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REGULATORY BODIES IN EC SECURITIES MARKETS

BETWEEN

SELF- AND STATUTORY REGULATION :

INVESTOR PROTECTION AND THE NEW FINANCIAL
INTERMEDIARIES.

A STUDY OF THE FRENCH, ITALIAN AND BRITISH
SYSTEMS

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Ph. D. Thesis

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Summary

Since the 1970s securities markets in the EC have undergone significant reforms. The use of new information and communication technologies and above all the envisaged integration of the Community financial markets have been strong driving forces behind the developments. Considerations of competition between the national securities markets in the emerging single space of the EC have also motivated the reforms and, not least, better investor protection has been a point of considerable importance not to be neglected in a progressively bigger and complex market.

The thesis analyses and assesses new legislation in three of the currently 12 member states (France, Italy and the United Kingdom) in terms of the impact of self-regulatory and statutory rules and bodies on financial intermediaries with investor protection in mind.

Eföre referring to the background of securities regulation in the selected three member state, the thesis examines, with, whenever relevant, reference to the situation in the USA, the notions of self-regulation, regulation with transition to deregulation, re-regulation and lastly "new regulation". Professional deontology is discussed as a regulatory element in the practice of the intermediaries, again with investor protection in mind.

Dealing with the newly established regulatory bodies in the selected three member states, the thesis analyses the respective functions and effectiveness of the CQB in France, CONSOB in Italy and the SIB in the United Kingdom. The last two chapters of the thesis concentrate on the question of investor protection in the light of the new regimes with regard to self-regulatory and statutory standards.

F o r e w o r d

Acknowledgement and gratitude are due to Dr. W.H. Balekjian for all the supervisory care he gave and the intellectual interest he generated to accompany my interest in the topic of the thesis; to Professor R. Jack for very valuable guidance towards questions and issues of vital importance. I owe thanks to Professor Doctor Noreen Burrows for all the encouragement and support she gave. I wish to thank not least Ms. Marie-Claude Robert, of the COB in France, Professor Mario Bessone, of the CONSOB in Italy, and Mr Michael Blair, of the SIE in the United Kingdom for all the interest and care with which they dealt with my multiple enquiries.

I also wish to thank this University of Glasgow where I spent much time and where I discovered links which have existed between the British and the Sicilians, as customs and traditions that the Normans brought with them to both countries in the 11th century.

Last and not least I am most grateful to my husband, who inspired confidence in my studies and as always encouraged me with inexhaustible support, and to my family, who gave to me that curiosity and interest which I have cherished towards cultures different from ours in Italy.

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- e. From "Equivalent" to "Adequate"
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E C L E G I S L A T I O N

E C D I R E C T I V E S :

a) O N S E C U R I T I E S R E G U L A T I O N

the "Admissions Directive"

- Directive 79/279/EC of 5 March 1979, coordinating the conditions for the admission of securities to official stock exchange listing, (OJ 1979, L 66, 15 March 1979) amended by directive 82/148 (OJ 1982, L52).

The Listing Particulars Directive

- Proposed Directive of October 5, 1972 (J.O. C 131/61, December 13, 1972)

- Amended by proposed Directive of 10 December 1975

- Directive 80/390/EC of 17 March 1980 (OJ 1980, L 100, 17 April 1980), coordinating the requirements for the drawing-up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing; Amended by Directive 82/148/EC, - 87/345/EC, - 90/211/EC.

The Mutual Recognition Directive

- Directive 87/345/EC of 22 June 1987, (OJ 1987 L 185/81) amended by Directive 80/390/EC of 17 March 1980 to incorporate the principles of mutual recognition and home state control.

The Interim Reports Directive

- Directive 82/121/EC of 15 February 1982 (OJ 1982, L

48), on information to be published on a regular basis by companies the shares of which have been admitted to official stock exchange listing; Amended by Directive 82/148.

The Public Offer Prospectus Directive

- Directive 89/298/EC of 17 April 1989 (OJ 1989, L 124/8, May 5, 1989), coordinating the requirements for drawing up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public.

The integration Directive

- Directive 90/211/EC of 23 April 1990 (OJ 1990, L 112), amended by Directive 80/390/EC in respect of the mutual recognition of public offer prospectuses as stock exchange listing particulars.

The UCITS Directive

- Directive 85/611/EC of 20 December 1985 (OJ 1985, L 375) on the co-ordination of laws, regulations, and administrative provisions relating to undertakings for collective investment in transferable securities, amended by directive 88/220/EC of 22 March 1988 (OJ 1988 L100)

b) REGULATING FINANCIAL INTERMEDIARIES

First Banking Directive 77/780 of 12 December 1977

Second Banking Directive 89/646 of 15 December 1989 (OJ L386/1)

The Investment Services Directive (ISD) 93/22 of 10 May

1993, (OJ L141/27)

The Capital Adequacy Directive (CAD) of 15 March 1993 (OJ L141/1)

c) REGULATING MARKET BEHAVIOUR

The Insider Dealing Directive of 13 November 1989 (OJ L334/30)

FRENCH LEGISLATION

- 1966 Loi n. 66-537, July 24, 1966, reforming Company law.
- 1967 Ordonnance n. 67-833, 28 September 1967.
- 1968 Décret n. 68-23, 3 January 1968, on COB's organisation.
- 1970 Loi n. 70-1208, 23 December 1970 (J.O. of 24 December 1970)
Loi n. 70-1283, 31 December 1970 (J.O. of 31 December 1970)
Loi n. 1299, 31 December 1970
Loi n. 70-1322, 31 December 1970
- 1972 Law of January 3, 1972
- 1973 Décision générale, 27 February 1973, sur la réglementation des cessions de blocs de contrôle
- 1978 Loi n. 78-741, 13 July 1978 (OPA);
- 1979 Loi n. 79-12, 3 January 1979 (SICAV)
Loi n. 79-594, 13 July 1979, on common investment funds.
- 1981 Loi n. 81-1162, 30 December 1981.
- 1983 Loi n. 83-1 of 3 January 1983, (J.O. of 4 January 1983)
Décret n. 83-363, 2 May 1983, creating a second market.

- 1984 Loi of 1st March 1984.
- 1985 Loi n. 85-11, 3 January 1985
Loi n. 85-695, 11 July 1985 (J.O. of July 12,
1985) creating the MATIF
CAC System created (marché continué informatisé)
Loi of 11 July 1985
Loi of 14 July 1985
Loi n. 85-1321, 14 December 1985 (J.O. of 15
December 1985)
Loi 31 December 1985.
- 1986 Loi, 2 July and 6 August 1986, on privatisations
MATIF opened on 20 February 1986.
- 1987 Group on Deontology formed, chaired by M. Brac
de la Perrière
Loi n. 87-416, 17 June 1987, on savings.
Loi n. 87-1158 on MATIF
MONEP opened.
- 1988 Loi n. 88-70, 22 January 1988 (J.O. of 23 January
1988)
Tends communs de créances formed (loi of 23
December 1988)
- 1989 Loi n. 89-531, 2 August 1989, (J.O. of 4 August
1989).
- 1990 Arrêté of 23 March 1990.
- 1992 Loi n. 92-666 of 16 July 1992.

ITALIAN LEGISLATION

- 1974 Decree-Law of 8 April 1974, n. 95, converted into the Law of 7 June 1974 n. 216.
- 1975 D.P.R. of 31 March 1975, n. 136.
D.P.R. of 31 March 1975, n. 137.
D.P.R. of 31 March 1975, n. 138.
- 1977 Law of 23 February 1977, n. 49.
- 1983 Law of 23 March 1983, n. 77.
- 1985 Law of 4 June 1985, n. 281.
- 1986 Law of 19 June 1986, n. 289.
- 1987 D.L. of 16 February 1987, n. 27, converted into the Law of 13 April 1987 n. 40.
D.P.R. of 29 December 1987, n. 556.
- 1988 D.P. Tesoro of 8 February 1988.
- 1991 Law of 2 January 1991, n.1 (G.U. n.3 of January 4, 1991)
Law of May 17, 1991, n. 157.
- 1992 D.Lgs. of January 25, 1992, no 83.
D.Lgs. of January 25, 1992, no 84 (SICAV)
D.L. of January 25, 1992, no 85.
D.Lgs. of January 25, 1992, no 86
D.L. of January 27, 1992, no 89.
Law of February 18, 1992, no 149 (G.U. n. 43 of February 2, 1992)

- 1993 D.Lgs. of April 1993, no 124 (Pension Funds)
Law of August 14, 1993, n. 344 (G.U. n. 205
of September 1, 1993)
- 1994 Law of January 25, 1994, no 86 (Estate Funds)
D.M. of February 24, 1994 (G.U. no 50 of March 2,
1994)
CONSOB Regulation N. 8850 of December 9, 1994
(G.U. no. 295 of December 9, 1994)

UNITED KINGDOM CHRONOLOGY AND LEGISLATION

- 1953: Prevention of fraud (investments) Act
- 1968: The City Code (March 1968)
- 1979: Stock Exchange rulebook referred to by OFT to Restrictive Trade Practices (RTP) Court (February 1979)
The Banking Act
- 1980 The Wilson Committee
- 1981 Professor Gower is appointed by the government to undertake a review of investor protection.
- 1982 The first publication by Professor Gower: "Review of Investor Protection" (January 1982);
- 1983 RTP case against stock exchange dropped after agreement between Secretary of State for Trade and Chairman of Stock Exchange on reform relating to the Stock Exchanges practices (September 1983)
- 1984 Second publication of Professor Gower's "Review of Investor Protection" (January 1984)
- 1985 Publication by Professor Gower of a White Paper (Financial Services in the United Kingdom: A New Framework for Investor Protection) (June 1985);
The Securities and Investment Board (SIB) incorporated (June 1985).
The SIB's first Regulation of Investment Business (December 1985).

- The Financial Services Bill introduced (Autumn 1985);
- 1986 Merger of the MICDB and SIB to form a single regulatory authority, the SIB (July 1986);
The "Big Bang", October 27 1986;
The Royal Assent extended to the Financial Services Bill (November 7, 1986);
- 1987 SIB's statement on its approach to its regulatory responsibilities (February 1987).
The first Delegation Order made by the DTI granting SIB most of its powers under the 1986 Act to develop and operate the regulatory system (May 18, 1987).
DTI responsibility for unit trust given to the SIB (Summer 1987).
Five SRD applications lodged with the SIB to assess the 'equivalence of their rulebooks and other requirements for recognition'.
The first tranche of SIB's rules established, with further separate rules instruments made by the end of May 1986.
Five SRD's recognised (Dec '87/Apr. '88).
- 1988 Nine RPB's recognised (Jan/Feb 1988).
'P Day' as the deadline for firms to apply for SRD membership or SIB authorisation with interim authorisation before processing applications. Over 13,000 firms apply.
'A Day' - for inaugurating the new live regulatory system (April 29, 1988).
The Investors Compensation Scheme introduced (August 1988)
The government announced it would legislate so

that s. 62 (actions for damages) of the FSA could not be applied to professional and business investors (November 1988).

'Conduct of Business Rules; A New Approach' published by the SIB (November 1988).

1989 A discussion paper ('Regulation of the Conduct of Investment Businesses: a Proposal') published by the SIB, including proposals for the two upper tiers of principles and designated (or 'core') rules (November 1989).

1990 The final text of the 10 principles published by the SIB (March 1990); Principles in force in April 1990.

1991 The final version of its core rules published by the SIB (January 1991).
Irregularities in London FOX's property futures contract market (Oct/Nov, 1991).
Details of Robert Maxwell's thefts from pension funds within his group emerged. Programme of investigation and review of IMRO and other inquiries into aspects of the 'Maxwell affair' set in train by SIB and other authorities.

1992 Merger of two RIEs, LIFFE and LTOM, resulting in a total of six RIEs.
Publication of Sir Kenneth Clucas' Report recommending the formation of a new retail SRO.
The PIA Formation Committee subsequently established (March 1992).
The Personal Investment Authority Limited formed (December 17, 1992).

- 1993 Making the Two Tier System Work, by A. Large, published (May 1993).
- 1994 The PIAs approach to Regulation and the Memorandum and Articles of Association published (February 1994).
Revocation of Recognition of FIMBRA and LAUTRO as Self-Regulatory Organisations. Report to the SIB (June 1994).
PIA recognised by the SIB (July 17, 1994).
SIB published the Discussion Paper on Implementation of the ISD and CAD published by the SIB (July 1994).
SIB's consultative paper on Designation of the Core Conduct of Business Rules, the Client Money Regulations and the Financial Supervision Rules published (August 1994).
The Pensions Transfer and Opt Out Review SIB Factsheet (October 1994).

ABBREVIATIONS

- A.A.I. - Autorité Administrative Indépendante
- ASFFI - Association des Sociétés Financières et Fonds Français d' Investissement
- BOARD - Securities and Investment Board
- CAD - Capital Adequacy Directive
- CBV - Conseil des Bourses de Valeurs
- CIRC - Comitato Interministeriale per il Credito e il Risparmio
- CMT - Conseil de Marché à Terme
- CNCC - Compagnie Nationale des Commissaires aux Comptes
- COB - Commission des Opérations de Bourse
- COB Report - Commission des Opérations de Bourse. Rapport au Président de la République
- COMMISSION - COB
- CONSOB - Commissione Nazionale per le Società e la Borsa
- CSI - Council for the Securities Industry
- DIE - Designated Investment Exchange

- D.L. - Decreto Legge
- D.Lgs. - Decreto Legislativo
- D.M. - Decreto Ministeriale
- D.P.R. - Decreto Presidente Repubblica
- DTI - Department of Trade and Industry
- EC - European Community
- EEA - European Economic Area
- EEC - European Economic Community
- EU - European Union
- FIMBRA - Financial Intermediaries, Managers' and
Brokers' Regulatory Association
- FNACI - Federation Nationale des Clubs
d'Investissement
- FSA - Financial Services Act 1986
- Gaz. Pal. - Gazette du Palais
- G.U. - GAZZAETTA Ufficiale
- HMT - Her Majesty's Treasury
- IAA - Independent Administrative Authority
- ICD - Investor Compensation Directive

- ICS - Investors' Compensation Scheme
- IMRO - Investment Management Regulatory
Organisation
- IOSCO - International Organisation of Securities
Commission
- ISD - Investment Services Directive
- J.C.P. - Semaine juridique.
- J.O. - Journal Officiel.
- L. - legge (Law)
- Lautro - Life Assurance and Unit Trust Regulatory
Organisation
- LAW No 1/1991 - Law No 1 of January 2, 1991
- LAW No 216/1974 - Law No 216 of June 7, 1974
- LIFFE - The London International Financial Futures
Exchange.
- LSE - London Stock Exchange.
- MATIF - Marché à Terme International de France
- MIF - Mercato Italiano Futures
- OECD - Organisation for Economic Cooperation and
Development

- OFD - Own Funds Directive
- O.J. - OFFICIAL Journal
- OPCVM - Organisme de Placement Collectif en Valeurs
Mobilieres
- ORDINANCE of 1967 - the ordinance of September 28, 1967
- PIA - The Personal Investment Authority
- Post-BCCI - Draft Directive on the Reinforcement of
Directive Prudential Supervision of Credit
Institutions, Investment firms and Insurance
Companies
- Rapport - Rapport Annuel de la Commission des
Opérations de Bourse.
- RB - Recognised Body
- RCH - Recognised clearing House.
- Rev.trim.dr.civ. - Revue trimestrielle de droit civil.
- Rev.trim.dr.com. - Revue trimestrielle de droit
commercial.
- Rev. Dr. Pub. - Revue de Droit Publique.
- RIE - Recognised Investment Exchange
- Riv. Soc. - Rivista delle Società

- RPB - Recognised Professional Body
- SCPI - Société Civile de Placement Immobilier
- SEA - Single European Act
- SEC - Securities and Exchange Commission (USA)
- SFA - Securities and Futures Authority
- SFO - Serious Fraud Office.
- SI - Statutory Instrument
- SIB - Securities and Investment Board
- SIM - Società di Intermediazione Mobiliare
- SRO - Self Regulating Organisation
- SRD - Solvency Ratio Directive
- TAR - TRIBUNALE AMMINISTRATIVO
- TSA - The Securities Association
- The Stock Exchange - The International Stock Exchange of
the United Kingdom and the Republic of
Ireland Limited

P A R T IC h a p t e r 1Introduction : Purpose, Contents and Method

Since the 1980s securities markets in the EC have undergone, in the wake of reforms, significant and quite outstanding changes in their history and development. As important factors, new information and communication technologies, the progressive integration of Community financial markets, access by tens of thousands of new participants in stock market transactions, involving highly respectable numbers of and not always knowledgeable small investors, have transformed the existing markets into increasingly multidimensional and growingly complex ones. Investor protection, particularly the protection of small investors, has been a preoccupying point to consider and promote. The functions and responsibilities of hitherto existing regulatory and supervisory bodies have had to be correspondingly re-assessed. New approaches had to be shaped in the light of various self-regulatory and statutory standards or a mixture of them with the need for reliable standards of professional conduct and practice applicable to new financial intermediaries as important participants, if not pillars, in the proper functioning of stock markets.

Delimiting the topic with due regard to available spaces, the present thesis concentrates on developments in three of the 15 EC member states : France, Italy and the United Kingdom, and looks at investor protection and as related thereto the regulation of the new financial intermediaries in the light of self-regulatory and statutory standards. It looks at the situation in terms of the following basic questions :

- (i) How adequate has been, after reforms initiated in the 1980s, the respective regulation of the conduct and responsibilities of the intermediaries? Which bodies are entrusted with their supervision and control?
- (ii) What assumptions and principles characterise the respective regulatory and supervisory systems affecting the intermediaries? To what extent are they based in a dominantly centralised state or governmental, or self regulatory approach, or varyingly on a coordination of both approaches?
- (iii) How do the respective regulatory systems promote and maintain the trust and confidence of the investing public, not least of small investors?

In the thesis reference is made to EEC/EC legislation. While national regulation of stock markets in EC member states may deal with the structure and adequate functioning of supervisory bodies, EC legislation is in charge of promoting the progressive integration of the national markets with standards of fair and workable competition between them.

After the (present) introductory Chapter 1, the background of stock exchanges in France, Italy and the United Kingdom is surveyed in chapter 2, with some reference to the situation in the USA for comparative purposes. Chapter 3 focuses on a discussion of the notions of self-regulation, deregulation, re-regulation and "new regulation". The discussion is based on the consideration that regimes and the regulation of securities markets are inspired also from philosophies of centralised government regulation, or of liberal self-regulation, or of total deregulation, or of a mixture and individually adopted balance between them. A mixed approach to regulation may be due to historical reasons or deliberate choice decisions. Whatever the outcome, the

different notions of regulation can be helpful for a realistic assessment of the way securities markets are currently regulated in France, Italy and the United Kingdom. Professional deontology, as a non-negligible regulatory element in the operation of the securities markets, particularly in regimes resting dominantly on standards of self-regulation (as in the United Kingdom in the past), is referred to in Chapter 4, concluding therewith Part I of this thesis.

Chapters 5-7 in Part II survey the new regimes of securities regulation respectively in France, with the COB; Italy, with the CONSOB; and the United Kingdom with the SIB, which since its inception has been the subject of an ongoing debate and suggestions for improvements. With the materials of Chapters 5-7 as a background, Chapter 8, concluding Part II of this thesis, looks at investor protection in the EC in a comparative light. The comparative approach serves the purpose of greater emphasis

as to the merits and possible weaknesses and characteristics of each of the (in a way mutually competing) national regimes in France, Italy and the United Kingdom.

In Part III, conclusions in Chapter 9 assess the lessons that can be extracted from the new developments in the selected three EC member states, not least with the interests of the investor, particularly the small investor, in mind.

As for the method underlying the contents of the thesis, it obviously involves a comparative approach supported by reference to primary as well as secondary legislative sources and literature by leading authors or experts.

Chapter 2

Historical Background

Stock Exchanges in France, Italy and the United Kingdom

Depending on the definition of stock exchanges or stock markets, their beginnings may be traced in Europe in the light of available historical sources and documents, up to ancient Rome,¹ while stock markets in the sense and functions attached to them in current economic and financial life are to be treated as creations of the commercial and industrial age in approximately the last 150-200 years.² The notion and function of intermediaries are also of relatively recent development. They have developed in the wake of the increasingly more and more complex functions of securities markets with more and more participants as investors and investment users. Lastly, the regulation of securities markets and the role of intermediaries played therein have not least been influenced by a centralistic or governmental or very markedly statutory regulation, for example in France and Italy, and a hitherto dominantly self-regulatory approach in the United Kingdom. This makes an understanding of the principles (or philosophy) which underlie debate on and reforms of securities markets in the slowly emerging singly EC financial markets easier.

Stock markets have become however more than a simple meeting place for investors and borrowers. In modern times the complex structure and system of available shares and stocks, the different types and categories of investors and borrowers (small investors, institutional investors; corporate bodies, governments, as examples), the diversity of transactions and operations involve the

participation of a large number of persons with expertise and correspondingly allocated functions, and, not least, trust invested in them. Most important among them are, for the purpose of the present thesis, the intermediaries whose functions necessitate not only an essential amount of expertise, but also and no less importantly elements of personal integrity and professional conduct deserving the trust of investors. It is noteworthy how the standards of professional expertise and conduct applicable to intermediaries have in the last 150 years become more and more complex and increasingly demanding, particularly in large and complex markets as those in the USA, the emerging single market of the EC and in other financially leading countries of the world. The stock market fulfils a public function for the benefit of investors, on the one hand, and admitted or listed corporate bodies or companies which are authorised or approved to issue shares, bonds, debentures etc. on the other. Therewith the economic and commercial system benefits by attracting available capital resources to where they are needed; investors benefit with returns on their lent or invested capital and the recipients of investment benefit by having access to investment resources needed for their financial activities. Francis Bacon, in his book on a Decalogue for Travellers, recommends to discover a visited country all the more by visiting also its stock markets and exchanges.³

While in English, "securities market", "exchange market", "stock market" are used, in many European languages the word "bourse" (in French) or its equivalents are used : "borsa" in Italy, "beurs" in Belgium and The Netherlands, "bors" in Scandinavia, "Borse" in Germany etc. The root of this continental European word has been traced to the 13th century, to the medieval Flemish town of Bruges (now in Belgium), to the

house of a certain merchant Van de Buerse. There, then a prosperous centre of the Low Countries, merchants gathered in front of the Van de Buerse family house to engage in trading, lending and borrowing transactions, for which certificates (or titles) were issued.⁴

The name of the family subsequently became identified with the name where similar transactions were effected: a "bourse" or stock exchange. The first "bourse" as such is that of Avers (1549), followed by those of Lyon, Toulouse, Paris, Rouen and Bordeaux between 1549 and 1571.⁵ Amsterdam in The Netherlands can claim to have historically the first building used exclusively as the seat of an stock exchange, built in the form of a cloister in the first years of the 17th century.⁶ From similar roots in trade and industry, the institutional beginnings of stock exchanges appeared in Europe in the 16th and 17th centuries in other important trading centres in Europe :the British Isles, Denmark, Germany, as examples. It may be assumed therewith that also the origins of the functions of intermediaries or brokers emerged, but historical sources are short on information in this respect, particularly as to their specific duties and responsibilities as well as liabilities, if any.

In Renaissance Italy, approximately from the 14th to the 16th centuries, also noteworthy economic developments took place. Great commercial and monetary activities induced leading bankers like the Medicis in Florence to promote stable arrangements facilitating financial transactions. At the Rialto market in Venice, as one among many other examples, already in the 15th century public debits certificates were largely negotiated with a sufficiently continuous stability in values and quotations. A century later, as a marked development, exchange fairs organised in France in the first place by

Genoese and Milanese merchants became comparable to modern exchange markets when transactions in them assumed an exclusively financial or monetary nature with lending and frequent exchanges of "papiers valeurs" as title certificates concerning public bonds.⁷ As professional standards in accounting and auditing are also related to the interests of investors and their protection, it is historically relevant to mention that the Italian monk Pacioli wrote the first known treatise on accounting based on double entry bookkeeping. SEC President Richard C. Breeden, at a conference on November 13, 1992, at the University of Bicconi in Milan, said, "without Pacioli's innovative achievements we would not have an accounting alphabet or language /.../ nor a system of dealing in shares or the organisations which deal with shares."⁸ In passing it may be noted that the Catholic Church did not welcome stock market transactions and prohibited them as usury in the guise of profit-making through the exploitation of capital. Merchants and financial transactors on their part found ways of bypassing the prohibition which did not exclude any possible voluntary "donations" or "gifts" added by the debtor to the repayment of the borrowed capital as a gesture of appreciation for "benefits" derived from the borrowed capital used for commercial transactions exposed to possible risks. This may remind one of the strict Islamic approach to financial transactions. It bans profit making from lending money at interest.⁹

With inter-European as well as overseas trade the need for banks and insurance was generated. In emerging secular and national states, governments sought new modern sources of monetary funds. A combination of expanding activities and intermittent (if not chronic) capital shortages stimulated governments, banks, insurance companies, and some joint stock enterprises,

particularly the great trading companies, to issue stocks. From the existing exchanges for commercial bills and notes, it was a relatively logical and uncomplicated transition to the establishment of stock exchanges for securities. By the early 1600s, shares of the Dutch East India Company were being traded in Amsterdam.

In 1773, London stock dealers, hitherto accustomed to meeting in coffee houses, moved into a building to be used as their own, and by the 19th century, trading in securities was common on a more or less formalised basis in the emerging industrialised countries.¹⁰

The reforms and regulation of securities markets in the EC in general, and in France, Italy and the UK in particular for the purposes of the present thesis, are situated and move, for theoretical purposes, between the two poles of (i) central or centralised or statutory regulation, in which the central state authorities play a predominant role, and (ii) self-regulation, in which the professional bodies and their members enjoy an extensive margin for establishing and maintaining standards of professional integrity, efficiency and reliability. Centralised regulation has been historically characteristic of continental European legal systems, whereas self-regulation is closely and successfully linked with the history of the securities markets in the UK. That is, both approaches have been historically conditioned.

In France, as an expression of central authority, Philip the Fair (1268-1314), in order to regulate the incipient stock exchange(s), instituted the profession of *courratier* as the forerunner of the *agent de change* (exchange agent).¹¹ Already since 1141 exchange agents (*changeurs*) had established their meeting or working place on the *Pont-au-Change* in Paris for regularising their transactions between buyers and sellers, in

exchange for the payment of a commission for their services.¹²

The Royal missive (lettre de Chartres) of 1141, legitimising exchange transactions on the Grand Pont in Paris, and later ordinances and edicts gave the slowly emerging exchange market in France some characteristic traits still surviving in our days in France : trading at an approved place, the compulsory participation of specialised/expert intermediaries; commercially neutral professional conduct by intermediaries in transactions.¹³ As yet, as to be expected, standards of professional ethics, conduct and integrity had to wait, for their detailed articulation, until developments in the 20th century, except for a professional monopoly.

In March 1720 the monopoly of exchange agents was instituted for trading in public stocks. Decrees on September 24 and October 14, 1724, confirmed the exclusive professional rights of stock agents to trade and sanctioned the use by them of the Bourse in Paris. The Bourse, officially recognised by the French royal government, was subject to the authority of the lieutenant general of police. During 10-13 stock trading hours, only professional agents as intermediaries and private persons with a known and regular domicile had access to the Bourse. Access by foreigners was dependent on authorisation; women were excluded.¹⁴ At one time, there were three securities markets in Paris: an official one known as the Parquet (the floor); a semi-official market "la coulisse" (the wing), "the corridor"; and the "Hors Cote" (non-listed) outside the first two. As to intermediaries participating in them, they were distinguished in terms of a category with access to the Parquet and a further category for intermediaries with access to the other sections of the market. This distinction prevailed until 1967. Relations between the

categories were not always smooth, because the distinction between them was in terms of (I) official and public agents and (II) non-official agents, more of a private nature. Official change agents acted as intermediaries and only as such. The coulissiers, later integrated into a single professional association, were authorised to act solely as intermediaries for establishing contact between buyers and sellers. To this extent they were comparable to stock exchange agents, but the latter were in addition empowered to acquire and sell stocks on their own account, that is, to operate as a "marche en banque". Both professional groups in time achieved a modus vivendi under the patronage of the ministry of finance.¹⁵ The Ministry from time to time introduced new statutory rules affecting the professional groups and their relationship. For example, the law of February 14, 1952, amending the Ordinance of October 18, 1945, re-confirmed the privileged position of the exchange agents, but it instituted a second category of trading privileges in favour of a new professional association, the "courtiers en valeurs mobilières" (security agents) consisting of old bankers. In time the dualistic system involving agents and courtiers pointed to the necessity of having an arbiter to deal with possible litigation between members of the two professional groups. For this purpose, the law of 1953 had provided for the creation of a Committee of Stock Exchanges to act basically as an arbiter between the two groups. Its function was extended after 1961 to include the various markets related to the authorisation and distribution of French securities for official listing.¹⁶

When reforms on July 29, 1961, integrated the Paris stock markets, the category of courtiers of securities was abolished parallel to the creation of a "hors cote"

("non-listed") market. The powers of the Committee of the Stock Exchange were strengthened; the principle of a unitary system of listings was confirmed with the complementary rule that officially quote stocks may not be offered in more than one stock exchange in France.¹⁷ The same law sanctioned the professional monopoly of the agents de change. The reform of 1967 initiating the establishment of the Commission des Operations de Bourse (COB), the current stock exchange supervisory body (see below, Chapter 5), integrated all associations of stock exchange agents into a single national body and made authorisation to act as an stock exchange agent dependent on a decree of the Ministry of Finance subsequent to approval by the COB. On March 31, 1975, there were 113 stock exchange agents in France, of whom one was a woman.

In Italy, after the establishment of the first stock exchange, the Borsa di Commercio di Milano, in 1808 by a Vice-Royal Decree of January 16, the exchange agents did not have a monopoly recognised by the state as in France. The right of access to the stock exchange was the object of a long controversy which ended with an extraordinary measure of policing or controlling: the nomination in 1856 of a governmental commissioner. It should be added that the stock exchange in Milan did not enjoy autonomy either; it was attached to the Milan chamber of Commerce. These characteristics of the Italian securities market were comparable to those of the German securities markets. Owing to the relative backwardness of the economy prior to national unification in the 1860s the stock exchange in Milan was put under the control of the Chamber of Commerce. After the unification of Italy, the Milan stock exchange was re-constituted as a body consisting of a director (sindaco) and four associate directors nominated by the Chamber of Commerce for a

period of one year. The decree of March 10, 1860, provided in Art. 43 that, according to the procedure of the Chamber syndacale des Agents de change in Paris, two associate directors should be then selected by each of the two professional categories (brokers and exchange agents) of the stock exchange, but the application of this rule was blocked by the minister of interior affairs on the grounds that it was incompatible with Art. 4 of a preceding Decree. As to members of the stock exchange professional association, they were nominated by the association itself among persons not classified as exchange agents but as persons belonging to the class of merchants, provided that such a nomination "would not entail any inconvenience."¹⁶

In and after 1865 new provisions were included in the Italian Code of commerce, concerning also the establishment of some institutions of fundamental importance : the stock exchange council, appointed by the Chamber of Commerce; the quotation of bonds of public debt; guarantees and basic fees; a clearer procedure for the admission of stocks to the exchange; a system of authorisation for the quotation of non-Italian (foreign) stocks. Meanwhile the Italian economic situation developed rapidly and by 1906 the Bank of Italy reserves exceeded those of the Bank of England.¹⁷ In 1907, the "diritto di sconto," a legal institution of French origin, translatable as the law on financial transactions, was adopted. It regulated in addition to the administration of stocks for official listing, to the control of stock values, the monopoly of brokers (agenti di cambio) confirmed by the basic law of March 30, 1913. The figure of the exchange agent as a public person was abolished by Law No. 1 of January 2, 1991, and substituted by that of a juridical person, a company.

In the United Kingdom, as characteristic of a system based on a self-regulatory approach, the creation of the London Stock Exchange on March 27 1802 was by a "deed of settlement", a contract. This legal act, with notable changes in 1875, had been in force for quite a long time. The beginnings of a stock exchange in the UK go naturally much further back: first tradings of stocks have been traced back to 1568.²⁰

They were concentrated in the Royal Exchange founded by Sir Thomas Gresham in 1566, financial councillor to King Edward VI and Queen Elizabeth I. The pattern of operation followed that of the stock exchange in Amsterdam in The Netherlands. The London Royal Exchange moved to a new building in 1669 after the great fire in 1666 had destroyed the old building.

The supply of traded stock and securities was promoted by the formation of stock companies and later, towards the end of the 17th century, by an increase in public borrowing and debt. Joint participation in commercial ventures was already known in medieval England, whereby possibly a few sleeping partners contributed with capital and left the management of the commercial ventures to the other partner(s). Such "sleeping" participation was advantageous for those who wanted to have their capital exploited but at the same time wanted to avoid any accusation of usury for profits on lent money.

Another familiar institution was the corporation. With a marriage between the form of a company with participatory shares and that of a corporation there emerged in the middle of the 17th century the form of stock companies with its essential characteristics, whereof the oldest stock company was the Russia company while the more known is the East-India company.²¹

After the establishment of the Bank of England in

1694 the stock trading transactions took place in a nearby coffee house. The first quotation list dates back to 1697, related to the name of John Castaing and Sons as brokers.²² In the same year, relevant to the topic of the present thesis, a law was enacted for checking malpractices by brokers and stock-jobbers. It prescribed the grant of a broker's licence by the mayor and the tribunal of Aldermen.²³

In 1876 the London Stock Exchange was considered by A. Ellis "the most highly organised market in the world",²⁴ but it was not the only securities market in Britain in the 19th century.²⁵ In 1836 stock exchanges in Liverpool and Manchester had opened their doors, followed by Sheffield, Leeds, Glasgow and Edinburgh, and further regional stock exchanges in 1845. In 1973 all stock exchanges in the UK, Great Britain and Northern Ireland were merged into the London Stock Exchange.

With relevance to the topic of the present thesis, the London Stock Exchange, hitherto the largest in the world and having to compete more and more with other centres in terms of the number and variety of domestic and international securities traded, has traditionally been an independent (self-regulated) institution not subject to governmental or central regulation. It has resembled a private club with its own constitution and operating rules, administered by a council whose now members, except for the government broker as an ex officio non voting member, were elected by the existing members. Operating responsibility was vested in a secretary and his staff, with no possibility for the government to participate in the operations and administration of the exchanges.

As to trading on the London Stock Exchange, it was carried through a unique system of brokers and jobbers. A broker acted as an agent for his clients while a jobber

or dealer transacted business on the floor of the Exchange without dealing with the public directly. A client's order given to a brokerage house was relayed to the floor for execution. A broker's income was from a commission received from the client as compensation for services rendered. The jobbers sought to maximise profitable business by adjusting stock buying and selling prices. As the ultimate dealer in the London market, the jobber with his activities provided a stabilising factor in many respects. Unlike the specialist on the floor of the New York Exchange, the jobber was under no obligation to help support the quotations.²⁶

To become a member of the London Stock Exchange, an individual had to secure a nomination from a retiring member at a price varying with demand and supply. Every applicant had to be approved by at least three members of the Stock Exchange Council. A member could be a broker, dealing as an agent of the public, or a jobber dealing for his own account with other jobbers or brokers.²⁷ The distinction between a broker and a jobber had emerged in 1812, but not before 1908 was a member of the London Stock Exchange held to declare formally whether he was a broker or a jobber. Members of the exchange did not have to obtain a licence which legislation in 1858 prescribed for the prevention of fraud in the sphere of investment activities. This last point indicates how in the wake of complex developments and expansion both at the level of activities and investors consideration for better standards for supervision as well as for investor protection were moving to the fore.

The historical background of stock exchanges in France, Italy and the United Kingdom shows that in France and the United Kingdom the structure, organisation and membership of stock exchanges emerged from the initially free association of its members. While this development

lasted longest in the United Kingdom, in France the central authority of the state in due time asserted its influence as a factor of regulation. In Italy, the organisation and operation of the stock exchange was from the beginning influenced by the tradition of the Bourse du Roi in France, founded in 1724 by the will of royal authority. Consequently, the Milan Stock Exchange was different from the French and UK models in two important respects : (1) the exchange agents did not succeed in achieving a professional monopoly that the French and London agents enjoyed for trading in the stock exchange, the French agents enjoying such a monopoly initially in self-regulation and later in a form sanctioned by central state authority; (2) in Milan the right of quotation was the object of a long controversy ending with an extraordinary measure of policing or monitoring when a Commissioner of the government was appointed in 1856; and lastly (3) the Milan stock exchange was not autonomous; it was linked to the Chamber of Commerce. As a marginal remark it can be said that the characteristics of the Milan stock exchange as the model of the Italian system was comparable to the status of the German stock exchanges.

Notes

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1. On the earliest historical roots of stock exchanges on the European continent in Rome, see Larousse, la Grand Encyclopedie vol. 4, (1972), pp. 1928-1933. On more details as to who had monetary resources as bankers in Rome, see Larousse, *ibid.*; see also (Italian daily) *Il Sole* 24 ORE, June 22, 1992, pp. 3, 4 and 6.
2. After the decline of the Roman empire, in the middle ages which witnessed the development of flourishing cities, periodic major (trading) fairs offered to merchants the necessary opportunity to revive the idea of regular meetings for lending and debt certificates. Meetings took place at the same square ("piazza"), with lodge ("loggia"), exchange ("cambio"), convention, "estrade", used practically as synonyms. See Larousse, *op. cit.*, p.1929.
3. Cesare de Seta in a programme of the Italian radio-television company RAI in 1992.
4. Encyclopaedia Britannica, vol.23 (15th edn), 1992 p. 516.
5. Larousse, *op. cit.*, (note 1), p.1929.
6. G. Moreau-Neret, Les Bourses de Valeurs dans le Monde in Les Bourses de Valeurs dans la CEE, Foreword, p. vii.
7. U. Alotti, Les Bourses de Valeurs en Italie, *op. cit.* (note 6 above), p. 191.
8. Mercati dei titoli: fonte di capitali per gli anni 90 e oltre in Riv. Soc. vol. 3. 37, (1992), P. 1527.

9. See Il Sole 24 ORE, suppl. June 25, (1992), p. 36.
10. Encyclopaedia Britannica, op. cit., (note 4 above), p. 559.
11. Ibidem.
12. Larousse, op. cit. (note 1 above), p. 1929.
13. B. Mirat, Bourses de Valeurs en France, op. cit (note 6 above), p. 6.
14. Larousse, op. cit. (note 1 above), p 1929.
15. For further details, see B. Mirat, op. cit., (note 13 above), p. 6.
16. Larousse, op. cit. (note 1 above), p. 1930.
17. B. Mirat, op. cit., (note 13 above), p. 13.
18. U. Aletti, op. cit. (note 7 above), p. 193.
19. X. Ouset, L'Italie et le systeme financier international de 1861 a 1914 in Revue d'Economie Financiere. 14, (1990), p. 98..
20. J.R. Knight, Bourse de Valeurs en Grande-Bretagne, op. cit. (note 6 above), p. 113.
21. E.V. Morgan and W.A. Thomas, The stock exchange its history and functions (1962), p. 12.
22. J.R. Knight, op. cit. (note 20 above), p. 115.

23. Ibidem.

24. R.C. Michie, The London Stock Exchange and the British Securities Markets, 1850-1914 in the Economic History Review, (1965), p. 61.

25. Ibidem.

26. Encyclopaedia Britannica, op. cit. (note 4 above), p. 560.

27. Ibidem.

Chapter 3

Self-Regulation, Regulation, Deregulation, Re-Regulation and Co-Regulation, "New Regulation"

The removal of all barriers in the EC to the free movement of goods and persons, supply of services and the free movement of capital within the completed internal market of the EC has, as from January 1st 1993, generated a number of new regulatory issues for securities markets. Some of them are due to Community law and others are conditioned by the transnational dimensions and communication technologies affecting the operations of securities markets. Markets which in the past have developed their activities under different national systems with in practice, insulated national regulatory structures and standards, are now expected to operate within (a) a broad regulatory framework anchored in primary as well as secondary EC law, and (b) a system with transnational dimensions both within and outwith the EC legal system. This exposes the markets to competition and puts the national securities markets and thereto related forms and standards of regulation under pressure pointing towards new developments and not least towards coordinated regulatory standards with due regard to competitiveness, reliability and, eminently, the protection of the investor, more particularly the small investor.

Traditional systems of (i) self-regulation, (ii) regulation, more recent approaches of (iii) de-regulation and/or (iv) re-regulation and (v) co-regulation have to be assessed and re-assessed in the light of new realities, challenges and demands, even if they are capable of assuming variable or varied meanings and

shadings in the socio-economic, legal and cultural environment in which they are expected to operate. From a combination of these notions and associated systems a "new regulatory" approach may emerge for promoting the proper functioning of financial markets and access to investment capital. This "new regulatory" approach or "new regulation" is largely a product of the internationalisation of capital markets; in the case of the EC, it is a necessity generated by the transnational character of the emerging Community single market with no internal barriers. Both at international and intra-Community levels the pluralist and complex nature of the new dimensions of the capital markets is accompanied by a realisation that beside the legal standards, values or standards of professional ethics have to be necessarily considered as constitutive elements of a system of stable and reliable regulation.

The question of professional ethical standards is reflected in the notion of deontology, with origins in professional self-regulation. Such self-regulation implies, in ongoing changes and consolidation, a division of competences of regulatory powers between central governmental or administrative authorities, on the one hand, and members of the professions involved in the operations of stock markets on the other. In more legal terms, the search for the best new regulation concerns the search for a system involving central administrative as well as decentralised control standards, wherewith central administrative elements of the regulatory system are combined or coordinated with professional self-regulatory elements. In this process a so to speak osmosis between the state administrative authorities and professional bodies may take place, if capital and investment resources are not to move to other stock markets with detrimental effects for the national stock

exchange of the state concerned.

Obviously, the importance of deontology should neither be over- nor under-estimated. According to one leading opinion, it is an element which together with other factors contributes to implement a complex regulatory system relating to financial activities.¹ It is additionally accepted that (in our translation) "the firmness, at least as far as the financial sector is concerned, of such constructions based on a principle of sharing between governmental/centralised and self-regulatory systems, in traditional legal systems, have emphasised the development of novel approaches, solutions, as part of the expansion of the influence of law in essence generated by non-governmental organisations"²

Thus, the new regulatory system(s) are marked by diversification, both as to contents as well as origins; They are no longer the result of an authoritarian control; they are the result of a regulatory approach aiming at the promotion, development and optimal functioning of the markets.

The "new regulatory approach", based essentially on a deontology uses, for achieving its goals, most diverse systems such as that of self-regulation, regulation, de-regulation, re-regulation, co-regulation. This is justified by a desire to avoid a centralised government system which may be heavy, slow, rigid, stifling and as such inadequate for the rapid transformation of financial markets.

In the light of the above sketched development, in which a number of terms play a role, it is appropriate to deal with the content of the associated notions as concepts underlying the challenges of regulating the securities markets within a broad regulatory framework and EC legislation.

Self Regulation

For civil law jurists, self-regulation implies a philosophy of action, sounding almost like a magic word. It may be a key notion for unlocking entrance to the world of common law. It concerns not so much the objectives to be achieved as the means, the instruments to be applied to reach given objectives. Its basic elements are those of flexibility, clarity, simplicity, rationality, involving the application of detailed rules in internal regulatory texts as instruments of control from within. At the same time, the term self-regulation is an ambiguous one, because it can lend itself to multiple interpretations and definitions.

Normally, self-regulation is contrasted with statutory regulation, that is, with control enshrined in legislative or statutory texts, and sometimes with non-self-regulation.

Webster's Third New International Dictionary (1981) defines self-regulation as "regulation of or by oneself or itself; control or supervision from within." The Bank of England, in evidence to the Wilson Committee, defined self-regulation as originating "in the realisation by a group of individuals or institutions that regulation of their activities is desirable in the common interest, and their acceptance that rules for the performance of functions and of duties should be established and enforced. Typical of such arrangements are those to which members of professional bodies subscribe in order to establish appropriate standards of professional conduct and competence. In some cases the enforcement of such standards is entrusted to a committee of a profession or of practitioners in a market. Frequently, however, the enforcement of the regulations may be entrusted to an authority outside the group, which is or becomes customarily recognised and

obeyed and which may also become the initiator of new regulations ... In both cases the system can be described as self-regulation, the first intrinsically so, the second by common consent."³

In the financial sector too, self-regulation confirms its vocation to outline the configuration of a complex phenomenon of legal nature that does not exhaust its scope solely in an ethical dimension. On the contrary, it may stand for articulating itself through institutions and organisational structures affecting matters belonging to categories normally related to internal matters.

Self-regulation has long been common in professions like those of law, medicine, accountancy, with characteristics common to them.⁴ If a profession is self-regulating, in the sense that its members, as the sole suppliers of a certain type of professional service, are free to determine in one way or another whether or not to admit an applicant to the profession, then it might prima facie seem that such a profession could be regarded as a monopolistic supplier and seller of the service in question. If a negative effect is associated with such a monopolistic position, then the effects of the given self-regulation may appear to involve some loss for the public or society affected by it. The whole rationale of self-regulation rests however, on the notion that it provides a vehicle through which the quality of the service may be maintained in markets where the client or consumer may not be capable of assessing readily and/or measuring the quality of the monopolistic service offered. Gower explains that "the British experience has been made of three distinct methods of self-regulation : the first (of which the stock exchange and Lloyd's are examples) is where a professional organisation acts as a self-

regulatory body over the activities of its members; the second (of which the CBI CSI and the Panel are examples) is when a professional association or a number of professional bodies voluntarily set up a distinct self-regulatory agency over the members of that body or bodies and, where practicable, over those dealing with those members. The third (of which the Insurance Brokers Registration Council is an example) is where a professional body or bodies promote by legislation the establishment of an agency to regulate the practices and conduct of its members." The first of these, the "club" type of self-regulation, has the advantage that moral persuasion may work at its most powerful and it may be easier to enlist high-powered executives to play an active role in regulation." Gower observes that in the UK there exists "sometimes self-regulation; sometimes statutory and sometimes non-statutory ; and sometimes a mixture of all or some of these."

