EUROPEAN CAPITAL MARKETS LAW

SECOND EDITION

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HART

BLOOMSBURY

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Foundations

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I. Introduction

The European Union has had a largely uniform legal framework to combat market abuse since 2003. The Market Abuse Directive 2003/6/EC (MAD 2003) from 22 December 2003[1] required the Member States to prohibit insider dealing and market manipulation. The Member States also had to ensure that inside information and directors' dealings were disclosed as soon as possible and recommendations published by financial analysts were subject to specific standards. However, the MAD 2003 only required a minimum harmonisation of the national laws. 1

This changed on 3 July 2016 when the **Market Abuse Regulation** (MAR) and the **Directive on criminal sanctions for insider dealing and market manipulation** (CRIM-MAD) replaced the MAD 2003. The European legislator argued that the global economic and financial crisis had highlighted the importance of market integrity and it would be important to strengthen supervisory and sanctioning regimes in this regard. In this respect, the legislator took into consideration a report published by the former Committee of European Securities Regulators 2

[1] See R. Veil § 1 para. 21.

(CESR)[2] and the *de Larosière* Report[3], both of which drew attention to the disparities and lack of deterrence through the weak administrative and criminal sanctions in Europe.

3 The new legal framework established by the MAR and CRIM-MAD shall '**preserve market integrity**, **avoid regulatory arbitrage**' and 'provide more **legal certainty** and **less regulatory complexity** for market participants'.[4] It is based on the idea that 'an integrated, efficient and transparent financial market requires market integrity. The smooth functioning of securities markets and public confidence in markets are prerequisites for economic growth and wealth. Market abuse harms the integrity of financial markets and public confidence in securities and derivatives.'[5]

II. Legal Foundations

1. MAR

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

5 The MAR was enacted on Level 1 of the *Lamfalussy* process.[6] It is therefore a **framework instrument** that still requires substantiating legal instruments, which are already addressed in the MAR. In various provisions, the European Commission is required or authorised to adopt delegated acts, which it has enacted on the basis of the technical advice provided by ESMA.[7] ESMA is also charged with drafting

[2] See CESR, Report on administrative measures and sanctions as well as the criminal sanctions available in member states under the market abuse directive (MAD), February 2008, CESR/08-099.

[3] See The High-Level Group on Financial Supervision in the EU (de Larosière Group), Report, 25 February 2009, available at: http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf.

[4] Cf. Recital 4 MAR.

[5] Cf. Recital 2 MAR.

[6] For an overview of the structure of the Lamfalussy II process see F. Walla § 4 para. 24.

[7] See R. Veil § 5 para. 3.

RTS and ITS to be endorsed by the European Commission. These instruments are of a technical nature and do not contain any 'strategic decisions or policy choices'.[8]

2. CRIM-MAD

The European legislator also enacted a Directive on criminal sanctions for insider dealing and market manipulation (CRIM-MAD).[9] Until this time, none of the Level 1 directives had required Member States to adopt criminal provisions. The CRIM-MAD thus marks the start of a new era. 6

The criminal sanctions are intended to demonstrate 'social disapproval of a qualitatively different nature compared to administrative sanctions or compensation mechanisms under civil law'.[10] The introduction of criminal sanctions for the most serious contraventions remains within the jurisdiction of Member States. However, the CRIM-MAD uses the most important definitions from the provisions of the MAR. In this way, EU law is 'incorporated' into national criminal laws. 7

3. Further Measures by ESMA

Level 1 and Level 2 legislative acts are complemented by numerous ESMA Level 3 measures. These encompass **Guidelines** in the sense of Article 16 ESMA Regulation which aim to lay down specific interpretations in a uniform way for all Member States.[11] Additionally, ESMA can comment on questions arising with regard to the application of the legislative acts in **Question & Answers** (Q&As).[12] These constitute a flexible instrument of supervisory convergence, ESMA not being obliged to carry out public consultations prior to the publication of Q&As. 8

4. Overview on the Single Rulebook on Market Abuse

ESMA has named the sum of all Level 1 and Level 2 legislative acts and Level 3 measures the 'Single Rulebook on Market Abuse'.[13] Under consideration of the 9

[8] Cf. Art. 10(1) and Art. 15(1) ESMA Regulation.

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

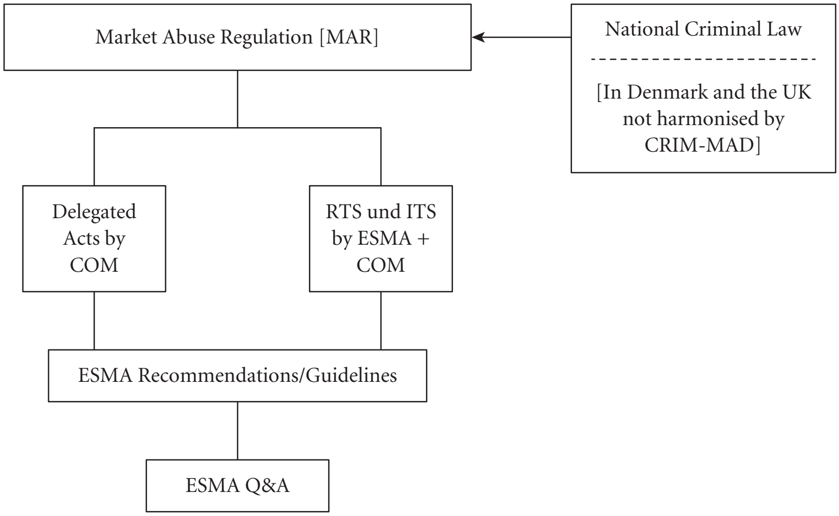
[10] See Commission, Proposal for a Directive of the European Parliament and of the Council on criminal sanctions for insider dealing and market manipulation, Explanatory Memorandum, 20 October 2011, COM(2011) 654 final, p. 3.

[11] Cf. ESMA, Guidelines on the Market Abuse Regulation—Market Soundings and Delay of Disclosure of Inside Information, 13 July 2016, ESMA/2016/1130.

[12] Cf. ESMA, Questions and Answers on the Market Abuse Regulation, 13 July 2016, ESMA/2016/1129.

[13] See in more detail R. Veil, ZGR (2014), p. 544, 601–603.

national provisions applying in addition to the rules at a European level, the Single Rulebook can be illustrated as follows:



10 The legislation depicted on the left hand side (MAR) is directly applicable in the Member States. Only the sanctions remain a topic of the national laws of the Member States, administrative measures and sanctions, however, being subject to a minimum harmonisation through the MAR. Criminal sanctions (top right hand box in the chart above) are also subject to the national regulation in the Member States, albeit on the grounds of the harmonization through CRIM-MAD. This does not apply with regard to Denmark and the UK, which both opted out of the CRIM-MAD. The criminal sanctions in these two Member States are thus not predetermined by European law.

III. Level of Harmonisation

1. Minimum versus Maximum Harmonisation

11 The **CRIM-MAD** establishes only 'minimum rules' for criminal sanctions.[14] It is expressly established as a minimum harmonisation legal instrument, so that Member States are allowed to impose or retain more stringent criminal sanctions.

12 It is more difficult to judge which concept is followed in the **MAR** which does not expressly address the issue of whether its intention is a minimum or full

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

harmonisation in the area of market abuse. Only the fifth chapter of the regulation relating to administrative measures and sanctions allows for other sanctions or higher fines to be introduced.[15]

The fact that the Commission enacted a regulation for the topic of market abuse allows no final conclusions about the degree of harmonisation. Therefore, other aspects have to be considered. The construction in the sense of maximum harmonisation concept is supported by the fact that, in the opinion of the Commission, the effectiveness of the MAD 2003 was undermined by 'numerous options and discretions'.[16] The Preamble to the new MAR does not give a clear indication of a specified level of harmonisation, but provides further indication that the goal is to achieve maximum harmonisation of prohibitions of insider dealing and market manipulation.[17] Also, the aim of the MAR to avoid potential regulatory arbitrage,[18] is best achieved through maximum harmonisation. 13

Overall, there is no general degree of harmonisation to be found in the regulation, each area of the MAR rather having to be examined separately. The fact that maximum harmonisation ensures a level playing field across the EU must also be taken into account. 14

2. Evaluation

From the legal policy aspect, it makes sense for capital markets law to be further unified at European level by legislation made in the form of regulations. In the past, many Member States 'gold plated' the provisions of the MAD 2003. Some had also retained some of their 'old' law. For example, insider dealing in the United Kingdom was covered by five different legislative provisions.[19] The disparate legal landscape lead to legal uncertainty and resulted in unnecessary costs for legal advice. In this respect, the MAR is an improvement. 15

The limits of harmonisation are exposed in the area of criminal law: pursuant to Article 83(2) TFEU, minimum requirements for the determination of criminal offences and sanctions may only be implemented in the form of directives. 16

IV. Presentation of Market Abuse Law in this Book

European Market Abuse Law consists of the insider trading prohibitions and the rules on market manipulation. Both regimes are described in the following paragraphs 17

[15] Cf. Art. 30(1) MAR.
[16] Cf. COM(2011) 654 final (fn. 10), p. 3.
[17] Cf. Recital 4 ('uniform framework'), Recital 5 ('more uniform interpretation' and 'uniform conditions') MAR.
[18] Cf. Recital 4 MAR.
[19] See R. Veil § 14 para. 55.

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Prospectus Disclosure

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I. Introduction

1 The aim of Directive 2003/71/EC (the PD) is to ensure investor protection and market efficiency.[1] Both **regulatory aims** are to be achieved by providing '**full information** concerning **securities** and **issuers** of those securities'. The European legislature justified this by arguing that information is an effective means of increasing confidence in securities and thus of contributing to the proper functioning and development of securities markets. The appropriate way to make this information available is to publish a prospectus.[2]

2 The rules on prospectus disclosure are based on the recognition that securities are so-called credence products. Unlike with search goods, an investor cannot reduce uncertainties by obtaining information about the product prior to acquisition, or realistically assess securities at acceptable information costs due to their complexity and the duration of capital investments. The investor must therefore rely upon the promised quality of the securities. This confidence can only be based on reliable information.[3]

[1] Recital 10 PD.
[2] Recital 18 PD.
[3] Cf. L. Burn, in: R. Panasar and P. Boeckmann (eds.), *European Securities Law*, para. 1.39; H. Fleischer, *Gutachten F 64. Dt. Juristentag*, p. F 23; N. Moloney, *EU Securities and Financial Markets Regulation*, p. 55–56.

Prospectus disclosure aims to reduce informational asymmetries.[4] Capital markets do not bear the characteristics of strong-form efficiency in terms of the ECMH,[5] resulting in an asymmetric distribution of information between issuers and investing market participants which are enhanced by the offer of such complex goods as securities.[6] These deficits are to be reduced with the help of prospectus disclosure. 3

The **obligation** to **publish a prospectus** applies when **securities** are **offered** to the **public** or **admitted** to **trading** on a **regulated market**,[7] as can be deduced from the aims and scope of application defined in Article 1 PD.[8] Article 3(1) PD further demands that the Member States prohibit any offer of securities to be made to the public within their territories without prior publication of a prospectus. Article 3(3) PD follows a similar aim, requiring that the Member States ensure that any admission of securities to trading on a regulated market is subject to the publication of a prospectus. 4

II. Legal Sources

1. European Law

The obligation to publish a prospectus was first introduced by the European legislature in 1979. Since then, it has been subject to a number of reforms.[9] For 'reasons of consistency', the legislature regrouped the provisions in 2003, making extensive amendments. The **Prospectus Directive** (PD) constitutes an instrument essential to the achievement of the internal market.[10] It is complemented by the **Prospectus Regulation** (EC) No. 809/2004, enacted by the European Commission on Level 2 of the Lamfalussy Process.[11] The PD defines the subject and scope of prospectus obligations as well as the procedure to be followed for the drawing up and approval of a prospectus. It further contains provisions concerning the prospectus for cross-border offers. The Prospectus Regulation (EC) No. 809/2004 primarily 5

[4] For more details on disclosure as a regulatory instrument see H. Brinckmann § 16 para. 23.

[5] See on the Efficient Capital Market Hypothesis H. Brinckmann § 16 para. 8–9.

[6] Cf. H.-D. Assmann, *Prospekthaftung*, p. 292 et seq.; N. Vokuhl, *Kapitalmarktrechtlicher Anlegerschutz*, p. 176.

[7] Cf. on the offering process G. Fuller, *The Law and Practice of International Capital Markets*, para. 6.01–6.264.

[8] Cf. Art. 1 PD.

[9] See R. Veil § 1 para. 5–6, 10 and 24; more details on historical aspects in N. Moloney, *EU Securities and Financial Markets Regulation*, p. 71 et seq.; A. Heidelbach, in: E. Schwark and D. Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, Einl. WpPG para. 3 et seq.; P. Schammo, *EU Prospectus Law*, p. 74 et seq.

[10] Cf. Recital 4 PD.

[11] Commission Regulation (EC) No. 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements, OJ L149, 30 April 2004, p. 1–126.

deals with the minimum content, the layout of the prospectus and possible forms of publication.

