finally supervise whether the criteria have are being correctly applied. In this scheme there is no difference between a stock exchange and any other ECN. The supervisory function of the stock exchange should be limited to review whether its own rules relating to trading on the market have been complied with, while the market supervisor, an external public agency, is in charge of evaluating this limited form of supervision by the exchange.

The next question relates to the extent this liberalised market for “securities trading services” is subject to the normal rules of competition, and whether the European competition authorities in charge of competition matters should not oblige member states to provide equal access to this market. Under the Treaty rules on freedom of establishment and of services, exchanges as bodies active in the competitive sector should be allowed to establish themselves in all member states. The competition issue has not directly been addressed in the directives: it was approached, in the ISD, in terms of remote access to markets. The directive formulated a weak response what resulted in states being able to de facto restrict access to foreign markets[14]. Under the changed market conditions which are now being framed, this question cannot be avoided anymore: there should be free access to all markets for those that meet the conditions in their state of establishment[15], while member states cannot prevent non resident exchanges to access their markets, e.g. by refusing to install trading screens or to give local brokers access to the foreign trading systems. Only on the basis of the “general good” reservation could member states restrict access. Review on the basis of the well known four pronged criteria will almost invariably lead to free access.

9. The role of the public regulatory body would become much clearer within the scheme which has just been outlined. Supervision and enforcement of all regulations established by of pursuant to an act of the legislature, are of the competence of an independent public agency.

In some of the regulations today, the stock exchange is in charge of certain supervisory matters, such as the admission of securities to the market, the tracing of insider transaction, or the review of company financial disclosures. There is an evident conflict of interest between the stock exchange, in charge of promoting its trading system and attracting new listings and at the same time exercising control over its clients. A recent

---

14 The ISD contains no rules on the recognition of markets within the EU. Only rules on recognition of market participants have been harmonised.

15 To be appreciated on the basis of the criteria formulated in art. 48 of the Treaty.

example in the Netherlands has shown the amplitude of this dilemma[16]. Conceptually spoken, this is the major objection against selfregulation. Therefore it is not striking that selfregulation will increasingly be abandoned: the FSA does not further rely on selfregulatory instruments, while in the Netherlands the role of the Exchange as a regulator was increasingly criticised even before the Euronext decision was taken. Although one may regret that this flexible alternative to hard law has to be abandoned: at least for the regulation of the modern, internationalised and highly competitive markets, times of the old forms of selfregulation are bygone.

10. Redefining the tasks of the public supervisory body and of the market organisers invites to reflect on their respective roles.

The public regulatory body will be in charge of the overall regulation of the market and of registering those securities market organisers that meet the criteria laid down by the regulator pursuant to the law.

These conditions for recognition as “market organiser” could be described as the minimal safeguards for the proper functioning of the markets:

- transparent, open and fair systems of price fixing, the methods of price determination being determined by the market (order or quote driven);
- open, objective and non discriminatory procedures for admitting securities to the market; these securities previously should file with the supervisory agency, for approval, company financial disclosure documents;
- open and objective procedures for admitting traders to the markets that meet the prudential conditions set in the bylaws of the “market organiser”;
- rules and procedures ensuring transparency and interconnection, including equal access to all other market participants with respect to price and quotes; to maximise competition and avoid excessive segmentation, rules have to be provided for safeguarding the interconnection of market organisers;
- rules on clearing of transactions, and appropriate and safe DVP requirements for settlement, including central counterparty systems.

Candidates meeting these requirements would be allowed to offer their services to the public. No discrimination should be allowed, as competition between systems should be guaranteed.

Market fragmentation is to be avoided by mandating appropriate interconnection at the level of trading and price formation and dissemination.