Non-statutory regulation is not synonymous with self-regulation. Statutory and non-statutory forms of regulation may seem to be mutually inconsistent ; there is, however in effect, something of a continuum linking them, on one side, most forms of non-statutory regulation, even of the self-regulatory type take place within some kind of statutory framework. On the other side, extreme statutory supervision of financial institutions may be invariably supported by non-statutory arrangements of one form or another. The issue is not therefore whether statutory or non-statutory methods of supervision are preferable in some absolute or mutually exclusive sense, but whether the existing balance between the two is appropriate for the particular circumstances and, one might add, tradition. The continuum between statutory and non-statutory regulation is well exemplified by the important regulatory form of internal

codes of good practice. Statutory and non-statutory internal codes may exist. They are much more flexible than statutory law and can be readily revised to respond to new circumstances.⁷

The status of such a code is considered to be, in some ways, similar to that of the UK Highway Code approved under Section 38(7) of the Road Traffic Act 1988, or to the codes of practice approved under Section 25(2) of the Consumer Protection Act 1987.

Bovey⁸ notes that self-regulation exists as an exception or reaction to two elements in the constitutional structure; the sovereignty of Parliament and the independence of the judiciary in the UK. He adds that pre-reform England was largely governed by Boards and Offices. They were not accountable to Parliament. As Parliament reformed itself, and thereby attained democratic legitimacy, this pattern changed. The Boards became the Ministries (Departments) and secretaries and ministers became accountable to Parliament. Thus, self-regulation is "what happens when some body or organisation successfully acquires power independently of Parliament."⁹

The independence of judges from the executive arm of government but their subordination to Parliament is worth noting in the following context: "The effective coming together of the executive and the legislature in a sovereign Parliament with the growth of a two-party system and party discipline left no checks or balances in the constitution other than the judges. There was no room for the growth of a system of administrative law on the continental or even the UK model because it would offend against the idea of the sovereignty of Parliament. Instead, the courts adopted a different role. It was that while Parliament has absolute power, and the judges would accept and respect the will of Parliament whatever it

did, if it conferred power on anyone else, notably any part of the Executive, the courts would ensure that the power was exercised strictly in accordance with Parliamentary instructions."¹⁰ It should be noted that the current structure of stock exchange regulation in the UK is derived largely from the Gower Report.¹¹ The contents of Gower's and particularly the corresponding Committee's terms of reference reflect two basic premises:

- (1) All financial services require regulation, and
- (2) Self-regulation is generally superior to statutory regulation.

Lobuono (Italy) has commented that (in our translation) "evidently the most significant limit of self-regulation can be ascertained in terms of protecting investors and, particularly, providing for the efficacy of rules of conduct in relation to third parties, that is, clients with contracts/agreements of investment concluded with the financial operators. The therein involved problems emerge above all in relation to forms of auto-(self-)regulation in a strict sense, that is, in circumstances with respect to which no reference can be made to statutory or administrative provisions. (One may think in this context of the integral or practice code set up by a professional body of French intermediaries)."¹²

Self regulation is not necessarily characterised by simple or comprehensive rule books. With such a point in mind, it may be said that, as has been universally admitted, the original SIB rules book was a little complicated. The competent Minister has said in the House of Lords that compared with the old Stock Exchange rules book, the SIB book read like Enid Blyton.

Another possibility to consider when establishing self-regulatory books is that self-regulation can best operate, or can only operate in a field untrammelled by

statutory or legal controls. Gower's suggestions and conclusions indicate that for him self-regulation could operate only with a vertical dividing line between it and statutory regulation. A horizontal division may destroy it and self-regulating organisations operating thereunder and under the Financial Services Act are not good or workable examples of self-regulation.

The main advantages of self-regulation can consist in flexibility, ability to deal with infringements of the spirit as well as the letter of conduct rules and thus to ensure high standards of reliability as to personal integrity and expertise in the matters to be regulated; the ability to take decisions speedily and lessen demands on the public purse.

In terms of main disadvantages, self-regulation may risk dependence on imprecise and vague rules, difficulties of effective enforcement over non-members, possible insulation from the public as opposed to professional opinion, and in particular danger that self-interest may outweigh public interest or may appear to do so and therewith may sap or undermine public confidence in the profession.

"The main disadvantage, however, is the risk of corruption and capture: regulators may be captured by the firms they attempt to regulate."¹³

Advantages and disadvantages of governmental regulation have been seen as largely the converse of those of self-regulation. According to Gower, the two types of regulation should not be regarded as being antithetical but rather as complementary.¹⁴ "It is now generally accepted, I think that gaps in the regulation need to be filled --- and filled, to the same degree at any rate, by governmental regulation." "The ideal would be to weld self-regulation and governmental regulation into a coherent statutory framework which would cover the

whole field that needs to be regulated; in which each would perform the role it does best, working harmoniously together.¹⁰

It is noteworthy that in France, with a civil law tradition, concerning the organisational aspects of the financial/securities markets, also after the reforms of 1985 and 1989, no elements of self-regulation have emerged in a strict sense or in any case no professional bodies comparable to the self-regulatory organisations (SROs) established in the United Kingdom. However, financial operators and in particular those employed under various titles in the sphere of investment activities have contributed no less than others to define the nature and structure of the market in which they operate. In fact, intermediaries in France are called upon to draft internal procedural codes for the market and above all have the possibility to designate, alongside other professional groups operating in the financial markets, their proper representatives at the level of central authority dealing with professional matters, such as the Conseil des Bourses de Valeur, the Conseil du Marche a Terme (futures market), etc. The functions of these centralised regulatory bodies involve aspects ranging from powers of control to drafting general rules for the market. These institutions, operating in an area intermediary between statutory regulation on the one hand and self-regulation for the activities of intermediary bodies on the other, compete to contribute to the efforts of the state to create a mixed regime governing financial activities.

A similar strategy of decentralised approach to traditional functions exercised by central government bodies manifests itself also with respect to control powers. The actors active on the markets are co-involved in the administrative processes affecting the market

through a system of synergy between financial institutions, on the one hand, and professional groups of market intermediaries on the other. In securities markets like those in France, in which control activities have to face extreme difficulties, that is, to cope with substantial delays affecting the process of financial innovation,^{1*} the desirable objective is in substance to introduce successfully at (1) a first and lower market level standards of control applied directly by the organisations involved in it, as standards intended to be more successful and as such desirable to achieve systematic effectiveness, and (2) at a second level, measures of an external control, tending to be exercised more indirectly, that is, as a mechanism of verification applicable to the validity of procedures applied to internal controls.

The above remarks suggest a first conclusion on the role of self-regulation in French financial markets : deregulation processes, quite far from leading to total liberation from state intervention, involve rather a deep reorganisation of the markets. This involves a transition from a system of centralised to a decentralised administrative system with elements of both administrative as well as professional decentralisation. Therewith financial operators have a guarantee to fulfill, under the control of the market authorities, functions of growing responsibility. It may be generally asked, whether self-regulation or statutory regulation can respectively be a better method for guaranteeing the proper functioning and reliability of financial services markets; or is a combination of both essential and hence inevitable? Or does the answer to these questions lie in specific historic factors which have shaped traditions, more self-regulatory in the UK and more statutory in France or Italy? Or is the nature and technicalities of

current financial services markets such that a radical break with tradition may have to be envisaged? Chapters 5-7 may cast some light on these points by discussing the way financial services markets in France, Italy and the United Kingdom are organised and regulated and what critique and weaknesses they involve. Philip Bovey,¹⁷ says that the term self-regulation is bandied about, sometimes as something to be aimed for, sometimes as a term of abuse to be contrasted with real or statutory regulation. For him, good regulation may be achieved with or independently from self-regulation.¹⁸ One has to agree with him that the virtues of a good regulatory system are : (i) it is clear in its contents; (ii) it is clear as to its targets, and (iii) it is enforceable with effectiveness and benefit for all market participants.

The differences between self-regulation and no self-regulation lie not in their regulatory aims; these may be assumed to be the same for securing the proper functioning, reliability and optimal immunity of the financial markets against fraud and manipulation, but in how the aspired objectives are achieved and maintained.

Regulation

Regulation literally means the "laying down of rules".

"Regulation exists because certain groups in society benefit from their existence at the expense of the rest of society - that is why the process of regulatory reform is a painstaking one with potent political forces pulling in different directions"¹⁹

"Regulation, particularly in the USA - at least "economic regulation" broadly conceived - typically refers to governmental efforts to control individual price, output, or product quality decisions of private firms, in an avowed effort to prevent purely private decision making that would take inadequate account of the

public interest."²⁰

In the USA regulation is a distinct type of policy-making and its study has been elevated to the status of a sub-discipline. In Europe the situation is different: despite the intensity of ongoing debate about deregulation at national and EC levels, research on the economics and politics of public regulation is still a relatively new area. Paradoxically, the study of deregulation has preceded the theory, if not the practice of regulation.²¹

Majone underlines that "There are several reasons why European social scientists have not developed anything comparable to the American theories of regulation. To begin with, the term itself is often used differently on the two sides of the Atlantic. In Europe there is a tendency to identify regulation with the whole realm of legislation, governance and social control. This broad use of the term makes the study of regulation coextensive with law, economics, political science and sociology, and thus impedes the development of a theory of regulation as a distinct kind of policy-making."²²

In the USA, regulation has acquired the more specific meaning of a control exercised by a public agency. As to securities markets, of direct relevance to the contents of the present thesis, the art of regulating them requires knowledge of details of its operations, ability to shift requirements as the changing conditions of the market may indicate, the pursuit of energetic measures upon the appearance of an emergency, and the power, through enforcement, to generate realistic conclusions as to policy.

Differences in meaning applicable to the notion of regulation reflect significant ideological and institutional differences between the USA and European approaches to the political control of market processes.

The long tradition of regulation in the USA, at the Federal level going back to the 1887 Interstate Commerce Act regulating the railroads and the corresponding commission set up to apply it, expresses a widely held belief that the market works well under normal circumstances and should be interfered with only in specific cases of "market failure" such as under the negative impact of monopoly, negative externalities or inadequate information. Thus, the primary rationale for regulation, along with other elements of public policy towards industry, is to remedy various kinds of market failure.²³

With, particularly, focus on financial systems and their markets, information problems provide the chief rationale for much regulation and are essential to understand the relationship between a regulatory agency and the firm or firms or professional bodies it regulates. Normally, the Government will be involved in regulation, either directly or indirectly. Indirect involvement may involve a quasi-governmental body, such as a regulatory Agency, for example, the SIB in the UK.²⁴

Regulation can be often regarded as a substitute for competition. One purpose of regulation may be to promote and maintain conditions for effective competition; liberalisation may alter the kind of regulation that is needed, not the need for regulation.

Regulators may be concerned with the way in which a market is organised. This is known as structural regulation. Regulators may also be concerned with the behaviour within the given market, dealing in a such a case with conduct regulation.

It is significant and curious that there has seemingly been so little regulatory response to Black Monday on 19 October 1987.²⁵

Finally, "some USA economic theorists have argued

that Regulation is a means whereby powerful coordinated Interest groups often (perhaps usually) the main establishment companies in the industry can transfer wealth from the less well co-ordinated, usually consumers, to themselves."²⁶

Deregulation

The term "deregulation" too carries different meanings, depending on the particular kind of regulation it concerns. The ambiguity of deregulation has been emphasised by Y. Gudon.²⁷ Deregulation has been a key element of both Thatcherism in the UK and Reaganomics in the USA.

In Europe in the 1980s and 1990s as in the USA in the 1960s and 1970s, traditional structures of regulation and control have been in the 1980s and 1990s breaking down under the pressure of powerful ideological, technological, economic and even pragmatic forces, and are being dismantled or considerably, if not radically transformed. This is often referred to as "deregulation", but this is a misleading term, because as often as not new and more explicit and also subtle regulatory structures are simultaneously generated and applied in place of what went before under the label of regulation.

The term "deregulation" is also used to indicate or qualify the "Big Bang" of 1986 in the City of London, as the provocative beginning of a gradual deregulation of the securities market in the 1980s. Therewith the United Kingdom has become the centre of an international process of regulatory reform. Older, informal as well as formal structures had started breaking down under the pressure of strong economic, technological, ideological and cross-border or transnational forces, and were being officially dismantled. This process is qualified as being one of "deregulation".

Deregulation may also mean, however, less

restrictive or rigid regulation. Thus, the rationale for public intervention has seldom been challenged in the increasingly important area of "social regulation" with environment, health, safety, consumer protection as examples. Thereby the important issue has not been so much deregulation as the challenge of achieving the relevant regulatory objectives by less burdensome methods of governmental intervention or participation.²⁰ Thus, neither in the USA nor in Europe has deregulation been a pure process for ending all regulation. In Europe, particularly in the UK, privatisation of natural monopolies as a process of deregulation has been followed by price regulation. "History might not judge Margaret Thatcher as having effected substantial deregulation of the British economy. Her major conservative accomplishment has been in the fields of privatisation and increasing inequality rather than deregulation. There is a tendency to confuse privatisation and deregulation as the same issue when indeed privatisation is often accompanied by an increase of regulation."²¹

The absence of a significant body of theoretical and empirical literature on regulation explains a certain confusion about the meaning of deregulation in the European context, and its relationship to other measures of liberalisation or to privatisation. In Europe, as in the USA, the dismantling of traditional structures of regulation and control and their replacement with new patterns is misleadingly qualified as "deregulation". Such a statement would be justified if the market concerned as "deregulated" were free of or not affected by any regulatory measures or rules. On the contrary, the market has never been as regulated and monitored. In reality it has been a matter of choice as to the method or regulation intended to replace a centralised administrative system with one which is decentralised but

is administrative and professional. The deregulation is characterised by the presence of systems of specialised control fulfilling a function of establishing standards for the market operators governed by their own authority and subject to their own authority.

The phenomenon of "deregulation" includes a substantial paradox concerning economic policy with respect to which "deregulation" does not result, as already pointed out above, in the total liberation of the market from any regulatory standards, but has to do rather with a transformation in the modality of defining the market structure and control of the markets. This is effected by resort to a series of innovations providing for the direct or indirect involvement of financial operators through the activities of professional organisations, for example, self-regulating bodies and recognised professional bodies. These may invoke professional authority, for example, the Conseil des Bourses des Valeurs in France, and sometimes may involve the financial operators themselves, for instance with respect to the code of internal procedure which the French associations of intermediaries are called upon to draft.³⁰ "Even the United States, after 8 years of an administration with a stronger ideological commitment to deregulation than any in the history of the western world (the only competitor for this title being the Thatcher government) has hardly the balance away from state regulation."³¹

It is difficult to conclude that the Regan presidency was an area of deregulation.

Re-Regulation

Re-regulation generally means the promulgation of a new set of rules.

Re-regulation may be better understood as a necessary effort to make the deregulated markets function

competitively. This means that there is in practice no total deregulation, but rather a combination of deregulation and re-regulation. The apparent paradoxical combination of deregulation and re-regulation, most clearly evident in the financial services industry, is what actually amounts to a regulatory reform.³² At the same time it should be remembered that a regulatory reform does not need, in the best interest of the markets and those involved in them, a reform effected with a single stroke: it may best emerge through some evolutionary process in which deregulation and re-regulation may have important functions to fulfill. Deregulation should really be called re-regulation since it is not the scrapping of regulations which is at issue, but the replacement of one set of regulations with another (albeit more liberal) code.

Co-Regulation

Co-regulation stands for a form of regulation based on international bilateral or multilateral agreements concluded between respective governmental authorities in charge of the control of financial services markets. Competition at a global or international level is not capable of developing and emerge solely with the abolition of internal state regulations. For promoting the dimension of compatibility of international competition and render it keener through the proper functioning and evolution of the international financial system, it is indispensable to set up new forms of internal cooperation. Co-regulation has been defined (in our translation) as "the complex interplay/interaction of bilateral or multilateral agreements between national authorities entrusted with the supervision of various market operations in various countries."³³ ("le jeu complexe d'accords bilatéraux ou multilatéraux entre les autorités chargées de surveiller la marche des marchés

divers dans les pays differents")

New Regulation

The challenge of "deregulation" in the USA meant for Europe adopting legislative, administrative and regulatory measures inspired from the American model consisting in its essence of the three-tiers approach.

This development seems to offer the most suitable instruments for regulating the activities of financial markets across frontiers and continents.

It offers for European Stock markets, as indicated above, the best possibilities to compete with the standards of efficiency in the USA.

The result of all the theoretical as well as applied developments has been that distinctions have been blurred between governmental (centralised) regulation, on the one hand, and self-regulation on the other, as well as between statutory and non-statutory regulation.

The New Regulation will inevitably be a sort of symbiosis between state regulation and self-regulation. It should remember, however, that "policies that secure the advantages of an evolution of cooperation between regulatory agencies and industry are policies that also run the risk of an evolution of capture and corruption".³⁴

In the chapters which follow below there will be direct or indirect reference to the way the regulation of the financial markets in France, Italy, and the United Kingdom is based on self regulation, central regulation or a combination of both approaches.

1. M. Lobbano, 'Deregulation dei Mercati Finanziari e Processi di Autoregolamentazione, in Banca, Impresa, Società,' vol. 9, n.2, p. 255.

2. Ibidem.

3. A.C. Page, 'Self-Regulation: the Constitutional Dimension, in The Modern Law Review, vol. 49, n. 2, (1986), p. 145.

4. A. Shaked and J. Sutton, 'The Self-Regulating Profession in Review of Economic Studies, (1981), XLVIII, p. 217.

5. L.C.B. Gower, 'Review of Investor Protection - A Discussion Document, (1982), p. 82.

6. Ibidem, p. 52.

7. A very remarkable innovation in the "new settlement" in relation to the SIB's legislative power is the introduction of the new section 63C which enables the SIB to issue "codes of practice" amplifying either its statements of principles or its rules or regulations (Whether designated or otherwise). See R.B. Jack, 'Banking Services: Report by the Review Committee, February (1989), p. 25.

8. P. Bovey, 'What is Self-Regulation?, in The Company Lawyer, vol 12, n. 1 (1991), p. 5.

9. Ibidem.

10. Ibidem.

11. J. Kay, The form of Regulation in Financial Regulation - or Over Regulation? (1988), A Seldon ed., p. 33.
12. M. Lobbuono, op. cit. (note 1 above), p. 258.
13. I. Ayres and J. Braithwaite, Responsive Regulation Transcending the Deregulation Debate, (1992), p. 133.
14. L.C.E. Gower, op. cit. (note 5 above), p. 79.
15. Ibidem. p. 82.
16. M. Lobbuono, op. cit. (note 1 above), p. 252.
17. P. Bovey, op. cit., (note 8 above), p. 3.
18. Ibidem, p. 4.
19. S.J. Koury, The Deregulation of the World Financial Markets - Myths, Realities and Impact (1990), p. 238.
20. S. Breyer, Regulation and Deregulation in the United States: Airlines, Telecommunications and Antitrust in Deregulation or Re-regulation? Regulatory Reform in Europe and the United States, (1990), G. Majone (ed), p. 7.
21. G. Majone, Introduction in Deregulation or RE-regulation? Regulatory Reform in Europe and the United States, (1990), G. Majone (ed.), p. 1.
22. Ibidem.

23. Ibidem, p. 2.

24. D. Gowland, *The Regulation of Financial Markets in the 1990s*, (1990), p. 7.

25. Ibidem, p. 87.

26. Ch. Goodhart, *The Costs of Regulation in Financial Regulation or over-Regulation?* (1988) A. Seldon, ed., p. 23.

27. Y. Gudon, *Droit des Affaires*, vol. 1 (5th edn), p. 16, note 14.

28. Ibidem, p. 3.

29. I. Ayres and J. Braithwaite, *op. cit.* (note 13 above), p. 11.

30. M. Lobuono, *op. cit.* (note 5 above), p. 255.

31. I. Ayres and J. Braithwaite, *op. cit.* (note 13 above), p. 7.

32. G. Majone, *op. cit.* (note 17 above), p. 3.

33. J. Saint-Geours, *Une Finance sans Frontières ?*, in *Revue de Deux Mondes*, March (1992), p. 86.

34. I. Ayres and J. Braithwaite, *op. cit.* (note 13 above), p. 6.

Chapter 4

Professional Deontology as a Regulatory Element of Securities Markets : The Regulatory Agencies

The deontology of the professions involved in financial services is a very important pillar in the system of the new regulation of the markets. The term deontology, first used by Bentham,¹ refers to all the duties which are borne by those active in a profession. In modern socio-economic systems, deontology is part of the basis on which the new application of competences between governmental administrative authorities and professional bodies is effected. Besides fulfilling a normative function at the level of legal thinking, deontology has also a so to speak moralising impact.

Reference to a moralising effect, implied by the use of the term deontology, raises some questions, for example, how to strengthen the sense of professional honour among those active in the given profession; how to strengthen professional honour and integrity, loyalty and reliability.² Or otherwise, is there an endeavour to achieve other unrevealed objectives? Whatever the answer to this last question may be, it is admitted that the maintenance of high professional moral standards is an objective in itself, and a desirable or even necessary one as such, as hinted by a simple definition of the term deontology, or may be it is a means subordinated to the imperatives of achieving a different objective.

The answer to those and related questions is given by the way the reform of the financial markets in France has been envisaged, by using deontology as an instrument for restoring order in the financial markets to the extent of restoring faith among investors in relation to

the markets. Restoring trust among investors toward the market is indeed an essential objective in an environment in which substantial amounts of capital have to be attracted for new economic and commercial ventures, products, services and the reliability of the thereof effected transactions has to be secured. This may suggest that the purpose of deontology is consequently a purely economic one. Such an assumption may in no way be surprising: the reform of the financial services in France, as an example, has aimed at re-invigorating and strengthening the markets, and the ideological component in it, suggested by the term deontology, has been considered necessary for re-assuring investors within the overall framework of economic policies and objectives.

Deontological standards differ from penal standards, because they are generated by an administrative authority of a professional nature, by an authority serving higher political and economic objectives. In addition, deontology is destined to maintain an equilibrium between diverse categories of interests. The categories in question are represented internally within and between different professional groups and bodies. Deontology functions additionally as a factor of self-regulation in the financial sector through groups associated together on the basis of common interests relating to the establishment of rules and standards affecting all of them.

The system of implementing and operating standards of self-regulation depends on self-discipline as an important element in the notion of deontology. Therefrom the question may arise,³ whether the deontology of financial activities and services is in its nature similar to that underlying standards applicable to other organised professions or whether it assumes a new significance specific to the financial sector. It is

submitted that deontology in the financial sector involves a significance specific to that sector, because it does not simply reflect the will of a professional category to insure the internal cohesion of its members within the category. It has had and may again rather have to meet the challenge of a crisis of legitimacy and public confidence in financial services in times of changing and evolving economic structures related to financial markets. The deontology of the financial professions aims at harmonising relations between investors, on the one hand, and financial intermediaries on the other under a canopy of public authority. Maybe this is the most specific and original aspect of deontology in its relation to financial services.⁶

In substance, professional deontology in the financial sector has assumed a new profile by overcoming classical patterns of corporate thinking and by assuming for its development new operational approaches with so to speak transverse dimensions. The association of different categories of interests, in financial markets, in the form of professional bodies and organisations, confirms in fact the view that deontology fulfils a series of functions extending well beyond that of merely organising all those concerned into one single professional body. Such a body pursues the purpose of acting as an instrument of "open" regulation keen to coordinate internally interests which may initially be conflicting in nature. In contrast, rules of (deontological) conduct do not have a point of reference, or a defined character of operators, but rather segments of professional activity to be regulated by affecting, so to speak diagonally or transversally, different exigencies and objectives.

Hannouin is of the opinion that the deontology of financial services constitutes one of the elements of the

recently expounded neo-corporate model.⁵ The neo-corporate approach points to a system of representing group interests within organisations charged with the responsibility of securing reconciliation between given group interests under the aegis of quasi-administrative institutions.⁶ With the application of the neo-corporate approach the proliferation of bodies qualified as commissions, councils or committees is in fact confirmed, as they aim at regulating a given sector of activity by associating together various categories of given interests, such as the COB and the Conseil des Bourses de Valeurs in France. These bodies, considered to be independent administrative authorities (IAA) (French: autorite administrative independante (AAI)) provide for the maintenance of a specific or particular relationship between the state and the public. As a model of coordinated economic system that of neo-corporatism seems to set up a new model of decentralisation: the model of an "auto-regulated" or "self-regulated economy"⁷ aiming at achieving an optimal economic system reconciling the logic of two systems, namely, that of a (free) market and that of a public service. This can be achieved by applying standards of self-regulation and self-discipline in the sector of financial services.

Self-regulation within the ambit of deontology does not mean that therewith the market will find as if an invisible hand is effecting a level of spontaneous equilibrium. The application of a deontology acts as an agent for bringing the state and the public or the society at large nearer to one another.

The first sign of deontology as to its specific originality is its value as an educational and normative factor affecting and conditioning in a positive sense attitudes and professional standards of conduct. In the light of a theory of emerging law, deontology may be

defined as a de facto authority possibly involving compulsory or peremptory rules which may in form include, whenever necessary, the imposition of severe sanctions. Paradoxically, it cannot be submitted that deontology carries with it the type of authority which law does; it belongs to the sphere of infra-judicial concepts.*

Deontology definitely addresses itself to members of the professional group concerned, but its range of validity stretches beyond the sphere of such a group, because its roots reach deeper than those of professional ethics. It is more comprehensive and more complex.

In relations between financial intermediaries and their clients deontology can assume various forms. The intermediary as operator will be subject to a certain number of specific duties in accordance with an administrative or management contract as a regulated professional act. Self-regulation and deontology do not mean that the market is definitively governed by the forces of total freedom. The market functions rather in a new environment in which a new normative dimension emerges. In it a closer relationship between the individual and the legal rules or rules adopted by the authority in charge of the financial markets exist. Decentralised self-regulation, involving deontology, aspires to render the organisation of the financial markets more efficient. This may involve a form of administrative and professional dirigisme motivated by an essential purpose: to secure the trust and confidence of investors as an essential condition for the satisfactory development of financial activities.

The new state of affairs finds its inspiration and justification in a desire shared by the quasi-totality of operators of the market: to avoid and avert a centralised, governmental statutory regulation considered to be inadequate for the market, to be stifling and

exposed to the need of fast overhauling in the wake of fast transformations and changes on the markets. In such a context, if statutory or governmental regulation should limit itself to the adoption of general guiding principles to be applied, the self-disciplinary regulation is then called upon to formulate for the profession deontological rules recognised and accepted by the profession.

It does not appear that standards of professional deontology can be assimilated to self-regulation and as such be clearly contrasted with statutory regulation; it is undeniable that the notion of deontology is wider and cannot be reduced to the concept of self-discipline; equally, it cannot be doubted that standards concerning professional conduct may be found in internal sources as well as in legal provisions. In this respect reference may be made, as an example, to the law reforming the French stock markets : it contains provisions relating to deontological matters.

Deontological self-regulation is based on the existence of regulatory agencies and independent administrative authorities (IAAs). It may even be said that both terms, deontological self-regulation and IAA condition or imply each other. For this reason and with their logical interdependence in mind, some attention will be focused below on the regulatory agencies.

The term "regulatory agency",¹⁰ applied to the situation in the USA, refers to a type of federal regulatory organ which has no equivalence in civil law and the English legal systems. In the USA such a body is called upon to supervise a particular economic sector. For such a purpose it has at its disposal a vast series of powers of diverse nature ; it can issue regulatory standards, insure their implementation and application and deal with thereto relative controversies. In the USA,

perhaps owing to a lack of historical tradition for centralised bureaucratic administration, the system relies, when settling administrative policies, less upon the judgement of highly trained "professional" civil servants than on the use of adversarial court-type procedures.

The first USA regulatory agency was the Interstate Commerce Commission created in 1867 by the USA Congress to control railroad rates, with powers to stabilise tariffs, grant concessions etc, thus securing the implementation of the relevant directive decisions of the Congress. In 1914 the Federal Trade Commission was created and in 1934 the Securities and Exchange Commission (SEC). In 1940 it was observed that operating as private-ownership associations, exchanges had always administered their affairs in much the same manner as private clubs. For a business so vested with the public interest, this traditional method had become archaic.' By the 1960s government regulation of "prices" or "entry" was commonplace in the transportation, communications and utility industries. Federal or state regulatory bodies exercised control over trucking, airlines, telephone services, radio, television and natural gas. The federal government regulated the safety of products or production methods in the transportation, food, and drug industries as well as in the sphere of banking and issuing securities for protecting depositors and investors. In the 1960s and '70s, the scope of regulatory activities had expanded still further. The federal government had begun to regulate oil prices, to impose controls on environmental pollution, and to regulate the safety of the workplace, on the highways, and of consumer products. It then also increased regulatory efforts to protect investors, including pensions holders and commodities traders.

From what has been outlined above it is evident that regulatory agencies can be part of a quite vast category of administrative agencies. Some describe regulatory agencies as acting like "little courts" and "little legislatures". Maybe a regulatory agency could be considered to be lying in the middle of the distance between nationalisation and complete laissez-faire. In Europe, as noteworthy, popular acceptance of the market ideology is a relatively more recent phenomenon.

For most of the period between the great deflation of 1873-96 and World War II (1939-1945), large segments of political opinion were openly hostile to the market economy and sceptical about the capacity of the then existing system to survive recurrent crises. Hence, in industrial sector after industrial sector the response of most European governments to perceived cases of market failure was not regulation but nationalisation, industrial reorganisation and planning, and other forms of corporate intervention. Moreover, even when regulatory instruments like price controls, standard-setting or licensing were used, there has been a general reluctance to rely on specialised, single-purpose agencies. Instead, regulatory functions have been assigned to traditional ministries or inter-ministerial committees. The absence of independent regulation, the preponderance of informal procedures for rule-making and the diffuseness of various corporatist arrangements of self-regulation have all been factors that can help to explain the low profile of regulatory policy-making in Europe.¹²

Gower has emphasised that "Since joining the [European] Communities [the UK] is no longer free to maintain or institute regulatory systems without regard to the Directives and Regulations of the [EU] Council [of Ministers]. Any system of regulation which [the UK] maintain[s] or introduces must be harmonised with that of

[the other member states] in the Community. To comply with EEC Directives and Regulations some increase in statutory, as opposed to non-statutory, regulation, seems inevitable in the long term.¹³ It may be wondered whether some of the critique aimed by the financial market participants at the statutory regulation of the financial services by the corresponding act of 1986 can be better understood and explained in the light of the relevant remarks of Gower. On the other hand, it has been remarked that experiences with self-regulation in the UK have not been encouraging and that there has been sufficient ground for doubt in the UK experience to make one wary of enthusiasm for self-regulation.¹⁴ Whatever the objective view may be, there has in the last years (1990s) been a tendency to encourage the creation of new self-regulatory agencies, such as the Panel, CSI, the Insurance Brokers Registration Council, and to assign (self-)regulatory tasks to them, either wholly or partly, either by statute or by persuasion. With respect to new statutory self-regulatory agencies, the statutes have provided for a measure of governmental control and supervision, for example, through the appointment of members of the agencies and approval of agency rules. This development has blurred distinctions between governmental regulation and self-regulation, and between statutory and non-statutory regulation.¹⁵

Thus the roots of regulatory agencies are to be found in the notion of centralised state control, with due regard to respective legal cultures in civil law countries and traditions of self-regulation typically identifiable in common law culture in the UK. Regulatory agencies in substance promote that which Gower has favoured: "The ideal would be to weld self-regulation and governmental regulation into a coherent statutory framework which would cover the whole field that needs to

be regulated and in which each part would fit harmoniously together."¹⁶ The practice and experience of regulatory agencies in civil law systems as in France and Italy are promoting the adoption and application of self-regulatory approaches as elements typical of common law tradition, while in the UK with its common law environment resort is being made to elements of governmental regulation as a typical tool of civil law tradition.

In conclusion it can be said that the COB in France, CONSOB in Italy and SIB in the UK as regulatory agencies are the products of a synthesis between self-regulation traditionally predominant in common law environment, on the one side, and centralised control typical of civil law systems on the other. This process of rapprochement as a means of integration has not least been promoted by the benefits of experience in the USA where the specific political and federal structure has favoured the integration of standards of common as well as civil law.

In Italy, the "amministrazioni indipendenti", administrative bodies exclusively governed by statutory standards, are bodies not closely studied while being part of the legal system. The very well known example thereof is the CONSOB (Commissione Nazionale per le Società e la Borsa) (National Commission for Companies and the Stock Market). These bodies, atypical but generally permanent, are marked not so much by a responsibility to pursue public interests of administrative nature as, somewhat similar to a judicial function, to protect the interests of citizens, particularly in situations of confrontation with particularly strong and influential economic entities. In fulfilling such a function, the organs entrusted with it are assumed to have a high standing as to impartiality and

objectivity comparable to that of a judicial authority. This comparison is verifiable in the light of the fact that these agencies are not governed by a system of exclusive hierarchy. They are subject solely to the law.¹⁷ Their existence as a model lends itself to their multiplication in other sectors such as that of the housing market, data protection, sanctity of the sphere of privacy of citizens etc. In the research literature on the topic, "independent" administrative agencies are treated by some as "atypical administrative" bodies,¹⁸ while others try to subsume them under the general heading of standard administrative functions.¹⁹

In France the novelty and particularly of independent administrative agencies is shown by decisions of the Conseil d'Etat, which while being part of the executive arm of state authority has but quite a tenuous link with the government hierarchy. Their independent status is not affected by the way they are financed or are related to judicial organs.²⁰

The freedom of action of independent administrative agencies has been underlined also by a French author.²¹ He considers them as bodies expressing a polycentrism which is replacing the old unitary approach to administrative organisation. They assume a public character by the fact that (in our translation) "they concern public liberties the protection of which can be assured but by the state, but which have at the same time to be defended against intrusions by the executive power; their statutory independence is intended to enable them to do justice to this challenging equilibrium".²² "The administrative authority of an independent agency is definitively dependent on the personal credibility of those to whom their tasks are codified", as stated by the Conseil d'Etat. The selection of the appropriate persons for office weighs as much as the quality of structures

and legal formulations.²³ The attribution of ample powers to administrative agencies may be comparable with those exercised by judicial authorities, in that we have to do with a sphere which is normally allocated to judges but is entrusted to an agency of public administration. This particular aspect of state administration generates questions. The independent agencies in question, with highly professional and specialised officials, substitute themselves in a way for so to speak legislative inertia and may generate the risk of setting up special legal standards. This and other points are, with particular reference to independent administrative agencies as a burning question, are abundantly discussed in the relevant research literature, in which the limits and the dangers related to such agencies which while on the one hand are not quite part of the executive arm of government are also partly not caught by the control of parliament.²⁴

Developments, particularly in France as a civil law country, evidently show that the law regulating the financial markets is now dependent for its effectiveness on the functions of a plurality of agencies which together with the legislator provide the organisational structure of the markets and have at their disposal means for protecting the investors.²⁵ In the way the law in question manifests itself self-regulation also is a market regulatory factor to which state authorities entrust a role of increasing relevance for guaranteeing adequate standards of efficiency and reliability on the financial markets. Self-regulation is, however, "controlled" in the sense that it is not generated by a spontaneous initiative of the markets operators themselves, but is deployed by them within a framework laid down by the state be it with respect to self-regulatory powers or self-regulatory supervision or

disciplinary competences. Thus, in the financial markets too self-regulation confirms its vocation as a complex phenomenon including judicial attributes which do not, however, make redundant ethical dimensions.

The implication of a self-regulatory system in financial markets points to the existence of problems of varying nature dependent on the characteristics of national legal systems and tradition. It is evident that a most significant aspect and limits of self-regulation concern the protection of investors and rules of conduct in relation to third parties, that is, clients who conclude contracts of investment with financial operators. Problems emerge particularly with forms of self-regulation in a strict sense there where legal or administrative standards may not exist in the form of an internal code of procedure, for example, by a firm of French intermediaries.

A survey of self-regulatory experience shows that it has its part to contribute, but without an exaggerated emphasis on it. Developments in France show that protection guarantee mechanisms applicable to the activities of intermediaries can be made more efficient by means of a coordinated intervention by the legislator and forces operative in the markets.²⁶ Self-regulation can generate within the markets a new area of creating binding standards which may be closer to the individual than legal and administrative standards would be. In such a sense, it has a potential to contribute, where central legislative effectiveness may be eroded, to the development of an authentic process of legislative legal pluralism.²⁷

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5. C. Hanoun, *op. cit.* (note 3 above), p. 423.
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18. Ibidem, p. 85.
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24. C. Teitgen-Colly, Sanctions Administratives et Autorités Administratives Indépendantes, in Petites Affiches, (1990), n. special of January 17, 1990.
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Chapter 5The Stock Exchange Commission : La Commission des
Opérations de Bourse (COB)1. Establishment and Development ; The SEC in the
USA as a model

In 1967 the French government under President Ch. de Gaulle proceeded to create the COB for promoting the trust of investors in the securities markets for the purpose of attracting investment capital for the French economy.¹ Inspired by the SEC in the USA as a model,² the COB was initially a control agency of the stock markets, without any financial autonomy. Currently, the COB supervises all types of financial products. It can in other words be said that the COB controls, with a few exceptions, the totality of the financial markets and protects all forms of investment.³

Since its birth, the COB has seen, as an independent administrative authority (IAA), its powers grow enormously. Favard observes that the COB has benefited from all the ensuing reforms for expanding its powers.⁴ The expansion in question has been justified with reference to the necessity of market reforms, the europeanisation and internationalisation of the financial markets in France. As a result in 1991 the Paris stock exchange ranks as the fourth in the world after New York, Tokyo and London.⁵ After having been one of the most centrally regulated markets of the world, it has undergone profound changes in the wake of five years of reforms and development between 1984 and 1989. This has involved a fast process of deregulation to which various measures of privatisation and the abolition of most measures of exchange controls have contributed. To them should be added the revival of the entrepreneurial spirit

of the French financial establishment.⁶

Among major initiatives to activate and develop the financial markets has been that of opening the futures market (marché à terme) (MATIF) in February 1986, considered in 1989⁷ the "third in importance in the world after the Chicago Board of Trade and the Chicago Mercantile Exchange, having overhauled the corresponding LIFFE in London."⁸ In July 1989 the French stock market abolished commission charges applied to small transactions, with results similar to those reported after the 1975 Mayday in the USA and the 1986 Big Bang in the UK. The results concerned (i) lower commission charges for institutional investors; (ii) elimination of the smallest and vulnerable firms in the wake of lower competitive commission charges; and (iii) no reduction or higher commission charges for private investors.

In the wake of consolidation measures, on January 1st 1991 all regional exchanges were closed and all transactions were concentrated in the Paris stock exchange. The regional stock exchanges did not have more than three per cent of the volume of transactions effected at the Paris stock exchange.⁹ For the representation of regional interests, Regional delegations were formed within the COB and 22 delegates were nominated.¹⁰

With further measures on August 2, 1989, the assimilation process of the COB with the SEC in the USA could be considered as complete, in the sense that the powers of the COB become more similar to that of the SEC, with due reference to a few exceptions.¹¹ A particular point of difference was the fact that whereas the SEC was under an obligation to refer a case to the US Department of Justice, the COB was given a margin of discretion to refer or not refer to the French Ministry of Justice. Further differences between the two institutions

concerned the exercise of disciplinary and administrative competences : the SEC may threaten members of the relevant professions, natural or legal persons with disciplinary sanctions like censure, suspension or withdrawal of licence; in France, in contrast, disciplinary measures are exclusively applied by the professional bodies, that is, le Conseil des Bourses de Valeur, Conseil du Marché à Terme, Conseil de Discipline des OPCVM; the COB may request solely a second (review) decision. Lastly, while the SEC is not empowered to impose administrative sanctions but may effect penal proceedings, the COB is empowered to impose administrative sanctions but has no powers to initiate penal proceedings. In conclusion, the relatively recent reforms affecting the COB have acted as a noteworthy impulse for bringing the COB to the normative standards of the SEC, with due reference of course to unchanged and maintained aspects typical of French legal tradition, for example, the exercise of disciplinary competences by professional bodies.

2. Legal Nature of the COB

It has been said that the COB, inspired in its creation by the SEC, has introduced in the French financial markets system "an element of Anglo-Saxon exotism".¹² Therewith is meant a new form of administration which can be defined as an agency of control and protection. Yves Le Portz has as President of the COB said it is "an autonomous public institution",¹³ while Duccouloux-Favard¹⁴ notes that we have to do with an "administration de mission", that is, an agency of public control endowed with a certain autonomy in relation to the state and with an uncomplicated structure for avoiding bureaucratisation while being able to exercise a rigorous control with speedy intervention methods. The COB itself is defined as an "independent public

regulatory authority" (*autorité publique de régulation indépendante*).¹⁵ It may also be said that the COB is a body with sources in the executive power.¹⁶ However, the constitutive law of 1967 is silent on the legal nature of the COB.¹⁷ Decree No. 68-23 of January 3, 1968 on the administrative and financial structure of the COB limits itself to a definition of the COB as a specialised agency of public nature, the finances of which are borne by the state.

In 1980 Nicole Decoopman¹⁸ referred to the COB as a public body with no legal personality but acting as a state agency, that is, a simple administrative entity acting on behalf of the state but not on its own behalf. Some authors assert¹⁹ that legal personality has in fact been implicitly given to the COB. In spite of the considerable expansion of the COB's institutional and financial autonomy, legislation on August 2, 1989, does not acknowledge the COB as a body endowed with legal personality, in contrast to the *Conseil des Bourses de Valeurs* (Stock Exchange Council) to which explicit legal personality has been granted. It should be noted that the conferment of legal personality is considered to be a valuable tool for ascertaining criteria of independence.²⁰ Alpa argues that the riddle of the legal personality of the COB has been resolved with the promulgation of, Law No. 84-16 of January 11, 1984 on functions and competences under public law.²¹ It regulates the "specialised administrative agencies". (See Art. 5, para. 3.) He concludes that the COB is a body governed by public law (*Commercial Tribunal* of Paris, July 28, 1986, in D., 1987, *sum. comm.* 305). Tunc submits that even if no legal personality has been conceded to the COB, it has obtained its financial autonomy under the law of 1989.²² It may however be countered that acceptance of an "administration de

mission" is not tantamount to the (legal) personification of the given agency. As has been underlined, the absence of legal personality bars the COB from becoming a direct interlocutor in international agreements.²³

Gavalda is of the opinion that the legal nature of the COB as an Autorite Administrative Independente (AAI) has not been modified even if it has been endowed with new competences. It continues to be a hybrid belonging to the category of AAI. It has not yet been given legal personality and hence it has a sort of jurisdiction. The attribution of legal personality supplemented with the attribution of the right to act as a party under civil law would have excluded the capacity to apply sanctions. This capacity constituted in reality, in spite of other circumstances, the fundamental purpose of the reform of 1989.²⁴

With Art. 10 of the Law of August 2, 1989, the legislator had considered it opportune to extend to the President of the COB the right to have locus standi under civil law, "deposer des conclusions, intervenir ou exercer des droits reserves a la partie civile en ce qui concerne, d'une part, les infractions au titre II de la loi No. 66-537 du 24 juillet 1966 sur les societes commerciales, d'autre part, les infractions prévues par les articles 10, 10-1 et 10-3." Such a capacity to act would have amounted to a most noteworthy amplification of the possibilities of the COB to intervene before judicial authorities, but the Conseil Constitutionnel (constitutional court) with Decision No. 89-260 DC of July 28, 1989, (JO August 1989) declared Art. 10 of the Law of August 2, 1989 to be unconstitutional by being incompatible or in conflict with the autonomous sanctioning powers given to the COB by the same Law. The right to sue under civil law has in fact been recognised for consumer associations. These may statutorily

undertake the defence of investors.²⁵ It may in conclusion be said that the COB as the "watchdog of the stock exchange" has been transformed into a "judicial authority" or "judge" after having again put on the mantle of the "legislator"²⁶

3. Composition and Financial Autonomy

What follows below is a bare outline. It serves the purpose of linking COB's structure and financial autonomy to the questions of (i) its independence from political influence and (ii) its functions as an objective, autonomous authority called upon to supervise the markets not least in the interest of investor structure.

Composition

The president of the COB serves in office for six years while the eight other members hold office for four years. Re-election is excluded for the president; the other members may be re-elected for a second term. All mandates to hold office may be interrupted upon reaching the retirement age.

The reform in 1989 has notably increased the number of members from five to nine and modified the composition and modality of appointment of members. The composition of the COB has become more stable by increasing the term of office of the president from four to six years.

The president is appointed by decree of the Council of ministers. Of the eight other members six are directly designated by the bodies to which they belong; the remaining two members are co-opted by the six other members "on the basis of their competence and experience in the sphere of savings business." (in our translation)²⁷ Gavalda is of the opinion that for the appointment of the two of the COB members with reference to their competence and experience, their selection by the other members is a "master key" formula which does no

harm to anybody but it confers a discretionary power on the other members, as a solution which is not ideal but better than appointment by the ministry of finance.³⁵

With respect to the president the principles of incompatibility provided for public office apply, but nothing similar is provided for the position of the COB's other members.