6 In November 2010, the PD was amended by Directive 2010/73/EU,[12] ensuring a more effective investor protection by introducing a summary in the prospectus, providing 'key investor information'.[13] All other the amendments mainly relate to technicalities.[14]

7 The Level 1 directive is supplemented by a number of **further Level 2 acts**. The European Commission first enacted two delegated acts, based on technical advice by the European Securities and Markets Authority (ESMA).[15] The amendments do not only refer to the format and the content of the prospectus, but also relate to the disclosure requirements for certain offers of shares, such as (1) rights issues of companies admitted to trading on a regulated market, (2) offers of small and medium-sized enterprises and companies with reduced market capitalisation and (3) credit institutions, issuing securities referred to in Article 1(2)(j) PD that draw up a prospectus in accordance with Article 1(3) PD. Thereafter the European Commission enacted two more delegated acts specifying the disclosure requirements for certain financial instruments[16] and the requirements for supplements to a prospectus.[17]

8 The prospectus regime also consists of a number of **Level 3 measures** issued by ESMA which aim to 'promote a practical and efficient implementation of the prospectus regime, contribute to a consistent application of the regime across the EU by building a common supervisory culture among competent authorities, and ensure an adequate balance between an investor's need for information and burdens on issuers to provide such information.'[18] The most prominent is the

[12] Directive 2010/73/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, OJ L327, 11 December 2010, p. 1–12.

[13] See para. 42–46.

[14] Overview in J.R. Elsen and L. Jäger, BKR (2010), p. 97; M.K. Oulds, in: S. Kümpel and A. Wittig (eds.), *Bank- und Kapitalmarktrecht*, para. 15.181 et seq.; T. Voß, ZBB (2010), p. 194 et seq.

[15] Commission Delegated Regulation (EU) No. 486/2012 of 30 March 2012 amending Regulation (EC) No. 809/2004 as regards the format and the content of the prospectus, the summary and the final terms and as regards the disclosure requirements, OJ L150, 9 June 2012, p. 1–65; Commission Delegated Regulation (EU) No. 862/2012 of 4.6.2012 amending Regulation (EC) No. 809/2004 as regards information on the consent to use of the prospectus, information on underlying indexes and the requirement for a report prepared by independent accountants or auditors, OJ L256, 22 September 2012, p. 4–13.

[16] Commission Delegated Regulation (EU) No. 759/2013 of 30 April 2013 amending Regulation (EC) No. 809/2004 as regards the disclosure requirements for convertible and exchangeable debt securities, OJ L213, 8 August 2013, p. 1–9.

[17] Commission Delegated Regulation (EU) No. 382/2014 of 7 March 2014 supplementing Directive 2003/71/EC of the European Parliament and of the Council with regard to regulatory technical standards for publication of supplements to the prospectus, OJ L111, 15 April 2014, p. 36–39.

[18] See www.esma.europa.eu/regulation/corporate-disclosure/prospectus.

(regularly updated) Questions and Answers-Document which provides responses to questions posed by the general public and NCAs in relation to the practical application of the PD.[19]

2. Implementation in the Member States

The Member States have implemented the PD's requirements into their national laws,[20] mostly by adapting their existing rules on prospectus regulation rather than adopting the directive's rules one-to-one. The Prospectus Regulation (EC) No. 809/2004 is directly applicable in the Member States, and thus does not need to be implemented. This is also true for the delegated acts enacted by the European Commission on Level 2 of the Lamfalussy Process. 9

The 2007 CESR Report on the Members' Powers under the PD and its Implementing Measures gives a good overview of implementation in national laws.[21] 10

3. Reform

On 30 November 2015, the European Commission proposed revising the prospectus rules to improve access to financial means for companies and to simplify the access to information for investors. To this end, the directive is to be replaced by a regulation.[22] The future **Prospectus Regulation** (PR) will be directly applicable in the Member States and fully harmonise prospectus law throughout the EU. The rationale for the use of a regulation instead of a directive is to ensure that prospectus law is applied uniformly throughout the EU: 'By turning the current Directive into a Regulation, a more streamlined and coherent approach will be ensured across the Union, reducing national fragmentation, as well as the scope for differences in national implementation.'[23] 11

The enactment of the new Prospectus Regulation is an essential part of the CMU Agenda.[24] The idea is to lower barriers for accessing capital throughout Europe, to reduce regulatory burdens (in particular for SMEs) and simplify existing prospectus law (for all issuers). 12

On 30 November 2016, the Council, the European Parliament and the Commission agreed on the new PR. It will however not enter into force before 2018. 13

[19] Cf. ESMA, Question & Answers, Prospectuses, 25th updated version, July 2016, ESMA/2016/1133.
[20] Directive 2010/73/EU of the European Parliament and of the Council was to be implemented into national law by the Member States by 1 July 2012.
[21] CESR, Report on CESR Members' Powers under the PD and its Implementing Measures, June 2007, CESR/07-383.
[22] Cf. Commission, COM (2015) 058.
[23] Cf. Commission, Press Release, 30 November 2015, IP/15/6196.
[24] See in more detail about the Capital Markets Union R. Veil § 1 para. 47–48.

III. Foundations of the Prospectus Regime

1. Approval by NCA

14 A prospectus may not be published until it has been approved by the competent authority of the home Member State (NCA).[25] 'Approval' is defined in this context as 'the positive act at the outcome of the scrutiny of the **completeness** of the **prospectus** by the home Member State's competent authority including the **consistency** of the information given and its **comprehensibility**'.[26] It is thus not sufficient that the national authorities consider the completeness of the prospectus from a merely formal perspective.[27]

15 In order to avoid unnecessary costs and overlapping of responsibilities that may arise from a variety of competent authorities in the Member States,[28] the PD demands that only one central competent authority be designated in each Member State to approve prospectuses and to assume responsibility for supervising compliance with the directive for all prospectuses published by issuers of that Member State.[29] The authorities should be established as an administrative authority and in such a form that their independence from economic actors is guaranteed and conflicts of interest are avoided.[30]

16 Since the BaFin was founded in May 2002, it has been responsible for approving offer and admission prospectuses in Germany.[31] The stock exchange management is only permitted to decide on the admission of securities to be traded on the stock exchange.[32] In the United Kingdom as of May 2002 the Financial Services Authority (FSA) became responsible for approving prospectuses. This task is now carried out by the Financial Conduct Authority (FCA), FSA's successor. Responsibility for approving prospectuses no longer lies with the London Stock Exchange (LSE).[33] Spain has declared the CNMV to be the responsible authority for approving prospectuses.[34] The managements of the stock exchanges only have the power to decide on the admission of securities to the stock exchanges.[35]

[25] Art. 13(1) PD.
[26] Art. 2(1)(q) PD.
[27] Cf. L. Burn, in: R. Panasar and P. Boeckmann (eds.), *European Securities Law*, para. 1.101–103; on the legal practice in the Member States cf. ESMA, Peer Review on Prospectus Approval Process, 30 June 2016, ESMA/2016/1055.
[28] Recital 37 PD.
[29] See definition of home Member State in Art. 2(1)(m) PD.
[30] Art. 21(1) PD.
[31] Cf. §§ 3(1), 13(1), (2)(17) WpPG.
[32] Cf. § 32(1) BörsG.
[33] Cf. sec. 87A, 72 and 417 FSMA.
[34] Cf. Art. 26.1 c LMV and Art. 24 RD 1310/2005.
[35] Cf. Art. 32.1 LMV.

In France approvals of prospectuses are given by the AMF.[36] The admission to the regulated market is decided by Euronext. In Italy Consob, founded in 1974, must approve a prospectus before it may be published.[37] Sweden has granted the power to approve of a prospectus to the FI;[38] the reform of the LHF abolished the possibility for the stock exchange management to decide whether a prospectus should be approved. In Austria prospectuses must be approved by the FMA.[39]

2. Approval Procedure

The respective national **authority** must **notify** the **issuer** of its **decision** regarding the **approval** of the prospectus within 10 working days of the submission of the draft prospectus.[40] This time limit is extended to 20 working days if the public offer involves securities issued by an issuer that does not have any securities admitted to trading on a regulated market.[41] It only commences when the documents and the information provided by the issuer are complete.[42] 17

The exact duration of the time limit can thus be unpredictable for the issuer or offeror of securities.[43] In legal practice it is therefore not uncommon to agree on a time plan with a number of dates for the submission of documents with the supervisory authority. The supervisory authority can then comment on the documents that have been provided and notify the issuer as to what further information is required. The issuer will often submit multiple drafts of the prospectus to the authority. 18

Once approved, the **prospectus** is filed with the competent authority of the home Member State[44] and must be **made available** to the **public** in advance of, and at the latest at the beginning of, the offer to the public or the admission to trading of the securities involved.[45] The details of an electronic publication are described in the Prospectus Regulation.[46] 19

A prospectus is valid for 12 months after its publication for offers to the public or admissions to trading on a regulated market, provided that it is updated with any supplements required.[47] 20

[36] Art. L. 621-8 C. mon. fin. and Art. 212-2 RG AMF.
[37] Cf. Art. 113(1) in conjunction with 94(1) TUF.
[38] Cf. Kapitel 2, § 25 LHF.
[39] Cf. § 8a(1) KMG.
[40] Art. 13(2) PD.
[41] Art. 13(3) PD.
[42] Art. 13(4) PD.
[43] Cf. C. Crüwell, AG (2003), p. 243, 251; U. Kunold and M. Schlitt, BB (2004), p. 501, 509.
[44] Cf. Art. 14(1) PD.
[45] Cf. Art. 14(1) PD; see L. Burn, in: R. Panasar and P. Boeckmann (eds.), *European Securities Law*, para. 1.116; M.K. Oulds, in: S. Kümpel and A. Wittig (eds.), *Bank- und Kapitalmarktrecht*, para. 15.176.
[46] Cf. Art. 29 Prospectus Regulation.
[47] Cf. Art. 9(1) PD.

3. European Passport

21 A prospectus may even be valid for the public offer or the admission to trading in any number of other Member States, provided that the competent authority of each host Member State is notified in accordance with Article 18 PD.[48] The **notification** must contain a copy of the prospectus and, if necessary, a translation of the summary produced by the issuer.[49] The competent authorities of the host Member States[50] may not undertake any approval or administrative procedures relating to prospectuses.[51]

22 The concept of a single European passport enables an issuer to offer his securities in a number of Member States without having to obtain multiple approvals of the prospectus or demand admission to trading on each market individually.[52] The European legislature introduced the concept of a single European passport in order to facilitate the widest possible access to investment capital on a Community-wide basis,[53] thereby replacing the former partial and complex mutual recognition mechanism which was unable to achieve the European objectives.[54]

23 The reports published by ESMA show that the possibilities of passporting play an important role in practice,[55] a prominent example being the IPO of Air Berlin. Air Berlin became an English public limited company (plc) in 2006 for a better comparability with competitors (and with the added advantage that the German co-determination rules are thus not applicable). The prospectus necessary for the offer of the shares and their admittance to trading was approved by the FSA. After BaFin had been notified, Air Berlin submitted a public offer and admitted its shares to trading on the regulated market in Frankfurt.

24 The facilitation of cross-border offers has also enabled securities (in particular with regard to debt financing) to be issued by foreign financing vehicles and the corresponding prospectus to be approved by the relevant national supervisory authority, before the notification is carried out in other Member States.

[48] Art. 17(1), Art. 18(1) PD. The competent authority of the home Member State must provide the competent authority of the host Member State with a certificate of approval within three working days following the request or, if the request is submitted together with the draft prospectus, within one working day after the approval of the prospectus, Art. 18(1) PD.

[49] Cf. Art. 18(1) PD.

[50] Art. 2(1)(n) PD.

[51] Art. 17(1) PD.

[52] L. Burn, in: R. Panasar and P. Boeckmann (eds.), *European Securities Law*, para. 1.108–109.

[53] Cf. Recitals 1 and 4 PD.

[54] Cf. N. Moloney, *EU Securities and Financial Markets Regulation*, p. 72–73, for further details on the failure of the principle of mutual recognition.

[55] Cf. ESMA, Report EEA Prospectus Activity in 2015, 28 July 2016, 2016/ESMA/1170, p. 18–22.

IV. Obligation to Draw up a Prospectus

1. Scope of Application

Offers of securities to the public as well as the admission of securities to trading on a regulated market[56] that fall within the directive's scope of application are generally subject to the publication of a prospectus.[57] The scope of application of European prospectus law is thus defined through the terms '**admission of securities to a regulated market**' and '**offers of securities to the public**'.[58] In Article 2(1)(a), the PD defines 'securities' as all transferrable securities with the exception of money market instruments having a maturity of less than 12 months.[59] The question whether a financial instrument should be classed as a security in this sense must thus be determined according to its tradability.[60] 25

The term '**offer** of **securities to** the **public**' means a communication to persons in any form and by any means, presenting sufficient information on the terms of the offer and the securities to be offered, in order to enable an investor to decide to purchase or subscribe to these securities.[61] This solves the problem that used to arise from the fact that the Member States had differing views on whether an offer requires a prospectus publication, resulting in a possible obligation to publish a prospectus in one Member State whilst the offer or the admission of the same security in a different Member State was possible without a prospectus.[62] Even with the new European rules, however, some interpretational questions are still answered differently amongst the Member States.[63] It remains particularly unclear what the requirements for an offer of securities to the public are. In Germany, even an offer to 100 or more people is not necessarily classed as such a public offer in the sense of the PD. Private placements are not regarded as public.[64] Determining a private placement must especially take into account the addressees of the offer and the method by which the information is distributed. 26

[56] Art. 3(3) PD; on the concept of a regulated market see R. Veil § 7 para. 19–28.
[57] Art. 3(1) PD.
[58] Cf. Art. 1(1) PD.
[59] See R. Veil § 8 para. 4.
[60] P. Schammo, *EU Prospectus Law*, p. 82–83; U. Kunold and M. Schlitt, BB (2004), p. 501, 502.
[61] Art. 2(1)(d) PD. This definition also applies to the placement of securities through financial intermediaries.
[62] P. Schammo, *EU Prospectus Law*, p. 80.
[63] Cf. ibid., p. 80–81; A. Heidelbach, in: E. Schwark and D. Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, § 2 WpPG para. 14.
[64] Cf. A. Heidelbach, in: E. Schwark and D. Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, § 2 WpPG para. 21.