11. In their redefined role of market organisers, exchanges would have limited regulatory and supervisory powers: these would be restricted to the transactions that are taking place on their “floor”, in order to ensure the market to develop in a fair and orderly way. So e.g. would it have to intervene to suspend trading in the securities which it lists, in case significant developments have been notified, whether by the issuer, by the

[16] One refers to the case of WorldOnLine, in which the Exchange reportedly was convinced not to postpone a public issue and listing, under pressure from the issuer to list abroad.

supervisory agency, or even by its own observation. For certain matters the exchange would be the starting point of further supervisory action, e.g. as with respect to detecting insider trading or manipulations. A certain stock watch would remain useful, along with the primary surveillance exercised by the agency. At the same time, the exchange would not be in charge of admission of securities, disclosure, prudential supervision of or enforcement against market participants, issuers, or any other parties. Although there certainly are a number of subjects for which appropriate allocation of supervisory competence should be further investigated, the general framework should be clear: exchanges and other market organisers, as commercial enterprises, offer their services to the public. They exercise monitoring and surveillance tasks but only within the limits of the efficient organisation of their markets, not as aides to the public administration function.

12. As providers of financial services, several rules of European Community law would be applicable. As mentioned before, competition law would be fully applicable, leading to spontaneous consolidation over time, without freezing out new initiatives. The planned mergers between the London and Frankfurt, and the Paris, Brussels, Amsterdam exchanges should be reviewed by the European Commission, in which review general consideration of market efficiency, and of avoiding segmentation schould play a important role. Freedom of establishment and of rendering services would allow these service providers to spread all over Europe, without national states being able to reserve their market to national competitors. Branches could be opened in other states, while access to the trading system opened to all professionals willing to abide to the rules set by the new organisation. Mutual recognition will be rendered applicable: although it is not yet clear which state will supervise which part of the new organisation, there can be no doubt that host states will be restricted in their review procedures for branches or for services to those aspects that are strictly related to the domestic "general good".

All these ideas point to the conclusion that there are good arguments for drafting a directive fixing the minimum criteria for establishing and operating a "securities market service provider". States should be obliged to provide for a registration procedure, in which certain minimum criteria should be established. There should be a provision that allows the applicant to be denied registration or be stricken off the list if its organisation does not - or no longer - meet certain minimum criteria, while the identity of the owners or shareholders should be open for review to avoid infiltration by criminal organisations. Organised according to the rule of private business, these market organisers could enter into alliances, conclude mergers or take-overs, and generally take all initiatives that they deem useful for the development of their markets. Finally, arrangements have to be agreed on with respect to the supervision organised on these service providers, and insure co-operation between national supervisors. Most of these proposals could probably be realised within a reform of the ISD, adding a special class of investment firms.

b. The new regulatory pattern

13. The developments that calls our attention consists of the formation of cross border, fully integrated securities trading schemes, whereby two or more traditional stock exchanges reorganise themselves in such as way that markets will be fully integrated, and that trading in shares listed on both exchanges will essentially take place on the trading platform organised and maintained by one of them. Without analysing the notion of

© Financial Law Institute, Universiteit Gent, 2000

"market"[17], the issue to be dealt with here is the regulatory one: what rules and regulations will be applicable to securities that originally were subject to the jurisdiction of state A and are now exclusively traded in state B?

Several answers could be given. In fact there is a long standing tradition of cross border listing: many major securities have been listed for many years on several European stock exchanges. These were secondary listings, most the time also of secondary importance, the original market continuing to attract the main trading. The securities remained subject to their original legal status: company law rules, disclosure rules etc. remained those of their "home market". Trading rules are those of the market where the securities are effectively traded, with some exceptions. So e.g. were foreign shares in most exchanges traded in the currency of the exchange, allowing for easier access to local investors. Only Amsterdam has a fairly developed market in US denominated shares, traded in US dollar. In fact the Community sustained this policy of "dual listing" in the - mistaken - belief that it would lead to the creation of an integrated European securities market[18].

"Foreign listing" whereby issuers from state A list exclusively in state B is a more recent phenomenon and developed especially in the high tech sector. Originally, the rules of the company's home state also remained applicable. However, an increasing number of market rules dictate the obligations of the company: so e.g. in the Easdaq system, does the system itself impose its own requirements in terms of disclosure, annual reports, and even corporate governance rules. In case of conflict between the home state rules and those of Easdaq, the market authority may consider to grant an exemption from the latter rules[19].

At present we are confronted with a further stage of development, in which all securities of the participant exchanges will be traded in one market, according to the rules of that market, and with as little links as possible to their market of origin. It should be observed that at the moment of writing no definite decision have been made as to the future market structure. The following analysis is made on assumptions that should first be detailed.