The exercise of direct sanctioning powers lies within the collegiate competence of the COB, but indirect sanctioning power lies within the ambit of autonomous authority of the president. Gavalda underlines³⁶ that while the President has at his disposal the exercise of powers delegated to him, the collegiate body has as a whole stronger powers. As to COB's autonomy, it is in the first place derived from a security of office of COB's members and COB's financial independence.

Before 1989 some members of the COB were selected from the sector of the stock exchange and financial affairs. Currently not more than half of the eight members of the COB may belong to the world of the stock exchange and finances. Members of the COB include a strong participation from the sphere of administration: a councillor of state and a councillor of the Court of Auditors participate in it, making the administrative arm of government strongly represented. At the level of professional representation, a member comes from the Conseil des Bourses de Valeur (CBV) (Council of the Stock Exchange) and another from the Futures market (marché à terme). There is also a representative of the Bank of France. No provisions have been made for the representation of investors.³⁷ Tunc³⁸ observes that among COB's eight members half of them are from the judicial establishment or are representatives of the Bank of France, as a guarantee for the protection of general interests, and the other half of the members come from

the sphere of the stock exchange and financial affairs, as representatives of another type of experience and awareness. Only one woman has been included on the board of the COB,³² but she has not been re-elected.

It should be noted that the reforming law of 1989 has weakened the link between the COB and the executive arm of the government, as while the COB's president is directly appointed by the Council of Ministers, six of the members are elected directly by professional bodies, which was not the case prior to the reform. The composition of the COB after the 1989 reform is considered³³ to be a guarantee for its independence and professional qualities. However, the question remains whether a member of the COB could be relieved of his function. Leading authors³⁴ are of the opinion that the mandate of a member is irrevocable. In reality until now no member has been removed from office. Other authors³⁵ think that on the contrary the members of the COB can be removed from office ad nutum. Within the COB it is maintained that the President cannot be relieved of his functions.³⁶

Financial autonomy

The financial autonomy of the COB is the best evidence in support of its independence from the executive arm of the state, a fact which did not exist prior to 1985 when the COB did not enjoy any financial autonomy.³⁷ Successively COB's right to cash fees related to activities subject to its control has been recognised, linking COB's finances to the development of the markets.³⁸ In 1992, the operational budget of the COB increased to FF 123.61m.³⁹ and to 131.8m. in 1993⁴⁰ while income decreased to 7m. Currently the COB is subject to a control a posteriori of the (state) Court of Auditors.

On December 31, 1986, the COB had 105 agents⁴¹

rising to 232 at the end of December 1992¹² and decreasing to 226 at the end of December 1993.¹³ In comparative terms, in 1992 the SEC had 2,835 persons as members of its staff, with a budget totalling to approximately US \$276m. or approximately L180m.¹⁴

4. Functions and Powers of the COB

What follows below, again in summary, is intended to outline the profile of the COB as an agency in charge of regulating and controlling the financial markets and, ancillary thereto, to protect the interests of investors in their contracts with the market operators and particularly with the intermediaries.

The practice of the COB involves (i) regulatory powers with a thereto related regulatory procedure; (ii) sanctioning powers involving injunctions and the imposition of pecuniary penalties; and (iii) new powers relating to penal actions.

a.) The COB in practice

Initially the functions of the COB were limited to controlling information offered by market operators and consumed by the public on societies appealing for investment and offering stocks and shares, as well as in monitoring the proper functioning of the stock exchange.¹⁵ Therewith two fundamental spheres of functions were indicated :

-- control, a priori as well as a posteriori, of information publicised by companies appealing to the investing public ; and

-- general monitoring and supervision of the stock market.

The first extension in the powers of the COB was effected by the Decree No. 68-50 of January 3, 1968. It abolished the Committee on the stock markets and transferred its competences to the COB.¹⁶ The latter was also entrusted with the competence of supervising the

admission of all listed stocks or the withdrawal of stocks from the market.

The first amendment of the Ordinance of 1967 was through Law No. 70-1283 of December 31, 1970. Its Art. 34 extended the supervisory powers of the COB to cover all companies capable of issuing shares and stocks. Arts. 5 and 10 of the Ordinance were amended and Art. 12-1 was added.⁴⁷ Thereafter with the Law No. 83-1 of January 3, 1983, for the purpose of promoting investment and protecting investors, the supervisory powers of the COB were enlarged to cover (in our translation) "investment in diverse assets". As to the attribution, to the COB, of penal powers, Art. 35 of the Law of 1983 (which corresponded to Art. 10-1 of the 1967 Ordinance) was in turn amended by a law in 1992. After the passage of this law, the powers which the COB could exercise were regrouped then into four categories :

1.) Regulatory powers

They were bound to the stock market and involved the capacity to approve the articles of association of a firm with exchange agents as partners. In this respect no sanctions were included for application.

2.) Powers "auxiliary" to judicial authority

Art. 4 of the Ordinance provided that the COB is empowered to receive from any interested party complaints, petitions which by their nature fell within the ambit of COB's competences, and to deal duly with them. Art. 5, para. 3 of the Ordinance of 1967, sanctioned by Art. 10 last para., enshrined the power of COB to mandate a witness to appear. This was and remains all the more remarkable in the light of the fact that in France solely judicial authorities dispose of such a competence and not even parliamentary enquiry commission can constrain a witness to appear.⁴⁸

3.) Action of persuasion by the COB

This still constitutes one of the most original traits of the COB. In the case of resistance, by Art. 3 of the Ordinance of 1967 the COB is empowered to bring to the public's attention observations which the COB has formulated (in the interest of the market and of investors). Disciplinary action and penal measures were in this context still considered by the law of 1983 to be extreme remedies.

4.) Actions by the COB and appeals related thereto

Since the COB is a public agency not subject to any hierarchical authority and not endowed with legal personality, its decisions cannot be the object of administrative appeals, but they are open to judicial review by administrative tribunals and the Conseil d'Etat as the highest administrative judicial authority. Art. 12-1st already provided that the relevant judicial authority could be requested at any stage of judicial proceedings to deal with an act or opinion of the COB. The Law No. 85-695 of July 11, 1985 defined and enlarged the functions of the COB.²⁰ A further important development for the COB took place when Law No. 83-1321 of December 14, 1985 (compare Art. 4-1 of the Ordinance of 1967), attributed amplified regulatory powers with respect to financial markets governed by its authority; with respect to information supplied to investors; and with respect to "professional practice" related to public appeals for investment and to portfolio management. The Law No. 88-70 of 22 January, 1988, by the range of its provisions, produced a "peaceful revolution" in four areas :

- 1.) Exchange agents were replaced by stock exchange companies for the purpose of making the profession accessible to new intermediaries, particularly non-French intermediaries;
- 2.) The antiquated national firm of exchange agents was

substituted by two organisations : the Council of the stock exchange and the firm of French stock markets ;

- 3.) The competences of the COB were extended to cover future contracts with powers to enforce them ;
- 4.) The financial markets were so to speak "moralised" with the introduction of deontological norms and with the reinforcement of the "suppressive" system by reformulating the nature and contents of infractions in the sphere of the stock exchange.

Hence, the law of 1988 amplified the control powers of the COB beyond the stock market into all financial markets, including futures and commodities. Moreover, consequent to the reform of 1988, the COB ceded its traditional power to prepare the admission of stocks to official listing or to ordain their withdrawal to the Council of stock markets; this competence of the Council may not be exercised in case of opposition by the COB. In substance, it can be said, the law of 1988 has renovated the institutional as well as moral architecture of financial markets.

The moral impact of the reform of 1988 is less visible in the words of the legislative text, but it is no less important : the affected professions were given a set of deontological standards. This should be underlined as to its importance, because a rigorous deontological system was installed, adapted to the new requirements of the reformed market.

On March 8, 1989, after less than a year subsequent to the reform of 1988, under the impact of the Pechiney scandal,²¹ the National Assembly had to deal with the draft text of the Law No. 544. It was rapidly adopted without any opposition on 27 July, 1989 and became binding law on August 2, 1989 (Journal Officiel, August 4, 1989, p. 9622). This new legislative text modified the composition and the powers of the COB to such an extent

that experts have been speaking of a "new COB".⁵²

The two driving motives underlying the new law of reform of 1989 concern the reliability and transparency of the financial markets. Both aspects are intimately interconnected because transparency can have but necessary repercussions on security on the markets. The 1989 reform left the attributions of the COB substantially untouched as to information and control over information. It heightened notably its powers of vigilance as to the proper functioning of the financial markets by attributing to the COB a sanctioning power and by increasing its investigatory competences.

The attribution to the COB of direct and autonomous powers to issue injunctions and impose sanctions is one of the most significant aspects of the last reforms affecting the reorganisation and the strengthening of the powers of professional and disciplinary groups affecting the activities of intermediaries. Presently the functions of the COB are enshrined in Art. 1 of the Ordinance No. 67-833 of September, 1967, as amended by the law of January 22, 1986. The given formulation in the legislative text points to a triple function of vigilance or surveillance affecting :

- the protection of savings ;
- information supplied to investors ;
- the proper functioning of the financial markets.

Bonavera points out⁵³ that two major lines of action can be distinguished for the purpose of protecting investors: on the one hand in connection with vigilance to be applied to information supplied to investors; and on the other in connection with vigilance affecting the proper functioning of the financial markets. Indeed, it is these two directions that the activities of the COB are deployed.

Control by which the COB is exercised with respect

to information which listed companies have to supply to the public or to their respective shareholders. The regularity and contents of the published information are verified. In case of need, the publication of rectifying information by companies may be prescribed, to remedy inexactitudes or omissions in the published documents. The COB may in this respect bring to the public attention its own observations and ulterior points of information.⁵⁴ In particularly serious cases, the COB may request the suspension of quotation of a listed stock.⁵⁵ It should be added that the control by COB extends also to non compulsory information, to individual points of practice and conduct which may be denounced for endangering the security of investors' interests. In this respect, particular mention deserve the following

- stock exchange delictual acts: abuse of privileged information or of illicit communication of a privileged information; delict of manipulation of quotations and the diffusion of false or erroneous information ;
- acts incompatible with the rules of the COB ;
- Infractions : (a) violating provisions of company law, for example, publication of false balance sheets; abuse of company assets; incorrect appeal to the investing public; (b) violating standards governing the management of individual or collective investment portfolio.

5.) Power to issue Regulations and the Rescript Procedure

The law of 1985 (with the introduction of Art. 4-1) has given to the COB real and proper regulatory powers which extend to almost all the financial sector.⁵⁶ Therewith the COB is empowered to issue regulatory rules concerning the functioning of the markets subject to its control as well as concerning standards of professional practice, addressed to those who make offers to the

investing public. This category of persons does not include those who participate, as part of their professional work, in the placement of investment offers or assure the individual or collective management of portfolios (Art. 4. 1, first para. Ordinance of 1967). Additionally, subject to approval by the Stock Market Council (Conseil des Bourses), the COB is authorised to adopt decisions on all questions of a general character touching the proper functioning of the stock market. The issued regulations are subject to approval by the Ministry of Economy and Finance and are published in the Official Journal. If regulations in question concern a specific market, then their approval by the supervisory authority of that market is necessary. The regulations may be challenged by application to administrative judicial authority. Their legality may be scrutinised by the highest administrative judicial authority, the Conseil d'Etat.

The COB can penalise conduct breaching its regulations. In extension of its regulatory powers, it has set up a particular procedure which completes and gives concrete expression to its powers: the rescript procedure. Regulation 90.07 of July 5, 1990, provides that the COB may be consulted with respect to the interpretation of its regulations, by all who planning a transaction, wish to know in anticipation whether the intended transaction is in conformity with COB's rules. For this purpose the COB has at its disposal the rescript procedure.

This procedure, introduced by the already mentioned COB Regulation 90.07, confirmed on July 5, 1990 (See J.O. of July 20, 1990), is inspired from Roman law. Rescripts were then so to speak responses of the Roman emperor which he put down as footnotes to the requests of all those who referred to him a controversial case and wished

therewith a decision for it. Rescripts had become sources of civil law.³⁷ The ratio of the French rescript is the same as that of Roman rescription, promoting legal certainty. In a way a rescript may also be compared with "rulings" in English and American legal tradition. They have been extensively used by the SEC in the USA. It should be however added that the scope of the French rescript is much ampler,³⁸ because COB's interpretations of its regulations bind the COB and it later cannot penalise a transaction with sanctions or refer it to judicial authority. Thus, a COB rescript has preventive effects. It should be noted that COB's rescript procedure is applicable to COB's regulatory rules only: the COB cannot indulge in the appreciation of the merits of statutory rules or standards adopted by other bodies, for example, by a disciplinary authority. Practice also shows that a request for a rescript may be submitted only by those who are a part of a proposed transaction; third parties are excluded (Art. 3 of the 90-07 Regulation). Specific standards guarantee confidentiality (Art. 4 of the 90-07 Regulation).

The COB has a maximum time limit of 30 days to respond to a rescript application, provided the application is clear and complete as to its contents, otherwise the time limit may be suspended and the COB may request clarification. If the COB finds itself not to be in a position to assess the real scope of the proposed transaction, or if it considers that the request for the rescript has not been submitted in good faith, it may decline to issue the rescript.

The new procedure differs profoundly from that of earlier informal consultations, already through the fact that the COB has to proceed formally in the case of a rescript, deal with it as a collegiate body in response to a (formal) request. If the proposed operation is

transacted in conformity with COB's standards and if the applicant(s) act in agreement with the rescript, the COB has no powers to prohibit the completion of the transaction or to forward a report to judicial authorities or to the relevant disciplinary body (Art. 8). Thus, the rescript binds the COB too while binding the applicant on the other side. Art. 9 of the 90-07 Regulation established that the rescript together with the formal request for it, is to be integrally published in the monthly Bulletin of the COB, as a sort of "binding practice" by the COB, so that inevitably future analogous cases can be treated equivalently without resort to a further specific rescript.

The Rescript procedure, by virtue of the ample drafting of COB's regulations and of professional standards, involves a delicate point for the intermediaries as specific forms of coordination between the various sanctioning procedures do not exist. At a formal level,³⁹ the various stock market authorities are invested with various competences and the legislative reforms have not reliably provided for certain coordination at an institutional level. Conflicts may be the result between the roles of the various competent quarters.

The legislative reforms of 1988 and 1989 defined as mutually independent the disciplinary procedure related to the COB, on the one hand, and a corresponding procedure allocated to the disciplinary bodies dealing with the intermediaries, without dealing with matters of procedure related to penal rules. Therewith the rescript procedure raises delicate points to the extent that it binds only the COB without having any binding effects for the judicial authorities or disciplinary bodies. It may hence be asked as to what would happen if a given transaction is bindingly assessed by the COB in

accordance with its own standards but found to be incompatible with professional, and even worse, with penal standards.

The initiation of an independent panel or disciplinary procedure concerning persons in possession of a favourable rescript remains, in principle, always as something possible, even if the COB would seek to make use in such a situation of all its proper "morally persuasive" efforts and, above all, its links of cooperation with judicial authorities and professional bodies. With respect to the latter the COB may request a second decision affecting disciplinary matters. In substance, however, it would be improbable to initiate an independent penal procedure in the absence of any signal from the COB to the judicial authorities.⁶² Consequently, the coordination of the various existing procedures constitutes one of the most evident problems of the new system.

If the rescript procedure shows that a growing need for adequate direct relations exists between the regulatory bodies and the market operators, it can also be an important opportunity for the COB to clarify the extent of its own regulations, but it at the same time involves a renunciation on the part of the control bodies to elaborate precise rules. The adoption of a regulatory system using generally drafted standards may serve the purpose of flexibility, but it at the same time obliges the same authority to indulge in a process of continuous interpretation for orientating from case to case the conduct of the market operators. Nonetheless, the new procedure definitely amounts to a novel and important development for giving concrete expression to the stock market reform in France, consolidating at the same time the role of the COB as one quite different from a less articulated "administrative mission" to which experts

used to refer in the not distant past.⁶¹

The specific characteristic of the rescript consists in its ambivalence: it is at one and the same time an individual decision which binds the COB with reference to its sanctioning powers, and an act with general effect with which the COB interprets its own regulatory standards. The reconciliation of these two aspects is a very delicate matter. The prudence manifested by the COB in drafting regulation No. 90.07 and its first and still unique rescript does not attenuate the point of legal certainty. This reflects up to now why there has been an absence of enthusiasm in support of the innovation.

6.) Sanctioning powers

- i. Direct and indirect powers ;
- ii. Power to issue injunctions.

i. Direct and indirect powers

The sanctioning powers of the COB, enshrined in the Law of 1989, are limited to the control of the proper functioning of the markets, of information supplied to investors and of the protection of savings. The exercise of such powers presupposes always a breach of a regulation of the COB. They may be exercised directly or indirectly, necessitating the adoption of provisions on the part of the judicial authorities. Hence, the COB may opt for one of the two possibilities. On the basis of the principle that special rules derogate from general ones, with reference to Arts. 9-1 and 12-2⁶² it may be deduced that Art. 9-1 enables the COB to act under "direct" sanctioning powers and anything which is not covered by the contents of this Article authorises the COB to apply to the judicial authorities to ascertain whether a certain professional conduct violates legislative or regulatory standards in such a way as to be detrimental to the rights of investors.

The COB may (a) issue injunctions; (b) apply

administrative sanctions; (c) submit reports to the judicial authorities; and (d) request addressed to disciplinary bodies.

(a) Injunctions

The COB can order discontinuance of violations of its rules when these may interfere with the functioning of the market, or provide to those concerned unjustified advantages not available in a normally functioning market, or interfere with the principle of equal access to information and with the treatment of investors and of their interests; or may help obtain benefits accruing to issuers or to investors with intermediaries involved in conduct contrary to professional standards. If the injunction does not generate results, a sanctioning procedure may be initiated.

(b) Administrative sanctions

The COB may apply administrative sanctions to infractions against its regulations, involving pecuniary sums not exceeding FF 10m, and if pecuniary benefits have been secured, up to ten times the amount of the benefit. The administrative measure is in proportion to the seriousness of the committed act and is related to the benefits and profits derived from it. The procedure provides for objections to COB's measures and an appeal from a decision of the COB may be lodged with the Appeal Court in Paris. The Appeal Court in Paris has confirmed the regularity of the sanctioning administrative procedure established by Decret No. 90-263 of March 23, 1990.⁶³

(c) Request addressed to a judicial authority

The President of the COB may turn to the President of the Grande Instance Tribunal in Paris for stopping or eliminating law or regulatory violations when it could be a danger for the rights of investors.

The Tribunal can order cautelative measures or apply

a pecuniary sanction.

The COB may turn to the Parquet in cases of penal infractions.

(d) Request addressed to a disciplinary body

The COB may turn to the Conseil des Bourses des Valeurs (Stock Exchange Council) or to the Conseil du Marché à Terme (Futures Market Council) when it becomes aware of irregularities committed by a professional member of the stock market or of the futures market; or the COB may address itself to the Disciplinary Council of OPCVM to report on infractions affecting statutory or regulatory standards applicable to the OPCVM; or the COB may communicate to the disciplinary chamber of the stock market operators breaches of duty by "auditing commissioners" ("commissaires aux comptes").

The sanctioning powers may be applied in two stages: -- an order to discontinue the conduct incompatible with the regulations; -- the imposition of pecuniary sanctions.

As the law does not subordinate the imposition of pecuniary penalties to non-compliance with an order to discontinue the incompatible act, it may be concluded⁴⁴ that both aspects of available powers are mutually independent. The imposition of pecuniary penalties depends on a valuational discretion on the part of the COB. Ascertaining the amount is dependent on the seriousness of the committed offence and on profits derived from it (Art. 9-2 of the 1967 Ordinance). Consequently, the sanctioning powers are flexible and lend themselves to rapid application.

ii) Power to issue injunctions

The power to issue injunctions is in substance the ability to impose the adoption of a defined conduct. It is one of the typical manifestations of the powers of judicial authority. Such powers have been more and more

frequently bestowed by French law to administrative bodies like the Conseil Superior de l'Audiovisuel, Conseil de la concurrence, the Commission bancaire.

The exercise of a power of injunction by such administrative bodies as the one just mentioned above raises a delicate balance of qualitative delimitation or distinction between administrative powers, on the one hand, and judicial authority on the other. Should administrative powers be allocated to the sphere of "administrative policing"? In the light of such a qualification "power to issue injunctions" could be recognised as being part of the administrative competences, as a power attributed solely indirectly, also as a competence subject to ultimate judicial review for approval of the injunction.

COB has been granted, since the Law No. 85-1321 of December 14, 1985 (Art. 31) "indirect" powers to issue injunctions, appeal from which for judicial review is possible when "conduct contrary to statutory or regulatory standards" is involved, with detrimental effects for the rights of investors. The same law, when amending Art. 37 of the Law No. 83-1 of January, 1983, had provided for a specific power for the COB to prescribe injunctions affecting offers to the investing public. In the meaning of Art. 20 of the Law of January 3, 1972, the COB is also competent to verify conformity with rules and may demand the communication of documents. Lastly, the COB is empowered, in accordance with Art. 3 of the Ordinance of 1967, to scrutinise information supplied by listed companies to shareholders or published. The company in question may be required to publish correct information or eliminate inexactitudes or omissions. The earlier Art. 4-2 of the Ordinance of 1967 had conceded to the COB indirect sanctioning powers of a quite vast magnitude enabling it to intervene immediately

in strictly limited cases. It should be observed⁴⁵ that the "indirect" sanctioning powers of the COB, necessitating recourse to judicial authorities, have been invoked by the COB with much discretion.

The sphere of "direct" sanctioning powers is quite vast. The "direct" sanctioning powers have been considered a substitution of a traditionally judicial function by that of an administrative authority.⁴⁶ Would not this involve the possibility of an abuse of powers?⁴⁷ Maybe preference should be given to "indirect" sanctioning powers (enshrined in the old Art. 4-2 of the Ordinance of 1967, now Art. 12), which, although wider in scope, prescribe intervention by judicial authority. With the possibility of such risks in mind, it is important to reflect on the contents of the Art. 9-1 of the Ordinance of September 28, 1967.

The attribution to the COB, by virtue of the Law of August 2, 1989, of an autonomous "direct" competence to issue injunctions, beside the formally non-variable "indirect" power, is part of an articulated autonomous sanctionary system of the COB and is one of the central elements of that system. Annunziata,⁴⁸ however, is of the opinion that it is difficult to distinguish clearly between acts which may be subject to injunctions under "direct" powers and acts which may be suitable for injunctions based on "indirect" powers. For the exercise of "direct" powers, the conduct in question has to be contrary to regulatory standards set up by the COB and have an effect of "fausser le fonctionnement du marché; procurer aux intéressés un avantage injustifié qu'ils n'auraient pas obtenu dans le cadre normal du marché; porter atteinte à l'égalité d'information et de traitement des investisseurs, des agissements d'intermédiaires contraires à leurs obligations professionnelles" (Art. 9-1 of the Ordinance of 1967,

attached to the Law of 1989); whereas recourse to a judicial injunction presupposes simply the existence of "une pratique contraire aux dispositions législatives ou réglementaires /.../ de nature à porter atteinte aux droits des épargnants." As violation of a rule set up by the COB may also affect detrimentally the interests of investors, it could be a question of applying both powers, "direct" as well as "indirect", of issuing injunctions. As a further factor of complication, the imposition of an injunction under "direct" powers is a matter for collegiate decision within the COB, while the exercise of "indirect" powers of injunction is included within the autonomous attributions of the COB President, with a different procedure provided for each category. In conclusion, in 1993 the COB initiated 10 procedures for sanctions and adopted 10 corresponding decisions in the course of five investigations affecting the following companies: Metrologie SA, Schneider, Ciments Français, Saint-Laurent and Suez.* The Paris Appeal Court partially modified the level of two administrative sanctions and confirmed five.**

7. Pecuniary Sanctions

Injunctions may be accompanied with fines in accordance with Art. 9-2 of the Ordinance of September 28, 1967 in the text modified by the law n. 89-631 of August 3 1989 as the logical complement of Art. 9-1. Differently from Art. 9-1, Art 9-2 expressly provides for an adversarial procedure and an explanation or ratio decidendi for the adopted decisions. The protection of persons affected by them is necessary because of the gravity of the fines which COB can impose on the basis of the new rules. Principles of (civil or continental European) public law would be the source of such defence rights even if the Ordinance of 1967 had not supplied any precision on this point. In spite of guaranteed defence

rights the legal provisions related to them have been in the parliamentary stage criticised by many members of the National Assembly and particularly by the Senate. The endowment of the COB with powers to impose pecuniary fines has been a most controversial point in parliamentary debates accompanying the adoption of the Law of August 2, 1989. The powers in question constitute a most relevant innovation mutating definitively the legal nature of the COB. The COB is given direct and articulated sanctionary powers in the interest of safeguarding the integrity of the market, in addition to the already existing regulatory powers. The COB can thus, as a "magistrature d'influence" or a "judicial authority of influence", act with binding powers in relation to the operators of the market. In this respect, as already mentioned, the COB is in the French legal system neither the first nor the unique administrative authority of control and vigilance entrusted with sanctioning powers. The Conseil de la concurrence and the Conseil supérieur de l'audiovisuel are other examples of comparable authority, but the COB necessitates a qualification; its sanctioning powers are added on top of its regulatory authority, which is not the case with respect to the mentioned two other bodies. Sanctioning authority invested in the Conseil de la concurrence and then in the Conseil de l'audiovisuel already constitutes a derogation from the principle of separation of powers, a derogation which necessitated an explicit intervention in the case of the Conseil de l'audiovisuel by the Constitutional court; in the case of the COB there is an additional aspect : the COB has sanctioning powers affecting conduct in breach of rules which itself has set up after confirmation by the Minister of the Economy and Finance (Art. 4-1, para. 3., of the Ordinance). The two other mentioned administrative bodies are allocated regulatory

powers which are strictly delimited and provisional in nature. A further important point related to the status of the COB is that the administrative sanctions it can impose may be part of penal sanctions or of disciplinary sanctions adopted by the professional control authorities responsible for the proper functioning of the relevant market, the Conseil des bourses des valeurs, the Conseil du marché à terme and the Conseil de discipline des organismes de placement collectif en valeurs mobilières. Hence it may be rightly asked whether the accumulation of sanctions by different authorities is a concrete threat and where its legitimate limits would be.

Looking more closely to the textual contents of Art. 9-2 of the Ordinance, we find that above all the legislator has endeavored to lay the foundations for COB's sanctioning powers on top of what is laid down for competence to issue injunctions. As to the relationship between powers to impose injunctions, on the one hand, and powers to impose pecuniary fines on the other, it is in the light of the legislative text not clear whether fines are dependent first on the imposition of injunctions. The subordination of imposed pecuniary fines as dependent on earlier issued injunctions may involve a factor of potential inefficiency in influencing the market positively. The evolution of the financial markets, high speed communication technology, the various types of effected transactions etc are all factors which may render recourse to injunctions useless. It may hence be concluded that in the interest of the markets, and participants in it, the COB may be free to act first as an agent of mediation before resorting to sanctioning measures.

Obviously any decisions on sanctioning measures shall have to be supported by the principle of proportionality (Art. 9-2, para. 2 of the Ordinance), of

defence (para. 3) and of the ratio decidendi (para. 5).

Referring again to the point of allocating sanctioning powers to administrative bodies, it can be said that such an allocation has been supported by the Conseil constitutionnel. In a decision relating to the Conseil supérieur de l'audiovisuel, the Conseil constitutionnel (decision n. 89-260 of July 20, 1989, JO August 1st) has decided that "le principe de la séparation des pouvoirs, non plus qu'aucun principe ou règle de valeur constitutionnelle ne fait obstacle à ce qu'une autorité administrative, agissant dans le cadre de prérogatives de puissance publique, puisse exercer un pouvoir de sanction dès lors, d'une part, que la sanction susceptible d'être infligée est exclusive de toute privation de liberté et, d'autre part, que l'exercice du pouvoir de sanction est assorti par la loi de mesures destinées à sauvegarder les droits et libertés constitutionnellement garantis." As long as constitutionally guaranteed rights and principles of justice are not violated, administrative bodies may, in the interest of their administrative functions and within defined limits, exercise judicial or quasi-judicial functions. In this respect, the Law of August 2, 1989, is quite a recent manifestation of this trend which two authors,⁷¹ some 30 years ago have defined as a "retreat of judicial authority ceding ground in the interest of administrative tasks" ("recul du pouvoir judiciaire au profit de commissions administratives"). They have qualified this development as a source of concern and anxiety for all who prefer to invest their trust in the first place in judicial rather than administrative authority for the protection of freedoms, adding that only an equilibrium between the control bodies of markets and their "moral authority" may secure the best protection of the interests of the participants.⁷² Today

the powers given to the COB are anchored in the Law of August 2, 1989.⁷³

8. New Powers in the Sphere of Penal Measures

The Law of August 2, 1989, provides also new provisions for strengthening the powers at the disposal of the COB for repressing stock market delicts. A new procedure has been established for the inspection activities of the COB as foreseen under Art. 5-ter of the Ordinance, 1967 and at the same time new precautionary measures have been adopted for guaranteeing a level of high efficacy in the activities of the COB, apart from judicial competences (art. 8-1 of the Ordinance of 1967).

For the prevention of penal infractions inspections may be made and items of evidence or proof may be collected "at any place", hence also in private homes, in accordance with the procedures of Art. 5-ter of the Ordinance of 1967. This includes conditions, criteria and principles found in other areas of application such as that of fiscal and competition matters. The inspection functions of the COB, in application of Art. 5-ter of the Ordinance of 1967, are subjected to the control of the judicial authorities and more precisely to the control of the President of the territorially competence Tribunal de Grande Instance (Department High Court). He may ordain in response to a request an inquiry by the President of the COB. As already mentioned, here we are dealing with, in distinction to the contents of Art. 5B of the Ordinance, with powers lying completely and exclusively within the competence of the President of the COB.

The new regime allows the COB not to limit itself to purely administrative enquiries for referring them to the judicial authority as to penally relevant facts, but may actively collaborate with the authorities

of criminal justice for the purpose of repressing stock market delicts. Reference to such delicts seems to exclude, with due regard to the contents of Art. 5-ter, Arts. 10-1 and 10-3 of the Ordinance of September 28 1967, any inspection activities within the framework of a procedure involving international cooperation in the meaning of Art. 5-bis of the Ordinance, if an investigation request by a foreign authority refers to penal acts committed abroad and penally non-relevant within France. As to preventative measures, Art. 0-1 inserted by virtue of the Law of August 2, 1989, into the text of the Ordinance instituting the COB, has given to the COB the possibility to adopt particular preventative measures and to request the judicial authorities to adopt special preventative measures, more precisely, to sequestrate defined assets, to prohibit the exercise of professional activities and to impose the obligation of providing a given pecuniary sum as deposit. Even if the letter of the legal text does not refer to it, the preferred interpretation⁷⁴ is to the effect that the applied measures, for the purpose of making the sanctioning system of the COB more incisive, are to be limited to infractions of penal relevance, thus excluding any application in with acts falling within the ambit of administrative matters. From the text of the law it can be deduced that an application to judicial authorities for the adoption of measures should be based on a collegiate decision within the COB.

When dealing with a case of sequestration of interdiction of professional activities, the judicial authority decides upon request by the COB in the form of an ordinance upon application ("ordonnance sur requête") as defined in the code of civil procedure (Art. 493) as a temporary decision taken without hearing all the parties concerned.

As to the measure of temporary exclusion of a person from the exercise of professional activities, applicable without access to complaint by the person affected, it is a measure for preventing the misappropriation of funds and particularly for controlling the extremely rapid development of certain financial activities and for excluding access thereto of any person to whom irregularities are imputed.

As to the imposition of effecting a deposit as "consignation", the President of the Tribunal de Grand Instance, always acting upon request by the COB, may decide as an interim decision that a deposit shall be made. The decision is provisional and may be altered by the judge maintaining it or augmenting the deposited sum in application of Art. 138 of the code of penal procedure. Any non-compliance with the obligation to provide a deposit or with the obligation of temporary withdrawal from professional activities is subject to penal measures (Art. 10, para 2, Ordinance of 1967). On October 15, 1993, invoking for the first time powers under Art. 8-1 of the Ordinance of 1967, the COB requested the imposition of a temporary interdict on Societe Luc Terme banning the latter firm from professional activities. The interdict was issued by the President on the same day of the application. On October 29, 1993, the Tribunal de Creteil has confirmed the decision of the President.⁷

9. Judicial protection against acts of the COB

Such protection has been introduced by the Law of August 2, 1989, and is reminiscent of experience linked with the Conseil de la Concurrence.

Acts of the COB, which prior to the Law of August 2, 1989, could have been challenged generically before an administrative tribunal, can now be challenged before ordinary courts and only residually before administrative

judicial authorities. Acts related to collective investment in moveable assets or to portfolio management can be challenged, as provided, before administrative courts. For all acts of the COB the competence of control is allocated to the judicial authority (Art. 12 of the Ordinance), which in a later decision (Art. 8, Decree No. 20-263 of March 23, 1990) has been vested in the Cour d'Appel de Paris. The decision has been necessitated for securing speedy decision making in situations involving controversy, where power exercised by the COB may affect the rights of individuals.

While "the good administration of justice" ("une bonne administration de la justice") has been a guiding principle for unifying access to a single court, its implementation has not been total in the sense that a residual intervention by administrative judicial authorities is possible. The appeal against the sanctionary decisions of the COB to the Cour d'appel de Paris is considered ambiguous and hybrid.⁷⁶

10. Changes in penal sanctions applicable to stock market delicts

After the reform of provisions affecting the delict of "insider dealing" ("délit d'initié") by the Law No. 88-70 of January 22, 1988, and in the course of a rigorous process for reinforcing the preventive or repressive system applicable to infractions committed in the financial markets, the Law of August 2, 1989 introduced the concept of "délit de communication d'information privilégiées" ("delict of communicating privileged information"), in the UK and American stock market systems known as "tipping".

In the meaning of Art. 8 of the Law communicating to third persons, reserved information acquired in the exercise of professional activities and concerning the prospects or situation of an issuer, or concerning the

future trend of the value of assets or of futures contract, is a criminal act. The rule states that such an act should have been committed outside the "normal framework" ("cadre normal") of professional work and professional functions. Communicated information should have the same characteristics as that related to insider dealing. As a clear definition and clear proof of the act as having been committed outside the "normal framework" of professional activities would be difficult, the law has dealt with moderation when providing penal consequences for it: imprisonment from six to twelve months and fines ranging from FF 10,000 to 100,000 "or only one of two punishments".

Insider dealing is more harshly treated in Art. 7 of the Law of August 2, 1989. Fines up to FF 10m and up to ten times the amount of illicit profits are foreseen. The fines may not be inferior to the level of profits. "False information" and the "manipulation of quotations" are equally subject to heavy fines (Art 10-1, last para, and Art. 10-3 of the Ordinance). Similarly, serious consequences may be attached to the "delit d'entrave" when hindering investigators authorised by the COB from proceeding with their work (Art. 6).

11. Critical remarks

The wide-ranging process of reform of French stock and financial markets has led to a complex restructuring of the powers and competences of the control agencies. Specialisation and the reinforcement of mechanisms of control have been vital points of consideration, be they in their relation to those who appeal to the public for investment or, and not least for the theme of the present thesis, financial intermediaries.

In particular the COB has been endowed with direct and autonomous powers to issue injunctions, apply sanctions, as one of the most significant facets of the

reforms focusing solely on the reorganisation and strengthening of the professional and disciplinary bodies affecting the intermediaries. In the wake of the reforms of 1988, with noteworthy increases in its powers the COB can conduct inspections, effect clarifications, and these competences have been reinforced with the institution of a new offence of "entrave" (hindrance) applicable to enquiries and investigations relating to investigatory work undertaken by its agents.

Looking at the situation from the angle of law, the powers of investigation had already made it into a first class investigative judicial authority. With direct sanctioning powers it has become an authority comparable with that of a lower ordinary court; it can apply sanctions on those who act contrary to rules it has established. While the sanctions of the COB are qualified they are based on its powers to issue regulations. These powers also included judicial functions. It should be remembered that judicial tradition in France (since the Ordinance of 1967 and the inception of the Code of penal procedure) basically rests on the principle of separation of the functions of prosecution, investigation and judgement. The decree N.90-263 of March 23, 1990 implicitly admits that the COB may initiate proceedings, may investigate and reach a decision at the end.⁷⁷ In this respect the COB is unique in that there is no distinct division for initiating proceedings, no distinct division to act as an investigating judge. The same COB, after having issued a notice, examines observations submitted to it and may decide to suspend or continue with the proceedings. After a decision to continue, the COB can appoint a rapporteur who may later be entrusted with further tasks. Lastly, the COB can hear the defendant and his lawyer, who may submit their observations orally. Then, the COB is considered a

"Magistrature d'influence", à "Jurisdiction économique",⁷⁸ a "sui generis institution, a very peculiar AAI, an archetype of the repressive administrative order"⁷⁹ It seems that a new "Ordre public bouvier" has been established in France.⁸⁰

It is worthwhile to note⁸¹ that the SEC in the USA, with noteworthy sanctioning powers, may intervene in proceedings only in a capacity as an appeal judge. A judicial decision at the first level comes from an "administrative law judge" who, while formally being part of the staff of the SEC, enjoys a wide margin of autonomy. (See Appendix "A" at the end of the present thesis) The thereto relevant procedure implies the existence of a dualistic approach to the acts of the (financial market) services and those of the SEC. Such a dualism cannot be detected in the structure of the COB, which acts as a single body dealing with three distinct functions. This situation has raised questions relating to problematic violations of the principle of presumption of innocence and respect for the adversarial system.

A further serious problem is generated by the fact that the COB is not under any obligation to issue first an injunction before proceeding with sanctioning measures. This touches the principle of independence or separation between the procedure applicable to injunctions on the one hand, and that applicable to sanctioning measures on the other. The COB has decided that sanctions may be adopted without the necessity to resort first to a preliminary injunction.⁸² As to administrative procedures, it is certain that some of the general principles linked to the notion of penal law apply equally to the sphere of administrative sanctions : no retroactive effects of laws, legality of the punishment, its proportionality and respect for the right to defence. Some experts favour the view that all rules

of penal law should apply equally to the imposition of administrative sanctions. The Conseil constitutionnel⁵³ has established that solely the general principles of law do apply to the exclusion of the rules enshrined in the penal procedure codes. Consequently, non-applicable are the rule non bis in idem and the pure procedural rules of the code of penal procedure.⁵⁴

A further problem is related to persons who may be addressed by sanctions issued by the COB. Contrary to a restrictive interpretation of Art. 4-1 of the Ordinance of 1967, limiting the applicable ambit to legal persons, the COB has maintained⁵⁵ that with reference to Arts. 9-1 and 9-2 of the same 1967 Ordinance, sanctioning powers may apply to all persons, be they physical or legal, including the management personnel of the latter. On the basis of such an extensive interpretation, the COB has issued Regulation No. 92-03, (confirmed by the Ministry of economy and finance on June 10, 1992,) modifying Regulations Nos. 90-02, 90-04, 90-06, and 90-08 and permitting to initiate proceedings also with respect to company directors.⁵⁶ Then, the COB can sanction cumulatively legal persons and their management personnel.⁵⁷

The series of the above pointed out problems may be expanded by a further one which concerns decisions adopted by the COB in the course of proceedings. When proceeding against the companies Concept and CCMC and their directors, the COB had decided to discontinue the proceedings against one of them and continue with respect to the others. The Paris Court of appeal ruled that in the application of Art. 3 of the Decree of 1990, the COB was capable, in the light of submitted observations, to interrupt the proceedings in question.⁵⁸

It has been observed with some concern⁵⁹ that it may no longer be noted how the COB has been accumulating

competences to elaborate, sanction and control the interpretation and application of its own Regulations with noteworthy flexibility and means at its disposal. May be all these competences were not intended to be claimed by the COB, but by now it can be said as in the case of a prince : *habet omnia iuria in corpore suo*.

Furthermore, the Law of 1989, having vested the COB with certain competences to legislate in the form of regulation, has also touched fundamental principles underlying the system of democracy in France. For example, Arts. 9-1 and 9-2 of the Ordinance of 1967, introduced on the basis of Art. 5 of the Law of August 2, 1989, seem to attach two conditions to the sanctioning powers of the COB: (1) sanctions may be applied to conduct violating a COB regulation, (2) sanctions may be applied to conduct which interfere with or disturb the proper functioning of the stock markets.⁹⁰ In reality the sanctioning powers of the COB are subject to a single condition : the existence of a COB regulation confirmed by the Ministry of the economy and finance (Art. 4-1(3), Ordinance of 1967). The problem consists in the fact that the regulations of the COB bear more the characteristic traits of "code de bonne conduite" ("code of good conduct") than those of a penal code. It cannot be claimed that Art. 9-1 of the Ordinance of September 28, 1967, defines the incriminating aspects of conduct which may be caught by COB sanctions. Art. 9-1 establishes simply a broad framework within which incriminating conduct may be defined. For Gavalda the Law of 1989 is exposed to critique because it involves the risk of violating the fundamental principle of the legality of imposed punishment. The "flou" (blurred contours) of a penal legislation is not admissible, because it inevitably leads to standards of arbitrariness. It is indispensable to respect the rule "nulla poena sine

lege".⁷¹ Gavalda admits, however, that it would be unjust and futile to start a campaign against the reform of the COB effected by the Law of August 2, 1989. There would be no point in indulging in sterile discussions. It is important to realise that the credibility of French financial markets implies and demands an alignment with the other financial markets in the EC. Nonetheless, many quarters underline a certain anxiety with which the variety, importance and excessive powers vested in the COB are assessed.

The COB has become the inspector of inspectors,⁷² with quasi-legislative regulatory powers. Its executive powers are vast to the extent it controls the "commissaires aux comptes" (auditing commissioners); it may invite them to submit clarifications, may initiate an inquiry, may impose injunctions, and may proceed with the collaboration of judicial authorities to undertake searches and sequestrations. Like a judge, it may prescribe significant pecuniary fines. One may consequently ask whether this accumulation of powers does not breach constitutionally guaranteed principles.

In defence of the COB⁷³ it has been said that the given concentration of powers should neither surprise nor preoccupy. In the USA it has been since 1887 understood that the problems related to railways may not be resolved within a framework within which the state powers are rigidly separated. It has therefore been necessary to set up an independent Commission endowed with parts of the three powers in question: the Interstate Commerce Commission, as the first of the major commissions entrusted with regulatory powers. In other spheres many more commissions with similar regulatory functions have been created. Such a commission was entrusted in 1934 with the control of publicly offered shares, of operations on the stock market and to some extent

companies. In 1967 the COB was given insufficient powers, while in the USA and the UK the SEC and the SIB respectively enjoy powers which in certain respects are superior to those of the COB. One becomes aware of how necessary it is to strengthen the powers of regulatory and control bodies dealing with stock and financial market operations when considering the gravity of scandals experienced in all of the big industrialised countries. On this point various opinions have been expressed in the USA in the course of the last 20 years. For some it has been necessary to strengthen the control of stock and financial market operations for safeguarding greater market transparency, equality and security. For others, insider dealings are part of the normal practices and as such are inevitable. All in all, however, the regulation of stock and financial markets has reached a level which cannot be easily accepted. The number and magnitude of financial market scandals document the inefficiency of regulation and control. The desire of financial companies to deserve and maintain a good reputation should have constituted an effective factor of regulation. It seems that the BCCI and Maxwell cases dramatically favour a certain opinion. The BCCI case demonstrates that in the present state of regulation it has been possible, for years, to syphon dozens of thousands of millions of US dollars at the expense of investors but to the benefit of terrorists, using arms and drug dealers by assisting them in their activities and transactions.

It has also been noted⁴ that the rampant "néo-dirigisme" of AAls (autorites administratives independantes), in the light of reassuring foreign models like that of the SEC in the USA, is of no use for enhancing the international credibility of the French system. One may detect some americophilia suggesting the

creation of strange innovations, but the foreign model is misunderstood and badly imitated. Legal culture and tradition are more subtle things than many legal experts may realise. It has been verified with great frequency, when a competence is vested in a given AAI, other comparable bodies, when the opportunity for reform arises, grab the occasion to have comparable powers vested in them. This escalation in powers may become worrying.

The current confusion between allocated powers in France, documented by a flowering series of Councils, Commissions and various IAAs would not be the right model to recommend for resolving also the relevant problems related to the regulation and control of the financial markets.⁷⁵ Security and predictability as categorical imperatives of democratic legal systems, seem to have been forgotten in the process of proliferating IAAs. The generalised multiplication of IAAs, to the detriment of judicial power as the natural authority, is the consequence of a worrying phenomenon deserving further research and knowledge in order to confront it. Gavalda stresses that⁷⁶ in a democracy the roles of the police and that of the judge should be mutually separate. To a similar conclusion comes Ducouloux Favard⁷⁷ when stating that it is amazing to see how a legislative act does not per se constitute a guarantee against the arbitrary but leaves it to the executive power the function of regulating itself. In the related literature, authors are becoming more and more aware of the perils and dangers generated by the existence of IAAs like the COB, as entities partly escaping parliamentary control.⁷⁸ In 1975 Pr. Guyon had foreseen with worry that "informal and occult administrative activities could lead to an arbitrary system because the defence rights and the adversarial principle could not be observed".⁷⁹ It is

legitimate to ask whether the penal judge can feel bound by the opinion expressed by the COB because he is obliged (art. 12-1 of the Ordinance of September 28, 1967) to request the opinion of the COB in case of "delicts bouviers".¹⁰⁰ In 1989 Favard¹⁰¹ emphasised that a real curiosity is the fact how in the grandiose and spectacular bicentennial celebrations of the French revolution (1789), a legislative text has ignored the principle of separation of powers: a singular and unlikely expression of homage to Montesquieu.