27 The PD does not apply to all types of securities.[65] The securities to which it does not apply mainly include non-equity securities issued by a Member State, by one of a Member State's regional or local authorities or by the central banks or securities which have been unconditionally and irrevocably guaranteed by a Member State.[66] It further does not apply to securities issued in a continuous or repeated manner by credit institutions where the total consideration for the offer in the Union is less than € 75 million EU and securities included in an offer where the total consideration for the offer in the Union is less than € 5 million.[67]

2. Exemptions from the Obligation to Publish a Prospectus

28 The PD does not apply to certain constellations.[68] These exemptions can be put into three categories. The first category makes an exception from the obligation to publish a prospectus for certain addressees, offers or securities.[69] The second and third categories exclude offers of securities to the public[70] and the admission of securities to the regulated market[71] from the obligation to compile a prospectus if the securities are issued under certain conditions.

(a) Exceptions for Certain Addressees, Offers or Securities

29 The PD exempts **offers** of securities addressed solely **to qualified investors** from the obligation to publish a prospectus.[72] The term 'qualified investors' primarily refers to all professional investors such as credit institutions, investment firms, financial institutions and insurance companies.[73] These investors do not require protection due to their level of expertise and better access to information.[74]

30 The PD further contains an exception for an offer of securities addressed to fewer than 150 natural or legal persons per Member State, other than qualified investors,[75] which is aimed at facilitating **private placements**. It can, however, be difficult to determine how many investors were actually addressed with the respective offer.[76]

[65] Art. 1(2) PD. The Member States may, however, provide an obligation to publish a prospectus for public offers thereof. Cf. T. Holzborn and N. Schwarz-Gondek, BKR (2003), p. 927, 928; U. Kunold and M. Schlitt, BB (2004), p. 501, 502; C. Crüwell, AG (2003), p. 243, 245.

[66] Art. 1(2) PD. The European legislature regarded the national possibilities on the regulation of bonds more suitable, cf. T. Holzborn and N. Schwarz-Gondek, BKR (2003), p. 927, 928–929.

[67] Art. 1(2)(h) and (j) PD; for details on these exemption cf. P. Schammo, *EU Prospectus Law*, p. 88 et seq.

[68] Art. 3(2) and Art. 4 PD.

[69] Art. 3(2) PD.

[70] Art. 4(1) PD.

[71] Art. 4(2) PD.

[72] Art. 3(2)(a) PD.

[73] Cf. the extensive definition in Art. 2(1)(e) PD.

[74] Cf. Recital 16 PD; cf. in more detail P. Schammo, *EU Prospectus Law*, p. 126 et seq.

[75] Art. 3(2)(b) PD.

[76] Cf. U. Kunold and M. Schlitt, BB (2004), p. 501, 504.

31 The obligation to publish a prospectus further does not apply to offers of securities addressed to investors who acquire securities for a total consideration of at least € 100,000 per investor for each separate offer[77] or to offers of securities whose denomination per unit amounts to at least € 100,000,[78] the European legislature thereby taking account of the different requirements for protection of the various categories of investors and their level of expertise.[79] The obligation to publish a prospectus is thus restricted to cases where this is necessary for protecting the investor.

32 If the obligation to draw up a prospectus is to be avoided when submitting an offer for securities, use will generally be made of this last exemption in practice. Securities with a minimum consideration of € 100,000 per investor are offered publicly with a minimum denomination of € 100,000 (or full € 1,000 above € 100,000) or with a minimum denomination of € 1,000 (whereby only securities with a minimum consideration of € 100,000 or full € 1,000 above € 100,000) may be transferred. This exemption is of particular relevance in practice, as adherence to the prerequisites can already be ensured when the securities are developed and there is no need to rely on the issuing banks to carry out the offer in a specific way. Nevertheless issuing banks will generally declare in their contract with the issuer to submit the offer only under the preconditions described above, ie only to qualified investors or less than 150 investors. As the persons subscribing for or acquiring the securities must confirm that they are qualified in the sense of the directive, this approach can be described as a '*belt and braces*' strategy.

(b) Exemptions for Certain Issuances in Cases of Public Offers

33 The obligation to publish a prospectus does not apply to offers to the public for certain types of securities.[80] The exemptions refer to constellations in which the securities are offered as substitutes for existing securities or in connection with certain transactions. In these cases investors have already been supplied with the necessary information at an earlier point.[81] Shares issued as substitutes for shares of the same class already issued need therefore not be accompanied by a prospectus if the issuing of such new shares does not involve any increase in the issued capital.[82] Similarly, securities offered in connection with a takeover or a merger by means of an exchange offer do not require a prospectus to be published provided that a document is available containing information which is regarded as being equivalent to that of a prospectus by the competent authority.[83] This requirement will usually be fulfilled by the offer document in takeovers and the merger report.

[77] Art. 3(2)(c) PD.
[78] Art. 3(2)(d) PD.
[79] Recital 16 PD.
[80] Art. 4(1) PD.
[81] In more detail C. Seibt et al., AG (2008), p. 565 et seq.; R. Veil and M. Wundenberg, WM (2008), p. 1285 et seq.
[82] Art. 4(1)(a) PD.
[83] Art. 4(1)(b) and (c) PD.

(c) Exemptions for Certain Issuances for the Admission to the Regulated Market

34 The obligation to publish a prospectus is also not applicable to certain types of securities and their admission to trading on a regulated market.[84] The constellations are similar to those mentioned above, with the addition of exemptions, such as that for securities already admitted to trading on another regulated market, provided certain conditions ensuring investor protection are fulfilled.[85] The admission of shares resulting from the conversion or exchange of other securities or from the exercise of the rights conferred by other securities to the regulated market is also not subject to the publication of a prospectus, provided that said shares are of the same class as the shares already admitted to trading on the same regulated market.[86]

(d) Supplements

35 A **prospectus** is **valid** for **12 months** after its publication, provided that the prospectus is complemented by the necessary supplements, as described in Article 16(1) PD:[87] every significant new factor, material mistake or inaccuracy relating to the information included in the prospectus must be added to the prospectus in a supplement if it is capable of affecting the assessment of the securities and arises or is noted between the time when the prospectus is approved and the final closing of the offer to the public or, as the case may be, the time when trading on a regulated market begins. The summary and any translations thereof must also be supplemented.[88]

36 Where the initiative for the supplement does not come from the issuer itself, the competent supervisory authority must ensure that the supplement is published correctly. The information requiring a supplement can be obtained through ad hoc notifications, enquiries, complaints or reports in the media.[89] A supplement must be approved by the supervisory authority and must be published within a maximum of seven working days.[90] The obligation to publish a supplement is accompanied by the investors' right to withdraw their acceptance if they agreed to purchase or subscribe for the securities before the supplement was published.[91]

[84] Art. 4(2) PD.
[85] Art. 4(2)(h) PD.
[86] Art. 4(2)(g) PD.
[87] Cf. Art. 9(1) PD.
[88] Art. 16(1) PD.
[89] CESR, Report on CESR Members' Powers under the PD and its Implementing Measures, June 2007, CESR/07-383, p. 12.
[90] Art. 16(1) PD.
[91] Art. 16(2) PD.

This provision has been strongly criticised,[92] mainly with regard to the time frame within which the investor's acceptance may be withdrawn.[93] The European legislature took this criticism into account in the PD's amendment by reducing this time frame to two days after the publication of the supplement. This period can only be extended by the issuer, the offeror or the person applying for the admission to trading on the regulated market. The European legislature did not, however, take into account the criticism regarding the fact that the investor's right to withdrawal is not limited to those cases in which the supplemented information had a negative influence on the investment decision.[94] As a result, the investor can withdraw from the agreement simply if it realises that it has made a 'bad deal'.[95] 37

3. Content, Format and Structure of a Prospectus

(a) General Rules

Pursuant to Article 5(1) PD, the prospectus must contain all information concerning the issuer and the securities to be offered to the public or to be admitted to trading on a regulated market, necessary for investors to make an informed assessment of the rights and obligations, the financial situation, profits and losses and the future of the issuer, and the rights connected to its securities. Such information, which needs to be sufficient and as objective as possible concerning the financial circumstances of the issuer and any guarantor as well as with regard to the rights attached to the securities, should be provided in a form that is easy to analyse and comprehend. 38

(b) Format of the Prospectus

(aa) Single or Separate Documents and Base Prospectus

The PD provides the possibility for the issuer, offeror or person asking for the admission to trading on a regulated market to draw up the prospectus as a single document or separate documents. **Separate documents** must divide the required information into a **registration document** (including information on the issuer), a **securities note** and a **summary note**.[96] In these cases, the registration document can be published in advance and remains valid for 12 months after its publication 39

[92] Cf. U. Kunold and M. Schlitt, BB (2004), p. 501, 510; K.-M. König, ZEuS (2004), p. 251, 275; W. Kullmann and J. Metzger, WM (2008), p. 1292, 1297.

[93] Cf. P. Schammo, *EU Prospectus Law*, p. 105.

[94] Cf. N. Moloney, *EU Securities and Financial Markets Regulation*, p. 104; P. Schammo, *EU Prospectus Law*, p. 104.

[95] Cf. W. Kullmann and J. Metzger, WM (2008), p. 1292, 1297.

[96] Art. 5(3) PD.

for numerous offers to the public or admissions to trading on a regulated market (of course, a securities note and a summary note have to be published for each offer). It is especially suited to the needs of issuers that regularly place offers for the acquisition of securities to the public, such as banks.[97] As opposed to this, the single document appears more suited to the issuance of shares.[98]

40 The Prospectus Regulation contains details on the necessary content and the 'composition of the prospectus'.[99] A single document prospectus, for example, must be composed of a clear and detailed table of contents, a summary, the risk factors linked to the issuer and the type of security covered by the issue, and other information items included in the schedules and building blocks according to which the prospectus is drawn up[100] in this given order.[101] A prospectus composed of separate documents must comprise the following parts, so ordered: a clear and detailed **table of contents**, the **risk factors** linked to the issuer and the type of security covered by the issue, and the **other information items**.[102] Where the order of the items does not coincide with the required order of the information, the competent authority of the home Member State can ask the issuer, the offeror or the person asking for the admission to trading on a regulated market to provide a cross-reference list for the purpose of checking the prospectus before its approval.[103]

41 For offers of certain non-equity securities the prospectus can consist of a **base prospectus**[104] which must contain the same 'relevant information' on the issuer and the securities as a single or separate document, with the exception of the final terms of the offer.[105] The information must further be supplemented where necessary. The base document provides the possibility to avoid making public the specific elements of an offer until directly before the commencement of the offer period. In practice, base prospectuses are therefore primarily applied for offering programmes such as medium-term notes and structured products such as certificates.[106] If the final terms of the offer are not included in either the base prospectus or a supplement, the final terms must be provided to investors and filed with the competent authority when each public offer is made as soon as practicable and if

[97] Cf. R. Panasar et al., in: R. Panasar and P. Boeckmann (eds.), *European Securities Law*, para. 2.73; U. Kunold and M. Schlitt, BB (2004), p. 501, 505; K.-M. König, ZEuS (2004), p. 251, 272; N. Moloney, *EU Securities and Financial Markets Regulation*, p. 102–103.

[98] Cf. M. Schlitt et al., BKR (2005), p. 251, 251; U. Kunold and M. Schlitt, BB (2004), p. 501, 505.

[99] Art. 25 Prospectus Regulation.

[100] See para. 48–50.

[101] Art. 25(1) Prospectus Regulation.

[102] Art. 25(2) Prospectus Regulation.

[103] Art. 25(4) Prospectus Regulation.

[104] Cf. Art. 5(4) PD and Art. 22(6) Prospectus Regulation.

[105] Art. 2(1)(r) PD; Art. 22(7) Prospectus Regulation.