14. Several hypotheses could be compared.

In a **first, minor hypothesis**, the linkage of the market is limited to offering privileged access to each other trading floor. Investment firms active in one market would obtain direct access to the market without having to pass through a local broker, member of the other market. Transaction costs would be reduced by avoiding fees for the corespondent broker. In general, the market structure would not be changed and remain subject to the regulation of the different exchanges involved. As the exchanges have merged institutionally, this scheme may be the first stepping stone towards further integration. From the regulatory point of view, it changes very little: co-operation between supervisors should be strengthened to insure foreign brokers to abide by the rules applicable on the market of execution.

---

[17] See R. LEE, *What is an exchange: the automation, management and regulation of financial markets*, Oxford University Press, Oxford, 1998, 405 p.

[18] See the amendments introduced by the directive 94/18 (Eurolist) of 30 May 1994, OJ EC, L. 135, 31 May 1994, 1-4.

[19] See § 4200 of the Easdaq regulation.

In a **second** hypothesis, the merger of the stock exchanges would lead to the creation of a common trading platform, on which the major securities of each of the participant exchanges will be listed and traded. A single trading list will be drafted, composed of the major securities of each of the constituent exchanges. Notwithstanding the differences in legal regime, there will be - or there will not be - an indication as to the nationality to which the issuers belong.

All members of each of the affiliated exchanges will have access to this common platform, at the same conditions, and according to the same trading rules, i.e. those of the state responsible for the single trading list. In fact trading rules should be unified over the constituent exchanges: order and quote driven systems might eventually have to be integrated. Clearing and settlement will be integrated, so that sales originating in one market will be matched against purchases from the other.

The question arises which part of the regulatory framework will be governed by the state of trading and which part by the state to which the issuer is subject. The first set of rules could be designated as "market rules" while the second are "company law rules". At least in an intermediate stage, it seems inevitable that the rules involving the legal status of the company will be governed by the law applicable to the company, whatever techniques are used to define that law[20]. How far this field will extend should than be further discussed: company structure including corporate governance, the legal position of shareholders, the rules relating to distributions, legal capital, voting rights, and so on, would remain governed by the home state of the company. But disclosure, perhaps also accounting, insider rules, part of take-over regulation are rather subject to "market law". The rules of trading on the market, inclusively the rules applicable to IPO's would also exclusively belong to the "market rules".

This approach is comparable to the dual listing technique mentioned above, but extend the ambit of market rules to a large part of the factors that have a direct impact on the market, such as disclosure. There is a significant difference however, and that is that the price list would be fully integrated: the adoption of the euro as the trading currency on most of the continental markets will facilitate this presentation. But what with the London-Frankfurt merger: will there be a two part price list, one in sterling, one in euro?

---

[20] See the Centros case ECJ, 9 March 1999, Case C. 212/97, ECR, 1999; Among the very numerous comments: W. EBKE, "Das Centros-Urteil des EuGH und seine Relevanz für das deutsche internationale Gesellschaftsrecht. Das Schiksal der Sitztheorie nach dem Centros-Urteil des EuGH", *JZ*, 1999, n° 13, 646; W.F. EBKE, "Das Schicksal der Sitztheorie nach dem Centros-Urteil des EuGH ", *JZ* 1999, 656; M. GÖTTSCHE, "Das Centros-Urteil des EuGH und seine Auswirkungen", *DStR*, 1999, n° 34; P. KINDLER, "Niederlassungsfreiheit für Scheinauslandgesellschaften?", *NJW* 1999, 1993; K.W. LANGE, "Eintragung der inländischen Zweigniederlassung einer ausländischen Gesellschaft", *DNotZ*, 1999, 658-607; O. SANDROCK, "Centros: ein Etappensieg für die Überlagerungstheorie", *Betriebsberater* 1999, 1337; J.J. SONNENBERGER & H. GROßERICHTER, "Konfliktlinien zwischen internationalen Gesellschaftsrecht und Niederlassungsfreiheit. Die Centros-Entscheidung des EuGH als gesetzgeberische Herausforderung", *RIW*, 1999, n° 10; S. STIEB, "Sitz- oder Gründungstheorie: der Gesetzgeber muß eindlich Farbe bekennen", *GmbHR*, 1999, n° 15, p. 257; P. ULMER, "Schutzinstrumente gegen die Gefahren aus der Geschäftstätigkeit inländischer Zweigniederlassungen von Kapitalgesellschaften mit fiktivem Auslandssitz", *JZ* 1999, 662; S.M. VAN DEN BRAAK, "Het Centros-arrest en het Nederlandse internationaal privaatrecht betreffende vennootschappen", *WPNR*, 2000, p. 347.; E. WERLAUFF, "Centros aus dänischer Sicht", *ZIP* 1999, 867; J.C. CASACANTE, note in *RIW* 1999, 450; E. WYMEERSCH, "Centros: A landmark decision in European Company Law", in Festschrift for Richard Buxbaum. TH. BAUMS, K.J., HOPT, N. HORN, *Corporations, capital markets and business in the law*. Kluwer Law International 2000; H. DE WULF, Centros: Vrijheid van vestiging zonder race to the bottom, Ondernemingsrecht, 1999, n° 12, 318-324.