Notes

1. The originator of the idea of the COB is considered to be Michel Debré, then Minister of economy under the Presidency of Charles de Gaulle.
2. See, A. Tunc, La Nouvelle Commission des Opérations de Bourse, in *Revue de Droit International et le Droit Comparé*, (1992), p. 132.
3. A. Tunc, *op. cit.*, (note 2 above), p. 133.
4. C. Ducouloux Favard, Nuovi poteri per la COB, Commission des Opérations de Bourse, in *Banca, Borsa e Titoli di Credito*, (1990), vol. 43, n. 5, p. 680.
5. N.S. Poser, *International Securities Regulation* (1991), p. 379.
6. COB Report 1992, p. 4.
7. N.S. Poser, *op. cit.* (note 5 above), p. 386.
8. On the activities and increase thereof in 1991, 1992 and 1993, see COB Report 1992, pp. 5, 43, 75, 69, and 1993, pp. 5, 88. On further and various statistical data, see *ibidem* 1993, pp. 5-88 and N.S. Poser, *op. cit.* (note 5 above), p. 379.
9. See *Riv. Soc.* vol. 36, n. 1 (1991), p. 371.
10. COB Report 1992, Annexe II, p. 8.

11. A. Couret, D. Martin and L. Faugerolas, Sécurité et Transparence du Marché Financier, in Bulletin Joly, (1989), pp. 21-22.
12. M. Guillaume-Hofnung: Réflexions sur la Nature Juridique de la Commission des Opérations de Bourse, in Rev. Dr. Pub., (1982), p. 1345.
13. Y. Le Portz, L'Evolution du Rôle et des Pouvoirs de la COB, in Revue de Droit Bancaire (1988), p. 119.
14. C. Ducouloux Favard, op. cit. (note 4 above), p. 681.
15. COB Publication (1993), p. 1.
16. C. Ducouloux Favard, op. cit. (note 4 above), p. 703.
17. In the case of the SEC too, the legislator has not given a precise definition to its legal nature but only indicates it as an "independent agency". See L. Loss, op. cit., chap 4 (note 11), p. 35.
18. N. Decoopman, La Commission des Opérations de Bourse et le Droit des Sociétés (1980), p. 8.
19. M. Vasseur, La Commission des Opérations de Bourse, in Banque (1969), p. 62.
20. Y. Guyon, La Commission des Opérations de Bourse in a colloque organised by Le Centre d'Etude et de Recherche sur l'Administration Publique, on Les Autorités Independantes of June 11-12, 1987, p. 7.

21. Alpa, Note sulla Commission des Opérations de Bourse e sulla Riforma della Disciplina del Mercato Finanziario, in Riv. Soc. vol 33, (1988), p. 1157.
22. A. Tunc, op. cit. (note 2 above), p. 133.
23. P. Jalade: Vers un renforcement des pouvoirs de la COB, in Petites Affiches (1989), n. 72, p. 4.
24. C. Gavalda, Commentaire de la Loi du 2 aout 1989, concernant l'Amélioration de la Transparence et de la Sécurité du Marché Financier, in Revue des Sociétés, vol. 108, n. 1, (1990), p. 7.
25. art. 12, law n. 88-14 of January 5, 1988, as amended by law n. 88-421 of June 23, 1989.
26. C. Ducouloux Favard, op. cit. (note 4 above), p. 684.
27. art. 2, paras 2-3 of the Ordonnance n. 67-833 of September 28, 1967.
28. C. Gavalda, op. cit. (note 24 above), p. 6.
29. Ibidem.
30. Ibidem.
31. A. Tunc, op. cit. (note 2 above), p. 133.
32. Jeanine Loreau, Councillor at the Cour de Cassation with mandate from November 22, 1990 to November 21, 1994.
33. A. Tunc, op. cit. (note 2 above), p. 133.

34. A. Couret et al., op. cit. (note 11 above), p. 10.
35. N. Decoopman, op. cit. (note 18 above), p. 14.
36. COB Publication 1993, p. 1.
37. Art. 1, para. 2, Ordinance 67-833 of September 28, 1967.
38. by Decrees n. 85-809 of July 31, 1985, n. 67-799 of September 30, 1987 and n. 89-34 of January 29, 1989.
39. COB Report 1992, p. 9.
40. COB Report 1993, p. 9.
41. COB Report 1986, p. 194.
42. COB Report 1992, p. 9.
43. COB Report 1993, p. 9.
44. A. Largo: Financial Services Regulation (May 1993), p. 124.
45. art. 1 of the Ordinance n. 67-833 of September 28, 1967.
46. Arts 2 and 3 provided that the COB, subsequent to opinion by the professional chamber of the exchange agents, may adopt decisions on all questions of general nature relative to the functioning of the stock exchange. Such decisions were subject to approval by the minister of the economy, finance and privatisation.

47. See Arts. 5 and 10 as well of 1970 and Art. 12-1.
48. J.L. Lepine, *La Società per Azioni e le Commissioni di Controllo in collana della Riv. Soc.* (1982), p. 90. See Art. 5.
49. Joined to Art. 6 of the Law of 1970.
50. Art 1 of the Ordinance of 1967, as amended by the Law of July 11, 1985.
51. N.S. Poser, *op. cit.* (note 5 above), p. 387.
52. Tunc, *op. cit.* (note 2 above), p. 132.
53. E.E. Bonavera, in *Le Società*, vol. n. 6 (1991), p. 742.
54. Art. 3, paras 2-4.
55. Art. 7, Law n. 88-70 of January 1988.
56. Tunc, *op. cit.* (note 2 above), p. 135.
57. M. Marrone, *Istituzioni di Diritto Romano* (1989), p. 52.
58. N. Decoopman: *Le Rescrit Boursier in Revue des Societes*, n. 3 (1991), p. 451.
59. F. Annunziata, *La Commission des opérations de Bourse et la Procédure de Rescrit*, in *Riv. Soc.* vol. 35, n. 5-6 (1990), p. 1530.
60. *Ibidem*, p. 1531.

61. Ibidem, p. 1532.
62. See Arts. 9-1 and 12-2 of the Ordinance of September 28, 1967.
63. COB Report 1993, p. 195 ff.
64. E.E. Bonavera, op. cit. (note 53 above), p. 745.
65. A. Couret et al., op. cit. (note 11 above), p. 13.
66. Ibidem, p. 14.
67. Ibidem.
68. F. Annunziata, La Legge di Riforma della Commission des Operations de Bourse tra "sécurité" e "Transparence" del Mercato Finanziario, in Riv. Soc. (1990), p. 627.
69. COB Report 1993, p. 195.
70. Ibidem.
71. Y. Loussouarn and J. D. Bredin, La Réglementation des Ententes: le recul du contrôle judiciaire, in D., 33 ff., quoted by F. Annunziata, op. cit. (note 67 above), p. 637.
72. F. Annunziata, op. cit. (note 68 above), p. 637.
73. Ibidem.
74. Ibidem, p. 693.
75. COB Report 1993, p. 209 ff.

75. D. Vatel, Aspects judiciaires et juridictionnels du pouvoir de sanction de la COB, in *Revue des Sociétés*, vol. 112, n. 1 (1994), pp. 39-40.

77. COB Report 1992, p. 181 and COB Report 1993, p. 195.

78. D. Vatel, *op. cit.* (note 76 above) p. 26, note 8.

79. *Ibidem*, p. 39.

80. *Ibidem*, p. 27.

81. COB Report 1992, p. 181.

82. *Ibidem*, p. 182.

83. *Ibidem*.

84. D. Vatel, *op. cit.* (note 76 above), p. 34. For Decision of the Conseil Constitutionnel n. 88-248 of January 17, 1989 that has sanctioned the applicability of the principle of legality of delicts and points to the administrative sanctions, see D. Vatel, *op. cit.* (note 76 above), p. 28.

85. COB Report 1992, p. 182.

86. *Ibidem*, p. 183.

87. D. Vatel, *op. cit.* (note 76 above), p. 34.

88. COB Report 1992, p. 181.

89. F. Annunziata, *op. cit.* (note 68 above), p. 616.

90. See Art. 9-1 "La Commission des opérations de Bourse peut ordonner qu'il soit mis fin aux pratiques contraires à ses réglem^{en}ts, lorsque ces pra^{cti}ques ont pour effet de:

- fausser le fonctionnement du marché;
- procurer aux intéressés un avantage injustifié qu'ils n'auraient obtenus dans le cadre normal du marché;
- porter atteinte à l'égalité d'information et de traitement des investisseurs ou de leurs inté^{re}ts
- faire bénéficier les emetteurs et les investisseurs des agissements d'intermediaires contraires à leurs obligations professionnelles".

The above long enumeration rather perfectly covers the sphere of CDB's competences relating to the regulations it can issue (art. 4-1, Ordonnance 1967).

91. C. Gavalda, op. cit. (note 24 above), p. 1.

92. Tunc, op. cit. (note 2 above), p. 137.

93. Ibidem, p. 144.

94. Gavalda, op. cit. (note 2 above), p. 2.

95. Ibidem., p. 3.

96. Ibidem.

97. C. Ducouloux Favard, op. cit. (note 4 above), p. 684.

98. C. Teitgen-Colly, op. cit., (Chap 4, note 4), p. 1, 1990.

99. D. Vatel, op. cit. (note 76 above), p. 25.

100. *Ibidem*, p. 41.

101. C. DuchVieux Favard, *op. cit.* (note 4 above), p. 604.

Chapter 6The National Commission for Companies and the Stock Market
(La Commissione Nazionale per le Società e la Borsa)
- CONSOB -1. Law and Practice

The CONSOB was established by Law No. 216 of June 7, 1974, in implementation of the Decree Law (Decreto Legge) of April 8, 1974, No. 95 (O.J. no 149 of June 8, 1974). Its creation took place in a socio-economic context conditioned by three main structural causes:

- i) an alarming spending deficit,¹
- ii) a peculiar relationship between small and medium sized enterprises on the one hand, and big enterprises on the other,² and
- iii) the absolutely prominent role played by banks in the sphere of savings and investments.³ The comparative level of private savings in Italy was higher than anywhere else in the world,⁴ but while this implied a great potential for access to savings and capital for investment, access to them for investment was not adequate. In order to finance public spending deficits, private savings were channelled towards the purchase of public bonds (titoli pubblici) with the banking system playing a fundamental intermediary function. In this way private savings were invested in schemes of low risk but high liquidity.⁵ Such developments could but reduce the stock market to a residual and marginal function with low liquidity outside the market for bonds and the strong presence of public capital. Inflation accentuated the gap between the propensity of private persons to save, on the one hand, and the capital and investment needs of undertakings on the other. The latter were becoming more and more dependent on i) banks for long term credits as risk

capital for investment, and ii) a marked public discretion influencing the availability of commercial and industrial credits. Such a system, conditioning the various functions of banks, of the capital markets, and of the state too, was inducing the emergence of complex situations financially dirigistic and not only economic in nature. The atrophy of the financial markets was generated not only by uncontrolled or uncontrollable developments but also by deliberate, not always coherent policy choices and impulses which in due time cumulatively resulted in a system which may be properly called protectionistic. In such a socio-economic framework the CONSOB was established.

The integration of the CONSOB into the then existing situation can be better understood not only with reference to the legal framework of its competences, but also with reference to practice. There is an interaction between the legal status and the actual practice of the CONSOB, the CONSOB acts as a (secondary) legislative body as well as an executive institution. In the 1960s the intention was to create a public (governmental) body as a watchdog entrusted with monitoring the activities of companies. It would have been a body subordinated to the Banca d'Italia. "The initial intention was only to placate the unquenchable habit of tax evasion of the Italian taxpayer /.../ to promote his/her peace of mind, trust and will to invest for revitalising the stock markets."⁴

The Law No. 216 of June 7, 1974 instituting the CONSOB was "promptly" enacted with "great delay" after a long and laborious period of gestation which can be traced back to the 1950s. It was influenced by political concessions between liberalistic visions and a dirigistic approach to economic affairs. It may be noteworthy that in 1972 the "Sindona affair" had exploded, resulting in a

profound crisis of trust in the financial markets. After years of very elaborate discussions and considerations in the 1960s and into the 1970s, the quasi-improvised Decree Law No. 95 of April 8, 1974 was approved, giving birth to the CONSOB. Even more noteworthy is the decision to proceed legislatively by adopting a Decree Law, under Art. 77 of the Italian Constitution, for application solely in cases of "necessity and urgency" ("necessita e urgenza"). Thereafter the Law No. 216 of June 7, 1974, was enacted, profoundly modifying the contents of the Decree Law No. 95.⁷ The Law No. 216/74 has been criticised for its ambiguity.⁸ Jaeger has pointed out that Law No. 216/74 did not at the time evoke the impression of being a milestone in Italian economic law; it was a milestone but by the government with analogous governmental (public) bodies operating in other legal systems tried to reveal an endeavour to show that the CONSOB differs from the original and fundamental model of the SEC in the USA.⁹

The Law No. 216/74 has proved, however, to be "an authentic revolution" ("una autentica rivoluzione");¹⁰ it has shifted the accent as to information supplied by companies from "legal information" to "information necessary and adequate in relation to circumstances", and from "shareholders" to "the public in general". Moreover, it requires from the instituted body, in fulfilment of its publicised market supervision, to assess from case to case the necessity and adequacy as well as the purpose of an investment appeal, thus transferring the purpose of tutelage or protection from shareholders to the saving and investing public. Thus, the Law No. 216/74 has modified the valency of information required from companies, such information, which, initially private, has become public in nature by virtue of the intervention of the Commission (CONSOB)¹¹ addresses itself, beyond

shareholders, to the saving public and to the financial market.

In spite of the creation of the CONSOB, the Italian stock markets languished, with the index reaching on December 22, 1977, a historical low of 54.90.¹² The "first" CONSOB, under the presidency of the democratic party Gastone Miconi, did not intervene, and its role did not become noticeable prior to the "second" CONSOB under the presidency of Guido Rossi. The Law No. 49 of February 23, 1977, had amplified the functions of the CONSOB. The regulation of the so to speak second market, also referred to as the "restricted market", had attributed to CONSOB powers to discipline the market with a proper regulation affecting the organisation of the market, the way it should function and its supervision. The merit of the new Law was the introduction, in the Italian financial markets, of the tutelage or protection of the saving public.¹³ In 1978 the markets seemed to wake up and government quarters seemed to develop an interest in the problems of the stock markets. However, not long thereafter, the case of Roberto Calvi and of the Banco Ambrosiano surfaced, with the death of Calvi under the Blackfriars bridge in London in 1982.¹⁴ This was, within ten years, the second major affair after that of Sindona in 1972.¹⁵

Ten years after the mysterious death of Calvi the condemnation, on April 16, 1992, of 31 persons dealt a further very heavy blow to the international image and prestige and credibility of Italian entrepreneurship.¹⁶ It was related to the financial operations (and losses) of the Istituto per le Opere di Religione (IOR) with close links to the Vatican.

The first years of the 1980s proved to be a very difficult financial time in Italy. Losses by the Europrogramme of Bagnasco, to mention but one person,

suffered a serious crisis involving the savings of some 70,000 investors.¹⁷ However, the 1980s marked at the same time the period in which the stock markets experienced an upward turn.¹⁸ A further Law, of March 23, 1983, No. 77,¹⁹ beyond enlarging the competences of the CONSOB introduced detailed rules applicable to appeals for investment, in addition to instituting and regulating a new and important financial instrument in the form of common investment funds. The technical terms (with definitions) of "valore mobiliare" (stocks) and of "sollecitazione al pubblico" (offer to the public) were established. The functions of CONSOB as to promotion and control of information was extended to all aspects of the stock market by virtue of Art. 18 of the Law No. 216/74. In the scope of functions and operations of the CONSOB the best promotion of the whole market became a matter of central concern: the limits of the Law No. 216/74, which identified the market substantively with reference to only one of its segments, namely, the stock markets, was overcome. Thus, in substance, the existence of a financial market larger than the stock market was established "by applying the term 'control' in an ampler and more comprehensive context" for the purpose of unifying and harmonising more transparently all aspects dealing with appeals to the investing public.²⁰ The importance of this legislative innovation and extension is given by the fact that loopholes in the past powers of the CONSOB were eliminated and the principle of disclosure was raised to a level of general and dominant principle in the system of rules. Therewith, a genuine system of investor protection was introduced into the Italian legal system.²¹ As a real minireform of the CONSOB, the Law of 1983 constituted an exceptional legal forward jump of both cultural and practical nature: concern for shareholders was replaced by that of

investors, from a level of contractual relationship to one of pre-contractual relationship.²² As a positive result, interest in common funds of investment increased noticeably on the stock markets at the end of 1984. Thousands of small investors, as if feverishly possessed by an urge to make profits, discovered the existence of the stock market.

In 1985 a further so to speak minireform of the CONSOB was instituted by the Law of June 4, 1985, No. 281 (Italian Official Gazette, June 4, 1985), when the existing rules were truly and properly integrated. Its general text translated into law the valid aspects of observations and proposals made by the VI Permanent Commission for Finance and Treasury of the Chamber of Deputies. It contains provisions on the legal status of the CONSOB; rules for identifying the partners of a listed public company (*societa con azioni*) and of credit institutions; rules for the implementation of EC Directives 79/279, 80/390 and 82/121 relating to stock markets and to provisions for the protection of investors.²³ The approach underlying the law is unitarian in the sense that it emphasises the discretionary powers of the CONSOB for the purpose of promoting an increasingly greater disclosure of data concerning participants in the market.

Art. 20 empowers the CONSOB to scrutinise the request for admission to official listing and to check whether the listing would not be contrary to public interest. The discretion of CONSOB to authorise admission to official listing in the light of the overriding interests of investors is confirmed by Art. 20 para 2.²⁴ in accordance with the provisions laid down in the EC Directive n. 279 of 1979.

The whole administrative procedure for admission for listing is based on the system of the information

prospectus. Its contents and modalities of publication are determined by CONSOB in general terms with due regard to the interests and protection of investors. Rules governing the form and contents of the prospectus are guided by the principle of information, and as such they correspond to a systematic approach to the legal regulation of capital markets, with an expanding trend to reinforce the mechanisms of pressure and control on operators active in the market and on their activities, for covering, if possible, new areas for the ultimate purpose of insuring the best possible protection of both investors and the market.

The Law 281/85 gives to the CONSOB also the sanctioning powers provided under Art. 2377 of the Codice civile (civil code).²⁵ The law also improves the administrative structure of companies, by introducing standards for identifying the partners of a listed company, for indicating the real assets and relationships between listed companies, on the one hand, and participating companies on the other, by overcoming formal barriers of evidence as to shares or quotas in company ownership. Furthermore, under Art. 20, par. 3, publication is prescribed for a prospectus containing information and notices relating to a company or corporate entity the stocks of which are admitted for listing on the stock market in accordance with requirements prescribed by the CONSOB. Art. 13 refers also to the requirement of a semi-annual report.

The fundamental legislation in its substance marked by an intensification of links, strengthening ties between standards governing the control bodies, on the one hand, and standards governing the stock markets on the other, and since the inception of Law 281/1985, activity on the financial markets has been improving. On May 20, 1985, the stock market index reached a highest

level with 908,20 points, but downward trends on the world stock markets in October 1987 affected also the situation in Italy, and in September 1992 instability on international money markets led to a devaluation of the Italian Lira by seven per cent. Subsequently a period of recession affected also the situation in Italy. As a result, the stock market in Milan dropped to half the level of its historic high referred to above.²⁶

All in all the latest reform of the CONSOB has, as a merit, transformed the CONSOB from a mere organ of control for companies and for the stock market to a body of governance for the stock market in its global meaning. Furthermore, new legislative texts regulating the activities of stock market intermediaries and standards for the organisation of the stock markets (No. 1 of January 2, 1991, G.U. No. 3, January 4, 1991; "insider dealing" (No. 157, May 17, 1991, GU, No. 116, May 20 1991); and standards applicable to public offers for shares, subscription acquisition or exchange of shares (No. 149, February 12, 1992, G.U. No. 43, February 12, 1992). This development justifies the conclusion that within the framework of an organic structure, the regulation and to a certain extent, the fundamental restructurisation of the activities of the stock markets in Italy have been promoted.

2. Legal Personality

Applying the French legislative approach, the Law 216/74 made originally no reference to the legal nature of CONSOB. This has led to the claim, on one side, that the CONSOB possessed herewith implicit legal personality, while on the other side it has been alleged that the legislator did not intend to endow the CONSOB with legal personality. Probably in order to put an end to a sterile debate, Art. 1 of the Law 281 of June 4 1985 explicitly attributed legal personality to the CONSOB. While this has generated further discussions on the topic, attention should be given to the question of the real autonomy of the CONSOB.

The recognition of the legal personality of CONSOB confirms the CONSOB as a subject endowed with autonomous powers, in the first place for the purpose of establishing for itself its own internal order. In this respect it is comparable with the French CDB as a model created by positive law, as an independent administrative authority separate from the general executive and administrative arm of the state authority. This underlines the autonomy of the CONSOB, be it at an institutional or political level, within the general framework of the legal order as a whole.²⁷

Such an independence or autonomy is not a novelty in the Italian legal tradition, that is, historically, in relations between the administrative and political spheres of the state. Admittedly, however, with due regard to the principle of legality, the subjection of state administration to the rule of law in the form of legislative texts has served the purpose of defending the administration from political influence and endowing it with a non-political quality.²⁸ In due time the concepts of impartiality and objectivity have undergone a profound transformation parallel to the increasing

responsibilities assumed by the state in administration for the sake of safeguarding interests of general nature and for complying with the imperatives of independence. Independence is not tantamount to guarantees applicable to the functions of a civil servant, but extends also to the entire operative sphere of administration. Beyond doubt it may be submitted that by an explicit recognition of the legal personality of the CONSOB, the Italian legal system has acted differently than the French system. In France, preference has been given not to have a defined express recognition of legal personality for the COB, because French law looks at substance, not at the formal aspect of legal personality. In this way, French law has the same approach as the law in the UK.

However, the question of legal personality should not be confounded with the question of the autonomy and independence of the CONSOB. Legal personality is by itself not sufficient to insure the autonomy and independence and, inversely, autonomy and independence may not presuppose necessarily the existence of legal personality. Autonomy is a substantive fact which may not by itself accompany the formal recognition or award of legal personality. The recognition of legal personality could constitute a mode for avoiding confrontation with the substantive problem of CONSOB's autonomy. Possibly, with this very point in mind, the French legislator has avoided clarifying the question of the legal personality of the COB. In Italy, the necessity was felt to have an institution endowed with a large scope of autonomous action, independence accompanied with the highest standards of professional quality: a type of "economic judicial authority" ("magistratura economica") enjoying credibility and prestige.

Such a situation cannot be created, however, with the proclamation of a decree, nor can it be achieved in a

single day. It can be but the result of a process in which the quality of the government, the quality of initiatives deployed by commissioners as members of the CONSOB, their professional qualifications, the impact of their collaborators, and the existence of an economic and professional environment all contribute to help the actions of CONSOB assume concrete form.

CONSOB is endowed with legal personality as a subject of public law, with full autonomy within the scope determined by law. Thus, no longer is any decree by the Ministry of the Treasury necessary for implementing a decision by the CONSOB, and in any case in which the participation by the Ministry is provided for, such participation concerns the question of the legitimacy of the act by CONSOB and not its substantive merits. A major guarantee is anchored in the particular requirement that a majority of four fifths shall prevail for decisions. The relationship between the CONSOB and Ministry of the Treasury is regulated comprehensively, and there is provision for dissolution of the CONSOB in case of functional paralysis or continued inactivity.

3. Organisation of CONSOB

The CONSOB, as a collective body governed by public law, consists of five members who hold office for five years and may be re-elected once.²⁷ They are nominated by decree of the President of the Republic upon proposal by the President of the Council (Presidente del Consiglio) after consultations with the Council of Ministers (cabinet). The nominations are subject to scrutiny by a competent parliamentary commission, as provided for by the Law of January 24, 1978, No. 14.

Underlying the collegiate nature of CONSOB has been the realisation that the plurality and complexity of functions entrusted to CONSOB could be best coped with by a collegiate body.³⁰ CONSOB's collegiate nature has been confirmed by the Law of June 4, 1985, No. 281. It lays down the procedural dimensions of CONSOB's functions as that of a collegiate body, thus delimiting the functions of CONSOB's President. A qualified forum is prescribed for some of the decisions of major importance (Art. 25, para 1 and 2 of the CONSOB regulation).

For decisions of highest importance, a majority of four votes is required. For the adoption of internal organisational and accountancy rules, in addition to the four votes within the CONSOB, the control of legitimacy by the President of the Council of Ministers is required, whereafter he approves them for implementation by issuing a relevant decree (Art. 25, para. 9 of the CONSOB regulation).

It goes without saying that for the nomination of CONSOB members, persons considered for office must evidence high standards of proven competence, experience, unchallengeable morality and impartiality.³¹ Some standards of incompatibility with office in CONSOB have been established. Art. 1, par. 5 of the Law 216/74 has laid down that members of CONSOB may not indulge in any

activity outside their functions within CONSOB; as consultants, administrators, partners in companies with limited liability or in commercial undertakings; as auditors; be in any way dependent on commercial enterprises or of public or private undertakings, nor act as public officials of any kind. A curiosity is that no similar catalogue of incompatibility is foreseen for the office of the CONSOB President.³²

Minervini³³ points out that the activities of the CONSOB are not subjected to any control by the executive arm of the state, thus making the CONSOB a sort of "economic judicial authority governed solely by the law", with evident reference to Art. 101 of the Italian Constitution.³⁴ However, some functional link exists between CONSOB and the executive part of the state authority. This link is peculiar in that a flow of information from CONSOB to the Ministry of the Treasury has to be maintained, not only for keeping the Ministry informed about the situation on the market, but also for enabling the Ministry to assess continually the intentions and activities of the CONSOB. In this respect, Minervini points out that the executive arm of the state authority has recovered its possibility to influence the decisions of CONSOB, while by virtue of the law CONSOB is a completely autonomous authority.³⁵

4. Functions and powers of the CONSOB; regulatory powers as a quasi-legislative function

The functions of CONSOB concern fundamentally :

- 1) Matters related to the stock and financial markets ;
- 2) Matters related to companies and information related to companies.

In comments related to the intended conversion of the Decree-Law of April 8, 1974, No. 95 into more elaborate legislation, the government expressed the view that CONSOB should restore the trust of investors in the stock market and should propose solutions to some of the felt needs of the stock market, so that the flow of investment could be reactivated in productive sectors. With the creation of CONSOB concrete expression should be given to the tenets of good information, adequate levels of savings, contractual freedom, equality, with due regard to justiciability applicable to powers related to information, contractual activities etc., under exclusion of any "contamination" of political nature.³⁴

The essential functions of CONSOB are referred to summarily in Art. 3, para. c of the Law 216/14: "ascertain the exactitude and completeness of information and notices communicated to the public". The same Art. 3 under para. g refers to the "control of the operations of the individual stock markets and checking the regularity and the modes of transactions involved in the intermediation and negotiation of stocks listed on the stock market."

In substance, the duty of CONSOB is to exercise, with reliable standards of objectivity and ability to act, public control promoting market transparency both on the stock markets as well as in the conduct of companies, so that investors can be adequately protected and the good standard can prevail in private contractual

transactions.³⁷

CONSOB, beyond a duty to regulate adequate standards of information and transparency serving the interests of investors, has also a responsibility to see that new (atypical) forms of investment incompatible with prevailing and desirable forms do not find access to the market.³⁸

In the fulfilment of its functions and responsibilities, CONSOB acts directly or through other intermediary organs subject to its supervision such as auditing firms.

The powers of CONSOB are also of relevance externally.

In conclusion, if prior to the mini-reform of 1985 the CONSOB could have been defined as an organ of governmental authority attached to the Ministry of the Treasury without a necessary relationship of dependence from the Ministry, currently the major competences awarded to the CONSOB, in terms of autonomy by virtue of enacted legislation, apart from the attribution of a legal personality, makes CONSOB into a so to speak auxiliary organ of the state.

5. Financial administration, personnel and seat of CONSOB

In agreement with the autonomous status it enjoys, CONSOB financially too enjoys autonomy. The expenses (which the law euphemistically defines as "indemnities" are determined and approved by decree of the President of the Council, upon proposal from the Minister of the Treasury (Art. 1, para 4, Law 216/74). In 1991, expenditure totalled Ital.Lire 42,000m; 72.9 per cent were expenses for personnel, 19.9 per cent for administration, and 7.22 per cent for the acquisition of property.

In 1992 expenditure amounted to Ital.L. 73,960m, with 73.1 per cent of it being spent for personnel, 5.2 per cent for the acquisition of property.³⁹ By the end of December 1993, the number of CONSOB staff was 318.⁴⁰

The choice of Rome as CONSOB seat instead of Milan as the traditionally most important Stock Exchange in Italy, has been a bureaucratic decision.⁴¹ A second seat in Milan has been established by the Law No. 175 of April 1981, under the Presidency of Guido Rossi. Finally, Milan was defined as the principal seat of the Stock Exchange Council by Law No. 1 of January 2, 1991 (art. 24). Secondary seats may be established at the site of each stock market.

6. The exercise of the functions of the financial intermediaries and the organisation of the stock markets (Law No. 1 of January 2, 1991)
1. Regulation of Activities of Intermediaries on the Stock Market and the Società di Intermediazione Mobiliare (S.I.M.)

Law No. 1 of January 2, 1991 (JO n.3 of January 4, 1991) governing the regulation of the activities of intermediaries on the stock market and concerning also various standards affecting the organisation of the stock markets came into force after a long and stormy parliamentary stage.

It is a legislative instrument with an ample scope and innovative dimensions affecting the set of rules regulating the financial markets. The notion itself of "intermediazione mobiliare" (intermediation on the financial market) was extensively modified and now embraces in substance the entire range of activities related to stocks. The term "valori mobiliari" has in turn been defined in such a way as to include omnicomprehensively all contractual aspects.

Title I of the Law concerns the regulation of the activities of intermediation related to stocks; Title II concerns provisions affecting the organisation of stock markets.

The essential elements of reforms introduced by the Law are, in essence :

a) Allocation of the activities of exchange agents to and substitution thereof by a corporate structure: the SIM (Società di intermediazione Mobiliare)

b) Multifunctionality of the intermediary;

c) Monitoring or control of those acting as intermediaries;

d) Obligation to treat negotiations with a concentrated approach;

e) Introduction and establishment of a national compensation fund;

f) Establishment of the Consiglio di Borsa.

a) Replacement of stock exchange agents by a SIM as a corporate entity and allocation of the activities of agents to SIM.

The purpose of Law No. 1/91 has been to reorganise the services of the stock market intermediaries by replacing the preexisting framework wherein all or almost all activities were treated liberally or were regulated with reference to a specific group such as the exchange agents and to the place where the activities were exercised. The then existing fragmentary and dispersed organisational approach was characterised by the existence of a number of agents with sufficiently ample and diversified functions and services which were offered, and the same remark applied to their organisational nature.

Until January 1991, the Agents di Cambio (exchange agent) was exclusively competent to be in charge of negotiations in the stock market, with access to the grids and matters of quotation were part of their reserved domain. Banks were able to offer a wide variety of services but were governed by precise limitations related to their particular statutes, while commissioners acted multifunctionally including acting on their own behalf.⁴²

Art. 1 of the Law No. 1/1991 not only abolished the functions of the Agente di Cambio, but also excluded physical persons from the sphere of activities as intermediaries in the stock market. Such activities of intermediation were transferred and reserved to legal persons organised as stock companies (società per azioni (S.p.A.) or possibly as società in accomandita per azioni (S.A.p.A.) (in which part of the partners would be

exposed to unlimited liability).

The law opted for the single notion or category of a multifunctional intermediary, authorised to participate in all transactions of the stock market, transactions which earlier were affected by a myriad of agents, corporate entities and credit institutes, *societa fiduciare* (trusts), missionary stock market firms, stock market agents, insurance companies, financial firms of various forms.

However, not only SIMs may act as intermediaries on the stock market, credit companies and institutes too may operate as intermediaries, in agreement with the second EEC Directive related to the coordination of banking activities (89/646/EEC) In the meaning of Decree-Law No. 481 of December 14 1992 (O.J. No. 296, December 17, 1992), which has implemented the above mentioned EC Directive, credit establishment in the EC (since November 1st 1993) may establish branch offices in Italy or may transact in Italy directly within the whole range of mutually recognised activities, that is, without prior authorisation (Art. 13, par. 3, and Art. 14, par. 1 and 3). This rule applies to credit undertakings to all financial institutions which have their seat in an EC member state and are controlled by one or more credit undertakings with a seat in the same member state (Art. 15, par. 2, Decree-Law 481/92).

What has been said above with reference to banking institutions within the EC concerns licensed entities. Not licensed intermediaries within the EC shall not benefit under Community law for activities in Italy, unless they form a SIM under Italian law with a registered seat within the territory of Italy (Art. 3, par. 2, a) of the Law of 1/91), or may avail themselves of an already existing SIM acting as an agent/representative for them, as provided for in Art. 5

of the Regulation (Regolamento) of the Bank of Italy of July 2 1991, which empowers a SIM to act as a representative of non-Italian intermediaries. This limitation affecting non-Italian entities has been rightly considered to be contrary to the principle of freedom of establishment within the EC and with Arts. 52, 53, 59 and 60 of the EC Treaty. This limitation has been definitively condemned by the ISD.⁴³

Art. 16 of the Law indicates clearly that functions as an intermediary exercised by a bank shall be governed by the same rules as those relating to a SIM. Thus a unified approach applies to the transactions of an intermediary, be it by a firm of the stock market or by a bank, and investors too are governed by the same system of regulation.

Besides the SIM as new intermediaries credit firms and institutes shall continue to operate if authorised accordingly by the Bank of Italy. They shall be, however, responsible to distinguish between activities as intermediary, on the one hand, and their other activities in the areas of accountancy or internal organisation.

A SIM itself shall not be allowed to operate unless authorised or approved by CONSOB, which shall put the name of the given SIM in the relevant registry of firms acting as intermediaries, indicating in addition the activities for which the intermediary has already been given authorisation.

As already mentioned, a SIM must be constituted as a stock company or *commandita per azioni*, and the corporate identification text of the SIM has to include the terms "società di intermediazione mobiliare" (licenced as intermediary on the stock market). Its registered seat must be situated in Italy, and the corporate capital (*capitale sociale*) has to be paid at a level not lower than thrice the capital prescribed for the formation of

stock companies, that is, a minimum capital of Ital.L.600m, or to a higher amount determined by the Banca d'Italia in agreement with the CONSOB. It goes without saying that normative standards govern the question of qualification competences of persons expected to act as members of a SIM. The law has been preoccupied with the guaranty for investors based on high professional qualifications and the integrity of persons responsible to manage the financial assets of other persons. Thus, the protective net for safeguarding the assets of investors is reinforced not only by the institutional structures of intermediaries, but also qualities attached to natural persons active in the administrative organs involving persons who monitor or control them.

The authorisation of a SIM may be withdrawn by the Ministry of the Treasury upon proposal by the Bank of Italy or CONSOB (Art. 16, last par.)

On December 31 1992, there were 205 authorised SIMs with, geographically the largest concentration in Northern Italy. As to natural or legal persons constituting these SIMs, there were 121 natural persons, 55 credit institutes, 52 financial groups, 27 stock market agencies, nine insurance companies and 21 non-Italian banks.⁴⁴ On December 31, 1993, the SIMs decreased to 267 of which 121 were controlled by natural persons, 55 by Italian credit institutions and 27 by foreign credit institutions.⁴⁵ The SIM's process of concentration is destined to undergo an acceleration in the coming years (see Il Sole 24 ORE of October 16, 1994, p. 20)

a. Multifunctionality of the intermediary

A multifunctional approach to the tasks of an intermediary corresponds to an internal trend, and it is not that new for developments in Italy. A great number of complementary functions were fulfilled by a person: the execution of orders, the administration of stocks, tasks related to planned stock offers etc. Licensed bodies too acted as brokers as well as dealers.

The notion of multifunctionality is also related to the second EC Directive relating to the harmonisation of banking institutions' activities, and to the Decree-Law No. 481/92 implementing the Directive, wherewith banking institutions would be enabled to deploy, in addition to banking activities, also activities as stock market intermediaries. For guaranteeing a maximum of neutrality or objectivity by the intermediary negotiator, it is prescribed exhaustively for banks that the principle of functional specialisation, making it clear that the function of a negotiator is to be treated as a function incompatible with the strict meaning of banking activities. Therewith applying the principle of a rigid separation of services offered as an intermediary from other services offered as a banker, a functional specialisation is intended and prescribed, and all in all progress is made toward the promotion of a proper sector of services by intermediaries in the developing stock markets of Italy.

b) Supervision and control of the intermediaries

Prior to the Law No. 1/91, stock market intermediaries were not governed by a strictu sensu system of monitoring and vigilance.⁴⁶

Now the philosophy underlying the system of vigilance applicable to the SIMs is that of a real and proper administrative control affecting the activities of the physical and/or legal persons concerned, as a sort of dirigistic and functional responsibility of those to whom it addresses itself.⁴⁷

The system of supervision and control is initiated already at the level of authorisation or licensing. Beyond it, the allocation of control competences is based on Art. 9 of the Law No. 1/1991, which refers to CONSOB as a body of vigilance of great importance for monitoring the quantity and quality of information supplied to investors, the standards of regularity applied to negotiations affecting stocks; the Bank of Italy is mentioned by the Law with reference to the stability of monitoring. In this respect there is an element of so to speak institutionalised delegation by CONSOB to the Bank of Italy relating to the supervision of banking institutions, and vice versa there is in turn a delegation of control from the Bank to CONSOB relating to the activities of SIM's and trusts (società fiduciarie). Thus there is a segmental sharing of the same market between the CONSOB and the Bank of Italy. CONSOB concentrates on the prerequisite qualities of transparency and the Bank of Italy pays particular attention to aspects affecting market stability. This may be referred to also as a functional division of vigilance, and the result of a difficult compromise with unpredictable consequences.⁴⁸

What has been said above may generate a doubt: Does the system of outlined vigilance applied to

intermediaries have bureaucratic or dirigistic dimensions while protecting the interests of investors? Could it possibly inhibit the freedom and economic or financial initiative of firms acting as intermediaries? The optimal efficiency of the stock markets may possibly require also a coordinated system of auto- or self-regulation operative within the category of the participants in the market.¹⁷

The Law no 1/1991 (in arts 4-5-14 and 25) introduced some penal dispositions concerning the financial markets. Until 1974, only the unauthorised exercise of the Exchange Agent profession was punished by Art 53 of the Law no 272 of March 20, 1913. The principal penal dispositions of the Law no 1/1991 are the following:

- Art. 14 punished with arrest (6 months to four years) the unauthorised exercise of intermediary activity;
- Art. 14 par 4 obliges the SIMs to communicate to the Bank of Italy any changes in the control and in the composition of the corporate bodies. The sanctions consist in arrest up to three months or a fine from Italian lire 2 millions to 40 millions. It is worth noting that the powers of Independent Administrative Agencies do not include a guarantee for the due process. The procedures of such Agencies do not have the high standards of professionalism and independence associated with judicial powers. This could lead to distortions. We should not forget that administrative sanctions have been particularly used by authoritarian regimes.¹⁸

c) Duty to concentrate Transactions

Art. 11, par. 1 of the Law No. 1/1991 introduces a principle not always heeded by market participants : that of the obligatory concentration of transactions in markets regulated and where different shares are traded. It is a principle intending to yield in due time benefits, be they in the form of developing markets or in the form of promoting, through concentration at a single place, better levels in quotations and therewith better benefits to the investors.

The purpose of the rule is to "guarantee a parity" in the way the clients are treated.⁵¹ CONSOB has pointed to the need of the said principles in 1987, making its absence responsible for part of the deficient functioning of the markets. It has been observed that any transaction effected outside the market of reference involved lesser protection affecting investors, be it because the transaction lay outside the proper market mechanism, or because therewith the quality of prices or quotations were not what the proper market may have generated. However, transactions outside the proper market site may take place if "the client ordains or authorises accordingly, in writing and if therewith a better quotation or deal for the client may be expected". (Art 11 par. 2). A second derogation from the principle is provided under Art. 11, par. 9 of the Law and by virtue of the CONSOB Regulation No. 5552 of November 14 1991. Agreements in derogation of the contents of Art. 11 are to be treated as void.

In 1992, that is, in the first year of application of the principle of concentration, it was still difficult to assess what the beneficiary impact of the principle had been on the market and on the interests of investors.⁵²

d) Establishment of a National Fund of Guaranty or Compensation

The fund, created by Art. 15 par. 1 of the Law of No. 1/1991, has been regulated by the Finance Ministry (Decree of September 30, 1991). On March 25, 1990, as proposed by the CONSOB, the fund was integrated with the Bank of Italy. In 1993 there were 4 collapses 1 exchange agent and 3 SIMs. In the Annual Report it recounted that the fund is not adequate to the losses.¹³³ Participation thereto is compulsory, but contributions may not be higher than two per cent of income derived from activities as an intermediary, with due regard to the structure of various risks affecting the active side of the intermediary's balance (Art. 15, par. 3, Law No. 1/1991). 10 SIMs were involved in failures affecting 13 thousand clients. These clients may possibly recover a small part of their invested assets. Only a negligible part of the recovery payments will come from the National Fund of guaranty because its total capital assets amounted only to Italian lire 10 billions. (See II SOLE 24 ORE of October 16, 1994, p. 20)

ii) Organisation of the Stock Markets

Title II of the Law no 1/1991 has transformed the entire structure of the stock markets (subdivided into 10 exchanges) by integrating them into a single national market related or connected to each other by means of information and telematic systems. CONSOB is in addition empowered to establish markets, also of local importance for trading in non-quoted shares (OTC). A further innovation of relevance to trans-frontier trading within the EC and possibly beyond, is that of "recognition" and agreements of cooperation between the CONSOB, on the one hand, and corresponding institutions or bodies of control of financial markets abroad, wherewith market intermediaries will be in a position to have access to markets outside Italy, thus extending the geographical scope of their transactions beyond the frontiers of Italy.

In 1992 the Mercato Italiano dei Futuro (MIF) sui Buoni del Tesoro Poliennali (BTP), the Italian Futures Market for long term treasury bonds, started its activities.⁵⁴

A Council of the Stock Market (Consiglio di Borsa) was created by Art. 24 of Law 1/91. It consists of 14 members. One of them is appointed by CONSOB, one by the Bank of Italy (Banca d'Italia), a third is nominated by the cameral consortium responsible for the coordination of stock markets; seven members represent the SIMs, while two act as representatives of corporate bodies and credit institutes authorised to act as financial/stock market intermediaries; a further two members represent companies and enterprises issuing shares traded on the stock and restricted markets. Members designated by CONSOB and the Bank of Italy are not eligible for the posts of Council President and Vice-President. The Council of the Stock Market is appointed for a period of three years by a

decrees of the Ministry of the Treasury. Beside its principal seat in Milan, it has secondary seats at the site of each stock market.

The Consiglio di Borsa can exercise the totality of powers and attributions already allocated to the chambers of commerce, to the commissions per il listino and to deputations of the stock market. (Art. 24 of the Law No. 1/91). The Consiglio di Borsa may delegate to the chambers of commerce the exercise of competences. (Art. 24, par. 1). The innovative institution of the Consiglio di Borsa is based on the principle of concentration not so much physical as informational functions of the stock market; it is based on comparable positive experiences gained in foreign stock markets.

Minervini²⁵ makes the interesting observation that undeniably, the legislator, with respect to the organisation of the markets, has used fantasy, and an awareness of the sense of responsibility to be exercised by a controlling authority, by providing a real and proper delegation to the Consiglio di Borsa, as evidence of trust on the part of the legislative power in the executive arm of government.

1. The Italian state spending deficit has reached Italian lire 2,000,000 billions in 1994. (See La Repubblica of January 20, 1995, p. 44.)
2. The Italian economic structure is dominantly based on small and medium sized enterprises. This structure rests on Roman and Renaissance traditions.
3. The Bank of Italy governor, in the annual meeting of May 31, 1994 has defined "essential" the role of banks for the development of financial markets in Italy. (see Riv. Soc. no. 3 (1994), p. 613.
4. According to OECD, the Italian family savings first in the world until 1992, have decreased in 1993 to a third place after Belgium and Portugal. (See IL SOLE ORE of July 13, 1994).
5. A. Marzano, la Finanziarizzazione della Economica Italiana, in Studi in memoria di F. Piga, (1992), vol. 2, p. 1521.
6. G. Cottino, La Commissione per le Società e la Borsa: luci ed ombre della mini-riforma, in Giurisprudenza Commerciale (1974), p. 439.
7. For example, the power given by Art 2 to the CONSOB to "determine", "order" and "statute" has been changed in "can determine", "can order" and "can statute", giving more discretionary powers.
8. G. Rossi, Il Mercato Finanziario dopo la legge 216, in Riv. Soc., vol. 29, p. 2.

9. F. G. Jaeger, *la legge No. 281 e i nuovi poteri della CONSOB*, in *Giurisprudenza Commerciale* (1985), p. 946.
10. G. Rossi, *op. cit.* (note 8 above), p. 1.
11. CONSOB Report 1983, p. 33.
12. *La Repubblica* of January 10, 1992, p. 1.
13. Art. 18 of the law 216/1974 laid down the first rules on information as a matter of transparency relating to the activities of operators and the market.
14. *La Repubblica* of January 10, 1992, p. 1.
15. Sindona had indulged in extensive fraud. He died in 1986 in a maximum security prison. See *La Repubblica* of April 20, 1992.
16. There were many penal proceedings and sentences. See *La Repubblica* of July 30, 1994.
17. *La Repubblica* of January 10, 1992, p. 1.
18. Fiat is growing and Carlo De Benedetti has already started building his empire.
19. J.O. n. 85 of March 28, 1983.
20. N. Marzona, *op. cit.*, (Chap. 4 note 17), p. 16.
21. G. Rossi, *op. cit.*, (note 8 above), p. 11.
22. G. Minervini, *la CONSOB* (1989), p. 27.