[106] Cf. R. Panasar et al., in: R. Panasar and P. Boeckmann (eds.), *European Securities Law*, para. 2.74; W. Kullmann and J. Metzger, WM (2008), p. 1292, 1296; N. Moloney, *EU Securities Regulation*, p. 102; P. Schammo, *EU Prospectus Law*, p. 96 et seq.

possible before commencement of the offer.[107] The final terms must then clearly indicate that the full information on the issuer and on the offer is only available on the basis of the combination of base prospectus and final terms.[108] The Prospectus Regulation contains rules on the structure required for a base prospectus[109] and allows the supervisory authorities to demand a cross-reference list, where the order of the items does not coincide with the order of the information provided for by the schedules and building blocks according to which the prospectus is drawn up.[110]

(bb) Summary

The prospectus must also include a **summary** that, in a concise manner and in non-technical language, provides key information in the language in which the prospectus was originally drawn up.[111] According to the European legislature, the summary constitutes a **key source** of **information** for **retail investors**,[112] requiring a further specification of its necessary content: 'It should focus on key information that investors need in order to be able to decide which offers and admissions of securities to consider further.' The summary should be formatted in a way that allows comparison of the summaries of similar products by ensuring that equivalent information always appears in the same position in the summary. It must further contain a number of **warnings** informing the investors of the fact that the summary should be read as only the introduction to the prospectus and an investment decision should only be based on the entire prospectus. The investors must further be warned that claims relating to the content of the summary are subject to very specific conditions.[113] The directive contains precise details on the warnings that must be given.[114] 42

In the course of the reforms of prospectus law in 2010, the European legislature amended the provision on the summary, in order to guarantee a more effective investor protection, upgrading the summary to a form of key investor information.[115] **Key investor information** is defined as 'essential and appropriately structured information which is to be provided to investors with a view to enabling them to understand the nature and the risks of the issuer, guarantor and the securities that are being offered to them or admitted to trading on a regulated market and to decide which offers of securities to consider further'. Depending on the respective offer and security it includes the risks associated with and essential 43

[107] Art. 5(4) PD.
[108] Art. 26(5) Prospectus Regulation.
[109] Art. 26(1) Prospectus Regulation.
[110] Art. 26(3) Prospectus Regulation.
[111] Art. 5(2) subsec. 1 PD.
[112] Cf. Recital 15 Directive 2010/73/EU.
[113] See para. 56.
[114] Cf. Art. 5(2)(a)–(d) PD.
[115] Cf. J.R. Elsen and L. Jäger, BKR (2010), p. 97, 99.

characteristics of the issuer (such as assets, liabilities and financial position), the risks associated with and essential characteristics of the investment in the relevant security, the general terms of the offer, including estimated expenses charged to the investor by the issuer or the offeror, details of the admission to trading, and reasons for the offer and use of proceeds.[116]

44 The exact format of the summary and content and form of the key information to be contained therein are laid down in Delegated Regulation (EU) No. 486/2012 on the basis of Article 5(5) Directive 2010/73/EU. In Annex XXII the Regulation contains detailed requirements on the composition and the content of the summary. Each summary has to consist of five tables (introduction and warnings, issuer and any guarantor, securities, risks, and offer) which are to be completed in the order provided in the Regulation—both with regard to the tables themselves as with regard to the individual elements therein. All elements are to be completed. Where an element is not applicable to a prospectus, the element may not be deleted, but must rather appear in the summary with the comment 'not applicable'.[117] The complete tables are to be copied into the summary of the prospectus as described. These requirements aim to ensure that the summaries contain equivalent information, are always to be found in the same place of the summary and similar products are easily comparable.[118]

45 It appears doubtful whether these provisions actually ensure a higher level of investor protection. For certain products, eg shares, certificates and high-yield-bonds, existing market practices already ensured a comparable structure and content of summaries without these strict legislative requirements. The strictly tabular format further leads to a confusing and difficult to read presentation, instead of a short, simple, precise and easily comprehensible description that was the aim of the Regulation.

46 The length of the summary is to take into account the complexity of the issuer and of the securities offered, but is not supposed to not exceed 7% of the length of a prospectus or 15 pages, whichever is the longer.[119]

(cc) Incorporation by Reference

47 The PD allows the issuer to incorporate information in the prospectus by reference to other documents.[120] The investors must then be provided with a cross-reference list enabling them easily to identify specific items of information.[121] As opposed to this, the summary may not incorporate information by reference.[122] Additionally

[116] Art. 2(1)(s) PD.
[117] Recital 10 Delegated Regulation (EU) No. 486/2012.
[118] Recital 10 Delegated Regulation (EU) No. 486/2012.
[119] Art. 24 Prospectus Regulation.
[120] Art. 11(1) PD.
[121] Art. 11(2) PD.
[122] Art. 11(1) PD.

the cross-reference is restricted to previously or simultaneously published documents that have been approved by or filed with the competent authority of the home Member State.[123] The possibility to include cross-reference information mainly applies to information contained in annual and interim financial information, documents prepared on the occasion of a specific transaction such as a merger or demerger, audit reports and financial statements, memorandum and articles of association, earlier approved and published prospectuses and/or base prospectuses, regulated information or circulars to security holders.[124]

(c) Specific Information Depending on the Type of Security and the Issuer

The minimum information to be included in the prospectus depend on the type of security offered and on the issuer.[125] The Prospectus Regulation follows a so-called building-block approach:[126] the numerous schedules and building blocks in the annex to the Prospectus Regulation contain lists of the information required. A 'schedule' is defined as a list of minimum information requirements adapted to the particular nature of the different types of issuers and/or the different securities involved.[127] By combining the lists in the applicable annexes the information required for each specific security offered by the issuer can be determined. 48

The PD not only determines the scope of application for each individual schedule and building block,[128] but also which 'combinations' of schedules and building blocks are possible.[129] The issuer of a security not listed in the Regulation must add all the information required for comparable securities.[130] Where the issuer applies for approval of a prospectus or a base prospectus for a new type of security, the competent authority must decide, in consultation with the issuer, what information must be included in the prospectus.[131] 49

The minimum information required for certain types of securities is listed in the Prospectus Regulation's annexes: for shares, for example, Annex I on the Minimum Disclosure Requirements for the Share Registration Documents and Annex III on Minimum Disclosure Requirements for the Share Securities Notes apply,[132] requiring information on the issuer, such as risk factors, a business overview, the operating results and financial condition, equity, management and supervisory bodies, major shareholders and financial information concerning the 50

123 Art. 11(1) PD.
124 Cf. Art. 28(1) Prospectus Regulation.
125 Cf. Art. 14, 18, 19 and 20 Prospectus Regulation.
126 Cf. Art. 3(1) Prospectus Regulation.
127 Cf. Art. 2(1) and (2) Prospectus Regulation.
128 Art. 4–20a Prospectus Regulation.
129 Art. 21(1) Prospectus Regulation; Annex XVIII Prospectus Regulation.
130 Cf. Art. 23(2) Prospectus Regulation.
131 Art. 23(3) Prospectus Regulation.
132 According to Art. 4 Prospectus Regulation the schedule set out in Annex I is applicable and pursuant to Art. 6 Prospectus Regulation the schedule set out in Annex III.

issuer's assets and liabilities, financial position, and profits and losses. The prospectus must further contain specific information on the securities to be offered, ie security-related risk factors, the issuer's capital, the terms and conditions of the offer and the admission to trading, and any dilution resulting from the offer.

(d) Language of the Prospectus

51 In the past, difficulties have arisen from the fact that the prospectus had to be translated into the language of the host Member State in order to be mutually recognised.[133] In order to facilitate the cross-border raising of capital, the European legislature amended this requirement in the PD. Article 19 PD distinguishes between four scenarios, the cross-border constellations being of particular practical relevance. Where an offer to the public is made or admission to trading on a regulated market is sought in one or more Member States excluding the home Member State, the prospectus may be drawn up 'in a language customary in the sphere of international finance'.[134] The competent authority of each host Member State may only require that the summary be translated into its official language.[135] Generally a prospectus will therefore be published in English.[136]

(e) Update

52 The PD originally obliged issuers whose securities were admitted to trading on a regulated market to provide annually a document that contained or referred to all information that they had published or made available to the public over the preceding 12 months in one or more Member States and in third countries.[137] It was thus sufficient to provide a list containing all publications and where they could be found, if necessary indicating that some of the information was outdated. This obligation was strongly criticised.[138] The European legislature thus deleted the provision in the course of the reforms of the PD in 2010.[139] As a consequence, a registration document must now be updated by means of a supplement or securities note.[140]

[133] Cf. N. Moloney, *EU Securities and Financial Markets Regulation*, p. 112–113; C. Crüwell, AG (2003), p. 243, 248; U. Kunold and M. Schlitt, BB (2004), p. 501, 508.

[134] For a list of the languages accepted for prospectus review and the translation of the summary in case of passporting, cf. R. Panasar et al., in: R. Panasar and P. Boeckmann (eds.), *European Securities Law*, para. 2.124.

[135] Art. 19(2) PD.

[136] R. Panasar et al., in: R. Panasar and P. Boeckmann (eds.), *European Securities Law*, para. 2.122; N. Moloney, *EU Securities and Financial Markets Regulation*, p. 113.

[137] Art. 10 PD.

[138] DAI, NZG (2002), p. 1100; J.R. Elsen and L. Jäger, BKR (2008), p. 459, 460–461.

[139] Cf. Art. 1(10) Directive 2010/73/EU.

[140] Recital 21 Directive 2010/73/EU.

V. Supervision and Sanctions

1. Requirements under European Law

53 The Prospectus Directive requires a central competent administrative authority to be responsible for supervising the adherence to the prospectus obligations in the Directive and the provisions adopted pursuant to this Directive.[141] These competent authorities are to be completely independent from all market participants.[142] Each competent authority shall have all the powers necessary for the performance of its functions, the powers upon receipt of an application for approving a prospectus[143] and in connection with the securities admitted to trading on a regulated market[144] being described in detail.

54 Furthermore the Member States must ensure that the appropriate **administrative measures** can be taken or **administrative sanctions** be imposed against the persons responsible, where the provisions adopted in the implementation of the PD have not been complied with. The measures must be effective, proportionate and dissuasive.[145] This wording gives the Member States much freedom in the construction of their national provisions,[146] in particular leaving it to their discretion whether to provide the right to impose criminal sanctions. The PD permits the competent authority to publicly disclose measures and sanctions that have been imposed for an infringement of the directive's provisions, unless the disclosure would seriously jeopardise the financial markets or cause disproportionate damage to the parties involved (so-called naming and shaming).[147] The directive does not oblige the supervisory authorities to use this sanctioning instrument or define more fully how the disclosure is to be made.[148]

55 The PD further requires the Member States to 'ensure that responsibility for the information given in a prospectus attaches at least to the issuer or its administrative, management or supervisory bodies, the offeror, the person asking for the admission to trading on a regulated market or the guarantor, as the case may be. The persons responsible shall be clearly identified in the prospectus by their names and functions or, in the case of legal persons, their names and registered offices, as well as declarations by them that, to the best of their knowledge, the information contained in the prospectus is in accordance with the facts and that the prospectus

141 Art. 21(1) PD.
142 Art. 21(1) PD.
143 Art. 21(3) PD.
144 Art. 21(4) PD.
145 Art. 25(1) PD.
146 See R. Veil § 12 para. 10.
147 Art. 25(2) PD.
148 Cf. ESMA, Report, Comparison of liability regimes in Member States in relation to the Prospectus Directive, 30 May 2013, ESMA/2013/619.

makes no omission likely to affect its import' (**civil liability**). The provision does not attach the responsibility to a certain person, leaving the choice of the liable person and the construction of the respective provisions on liability to the Member States.

56 Originally the PD aimed to avoid liability for incorrect summaries. This is now different, the summary being classed as 'key investor information' since the 2010 reforms to the PD.[149] The Member States must now ensure that no civil liability is attached to any person solely on the basis of the summary, including any translation thereof, unless it is misleading, inaccurate or inconsistent, when read together with the other parts of the prospectus, or it does not provide key information in order to aid investors in their decision whether to invest in such securities.[150] The Member States had to implement this controversial arrangement into their national laws by 1 July 2012.[151]

2. Supervisory Measures

(a) Suspension or Prohibition of an Offer

57 Pursuant to Article 10(1) PD, a prospectus may not be published until it has been approved by the competent authority of the home Member State (ex ante-approval). This indicates the important role the supervisory authorities play in compiling a prospectus. The European legislature has equipped the supervisory authorities with a number of powers it regarded as necessary for carrying out the obligations laid down in the directive.[152] The competent authority has, for example, the right to require that the issuer include supplementary information in the prospectus, if it regards this as necessary for investor protection. It can further suspend a public offer or admission to trading for a maximum of 10 consecutive working days if it has reasonable grounds for suspecting that the provisions of this Directive have been infringed, or even prohibit a public offer if it finds that the provisions of the directive have been infringed or if it has reasonable grounds for suspecting that they would be infringed. The Member States have implemented these powers into their national laws; in some Member States the supervisory authorities have delegated the powers to the stock exchange management.[153]

(b) Administrative Sanctions

58 The administrative sanctions, mostly fines, differ considerably between the Member States.[154] The majority of the Member States have introduced either

[149] See para. 42–44.
[150] Art. 6(2) subsec. 2 PD.
[151] Cf. T. Voß, ZBB (2010), p. 194, 205.
[152] Cf. Art. 21(3) and (4) PD.
[153] CESR/07-383 (fn. 89), p. 14 et seq.
[154] Cf. CESR/07-383 (fn. 21), p. 65 et seq.; ESMA/2013/619 (fn. 148), p. 17 et seq.

provisions regulating the maximum fines permitted or their competent authorities have set such a maximum fine. These vary between DKr 30,000 (€ 4,050) in Denmark and € 2.5 million in France. The United Kingdom does not regulate the maximum height of fines.[155] Some Member States further regulate the minimum fine to be imposed, which, as in the case of Italy (about € 25,000), may even exceed the maximum fine in other Member States. Neither the CESR Report nor the ESMA Report contains information on the practical effects of administrative fines. These can thus only be determined for each Member State individually through the respective, publicly accessible, sources.[156]

3. Sanctions under Criminal Law

The enforcement of the PD's provisions is primarily ensured through adminis- 59
trative measures and sanctions in the Member States, criminal sanction playing a subordinate role with only few Member States having actually introduced special provisions.[157] Most Member States have limited the protection under criminal law to the general rule,[158] which nevertheless plays an important role in legal practice.[159]

4. Private enforcement

The civil liability for the publication of an incorrect prospectus could not differ 60
more throughout the European Member States.[160] Whilst Germany,[161] the United Kingdom,[162] Spain,[163] Italy[164] and Austria,[165] for example, have introduced special provisions thereon, and may additionally apply general civil law provisions, other Member States, such as France[166] and Sweden,[167] rely solely on their general civil law liability concepts.