From the supervisory angle, the question arises whether supervision will be concentrated in the hands of the supervisor in charge of the market where the securities are listed, or which part will remain under the supervision of the "home state" of the company. The idea has been put forward that in each case, there should remain a "local window" so that issuers and investors alike can address themselves to a local supervisor. That supervisor would then be acting in a double capacity, as the ultimate company law supervisor, but simultaneously a local representative of the market supervisor. Would it apply only "home state rules" or also "market rules"?

A **third hypothesis** would be based on a scheme of stronger integration. Here too the partners will have divided the securities to be traded on the trading "floors" of each of the exchanges: the major securities going to A, the intermediate ones to B, and the small caps to C. A would be fully responsible for all aspects relating to the securities traded on the A market: in principle the same rules should be applicable to all the A securities, whatever the legal regime applicable to their issuers. These would be entirely subject to A's authority. Trading will take place in one currency. Uniform rules would deal with matters such as: trading techniques, company disclosures, ad hoc disclosures, market manipulation but also with insider trading and corporate control changes, take-over rules, reporting by major shareholders, corporate governance, and so on. Ultimately, within the limits set by the domestic law of the company, company structure would largely become governed by the rules of market A.

From the supervisory angle, most of the competencies of the "home state" supervisor would be exercised by the market supervisor, while efforts are made to "harmonise" company law on a single mould.

15. As far as trading rules are concerned, both in the second and third hypotheses, the members of the participating exchanges will have to adapt and familiarise themselves with a common set of rules, fixed or approved by the supervisor in charge of the market. One could see agreements on trading hours, on quotation in full currency or in percentage points, rather than in fractions (1/8th), on cash payments and DVP rules, which should tend to real time DVP anyway. Integrating an order driven system with a quote driven system may raise more difficult questions: a combination of the two has already been practised in some of the continental markets, and seem to have allowed the maintaining of sufficient levels of liquidity.

If there is a subdivision of markets segments as outlined above, an effort could be made to integrate the market rules, although specific characteristics will be determined by the concrete functional needs of each of the segments.

16. The question to be analysed mainly concerns the conflict with the company related matters. The basic concept would be that investors should know that they buy financial instruments that are governed by legal systems that are not necessarily that of the state where the market is being organised. This idea results in the need to differentiate between "domestic" and "foreign" securities, a distinction market are not likely to make. At present, there is no clear answer to this hurdle.

Under that proviso, a further distinction can be introduced: some topics have a direct influence on the functioning of the markets and on price formation, while other matters, although far from neutral, have an only indirect, remote influence. One could imagine that the former type of items will be more readily of the competence of the market regulator and supervisor, while the latter inevitably belongs to the realm of the company law.

The dividing line, as here proposed, is also found in the proposal for a thirteenth company law directive. This proposal contains an elaborate set of rules on conflicts of laws issues raised in case of cross border take-overs. The proposal draws a distinction between the competencies of the supervisory bodies, and the laws on which these bodies will have to base their decisions. It is especially the latter subject that deserves to be further analysed:

According to the proposed take-over directive, art. 4, belongs to the market related matters, and hence are of the competence of the state of trading, the following matters:

- "consideration offered in the case of a bid
- the procedure of the bid:
  - the information on the offeror's decision to make an offer
  - the contents of the offer document
  - the disclosure of the offer"

Belong to the realm of company related matters, and hence will be supervised by the "supervisor in charge of the company law"

- the information for employees of the offeree company
- "matters related to company law:
  - the percentage of voting rights which confers control
  - any derogation from the obligation to launch a bid
  - the conditions under which the board of the offeree company may undertake any action which might result in the frustration of the offer".