23. A. Jannuzzi, *la Consob* (1990) pag. 27.
24. Art. 20 comma 2 "L'ammissione di un titolo alla quotazione di borsa puo' essere subordinato dalla Commissione, nel solo interesse degli investitori, a condizioni particolari, che devono essere comunicate al richiedente."
25. ex Art. 2377 the CONSOB has the power to challenge decisions of listed companies.
26. CONSOB Report 1992, p. 59.
27. N. Marzona, *op. cit.*, (Chap 4, note 17), p. 261.
28. *Ibidem*, p. 264.
29. art. 1, para, 3 and 5 of law n. 216/74.
30. N. Marzona, *op. cit.*, (Chap. 4, note 17), p. 230.
31. art. 1, para 3, of law n. 216/74.
32. N. Marzona, *op. cit.*, (Chap. 4, note 17), p. 263.
33. G. Minervini, *op. cit.* (note 22 above), p. 40.
34. art. 101, "La giustizia e amministrata in nome del popolo. I giudici sono soggetti soltanto alla legge".
35. G. Minervini, *op. cit.*, (note 22 above) p. 41.
36. A. Jannuzzi, *op. cit.* (note 23 above), p. 30.
37. *Ibidem*, p. 15.

38. Ibidem, p.33, note 10.
39. CONSOB Report 1992, p. 245.
40. CONSOB Report 1993, p. 172.
41. Milano, over 91% and Roma 3,81% (CONSOB Report 1993, p. 8).
42. M. Cera, l'Intermediazione in Valori Mobiliari: dall'Agente di Cambio alla S.I.M., in Trattato Società per Azioni, G.E. Colombo and G. Portale eds, (1993), p. 13.
43. See Preamble 1 and arts. 14 and 15 of the ISD.
44. CONSOB Report 1992, p. 103.
45. CONSOB Report 1993, p. 44 ff.
46. M. Cera, op. cit., (note 42 above), p. 115.
47. Ibidem, p. 117.
48. M. Baglioni e U. Fantigrossi, Corr. giur. 1991,3,289 (11).
49. M. Cera, op. cit., (note 42 above), p. 117.
50. L. Conti, La Politica legislativa: Criteri di Scelta tra Sanzioni Penali, Amministrative e Civili in Mercato Finanziario e Disciplina Penale, (1993), p. 53.
51. M. Cera, op. cit. (note 42 above), p. 30.

52. CONSOB Report 1992, p. 63.

53. CONSOB Report 1993, p. 54.

54. On the French MATIF market in 1993 more than 72 million contracts were transacted, 30% more than in 1992 (COB Report 1993, p. 5).

On the LIPFE, transactions in 1993 involved 101,8 million contracts, 42% more than in 1992 (IL SOLE 24 ORE of January 6, 1994).

55. G. Minervini, SIM e riorganizzazione del mercato mobiliare. Alcuni appunti su una legge difficile in Il Corriere Giuridico n. 2 (1991), p. 131.

Chapter 7

The United Kingdom : The SIB

1. Development of the British System

The landscape and regulation of British financial markets has undergone significant changes in the 1980s. A main instrument for the changes has been the Financial Services Act 1986. In the history of financial regulation in the United Kingdom it has been the most complete normative instrument since the Joint Stock Companies Act of Gladstone in 1844.¹ The reform has aimed inter alia rightly at the consolidation of the position of London as a leading financial centre at an international competitive level, by establishing clear rules of conduct addressed in general to all British and non-British operators. The new rules have been introduced to remedy manifest gaps found in the traditional approach of self-regulation in a modern and increasingly complex market system.

The economic results of the introduced reforms were soon manifestly clear and positive : London succeeded to confirm its position as the capital of financial capitals. Already in 1987, members of the international stock exchange in London were, in the wake of reforms, in a position to claim to have a truly cosmopolitan market function starting in March 1987 at a time when foreigners were authorised to be in charge of firms participating in transactions on the London Stock Exchange (LSE) market. Of the then 338 members of the LSE 71 were owned by non-British firms, those from the USA being with 32 the most numerous among them; followed by those owned by the French (8), the Canadians and the Danes. Only four firms were from Japan.²

Looking at it from a socio-legal angle the FSA 1986

represents an uneasy compromise between the views of those who would like to retain self-regulation and the views of those who do not believe that self-regulation alone could provide adequate protection for investors. The new system governing the regulation of financial services in the UK is thus a combination of the two principles of central or government supervised regulation, on the one hand, and self-regulation on the other. Having stated this, it is difficult, however, to establish clearly as to which of the two principles is the more dominant, just as it is still difficult today, to make the two principles in question "co-exist" in the new system.

When confronted with the alternative of a choice between the two principles of centralised or self-regulated systems in terms of pure models, there has been, when preparing the review of the traditional regulatory system, an attempt to avoid a complete break with the past (of self-regulation), thus preferring to tread the difficult path of both continuity and innovation. The search for a just balance between "self-regulation" and "statutory" regulation has tried to do justice to the attempt to retrieve the tradition of self-regulation with reform(s) at the level of statutory regulation. Reforming without denying the positive lessons of the past has been a guiding tenet, just as regard for tradition and for cultural and doctrinal roots has been in consideration in the mutations in question in the 1980s.

Nevertheless, the introduction of the new system has raised and continues to raise doubts, questions, pre-occupations and to meet resistance. After a long and uninterrupted tradition of "self-regulation" that has characterised the history of British stock markets since their origins, the idea of control and supervision by

central (state) authorities has generated understandable reactions. For professionals active in the stock markets, the thought of continuing along the path of tradition of "self-regulation" seemed particularly attractive and tempting, while at the same time, in new dimensions of globality and competitiveness, a new approach to regulatory dimensions commended itself as no less necessary and urgent.

The FSA 1986 has been amply criticised. In Parliamentary debate Sir Gordon Borrie has underlined the "impenetrability" of the rules set up by the SIB, and Robin Cook has attacked the length, the language and complexity of the texts of the rules.³ Also in the report by the Director General of Fair Trading to the Secretary of State on the rules adopted by the SIB, worry is detectable as to the scope and complexity of the rules, apart from the already above mentioned points of impenetrability of the language used and of the enormous quantity of cross-references in the texts. While it was partially accepted that such a situation was partially inevitable, it has been asserted that the meaning of what was supposed to be said would probably be difficult to understand by those called upon to apply such rules as well as by those for whom the rules would have meaningful significance.⁴ It has in general been claimed that the scale and complexity of the rules in question has to be qualified as "disproportionate" to the activities which the rules are intended to regulate.⁵

The hybrid solution, which provides that the principle of self-regulation should operate within a framework resting on statutorily adopted standards, could be capable to impede the effective functioning of a self-regulatory system when the latter has to be characterised principally by qualities of flexibility and speed of adaptation as well as respect for the spirit and the

wording of what is to be applied.⁶ The impression is that the resulting hybrid approach which has been adopted is producing not a few problems of its own. The relationship between the role of the SIB and the role of SROs is one of the difficulties in question, in addition to the fact that determining the content of the Core Conduct of Business Rules dramatises the situation.⁷ Charles Goodhart⁸ has critically pointed out that less costly methods could and should have been taken into consideration for protecting investors, just as less severe penalties should have been considered for those violating rules, in addition to greater transparency for public information. David Lomax, economist with the National Westminster Bank, has observed that the cost of the new regime of control is much higher than that of any losses suffered by investors in the wake of scandals of recent years.⁹ All that has been said above seems to validate the theory that "The need to revitalise and restructure the economic and financial institutions of the City /of London/ was dictated more by political and economic considerations than an admitted deficiency in regulation and supervision."¹⁰

Models scrutinised for the purpose of reforming the financial markets have been substantially of two types :

- 1) A system concentrating on regulatory responsibility in a single statutory regulator;
- 2) A two-tiered structure.

The first, as a model is a product of the legal tradition of civil law, and has been correspondingly adopted in France and Italy. The second approach, related to the common law tradition, has been applied in the USA. Although "the City has always harboured an almost paranoid fear that it would have a governmental body similar to the United States' SEC imposed upon it",¹¹ has opted for the second system, as a choice

substantially motivated by a necessity "to avoid a bureaucratic juggernaut of a regulator and to ensure common sense and flexibility".¹² It should also be noted that preference for a two-tiered system is due, if not in the first place, to the possibility this system offers for retaining alive the secular or pragmatic tradition of self-regulation. Thus continuity and tradition seem to have inspired the nature of the Big Bang. The term Big Bang may be used in two meanings :

-- As the series of changes introduced on October 27, 1986 ;

-- As the entire process of deregulation extending over the course of several years.

In the second meaning, the Big Bang is in reality a process with profound and varied roots.

In March 1877, the report of the Royal Commission to look into the administration and operation of the Stock Exchange "recognised a great public advantage in the fact that those who bought and sold for the public in a market of such enormous magnitude ... should be bound in their dealings by rules for the enforcement of fair dealing and the repression of fraud, capable of affording relief and exercising restraint far more prompt and often more satisfactorily than any within reach of the Court of law". The commissioner recommended that inquiries into fraud and suspicious dealings should be undertaken promptly by "some public functionary and enforced by law"¹³

In 1938 the Prevention of Fraud (Investment) Act was passed. The Act prohibited dealing in securities except by persons who obtained a licence from the DTI. A member of a recognised stock exchange or recognised association of dealers in securities was not required to obtain a licence.

Section 14 of the Act imposed a general prohibition

on the distribution of investment circulars inviting investment.¹⁴ The Licenced Dealers (Conduct of Business) Rules 1983 (SI 1983 N.585) introduced a number of new and radical concepts, like the Chinese Walls, an obligation of "know your client". The scope of cold callings was restricted and dealers were held to generally accepted standards as to what constitutes "good market practice". The rules lacked any real sanction other than an unlikely disciplinary jurisdiction vested unenthusiastically in the DTI.¹⁵ Its provisions are considered "complicated and in places obscure".¹⁶

In 1964, the incoming Labour Government had created a new Department of Economic Affairs (DEA). A host of regulatory agencies were set up to work along side it. Regulatory agencies also survived the next change in governmental philosophy.¹⁷

The sixties, and to a lesser extent the seventies, were decades of economic growth. In 1973, the oil crisis created a new demand for international finance. Intermediating these needs and recycling "petrodollars" confirmed the international role of the City.¹⁸

In 1976 the Labour Government issued the Restrictive Trades Practices (Services) Order extending the scope of the restrictive practices legislation to the service sector.¹⁹

In 1979 the Office of Fair Trading, the government agency charged with enforcing the Restrictive Practices Act 1976 decided that certain Stock Exchange rules did not conform to the law on restrictive trade practices and a court case was begun against the Exchange. The suit charged that the Exchange's fixed commission rates and membership restrictions were illegal under the Restrictive Practices Act.

In 1979, there was a change of government. The Stock Exchange was disappointed when the Conservative

Government refused to interfere despite urging from the Bank of England. Mrs Thatcher has never been a supporter of the "club mentality" which characterised the City.²⁰

In 1979 the Thatcher administration's repeal of currency restrictions made it possible for British investors to purchase foreign securities. The removal of exchange controls made easier for foreign investment packages to move in and for British investors to move their money out and invest abroad.²¹

The late 1970s saw considerable growth in activity on the New York Stock Exchange following the abolition of minimum commission charges in 1975. Foreign securities firms, many of them American, found that since they were not bound by the London Securities Exchange's fixed commission rate schedule they could compete successfully with London Stock Exchange members in trading equities of large capitalisation British companies. The erosion of business became so severe by the early 1985 that the exchange was obliged to appeal to the Bank of England and the Board of Trade for protection from "off Exchange" dealers.²²

In 1980, the Wilson Committee ((1980) Cmnd 7937) had reviewed the functioning of financial institutions in its Report, while recognising the need to improve certain aspects of the system, "on the whole it thought that it worked tolerably well and was probably better than any other system that could reasonably be devised".²³

Professor Gower observed²⁴ that the Wilson Report seemed to imply that in respect also of the balance between Governmental-regulation and self-regulation the present balance is about right. He found it impossible to accept also because it seems to assume that, one of the two related distinctions, that between statutory and non-statutory regulation is more important than that between Governmental-regulation and self-regulation. He would

have thought that the former is of less importance than the latter.

"The approach in the UK has traditionally been by devising methods of regulation which operate along less formalised lines than in most major countries, with less emphasis on statutes and more on non-statutory forms of regulation, especially self-regulation."²³ However, the Wilson Report recognised that (Cmd 7937, para 1073) "there is little doubt that the overall tendency has been towards more, and more stringent, statutory controls" and "we do not regard it as acceptable that the regulation of financial institutions, particularly those as important as the Stock Exchange and Lloyd's should be left entirely to the institutions themselves" (Cmd 7937, para 1108).

In July 1981, Professor Gower was commissioned to study new systems for investor protection and to undertake a review with the following terms of reference:

- to consider the statutory protection now required by private and business investors;
- to consider the need for statutory control of dealers in securities, investment consultants and investment managers;
- to advise on the need for new legislation.

He was also asked to take account in the review of any relevant developments in the European Community.²⁴

On January 28, 1982 was published as a discussion document by Professor Gower the "Review of Investor Protection", called the "green paper". He underlined that the perceived defects of the then existing system were complication, uncertainty, irrationality, failure to treat like alike, inflexibility, excessive control in some areas and too little (or none) in others, the creation of an elite and a fringe, lack of enforcement, delays, over-concentration on honesty rather than competence, undue diversity of regulations and

regulators, and failure overall to achieve a proper balance between Governmental regulation and self-regulation.

Most of the defects were unlikely to be cured without a redistribution of responsibilities between Governmental and self-regulation and between statutory and non-statutory regulation.²⁷

Professor Gower²⁸ "off-shore tax havens and financial centres have sprung up in archipelagos such as the Channel Islands and the Isle of Man, the Cayman Islands, the Bahamas, Vanuatu and many more. This has enormously increased the difficulty of providing British investors with effective protection". "It was high time that all clearing banks looked very carefully at all their subsidiaries in the Channel Islands and the Isle of Man to ensure that there was no longer any scope for those companies being used as a cloak for fraud."²⁹

By 1982, growing commercial pressure for change was being exerted on the Stock Exchange. Member firms were increasingly frustrated by the restraints imposed by fixed commission rates and the single-capacity system on their ability to diversify and to compete with foreign firms.³⁰

In January 1984 Gower published, as a Command Paper (Cmd 9125), the "Review of Investor Protection" Part 1.

He recommended that

- A new Act to replace the Prevention of Fraud (Investments) Act 1958 should be called the Investor Protection Act.³¹

- The Investor Protection Act should afford the same protection to both private and professional investors.³²

- The criteria³³ for the recognition of self-regulatory agencies should be set out in the Investor Protection Act and should be satisfied that:

- a) There is a need for the recognition of another self-

regulation agency in the field concerned.

b) The agency's rules and practices relating to the admission, suspension, expulsion and discipline of its members are fair and reasonable.

c) Its rules and practices relating to admission to membership are such as to ensure that those who will thereby be permitted to undertake investment business are fit and proper persons by virtue of their character, training and experience, and financial resources.

d) It has rules relating to the conduct of business by its members which afford investors adequate protection and which, to the extent that the Department (or Commission) has promulgated Rules relating to the conduct of that business by those registered directly with it, will afford at least equal protection.

e) It has procedures and resources enabling it effectively to monitor and enforce observance of its rules.

f) Its constitution secures adequate independence of its governing body from the sectional interests of its members and effective procedures for investigating complaints against itself or its members.

g) Its rules do not impose restrictions on competition greater than are necessary for the adequate protection of investors and the orderly conduct of the relevant business or market.

Recognition should be withdrawn if the Department (or Commission) ceased to be satisfied that these criteria were met.

In 1985 Gower published, as a Command Paper the "Review of Investor Protection" - Part II; He considered that the title "the Financial Services Act" was "not appropriate" since the Act would not replace the legislation on banking and deposit taking, a major financial service, and concluded³⁴ that the City

revolution has made it essential to introduce a regulatory system which will ensure that the City remains what the White paper describes as a "clean place to do business" and which inspires deserved confidence in those who use its services.

In 1984 the Restrictive Practices Act 1976 had been amended to exempt the Stock Exchange from its provisions. The RTP case against the Stock Exchange was dropped after agreement between the Secretary of State for Trade and the Chairman of the Stock exchange on the reform concerning the Stock Exchange's practices (September 1983).

The London Stock Exchange for its part, agreed to change its rules voluntarily opening its membership and abolishing fixed commissions in equities and gilts by the end of 1986.³³

The changes were considered necessary if the Stock Exchange was to remain competitive. In the 1980s, with increasing international competition in financial services and developments in information technology, a rapid growth had taken place also in the international markets for securities. Much of this activity had taken place in London, particularly as a consequence of the freedom that followed upon the abolition of Britain's foreign exchange controls in 1979.

It soon became apparent that the abolition of fixed commissions would have a profound impact on the London stock Exchange and its members. The three main changes in the Stock Exchange rule-book (first published in 1812) were:

- 1) the abolition of minimum commissions. All Commissions became negotiable between brokers and their clients and thus enabled the London Market to remain competitive with markets abroad that already had changed to a system of negotiated commissions.

2) Allowing outside firms to take over member firms. This had been possible in the past up to maximum level of 29.9%, but in the future there would be no limit.³⁶ It changed the membership structure of the London Stock Exchange, giving access to the Exchange to major British and foreign investment banks and commercial banks; it brought about fundamental changes in the Exchange's systems for trading securities, which were designed to create a more efficient and fairer market for investors;

3) the abolition of the single capacity system - The single-capacity system had been in force at least since 1847, when the Exchange's rulebook banned partnerships between brokers and dealers as being "highly inexpedient and improper".³⁷ The single capacity dealing system is based on a separation of brokers and dealers. every stock exchange member or member firm could be either a jobber or a broker, but not both.

In 1967 to restrain the number and ill practice of Brokers and Stock-jobbers, on admission the stockbroker was bound to swear that he would execute his duties without fraud and collusion, "to the best of my skill and knowledge"³⁸

Financial surveillance of firms was tightened up in 1974 and each was obliged to maintain a minimum solvency ratio, to submit a monthly profit and loss statement and a quarterly balance sheet.³⁹

A jobber (or dealer) traded only for his or her own account and did not deal directly with members of the public. A broker traded only for the account of his or her customers and dealt only with jobbers. Exchange rules required a broker to bring every order to a jobber on the floor of the exchange, even if the broker had matched orders for both sides of a transaction. The broker was expected to shop around among competing jobbers for the best price, but was not permitted to execute transactions

in his own office, either as agent or principal.

This prohibition was made explicit in 1908 when a revised rule provided that, with the exception of arbitrage outside the United Kingdom, "all members must declare whether they were brokers or jobbers, and might only change with the consent of the Committee; that brokers might not make prices and might not deal with non-members unless by doing so they could get better terms for their principal; and that jobbers might not deal with non-members."¹⁰

The single-capacity remained in effect until October 1986. In dual capacity trading, in line with the US system, one type of dealer can operate in both role of broker and jobber. In order to allow member firms to organise themselves for dual capacity trading from 27 October 1986, the Stock Exchange introduced its new membership rules on March 1st, 1986. These permitted outsiders to own up to 100 per cent of member firms (removing the earlier ceiling of 29.9 per cent) and allowed "limited liability" corporate membership for the first time.¹¹

In fact until then the liability of members of the stock exchange was unlimited. Initially considered to be a weapon against fraudulent conduct, this rule in due time became one of the greatest obstacles to the enlargement of the numbers of stock exchange firms. In 1969 this rule was slightly modified and externals (individuals, banks, financial institutions etc.) were allowed to hold up to a maximum of ten per cent of the capital. In 1982 this limit had been raised to 29.9 per cent.¹²

Between 1960 and 1984 the number of registered brokers and jobbers fell from 305 to 100 and from 201 to 17 respectively.¹³ The loss of competitive standards in the market, caused by the drastic reduction of the stock

exchange members has been generally considered to be one of the main reasons motivating developments in 1986.⁴⁴

The Big Bang has been compared with changes on Wall Street in May 1975 when fixed commission fees on all stock transactions valued between 100 and 300,000 dollars were abolished. Commission charges were drastically reduced from May 1975 to December 1978, ranging from deductions of approximately 50 per cent on large stocks traded by "institutional" investors to 10 per cent for small investors.⁴⁵ "Big Bang has been a unique, fascinating and influential experiment in the technology, operation, economics and regulation of a modern securities market."⁴⁶

The term Big Bang has been generally considered to be synonymous with revolution: "City revolution" or the "Margaret Thatcher October revolution". "Something revolutionary in the City" stood in The Daily Telegraph of August 12, 1985. The Financial Times of October 28, 1986 was ironic, describing the Big Bang day: "A solid downpour of English rain set the scene for what was to be a trying day /... / Big Bang breakfasts advertised by enterprising restaurateurs.". France had sought to challenge the advent of the Big Bang by launching on February 20, 1986, the Marche a terme international de France (MATIF), the French futures market, and was both diffident as well as preoccupied. Le Figaro (Paris) of July 1st, 1987, advocated a reform of the Paris stock exchange for "containing" the expansion of the City of London into Europe: it urged patriotically that it was "time to react". Les Echos (Paris) of February 16, 1987, carried a headline that "London's advantage was a threat to Paris". It reported that a study of the COE indicated how the reduction of stock market transaction costs in London in the wake of the Big Bang had generated noteworthy advantages for London to the disadvantage of

Paris. It concluded that "the international SEAQ constitutes a real threat for the French financial markets". French stock exchange agents, seeing their monopoly threatened, claimed that "the transposition of the British system into France would be inauspicious for investors."*

The Italian press oscillated between the desire to deepen the understanding of the events and the temptation to stupefy the readers. The Italian daily La Repubblica of 24 October 1986, commented that the Big Bang would enable the banks "to launch new issues to increase their capital of big companies by offering shares and bonds directly to expand their own investment funds, to offer to their clients the purchase or sale of shares, bonds or other stocks at possibly better conditions."

"An explosive mixture capable to cancel centuries of history and tradition", titled Il Sole 24 Ore of October 26, 1986.

2. The Structure of the Two-Tier System

The Financial Services Act 1986 provided a two-tiered system, thus adopting the system prevailing in the USA. It can be described as one with a vertical structure, at the vertice of which the principle of statutory regulation is housed, with supervisory functions exercised by the state and assumed to serve at the same time as the basis of the whole system.

The supervisory functions of the state or central authority are exercised through the Secretary of State for Industry and Commerce (Treasury). Between the level of the Secretary of State and the lower echelons of the system the SIB is inserted as a new institutional body. It is called upon for the important function to guarantee that at the lower levels referred to in the Financial Act, expected standards are maintained and even possibly improved by Self-Regulatory Organisations (SROs) within an ambit supported by the principle of self-regulation.

The SIB may be referred to as a senior regulator, responsible on the first tier for validating or recognising the second-tier bodies (SROs, RIEs, RCHs), who in turn take care of the so to speak frontline regulation of authorised firms and of markets. At a higher level the Secretary of State exercises powers by virtue of Section 114 of the 1986 Act, by delegating regulatory authority to the SIB. The SIB in turn exercises supervisory powers over the various SROs, and these in turn supervise individuals and firms providing services to customers. To coordinate a dimension of self-regulation with measures concerning the protection of investors, each SRO generates its own, very detailed set of rules complying with the core rules laid down by the SIB. This framework is intended to promote investor protection through the existence and authority of (1) a

senior regulator dedicated to the public interest and to setting fundamental standards; (ii) frontline regulators in charge of practising and delivering "adequate" investor protection. To coordinate the needs of operating within a statutory framework while doing justice to the needs of day-to-day activities, powers initially vested in the Government are delegated to the senior regulator. This enables the regulatory system to be anchored in public policy objectives, but, as separate from government, to respond to day-to-day needs with minimum of or at least limited bureaucracy. In practical terms, in the interest of the investor, the system is destined to control and see that those offering investment services are qualified and capable in accordance with determined standards including qualities of integrity, honesty, competence and financial knowledge.

i) The Upper-Tier: Rules, Functions and Competences relating to the SIB

The primary task of the SIB has been the promotion of a new regulatory system capable to respond to two fundamental tasks in terms of 1) the protection of investors and 2) the maintenance of an adequate level of efficiency on the financial markets. Created in the spring of 1985, it has proved worthy of recognition by the UK Parliament as a "designated Agency". By December 1985 it had published its first set of rules on investment, and on November 7, 1986 Parliament passed the Financial Services Act 1986 defining the scope of competences of the SIB. "This new normative system is destined to equip the SIB with a formidable arsenal of sanctions ranging from admonitions, be they private or public, to civil actions for the restitution of funds owned by clients, to suspension and withdrawal of authorisation. There is provision also for the application of direct mechanisms for the protection of investors, such as compensation, arbitration and systems of protection of the rights of citizens."¹⁷

Continuing the affirmation of its responsibilities, the SIB published in February 1987 its second set of regulatory rules under the title of "Approaches of the SIB to its regulatory Responsibilities." On May 18, 1987, the UK Parliament approved the Financial Act 1986 (Delegation Order 1987), recognising the SIB as a "designated Agency", to which some powers were delegated as provided for in the Financial services Act 1986.¹⁸

SIB's statutory tasks, (all with relevance to the interests of investors,) include:

-- initial and continuing recognition of SROs, RIEs, RPBs and RCHs; creation of a rulebook (both for firms directly regulated by SIB, and for providing the benchmark of equivalence necessary to judge the rulebook

of SROs);

-- exercise of enforcement powers, e.g., in relation to unauthorised investment business, supplementing of SRO powers and restitution;

-- collective investment scheme authorisation, recognition and regulation;

-- maintenance of a central register of authorised firms;

-- direct regulation of firms who choose to be regulated by SIB rather than by an SRO or RPB.

In addition the SIB is empowered to refer a relevant matter to judicial authority.

Among SIBs powers of supervision the most important are:

a) A binding request addressed to a SRO to modify a rule or rules considered to be inadequate in comparison to SIB standards;

b) To award recognition to SROs (self-regulatory organisations), to investment exchanges and to recognised professional bodies (RPBs);

c) To extend authorisation directly to a natural person or legal person.³⁰

Section 3 of the Financial Services Act 1986 (FSA) provides that no one may be active in investment business in the UK without previous authorisation provided for under Chapter 3 of the FSA, unless express exemption is provided for, such as for the Bank of England, Recognised Investment Exchanges (RIEs), clearing houses, Lloyds etc.

Part I, Chapter 1 of the FSA 1986 includes a normative definition for "investment" as well as for "investment business". "Investments" are further defined in detail in Schedule 1, Part 1 of the FSA, while activities constituting "investment business", hence with necessary authorisation, are described in detail in the same schedule 1, Part II of the FSA. Part III of Schedule

1 contains a list of activities excluded from the definition of "investment activities".

Under the FSA authorisation for "investment business" may be obtainable :

- 1) For members of an SRO recognised by SIB;⁵¹
- 2) For members of a recognised professional body (RPB) who are expressly authorised by the RPB to exercise an "investment business".⁵²
- 3) For those authorised to exercise "investment business" in the sphere of insurance in the meaning of the Insurance Companies Act 1982;⁵³
- 4) For those registered as a "friendly society" in accordance with the Friendly Societies Act 1974;⁵⁴
- 5) For operators of some "Collective investment schemes" recognised by SIB;⁵⁵
- 6) For those "directly" authorised by SIB;⁵⁶
- 7) For those authorised in another member state of the European Community.⁵⁷

Each SRO is empowered to control its members and to apply, if needed, disciplinary measures against them. This same rule applies in the relationship between SIB, on the one hand, and those "directly" authorised by SIB on the other. The latter may be physical or legal persons (companies as well as associations), who must obviously supply evidence as to being fit and proper persons. SIB is responsible for verifying with great care the contents of information supplied by applicants. Whenever necessary, powers to suspend or withdraw an authorisation may be exercised under the Financial Services Act 1986. FIMBRA and

LAUTRO will be officially derecognised on 1 October 1995. " "

It is possible to be a member of more than one SROs or have at the same time an authorisation directly from SIB for exercising some functions. For such situations, SIB has introduced the notion and solution of a "lead regulator" who then accordingly bears responsibility as well as control functions as a "single authority". Such a "lead regulator" shall be the SRO related to the most important part(s) of an authorised person's activities. The "lead regulator" may also be the SIB if SIB has issued an authorisation "directly" for the given major or most important of exercised activities. A situation of multiple authorisation presupposes and even more importantly requires close contact and collaboration between the various SROs concerned or between the relevant SROs, on the one hand, and the SIB on the other. In any case the SIB is always to be kept informed about agreements reached between various SROs as to the designated authority called upon to exercise supervision and control as a "lead regulator".

ii) Composition, Legal Nature and Financial Aspects of SIB

The FSA 1986 makes no concrete reference to the legal nature of SIB. Although it is a private company limited by guarantee, formed on May 30 1985 between a broker (Sir Kenneth Berrill) and a banker (Martin Wakefield Jacomb),³⁷ it exercises public functions and statutory powers in the interest of the stability and reliability of the financial markets, and not least, in the interest of investors. While being in form a private, practitioner-oriented body, it exercises in substance public functions by statute, as the prolonged arm of public authority, and as such it is subject to statutory and public law constraints just as if it were a public body incorporated by statute.³⁸ Such delegation of governmental powers to a private body as a "constitutional anomaly" presents constitutional legal problems, and it involves challenges to the legal logic at the level of continental European or civil law tradition.³⁹

Already at the level of Parliamentary debates,⁴⁰ it was evident that the SIB was conceived as being a "creation" of the Parliament and not of the City, created for the purpose of guaranteeing the protection of investors. At the beginning of its conception and thereafter the SIB has tended to seek an adherence to professional standards applied in the City of London, thus generating at the level of definitions a difficulty as to what the legal status or nature of not only the SIB but also of the other "recognised regulatory bodies". The situation may be considered even as more complex in the light of the fact that the creation of the SIB was envisaged for assuming a peripheral role within the system of regulation applicable to the "corporate issuer" under the jurisdiction of the FSA 1986, the main

function to be assigned to the SIB being that of controlling the financial intermediaries.

The SIB is not an entity based on the notion of self-regulation, in spite of the fact that many of its members come as professionals from various areas of experience on the market.⁶³ The SIB is a creature the legal nature of which is unusual. It is destined to exercise regulatory powers, including the competence to submit to judicial control questions relating to investment and the protection of investors' interests, and to see applied, whenever justified, the penal provisions included in the FSA 1986. Yet, the SIB is not a governmental department, but a specific body with the formal nature of private company.⁶⁴ It has regulatory competences anchored in the FSA 1986 and delegated to the SIB. As a further definition the SIB may be qualified as "the new watchdog of the City of London"⁶⁵ or the "umbrella supervisory body for Britain's securities markets".⁶⁶ The SIB has self-defined itself "a new watchdog with teeth". The SIB constitutes, in substance, the principal executive instrument of the FSA 1986, and therewith an instrument of intervention of the state in the economic sphere.

In the SIB's Board there are currently 13 members, a size which has been qualified as excessive by Gower.⁶⁷ More relevant to the topic of the present thesis are the qualifications of the members of the SIB Council. They include professional experience in the area of investment and independence. The members include :

- a) Persons with experience in investment business of a nature relevant to the functions or proposed functions of the agency; and
- b) Other persons, including regular users on their own account or on behalf of others of services provided by persons carrying on investment business.⁶⁸

Thus, this arrangement tends to secure the representation of users of investment services or/and of the public in general, providing therewith for an equilibrium between the interests of the category of service providers, on the one hand, and of the category of recipients of services on the other, as expressly required by the FSA 1986: "the composition of that body must be such as to secure proper balance between the interests of persons carrying on investment business and the interests of the public."⁶⁹

In comparative terms, members of the Board do not hold office for a given period of time, as is the sanctioned case for the COB in France and CONSOB in Italy; but at the highest level, the appointed chairman and other members of the governing body of the SIB are "liable to removal from office by the Secretary of State (Chancellor of the Exchequer) and the Governor of the Bank of England acting jointly."⁷⁰ Therewith a threat of dismissal exists, considered to be an effective sanction that the Government may apply to ensure that the private body does not neglect public interests and does what these interests demand.⁷¹ Moreover, since January 28, 1987, members of the SIB Council have to comply with some rules relating to a duty to communicate investments in "securities".⁷²

As a measure of periodic control, the Board makes an annual report pursuant to Section 117 of the FSA 1986, covering functions transferred to it under the SFA 1986 and Companies Act 1989. Of course, highest standards of integrity at a practical level apply to officials of the SIB: no acceptance of favours or of gifts without prior authorisation by the head of the executive office; optimal discretion when responding to hospitality, so that in any case no bad interpretation may result. The SIB and its officials enjoy immunity for acts and

omissions, in good faith, in the exercise of their functions. The same immunity applies with respect of the SROs.⁷³ Stating the same rule differently, the SIB, its members, officers and employees are immune from damages claims except where the alleged act or omission is shown to have been committed in bad faith.⁷⁴

An advantage for the public finances, resulting from the private nature of the SIB, is that the SIB is financed by the financial markets, without any public contributions; but while not being a governmental body, the SIB Council is responsible for its activities to the Secretary of State (now Treasury). The Secretary in turn is responsible for the SIB in relation to Parliament.⁷⁵ Thus, the element of self-regulation deploys itself also in the form of self-financing,⁷⁶ with resources supplied by those who are subject to SIB's regulatory authority; all those recognised and/or authorised by SIB periodically pay fees. It deserves underlining⁷⁷ that because the SIB is financed by payment of fees by SROs, other recognised bodies and authorised persons under Sections 112-113 of the FSA 1986, it is able to maintain "a flexibility which, it is argued, would not be available to a body dependent on government funding", as is the case with COB in France and CONSOB in Italy. While financing the SIB is not a matter of public finances, it does not escape discussions and polemics.

Gower,⁷⁸ in keeping with the spirit of self-regulation and self-financing as part of the tradition in the UK, maintained that the cost of regulation "will inevitably be borne by investors, for whom the protection is intended, and that it is right that it should", adding however, that "it is in the national interest that a country should have an effective system of investor protection and accordingly the taxpayer should bear part of the cost /... / The cost of day-to-day regulation

should be borne initially by those regulated, who would pass it on to their clients, but that of the body charged with decisions on policy and overall surveillance should be borne by the taxpayer."⁷⁹

A general and common criticism, difficult to assess objectively at the level of non-financial discussions as is the case in the present thesis, has been that "the present regulatory structure generates unnecessary cost; it is too complex; there is duplication, but inefficiency also arises because of underlaps: the regulators, in monitoring, create needless requirements /... / all leading to a bottom line conclusion of excessive cost, which the investor has to pay for".⁸⁰ This is a matter to be adjudicated best by experts and consultants of financial and administrative management. The net costs of SIB had gone up from £11.4m on March 31st 1989 to £14.216m on March 31st 1993 and to £17.733 on March 31st 1994.⁸¹ Personnel or employment costs, representing less than 50 per cent of total budgetary costs, had increased from £4.618m on March 31st 1989 to £7.048m by March 31st 1993, and £7.717m by March 31st 1994.⁸² The employees of the SIB had increased relatively lightly from 164 to 183 between 1989 and 1994.⁸³ In March 1993 the City Research Project, in a study by Julian Franks and Steven Schaefer from the London Business School, dealt with the costs and effectiveness of the UK regulatory system to estimate the cost of regulation for individual sectors, both in absolute and relative terms in order to compare with the cost of regulation in the USA and France.⁸⁴ The general conclusion was an obvious one. In the words of Large, "we must insure not only that the costs of regulatory bodies are well controlled but, above all, that they give value for money in investor protection terms" /... / "strong cost control discipline should be built into the regulatory system".⁸⁵

iii) Self Regulation at the Lower Tier
Self-Regulatory Organisations

The relationship between the role of the SIB and the role of the SROs is a very delicate one. Each SRO has its own, very detailed set of rules which must comply with the rules laid down by the SIB. In a hierarchical or vertical relationship, the SIB exercises supervisory powers over the SROs, and the SROs in turn supervise individuals and firms which provide the services to customers or investors.

With particular reference to regulation at the lower tier, the primary function of the SIB may be defined as that of supervising the activities of all recognised bodies, that is, the SROs, RPBs, RIEs and the Recognised Clearing House (RCH). The SIB has asserted its ongoing supervisory function also in respect of the one RCH, the London Clearing House, in order to satisfy itself that the Clearing House has satisfactory procedures and adequate financial resources to fulfil its obligations.⁶⁶

In terms of a regulatory hierarchy relating to the investment markets in the UK, operative since April 29, 1988 ("A Day"), the following organisations, all based on self-regulation, exist:

- a) SROs - Self-Regulation Organisations ;
- b) RIEs - Recognised Investment Exchanges and
RCHs - Recognised Clearing Houses ;
- c) RPBs - Recognised Professional Bodies.

Here mention should be made of a body that has been and constitutes also currently the oldest cornerstone in the history of self-regulation in the UK : The Stock Exchange, rightly referred to as the "senior self-regulatory body". The Stock Exchange has united in itself the two functions which in the new system are exercised by two different or separate organisations, namely, the SROs and RIEs. With the introduction of the new system,

the Stock Exchange has been constrained to structure itself in the form of two different bodies for the sake or necessity of obtaining recognition by the SIB.

The first body of the Stock Exchange, generated at the end of 1986 through the fusion or merger of the Stock Exchange and the International Regulatory Organisation (ISRO), is destined to operate as a SRO and has been given the name The Security Association (TSA);

The second body of the Stock Exchange is The International Stock Exchange of the United Kingdom and the Republic of Ireland, and is structured to function as a RIE.

The Stock Exchange continues to function as the unique body responsible for the admission of securities to listing as well as for the establishment of rules and standards regulating such admissions.

The Council of the Stock Exchange has been confirmed by the FSA 1986⁷ as the "competent authority" already designated as such in The Stock Exchange (Listing) Regulations 1984 as a RIE. The task of The Stock Exchange is to organise efficient and properly regulated markets. Possibly psychologically and historically understandable, The Stock Exchange has been the strongest opponent to the creation of the new system and, in particular, the creation of the SIB.

With the protection of investors in mind, as the topic of the present thesis, the following observations may be made on SROs, RIEs, and RPBs.

a) SROs : Recognised Self-Regulating Organisations

A SRO is a body qualified to authorise its members to carry on an investment business; it is competent to set up its own rules of professional conduct and to monitor the implementation of the rules. With respect to

investor protection, a SRO is essentially a body responsible for the regulation of the relationship or of relations between its members active in the field of investment business, on the one hand, and their clients on the other.

A SRO operates exclusively on the principle of self-regulation, that is, once recognition as a SRO is extended to it by the SIB. The recognition of a SRO effects, for members of the SRO, the authorisation to carry on the type of investment business to which the authorisation as a SRO by the SIB is related. As an important point in terms of self-regulation, a SRO is responsible for the selection, admission to membership, evaluation of professional qualifications of its members. Parallel thereto it should be added that the authority of a SRO over its members is derived from a contractual relationship to them. Membership of a SRO is voluntary, and does not involve any delegation of competences from the SIB to the recognised SRO.

To qualify for recognition by the SIB, an aspiring SRO must do its homework by equipping itself with an adequate set or body of rules related to the exercise of an investment business in a given sector and must provide evidence as to being in possession of certain requisites specified in the FSA 1986.

If a SRO is not able to satisfy all the conditions and requirements stipulated by the FSA 1986, the SIB shall decline to extend recognition to it.

The SROs' framework was divided, in terms of types of investment business being carried out in the UK, partly on functional grounds and partly by reference to the product or service provided. The structure originally involved five SROs and nine RPBs, as well as numerous recognised and designated investment exchanges.⁹⁹

b. Recognised Investment Exchange (RIE)

An investment exchange regulates the markets and the conduct of those who offer securities. It may need recognition by the SIB. Unlike the situation between SROs and their respective members, membership in a RIE does not automatically include an authorisation for the given persons. This constitutes a major difference between the RIEs and the SROs. All members of an SRO are as such automatically authorised to exercise investment business once the SRO itself is granted an authorisation by the SIB. Recognition by the SIB of an RIE applies to the RIE itself but does not exonerate its members from authorisation. RIE members may obtain recognition if the RIE fulfils fundamental requirements, among which are :

- a.) sufficient financial resources ;
- b.) adequate standards regulating conduct ;
- c.) adequate liquidity ;
- d.) systems for documenting financial transactions ;
- e.) possibilities of effective control and effective application of the same.

c.) Recognised Professional Bodies

The FSA 1986 includes also provisions for persons certified by RPBs, who are engaged in investment business but not as the main part of their business activities.*

The FSA 1986 also empowers professional bodies recognised by the SIB to authorise firms under the control of their members to carry on investment business.

As the FSA does not specify the limit of investment business required to be "wholly or mainly" an investment business, the limit is agreed with the SIB at the time of recognition. The FSA 1986 provides* that a professional body may request recognition for carrying on investment business. If a professional body does not acquire recognition, individual members may become members of an SRO or may apply for authorisation directly from the SIB.

The requirements for recognition of an RPB are

similar to those required for the recognition of SROs. Additionally, Schedule 3 of the FSA 1986 lays down strict requirements to ensure that the control of RPB firms remains in the hands of RPB members, whose main business is the practice of the particular profession regulated by the RPBs concerned.

Unlike firms which obtain their authorisation to carry on investment business by becoming members of an SRO, RPB firms (the partners and controllers of which will already be members of the RPB) require specific certification for investment business activity. The FSA 1986 requires therefore the RPB to have adequate arrangements for monitoring a firm's continued compliance with the certification conditions, and enforcing the withdrawal or suspension of certificates and other disciplinary procedures where firms fail to fulfil the relevant conditions.

The constitution of a governing body of an RPB does not require the balance of membership required by Schedule 2 of the FSA 1986 for SROs.

There were in 1993 nine RPBs.²¹

The FSA 1986 gives the SIB discretion whether or not to recognise a body as a self-regulating organisation. Once the SIB has recognised an SRO it has no power to modify, other than by agreement, the SRO's activities. Thus, the powers of the SIB to withdraw recognition from an SRO completely are very circumscribed. By contrast, in the case of RPBs, the SIB has no power to refuse recognition to a professional body which it considers meets the necessary criteria, nor to specify, otherwise than by agreement, what its threshold for investment business shall be. The absence of those various powers limits the ability of the SIB to effect or prevent changes in regulatory coverage in the interest of

the system as a whole.

1. C.M. Schmitthoff, in preface to J.L. Powell, *Issues and Offers of Company Securities: the new regimes*, Sweet and Maxwell, London (1988). See L. De Angelis, *Il Financial Services Act e la Riforma del Diritto dei Valori Mobiliari nel Regno Unito* in *Riv. Soc.* vol. 34, (1989), p. 401.

2. *The World comes to London*, in *International Securities Digest*, n. 4 of July 1987, p. 14.

3. House of Commons, *Parliamentary Debates, Weekly Hansard*, 5-8 May 1987, p. 909.

4. R.B. Jack, at a Conference on *An Assessment of the Financial Services Act*, London, June 4, 1987, p. 14.

5. *Ibidem*.

6. *Ibidem*, p. 15.

7. A. McGee, *The Securities and Investment Board's Core Conduct of Business Rules 1991* in *the Company Lawyer* vol. 13, n. 7, (1992), p. 132.

8. Charles Goodhart, *Il Sole* 24 Ore of Jun 1987.

9. *Ibidem*.

10. B.A.K. Rider, C. Abrams and E. Ferran, *Guide to the Financial Services Act 1986* (1989), 2nd ed., p. 21.

11. *Ibidem*, p. 13.

12. A. Large, *op. cit.*, (chap 5 note 44), p. 4.

13. B.A.K. Rider, C. Abrams and E. Ferran, op. cit., (note 10 above), p. 5.
14. Ibidem, p. 7.
15. Ibidem, p. 6.
16. L.B.C. Gower, op. cit., (Chap. 3, note 5), p. 12.
17. B.A.K. Rider and C. Abrams and E. Ferran, op cit., (note 10 above), p. 21.
18. B.A.K. Rider, C. Abrams and E. Ferran, op. cit., (note 10 above), p. 9.
19. Ibidem, p. 23.
20. Ibidem.
21. L.B.C. Gower, op. cit., (Chap. 3 note 5), p. 12.
22. N.S. Poser, op. cit., (Chap. 5, note 5), p. 24.
23. B.A.K. Rider, C. Abrams and E. Ferran, op. cit., (note 10 above), p. 13.
24. L.B.C. Gower, op. cit., (chap. 3, note 5), p. 77.
25. L.B.C. Gower, op. cit., (Chap. 3, note 5), p. 75.
26. L.B.C. Gower, op. cit., (Chap. 3 note 5), p. 1.
27. Ibidem, p. 137.
28. Ibidem, p. 58.