155 Sec. 91(1A) FSMA; see R. Veil and M. Wundenberg, *Englisches Kapitalmarktrecht*, p. 37–38.

156 However, ESMA has begun to examine how NCAs carry out their supervisory tasks by conduction peer reviews. This work shows different approaches in the Member States and a number of deficits. Cf. ESMA/2016/1055 (fn. 27).

157 Italy (Art. 173-bis TUF) and Austria (§ 15 KMG) provide a criminal provision specifically for sanctioning the publication of an incorrect prospectus.

158 Cf. Germany § 399 AktG (incorrect information) and § 400 AktG (incorrect description) and also § 263 StGB (fraud) and § 266 StGB (embezzlement).

159 Cf. for Sweden Högsta domstolen, NJA (1992), p. 691 et seq. (*Leasing Consult*).

160 Cf. N. Moloney, *EU Securities and Financial Markets Regulation*, p. 121–122.

161 Cf. §§ 21–25 WpPG (prior to June 2012, the provisions were contained in §§ 44, 45 BörsG).

162 Cf. sec. 90 FSMA.

163 Cf. Art. 28 LMV.

164 Cf. Art. 97(7) TUF.

165 Cf. § 11 KMG.

166 Cf. Art. 1382 Cc.

167 An issuer may be held liable on the legal basis of the Kapitel 29, § 1(1) sentence 2, (2) sentence 2 ABL and the general rules of tort law, cf. R. Veil and F. Walla, *Schwedisches Kapitalmarktrecht*, p. 25 et seq.

61 The comparative legal literature has carefully scrutinised these different national legal concepts of civil law liability.[168] The underlying concepts[169] and details of the different provisions cannot be examined in detail here. Some central problems regarding prospectus liability in the Member States must, however, be examined more closely: which deficiencies result in prospectus liability? Which Member States require causation between the incorrect publication and the transaction? What must be considered regarding the other requirements of a prospectus liability, such as responsibility, the capacity to sue and the legal consequences of prospectus liability?

(a) Deficiencies of the Prospectus

62 A prospectus is regarded as deficient if it contains **incorrect** or **insufficient information**. Information is incorrect if it does not relate to the facts. A prospectus contains insufficient information if it does not include all the information required by the Prospectus Regulation.

63 Common examples are the reference to an incorrect or manipulated balance sheet in the prospectus or the omission of the fact that an action for annulment is pending against the capital increase resolution.

64 A prospectus can further be deficient if it **reflects** an **unrealistic picture** of the **issuer** or his financial situation or **profit expectations**.[170]

> *Facts (abridged and simplified)*:[171] The Beton- und Monierbau AG (BuM) was experiencing liquidity problems that could only be cleared with the help of a loan, guaranteed by the federal state of North Rhine-Westphalia. When new financial difficulties arose a short time later the company applied for a federal guarantee which was granted under the premise of a capital increase. After the prospectus was published, an investor acquired new shares from the capital increase. Less than six months later, bankruptcy proceedings were instituted against BuM. The Bundesgerichtshof (BGH—German Federal Court of Justice) ruled that when determining whether a prospectus contains incorrect or insufficient information it is not sufficient to examine the presented facts individually. One must rather also take into account the impression these facts give as a whole. In the case at hand, the general picture conveyed did not sufficiently indicate that the shares had to be classed as high-risk investments of a highly speculative nature. The prospectus rather attempted to give the impression that the difficulties were merely temporary and the

[168] Cf. K.J. Hopt and H.-C. Voigt (eds.), *Prospekt- und Kapitalmarktinformationshaftung* (2004); R. Veil and M. Wundenberg, *Englisches Kapitalmarktrecht*, p. 24 et seq.; R. Veil and P. Koch, *Französisches Kapitalmarktrecht*, p. 29 et seq.; R. Veil and F. Walla, *Schwedisches Kapitalmarktrecht*, p. 20 et seq.; C. Gerner-Beuerle, 23 Temp. Int'l & Comp. L.J. (2009), p. 317, 344–372.

[169] See H.-D. Assmann, *Prospekthaftung*, p. 213 et seq.

[170] BGH, NJW (1982), p. 2823 et seq. (described in further detail in the example below); cf., however, OLG Frankfurt, ZIP (2012), p. 1240 et seq., which held that a prospectus is not incorrect, if the valuation of the real estate owned by the issuer is overstated by 12%, as such deviation still ranges within the acceptable margin.

[171] BGH, NJW (1982), p. 2823 et seq.

capital increase was intended to consolidate the company's budget, indicating that the financial results would improve compared with those of previous year.

In Germany, Italy and Austria the rules on liability require that the prospectus has to be **incorrect** in an **aspect material** for the **evaluation** of the **security**.[172] This can be assumed, if the relevant aspect is taken into account for an investment decision of a reasonable investor. The prevalent understanding in Germany is that a reasonable investor must be able to read and understand a balance sheet without, however, having above-average expert knowledge.[173] 65

Example: In the case *Beton- und Monierbau AG (BuM)* the prospectus contained the information that the company's financial results would improve considerably in 1978, compared to 1977 when the company suffered severe losses. The BGH ruled that no reasonable investor would have got the overall impression that this improvement could still mean overall losses—albeit reduced compared to the year before. An average investor need not understand the terminology common to insiders.

It is particularly difficult to determine whether a prospectus is incorrect with regard to statements referring to future events and prognoses. In Germany, incorrect statements are also subject to prospectus liability. **Statements** on **future events** are regarded as **incorrect** if they are **not** reasonable or are **not based** on actual **facts**.[174] 66

Example: In *BuM* the BGH ruled that the wording of the provisions on prospectus liability did not include facts in the term 'information' but also evaluative statements on the economic situation of the company and its future developments, as these could not always be clearly distinguished. An investor must therefore be able to rely on the evaluative statements to be conclusions deduced from the facts on the basis of a thorough analysis. Accordingly, the issuer of the prospectus could not be held liable for the incorrectness of the statements, his liability rather depending on whether the prognosis is commercially justifiable on the basis of the underlying facts.

France treats the problem of a liability for an incorrect prognosis similarly, all statements on future developments requiring a verifiable foundation.[175] If this is not the case and the prognosis is based on intentions (eg future acquisition of a company) or estimations (eg future profits), this must be made clear in the prospectus. A prognosis based on facts must be accompanied by information on how it was established. A number of examples put the content of prognoses into more concrete terms.[176] The United Kingdom offers a number of common law examples 67

[172] In Germany, a prerequisite is that the aspect is sufficiently definite, which is deemed to be the case if the supervisory board has approved a transaction, cf. OLG Frankfurt ZIP (2012), p. 1236 et seq.

[173] Cf. BGH, NJW (1982), p. 2823, 2824; OLG Frankfurt am Main, AG (2005), p. 851, 852; OLG Frankfurt am Main, WM (1994), p. 294, 295; OLG Stuttgart, WM (1984), p. 586, 592.

[174] BGH, NJW (1982), p. 2823, 2824; OLG Frankfurt am Main, WM (1994), p. 291, 295; LG Frankfurt am Main, WM (1998), p. 1181, 1184.

[175] Cf. Art. 212-14–212-16 RG AMF.

[176] Cf. H.-J. Puttfarken and A. Schrader, in: K.J. Hopt and H.-C. Voigt (eds.), *Prospekt- und Kapitalmarktinformationshaftung*, p. 600–601.

on this matter. The courts determine liability according to the question of whether the person to be held liable for the incorrect prospectus was convinced that his statement on future developments was correct[177] and whether it was assumed that his predictions would prove to be true.[178]

(b) Claimant and Opposing Party

68 In Germany, France and Austria it is not only **investors** still holding securities who are entitled to assert claims, but also investors who have already disposed of the respective securities. Under German law this right exists for the acquisition of securities within six months of the prospectus publication, irrespective of whether the securities were acquired on the primary or secondary market.[179] Spain[180] and the United Kingdom[181] also provide for compensation claims for investors who have acquired respective securities on the secondary market within a certain time frame after the prospectus was published.

69 The PD does not specify against whom the claim is to be brought. It is thus hardly surprising that the Member States have not answered this question uniformly. In general it can be said that Germany, France, Italy, Austria, Spain and the United Kingdom all assume the **issuer** to be **held liable**, whilst Sweden does not provide a possibility for claims against the issuer.

70 In **Germany**, the action for prospectus liability can further be brought against any person responsible for the drawing up and publication of the prospectus,[182] ie the **issuer**[183] and the **banks** issuing the securities,[184] as well as against any person upon whose initiative the publication is based.[185] The latter is any person with an economic interest in the issuance, such as **major shareholders** or banks participating in the issuance of shares by a smaller and less solvent issuing company.[186] German

[177] A. Alcock, in: Lord Millett et al. (eds.), *Gore-Browne on Companies*, sec. 43-22 (Update 88); P.C. Leyens and U. Magnus, in: K.J. Hopt and H.-C. Voigt (eds.), *Prospekt- und Kapitalmarktinformationshaftung*, p. 417, 462–463.

[178] *Aaron's Reefs v. Twiss* [1896] AC 273, 284; *In re Pacaya Rubber and Produce Company, Limited* [1914] 1 ChD 542, 549; A. Alcock, in: Lord Millett et al. (eds.), *Gore-Browne on Companies*, sec. 43-22 (Update 88); in more detail see R. Veil and M. Wundenberg, *Englisches Kapitalmarktrecht*, p. 37.

[179] Cf. § 21(1) WpPG; see E. Schwark, in: E. Schwark and D. Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, §§ 44, 45 BörsG para. 38.

[180] Cf. M. Iribarren Blanco, *Responsabilidad civil por la información divulgada por las sociedades cotizadas*, p. 47 et seq.; M.I. Grimaldos García, 102 RDBB (2006), p. 271, 278–279.

[181] Cf. P.L. Davies, *Gower and Davies' Principles of Modern Company Law*, para. 25–33; A. Alcock, in: Lord Millett et al. (eds.), *Gore-Browne on Companies*, sec. 43-8 (Update 107).

[182] § 21(1)(1) WpPG.

[183] § 5(3) WpPG.

[184] § 5(4) WpPG. All banks are held responsible in bank syndicates, independent of whether they actually participated in the drawing up of the prospectus, cf. E. Schwark, in: E. Schwark and D. Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, §§ 44, 45 BörsG para. 10.

[185] § 21(1)(2) WpPG.

[186] E. Schwark, in: E. Schwark and D. Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, §§ 44, 45 BörsG para. 9.

legal literature does not assume any liability of experts (lawyers, accountants, etc.) who only participate in drawing up parts of the prospectus without any personal economic interest in the issuance.[187]

In the **United Kingdom**, prospectus liability extends to the **issuer**, its **directors**, all prospective directors, and any person responsible for drawing up or approving the prospectus.[188] The risk of liability thus applies to both the bodies of the issuer and **experts** responsible for the prospectus. Professional advice on the content of the prospectus alone does not, however, entail liability.[189] 71

(c) Causation

An essential element of prospectus liability is the question as to whether the claimant actually based his investment decision on the incorrect information. Germany and the United Kingdom have both eased the **burden** of **proof of causation** whilst the Austrian court has refused to do so.[190] In Spain[191] legal literature recommends similar facilitations. France, Italy and Sweden do not provide any rules easing the burden of proof for the investor. 72

In Germany, the courts formerly ruled that a general disposition towards the acquisition of shares, initiated through publications in the media or investment consulting, was sufficient for the assumption of causation between the prospectus and the investor's decision to acquire the securities (so-called *Anlagestimmung*).[192] The investor was assumed to have indirectly gained knowledge of the content of the prospectus through information that was publicly available. The BGH ruled that the investor need not have read the prospectus or gained knowledge of it, ruling that it was sufficient if the report was decisive for the assessment of the security amongst experts and had thus helped to create a general disposition towards its acquisition.[193] The legislature finally adopted this understanding, implementing the concept of a general disposition towards acquisition in § 23(2)(1) WpPG, which now contains a **legal assumption of causation**: the claim is unsubstantiated 73

[187] E. Schwark, in: E. Schwark and D. Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, §§ 44, 45 BörsG para. 12.