It should be added that the applicable company law will be designated by applying the rules of article 48 of the Treaty that is "the registered office, central administration or principal place of business" The proposed directive refers to the "registered office" in the English text, and to the "siège social" in the French version. These are meant to be equivalent.

17. Attention should be drawn to the practice, existing in several EU states according to which the stock exchanges, and the market supervisors imposed additional requirements at listing the issuer's securities or on the basis of their general oversight over financial disclosure. These requirements are directly related to company law matters, and deal with issues such as preferential subscription rights, share buy-backs, but also the relationship with dominant shareholders or more recently the recommendations on corporate governance. The interest shown by market regulators for these topics originate not only in genuine investor protection motives, but also, if not mainly as promotion devices for the product offered on the "trading floor" So e.g. does the London Listing Agreement contain rules leading to neutralising the dominating influence of a controlling shareholder in its listed subsidiary, an interesting example of informal law on company groups. The most recent wave of regulation relates to the corporate governance rules, which were strongly supported by the exchanges involved. There is therefore nothing new in market supervisors treading on the field of company law, although this action is not based on any formal authority. On the other hand it is clear that these recommendations or guidelines, or rules of best practice cannot run against formal provisions of the company law to which the issuer is subject.

© Financial Law Institute, Universiteit Gent, 2000

18. An attempt to identify the rules which would rather belong to the market rules versus those that will be more readily viewed as company law rules can be undertaken by analysing the main sets of rules.

- disclosure

Company disclosures have on the one hand be harmonised by different EU directives, on the other, these directives have only introduced minimum standards which several regulators have supplemented. Therefore disclosure obligations could be placed under the guidance of the market supervisor. This would apply to prospectus disclosure: this type of disclosure is part of the conditions for access to the market, and therefore could be governed by the market of listing, to the extent that its disclosure requirements would go beyond the ones applicable in the home state of listing. Accounting rules would also be governed by the same principle: as most internationally active companies follow the IAS, there cannot remain much objection against urging all listed companies to follow IAS. But whether the same could apply to companies listed on the segments for small caps, is debatable, especially as divergence with domestic accounting regulations may be more significant. Indeed, several of these companies are subject to less sophisticated accounting rules, or may be located in third countries.

The same approach could be followed to other forms of disclosure, such as interim disclosure. There might be difficulties for ad hoc disclosure, as some member states[21] have introduced a catalogue of items about which disclosure should be made, while other states have merely adopted the general formulation that was followed in the directive.

Ironically, in the fields of disclosure and accounting, there is a good chance that under the unifying influence of the securities markets, voluntary harmonisation will soon reach a higher level than in case of legally mandated harmonisation.

Undoubtedly these will be tensions between legal systems. Differences in national sensibilities may become apparent: disclosure of remunerations of individual directors is a good example of constantly advancing de facto harmonisation. Now that this type of disclosure has also been advocated in France, one can expect several other states following. In some states objections will be raised in the name of privacy. The disclosure of significant shareholdings has been refused in some jurisdictions out of fear of criminal actions against their owners.

Disclosure of major holdings cannot be classified without more under the heading of disclosure: the subject is more closely related to the position of the shareholders in the company. Additional disclosures are already imposed in some states e.g. with respect to the relationship between major shareholders (e.g. on concert action). Exemptions are more touchy: here the market discipline should prevail.

- listing procedure

19. The procedure for listing on the market will be a sensible point, especially for new entrants. Will companies applying for listing be entitled to file the application in their home state and according to the rules applicable there, or should they necessarily have to address themselves to the offices in the location where the market is legally situated? Proximity, better knowledge of local traditions, language differences and other similar

[21] Germany e.g. see H.-D. ASSMANN and U.H. SCHNEIDER, *Wertpapierhandelsgesetz: Kommentar*, Keulen, Schmidt, 1999, 1047 p.