29. Ibidem, p. 59.
30. N.S. Poser, *op. cit.*, (Chap. 5 note 5), p. 24.
31. L.B.C. Gower, *Review of Investor Protection*, (1984), Part. 1, p. 197.
32. Ibidem, p. 198.
33. Ibidem, p. 200.
34. L.B.C. Gower, *Review of Investor Protection* (1985), Part. II, p. 83.
35. N.S. Poser, *op. cit.*, (Chap. 5, note 5), p. 28.
36. D.F. Lomax, *London markets after the Financial Services Act*, (1987), p. 2.
37. E.V. Morgan and W.A. Thomas, *op. cit.*, (Chap. 2, note 21), p. 145.
38. B.A.K. Rider, C. Abrams and E. Ferran. *op. cit.*, (note 10 above), p. 3.
39. L.B.C. Gower, *op. cit.*, (Chap. 2, note 21), p. 145.
40. E.V. Morgan and W.A. Thomas, *op. cit.*, (Chap. 2, note 21), p. 146.
41. D.H. Ingram, *Change in the Stock Exchange and regulation of the City*, in *Bank of England Quarterly Bulletin*, vol. 21, February (1987), p. 55.

42. M.A. Figato, Il big bang al London Stock Exchange. Una valutazione in Il Risparmio n. 2, (1987), p. 286.
43. N.G. Terry, The Big Bang at the Stock Exchange in Lloyds Bank review of April 1985, pp. 17-18.
44. N. A. Figato, op. cit., (note 42 above), p. 268.
45. Ibidem.
46. N.S. Poser, op. cit., (Chap. 5, note 5), p. 26.
47. Investir n. 680, of February 2, 1987, p. 14.
48. SIB, Financial Services, a Guide to the Regulatory System, (1986), p. 5.
49. The FSA confers the powers on the Secretary of State but by the Transfer of Functions (Financial Services) Order 1992, S.I. 1992 n. 1315, most of the functions of the Secretary of State under FSA have been transferred to the Treasury from June 7, 1992.
50. FSA, s. 27.
51. Ibidem, s. 7.
52. Ibidem, s. 15.
53. Ibidem, s. 22.
54. Ibidem, s. 23.
55. Ibidem, s. 24.

56. *Ibidem*, s. 25.
57. *Ibidem*. s. 31.
58. *The Company Lawyer*, vol 15, n. 9(1994), p. 282.
59. L. De Angelis, *op. cit.*, (note 1 above), p. 413.
60. L.B.C. Gower, *op. cit.*, (note 34 above), p. 12.
61. *Ibidem*, pp. 11-12.
62. A. Nelson, *House of Commons Parliamentary Debates Weekly Hansard Issue n. 1417, 5-8 May (1987)*, p. 945.
63. SIB, *op. cit.*, (note 48 above), p. 7.
64. *Ibidem*, p. 3.
65. *The Economist* of March 1-7, 1986, p. 64.
66. *Financial Times* of October, 29, 1987.
67. *Il Sole 24 ore* of June 1987.
68. SFA, Schedule 7, 1-(3) (b).
69. FSA, Schedule 7, 1-(3).
70. FSA, Schedule 7, 1-(2).
71. L.B.C. Gower, *op. cit.*, (note 34 above), p. 11.
72. F.S.A., s. 5, Annex D. Rules Governing Dealing in Securities by Members of the Board.

73. Ibidem, s. 187 (3).
74. Ibidem, s. 187 (3).
75. SIB, op. cit., (note 48 above), p. 4.
76. FSA, s 112.
77. B.A.K. Rider, C. Abrams and E. Ferran, op. cit., (note 10 above), p. 305.
78. L.B.C. Gower, op. cit., (Chap. 3 note 5), p. 140.
79. L.B.C. Gower, op. cit., (note 31 above), p. 7.
80. A. Large, op. cit., (Chap. 5, note 44), p. 86.
81. SIB's Reports from 1988 to 1994.
82. SIB's Reports from 1989 to 1994.
83. SIB's Report 1993/1994, p. 98.
84. A. Large, op. cit., (Chap. 5, note 44), p. 69.
85. A. Large, op. cit., (Chap 5, note 44), p. 68.
86. SIB's Report 1992/1993, p. 11.
87. FSE, s 142.
88. The five recognised Self-Regulating Organisations (SROs) initially were :
 - 1.) The Securities Association (TSA), born out of the merger between the International Securities

- Regulatory Organisation (ISRO) and the Stock Exchange ;
- 2.) The Financial Intermediaries, Managers and Brokers Regulatory Association (FIMBRA) ;
 - 3.) The Association of Futures Brokers and Dealers Limited (AFED) ;
 - 4.) Investment Management Regulatory Organisation (IMRO) ; and
 - 5.) Life Assurance and Unit Trust Regulatory Organisation (LAUTRO).

In 1991 the amalgamation of TSA and AFBD reduced the number from five to four SROs. Firms engaging in investment business have the option of being directly regulated by the SIB, instead of membership in a SRO.

89. "(1) A professional body means a body which regulates the practice of a profession and references to the practice of a profession do not include references to carry on a business consisting wholly or mainly of investment business ;

"(2) in this Act references to the members of a professional body are references to individuals who, whether or not members of the body, are entitled to practice the profession in question and, in practicing it, are subject to the rules of the body"

90. FSA 1986, s 15.

91. The Background to Investor Protection, SIB publication 1992.

Chapter 8

Investor Protection

1. EC Legislation. Investor Protection and new financial intermediaries in (2.) France, (3.) Italy and (4.) the United Kingdom

1. EC Legislation

The cardinal principles adopted by EC legislation for creating a single European market for banking and financial services aim at providing for investors safeguards substantially equivalent in the member states. For this purpose they apply (i) minimal essential harmonisation, (ii) mutual recognition and (iii) home member state control. More specifically, minimal essential harmonisation is conceived as constituting the presupposed basis for mutual recognition and home state control.

1) From Disclosure to Investor Protection : the Prospectus

The function of EC legislation in the sphere of financial markets has been twofold :

-- to regulate the activities and interpenetration of securities markets for the purpose of creating a "common (capital) market"; and

-- to provide an adequate control relating to the operations of the markets by establishing for that purpose a Community model for the protection of investors.

The strategy for a Community wide investor protection started emerging in the 1970s with respect to the prospectus addressed to potential investors. As such it was the first instrument or document of interest for EC legislation. Therewith the extent of attention of EC

law was enlarged beyond the field of disclosure to that of investor protection.

The philosophy of disclosure underlying the basis of approach to information contained in a prospectus relates coherently to a line of historic evolution going back to a French law in 1867. In it, beside the freedom of activities granted to stock companies (*sociétés anonymes*), were instituted obligations governing publicity and information on companies as a counterweight to corporate freedoms granted by law. Therewith the possibility to solicit for investment by the public involved a duty to inform the potential investor(s) on the identity and quality of an applicant company, on the details and risks involved in a proposed investment, on specific and atypical risks related to it. Solely the availability of relevant information would enable the investor(s) to assess adequately any risks and adopt a decision based on proper information.¹

In the USA, more than 70 years ago, the philosophy of disclosure was generated by the necessity to induce small and average investors, traumatised then by the Big Crash of October 1929, to regain confidence and participate in a model of economic development not based on banks as intermediaries but on channelling savings for investment directly toward the interested companies. The control system, resting on a duality of inherent risks and freedom to take them in an environment of adequate transparency free of any manipulation affecting relevant information, tended to motivate small and average investors to participate directly in the market without the fear of getting exposed to unclear transactions involving excessive risks.²

The Directive 80/390 EEC of March 17, 1980 (OJ L 100/1 April 17, 1980) coordinating the requirements for the drawing-up, scrutiny and distribution of the listing

particulars to be published for the admission of securities to official stock exchange listing, adopted the provisions of Directive 79/279 EEC of March 5, 1979 (OJ. L 66/21 of March 16, 1979 coordinating the conditions for the admission of securities to official Stock Exchange listing) and subordinated admission for official listing to the publication of a special informative prospectus. Conditions governing its contents, mode of publication and exception clauses constituted therewith the first step at Community level for the harmonisation of rules prevailing individually in the member states. However, already the proposed Directive of October 5, 1972 (OJ C 181 61, of December 13 1972, adopted as Directive 80/390/EEC of March 17, 1990) contained the gist of fundamental elements underlying the emerging EC legislation. The scope of the proposed Directive intended to render "sufficiently equivalent guarantees offered by each member state as to adequate and objective information made available to third parties as actual and potential shareholders" (preamble par. 4), for protecting investments and for regulating the functioning of stock markets.

The proposal was born out of the preoccupation that in their relations with the investing public "issuers furnished absolutely unequal information both in qualitative as well as quantitative terms, resulting in unequal standards of protection for investors." It was noted that information which issuers had to provide for official listing of shares at the stock markets in London and New York was clearly subject to more rigorous requirements; additionally, experience gained at these stock markets confirmed that a duty to provide ample information did not involve any negative consequences.

(The introduction to the Comments accompanying the proposed Directive). The proposed Directive underlined the necessity that the provisions in question should apply not only to the required information supplied in the form of a prospectus, but also to the control of the same information.

Art. 1 of the draft Directive introduced the obligation to issue a prospectus and its control by the designated (national) authority. Art. 2 determined its contents. "The prospectus shall contain all the information which, in accordance with the characteristics of the issuer(s) and the stocks in question, are necessary for enabling the investors and their financial advisors to form an opinion on the assets, financial situation, performance and prospects of the issuer(s) as well as on rights related to the stocks proposed for official listing."

Art 13, governing the control of prospectuses, provides for the authorisation by the competent authority only "if it considers that the prospectus fulfils all the conditions of the Directive and there is no good reason to believe that the prospectus is free of any indications or omissions which may mislead the public." As to the control of prospectuses, in the report accompanying the proposed Directive it was considered to be necessary that they contain analogous information verified with equal efficacy.

In the Directive 80/390 EEC, the purpose of "protecting the interests of actual or potential investors is expressly laid down in the preamble. It has in addition been recognised that "guarantees presuppose the existence of adequate and as much as possible objective information concerning particularly the financial situation of the issuer(s), the nature of the stocks intended for official listing."

When confirming the scope of "rendering sufficiently equivalent the 'requested' guarantees in each of the member states as to adequate and objective information on actual or potential bearers of shares, the term "offers" of the draft proposal has been modified into "requests".

The contents of the prospectus, which substantially follow the proposals of the Directive, are governed by a rule of general character: "The prospectus shall contain all the information which, in accordance with the particular characteristics of the issuer and of the stocks the admission of which is requested for official listing, are necessary for the purpose of assisting investors and their advisors to assess thoroughly the assets and financial situation, the performance and prospects of the issuers, not excluding rights connected with the stocks in question." (Art. 4)

The Directive, as the draft underlying it, has left to the member states (Arts. 6 and 18, paras. 1 and 3) the designation of the authority, which within the framework of the respective national legal systems, should be entrusted with the control of adequacy of the prospectuses as to prescribed standards regarding their contents. Publication of the prospectuses has been made dependent on such an adequacy (Art. 18 para. 2). As to the modality of control affecting a prospectus, in simple confirmation of the principle already laid down in the draft text that "the competent authorities shall approve the publication of the prospectus only if they are satisfied that it fulfils all the conditions of the Directive" Art. 18, para. 3), the phrase "and if they have no reason to believe that it is devoid of indications or omissions which may mislead the public" has been deleted (Art. 13 para. 3 draft Directive). In addition, while in the draft text it was underlined that "for absolving its responsibility the designated

authority shall be endowed with all the necessary control competences and powers" (Art. 13, para. 4), the text of the Directive was drafted in terms of "the member states shall see to it that the competent authorities are endowed with the powers necessary for the fulfilment of their functions" (Art. 18, para. 3), and it is clarified that "the present Directive shall not in any way modify the responsibility of the competent authorities governed exclusively by the disciplinary standards of national law (Art. 18, para. 4).

As to the modality of publication of a prospectus, Art. 20 enables opting for its publication "in one or more national or large distribution news papers", or for its reproduction as a separate publication made freely available for the public at the seat of a stock market where the official listing is requested, or at the seat of the issuer or of bodies in charge of providing financial services at the expense of the issuer.

If it appears to be necessary to publish the prospectus prior to the beginning of trading, a "reasonable space of time" is to be considered (Art. 21, para. 1). As to any "new significant fact which may influence the quotation of the stock(s), having emerged between the editing of the prospectus and the beginning of trading, it is obligatory to prepare a new supplement to the prospectus, subject to the same control as the latter and to publication in the same way as laid down by the control authority (Art. 23).

Directive 87/345/EEC of June 22, 1987 (OJ L185/81 of Jul 4, 1987), amending Directive 80/390/EEC has introduced the principal of mutual recognition of prospectuses: "Once approved in accordance with Art. 24, the prospectus shall be approved, with due regard to any required translation, in the other member states where admission for official listing is not subject to ulterior

approval by the competent authority or to the condition of including additional information in the prospectus." (Art. 24 bis).

The replacement of harmonisation by mutual recognition and by the delegation of standard setting to technical bodies introduces a principle of competition between rules and between regulators in a way that may stimulate flexibility and policy innovation.

The Directive 89/298/EEC of April 17, 1989 (OJ L 124/8, May 5, 1989) coordinating the requirements for the drawing up, scrutiny, and distribution of the prospectus to be published when transferable securities are offered to the public, has laid down the rule that member states shall coordinate their standards regarding the above mentioned matters, the contents and the mode of publication of the prospectus when transferable securities are offered to the public. As to investor protection, it is expressly mentioned in the preamble of the Directive: "Whereas investment in transferable securities, like any other form of investment, involves risks; whereas the protection of investors /emphasis added/ requires that they be put in a position to make a correct assessment of such risks so as to be able to take investment decisions in full knowledge of the facts;

"Whereas the provision of full, appropriate information concerning transferable securities and the issuers of such securities promotes the protection of investors /emphasis added/;

"Whereas, moreover, such information is an effective means of increasing confidence in transferable securities and thus contributes to the proper functioning and development of transferable securities markets;

"Whereas a genuine Community information policy relating to the transferable securities should therefore be introduced; whereas, by virtue of the safeguards that

it offers investors and its impact on the proper functioning of transferable securities markets, such an information policy is capable of promoting the interpenetration of national transferable securities markets and thus encourages the creation of a genuine European capital market.

For guaranteeing the effective implementation of investors' protection, member states shall ensure that any offer of transferable securities to the public within their respective territories is subject to the publication of a prospectus by the person making the offer (Art 4.)

Concerning mutual recognition, Art. 21 stresses that "the prospectus must /... / be recognised as complying or be deemed to comply with the laws of the other member states in which the same transferable securities are offered to the public simultaneously or within a short interval of one another, without being subject to any form of approval there." By virtue of this principle approval of a prospectus by the competent authority of a member state in which the offering person has his registered seat (or possibly in another member state selected by the offering person, if the member state of his registered seat is not interested in the offer or in the request for possible listing) has to be recognised as valid also by the respective authority of another member state interested in the offer. In substance the Directive 89/298/EEC has ruled that the public offer prospectus published in the issuer's home member state should be accepted for public offers in all member states.

The principle of mutual recognition of a prospectus has been in addition used to widen its scope of application with respect to prospects of public offers prepared and approved in conformity with the standards of third states in accordance with agreements which the EC

may be capable to conclude with them, with due regard to the requirement that the standards of such third states may guarantee the protection of investors in a manner equivalent to that prevailing under the EC Directives (Art. 24).

Lastly, Directive 90/211/EEC of 23 April, 1990 (OJ L 112/24 May 3, 1990), amending Directive 80/390/EEC in respect of the mutual recognition of public offer prospectuses as stock-exchange listing particulars, allows issuers to use the public offer prospectus as a stock exchange listing prospectus as well with the result that a single prospectus can enable an issuer not only to raise capital on a Community wide scale, but also to apply for listing for its securities on all EC stock exchanges.³ Hence, a prospectus constitutes a primary and fundamental instrument for the protection of investors within the EC legal order. It should be on the one hand pointed out that no Directive has thus far provided for provisions governing the function of part of a prospectus in ascertaining liability. Under "liability" in conjunction with a prospectus may be subsumed all those facts and circumstances dealing as an object with an obligation to guarantee the reliability or veracity of all the information material used in written form for offering to the public transferable securities.

The historical background of the link of the notion of liability with a prospectus has its beginnings towards the middle of the 19th century, as a reaction to the fraudulent way in which stock companies were formed.⁴ In the Companies Act 1867 the introduction of liability for the veracity of certain obligations to supply information by founders of companies remained, however, totally linked to the idea of a control on the formation of limited companies. Not before the end of the 19th century was a link or connection established between the

obligation to issue a prospectus, on the one hand, and liability on the other. The primary scope of liability related to a prospectus consisted in the protection of individual investors opting for the acquisition of shares on the basis of inexact and erroneous contents of a prospectus (individual protection). Only successively were liability for a prospectus and the (individual) protection of investors transformed into means for the creation of financial markets and guaranteeing their efficient functioning (functional and institutional protection). In the United Kingdom, the "Bubble Act" of 1720 prohibited the constitution of private associations devoid of legal personality, with members exonerated from collective liability and able to transfer association shares. Instead, in the states of continental Europe the advantage or privilege of limited liability was subordinated to a so to speak concession. The control of the state over the formation of commercial companies endowed with a concession made liability for the contents of a prospectus superfluous.

After the abrogation of the Bubble Act in 1825, the Gladstone Committee decided to opt for the regulatory effect of publicity (as having a decisive influence) : "publicity is all that is necessary. Show up the roguery and it is harmless."³ The Companies Act of 1844 prescribed to register prospectuses made available for the public, whereas the Companies Act of 1867 demands the inclusion of determined details in the contents of a prospectus. In 1889 the Lord's Chamber decided in *Derry v. Peek*, that a liability from prospectus could exist only in the case of deceit, and in 1890 the Directors Liability Act invoked a responsibility for negligence.⁴ Finally, the Companies Act of 1900 provides details of what a prospectus should contain : it should not only be free of any false claims

but should also inform with respect to all the circumstances which could influence the decision to invest of a person of average knowledge and capacity. In this way the foundation for liability for a prospectus was laid and would become a regulatory fact for the first time in the USA in 1933 and 1934 for any form of investment offered to the public. Even prior to the Securities Act 1933 and Securities Exchange Act 1934, some states in the USA began, while their company laws became more and more permissive, to adopt legislative provision (blue sky laws) directed at the elimination of illicit practices applied for attracting investment capital.⁷ This approach was essentially based on the assessment of power which publicity could mobilise: "publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfections; electric light the most efficient policeman."⁸

From the angle of a systematic approach, liability for the prospectus is prevailingly considered to be an aspect of non-or extracontractual liability.

EC legislative efforts have endeavoured thus far solely to introduce in all of the member states a lowest common denominator as a standard for the protection of investors, as one of the conditions for the creation of an integrated European financial market in the meaning of EC Article 68. For the implementation of this objective, the EC has made exclusively use of the Directive as a legislative instrument for the reception of relevant standards into the national legal systems of the member states on the basis of EC Art. 54(g) and Art. 100, thus leaving to the member states the regulation of liability related to the prospectus. Therewith arises, for the national legal systems, the necessity to define the nature of guarantee with respect to the reliability of

information addressed to investors, that is, with the help of ordinary standards and laws of domestic law in the absence of more specific legislative texts.⁹

The question of liability related to the prospectus may arise solely when the prospectus is either inaccurate or incomplete as to its contents. The basic standard concerns the correctness and completeness of the contents of the prospectus (Art. 4 of Directive 82/146/EEC), points which may arise only with respect to recent information.¹⁰ It is therefore necessary to institute a system of integrated liability which assigns liability to different aspects of the prospectus in a differentiated manner, in accordance with assumed functions and possibilities of manifest influence in the various phases of sales of transferable securities to the public.¹¹ In the USA, as an example, so called "control persons" have been held to be collectively liable, while in Germany, liability for the prospectus has been defined as including all those persons who have participated in the decision to produce the prospectus.¹² Auditing firms in the USA have been the object of an increasing demand for compensation to investors who have contested the correctness and reliability of accounting prospectuses. Court actions for liability are based on Rule 10b-5, adopted in 1942, prohibiting in quite a generic manner misleading or fraudulent conduct on securities markets, using any form of presentation or tricks, including false claims or fraudulent omissions or exclusion of relevant facts which may be related to the acquisition or sale of transferable stocks.¹³ Courts in the USA have applied as valid, when applying relevant rules, two types of liability: involving directly the person committing the violation or the person, who while not directly violating the rule, has lent substantial support to the person committing the violation. As to liability affecting

auditors arguments of improper certifications and claims of failure to divulge relevant information have been submitted.

In some countries like Italy and Germany, the legal system based on civil law tradition has proved to be sufficiently flexible to provide norms for regulating new situations. A group of individuals was considered liable for prospectuses in a manner similar to situations affected by specific rules.¹⁴

The emerging claims for liability related to the prospectus may be raised only by investors in possession, or involved in a not yet concluded transaction in a national market, relating to a transferable security to which there is reference in the contested prospectus. As for the nexus of causality, it is maintained that it would be preferable to exonerate the investor from the burden of supplying the evidence in abstraction that the investment was effected on the basis of trust in and reliance on the correctness of the contents of the contested prospectus. The existence of proof should be treated as reasonably given if the investor has acquired the stocks after the publication of a prospectus vitiated by essentially incorrect contents.¹⁵

All legal systems provide for compensation for damages in case of guilt on the part of those responsible for the prospectus, but many differences exist as to the seriousness of guilt and the possibility of those assumed or alleged to be responsible to prove their innocence.¹⁶

Minimum "multi-purpose" Community wide standards have been introduced through EEC Directives in the sphere of securities markets. They aim at (i) promoting the free movement of capital within the EU also for the purpose of investment in the service of stock market listed companies, (ii) investor protection at a level of a

common legislative denominator applicable in all member states, (iii) promoting competition between the national stock markets and making them thus more efficient and dynamic, and (iv) making the capital and stock markets of the EU also competitive at an international level in an age of liberalisation. Concerning investor protection, the situation may become more challenging and problematic when not only institutional investors but also and above all small and average investors get interested in cross-border investment in various member states. Such a development may point toward the need to move from standards of protection at the level of a lowest common denominator to higher and more sophisticated arrangements on the way toward a system which may become truly comparable with the system in the USA at a federal level. Both at Community as well as member states' level interest in such a development exists, but progress for it may be gradual and effected through small steps from current systems marked by traditionally national horizons to a truly EC or EU approach. The logic and dynamics of progressive integration and not least the pragmatic necessity of competitiveness at an international level point in such a direction. As a further step toward a "more efficient EU securities market" as a reality, EC finance ministers have adopted a directive amending stock exchange listings standards. The Directive promises to simplify cross-border listing requirements. International companies seeking listings in more than one member state shall be able to be listed with reference to one prospectus. The new cross-border requirements are expected to facilitate the launching of the Federation of European Stock Exchanges' EUROLIST project. The cross-border approach is an initiative aiming to provide deeper and more liquid markets for large, high quality, international EU companies by enabling them to have their

share listed simultaneously in at least six member states.¹⁷ This will also be relevant for small and average investors' cross-border protection (as a topic of research which transcends the delimited purpose of the present thesis).

(i. Mutual Recognition and "single passport")

The Single European Act (SEA) of 1986 (O. J. 1987, L. 169/1) following the Commission's original White Paper on "Completing the Internal Market" (COM (85) 310 final, June 14, 1985 -), shifted the emphasis from a process of harmonisation to a process of coordination based on the notion of "substantial equivalence". Therewith the EC moved to the gradual establishment of Community wide common minimum standards in every member state for providing substantially equivalent standards of safeguards for investors. This minimalist approach has been accompanied by the supplementary principle of "mutual recognition". Thereunder a company satisfying minimum standards of recognition in one member state shall be entitled in any other member state to engage in investment activities in respect of which it is licenced under the jurisdiction of the home member state. It may claim the possession of a so-called Community passport. The EC wide authorisation known as the "single passport" which enables firms to provide investment services anywhere in the EC without separate authorisation, has been introduced by ISD.

The "single licence" or "home passport" concept is marked by three interrelated characteristics :

-- An authorisation for defined enterprises to carry on certain activities from their home member state as base, to establish a branch or to provide cross-border services in the "host" member state(s) with respect to listed activities, that is, without the need for further (intra-Community) authorisation ;

-- EC member states shall have harmonised certain minimum or key standards, the application of which shall fall within the province of the "home" member state ;

-- The principle of "home" member state control recognises the sole competence of the "home" state to authorise its home enterprises and to exercise supervisory control over them, that is, wherever they operate. Complementarily, the "host" member state has a merely complimentary control role to fulfill.¹⁸

The nature of authorisation under ISD is different because it is potentially EC-wide rather than confined to the single member state. An authorisation granted in accordance with the ISD will no longer have a national scope, but will be potentially EC-wide.

The differences in scope between ISD investment services and member states investment services, and the fact that ISD authorisation is Community-wide, mean that after implementation there will in effect be two types of authorisation.

A firm whose business is outside the scope of the ISD, or which is excluded from the ISD, will need, as presently, its home state authorisation, if it is carrying on investment business within its country.

The ISD introduces some new criteria to the authorisation:

- a firm must have its head office in the same member state as its registered office (Art. 3(2));
- The so-called "four eyes" principle : the business of a firm must be directed by at least two persons of sufficiently good reputation and experience;
- Special requirements in the case of individual trader or a one-man company -

Natural persons have, in particular, to make arrangements for the protection of investors in the event of cessation of their business following death, incapacity, or any

other similar event. The requirements for natural persons authorised to hold client money or securities are most relevant. Such firms must meet three additional conditions - four if the firm is a sole trader - over and above the other relevant requirements of the ISD and CAD.¹⁷

The "home state control", as the corollary of mutual recognition, shall act as a basis enabling the "home state" to qualify as the leading regulator, while any other member state in which the company operates shall enjoy, as the "host state", a merely accessory control/competence. Both principles of "home member state authorisation" and "host member state accessory competence" were introductorily included in the UCITS Directive EEC Directive 85/611, as amended by EEC Directive 88/220.²⁰

To dispel any confusion as to what the terms "home member state" normatively cover, the ISD states under Art. 1(6), that the terms apply to

- "where the investment firm is a natural person", "the Member State in which his office is situated";
- "where the investment firm is a legal person", the Member State in which its registered office is situated or, if under its national law it has no registered office, the Member State in which its head office is situated;
- "in the case of a market, the Member State in which the registered office of the body which provides trading facilities is situated or, if under its national law it has no registered office, the Member State in which that body's head office is situated".

Responsibilities of the "home" member state include also supervision of the financial soundness of an investment firm by the competent authorities, pursuant to the CAD, (see consideration 26 relating to the ISD). The

CAD's requirements are an essential element of the coordinated requirements which make possible for ISD investment firms authorised in their home member state to carry on business in other EC states. The CAD is also a necessary follow up to the Solvency Ratio Directive and Own Funds Directive (OFD) which complement the Second Bankruptcy Directive for credit institutions.

To obtain home member state authorisation, an investment firm shall have to demonstrate that

-- It has a "sufficient initial capital in accordance with the rules laid down in the CAD";

-- "The persons who effectively direct the business of an investment firm are of sufficiently good repute and are sufficiently experienced" (Art. 3).

The competent authority shall not grant an authorisation without prior knowledge as to the identity of shareholders and persons who effectively direct the business of an investment firm (cf. Art. 4).

To pre-empt complications generated by considerations when dealing with intricate questions of priority to be given, for vital legal purposes, to the site of the real administration of a firm, or the site of its statutory (registered) seat, a firm shall maintain, for enabling the home member state to exercise effectively its supervisory functions, its central administration in the same member state where its statutory seat is indicated to be : "any investment firm which is a legal person and which, under its national law, has a registered office, shall have its head office in the same Member State as its registered office"; "any other investment firm shall have its head office in the Member State which issued its authorisation and in which it actually carries on its business" (Art. 3(2)). In this way an undeniable nexus is established between statutory seat, central administration and the member state of

origin granting authorisation and in which a firm effectively carries on its business. Because such provisions are not instituted as applicable to credit and insurance firms, the EU Commission has adopted a proposal for a Directive which, beside extending the scope of application of such provisions, shall horizontally modify a series of Directives related to credit institutions, insurance and financial services firms. The proposed Directive tends to integrate with ISD provisions intended to (i) supplement conditions for granting an authorisation, a new requirement that a group heading a credit institution, insurance firm or investment company shall be transparent for the purpose of effective individual supervision; (ii) amplify the scope of competence or organs of authorities called upon by law to collect and exchange information related to supervisory vigilance; (iii) put auditors under an obligation to communicate to the competent authorities any irregularities discovered in the course of exercising, under law, auditing functions related to a relevant company, if such irregularities are prejudicial to the interests of the company's clients, to the financial system or to the financial stability of the given company.²¹ As the ISD is expected to enter into force by December 31st 1995, until then credit institutions and insurance firms will benefit from greater independence with respect to the seat of their central administration, that is, compared with investment firms already bound by relevant obligations under Art. 3(2) of the EEC Directive 93/22.

It has been observed²² that in many cases the "passport" provisions of the investment services Directive may be of little practical effect. In many countries, and thereto EU/EC member states are not exceptions, investment services are conducted by banks,

and for commercial reasons firms from member states establishing a presence in a member state are likely to set up a banking subsidiary or branch. Even when financial services are to be carried out by an investment firm and not a credit institution, there may be tax and commercial reasons to set up a separate subsidiary in the given member state rather than establish a branch. The subsidiary would then need local authorisation in the same way as at present (1994). In addition, where a firm does provide services in another member state within the scope of the ISD, the notification procedures applicable under the Directive may be rather involved, bureaucratic; ultimately, there may be little difference in practice between obtaining the "passport" and obtaining local authorisation under EC Arts. 52 and 58.

iii) Home and host state supervision in the ISD:

Prudential Rules and Rules of Conduct

The here relevant Council Directive on investment services in the securities field, no. 93/22/EC, proposed in 1989 (OJ C43/7), amended on February 8, 1990 (OJ L366/1), and definitively approved on May 10, 1993 (OJ L141 (June 11)), has had a long and rather tortuous distance to cover owing to diverging interests in individual member states and particularly owing to the use of the terms transparency and recognised markets. Much of the difficulties in reaching agreement on the Directive have revolved around the extension of its applicability to matters relating to investment exchanges, referred to as regulated markets.²³ For the so called "concentration" problem a compromise was reached on June 29, 1992 by the ECOFIN Minutes.²⁴ Investors shall have the right to apply the established order outside the markets. The ISD allows EC states to require that certain transactions must be carried out on a regulated market (Art. 14(3)). However, the exercise of this right can

eventually be subject to express authorisation (Art. 14(4)).

The UK does not propose to introduce a new concentration requirement as part of its implementation of the ISD and will be watching closely to see that other member states do not abuse the requirement for the purposes of market protectionism rather than investor protection.²³

The ISD achieves, for investment firms which are not banks, the same freedom of establishment and freedom to provide services which banks currently (1994) have under the second banking co-ordination Directive.²⁴ It therewith sanctions the defeat of the Italian system in two respects : the principle that stock transactions should in Italy be concentrated only within the stock market and that to transact a stock market intermediation firm (SIM) with a seat in Italy is necessary as an intermediary (Arts. 3 and 11 of the Italian Law of January 1991).

On January 19, 1994, the EU Commission applied, under EC Art. 169, to the ECJ in Luxembourg with a complaint concerning the Italian Law No. 1 of January 2, 1991, on the requirement to form a stock market intermediation company (Societa di Intermediazione Mobiliare) (SIM) for offering financial services in Italy. The Commission referred to a violation, by the Italian Law, of the freedom of establishment and the free supply of services as cornerstones of the system of the single and integrated EC market. Art. 3(a) of the Italian Law lays bindingly down that financial services shall be offered only by SIMs, with statutory seats in Italy. The EU Commission (rightly) argues this to be in open contradiction (if not conflict) with basic provisions of the EC Treaty, particularly with Art. 52 on the right of establishment applicable to all EU/EC nationals without

discrimination. The United Kingdom too has presented a formal protest to the EU Commission in Brussels on the Italian Law on the compulsory formation of SIMs. Art 3 of the Italian Law has been judged to be a protectionist (and discriminatory) measure. The President of the CONSOB in Italy, Enzo Berlanda, has reacted by declaring (in our translation) "we are not the only ones in this respect. Other nine (of the 12) EU member states have the same normative standard as a guarantee with reference to their nationals as investors".²⁷ The conclusion is implicit that the Italian Law will have to be consequently modified as a necessity for complying with EC Directive 93/22 when the latter enters into force by December 31st, 1996 (Art. 15(3)). It is to be noted that this date has been implicitly conceded for enabling member states to adjust their national standards to the requirements of the Directive.²⁸

The ISD is intimately correlated to Council Directive 93/6/EC (OJ L141/71) of March 15, 1993, on the capital adequacy of investment firms and credit institutions (CAD). In addition, EC legislation has used the CAD (Directive 93/6/EC) for clarifying the scope of the ISD (Directive 93/22/EC). Concerning the protection of investors, EC standards tend historically as well as currently to reconcile and coordinate the exigencies of investor protection with those of the development of the markets and operators involved in it. This has involved and still involves the promotion of a difficult and delicate balance between competing interests which may after all be reconciled and may meet for a better and more efficient economic system as a whole. Such an objective involves the consideration and participation of two points:

-- Integration between EU member states should generate and lead to greater and better competition

between firms and therewith to a better supply of services to investors as eventual beneficiaries ;

-- Investors as ultimate beneficiaries should be capable to select the firms which offer greater guarantees and better quality of services, thus unleashing in turn a gradual increase in better standards for protecting investors.²⁷

The above two points as keys to a better interpretation and understanding of the relevant issues may reflect the great care which EC legislation has taken with respect to investor protection, particularly in the two recent (here considered) Directives. The protection of investors has been placed at the same level and has been given the same valency as those attached to the stability and reliability of the financial markets ; authorisation by the home member state pursues the purpose of investor protection as well as the stability of the financial system (cf. preamble par. 2 of the ISD). In other words, the scope of investor protection has been recognised as merely one of the objectives : "one of the objectives of this Directive is to protect investors" (ISD Directive 93/22/EC, preamble par. 32). The Directive more explicitly identifies, as a principal objective, facilitation for investment firms to establish branch offices and to supply services freely in other member states (preamble par. 1).

The scope of protection of investors is defined by CAD (Directive 93/6/EC of June 11, 1993) coordinating rules on matters of risk on the markets (cf. ISD, preamble par. 26). In this way both directives are intimately correlated, to such an extent that their entry into force at different dates would induce a distortion in competition (cf. CAD, preamble, last par.). Member states shall see to it that the implementation of both Directives are effected as foreseen under Art. 31 of ISD

(Directive 93/22/EC) that is, on July 1st 1995 (see also Art. 12(2) of CAD, but they will not come into force until December 31, 1995. Once again, the approach to the integration and coordination of the national markets is made clear, as follows, in terms of lowest common denominators: "the approach that has been adopted is to effect only the essential harmonisation that is necessary and sufficient to secure the mutual recognition of authorisation and of prudential supervision systems" (Preamble par. 3 of CAD Directive 93/6/EC).

The ISD (Directive 93/22/EC) allows taking into account the professional nature and expertise of the firm's client or customer: it is appropriate to take account of the different requirements for the protection of various categories of investors and of their levels of professional expertise" (preamble par. 32). "The rules of conduct must be applied in such a way as to take account of the professional nature of the person of the person for whom the service is provided" Art. 11(1). "Where an investment firm executes an order for the purpose of applying the rules referred to in paragraph 1, the professional nature of the investor shall be assessed with respect to the investor for whom the order originates" (Art. 11(3)), "taking into account investors' differing needs for protection and in particular the ability of professional and institutional investors to act in their own best interest" (Art. 14(4). Moreover, the ISD introduces the concept of "indirect customer": the professional nature of the investor shall be assessed with respect to the investor from whom the order originates (whether private, professional etc) and must be considered in determining how conduct of business rules should be applied not the intermediary with whom the firm may be dealing directly. (Art. 11(3)).

One of the more incisively normative rules affecting

the protection of investors could be the possibility to revoke the authorisation: the competent authorities can withdraw the authorisation issued to an investment firm where it has seriously and systematically infringed the provision adopted pursuant to Articles 10 and 11 of the ISD (Art. 3(7.e)).

It has been commented that when qualifying a violation as grave and systematic, it would not be sufficient to refer to a single or some serious violations. It may be wondered whether this approach does not favour the protection of the institutional investors more than private or non-institutional investors, because institutional investors, with financial strength as well as legal and financial expertise available at their disposal, may much more easily survive a few and even a few serious violations as blows, whereas for private investors, particularly for small investors, even a single serious violation of a rule or standard of conduct may mean the difference between financial security in old age or total financial ruin, as practical experience and cases from the last ten years from more than one EU member state amply illustrate. Is a national compensation scheme with tax payers' money a proper remedy? The SIB does not believe that ISD will require to limit the existing ground for UK authorities to withdraw an authorisation they have granted.³⁰

The host member state is to be informed about the revocation of an authorisation and shall take adequate measures to impede the investment firm in question from undertaking further investment activities in its territory and for safeguarding the interests of investors (Art. 19(9) of ISD).

The Directive lays down other prudential requirements for the home state to be applied in the interest of investor protection. All investment firms

affected by the contents of the ISD and needing home member state authorisation have to satisfy applicable criteria, irrespective of the question whether or not they wish to take advantage of the "passport" to provide services in other member states. They are also caught by the conduct of business rules of their home member state in which they provide investment services. These requirements are also to apply to credit institutions in possession of the "passport" under the Second Banking Co-ordination Directive 89/646/EEC (OJ L386/1 (1989)). The ISD introduces a split of supervisory responsibilities between prudential requirements (home state authorities) and conduct of business rules (host state authorities). The home member state shall be responsible for the prudential supervision of the investment firm (Art. 8(3) of the ISD). Each home member state is entrusted with drawing up prudential rules for observance by investment firms. The same rules shall apply also to credit institutions conducting investment business. The rules are intended to strengthen investor protection by obliging investment firms to adopt and apply, in permanence, determined norms relative in the first place to organisational and control matters.

There are five identified home member state prudential rules, concerning in the first place the structure and organisation of investment firms:

1. The firms are to have sound administrative and accounting procedures, control and safeguard arrangements for electronic data processing, and adequate internal control mechanisms, including, in particular, rules for individual transactions by employees;

2. They are to make adequate arrangements for instruments belonging to investors with a view for safeguarding the latter's ownership rights;

3. Adequate arrangements are to be made for funds

belonging to investors with a view to safeguarding the latter's rights and, except in the case of credit institutions, preventing the investment firm using investors' funds for its own account;

4. Arrangements are to be made for keeping records of transactions executed in such a manner that they shall be at least sufficient to enable the home member state's authorities to monitor compliance with the prudential rules they are responsible for applying ; such records shall be retained for periods to be laid down by the competent authorities ;

5. The firms are to be structured and organised in such a way as to minimize the risk of prejudicing clients' interests by conflicts of interest between the firm and its clients or between one of its clients and another. Where a branch is set up the organisational arrangements may not conflict with the rules of conduct laid down by the host member state to cover conflicts of interest (Art. 10 of the ISD).

The above mentioned rules, general in nature, may be variously interpreted. As a result, their real efficacy in investor protection may depend on their interpretative elaboration by the home member state which also may lay down rules more stringent than those enshrined in the ISD, particularly with reference to matters related to authorisation, prudential arrangements and rules on statements and transparency (Cf. par. 27 of the preamble of the Directive).

For adopting the ISD each member state shall above all establish whether to coordinate or to let investors' interests prevail in the first place or let the interests of investment firms prevail. This involves a delicate question touching the long term economic and financial interests of individual member states. A neglect of investors' interests by a member state may motivate

investors to move to the financial markets of other member states, while a neglect of investing firms' interests may in turn motivate the latter to abandon the member state in question in favour of other member states where lesser investor protection may prevail. Hence there is a need, as hitherto, for at least minimal standards of coordination between national financial markets on the road to a really integrated single EC market. An awareness of the herewith implied problem and challenge is reflected by ISD when its preamble in paragraph 4 states that "the principles of mutual recognition and home Member State supervision require that the Member States' competent authorities should not grant or should withdraw authorisation where factors such as the content of programme of operations, the geographical distribution or the activities carried on indicate clearly that an investment firm has opted for the legal system of one Member State for the purpose of evading the stricter standards in force in another Member State within the territory of which it intends to carry on or does carry on the greater part of its activities". Conduct by investment firms fleeing from the more demanding standards of the legal system of a member state may be scrutinised by the home member state where authorisation for the activities of the firm has been granted. The home member state is under an obligation to require that an investment firm's head office must always be situated in the relevant home member state and that the firm also actually operates there (cf. par 4 of the preamble of ISD). At a higher level of judicial control under EC law it may be worthwhile to note that if a home or host member state fails to fulfil obligations undertaken under primary or secondary EC law, the matter may be submitted to a decision by the ECJ in accordance with the provisions of EC Arts. 109 or 170.

With respect to a balance between the application of the home member state rule, on the one hand, and the host member state rule complimentary to it on the other, it has been critically remarked that if dogmatically applied, the home member state principle may prove to be unfair and unworkable with reference to the interests of the investor as a consumer; it may produce political difficulties if applied too dogmatically, as it has advantages for firms as they are able to know they can operate and are governed by one set of dominant rules as a general proposition,³¹ while the regulatory role of the host member state seems to be relatively unclear and as such marginal, particularly with regard to sanctionary competences. In general terms, Art. 11(1) of the ISD provides for the host member state to specify conditions, including conduct of business rules applicable, evidently, to business which must be carried on in that host member state, and the rules and any other conditions have to be justified as being in the general good, that is, be non-discriminatory, not duplicate home member state requirements and be proportionate to the risks they are intended to address. The exact normative and regulatory content of these expectations may not be easy to define and inter-coordinate even if under Art. 11(1) of the Directive the host member state is guided to implement at least the following seven general principles :

1. Firms shall be expected to act honestly and fairly in conducting their business activities in the best interests of clients and the integrity of the market;

2. Firms shall act with due skill, care and diligence in the best interests of their clients and the integrity of the market;

3. Firms shall have and use effectively the

resources and procedures necessary for the proper performance of their respective activities;

4. Firms shall seek to get from their clients information regarding their situation, investment experience and objectives as regards the service requested;

5. Firms shall make adequate disclosure of relevant material information in their dealings with their clients;

6. Firms shall avoid conflicts of interests; when such conflicts cannot be avoided, firms shall ensure that their clients are fairly treated; and

7. Firms shall comply with all regulatory activities applicable to the conduct of their business activities, so as to promote the best interests of their clients and the integrity of the market.

These are based on principles agreed between international supervisors in IOSCO, in turn based largely on SIB's own Principles. The SIB's view is, therefore, that, in general, the substance of the UK's existing requirements (currently involving a mix of Principles, Core rules and Third Tier conduct of business rules) already satisfy the ISD. Even once the Core rules are deregulated, the SRO rules based on them will provide similar safeguards.³²

Because of the division of responsibilities between home and host states, the authorities of each member state need to change the way in which their rules and practices apply to ISD firms so that they have sole responsibility for the prudential supervision of firms they have authorised, extending throughout the EC but reduced responsibility for firms operating in their territories but authorised in other states.

The Directive evidently sets out only the general principles which shall condition the conduct of business

rules. Any state may impose additional requirements as long as they are justifiable in the interest of the general good. The concrete elaboration and implementation of conduct of business rules is left to the host member state in which the investment service is being conducted by a "host" firm: the concrete dimensions and normative impact of conduct of business rules may vary considerably from member state to member state with potential confusion for the firms concerned and headaches for the regulatory authorities and even bodies called upon to exercise a judicial function.³³ Although the LSD affirms in the preamble (see paragraph 41) that the stability and soundness of the financial system and the protection of investors presupposes the right and responsibility of a host member state both to prevent and to penalise within its territory any conduct by investment firms contrary to the conduct of business rules as well as contrary to other legal or regulatory provisions it has adopted in the interest of the general good, and to take action in emergencies, the real powers of both the home as well as the host member state do not seem to be as yet adequately clarified. It is submitted that admittedly at the current stage of the development of the EC financial markets with national traditions and divisions influencing them, an adequate clarification of what has been implied above as a problem and challenge cannot be as yet achieved, nor is such a clarification a top urgency; but it is important to be aware of it while the cross-and interpenetration of national markets slowly evolves and emerges. Later, the creative challenge for lawyers may be the question whether to proceed, in the best general interest, with a more pragmatic and case by case approach more pronounced in the UK legal tradition, or with a more a priori normative approach more typical of Continental European civil law tradition. Probably, the best approach will be

a mixed one. In the meantime, where an investment firm breaches host member state rules, the Directive offers both general as well as rather complex provisions on the extent to which the state regulators may resort to concrete action against the firm. Such action may involve first by administration and then if necessary, subsidiarily, judicial measures such as an injunction. At an administrative and regulatory level, the host member state authorities can require the investment firm to remedy the breach, but if the firm fails to do so, the authorities should generally refer the matter to the home member state authorities for action to be taken by the latter (see Arts. 18(4) and (5) of the ISD). As already stated above, these provisions are vague and may create uncertainty and even harmful confusion both for firms and affected investors; not least they involve a potential for disputes which may ultimately end in Luxembourg for judicial interpretation and settlement by the ECJ.³⁴

This possibility could be averted by setting up a control authority at EC level with supranational powers: a European SEC model could establish a centrally cited body similar in functions to the USA SEC, and competent to institute investigations and impose sanctions. Such a proposal conjures up, however, in the member states political fears and can generate correspondingly stubborn resistance: it explicitly indicates the necessity, if not the inevitability, of ceding traditional state powers to a central supranational authority escaping their collective as well as individual control, with the ECJ as an example.³⁵

The EC Commission seems to be aware of the above outlined problems and challenges. For expanding the scope of investor protection it intends to prepare a further Directive requiring the member states to introduce, individually, an investors' compensation scheme

satisfying minimum standards. The scheme would cover claims by investors in the home as well as in other EU/EC member states (see Art. 12(2) of the ISD).