[188] English legal literature is actively discussing the question of who is to be held liable for deficiencies in a prospectus (cf. P.L. Davies, *Gower and Davies' Principles of Modern Company Law*, para. 25–35: 'sensitive question'). Meanwhile PR 5.5. FCA Handbook contains detailed rules on liability. In more detail A. Alcock, in: Lord Millett et al. (eds.), *Gore-Browne on Companies*, sec. 43-9 (Update 107).

[189] PR 5.5.9 FCA Handbook.

[190] Cf. on the legal situation in Austria S. Kalss et al., *Kapitalmarktrecht I*, § 12 para. 79.

[191] Cf. with different explanations M. Iribarren Blanco, *Responsabilidad civil por la información divulgada por las sociedades cotizadas*, p. 118; M. Valmaña Ochaíta, *La responsabilidad civil derivada del folleto informativo en las ofertas públicas de suscripción y venta de acciones*, p. 379.

[192] Cf. RGZ 80, p. 196, 204; BGHZ 139, p. 225, 233; BGH, NJW (1982), p. 2823, 2826; BGH, NJW (1982), p. 2827, 2828; OLG Düsseldorf, ZIP (1984), p. 549, 558; OLG Frankfurt am Main, WM (1994), p. 291, 298; OLG Frankfurt am Main, WM (1996), p. 1216, 1219.

[193] BGHZ 139, p. 225, 233.

if the decision to acquire the respective securities was not based on the information in the prospectus. The issuer must prove this missing causation by describing why there was no general disposition towards the acquisition of the respective shares, due to negative developments or reports or a sharp fall in the security's price, for example.

74 The United Kingdom also does not require the investor's actual knowledge of the content of the prospectus.[194] Causation in the sense of section 90(1)(b) FSMA can be assumed if the deficiency in the prospectus adversely affected the price of the security. The proof of causation in United Kingdom and in Germany is thus similarly facilitated.

(d) Responsibility

75 All jurisdictions require responsibility for prospectus liability, **negligence** sufficing in the United Kingdom, Spain, France, Italy and Sweden, whilst in Austria the required standard of fault depends on the person who is to be held liable.[195] Germany has the most restrictive rules concerning responsibility.[196]

76 The legal foundation for prospectus liability in Germany is § 23(1) WpPG. Pursuant to this provision a person is exempt from liability if he can prove that he did not know that the prospectus contained incorrect or insufficient information and that his lack of knowledge was not based on gross negligence.[197] Proof of causation is thus reversed: the opposing party must prove that it was not responsible for the deficient prospectus. A person acts with gross negligence if he fails to exercise reasonable care in a particularly serious way,[198] ie if he failed to make the most obvious deliberations.[199] The standard can vary, as the personal and expert knowledge of a person must be taken into consideration when determining whether it acted with gross negligence.[200]

77 The United Kingdom has also introduced a provision (schedule 10 FSMA) according to which a person is exempt from liability:[201] a person does not incur any liability for loss caused by a statement if he satisfies the court that he reasonably believed the statement was true and not misleading, he could reasonably rely on the statement of an expert,[202] he published a correction in a manner calculated to bring it to the attention of persons likely to acquire the securities before the

[194] A. Alcock, in: Lord Millett et al. (eds.), *Gore-Browne on Companies*, sec. 43-3 (Update 114); A. Hudson, in: G. Morse (ed.), *Palmer's Company Law*, para. 5.790 (as of R.139, October 2013).

[195] Cf. § 11(1) KMG.

[196] Cf. C. Gerner-Beuerle, 23 Temp. Int'l & Comp. L.J. (2009), p. 317, 374.

[197] § 23(1) WpPG.

[198] Cf. BGHZ 10, p. 14, 17; BGHZ 89, p. 153, 161.

[199] Cf. OLG Düsseldorf, WM (1984), p. 586, 595.

[200] Cf. W. Groß, *Kapitalmarktrecht*, §§ 44, 45 BörsG para. 75.

[201] Only selected exemptions can be described in more detail herein. For a more detailed presentation see R. Veil and M. Wundenberg, *Englisches Kapitalmarktrecht*, p. 28.

[202] Cf. C. Gerner-Beuerle, 23 Temp. Int'l & Comp. L.J. (2009), p. 317, 356–362.

securities were acquired, or the investor acquired the securities in the knowledge that the published information was incorrect, misleading or incomplete. Schedule 10 FSMA thus assumes responsibility, even in cases of negligence, unless the defendant proves otherwise.[203]

(e) Legal Consequences

The Member States attach different legal consequences to the liability for incorrect prospectus information which can be divided into two categories. In some jurisdictions, investors may claim the **difference** between the **acquisition price** and **disposal price** for the shares or the actual value of the security as damages. Other Member States additionally provide the possibility to rescind the contract or claim compensation by restoration of the previous situation (**restitution in kind**). 78

In Germany, an investor can demand specific performance, ie the return of the securities against reimbursement of the acquisition price, pursuant to § 21(1) WpPG. If an investor has meanwhile disposed of the securities he can alternatively demand the difference in price between the acquisition and disposal, including all costs related thereto, such as the broker's commission paid to the issuing bank or a stockbroker and all costs attached to the exercise of subscription rights.[204] 79

The British FSMA does not contain any provisions on the calculation of damages. As no case law has as yet been spoken on section 90 FSMA, the legal effects of liability remain unclear.[205] According to the legal literature, the claimant is to be compensated for all detriments suffered due to the incorrect prospectus (out-of-pocket loss rule),[206] and is thus to be awarded the difference between the acquisition price and the actual value of the securities.[207] Section 90 FSMA does not, however, allow specific performance, ie the return of the securities against reimbursement of the acquisition price.[208] 80

[203] Cf. P.L. Davies, *Gower and Davies' Principles of Modern Company Law*, para. 25–34: 'The purpose of Schedule 10 is to implement the policy of imposing liability on the basis of negligence but with a reversed burden of proof'.

[204] E. Schwark, in: E. Schwark and D. Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, §§ 44, 45 BörsG para. 66.

[205] Seen critically by A. Alcock, in: Lord Millett et al. (eds.), *Gore-Browne on Companies*, sec. 43-4 (Update 107).

[206] Cf. ibid.

[207] Cf. P.L. Davies, *Gower and Davies' Principles of Modern Company Law*, para. 25–33; see also E. Lomnicka and J.L. Powell, *Encyclopedia of Financial Services Law*, p. 2A-327 (as of R. 110, February 2016): 'awarding him a sum representing the amount he overpaid for the securities'; A. Alcock, in: Lord Millett et al. (eds.), *Gore-Browne on Companies*, sec. 43-4 (Update 107): 'mispricing loss from the error'.

[208] Specific performance may, however, be possible under common law principles, cf. R. Veil and M. Wundenberg, *Englisches Kapitalmarktrecht*, p. 31 et seq.

81 It has been discussed controversially whether **payments** the **issuer** must **make** to the investors based on the rules of prospectus liability **comply with** the (European) **capital maintenance regime**. German legal literature tends to purport that the German rules on prospectus liability comply with the principles on capital maintenance,[209] arguing that the respective stock exchange law provisions came into force after the rules on capital maintenance (*lex posterior* rule). The highest civil court in Austria (Oberste Gerichtshof) also ruled that the provisions on prospectus liability would override the rules on capital maintenance.[210] It appears doubtful, however, whether this interpretation complies with European law.[211] Whilst the PD requires an effective liability regime for incorrect prospectus publications, the Capital Directive requires that a certain amount of the company's assets may not be reduced by distributions to shareholders in order to protect the creditors of a company.[212]

82 The ECJ, however, rejected this argument: 'In those circumstances, a payment made by a company to a shareholder because of irregular conduct on the part of that company prior to or at the time of the purchase of its shares does not constitute a distribution of capital within the meaning of Article 15 of the Second Directive and, consequently, such a payment ought not to be subject to the conditions stated in that article.'[213] The Court argued that 'liability of the company concerned to investors, who are also its shareholders, by reason of irregular conduct on the part of that company prior to or at the time of the purchase of its shares, does not derive from the memorandum and articles of association and is not directed solely at the internal relations of that company. The source of the liability at issue in such a case is the share purchase contract.'[214] According to the ECJ, the 'establishment of [...] a liability regime is therefore within the discretion conferred on the Member States and is not contrary to European Union law.'[215]

[209] Cf. W. Bayer, WM (2013), p. 961, 966; S. Gebauer, *Börsenprospekthaftung und Kapitalerhaltungsgrundsatz*, p. 190 et seq.; distinguishing between acquisition on the primary markets (liability is restricted to free assets) and acquisitions on the secondary markets (no restriction on liability, cf. § 57 AktG); E. Schwark, in: E. Schwark and D. Zimmer (eds.), *Kapitalmarktrechts-Kommentar*, § 45 BörsG para. 13–14; cf. also BGH NZG (2005), p. 672; OLG Frankfurt am Main, AG (2000), p. 132, 134.

[210] Cf. OGH, GesRZ (2011), p. 193.

[211] This is the position of some authors in the German discussion; cf. N. Vokuhl, *Kapitalmarktrechtlicher Anlegerschutz*, p. 46 et seq.; E.-M. Wild, *Prospekthaftung einer Aktiengesellschaft unter deutschem und europäischem Kapitalschutz*, p. 183 et seq.

[212] According to Art. 15(1)(a) Capital Directive, '[n]o distribution to shareholders may be made, except for cases of reduction of subscribed capital, when on the closing date of the last financial year the net assets as set out in the company's annual accounts are, or following such a distribution would become, lower than the amount of the subscribed capital plus those reserves which may not be distributed under the law or the statutes'. See H. Drinkuth, *Die Kapitalrichtlinie—Mindest- oder Höchstnorm*, p. 184.

[213] ECJ of 19 December 2013, Case C 174/12 (*Hirmann*), para. 32.

[214] ECJ of 19 December 2013, Case C 174/12 (*Hirmann*), para. 29.

[215] ECJ of 19 December 2013, Case C 174/12 (*Hirmann*), para. 44.

VI. Conclusion

With the enactment of the PD in 2003, the European legislature aimed to ensure the largest possible access to investment capital at a European level. The aims of the provisions further include investor protection and market efficiency. These aims have largely been achieved. The detailed provisions of the PD leave the Member States with only little scope regarding their implementation. In connection with the provisions on Level 2, extensive harmonisation of the requirements for the drawing up and content of a prospectus for public offers and the admission of shares to trading is thus achieved. The density of regulation has, however, not prevented the national supervisory authorities from following different approaches regarding the interpretation and application of prospectus law. It must therefore be regarded as a step in the right direction that the European legislator wishes to achieve a further unification of the laws on prospectuses. The future Prospectus Regulation will ensure improvements in various additional ways. It is particularly important that the prospectus obligations for frequent issuers are made more flexible by introducing the universal registration document as a new type of prospects format to be used by frequent issuers and by providing a less prescriptive disclosure regime for secondary issuances. Furthermore it is to be welcomed that the requirements for the prospectuses of SMEs are rendered simpler and more specific. 83

As opposed to this, the sanctioning level does not appear to be as well harmonised. 84
The Member States provide a number of different sanctioning instruments under supervisory law and also varying sanctions under civil law. Prospectus liability is subject to very different prerequisites in the Member States. This sum of disparate regulatory concepts can cause uncertainty in the issuers[216] and investors concerning the exact risks of an offer or the admission of shares to trading in another Member State. The noticeable differences also have a negative effect on investor protection and market efficiency. It is therefore necessary to develop a more uniform level of protection for investors. The new Prospectus Regulation is only a first step, as it is limited to the harmonisation of administrative measures and sanctions. Private enforcement is at least equally important. It is insufficient in this regard to merely harmonise the legal basis. The European legislator must rather also adapt the procedural laws, only class actions providing adequate means to combat the rational apathy of investors to and incentivising them to file lawsuits with regard to any damages they suffer.

[216] Cf. E. Ferran, 4 ECFR (2007), p. 461, 483 et seq.

§ 24

Short Sales and Credit Default Swaps

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I. Introduction

1 The financial and sovereign debt crisis caused the regulation of short sellings and credit default swaps to re-appear on the Member States' and the EU's political agendas, politicians criticising investors for employing investment strategies that rely on a speculation on falling prices of securities/debt instruments. A number of Member States—and later the EU itself—thus regulated short sellings and the investment in credit default swaps in order to secure the **stability of the financial system** and to prevent investors from profiting from a speculation on decreasing prices.