© Financial Law Institute, Universiteit Gent, 2000

sensibilities may turn out to become barriers that plead for a decentralised approach. This might result in each of the participant exchanges maintaining its present listing window, whether for new listings but also for maintaining contact with issuers whose shares have previously been listed. Differences in listing practices - but not in conditions - might result but should be kept to a minimum. Here a first difference between the three hypotheses appears: in the first and maybe also in the second hypotheses, listed shares essentially maintain their national status and rules may be different depending on the state where they have originally been listed.

- insider rules

20. What insider trading rules should be applied, those of the home state, or those applicable to the market of listing? The question cannot be reduced to the application of the legal rules, even harmonised according to the directive[22]. Many exchanges have developed additional rules and restrictions relating to trading in sensitive periods. One can expect companies listed on participating exchanges to be bound by these additional requirements, whether these have been imposed by the exchange or by the supervisor in charge of the market where the exchange is located.

Notwithstanding harmonisation, the definitions of insider trading are far from identical in each of the EU member states. Art. 5 of the directive gives some relief as far as cross border insider transactions are concerned: any action, defined in the directive as falling under the insider trading prohibition, may give rise to prosecution in any state where action was undertaken, and not only where the insider transaction was executed on the market. But the latter can in any case prosecute, although it may find it difficult to find the right data on which to base its prosecution [23].

Insider cases originate most of the time from market observations through the so-called stock watch programmes. These programmes are activated in the state of trading, and hence the rules applicable there would initially apply. The supervisor in the state of trading will request additional information from the state where the company is located: this request for information will normally be addressed to the supervisor in the company's home state. The competent public prosecutor should be entitled to act on the basis of that information, which is not necessarily the case today, as treaties on mutual assistance and exchange of information relate to criminal information, not to administrative information.

The question may become more difficult if the criteria used in the state where the market is located are much broader than in the state in which the company is located. This seems to be the case with the broad definition of "market abuse" as is now adopted under the new UK FISMA[24]. The state in which the company is located may be unwilling to transmit information as the action involved is not a criminal act according to its regulation. There will be a new need for adapting existing regulations, bilaterally or according to the rules of a EU wide harmonisation. In the meantime bilateral co-operation will be restricted.

---

[22] Notwithstanding the directive, some members states have maintained exemptions e.g. does art. 181 of the Belgian law of 4 december 1990 contain an exemption for holding companies trading on the basis of the information that the holding company has obtained as a shareholder, and provided the information is not liable to be disclosed under the ad hoc disclosure rules. The exemption has been challenged in a referral before the ECJ.

[23] See for an analysis HOPT, in HOPT and WYMEERSCH, *Insider Dealing*, at 146.

[24] s. 188 Financial Services and Markets Act 2000.

To summarise: the insider trading issue should not be a major stumbling block as long as the original definitions and criteria of the directive are followed. Extending the ambit of violations of market rules gives rise to new and difficult issues.

- general company law

21. The subject becomes more touchy once one enters into fields that are more directly related to company law matters.

There can be no argument that companies listed in a non-domestic market will not have to adapt their legal status to the company law of that market: on all of the EU markets today, there are securities that have been issued by companies that are established under the jurisdiction of foreign states. There has never been any claim that these companies should organise themselves according to the rules of the state where their securities are trading. The French Cour de Cassation decided that the status and rules applicable to the securities are those applicable by the lex societatis, not by the place of trading[25]. Therefore, in clear terms, German companies functioning under the co-determination system would not have to abandon co-determination in order to be traded in London. This applies to all other features of mandatory company law. One can presume that continental company law is generally more mandatory than UK law[26]. As a consequence, by acquiring shares of companies originating in different jurisdictions, investors necessarily buy "products" that are fundamentally different. This should not be a major problem, as the same already happens today. It is however important that investors should be clearly informed.

22. The problems arise out of the additional rules that have been developed by the stock exchanges or by other bodies and that have an impact on company law and practice. A few topics immediately spring to mind.

The London Stock Exchange rules on corporate governance are recommended to UK companies[27]: they cannot possibly be applied to German two tier boards. Independent directors are unknown and CEO's have a different function in the German company structure. One can presume that it will not be attempted to apply UK governance principles to non-UK companies, so that German governance rules can be further developed. Even the development of "substantially similar" rules would not be feasible.