With reference to the currently prevailing situation (1994), it may well be said that as every member state will have conduct of business rules applicable to investment services effected in that state by both credit institutions and investment firms, it is not excluded that there may be unnecessarily more rather than less regulation of investment activities.³⁶

As the freedom of establishment and freedom to provide services are directly applicable, "it may be asked why there was a need for any further EC legislation at all in the form of directives or anything else, to enable firms to exercise these freedoms in the financial services context."³⁷

"Entirely unclear is the level of regulation that will result from the new approach. Opinion is divided as to whether securities regulation and, in particular, investor protection rules will be relaxed or strengthened."³⁸

Concern has been also expressed for the so-called "race to the bottom" : an increased competition between the national markets that could encourage member states to impose the minimum standards possible under the EC Directives. "The division of the responsibilities between home and host countries for the most part follows the expected pattern for international regulation, although there remains some concern that the European Court may, by restrictive interpretation of the general good, unduly favour home country regulation and thereby encourage a competitive rush to the bottom. It is too early to tell if the expansion of the passporting system will lead many European banks and investment firms to move their UK business out of UK subsidiaries and into home country

regulated branches, in order to take advantage of a more relaxed regulatory regime" ... "the ISD does recognise the possibility of host country regulations imposing their own home structural rules on passported credit institutions' own investment firms' branches; but with competitive forces pushing the European market towards greater concentration into integrated houses and a European Court favouring unified home country regulation over close host country supervision, fear it will take a major scandal to reopen the whole basis for the single market in investment services."⁷

At this point it is useful to verify whether the fundamental thrust and spirit of EC legislation and particularly of investor protection are being adequately integrated into national legislation. Parts of this complex question will be discussed in the remaining parts of the present Chapter 8 below, as it is useful to scrutinise how investor protection has been integrated and interpreted into national legislation in the member states and what objectives have been achieved, for the purpose and scope of the present thesis, in France, Italy and the United Kingdom.

2. Investor Protection in France

Although the French, in international comparisons, are not renowned as so to speak great promoters of savings, they have in the last decade of the 19th century and more precisely starting 1878 generated abundant financial savings,¹⁰ even if in the second half of the 20th century the level of savings has been lower as a result of investment in private housing. On the side of investment, demand has been relatively modest as around 1880 major railway lines and major urban renewal or development projects had been completed. In the second half of the present century, demand or need for investment capital was greater than the supply of it. It is also noteworthy that in 1890 55 per cent of savings were generated by property owners and only 6.5 per cent by wage earners; in 1967 the category of so to speak "inactive" part of the population contributed but by ten per cent to the accumulation of savings, while wage earners increased their comparable share to 55 per cent. In the meantime developments at the legislative level had shifted from the protection of savings to the protection of investors.

i. From the protection of savings to the protection of investors

The trend towards investor protection is a major characteristic accompanying the restructuration process of financial markets in France: there has been a promotion of rules affecting the protection of investors. The result is that investors alleging to be victims of irregularities ascribed to companies or to those active in financial markets may turn to the COB. Within the category of investors individual shareholders constitute a numerous group; institutional shareholders are represented at a stable level, while the numbers of non-French shareholders is increasing rapidly, having reached

at the end of March 1992 31.2 per cent of capitalisation in French stock markets.⁴¹ It has also been noted that institutional investors have the capacity to mobilise more rapidly investment capital, while individual investors distinguish themselves by a trend towards so to speak "loyalty", keeping their acquired shares for an average of four years against a comparable standard of 24 days to 10 months for institutional investors, according to a study undertaken by the COB. Hence, it may be said that individual investors constitute a factor of stability in the market, financially enriching economic tradition in France and in a way also playing a determining "educational role".⁴² In the 1980s there has been a considerable increase in the number of individual shareholders, from 1.7m in 1982 to 6.2m in 1987.⁴³ After 1991, individual shareholders have decreased from 5.4M to 4.5M. More men than women are shareholders; 55 per cent of individual shareholders are more than 65 years old; 53 per cent are retired.⁴⁴

The function of protecting savings invested in transferable assets consists essentially and principally in

- upholding the principle of equality between shareholders ;
- promoting transparency at the level of operations and transactions.

The principle of equality has been an inspiring force underlying the reform of 1989. No shareholder may claim any particular conditions of privileged treatment with respect to access to transactions or to quotations or prices. The notion of transparency concerns not only information which the COB requests companies to supply on themselves, on their operations, but also concerns exact information as to the competences and powers which diverse authorities may exercise in the market,

particularly available measures of control effected by the COB. All these points are related to the scope of enabling investors to understand where protection ends and risk taking begins. In other words, it is professed that only an exact identification of the relevant rights and duties of the issuing companies and of shareholders will permit to act and transact with optimal reliability or security. The corresponding programme of investor protection of the COB is articulated in the form of three fundamental points :

- security for savings invested in financial markets ;
- transparency of the financial markets ;
- simplification of procedures.

The security of invested savings depends essentially on the professional integrity and ability of the intermediaries and on legal guarantees accompanying the transactions of investors. If the development of financial markets is based on trust by investors in the markets, it is necessary to organise the professional activities of the intermediaries in such a way that the reliability and the integrity of the markets is guaranteed. Therewith the need to dispose of modern standards of professional conduct moves from the sphere of a logic of economic expediency to that of an awareness that respect for determined standards of conduct binding financial intermediaries represents one of the fundamental criteria for determining the international reputation of a stock market. On the basis of such an approach in France an ample process of reevaluation of professional ethics (deontology) is taking place.

Already in its report for 1986 the COB enunciated two general principles :

- 1.) The interests of the client shall prevail. This postulates that the intermediary shall not take his own

particular interests in consideration when involved in making a decision for his client ;

ii.) Information in the possession of the client that a plurality of interests may exist. This principle comports an obligation for the intermediary to bring to the attention of the client the existence of all relevant interests and to inform him on the respective role(s) or function(s) fulfilled by them, including or not excluding conflicts of interests which may emerge in the course of the operation or transaction.

In 1987 the COB formed a working group consisting of experts from the financial world, directed by Brac de la Perrière, President of the Banque privée de Gestion financière. The mandate of the working group was to identify and define the so to speak deontological profile of financial activities. In a first part of its programme, the COB intended to clarify the fundamental principles underlying the deontology of financial intermediaries. The second part was dedicated to the elaboration of more detailed rules regulating conduct.

In July 1987 a first report¹⁵ pointed to two fundamental principles which should guide professional operators in their activities: (i) the interests of the client and (ii) respect for the integrity of the market shall prevail. In relation to a client an intermediary is held to observe obligations of diligence, loyalty, neutrality and discretion, to which attached itself the duty to let prudence prevail when managing the capital. The intermediary may not expose the client to excessive risks which have not been brought to the express attention of the client.

The duty to let neutrality prevail, imposed on an intermediary, assumes particular relevance to the extent it contributes to mobilise attention to problems of conflicts of interest between the firm acting as an

intermediary, on the one hand, and its clients on the other. For coping with this problem for the purpose of resolving it, the system of separation of functions, for a substantially preventive purpose, has been complemented by some legal remedies which may be invoked in a situation of inevitable conflict.

In the second (and final) stage of its agenda, the working group induced the formation of four commissions, prevailingly composed of sectorial operators, with the task of defining in specific terms the deontological standards applicable to financial activities. With reference to conclusions submitted by these four commissions, the working group edited a final general report as a basis for guiding the activities of professional operators as well as the activities of directors of firms operating as financial intermediaries.

In the first of its two parts, the general report dealt with the deontological principles which should guide the activities of its intermediaries; the second part contained 44 rules as the first phase towards the establishment of a corpus of rules of professional conduct. It is important to underline that the contents of the report are not intended to be binding. The COB, after approving the general thrust of the report and publishing its unabridged text, limited itself to recommending a rapid application of the rules of conduct by the market authorities, including application by firms and interested persons.⁴⁶

This way of proceeding by the COB reflects how in France elements of a process of self-regulation are emerging. On the one hand it is possible to deduce that much relevance is attached to the role of professional conduct after the reform of 1988, and to see on the other hand how once more the central importance of firms acting as intermediaries and not of the market authorities is

confirmed in the process of generating and applying rules of conduct. Moreover, it can be said that the purpose of deontology is not understood to be not only one of morality but as a factor for stabilising the rules of the game as rules of professional conduct.¹⁷ The COB, while having authority to lay down rules of professional conduct (as deontology),¹⁸ has preferred instead to abstain from invoking this authority and has preferred to promote the interest of the members of the profession themselves in setting up the rules. This approach has conditioned the genesis of some of the principles elaborated by the group working under Eric de La Perriere in March 1988 and September 1989. It could be said that the COB could itself have inserted such principles in a system of regulation. The COB has preferred instead to accept in deontological standards the existence of a cultural rather than legal phenomenon and has decided to agree with the conclusions of the working group and has turned to the professional bodies to elaborate rules of conduct and attach consequences to their violation. This deontological approach has not intended to create a new source of law like the codes of good conduct; it has made use of existing legal standards which in relation to the rules represent a type of "natural law". The deontological standards are composed principally of

- internal rules affecting the financial intermediaries, generated in application of Art. 19 of the Law of January 1988 ;

- rules and decisions by professional bodies active in the market, for example, the general rules of the Conseil de bourse des Valeurs, general rules of the Council of the futures market, and decisions by both bodies ;

- contractual rules which govern relations between the intermediaries and their clients.

ii. Deontology of financial Activities : Objectives, Principles and Rules

Among the two basic objectives of professional deontology, namely, (i) primacy of client's interests and (ii) integrity of the market,⁴⁷ the latter usefully complements the first in situations involving

- relations between different professionals ;
- advantages offered to a client in violation of a professional standard : and
- conduct which, while not causing any damage to a client or to a group of clients, detrimentally affects the proper functioning of the market.

The 44 rules already mentioned earlier (above), were set up between September 1987 and February 1988 by the four appointed commissions (already mentioned above).⁴⁸ They constitute the substance of deontology which in turn consists of a body of principles and recommendations. Their implementation is entrusted to the financial intermediaries, to their professional bodies as well as to the market. They all together are entrusted with the task to elaborate them, secure their control and to attach consequences to their violation.⁴⁹ Deontological standards are conceived as a necessary but distinct complement to legal rules and regulations.

With reference to principles, there are six of them with respective recommendations. The first three principles (1-3) concern relations with clients; the fourth principle relates to those who intervene on the market, the fifth to those who work together with financial intermediaries, and the sixth principle refers to the internal organisation of the financial intermediaries. These six principles, established by professionals involved in the work of the group Brac de La Perriere, synthesise the 44 propositions tabled in

March 1988. They are treated in the document with the title /in our translation / "Balance of the proposals submitted by the group chaired by Mr Gilles Brac de La Perriere", published by the COB in September 1989.

Principle 1 prescribes that a financial intermediary should have adequate means and resources necessary for a proper execution of services offered to his clients. The corresponding Recommendation 1.1 proposes that adequate means and resources should be at the disposal of employees who are both competent and informed ; the existence of an internal organisation which permits with precision the initiation, transmission and implementation of instructions ; a level of feasibility which permits to define and identify the various parts of an operation or transaction effected in execution of an order communicated by a client or his representative.

Recommendation 1.2 suggests that a financial intermediary should have at his disposal the means to be in control of his activities. The establishment of such an obligation relating to resources is one of the principal messages set up by the group under Brac de La Perriere, as a deontological exigency since an intermediary has a wide margin of discretion in order to do justice to what Recommendation 1.2 prescribes. The availability of adequate means can be effected with the creation of an adequate internal organisation which also provides for the availability of an internal control. Such a control can be exercised by a person who, aware of its demands, is in a position also to advise. Therewith authorities of protection, be they at professional or public levels, can then exercise their control functions in an efficient way.

The function of internal control has been largely inspired by the British-American institution of the

"compliance officer", introduced first in the USA some 20 years ago and transplanted to the United Kingdom by the Financial Services Act of 1986.²² Currently in France only stock market firms are obliged to designate a person in charge of control, sanctioned by Art. 2.2.6 of the General regulation of the Conseil de Bourse des Valeurs.

According to Principle 2 a financial intermediary shall guarantee the availability of adequate information for the needs of his clients, for which purpose Recommendation 2.1 indicates that he should endeavour to be well informed about the relevant situation and about the objectives of his clients. Recommendations 2.2, 2.3, 2.4 and 2.5 deal respectively with the contents of duties of an intermediary in relation to his clients (they should be defined as clearly as possible); with guaranteeing the availability of information for the clients; the duty to inform clients about any risks to which they may be exposed; and in each case the duty to indicate to clients the existence of eventual conflicts of interest.

It should be noted that Recommendation 2.1 may meet resistance within the framework of the stock market, because for a long time it has been taken for granted that an exchange agent may pass on an order without preoccupying himself with the question as to from whom the order comes. The change introduced by Recommendation 2.1 is conditioned particularly by two factors: (1) stock exchange firms above all, beside those who deal with arbitrage, frequently act as agents for third parties; (2) the access to the much riskier parts of the traditional markets makes it necessary for an intermediary to know who his client is for proposing transactions which adequately correspond to the material objectives of the client.

Recommendation 2.2 also raises demands in terms of

professional ethics. It was already included in rules laid down by stock market authorities, for which reference may be made to the contents of chapter 3, title 2 of the general rules of the Conseil de Bourse des Valeurs, (with respect to accounting conventions and management) and the decision of the Council of the futures market of March 1st, 1989, relative to management agreements which permit intervention in futures markets.

Principle 3 points out that a financial intermediary should seek to execute in the best possible way the order of a client. Recommendation 3.1 deals with the so to speak temporal dimension of this point by indicating that the intermediary should reduce as much as possible delays in the execution of an order after its initial registration up to the phase of accounting for it. Orders are to be registered chronologically from the moment of their arrival up to the phase of execution, is the message of Recommendation 3.2, while Recommendation 3.3 states that effected transactions should not be subjected to a posteriori changes, except when specific dispositions anticipatorily provide for such possible modifications. Referring to the necessity of fair allocation of a quantitatively limited offer, Recommendation 3.4 says the financial intermediary should ensure that a fair distribution of the available stocks is effected.

Recommendation 3.3 deals with professional habits which cannot be said to have completely disappeared. They concern the attribution of a transaction to an account, which may be that of a client or clients, or the account of the intermediary himself or the personal account of an employee, as soon as the conditions of a transaction become known. The abuses which may be committed are evident. The attribution of a transaction to a client should be a first point to

execute. However, in certain cases it may be for the client of a stock market firm acting as an intermediary convenient to have his order treated as part of a global order which may be accredited then to the individual clients once the transaction is completed. A general decision by the Conseil de Bourse des Valeurs has confirmed the acceptability of such a practice, affirming particularly that the contents of global orders may not be credited but to the clients accounts.⁵³

Principle 4 establishes for the financial intermediary a duty to seek to respect the transparency and security of the market, by seeking to contribute to them (Recommendation 4.1 and 4.2). For example, concerning futures markets, intermediaries may not hide the identity of clients if the market authority demands that their identity should be revealed.⁵⁴

Referring to the internal relationship of an intermediary with personnel who assist him, Principle 5 says he should establish a regime and a system of control governing the operations and transactions effected by professional employees. Recommendations 5.1 and 5.2 deal with some of the technical details related thereto. Recommendation 5.3 makes an interesting point : financial intermediaries should not knowingly execute, for employees of other intermediaries, transactions which breach principles and rules of professional conduct. This recommendation is supported by the contents of Art. 19 of the Law of January 22, 1988. This means that the standards laid down by law are to be supplemented at the level of professional ethics by corresponding arrangements. The law does not define, however, the exact contents of this duty. In conformity with the spirit underlying the conclusions of the working group chaired by Brac de La Perriere, it is individually left to each intermediary to elaborate the deontological standards he

specifically needs in a manner which the law abstains from defining for him. The contents of Art. 19 of the Law of January 22, 1988, are to be applied in the light of two Circulars issued by the French Ministry of Labour on January 9, 1989 and October 16, 1989.⁵³

Principle 6 prescribes that if conflicts of interest, which are to be avoided, arise, they are to be resolved in an equitable way. Elaborating this point, Recommendations 6.1, 6.2, 6.3 and 6.4 put an intermediary under an obligation to guarantee an organisational structure which reduces the risks of conflicts of interest, avoids the circulation of confidential information, and resolves conflicts of interest with due regard to the interests of the clients. Recommendation 6.4 indicates that the remuneration of professional persons should not violate the primacy of clients' interests. This involves one of the most important principles but it is at the same time possibly a principle which lends itself less for translation into positive law, because the best preventative shall be that adopted individually by a financial intermediary and the solution(s) he shall opt for. On this point the working group under Brac de La Perriere concentrated their analysis on the way bodies of collective portfolio management (OPCVM) operated. Some solutions preferred in British and American practice could possibly be of assistance as guidance in the consideration of professional persons. They concern in concrete terms the so to speak "Chinese walls", the famous walls which should separate between functions susceptible to generate conflicts of interest. Mention should also be made here of "restricted lists", lists of transferable assets with respect to which a firm with a particular interest in them or with particular information on them, undertakes not to transact.⁵⁴

As a first result⁹⁷ in the integration of the principle of professional ethics with legislative texts and national regulation standards, some of the principles generated by the working group have already been translated into normative rules:

The Law No. 88-1201 of December 23, 1988, relating to portfolio management firms (OPCVM), provides that an intermediary shall have at his disposal the means and resources necessary for the proper execution of services offered to clients. (See particularly Article 12.) Relevant hereto is also COB Regulation No. 90.06 concerning individual or collective portfolio management.

Art. 20 of Law No. 88-70 of January 22, 1988, regulates the duty of an intermediary to insure that the client(s) get all the adequate information they need. For such a purpose written guidelines are to be produced prior to the management of clients' accounts. (See also the General Regulation of the Conseil de Bourse de Valeurs, Arts. 2-6-3, and 2-3-1 to 2-3-3; the general decision No. 89-18 of the same ; General regulation of futures markets, Art. 4-1-3; Decisions of CMT No. 89-3. (Conseil du Marche a Tenure).

The Cour d'appel de Paris of February 28, 1994, decided that the client has the right to be informed and advised on the risks inherent in the nature of the transactions planned by the financial intermediary. The Court, accordingly, sentenced the Société France Compensation Bourse (FCB) to pay damages because the intermediary did not WARN the client, at the time of opening the account, on the serious consequences that could arise with respect to transactions with futures. The decision is related to the Conseil de Bourse general Regulation that, in the chapter dedicated to deontology, establishes the principle that the intermediary must make efforts to know the wishes of the

clients and to give them a clear, prompt and complete information on the transactions effected in the behalf of the clients. The intermediary should, in addition, check that the clients are aware of the nature of the risks involved. The duty to inform, as a general and permanent one, reflects a principle rooted in deontology. Ducouloux-Favard⁵⁶ observes that the duty to inform is an ancient one: there is reference to it already in a decision of 1893 (Appeal of Bourges of June 17, 1893). The duty to inform is a principle of the contract law. The deontology principle has only reported the law of contract, as the duty to inform is a general principle applicable to all kinds of contracts.

Regulation of the COB No. 89-05, relative to the execution of clients' orders stipulates that these shall be fulfilled in the best possible way by a financial intermediary. Regulation No. 90-12 of the COB, of July 25, 1990, deals with the standard of the chronological implementation of orders.

Concerning the duty of a financial intermediary with respect to setting up a regime governing the operations of professional assistants helping him, including means for exercising control over or monitoring them, Art. 19 of the Law No. 88-70 of January 1988, prescribes that in terms of professional ethics rules applicable to the activities of assisting personnel shall be set up. On the same point the General regulation of the CBV contains provisions in Arts. 2-6-5 to 2-6-9. (See also the instructions of the COB on bodies active for the sale of stocks.) The instructions are on the application of regulation No. 89-02 of September 30, 1989.

Reference to the duty of a financial intermediary to prevent conflicts of interest and to resolve them in an equitable manner can be found in COB Regulation Art. 6 of No. 99-08. It puts those who offer quoted stocks under an

obligation to have an internal procedure suitable for avoiding the spreading of privileged or sensitive information. thereto related is also Art. 2-6-2 of the General Regulation of Conseil de Bourse des Valeurs relating to the organisation of stock market firms and independence of certain functions. Regulation of the COB, No. 90-05, concerns the abusive use of powers and orders.

Thus, investor protection in France has involved substantial input by professional experts and bodies for a system which consists partly of elements of self-regulatory standards inspired from the notion of professional ethics (deontology) and partly of elements of legislatively codified standards. As to the application of deontological principles elaborated by experts representative of the profession, it is the COB which in the first place verifies that cases brought to its attention as test examples are in conformity with the principles laid down by the work done by the group chaired by Brac de La Perrière and suitable for achieving the objectives laid down in the sphere of investor protection. The control exercised by the COB is expected to check also the internal coherence of the whole body of deontological measures. In this respect the COB has already intervened in various ways. It has approved the ethical code of the ASFFI (Association des Sociétés financières et Fonds français d'Investissement). With due regard to the fact that the ethical code of collective portfolio managers prepared by the ASFFI strengthens the protection of investors rights, the COB has recommended and supported the extension of its application to all managers comprised in the OPCVM (Organisme de Placement collectif de Valeurs mobilières). For this purpose it has decided to check the conformity of the way the OPCVM is structured and functions with standards established by the deontological code laid down

by the ASFFI as one of the conditions to extend its consensus and has included this condition in its instructions of September 30, 1989, relative to the procedure of approval for OPCVM as bidues dealing with the collective placement of stocks. The COB has in addition considered a violation of professional conduct rules to be sufficient to request, in the meaning of Art. 33-1 of the Law of 23 December, 1988, the intervention of the disciplinary council of the OPCVMs.⁵⁷

In general the COB endeavours to facilitate the adoption of professional ethical standards by diverse professional associations and professional financial institutions. This corresponds to dealing with numerous questions which arise in the daily application of internal control functions. The COB collaborates similarly with all those who initiate, in conformity with the requirement anchored in Art. 6 of the COB Regulation No. 90.08, to generate internal procedures often in the form of deontological standards related to the activities of administrators and directors of firms, for the purpose of averting the circulation of privileged or sensitive information. In 1992 efforts mobilised in earlier years to define profession by profession the significance and practicability of the first basic principle upholding the primacy of clients' interests led to a concrete result : the deontological code was adopted by portfolio management firms. Discussions on professional ethics, conducted within the AFSGP (French Association of Portfolio Management Firms) led to the adoption of an ethical code specifically applicable to the problems of portfolio management firms. The code is based on the general principles contained in the report of the group chaired by Brac de La Perrière. To be sure that the ethical code can be extended to all portfolio management firms, the COB has decided that compliance with it as to

the proper functioning of a firm shall constitute a condition for granting it an approving concession and that in cases of an enquiry concerning a firm the code in question shall be used as source of professional standards.⁶⁰ All portfolio firms undertake as members of the AFSGP to respect and require their personnel to respect duties anchored in this code. In case of violations of this approach a firm may be excluded from the AFSGP. A further point of principle is that portfolio management firms have to provide for a proper atmosphere of cooperation. It is also worthwhile to point to the way the principle of respect for the integrity of the market is expected to be applied. The COB undertook an enquiry on the use of polls conducted on the occasion of the referendum related to the Treaty of European Union (Maastricht). In a communique on August 20 1992 and in a further one issued jointly with the commission on polls on September 11, 1992, it has been established that the publication and distribution of opinion poll results should have proper regard to a few principles: the publication and distribution of results shall be excluded in the week preceding the referendum, in the meaning of Art. 11 of the Law of July 19, 1977, and organs supervising the press shall see to it that the above principle is complied with.⁶¹ These points may seem to be a little far fetched but they have been deemed to be important with regard to the proper functioning of the market. The COB has made it clear that a violation of the relevant obligations may be investigated in the light of its regulations and in the light of penal law.⁶²

It is at this point relevant to enquire what the efficacy of deontological rules is in relations between a financial intermediary and his clients. A first circumstance which may not generate problems may arise when professional ethics are explicitly included in the

text of the management contract. In such a situation the given standards will be actionable in relation to any other contractual clauses or terms. A second circumstance may arise when a management contract represents simply the framework of legal support for the application of a series of specific duties anchored in deontological standards. In such a situation French law provides for the sanctionability of such violations affecting the professional ethical duties to apply due diligence, to act loyally and with prudence and discretion, provided that a court recognises and accepts their actionability. At the current level of developments such a solution seems to be fundamentally accessible, as has been the case with respect to a duty to supply adequate information as a natural part of a management contract, including all the related duties based on professional ethical standards. In this respect the role which deontology may have in consolidating the binding authority of common law, that is, when courts would proceed to accept and sanction more amply violations of duties related to the completion of financial transactions. This approach is confirmed by the opinion of some leading scholars as well as by judicial practice.⁴³ This may be due to the fact that the major part of the relevant duties can be reduced to or translated into duties to inform, to consult, to apply due diligence and prudence as duties enshrined in common law.

A weak point in the above outlined solutions relates to the way of proceeding with respect to protection. If it is true that investor protection can be achieved by means of procedural remedies, it is equally irrefutable that for a client it is difficult to prove satisfactorily that duties of professional conduct have been breached by the intermediary, for example, with

reference to the duty to maintain neutrality in the transaction.⁶⁴ Seeking a solution in the contractual relationship does not constitute in all cases the only way of dealing with the way professional ethical standards are expected to operate within the ambit of relations between investors and their financial intermediaries. In the relevant French literature it has been affirmed that the violation of a professional duty may lead to an assumption of delictual liability by a firm of intermediaries if a causal nexus is proved between violation and damage. In contrast to this, a court takes directly into consideration the deontological principles in question for using them as a technical category in support of its decisions. Of particular interest is the distinction⁶⁵ between cases of violations of deontological obligations in relations between professional operators, on the one hand, and cases of violation which concern relations with third parties. In latter cases there would exist, in addition to a disciplinary liability, civil liability.⁶⁶ On its part, judicial practice continues to insist that all conditions related to civil liability should exist, affirming in such a sense that non-observance of rules of professional conduct /in our translation / "does not per se justify awarding compensation for damages to a person applying for them". It can thus be said that for claiming civil liability it is consequently necessary that a violation of professional conduct implies also a violation of a legal standard protected by common law.⁶⁷ This raises for the topic of our thesis, investor protection, grave questions. To seek solutions for them, the COB has promoted as desirable, for strengthening the protection of investors, the search for a simpler way of proceeding for indemnifying investors.

In 1991 debate on the problem of awarding damages derived from failure to observe legal rules and regulations was initiated. The Law of July 24, 1966, had instituted specific procedures in favour of minority shareholders, but the procedures in question had proved to be too limited, as a result of which there remained the necessity to resort to the contents of common law; but such reference to remedies available under common law is a very costly matter for a single shareholder. In a report prepared by Alain Viandier it was rightly observed that the perimeter of offenses within the financial markets has become extended and that opportunities for committing fraud have become multiplied while, paradoxically, there has been an almost total absence of available remedies for compensation under civil law. This is a problem which does not concern France only. In a meeting organised under the auspices of the Council of Europe in Milan in 1993, it was concluded that "civil actions are little used in Europe". Truly, if in certain cases it would be possible to prove easily the existence of a committed offence, it would be more difficult, in contrast, to prove its prejudicial consequence and the nexus of causality between the offence and the ensuing damage.

Tunc⁶⁶ observes that the COB could generate pressure for having investors compensated for errors committed at their expense. For this purpose a procedure of mediation has been instituted, but the function of mediation is solely to act as a form of conciliation and not of arbitration. In such a situation the legal services of the COB would get preliminary information on the intention of the involved parties as to proceed or not to proceed with conciliation before transmitting the relevant files to the department of public relations of the COB.⁶⁷ It is thus evident that there is an urgency to

seek legislative solutions which provide for simple, accelerated and economical procedures.

iii. Information for Investors : the Prospectus

In matters related to information, French legislation has been marked by a notable delay compared with the situation in other countries like the USA and Belgium where a legal obligation to supply information to investors has existed since 1934-1935. The COB exercises the control of the quality of information in accordance with the control procedure laid down in Arts. 6-7 of the Ordinance of 1967 and in a manner clearly inspired by the example of the USA Securities Act 1933.⁷⁰

The prospectus constitutes the most complete and relevant information prescribed by law for the benefit of stock buyers and is, in the wording of the law, the most fundamental document put at the disposal of the public.

Various types of prospectuses exist, differentiated in terms of quantity of their contents (as complete, abbreviated or simplified); others are distinguished in terms of the modalities and procedures to which they make reference.⁷¹ In France, in application of standards established by the EC, a single terminology is used, "prospectus" which may include such other terms as "note abrégé", "note d'opération préliminaire", "note d'opération définitive", "résumé", as the source of much confusion.

Standards governing the edited form of the prospectus remained unchanged from 1907 to 1966, having been limited and strictly related to the offer of a (publicly subscribed) company, or at the time of increasing the corporate capital, subscription of bonds, introduction of stocks on the market or at the stock market. The prospectus had therewith an elementary function to fulfil: to inform the public (publicly or through the banking community) on data relative to the

intended transaction(s) and to the publication of notices in bulletins dealing with compulsory legal notices or announcements. If the data were erroneous, they involved (civil) liability and penal offenses for the issuers. With the reform effected in 1966 the prospectus assumed an obligatory character, including, summarily, its contents in a more amplified form and with disciplinary measures foreseen for promoting compliance with them. The Ordinance of 1967 provided for the supplementary editing of a "note d'information" different from the prospectus required by law with respect to the reform of commercial companies. Its contents have not been defined ulteriorly with precision, but the COB is competent to establish them. The COB has defined in binding form the various types of "notes d'information", without evolving, however, a standard system applicable to all types. In addition, the COB has laid down the standards subsequent to the adoption of an EC Directive providing for the Community wide harmonisation of standards applicable to the editing of a prospectus. Initially, even the best informed authors did not distinguish between the prospectus on the one hand and the "note d'information" on the other and has equated both types to the earlier type of the prospectus.⁷²

Subsequent to instructions issued on February 2, 1982,⁷³ a distinction has been introduced between

- a. an ordinary "note d'information";
- b. an abridged note, for the benefit of the public, to be compiled when shares or convertible bonds are issued and published in the daily press ;

- c. a "simplified" note for professional investors.

Companies which in a preceding year may have offered transactions similar to those offered in a current year may be dispensed from the publication of a prospectus.

The note is submitted as a project or plan to the

COB as a measure of provision; it is scrutinised and if amendments are proposed, it is resubmitted to the COB as a definitive note, which is equally checked, approved and deposited in the files of the COB. In the meantime, after approval the note is made available to the public. The Law No. 83-01 of January 5, 1983, extended the requirements of Arts. 6-7 of the Ordinance No. 67-833 of 28 September, 1967 (duty to issue a prospectus) to every issuer or intermediary making a public offer for investment, thereby the only exception being the French state.

The guidelines of July 31, 1987, have been inspired by the necessity to keep pace with the rapid evolution of the financial markets and, above all, to respond favourably to the requests of company managers to shorten and simplify the procedure governing the admission of transferable stocks. This procedure has become longer and complicated subsequent to the adoption of rules dealing with the preparation of notes d'informations. Against such a background the COB experimentally instituted a new procedure which provided for the preparation of a "document de reference" registered with the COB. Such a document contains all the information required for notes distributed to the public by companies appealing for investment. The document may consist of the annual report of the management council (conseil d'administration) of a company, compiled in accordance with existing guidelines. Within four months after the end of the period of corporate activities, the company submits to the COB a draft document which is scrutinised and if needed completed with additional information; it is registered and then made available for the public at the seat of the COB. Copies may be had by those who request them.

The note, published in compliance with rules in force and applicable to issues of securities and to any

other financial transaction, as a "note d'opération", contains the contents of the document registered with the COB for reference. The "note d'opération" contains information on the modalities of the financial transactions and a summary of the main corporate characteristics and, if needed, the financial situation of the company, with updated information taken from the document of reference. As a general practice, the sign of approval is attached to the "note d'opération" on the second day of the stock market after the draft text of the note d'opération has been submitted. In addition to publication as laid down by Art. 6 of the Ordinance of 1967, the note is also published in a daily paper with financial information distributed at a national level, on the same day on which the transaction is launched, unless other forms of publication have been approved by the COB. The prospectus for new issues of shares and bonds must be signed also by the Commissaires aux Comptes (Auditing Commissioner).⁷⁴

Judicial practice, to the extent it has dealt with cases involving liability for the omission of diligent and proper control,⁷⁵ has qualified such negligence concurrent with that of managers of a company who had omitted, in the succinct note d'information for launching bonds, to point out that serious losses had been incurred in the course of fulfilling a contract for the construction of four platforms for oil prospection for the Brazilian government. The note d'information had not in any way drawn attention to the thereto related facts of exceptional nature capable to have an impact on the financial situation of the company. The inspectors too had not detected this missing detail.⁷⁶ It should be pointed out⁷⁷ that the COB attentively controls the transparency of a given transaction and that the scrupulous respect for it, on the basis of the literal

contents and eventually of the spirit of what is said in terms of direct statements concerning the protection of the rights and interests of minority shareholders. It may thus be said that the protection of minority shareholders constitutes in the normal course of stock operations as well as in the case of exceptional transactions a constant preoccupation in the activities of the COB. It may be added that the COB has known how to deploy its control powers affecting adequate access to information in order to be active in areas in which it probably has not had an initial possibility to intervene. In this way it has noticeably influenced the financial press by constraining companies to show in the press whether they are supplying objective information, or an opinion, or a study prepared for publication upon request by a given company, or whether the given information are supplied on the basis of personal opinions. Moreover, in this way the COB has played a determining role for improving standards of control affecting the accounts and balance sheets of companies applied by the auditing commissioners (commissaires aux comptes). In 1967 such a control was often a formal matter, or at least superficial. By mobilising its powers to refuse approval of a note which fails to correspond to standards of guaranteed reliability as to its contents, the COB is in a position to promote higher and more serious standards of control. In collaboration with professional bodies, the COB controls the nomination and dismissal as well as the way in which the given functions are exercised.

In the new programme of privatisation, differences between the three kinds of shareholder (individual, institutional and foreign) have become more marked and the 90-02 Regulation enables to shape the prospectus as different documents, the COB has revised the structure of the prospectus and has developed the practice of

"resumés".⁷⁰ The "note d'opération préliminaire" and the "note d'opération définitive" are addressed to the institutional investors.⁷¹

iv. The Regulations of the COB

Regulation 90.02 : Equivalent Information ;
Regulation 91.02 : Mutual recognition ; Regulation 92.02
: The Simplified Prospectus.

Duties laid down by the COB do not address the same group of persons: some are for issuers soliciting investment by the public, others for professional persons like the commissaires aux comptes; and still others concern intermediaries who manage individual and collective portfolios, and lastly other are directed to all operators, be they physical persons or companies active in the market. For the sake of clarifying their respective obligations the COB published in 1991 a collection of texts comprising all rules relevant to transactions with securities.

Almost all of the regulations in question are subject to revision in the wake of EC Directives, for example on the prospectus, or in the wake of reforms. On such occasions the COB has endeavoured to secure a greater transparency within the market while avoiding at the same time rendering the relevant procedures too cumbersome and heavy generating additional work for issuers and hampering their access to the market. The COB has accordingly undertaken a series of revisions of guidelines and regulations concerning the notes d'information, for the purpose of standardising the schemes governing the contents of information documents and thus rendering them more similar to those intended as desirable by virtue of what is expected from a prospectus by virtue of the contents of EC Directives.

A first phase was completed with the adoption in

1991 of a regulation and a guideline of application intended to harmonise or approximate standards governing information affecting admission to official listing of securities with standards prescribed by EC Directives. As a technical term the prospectus is used as a single term in the new regulations. In 1993 no new regulations were issued." "

a. Regulation 90.02 : Equivalent Information

In implementation of an EC Directive 80/390 on "equivalent" information, Art. 7 of the Regulation 90.02 provides that any one intending to issue stocks in France must guarantee that the information supplied is complete, that is, "equivalent" to that guaranteed abroad. This provision aims at insuring that investors in all the various countries in which a company has applied for the official quotation of its shares enjoy equal treatment with respect to information available to them. For the COB, "good or adequate information for the public and the market implies that the systems used for standardising the data in question and making it available for the public are reliably clear. On the basis of Art. 2 the supplied information has to be "exact, precise and authentic". Art. 4 lays down that the public must be given the opportunity to acquire knowledge of all the important facts susceptible to affect, if known, in a significative manner the quotation of the given shares.

The COB applied sanctions for the company VEV for not having rectified information made available to the public in 1991 while having internally at its disposal a document which established that reported losses were noticeably higher than for the balance in 1989 when the said losses were consolidated for the year 1990; moreover, the company was considered to have failed to report any matter which would establish that a correction of the corporate results would have been of a nature to

be prejudicial to the legitimate interests of the company.⁶² The company VEV had made public, with respect to results for the first half of 1990, and moreover in an information document intended for the shareholders general meeting and dated December 28, 1990, that the losses of the corporate group had markedly diminished in comparison with those of 1989 and that consolidated results of the group indicated for 1990 a notable improvement in comparison with 1989. Because internal corporate documents of VEV referred to performance results which did not correspond to those made available for the public, the COB concluded that information made public in November and December 1990 had neither been exact nor precise and sincere.⁶³ Consequently sanctions were imposed on the company and its managers. In appeal proceedings initiated by Dervoley in his capacity as corporate director, the Court of Appeal of Paris annulled the unfavourable decision of the COB. The Court concluded on formal or procedural grounds that the contents of a communique issued by the COB a few days prior to the beginning of the proceedings, for informing the public on the nature of the inquiry, were of a nature susceptible to be prejudicial to guaranteed defence and to the principle of presumption of innocence until proven otherwise. The COB had developed the dangerous practice of publishing in a communique the results before the decision of the sanction and before the adversarial objection to it. The Cour d'appel de Paris (dec. of January 15, 1993) has condemned this practice as being contrary to the principle of presumption of innocence. The court accepted, however, that the COB had not infringed the duty of impartiality.⁶⁴

In another case the COB imposed sanctions addressed to the company Les Beaux Sites and its director, Pierre Dehaye, for having made public on many occasions in the

financial press news relative to the existence of negotiations concerning the control and transfer of a significant part of the company's capital, and relative to a request to the Société des Bourses françaises, in the form of a letter dated May 22, 1991, the suspension of quotations of the company's shares given the imminent conclusion of a financial transaction. The COB, having controlled and discovered that no document evidencing the imminent conclusion of an ongoing transaction nor negotiations existed, applied sanctions in relation to the company and its director. The Paris Court of Appeal upheld the decision of the COB.⁸⁶ The COB published a letter addressed to the directors of the Schneider company with respect to the communication of unfavourable information without having preliminarily published it in the press.⁸⁶ BY 1993, the COB had applied two administrative sanctions for violation of its Regulation 90-02.⁸⁷ The first sanction of 400,000 F concerned Pierre Conso, President of the Ciments Français.⁸⁸ The second for the amount of 250,000 F, affected the French company Metrologic Internationale.⁸⁹

b. The Regulation 91.02 : Mutual Recognition

The adoption of an EC directive relative to transferable securities has enabled the COB to replace its Regulation 88.04 with the Regulations 91.02 and 92.02. With reference to the adoption of EC Directives it has been observed that there has been an increased use of formalism.⁹⁰ In the new regulations a single technical term, the prospectus, is used as terminology, as a substitute for "note d'information", the "note succinte", the "fiche d'information", the "note abregé", as technical terms which had generated much confusion.⁹¹

Regulation 91.02, made binding by the Decree of December 23, 1991 (J.O. Dec. 27, 1991), confirmed on February 1st 1992, concerns all information which must be

divulged for the admission of transferable securities to official quotation, and implements the contents of the Directives 80/390/EEC, 87/345/EEC and 89/298/EEC. Therewith the procedure for the mutual recognition of the prospectus within the EEC is modified; the scope of its application is extended and aspects of the relevant modality are clarified. This new development should permit the effective application of the therewith supplied procedure (thus far little used). The approximated or harmonised presentation of prospectuses in accordance with the new standards should constitute a motivation for using the procedure of mutual recognition.⁷² Consequently, Regulation 91.02 permits the acceptance of documents or prospectuses, approved by the COB in France, by the relevant authorities in other member states of the EU/EC (Arts. 19-20 of the Ordinance of 1967). Therewith also the transparency of the markets within the EC would be promoted.

Regulation 91-02 eventually extends the range of persons as relevant for financial information. Under the old regulation based on earlier French law, the information was directed more specifically to shareholders; currently the information is aimed at the investors and the market. The Regulation extends the scope of public scrutiny and imposes consequently a major element of formalism in the manner certain transactions are presented particularly with regard solely to shareholders and activities which were earlier considered to be internal company matters (transactions reserved to the internal sphere, to proposals addressed to wage earners, related to restructuration, as examples).⁷³ As to transfrontier mutual recognition of relevant documents, it is the COB which issues the certificate of approval requested for submission to the relevant authorities of the other EU member states for access to

official listing and quotation.

c. Regulation 92.02 ; the simplified Prospectus

Regulation 92.02, confirmed by the Decree of March 3, 1992 (O.J., March 15, 1992) concerns offers to the public of transferable assets, in implementation of Directives 89/298/EEC and 90/211/EEC,⁴ makes access to public offer possible for investment known as so to speak "secondary."⁵ Earlier French legislation did not deal with public offer of investment effected on occasions of cession of already issued stocks. The new Regulation continues to treat public offers as primary if an offer of stocks is extended to a number of persons exceeding 300, as was provided for in the abrogated Regulation 88-04. The term "offer to the public" or public offer concerns not only the offer of new stocks (as appeal to the primary investment public), but also the cession of stocks which are already issued (offer to the secondary investment public).

The Regulation prescribes the preparation of a "simplified prospectus". As a document of information the "simplified prospectus" assumes a role considerably less important than the prospectus needed for admission to official listing; it is simply "deposited" with the COB, that is, without the need for a preliminary scrutiny of the transaction plan.⁶ It bears the signature of the company directors and of the intermediaries entrusted with the execution of the transaction. They can be stock market firms or banks. With their signatures the corporate directors and the firms testify that data contained in the prospectus correspond to the facts and are not vitiated by omissions which may distort the scope of the contents. Lastly, the *commissionnaires aux comptes* add their signatures.

The Regulation provides for new possibilities for eliminating the preparation of a prospectus, the most

important among them being referred to in Art. 4(a): /in our translation/ "The preparation of a simplified prospectus shall not be required if the offer is addressed to persons within the framework of their professional activities." Therewith Regulation 92.02 has introduced into the French system the notion of "professional investor" already known in the British and USA systems,⁹⁷ wherewith a differentiation is established between professional investors, on the one hand, and non-professional on the other.

For the COB⁹⁸ the currently valid laws and regulations do not extend any derogations from the general standards as applicable to professional investors. The system points out when an offer is addressed to persons with a number higher than 300, the distinction between professional and non-professional investors becomes irrelevant and the planned operation is classified as one addressed to the general investing public. However, the common investment transacted by professionals is treated as that of a single person, an innovation which definitely is in favour of the interests of professional investors.

v. Approval by the COB

It constitutes the last stage that seals the procedure of control effected by the COB.

Approval is obligatory and preliminary to the execution of the intended transaction(s); in addition the validity of an approval is limited to the proposed and defined transaction. With its approval the COB contributes to the reliability of the necessary information supplied in conjunction with a proposed investment by appeal to the public.