2 A short sale is a transaction in which a party sells financial instruments for a fixed price while having an obligation to deliver the respective financial instruments to

a third party at a later point in time without a fixed price.[1] Commonly, the definition is restricted to cases in which the seller does not yet own[2] or possess[3] the financial instruments at the time of entering into the sales agreement. This definition does, however, not include a constellation in which the short sale is covered.[4] ieIn this respect, it falls short of the mark.[5]

Short sales can be divided into two types: **covered short sellings** describes constellations in which a seller has a claim for the sold financial instruments, ie has borrowed the them or made other arrangements to ensure it can be obtained before the short sale, thereby ensuring that it will be able to fulfil his obligation. 3

In **uncovered** or **'naked' short sellings** at the time of the short sale the seller has not yet borrowed the financial instruments sold or ensured they can be borrowed.[6] The short seller hence has to acquire the financial instruments between the sale agreement and the execution of the transaction. He must ensure that he obtains the financial instruments he owes within the performance period. The seller can do so either by acquiring or borrowing the financial instruments.[7] Uncovered short sales can result in any number of transactions regarding the respective financial instruments. In extreme cases, they may even result in more financial instruments being traded than have actually been issued.[8] 4

For the seller the economic intention behind short sales is to make profits because of falling prices, enabling him to buy the financial instruments it owes at a lower price than the price it made with his sale. It will, however, suffer a loss if the price of the financial instruments rises higher than the price the buyer has the obligation to pay, before the seller has had the opportunity to acquire the financial instruments it owes. Profits made through short sales are primarily used for **hedging**[9] losses of other investments or for **speculation**[10] on falling prices.[11] 5

[1] T. Laurer, ZgesKredW (2008), p. 980, 982; in line with this: G. Trüg, NJW (2009), p. 3202, 3203; J. Tyrolt and A. Bingel, BB (2010), p. 1419; see para. 17 for the definition of short sales established by the SSR.

[2] Cf. A. Dörge, *Rechtliche Aspekte der Wertpapierleihe*, p. 28; F. Schlimbach, *Leerverkäufe*, p. 8 et seq.

[3] C. Kienle, in: H. Schimansky et al. (eds.), *Bankrechts-Handbuch*, § 105 para. 54; M. Lorenz, AG (2010), p. 511.

[4] On this term see para. 17.

[5] J. Tyrolt and A. Bingel, BB (2010), p. 1419.

[6] J. Ekkenga, in: K. Schmidt (ed.), *Münchener Kommentar HGB*, Effektengeschäft para. 66; G. Trüg, NJW (2009), p. 3202, 3203; D. Zimmer and T. Beisken, WM (2010), p. 485, 486; F. Walla, DÖV (2010), p. 853. The concept of uncovered short selling was first described at the outset of the 17th century in the Netherlands, cf. H. de Graaf and E. Kalse, '*Naakt short gaan*' *iseenoud-Hollands kunstje*, Handelsblad of 25 July 2008; cf. for further details A. Bris et al., 62 J. Fin. (2007), p. 1029.

[7] Cf. G. Trüg, NJW (2009), p. 3202, 3203.

[8] M. Lorenz, AG (2010), p. R 511. Cf. on the effects of short selling in the case *Porsche v. VW* L. Teigelack § 15 para. 44.

[9] Cf. IOSCO, Regulation on Short Selling Final Report, June 2009, available at: www.iosco.org/library/pubdocs/pdf/IOSCOPD292.pdf, p. 5.

[10] See on the term 'speculation' and its legal implications L. Klöhn, *Kapitalmarkt, Spekulaltion und Behavioural Finance*, p. 22.

[11] Short selling is a common investment strategy of hedge funds. See on the different types of investors R. Veil § 9 para. 7 et seq.

6 Credit default swap agreements (CDS) have similar effects as short sales. CDS are derivative contracts under which one party is obliged to make a payment to the other party in case a certain credit event (in particular a default of the creditor) occurs.[12] Accordingly, CDS have the same economic function as credit default insurance agreements.[13] CDS can in particular be used to hedge against the default of a creditor whose creditworthiness has a high correlation to a sovereign issuer.[14]

II. Need for Regulation

7 Notwithstanding all criticism against short sales and CDS, short sellings without doubt also have positive effects. Economically they provide the possibility to **hedge** risks, thereby securing investors against losses. Short sales can furthermore contribute to the efficiency of the capital markets by allowing investors to act when they believe a security is overvalued, thereby leading increased market liquidity which, in turn, leads to a **more efficient pricing**.[15] Some legal scholars thus conclude that there is no need to regulate short sellings.[16]

8 Short selling may, however, lead to **higher market volatility** and a **downward spiral** in prices.[17] These risks should only become legally relevant when short sellings or CDS are used as part of an abusive strategy, for example as a means to achieve market manipulation, or if they result in a destabilisation of the entire financial system.[18] Uncovered short sales, furthermore, are particularly dangerous as they are accompanied by the risk of **settlement failures**.[19]

[12] See J.C. Hull, *Options, Futures, and other Derivatives*, p. 528.

[13] O. Juurikkala, 9 ECFR (2012), p. 307, 310. As a result, some scholars argue that CDS' regulatory treatment should follow insurance contracts, see A. Kimball-Stanley, 15 Conn. Ins. L. Rev. (2008), p. 241 et seq.; B.B. Saunders, 10 J. Corp. Stud. (2010), p. 427 et seq.

[14] See S. Das et al., 111 J. Fin. Econ. (2014), p. 495 et seq.

[15] Cf. E. Boehmer and J. Wu, *Short Selling and the informational efficiency of prices*, p. 1 et seq.; E. Boehmer et al., 63 J. Fin. (2008), p. 491 et seq.; M. Mittermeier, ZBB (2010), p. 139, 141; D. Zimmer and T. Beisken, WM (2010), p. 485, 486. Also R.J. Gilson and R. Kraakman, 70 Va. L. Rev. (1984), p. 549 et seq.

[16] For example A.M. Fleckner, in: N. Moloney et al. (eds.), *Oxford Handbook of Financial Regulation*, p. 596, 624 et seq.

[17] IOSCO, Regulation on Short Selling (fn. 9), p. 21–22; cf. M. Mittermeier, ZBB (2010), p. 139, 141–142 on the dangers of short selling for market integrity and O. Juurikkala, 9 ECFR (2012), p. 307, 312 et seq. for the risks associated with CDS.

[18] See Recital 1 SSR.

[19] IOSCO, Regulation on Short Selling (fn. 9), p. 22; M. Mittermeier, ZBB (2010), p. 139, 142; E. Howell, 12 ECL (2015), p. 79, 80.

1. Short Sales as a Means for Market Manipulation

Short sales and CDS can be used as a means for market manipulation in the sense of Article 12 MAR.[20] This for example applies to so-called bear raids, ie the spreading of negative rumours in order to force down the share price.[21] Uncovered short sales must further be classed as market manipulations if they are abusive, ie if the seller never intended to fulfil his sales obligation, aiming only at misleading the market.[22] 9

2. Short Sales as a Means for Destabilising the Financial System

Under extreme market conditions with falling prices, short selling and CDS can also lead to further and excessive downward spirals in prices, causing the entire financial system to become destabilised. As a consequence, efforts were taken worldwide during the financial and sovereign debt crisis to adopt regulatory measures restricting or banning short sales and/or CDS. The predominant political agenda was to prevent speculation on falling prices of sovereign bonds and shares/bonds of financial institutions.[23] These measures were the result of the broad political consensus at that point in time that investors should be prohibited from profiting from an instability of the financial system.[24] 10

III. EU Regulation on Short Selling and Credit Default Swaps (SSR)

Prior to the enactment of the European regime the national approaches regarding the regulation of short sales varied significantly within the European Union. Whilst some Member States regarded the existing rules on market abuse to be sufficient with regard to the regulation of short sales, other Member States prohibited uncovered short sales entirely or enacted disclosure obligations for covered short sales.[25] 11

[20] See L. Teigelack § 15 para. 44; F.J. Payne, 13 EBOR (2012), p. 413, 416 et seq.

[21] G. Trüg, NJW (2009), p. 3202, 3206; D. Zimmer and T. Beisken, WM (2010), p. 485, 488.

[22] G. Trüg, NJW (2009), p. 3202, 3204; T.M.J. Möllers et al., NZG (2010), p. 1167, 1168.

[23] See the overview provided by A. Beber and M. Pagano, 68 J. Fin. (2013), p. 343, 354. See on the measures taken by EU Member States 1st ed. of this textbook, § 15 para. 8.

[24] See eg J. Payne, 13 EBOR (2012), p. 413, 415.

[25] Cf. ESMA, Measures Adopted by Competent Authorities on Short Selling, 9 February 2011, ESMA/2011/39a; see also J. Payne, 13 EBOR (2012), p. 413, 420 et seq.

12 The **Regulation on Short Selling and Credit Default Swaps (SSR)**[26] has rendered the various national regulations on short selling obsolete. The SSR entered into force in November 2012.[27] The Commission has since then endorsed **two Regulatory Technical Standards (RTS)** and one **Implementing Technical Standard (ITS)** drafted by ESMA[28] and enacted the **Delegated Regulation No. 918.**[29] All these measures put the provisions of the SSR into more concrete terms.

13 The EU framework for the regulation of short sellings and CDS thus consists of one Level 1 regulation and four Level 2 regulations. ESMA has additionally issued a '**Q&A list**' regarding the interpretation of the SSR[30] and **guidelines for exemptions of market makers and primary market operators** under the SSR.[31] However, a remarkable number of five Member States declared that they will not or only partially comply with said guidelines.[32] The European framework is complemented by national laws and guidelines by the national competent authorities

[26] Regulation (EU) No. 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps, OJ L86, 24 March 2012, p. 1–24. Cf. for a detailed analysis of the SSR cf. P.O. Mübert and A. Sajnovits, ZBB (2012), p. 2 et seq.

[27] Cf. Art. 48 SSR.

[28] Commission Delegated Regulation (EU) No. 826/2012 of 29 June 2012 supplementing Regulation (EU) No. 236/2012 of the European Parliament and of the Council with regard to regulatory technical standards on notification and disclosure requirements with regard to net short positions, the details of the information to be provided to the European Securities and Markets Authority in relation to net short positions and the method for calculating turnover to determine exempted shares, OJ L251, 18 September 2012, p. 1–10; Commission Delegated Regulation (EU) No. 919/2012 of 5 July 2012 supplementing Regulation (EU) No. 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps with regard to regulatory technical standards for the method of calculation of the fall in value for liquid shares and other financial instruments, OJ L274, 9 October 2012, p. 16–17; Commission Implementing Regulation (EU) No. 827/2012 of 29 June 2012 laying down implementing technical standards with regard to the means for public disclosure of net position in shares, the format of the information to be provided to the European Securities and Markets Authority in relation to net short positions, the types of agreements, arrangements and measures to adequately ensure that shares or sovereign debt instruments are available for settlement and the dates and period for the determination of the principal venue for a share according to Regulation (EU) No. 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps, OJ L251, 18 September 2012, p. 11–18. See under F. Walla § 4 para. 14 et seq. for an analysis of the function and legal classification of ITS and RTS.

[29] Commission Delegated Regulation (EU) No. 918/2012 of 5 July 2012 supplementing Regulation (EU) No. 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps with regard to definitions, the calculation of net short positions, covered sovereign credit default swaps, notification thresholds, liquidity thresholds for suspending restrictions, significant falls in the value of financial instruments and adverse events, OJ L274, 9 October 2012, p. 1–15.

[30] ESMA, Questions and Answers—Implementation of the Regulation on short selling and certain aspects of credit default swaps (2nd Update), 29 January 2013, ESMA/2013/159.

[31] ESMA, Guidelines Exemption for market making activities and primary market operations under Regulation (EU) No. 236/2012 of the European Parliament and the Council on short selling and certain aspects of Credit Default Swaps, 2 April 2013, ESMA/2013/74.

[32] These Member States are Denmark, France, Germany, Sweden and the UK, cf. N. Moloney, *EU Securities and Financial Markets Regulation*, p. 934 et seq.; R. Veil, ZGR (2014), p. 544, 591.

(NCAs)[33] which govern the national administration and the enforcement of the SSR as well as the applicable sanctions for violations of the SSR.[34]

This **multi-layer regulatory framework** is a blueprint for the future of European capital markets law, consisting of a complex interaction of rules made by the European legislator, the Commission and ESMA. These rules are applied and enforced by the NCAs on the basis of further national legislation. Whilst this variety of legal sources might at first appear complicated in legal practice,[35] only such a tight legal framework can result in a true harmonisation of law in Europe. 14

1. Scope of the SSR

According to its Article 1(1), the SRR applies to all financial instruments that are admitted to trading in the EU and to all derivatives relating to such instruments. The SSR thus also applies to transactions outside EU trading venues. Moreover, the SSR is applicable to debt instruments issued by the EU or a Member State as well as derivatives relating thereto. 15

The SSR is not applicable to financial instruments which are only traded on MTFs.[36] According to Article 16 SSR it furthermore does not apply to shares which have their main place of trading (Article 2(1)(o) SSR) outside the EU.[37] Pursuant to Article 17 SSR, certain market participants, ie market makers, primary market operators and certain entities whose sole purpose is the protection of the stability of the EU financial system (ie the ESM/ESFS and equivalent national institutions), are to a large extent exempt from complying with the rules of the SSR.[38] ESMA 16

[33] See e.g the FAQ issued by the German BaFin, Häufige Fragen zum Verbot ungedeckter Leerverkäufe in Aktien und öffentlichen Schuldtiteln gemäß Art. 12 et seq. der Verordnung (EU) Nr. 236/2012 über Leerverkäufe und bestimmte Aspekte von Credit Default Swaps (EU-LeerverkaufsVO), 10 August 2015, available at: www.bafin.de/SharedDocs/Veroeffentlichungen/DE/FAQ/faq_leerverkaufsVO_verbot.html, or the guidelines published by the Swedish Finansinspektionen, Guidelines for determining a special fine for certain breaches of the EU Short Selling Regulation, November 2014, FI Ref. 14-13923.