The UK listing agreement contains a provision limiting the influence of important shareholders: according to this document the shareholder with a stake of 30% of more in a listed company must abstain from exercising any influence in the company in which it holds shares. It is clear that this rule cannot be applied to continental companies, most of which are firmly controlled by one or a few shareholders. Also, to neutralise the influence of a controlling or significant shareholder will not necessarily be in conformity with the legal system applicable to the company. It seems inappropriate to introduce a system of group law by stock exchange regulation, even if the final outcome - at least in comparison with the German law on "de facto" groups - would come very close to the UK rule

---

25 Cass. comm. fr. 17 October 1972, *Rev. S.*, 1974, 127.

26 See for a comparative analysis: LUTTER and WIEDEMANN (ed.), "Gestaltungsfreiheit im Gesellschaftsrecht", *ZGR*, Sonderheft 13, 1998, 329 p.

27 This is the "Combined Code on Corporate Governance".

© Financial Law Institute, Universiteit Gent, 2000

Enforcement of company law rules would remain subject to the home state rules of the company: generally, the market supervisors do not intervene in applying to redress to company law violations. This is left to the initiative of the shareholders, or other organs of the company.

- take-over regulations

23. Would UK take-over rules be applicable? At present the City Code applies to "public companies[28] considered to be resident in the UK, the Channel islands or the Isle of Man". A company is considered to be resident only if it is incorporated in the mentioned territory and has its place of central management in one of those jurisdictions"[29]. But the code further calls attention to the need for "early consultation" in case of dual jurisdiction. It seems highly improbable that a take-over on a German company whose primary listing is in London will be dealt with according to - future - German law, and that the UK authorities - in this case the Take-over Panel - would apply German rules. On the other hand, the German supervisor will not be able to scrutiny transactions that are taking place in the market of the company's principal or even exclusive listing. Therefore an appropriate solution has to be worked out.

The future take-over directive states in this respect two sets of rules. The first addresses the issues of who is competent to supervise the transactions. The second designates the substantive regulation of one of the jurisdictions involved, and distinguishes between company law matters, and market related matters.

On the first point, the authority competent shall be the authority of the state in which the company has its registered office, provided the company's securities are admitted to trading in that state[30]. If the securities are listed on several markets, the company's "home state" will be competent, provided it is at least listed in its home state, whatever the volume of trading in these other states. This rules creates a parallelism between market rule and company law rule. Under present market conditions, at least 95% of EU companies will qualify under this rule.

Only in case there is no listing in the "home state", the directive further indicates that the state of trading will prevail[31]. Several hypotheses are further distinguished: if the home state and the state of trading are different, the state of trading will be competent; in case of multiple listing, the state where the first listing took place, will be competent. As in many cases simultaneous multiple listing took place, the issuer will determine which authority will be competent. By way of transitory measure, the supervisory bodies involved will have to decide, and if not, the company will designate the competent authority[32].

---

[28] Whether listed or unlisted, see for details the City Code, Introduction 4.

[29] See Introduction to the City Code, pt. 4(a). This double criterion obviously relies on elements that are also essential in the "siège réel" theory. The Panel normally considers a company to be so resident if it is incorporated in the UK etc., and if the place of central management is in due of these jurisdictions. If central management moves abroad the company will cease to be protected by the Code: S. MARCHANT, in: *A practitioner's Guide to the City Code on Takeovers and Mergers, City and Financial Publishing*, Old Woking, 1999-2000, 19.

[30] Art. 4 (2)(a) of the 13th directive, 22 June 2000.

[31] Art. 4 (2)(b) of the 13th directive.

[32] Art. 4(2) b and c and the transitory provision of 2(2) 2nd §.

Under the merged market structure the question will arise whether trading on a market organised by stock exchange located in another state will be considered trading on the market of "another state" even if the securities have originally been listed in the home state. In clear terms: would trading in London be considered trading in London, although the admission took place in Frankfurt? But what if the listing took from the outset place only in London, although the company is not a UK company?

24. Apart from designating who will exercise supervision, and hence will be in charge of applying the rules relating to take-overs, the proposed directive contains a further provision as to which rules will be of the competence of the market supervisor, and which will remain under the guidance of the national company law system, including implementation by a supervisor in charge in the home state of the company[33]. This list of subject matters was already cited above.

This division of competencies does not necessarily render the application of divergent take-over rules more easy. The subject matters that were explicitly mentioned in the directive may be reviewed as follows, it being understood that the reverse cases could be construed in case "small" UK companies would be made subject to German supervision.

- "the percentage of voting rights which confers control": in case the German take-over law would fix a 50% threshold for mandatory bids - which reportedly it will fix at 30% - there might be control acquisitions on the London market that are not governed by the general rule of the City code. The market might get confused by this differential treatment. Also the Panel would have to decide in what circumstances control is acquired under German law;
- "any derogation from the obligation to launch a bid": derogation to launch a bid may be more touchy, as this relates to cases where the threshold has been crossed without control being permanently acquired. These cases have to be construed under German law. Here the Panel would have to make difficult assessments involving items of German company, banking and contract law.
- "the information for employees of the offeree company": this items is to be construed under the law applicable to the company: as this condition does not touch upon substantive issues, is would be logical that there would be no objection against the Panel enforcing this condition.
- "the conditions under which the board of the offeree company may undertake any action which might result in the frustration of the offer": the City code is very strict on the point of frustrating action by the board. The directive takes an equally strict attitude but cases may show up where the board undertakes action opposing a bid which would not be forbidden under German regulation, although falling under the extended prohibition as applied by the Take-Over Panel (e.g. strict rules on press campaigns). Here a clash between the two jurisdictions might appear.

To summarise: the rules relating to the attribution of jurisdiction as laid down in the proposed 13th company law directive, may have to be put on the agenda again in light of

[33] The identity and function of this home state supervisor is not clear: would it mean that the German supervisor "the Bundesaufsichtsamt für des Wertpapierwesen" would be called upon to enforce German company law? This would be outside its present statutory ambit and contrary to the Germany's legal system. The opposite applied to the UK take-over panel, which is not in charge of applying company law in the UK.

© Financial Law Institute, Universiteit Gent, 2000

the proposed reorganisation of the markets. Matters that are more directly related to the correct functioning of the market should in any case be subject to the jurisdiction competent according to where trading takes place, even if the listing originally took place in another market centre. Better co-ordination has to be provided for with respect to the application of the company law related matters in general, and more particularly in the field of take-overs.

25. There certainly will be other rules or restrictions in company law that might render it difficult if not impossible for foreign companies to abide by UK stock exchange regulations: one could think about the differences in waiving pre-emptive subscription rights, the more liberal attitude towards share buybacks, the differences in dividend distribution practices (three monthly v. annual). Differences in the form of the shares have been bridged: the German legislator has adopted a law rendering nominative shares more market friendly. Whether these differences would constitute significant handicaps for integrating the two markets, should be analysed case by case.

26. This all ends up in the following general perspective. By having the markets integrate into one large trading system, under the guidance of one supervisor, the later will necessarily have to take account of differences flowing from the company law status of the companies whose securities are listed. This applies first to the rules of company law that have been laid down by act of parliament, and made mandatory in the law. Conversely, this also will apply to additional regulations the authorities would like to impose on these companies which cannot run against the mandatory - or even enabling? - rules under which they are functioning according to their lex societatis.

Within these limits however the market regulators can impose additional requirements. This applies especially to disclosure rules. If no agreement between regulators can be reached, directives will bridge.

27. A further issue relates to what extent an agreement between stock exchanges or other similar bodies could result in imposing new or additional rules that have not been imposed at the moment of the original listing. This question is the more pressing as the rules applicable in some jurisdictions have been rendered applicable by public act, and may now be changed by an agreement between exchanges governed by private law. The help of the government will be needed here, allowing for some changes in the applicable regulations.

Conclusion

The regulation of the securities markets in the EU is at a turning point: for the first time the issue of the reorganisation of the market structure is on the regulatory table. The merger between the exchanges will raise a number of new questions, calling for new patterns of regulation. Imagination will be necessary to negotiate workable solutions.

© Financial Law Institute, Universiteit Gent, 2000