[34] For example, the German *Gesetz zur Ausführung der Verordnung (EU) Nr. 236/2012 des Europäischen Parlaments und des Rates über Leerverkäufe und bestimmte Aspekte von Credit Default Swaps*, Federal Gazette (2012), p. 2286 or the UK Financial Services and Markets Act 2000 (Short Selling) Regulations 2012, Statutory Instruments 2012, No. 2554.

[35] Accordingly, some critique on the complexity of the framework has been raised in legal literature, see U.H. Schneider, AG (2012), p. 823, 824.

[36] P.O. Mülbert and A. Sajnovits, ZBB (2012), p. 266, 269; H. Krüger and V. Ludewig, WM (2012), p. 1492, 1946.

[37] The NCAs create a list of shares that qualify for a main place of trading outside the EU for the trading venues under their supervision. The NCAs have to consider the criteria of Art. 6 RTS No. 826 (method of calculation) and Art. 9 ITS No. 827 (period of time to be used for the calculation) when creating such list. Under Art. 10 and 11 ITS No. 827 these lists are to be submitted to ESMA which publishes them. The current consolidated list for all Member States can be downloaded under www.esma.europa.eu.

[38] See on this V. Ludewig and M.C. Geilfus, WM (2013), p. 1533 et seq.

has issued guidelines on the interpretation of Article 17 SSR.[39] However, as already noted, five Member States (Denmark, Germany, France, Sweden and the United Kingdom) have decided to only partially comply with ESMA's guidelines.

2. Rules on Short Sales

17 The SSR in principle stipulates a two-fold approach on the regulation of short sales. It (i) **prohibits uncovered short sales** and (ii) introduces **specific transparency requirements** for all other (ie covered) short sales. The legal rationale behind this approach is that uncovered short sales might result in delivery failures and in a particularly strong decrease of market prices. As opposed to this, covered short sales are not as critical for the market, it thereby being sufficient for the NCAs and/or the market to be aware of the existence of certain net short positions.

(a) Prohibited Transactions

18 Pursuant to Article 12 SSR, **uncovered short sales** in shares are generally prohibited.[40] The prohibition also refers to **intra-day transactions**.[41] The scope of this prohibition is first determined by Article 2(1)(b) SSR. Under this provision, a short sale is **defined** as a sale where the seller does not own the instrument sold at the time of entering into the sales agreement including a sale seller where has borrowed or agreed to borrow the instrument for delivery at settlement. Article 3 Delegated Regulation No. 918 clarifies that the ownership may also result from an **economic attribution** of financial instruments. Article 2(1)(b) SSR excludes (i) sales by either party under a repurchase agreement where one party has agreed to sell the other a security at a specified price with a commitment by the other party to sell the security back at a later date at another specified price; (ii) transfers of securities under a securities lending agreement; and (iii) future contract or other derivative contracts where it is agreed to sell securities at a specified price at a future date from being considered a short sale under the SSR.

19 According to Article 12 SSR short sales of **shares** under said definition are only legal if they qualify as covered short sales. A transaction can be qualified as a covered short sale if the seller has ensured that he actually holds the shares at the time of the transaction settlement. According to Article 12(a)–(c) SSR this can be achieved if the short seller (i) has borrowed the shares or has made alternative provisions resulting in a similar legal effect, (ii) has entered into an agreement

[39] ESMA/2013/74 (fn. 31). Cf. ESMA's overview on the Member States' compliance with these guidelines, 2 February 2016, ESMA/2016/205.

[40] It remains unclear whether this also applies to intraday transactions. Consenting opinion M. Lorenz, AG (2010), p. R 511, R 512; dissenting opinion T.M.C. Möllers et al., NZG (2010), p. 1167, 1170.

[41] Before the SSR came into force some Member States (eg Germany) excluded intra-day transactions from their ban of uncovered short sales.

to borrow shares or has another enforceable claim[42] under contract or property law to be transferred ownership of a corresponding number of securities of the same class so that settlement can be effected when it is due or (iii) has made an arrangement with a third party under which that third party has confirmed that the share has been located and has taken measures vis-à-vis third parties necessary for the natural or legal person to have a reasonable expectation that settlement can be effected when it is due (**locate agreement**). Detailed rules that substantiate the types of agreements, arrangements and measures that adequately ensure that shares will be available for settlement are laid down in Articles 5–8 of Implementing Technical Standard No. 827.[43]

Moreover, Article 13 SSR prohibits uncovered short sales of **sovereign debt**, ie in particular in bonds issued by state entities of the Member States or the EU. All issuers whose debt instruments are affected by this prohibition are defined by Article 2(1)(d)(f) SSR. Accordingly, debt instruments issued by the EU itself, a Member State (or its respective governmental departments, agencies or special purpose entities), in the case of a federal Member State, any member of the federation (such as the German and Austrian *Länder* or the Belgian *Gewesten/Régions*) as well as debt issued by the ESM/EFSF or the European Investment Bank fall within the scope of Article 13 SSR. Debt instruments issued by municipalities are, however, not covered by the prohibition. 20

The prohibition of short sales relating to sovereign debt under Article 13 SSR is subject to same exceptions as the short selling of shares. In addition, under Article 13(2) SSR the prohibition does not apply if a transaction serves to hedge a long position[44] in debt instruments of an issuer whose pricing has a **high correlation** with the pricing of the relevant bond. 21

Under Article 13(3) SSR and Article 22(2) Delegated Regulation No. 918 the prohibition of uncovered short sales of sovereign debt instruments may be **temporarily suspended** for up to six months by a NCA if the liquidity of a sovereign debt instrument has decreased significantly. This is deemed to be the case if the monthly turnover of a sovereign debt instrument is lower than the fifth percentile of the monthly volume traded during the previous twelve months provided the NCA notifies the ESMA and the other NCAs prior to the suspension. Such a suspension may be renewed multiple times with a maximum duration of further six months. 22

(b) Transparency Obligations

The SSR introduced **transparency obligations** for persons holding **net short positions**. The rules for disclosure of short positions for **shares** follow the model of 23

[42] See on the details of this requirement T. Wandsleben and V. Weick-Ludewig, ZBB (2015), p. 395 et seq.

[43] See on the scope of these exemptions A. Sajnovits and V. Weick-Ludewig, WM (2015), p. 2266 et seq.

[44] See para. 28 on the definition of a long position under the SSR.

German law at the time before the SSR became effective.[45] Under Article 5(1)(2) SSR a market participant must notify the relevant NCA of any net short position that reaches, exceeds or falls below a percentage that equals 0.2% of the value of the issued share capital of the company concerned and any 0.1% above that. If the net short position reaches, exceeds or falls below a threshold of 0.5% of the issued share capital, Article 6(1)(2) SSR requires that this fact is disclosed to the public.

24 Accordingly, the SSR stipulates for a **two-fold disclosure system,** following the rationale that a short position of more than 0.5% is so important that the market should be informed, whereas short positions of 0.2%-0.5% do not have such a severe impact on the market. Hence, a disclosure vis-à-vis the NCAs on such short positions is sufficient. The Commission is empowered to modify the aforementioned thresholds by means of a delegated act should the financial markets require such adjustments.[46]

25 Under Article 7 SSR **net short positions in sovereign debt** are to be disclosed to the NCAs only. Unlike with regard to short sales of shares, the SSR does not stipulate any duties of disclose to the public with regard to such short positions.[47] Article 21 Delegated Regulation No. 918 includes the relevant thresholds for the notification duty vis-à-vis the NCAs.

26 The applicable **initial threshold** depends on the total volume of all debt issued by a sovereign issuer: For issuers with an outstanding debt of less than € 500 billion the threshold is fixed at 0.1%, while the relevant figure for all other issuers is 0.5% (Article 21(7) Delegated Regulation No. 918). ESMA releases a continuously updated list which gathers the respective applicable thresholds for all sovereign issuers.[48] Article 21(8) Delegated Regulation No. 918 introduces **incremental notification thresholds** at each 0.05% above the initial notification threshold of 0.1%, starting at 0.15%, and at each 0.25% above the initial threshold of 0.5%, starting at 0.75%.

27 The key term of the transparency obligations under the SSR is the term **net short position**. Article 3(4) SSR defines this term as the balance between a short position under Article 3(1) SSR and a long position under Article 3(2) SSR.

28 A **long position** under Article 3(1) SSR equals the aggregate amount of all shares/sovereign debt instruments held and all financial instruments held by which the holder profits from a price increase of the underlying share/debt instrument. According to Article 5(2) SSR in connection with Annex I Delegated Regulation No. 918 such financial instruments can be, inter alia, derivatives, futures, index instruments or stakes in packaged retail or professional investment products. This

[45] See the (meanwhile repealed) §§ 30h et seq. *Wertpapierhandelsgesetz* (WpHG).

[46] Art. 5(4) SSR; Art. 6(4) SSR.

[47] Critical on this O. Juurikkala, 9 ECFR (2012), p. 307, 317.

[48] The list is available at www.esma.europa.eu/net-short-position-notification-thresholds-sovereign-issuers.

means the rules also encompass short positions accumulated over-the-counter (OTC). Under Article 3(5) SSR also positions in debt instruments of a sovereign issuer whose pricing is **highly correlated** to the pricing of another sovereign debtor shall be considered as if they were a long position. Article 8(5)–(7) Delegated Regulation No. 918 contains detailed rules for determining such high correlation.

29 A **short position** can either result from a short sale of a share/debt instrument issued by a sovereign issuer or a transaction which creates or relates to a financial instrument where the effect of the transaction is to confer a financial advantage in the event of a decrease in the price of the share or debt instrument upon the market participant. The rules for the calculation of short positions, again, also encompass short positions accumulated OTC.[49] The aggregate amount of the aforementioned positions equals the short position of a market participant under Article 3(2) SSR.

30 Article 7 Delegated Regulation No. 918 further clarifies that it is irrelevant for the purpose of determining a net short position whether a cash settlement or physical delivery of underlying assets is agreed and that short positions on financial instruments that give rise to a claim to unissued shares, subscription rights, convertible bonds and other comparable instruments shall not be considered as short positions when calculating a net short position. All relevant positions for determining the long or short position are to be considered with their **delta-adjusted value** under Articles 10, 11 and Annex II Delegated Regulation No. 918. The delta value describes the impact a price change of a financial instrument has in relation to a direct investment in a share or debt instrument (which respectively have a delta value of one). As a consequence, all financial instruments are considered in accordance with their economic impact.[50]

31 Finally, under Article 3(4), (5) SSR the long position is subtracted from the short position. The result is divided through the total amount of issued shares/the nominal value of all outstanding debt. The final net short position is expressed as a **percentage rate**. The following **formula** can be used to calculate a net short position:

$$\frac{(\textit{Short position}) - (\textit{Long position})}{\textit{Total amount of issued shares/total volume of outstanding debt}}$$

32 The disclosure procedure for net short positions is governed by Article 9 SSR and Articles 2 and 3 Regulatory Technical Standard No. 826 as well as Article 2 Implementing Technical Standard No. 827. The Annexes of the two latter legal acts contain templates for the public disclosure and the notification of a net short position

[49] E. Howell, 12 ECL (2015), p. 79, 81; R.B. Elineau, 8 Intl. L. & Mgmt. Rev. (2012), p. 61, 72.
[50] Cf. J.C. Hull, *Options, Futures, and other Derivatives*, p. 247 et seq., 360 et seq.; P. O. Mülbert and A. Sajnovits, ZBB (2012), p. 266, 277 f.

vis-à-vis the NCAs. The relevant time for the calculation of a net short position is at midnight at the end of the trading day on which the person holds the relevant position. Any disclosure necessary is required to be made not later than at 15:30 on the following trading day.

33 The disclosure rules of the SSR will further be complemented by Article 26(3)-(8) MiFIR in the future. Under this provision, investment fi rms are under an obligation to flag transactions that qualify as a short sale under the SSR to ESMA after the execution of such transactions.

(c) Rules for Central Counterparties (CCP)

34 In order to prevent settlement failures, Article 15 SSR stipulates further requirements for central counterparties (CCP)[51] that provide clearing services for shares. Such CCP shall ensure that procedures are in place which guarantee a **buy-in of shares** if a seller is not able to deliver the shares for settlement within four business days after settlement date. If a buy-in of the shares for delivery is not possible, compensation shall be paid to the buyer based on the value of the shares to be delivered at the delivery date plus an amount for losses incurred by the buyer as a result of the settlement failure.

35 The CCP must further ensure that the seller who fails to settle reimburses the expenses for the buy-in or compensation is paid to the buyer. Under Article 15(2) SSR the CCP has to make sure that in case of a failure to deliver share the seller makes daily payments for each day that the failure continues. The daily payments shall have a deterring effect.

[51] See on the regulation of CCP under the MiFID II/MiFIR regime R. Veil § 1 para. 45.