The approval testifies that control of the company has been effected in conjunction with the admission of new stocks to the market and that the control concerns

also the conformity of information supplied with reference to the financial situation of the offering corporate body. This in no way implies, however, an appreciation of the merits of the proposed investment nor an appreciation of the merits of the overall situation of the appealing company.⁹⁷ Approval means that the reliability of the supplied information is testified to but the liability or responsibility of company directors preparing the prospectus is left in relation to the investment subscribers, untouched; this remark applies equally with respect to the *commissionaires aux comptes* who are in charge of scrutinising to see whether accounting information is in agreement with standards of corporate and consolidated accounting.¹⁰⁰ Obviously the COB may before approval point to improvements to be made and ulterior information to be added. It may moreover demand explanations and justifications relating to the situation of the given company, on its activities and financial results. In some cases the COB expresses its views related to the approval in the form of a communication or note attached to the approval. Such supplementary views or notes are to be included in all publications related to a proposed transaction. For facilitating the process of financial transactions also with regard to their relevance abroad, the COB has simplified the procedure leading to the grant of approval and intends to promote the use of standardised documents as reference. Therewith time required for getting approval by the COB may be shortened.¹⁰¹

vi. Investors Associations

Law No. 89-421 of June 23, 1989, concerning information for and the protection of consumers, has supplemented Law No. 88-14 of January 1st, 1988, on the capacity of consumers' association to appear as a claimant party in court proceedings. Therewith the

possible establishment of a procedure of recognition for associations of savers investing in stocks and financial products and possibility for them to avail themselves of judicial remedies in a manner similar to that enjoyed by professional consumers' associations has been promoted.¹⁰² To such investors' associations recognition may be extended in conjunction with approval by the COB and the Ministry of public affairs under conditions laid down in Decree No. 90-235 of March 16, 1990. If they have been in existence for a minimum of two years, have at least 1000 members or another level of membership in accordance with membership conditions specific to a given individual association, deploy effective and public activities for the protection of investors. Recognition, granted for a period of three years, is renewable under the same initial conditions. It enables the associations in question to appear as a party in court proceedings, to make claims for damages for facts directly or indirectly prejudicial to the collective interests of investors, and to request the President of the Tribunal de Grande Instance to impose an end to irregularities or practices incompatible with legislative provisions or regulations and capable to cause damage to investors' rights. If claims are found to be well-founded, the court may rule that the defendant pay compensation for damages to the collective interests of the association members but no compensation for damages with respect to each individual member of a given association.¹⁰³

It is observed that there is a tendency among minority shareholders to propose asserting their rights. For example, the Federation nationale des Clubs d'Investissement (FNACI)¹⁰⁴ has applied to the Procureur (prosecutor) of the Republic and has claimed to have the legal capacity to appear in court for raising claims for damages against the ASYSTELE company.¹⁰⁵ In addition an

association for defending the interests of minority shareholders has been formed with reference to the Beaux Sites affair, for the purpose of finding an honourable solution affecting the minority shareholders. Lastly, mention may be made of the Association for the Protection of Minority Shareholders with investments in the company Mines et Produits chimiques de Salsigne.

vii. The COB and Investor Protection in France

In 1991 the reorganisation and mergers of stock market firms continued under the pressure of an imperative to reduce operational costs. From 61 in 1988 the number of firms has dropped to 57 in 1991 and of these, 13 had been dropped from the list of the Commission de Bourse des Valeurs. Currently some firms are operating only with institutional investors as clients. Few firms are able to operate independently. After the merger of the Pinatton and Wargny, the number of independent firms had been reduced to three on January 1st, 1993.¹⁰⁵

Concerning monitoring and control activities, the COB had initiated in 1990 75 enquiries,¹⁰⁷ with two reports transmitted by the COB to the Procureur (prosecutor) de la Republic on October 30 and December 11, 1990.¹⁰⁸

In its control activities the COB is able to depend on the cooperation of professional bodies and authorities as well as on the assistance of judicial organs. In 1992 it opened 17 sanctionary proceedings. Ten of them were concluded with decisions. There were four appeals from these ten decisions at the Appeal Court of Paris.¹⁰⁹ The pecuniary sanctions or penalties imposed varied from FF 10,000 to 10m. In 1993 the COB opened 10 sanctions proceedings and took 10 decisions imposing sanctions.¹¹⁰ Regarding market supervision there were in 1993, 85 decisions against 101 in 1991 and 90 in 1992.¹¹¹ On

December 31st 1993, there were 72 pending enquiries against 70 in 1992 and 68 in 1991. These figures concern also matters of collective management.¹¹² Twenty-four communications were sent to judicial authorities in 1992 33 in 1993¹¹³ (21 in 1991). In ten cases in 1993¹¹⁴ six cases in 1992 (three in 1991), the COB proceeded for the applications of administrative sanctions.¹¹⁵

In the sphere of measures against stock market offenses, the COB intends to supplement the resources it currently has at a national level with transfrontier cooperation. A policy of cooperation agreements is being deployed with respect to North American countries (Canada and Mexico), Asia (Japan). In 1992 a cooperation agreement was concluded with the Commission des Valeurs mobilières of Quebec, Canada, and the Ontario Securities Commission as well as with the Commission Nacional de Valores in Mexico. In 1993, within Europe the COB has concluded bilateral agreements with the stock market commissions of Belgium, Italy and Spain.¹¹⁶ In completion of its functions and actions of supervision with sanctionary measures, the COB is studying the possibility to institute civil court actions, available for shareholders and their associations for the purpose of facilitating the procedures of compensation.¹¹⁷ In this way the protection of investors is susceptible to continue the chronicle of remarkable progress in France, with respect to security and reliability of conditions for achieving control over quoted stock market companies. The COB has prompted adequate information for investors as well as a better understanding by them of such information. In turn quoted companies a wider distribution of shares among a more diversified public. Lastly, a better level of relationship between quoted markets and the shareholding public has been the result.

At a comparative level, it has been enquired whether

information supplied by French companies could be quantitatively and qualitatively comparable with information supplied by non-French companies abroad. D. Branger¹¹⁶ has been of the opinion that without any doubt the answer would be in the affirmative in favour of the French companies, adding that British requirements for such information may seem to be more demanding, but only apparently, because the pragmatic way in which British standards are applied renders them less severe. Branger admitted, however, that with respect to systems as that of the USA, the French system is deficient by not providing for the requirement that the supplied information should be regularly and automatically updated. The explanation for this deficiency in France is that France has no sources of centralised information. This nonetheless positive balance seems to be in contrast with more cautious if not directly critical opinions expressed by some experts.

Even if standards of professional ethics (deontology), applied to financial activities in France as an instrument of auto regulation, amount to a privileged option available for professional operators, it seems that the French system does not have the necessary disciplinary (sanctioning) mechanism capable to guarantee an efficient protection of investors rights if a rule of professional conduct is violated, because such a violation would but with considerable difficulty constitute the basis of a negligent intermediary. In contrast the British system provides that the violation of conduct of business rules can be directly sanctioned in the meaning of Section 62A of the Financial Services Act, even if it is limited to cases involving private and not institutional investors.¹¹⁷

In France a so to speak contractualistic solution generates serious difficulties of an evidential nature

for a client who may be invoking before a court the violation of a norm of deontological nature on the part of the intermediary. Adopting a tortious (delictual liability in Scotland) approach does not seem to offer a better approach to the extent French court practice is generally oriented towards the exclusion of civil liability on the part of an intermediary who has failed to apply principles of professional conduct. The efficiency of reliance on professional deontology for consolidating investors' trust in intermediaries is challenged with a negative conclusion. Seen in the light of the modernisation of financial markets involving increased movements of capital, recourse to standards of professional ethics offers currently but a hardly trustworthy solution to the need of having at our disposal adequate instruments of investor protection. As to the proliferation of regulations, it is emphasised that excessive regulation may affect detrimentally the usefulness of distributed standardised information.¹²⁰ It is, however, on the other hand accepted that the absence of adequate regulation could lead to heterogeneous dimensions in the quality and quantity of information, again with detrimental effects as to the proper use of available information. With due regard to these points it has been the endeavour of the COB to establish acceptable minimum standards so that issuing companies shall not be overburdened by too many details in their operations and their competitiveness shall not be adversely affected. As a good pragmatic example is cited the arrangement made by Saint-Gobain.¹²¹ It seeks to stabilise its relations and dialogue with its individual shareholders totalling 750,000. The company has established a specialised service for relations and contacts with individual shareholders. The office of this service gets some 1,100 telephone calls and more than 500 letters yearly, from

shareholders, in addition to some 6,000 consultations via the minitel network.

Referring back to the COB, it is observed that the margin of its discretionary powers is relatively narrow. Rules applicable to matters related to the prospectus are expressed in minimally defined terms as found in the EC directives; the discretionary margin given to the competent national authorities can be but a widening one for the minimum standards provided by the EC system. The same applies for conditions governing admission to official listing, in France embedded principally in a system of general regulation established by the COB, also with respect to duties to supply periodic information and deal with accounting standards. It is emphasised that as to financial information what is provided for is not only contained in regulations but also in a so to speak pyramid of diverse (various) tests.

A further aspect concerns the utility of information supplied to the public for the public itself. It can be said that in spite of much effort the public does not derive much benefit from the regulated system of supplying information: the prospectuses are comprehensible but to those who are particularly competent to understand their contents against a background of legal and financial knowledge, with an awareness that such documents do exist and are eager to enquire about them and procure copies of them. In reality few persons are able to respond satisfactorily to all these conditions. The duty to publish information has been extended to notes d'information relative to public offers for acquisition, exchange, sale or withdrawal of stocks.

In some European countries, for instance Germany and Luxembourg, the printed publication of all prospectuses is required, but numerous exemptions thereto exist. It

does not seem to be reasonable to require in France the general publication of prospectuses as voluminous documents with due regard to the very high costs which publishing involves. Current rules are in fact based on a traditional conception of (financial) operations and transactions which presuppose the existence of an homogeneous public with the implication that therefrom both professional as well as private investors should be treated the same way. The exigence of transparency involves a risk of overemphasising the technical characteristics of supplying information at a public level if the information in question concerns complex product items which necessitate the availability of information not easily accessible for a single average investor. Progress toward effective access by the public at large to controlled financial information does not seem to be sufficient as far as the distribution of documentary materials is concerned, and even less sufficient is the progress in the light of the question as to how comprehensible or digestible the contents of such documents are for a not particularly expert reader. The traditional approach to financial information has been discussed in terms of

-- how to respond to such diverse information needs as those needed by the public at large and those aimed at financial specialists ?

-- how to permit the public at large to have access to all the relevant information within a useful time ?

-- how to make information immediately available on a financial operation the modality of which is not yet formulated or the completion of which is as yet uncertain, but may nonetheless develop within a brief period of time, without harmful prejudice to the integrity of the market and without binding the interested investors definitively prior to having

knowledge about the conditions of the operation ? Such questions need thorough discussions for the purpose of offering concrete solutions, above all for the purpose of a major transparency applicable to the whole of the contents of rationally and selectively enriched financial information. The improved access to financial information needs only changes in existing rules, but presupposes, essentially, ability to inform the public in an objective and useful way. This point may concern the sphere of techniques used for spreading stocks on the market and the role of intermediaries in making access to transactions widely accessible for their clients. May be the establishment of a data bank easily accessible by any interested person, for collating and coordinating all the available information on companies in the stock market could be a step in the right direction. May be the COB could play a role in this respect by directing more attention to new configurations of information derived from the evolution and the growing sophistication of financial techniques.

Some authors¹²² are of the opinion that the desirable solution may consist in the preparation of a so to speak "intermediary" document conveying to individual investors easily understandable financial information, on the basis of a regulation designed by the COB or on the basis of an initiative by experts of financial communication entrusted with the task. Possibly therewith the burden of professional duties weighing on the shoulders of professionals could be reduced by increasing existing expectations from the increasing functions which diverse information documents are expected to fulfil. Lastly, considering the fact that modern financial markets are fundamentally characterised by the existence of institutional investors, one may conclude justly, that it is not easy to be critical

toward intermediaries who privilege the interests of institutional investors as their most important clients.¹²³ However, having mentioned at length professional ethics as an instrument for protecting investors, and among them not least the weak, it sounds disconcerting that the distinction between institutional investors on the one hand and non-institutional or private investors on the other can sanction the privileges of the institutional investors as a category of the strongest investors. Such a distinction may paradoxically strengthen the factual privileged status of institutional investors, instead of making place for a better protection of private investors who even if they may individually contribute relatively modest savings and investment sums to the economy, nonetheless constitute the masses of an economic democracy. If such a consideration is neglected, the conclusion may be that of "much ado about nothing".

Investor Protection and the new Financial Intermediaries
in Italy

i. Investor Protection in the Italian Constitution

The Italian constitution of December 27, 1947 refers to saving as a social value.¹²⁰ This is based on an awareness that it is necessary to protect citizens who save also as investors, hence also as conscious and informed investors. Therewith it is agreed that the protection of investors in relation to public investment offers is also included in the protective function attributed to Art. 47 of the Constitution which leaves to state institutions the function of providing for protection.¹²¹

The Constitution seems to refer to protection which is wider and more elaborate in its scope than the term saving. It seems to favour the protection of the interests of a multitude of individual investors. The terms "encourages and protects" used in the wording of Art. 47 are sufficient to indicate an intention directed not only toward an objective generic form of savings, but also toward interests which are collectively protected, that is, in the interests of individual savers beyond the notions of transparency and information, postulating thus systems of control able to promote real protection with duties of decent management addressed to those who are responsible for financial operations. Those soliciting public investment should be considered bound by a duty to observe good faith, decency and professional ethics not only as matters of moral duties. The protection of savings stands as a term referring to the interests of a large community, that is, of savers.

A recent theoretical approach¹²² has tried to give a new interpretation to Arts. 41 and 47 of the

Constitution. It has assumed the contents of these two Articles to be constitutional values underlying the existence of the economic market and has shifted the accent from the protection of savings to the protection of the confidence which savers have in the system. According to this approach, therefore, no direct protection of investors would exist, but simply an indirect protection which is effected by means of protecting the market. The reality is that thus far nothing has been undertaken to transform the relevant contents of the Constitution into applicable reality. The Italian Big Bang has been above all a big bang of words, proposals, projects of regulation, like a whirlwind of discussions which on the one hand testify to the topicality and urgency of the relevant problem(s), and on the other constitute symptoms of a so to speak schizophrenic pathology.¹²⁷ Nonetheless, already the first programme of the first centre left government, approved by Parliament, contained in 1963¹²⁸ a provision for the establishment of a body as a watchdog for stock companies, with the duty to protect the interests of investors and small shareholders by monitoring companies listed on the stock market.

ii. Investor Protection under Law No. 1/1991, relating to Stock Market Intermediary Firms (Societa di Intermediazione Mobiliare) - (SIM)-

a. From static to dynamic protection

Law No. 1/1991 has replaced the protection model of a static type with a dynamic model. The central part of which is taken by the question of the complex relationship prevailing when dealing with investors. The control of the private autonomy of firms is exercised by influencing a firm rather than the operations, with reference to honesty, professionalism, independence and stability. A Circular by the Bank of Italy on August 6,

1993, explained what the understanding of the CIRC (Comitato Interministeriale per il Credito e il Risparmio) (Interministerial Committee on Credit and Investment) was on the integrity and honesty of agents of banking and financial companies and recommended specific standards of conduct to be applied in concrete terms but not yet contemplated by the law.¹²⁹ As to the law itself, beyond laying down a network of rules aimed at guaranteeing the supply of information, it tends to guarantee also the professional qualifications, the adequacy of material resources and solvency of the operators. The law has been preoccupied with guaranteeing to the investor that persons called upon to manage the financial assets of others shall have a correspondingly high qualification for the fulfillment of his functions.

The relationship between an intermediary, on the one hand, and the client on the other does not involve compliance with duties in one direction, that is, from the intermediary to the client as investor, in which the intermediary is more properly under an obligation to provide for the proper resources for the fulfillment of his functions, rather under an obligation to achieve results while acting correctly and diligently. The investor in turn is expected to make his decisions consciously and in an informed manner as his part of the contribution towards the establishment of a proper relationship. Consequently, investors' expectations are not linked to the good outcome and "results" of the transactions; they are linked to an adequate flow of information which facilitates a well considered decision with respect to a transaction and its further development. It should be added that the new information system does not vouch for the simple transmission of data, but for the possibility of the investor to be in a position to understand the complexity and specific

aspects of the financial instruments which the intermediary makes available with regard to the client's interests. Thus, the protection of the multitude of savers as investors may not be exclusively based on the availability of information and market transparency.

Transparency in turn, to the extent it is necessary, may prove to be insufficient in the absence of a proper care in the relations between intermediary and client, and the discussion of transparency may turn out to be ambiguous. Adequate transparency is an aspect of a guarantee which is ampler and more comprehensive and requires above all a balance in the relationship between the two parties. Thereto related is also the exigence to supplement rules on transparency with arrangements which promote investors' interests entrusted to the care of the intermediaries.

Law 1/1991 provides for the strengthening of protection guarantees in favour of clients of firms acting as intermediaries also in the pre-contractual phase of the relationship (Art. 6, para. 1(b), (g) and (d)). Standards of professional conduct laid down for the promoters of financial services, rules directly regulating activities involving transactions at the level of the regulated markets, the management of material assets including those involved in the conduct of operations dealing with moveable assets, provision for a national guarantee fund and indeed all standards relating to the organisation of the stock markets, together constitute a complex system directed at guaranteeing the operability of the market and at protecting the investors. As to vigilance, it is directed at verifying that activities evolve in accordance with standards of conduct and transactions with stocks are effected with regularity (Art. 9 of the Law on the SIM).

Chapter II of the Law No. 1/1991, regulating the

activities of companies acting as intermediaries for stocks, (Arts. 20-23) entrusts the CONSOB with exclusive powers relative to the organisation of the financial markets and market institutions at local levels and of products related to the markets. It appears to have been strongly influenced by EC legislation and in particular by the EEC Council draft directive on investment services in the securities field (OJ 89/C43/10, as amended on February 8, 1990 and definitively adopted as Directive 93/22/EEC). Among new elements in the Law No. 1/1991, which may be related to the contents of the Directive, reference may be made to Art. 3, para. 2(e) which prescribes that standards of high professional reputation are to be treated as matters of capital importance with respect to firms operating as direct intermediaries for stocks or through persons acting as their agents or through trust firms or through firms governed by the contents of Art. 2359, para. 1(2) of the Italian Civil Code. When controlling agent is a legal person or a company managers and general directors of such legal persons must be in possession of the required standards of professional reputation. The protective network guaranteeing investments is thus additionally reinforced: not only management organs of intermediaries but also physical persons or management organs of entities exercising a control over them must be in possession of the qualities of honesty as required by the law. Otherwise a firm acting as an intermediary would not be put on the relevant registry and would not be able to operate on the market.

b. Inversion of the Onus of Proof

A rule intended directly to be a key standard in investor protection concerns the inversion of the onus of proof provided for judgments governing compensation for damages (Art. 13 para. 10 of the Law No. 1/91).

Thereunder it is up to intermediaries to prove that they have acted with due diligence. It is noted that this, as an inversion of the onus of proof, constitutes a double derogation from codified principles relating to contractual or non-contractual matters: the client is exonerated from demonstrating the existence of a nexus of causality between the violation or offence committed and the given damage; for the intermediary on the other side of the relationship it is not sufficient to give the contrary proof: he is held to prove in positive terms that he acted with due professional diligence.¹³⁰ Some authors of the relevant literature have submitted that the rule is not drafted in a most unambiguous and clear way and it may hence lead to noteworthy differences as to the sphere of its applicability and its effective capability to strengthen the protection of a client.¹³¹ The inverted onus of proof may have an effective purpose for reinforcing the protection of the damaged side with respect to liability in non-contractual relationships; however, when reference is made to contractual liability, the same rule seems to have little influence on the regime anchored in common law (Art. 1218 of the Italian Civil Code).¹³² With some concern for the protection of the intermediary more than that of the client, it has been criticised that the intermediary would have no other choice but either to accept liability or to be able to prove to have acted with the due diligence of an agent.¹³³ Such a construction may be, however, overcome by realising that the rule has been conceived for strengthening investors' protection and not for protecting the intermediaries. This can be gleaned from the contents of the travaux préparatoires.¹³⁴

With reference to contractual liability, the discussion has been on the links between Art. 1176 and 1218 of the Italian Civil Code. It would seem that the

way Art. 13 para. 10 of the Law No. 1/1991 is drafted adds little to what the substance of the existing common law is.¹³⁶ Undoubtedly the impact of the rule will depend much on the way the courts uses criteria for ascertaining the contents of the notion of diligence. Consequently, the current state of affairs in Italy with respect to "diligence" is marked by a position of moderation.¹³⁷ Annunziata observes that the French model without pleading for the adoption of class actions has nonetheless laid the foundations for guaranteeing an efficient intervention by investors' associations. Such an approach does not exist within the Italian system.¹³⁷

c. Information and Transparency: informative Prospectus and informative Document: the Responsibilities of the CONSOB

The custom of issuing information prospectuses has old roots in Italy. In 1848 the provisional government of Venice published a prospectus for subscriptions to a fund for helping the revolt in the provinces Lombardo-Venete and for contributing to the defence of Venice. The investors' protection was assumed and guaranteed by the provinces and as a pawn the Doge's palace in Venice was offered for a mortgaged guarantee for repayment with all its masterpieces of art, its paintings and all new acquisitions by Venice (See Appendix "B" at the end of the present thesis).

EC legislation can be credited with the great merit of reviving since 1972 the so to speak prospectus tradition in Italy, encouraging at the same time discussion on information for investors and on the essence of transparency essentially anchored in a prospectus. The latter as an informative instrument is consequently the result of legislative efforts, above all at EC level, to pursue objectives of optimal transparency.

The first regime of prospectuses was introduced in Italy by the Law No. 49 of 23 February 1977 relating to transactions with stocks not officially quoted and traded at the second level market known as the "restricted market" ("mercato ristretto"). This Law is meritorious mainly for introducing investor protection into the Italian financial market system. Art. 4 provides that the CONSOB (as the supervisory body) may establish standards concerning data and notices necessary for informing the public, with the exclusion of such information which may be as sensitive pre-judicial to the interests of a company. The thereto related Regulation approved by the CONSOB by Decision No. 233 on June 24, 1977 and amended by Decision No. 2725 of February 19, 1987, prescribes the publication of an information prospectus in accordance with the pattern established again by the CONSOB (Art. 6(8)).

Art. 12 of the Law No. 77 of March 23, 1983, amending Art. 18 of the Law 216/74 and adding thereto Arts. 18-bis, 18-ter and 18-quater, is inspired by a philosophy of transparency and extends the duty to publish a prospectus (introduced by the CONSOB for the first time in a Regulation of June 24, 1977, with reference to the restricted market) to appeals to the public for investment. The CONSOB was endowed with competence to determine as to what the contents of a prospectus should be. Therewith the legislator established a first grid of protection in favour of the "weaker" contracting party in all forms of appeal for investment by the public, also prescribing what bundle of notices generally associated with the notion of "transparency" should be considered. As Minervini has observed,¹⁵⁶ the law achieved therewith an exceptional jump, both doctrinal as well as practical: from a protection of shareholders to the protection of

investors; from the contractual phase to the pre-contractual phase. For Guido Rossi¹³⁷ the new law marked a real break or rupture in the system of investor protection under Italian law.

With CONSOB Decision No. 4173, July 18, 1989, relative to general conditions concerning the preparation of informative prospectuses and the manner in which an offer should be made to the public for investment in accordance with Art. 18 of the Law 216/74, the system of informative prospectuses for public offers was renovated in connection with Directive 89/298/EEC of April 17, 1989.¹³⁸ While the CONSOB asserted to have followed the contents of the EEC Directive within the limits of possibility, it has been claimed that CONSOB's Decision constituted an over-regulation beyond what had been intended by the EEC Directive.¹³⁹

Art. 3 of the CONSOB Decision 4173/89 excluded from the category of offers for public investment, transferrable stocks offered to professional investors. The exclusion has been founded on the consideration that a necessary level of information has to be secured for the investing public in order to enable its members to make choices and decisions against a sufficient background of informed and conscious selection. Such an approach is not considered necessary with regard to professional investors.

Concerning the quantity and quality of the desirable information, Art. 6 para. 1 of the same CONSOB Decision No. 4173/89 distinguished the so to speak "transparency indices" and laid down that an informative prospectus related to a public offer should contain the information which according to the characteristics of the offered stocks, issuers and offerers are necessary for enabling investors and financial advisors to evaluate thoroughly the economic and financial situation, market

results and trends in the activities of the issuers or their agents, not excluding thereto relevant rights and stocks. The CONSOB has limited itself, in substance, to reference to Art. 4(1) of the EEC Directive 80/390. In its circular 37/90, Assonime¹¹² pointed out that adequate criteria of transparency also imply in their generality the need to avoid loading the prospectus with weighty data not necessary for the proper and informed assessment of an offer; such data may confound the investor or distract his attention from fundamental issues.

The prospectus has to bear the signature of those who are responsible for its publication, immediately under the declaration or statement of responsibility at the end of the contents of the prospectus. Art. 4(2) of the same CONSOB Decision, prescribes as an amendment to existing practice, that if the prospectus is produced by a company or association, the signature of the chairman of the corporate control organ is required. In implementation of the EEC Directive 79/279 of March 5, 1979, Art. 20 of the Law No. 281 of June 4, 1985 provides that the whole administrative procedure for the admission of securities to official publication of a prospectus informing, with data and notes, on the company or firm the stocks of which are to be admitted to stock market quotation. Its contents and the modalities of the publication of the informative prospectus are determined by the CONSOB (Art. 20(3)).

Aware of the limited capacity of investors to evaluate and understand the significance of the information conveyed by a prospectus, the legislator has sought to help them with an informative instrument, more flexible and hence more purposeful as to its contents for the investing public than an informative prospectus in general. With this in mind, the provision of Art. 6(b) of the Law No. 1/1991 has been adopted. It aims at providing

potential investors with more direct and relevant information by firms acting as financial intermediaries. The CONSOB insists on the inclusion in the text of an informative document as a warning that the CONSOB shall not be in any form held to be liable /in our translation /: "The publication of the present informative document is not dependent on prior verification as to its contents by the CONSOB. The completed publication /of the informative document/ does not entail any valuation by the CONSOB on the suitability of the proposed service." Art. 10(2) of the CONSOB Regulation No. 5386/91 directs that the informative items of the document shall be presented "in a clear and unequivocal" manner and that before initiating the proposed financial operation a copy of the published informative document shall be sent to the CONSOB (Art. 11, para. 1 and 2 of the Regulation). Art 12 deals in minute detail with the circumstances and mode of postponing the publication of the document should a reason for it prevail.

Some authors in the literature on the topic¹⁴³ make a clear distinction between the prospectus, on the one hand, and the informative document on the other as to their respective functions and contents. The informative document is intended for those who wish to have it without being a potential client. It is a summarised presentation by the intermediary, while the prospectus contains more elaborate information relating to the one launching the operation, or to the issuer or on the proposed operation.¹⁴⁴ If divergences emerge between the two documents, preference is to be given to the more recent one.¹⁴⁵ The CONSOB is under any obligation to control, verify and ascertain the veracity of the contents of an information document as to absence of an express item as the one provided for under Arts. 18 ff of the Law 216/1974 with respect to the information

prospectus.¹¹⁴

The function of the information document, directly comparable with a similar document in the United Kingdom, is to condense in compiled form such information as is essential on the intermediary.¹¹⁷ In appendix D of the CONSOB Decision related to No. 5386/91, as amended by Decision No. 6165 of May 31st, 1992, the CONSOB has diluted the normative requirements prescribed by law, adding only the requirements to indicate the sum of subscribed or paid capital, to refer to cover by the Guarantee Fund, the composition of the administrative council, secure liabilities, persons in charge of the control of the company etc.¹¹⁸ In the meaning of Art. 13 of Regulation No. 5386/1991, the informative document should be available, prior to the conclusion of a contract, only to "unqualified" clients.¹¹⁹ The criterion for the need for protection has been considered by the CONSOB in the Regulation on informative prospectuses, approved by Decision No. 6430 of 26 August, 1992 (Italian Official Journal No. 208, September 4, 1992), amending the Regulation adopted by Decision No. 6243 of June 3, 1992.¹²⁰ The problem of liability by the CONSOB seems to have been overlooked in the relevant literature. When determining the obligatory contents of information (in an informative prospectus), the CONSOB disposes of an ample discretionary margin. This may be necessary and useful, but such a competence to operate within an ample discretionary margin should be accompanied with a corresponding margin of adequate responsibility. Since 1986, nonetheless, at a doctrinal level some differentiated efforts have been made to remedy legislative gaps affecting the effectiveness of control (until then considered to be a formal matter), in an endeavour to extend, supplementarily, powers and thereto connected responsibility by the CONSOB, also to the

(economic and financial) merits of a proposed operation (substantive or material control). For Libonati¹⁵¹ this concerns the issue of the completeness of the contents of the prospectus and not only the merits of that which is published. According to some authors, the control by the CONSOB should concern the completeness and analytical scrutiny of the supplied data, but it should not be extended to the merits and veracity of the offered points; but others argue that this should not be sufficient. They refer to Art. 18-quater, which refers to Art. 3(c) there where it is stated that the CONSOB is not competent to undertake controls for the purpose of ascertaining the exactness and completeness of the data, whereby exactness corresponds to veracity. For Minervini¹⁵² the control of the CONSOB extends from completeness and clearness also to the veracity of the data and notes included in the prospectus. It should be, however, pointed out, as to completeness and veracity of supplied information, administrators are held to be under civil law as well as penal law liable under Art. 2621(1) of the Italian Civil Code.

Judicial practice inclines toward a solution for the limited powers of the CONSOB, to restrict itself to the merely formal, being aware that an insufficient public control system for preventing the possible publication of prospectuses with unreliable contents exists, but that the same insufficient system does not hamper the access of private companies to the financial market, by setting up onerous bureaucratic hurdles. Thus the legislator has been keen to emphasise the regulatory powers of the CONSOB as a control body, without endowing it, however, with more incisive instruments of control, as stated in the penal tribunal in Milan on February 27, 1988. The same judicial authority agrees that the CONSOB, not exercising a control function over companies in the

strict meaning of the term, does not guarantee the truthfulness and completeness of information. Such responsibility rests with those who furnish the information, just as it remains the responsibility of the investor to assume and evaluate the furnished information.¹⁵³

The United Sessions of the Corte di Cassazione¹⁵⁴ have maintained that, with respect to shares claimed by investors from the CONSOB in compensation for damages suffered in the wake of omissions in the control of the prospectus of an offer to the investing public, appeals for remedies may be made to ordinary courts, but that the claim would be rejected on the grounds of its merits, because the investors would have solely a legitimate claim with respect to the proper handling by the CONSOB of its functions and not with respect to a genuine substantive right. A violation of the latter by a public administrative body would be able to justify a claim under Art. 2043 of the Italian Civil Code. The facts of the case were as follows: buyers of capital shares in the Hotel Villaggio Santa Teresa, a limited liability company, complained that in the prospectus information relating to an allegedly already effected increase in capital had been incorrect; that in addition the prospectus contained inexact or false information on the proposed financial operation; and that, lastly, the CONSOB had not forbidden the proposed operation in spite of alarming news published in the press; nor had the CONSOB provided for the acquisition of ulterior justifying documentary materials.

The Tribunal of Milan,¹⁵⁵ while rejecting the argument that the financial intermediation of the bank could be held as a ground for making the bank responsible as a guarantor for the solvency of the issuer of the securities, admitted the request of compensation for

damages on the grounds that a precontractual liability by the bank was involved in the meaning of Art. 1337 of the Italian Civil Code, owing to the diffusion of prospectuses containing incomplete and false information. The case from 1978 concerns an investor who had solicited a copy of a prospectus edited by the American Express Bank. The text underlined the high returns on the shares of a company which had acquired a package of convertible stocks and after the payment of the first two installments financially failed.¹⁵⁶ The first instance (prima Sezione) of the Penal Tribunal of Rome rejected by ordinance the request of the State Advocate (Avvocatura dello Stato) to exclude the civil liability of the Ministry of Industries. This decision of the Tribunal was taken within the framework of the proceedings against Lucio Sgarlata who as a (trusted) (management) fund manager had generated damages amounting to 3,000m Ital.Lire for 22,000 investors. The decision of the Tribunal confirms that if a Ministry as a body in charge of the control of management trusts does not act with due vigilance foreseen by the law, is liable together with the defendants for damages caused to investors. This concerns a principle sanctioned in 1992 by a revolutionary judicial decision, No. 6687 of the Sezione Unite Civili della Corte di Cassazione called upon to deal with the merits of liability by the Ministry of Industry within the framework of the Sgarlata scandal. This principle was applied for the first time by a Penal Tribunal, by a decision of the Tribunal of Rome which said the principle could be validly introduced as applicable to penal proceedings. If the principle of liability by supervisory organs would be further applied by judicial authorities, investors would be able to get damages from the same authority from case to case called upon to act as a control body. In addition to the

Ministry of Industry, the CONSOB itself and the Bank of Italy (for credit institutions) may act as such organs responsible to let prevail in their supervision, due and sufficient vigilance, otherwise they may have to indemnify for damages.¹⁵⁷

2. Principles, Objectives, Conduct Rules

The most innovative contents of the Law No. 1/1991 concern the principles, objectives and conduct rules relating to the activities of the intermediaries.¹⁵⁸ The Law, beside specifying some principles, enunciates also objectives, with reference to which the relevant rules on conduct would be applied (Art. 9, para. 2). Investor protection is not a matter limited to reference to single acts or contracts. It concerns the complex activities of intermediation.

Law No. 1/1991 sets on the one hand the most relevant general standards and rules of conduct for transactions, and circumscribes the way the competent authorities are entrusted with the adoption of rules of more specific contents.¹⁵⁹ In spite of the lack of clarity in the statutory texts, particularly in Arts. 6 and 9, the Italian system seems to concern three levels:

- a. The level of principles (Art. 6) ;
- b. The level of objectives (Art. 9 para. 2);
- c. The level of rules of conduct.

A first distinction between them concerns their sources: the principles and objectives are laid down by the legislator, while rules of conduct are adopted through regulatory decisions of the CONSOB. In agreement with the Bank of Italy it determines the rules of conduct and publishes them in the Official Journal for observance by firms of financial intermediation in their activities for which they have the necessary authorisation. The relevant rules shall be compatible with the principles laid down in Art. 6 and shall be inspired by the

objectives included in Art. 9 para. 2. Thus two of the above mentioned three levels of the system are marked by a rigidity and immutability which only the legislator may modify. The third level is characterised with flexibility, because the CONSOB may amend the rules of conduct in accordance with the exigencies of the situation. Therewith the CONSOB is empowered to react promptly to the demands of the market and the needs of the operators. It should be noted that the regulatory functions of the CONSOB shall always be in agreement with the principles and objectives laid down in Arts. 6 and 9, respectively,¹⁶⁰ and that principles and objectives imply reference to secondary regulation by the CONSOB and the Bank of Italy,¹⁶¹ whereby secondary regulation by the CONSOB shall be "in conformity with" the principles and be "inspired" by the objectives. In this respect there should not exist divergences and discordances between all three levels.¹⁶² "Inspired" in turn means motivated to find a model of proceeding for promoting their translation into reality.¹⁶³ Hence, the CONSOB enjoys freedom and discretion for achieving the objectives anchored in law, by measures it deems suitable, but it enjoys no freedom and discretion in the application of the principles.

Concerning the relationship between Arts. 6 and 9 and questions it may generate, a noted theoretical approach¹⁶⁴ has pointed out that a narrow interdependence prevails between the two Articles, and that they should be treated conjunctively, as the sum of general criteria to which both intermediaries and also the control body should attend. No hierarchical relationship can be established between the contents of Art. 6 and those of Art. 9 para. 2, as any attempt to reduce them to a scheme would risk to generate incongruencies. The same author raises,¹⁶⁵ in addition, the question whether the level of

principles should also include the complex accounting, administrative and organisational standards in the diverse activities of the intermediaries, because, according to him, the standards or rules in question do not represent an autonomous principle but a tool for promoting respect and monitoring such respect for rules governing the conduct of intermediaries. Minervini observes that there is no good coordination between directly generated rules and objectives considered as underlying the regulatory activity of the CONSOB.¹⁶⁶

Principles

d.1 Principle 1 involving Diligence, Correctness and Professional Skill

The first principle postulated in Art. 6 refers to diligence, correctness and professional skill (professionalism) while Art. 3(2) specifies that authorised intermediaries shall possess knowledge of the transferable securities included in their services, in a manner adequate to the type of service they are expected to supply. Thus, diligence or diligent conduct shall be assessed on the basis, as to correctness, with reference to a parameter commensurate to the type of the activity. An intermediary firm (SIM) is held to act with due diligence, correctness and professional quality when dealing with the interests of its clients. It is useful to emphasise that a rule of conduct should also include the duty of an intermediary to observe general principles relating to contractual matters with reference to the applicability of Art. 1176 of the Italian Civil Code.¹⁶⁷

Diligence expresses maximally an operative value in the non-execution or the inexact execution of investment duties in relation to an investor, while correctness is operative at a different level involving ulterior duties as provided for in a contract and with reference to specified limits in the exercise of competences by the

entrusted intermediary. The principle of correctness prevails undoubtedly in the first place with reference to information for the client; to conduct one's self in this respect correctly means, in the first place, to give knowledge to the client on the nature and risks of an operation, their implications, including knowledge on an action or circumstance which a client may need to know in order to make well informed choices of investment or disinvestment. (Art. 6(e)) It should be, however, added that correctness does not exist solely for supplying information. In the complex activities of intermediaries there exists also a parameter relating to stabilised concrete conduct expected from an intermediary in the course of developing the relationship, not least implying a quasi-contractual relationship of continuous service, such as that dealing with fund management (Art 8). As such correctness includes also a rule which governs the use of discretion which an intermediary lets prevail in his activities related to stocks.¹⁶⁵

Professional Skill / Professionalism

Professionalism or professional skill is included in a corresponding canon of professional diligence, as provided for in Art. 1176 para. 2 of the Italian Civil code, which defines as something which should be commensurate with the specific nature of the exercised activity.¹⁶⁷

Correctness

Rules of conduct inspired from the principle of correctness intend to guarantee the flow of information while diligence guarantees the fulfillment of a contract in accordance with the criteria of professionalism of an intermediary. Correctness actualises itself not only in the form of some typical obligations, such as that of publishing and transmitting to clients an informative document of the particularities and description of the

proposed operation (Art. 6(b) of the Law 1/1991), or drafting a written contract (Art 6(c)), but equally in the form of regulating the criteria affecting conduct related to specific aspects of the continued relationship between an intermediary and a client (see Art. 9(of the Law 1/1991)).

The principle of correctness includes a penal standard for door to door sales. Regulation No. 5378/1991 obliges the offerer to indicate with precision the deadline for the five days during which the client may decide to withdraw from accepting the offer (Art. 33).

d.2 Principle 2 relating to the Informative Document

For its contents see 3.ii.c above (pp 260 - 269) on information and transparency, the informative prospectus, in the light of the responsibilities of the CONSOB.

d.3 Principle 3, relating to the written Contract

The principles of correctness and good faith include also the obligation to adopt a written contract indicating the nature of the services offered, including the mode of executing the services in question as well as the unit of currency and the calculation basis for the remuneration, and other particular conditions agreed with the client. Art. 6(1)(c) provides that the contract stipulated between an intermediary and his client shall be in writing and shall contain all clauses which are currently included as relevant in any contract of investment in securities. The scope and purpose of the written contract have been ulteriorly defined in Arts. 9 and 33 of the CONSOB Regulation No. 5387/1991.

The principle of correctness imposes on the intermediary the adoption of a contract in written form. This form is not used so much in the interest of the contractual relationship as in the particular interest of the weaker contracting partner. The written form is also considered to be the best vehicle of information conveyed

to the weaker partner. The existing law does not foresee any consequences if the requirement of the written form is not observed. It may be deduced that, according to Di Majo,¹⁷⁰ if Art. 9 of the Law No. 1/1991 provides that intermediaries shall be able to supply services related to securities to a client only on the basis of a written contract, the absence of a written contract implies that the alleged contract is null and void through failure of its approval by one of the parties. Maisano too¹⁷¹ notes that in conformity with what is enshrined in Art. 1350(13) of the Italian Civil Code, the form is necessary for validating the substantive contents of the agreement. Annunziata is equally of the view that the formal requirements for contracts, imposed by Arts. 6 and 8 of the Law 1/1991 constitute an element the absence of which entails the nullity of a contract.¹⁷²

d.4 Principle 4, concerning relevant information

The novelty of Art. 6 is based on the contents of its sections under the letters d, e, f and h. They are intended to create a relationship between an intermediary and a client strongly based in trust. The intermediary should not limit himself, under Art 6(d), to receiving the stocks or the money of a client and then use them for an operation: he shall acquire, as a preventative measure, the relevant information of the financial situation of the client for the purpose of his activities as an intermediary. The rule seems to be based on a personalised approach: a firm acting as an intermediary shall make the investment and disinvestment choices with due regard to the specific exigencies of each single client or of his financial situation.

d.5 Principle 5, governing information on Risks

With due regard to the personal nature of a contractual link with a client, the intermediary is expected to inform a client not in abstract terms in

general, but with specific reference to the proposed and intended operation, such as investing in state bonds or in stocks involving risks, so that the client may be in a position to become aware of the opportunities and risks inherent to the specifically proposed operation.

d.6 Principle 6, affecting excessive risks

In the light of the notion of excessive operations does the content of Art. 6(1)(f) assume a significance: an intermediary shall not intend and effect operations of excessive proportions compared with the specific financial situation of a client. The written contract should, in the meaning of Art. 6(1)(e), yield reliable information as to what operations the client intended to have effected in relation to his effective financial possibilities.

The content of the text under Art. 6(f) has benefited from the British experience in suitability and churning.¹⁷³ According to Annunziata the rule tends to have priority over churning and suitability, even if it seems to put the accent more on the first than the second rule of conduct. The CONSOB, by Decision No. 5387/1991 has explicitly laid down (Art. 11) the applicability of the second rule of conduct. By virtue of an express and binding formulation the solution adopted by the Italian system seems to be more to the point than that found in the French system in relation to the progressive emergence of the obligation de conseil. Once more the Italian system looks to be more similar to the British system. Annunziata considers the British influence on the Italian system very relevant.¹⁷⁴ In the core rules the range of the suitability rule is a priori limited to discretionary operations and consultancy activities. Respect for a client's instructions (Art. 9 para 2(d)) cedes priority to the duty to let correctness prevail and to collaborate.¹⁷⁵ The suitability rule points to

responding to exigencies other than those which have inspired the contents of Art. 1711 para. 2 of the Italian Civil Code.¹⁷⁶ If Art. 11 of the CONSOB Decision No. 5387/1991 seems to be suitable for dealing with operations based on client's instructions, Art. 8 can be applied with reference to discretionary operations, and it represents as such the natural ground for the rule on churning. The regulatory rule can be used with precision to the delimitation of the relevant fact. In substance, Art. 8 lends itself to dealing with churning or with suitability while Art. 11 appears to be more suitable to deal with suitability.¹⁷⁷

d.7 Principle 7 concerning Conflicts of Interest

Some specific rules anchored in law are directed towards the prevention of situations involving conflicts of interest, while some other general rules are intended to guarantee a correct conduct on the part of an intermediary firm. Art. 6(g) deals with such a rule of general nature.

An investor normally finds himself exposed to suggestions by the intermediary because of the high technicality of the matters concerned and the involvement of risk in them. He is the weaker partner in the contractual relationship in which his interest on the receiving side of intermediations may not be completely satisfied by the prevalence of the interests of the counterpart. The option of law for the polyfunctionality of intermediaries increases the possibility of situations involving conflicts of interest, indicating the adoption of suitable caution interfering with private autonomy. The thereto related solution anchored in Law 1/1991 provides for the disclosure of the conflictual situation, to which is added the need to secure the specific consent of the client. The logic underlying it corresponds also to what is foreseen under Arts. 1394 and 1395 of the

Italian Civil Code.¹⁷⁸ A conflict of interest needs an absolute duty to secure information and transparency. Art. 6 para. 1(d) and (e) put an intermediary firm under an obligation to procure, as a preventive measure, all the information available on the financial situation of the client and to secure that the client in turn is always adequately informed in the course of the financial operation.

As to clients' groups, Art. 6(1)(b) applies a larger notion to what a group is, subjecting intermediaries to a duty to inform the relevant clients on the structure of the group to which they belong. Art. 8(1)(L) bars intermediaries from invoking the right to vote inherent to managed securities, except when specific authorisation for it is granted from case to case for each investors' meeting or in writing.

CONSOB Regulation No. 5387 of July 2, 1991, refers to conflicts of interest and imposes a duty on authorised intermediaries to identify potential conflicts of interest (Art. 4(1)). It also provides for a prohibition to execute operations with or on behalf of accounts of own clients if such operations are directly or indirectly related to group interests or to intermediaries' own interests, unless previously written notice has been given to the client(s) on the nature and extent of the operation and the client(s) has (have) consented expressly in writing that the operation in question may be effected (Art. 4(2)). Lastly, already printed forms may partly be of help to confirm, as graphic evidence, that the proposed operation involves conflicts of interest (Art. 4(3)). Art. 9 para 2(b) of the Law No. 1/1991, concerning the delimitation of the regulatory powers of the CONSOB provides that the system of separation of interests should help impede the exchange of information and management responsibilities between

those engaged in diverse activities. Art. 9 para. 5(c) of the same Law entrusts the Bank of Italy with the task of determining the accounting and organisational criteria to assure the separation of various activities and connex management responsibilities. In conclusion it can be said that, as in the British and French systems, the entirety of rules on professional conduct contribute to regulation and resolve conflicts of interest.¹⁷⁷ The Italian system seems to be much more closer to the British than to the French system. The Italian system reflects of the British system the more general approach and, in particular, attention to disclosure as well as to the superability of the prohibition to operate with an authorisation secured from the client.¹⁷⁸ Disclosure prescribed by the rule on the conflicts of interest is evidently preventive in nature, binding the intermediary to abstain from operating if the nature and extent of the conflict to the client and the latter has not explicitly consented to the execution of the given operation.

The French system does not include rules analogous to those on conflicts of interest. In France the challenge of conflicts of interest has been resolved by a marked strengthening in the scope and application of clauses and rules of general nature.¹⁷⁹ The major affinity between the British and Italian systems consists in the fulfillment of a function of so to speak Chinese walls at a first level. Beyond it the Italian system has, however, a more accumulated level of analytic contents than the British approach.¹⁸⁰ In the Italian system there is a reflection of a greater inquisitiveness as to the relationship between the means and ways of dealing with conflicts of interest, on the one hand, and rules thereon on the other; the information to be supplied to the clients, on duties to cooperate by virtue of the common law or by virtue of other legal rules enshrined in Law

No. 1/1991, and on implementation rules. The herewith implied problem is the object of special consideration in the British model in which the relationship between rules particular to professional conduct and rules of common law is treated as an important point.¹⁸³

d.8 Principle 8, related to internal Organisation

The Italian system contains no precise rules on personal operations executed by assisting personnel. CONSOB Decision No. 5387/91 limits itself in Art. 18 to provide for a duty of intermediaries to establish "conditions and procedural modalities". This is significant in that it may represent an opportunity for trying to experiment with techniques of auto-regulation and auto-supervision. This may involve a solution similar to the one adopted by the French system.¹⁸⁴

The listing of principles included in Art. 6 of the Law No. 1/1991 cannot be treated as exhaustive, because diligence, correctness and professional skill have to do with "general clauses"

e. Regulations of the CONSOB

The secondary normative function (competence) of the CONSOB at the third or inferior level (See above p. 269), concerning rules on professional conduct, has been exercised essentially through (i) Regulation No. 5387 of July 2, 1991; it regulates the activities of stock market intermediaries; (ii) Regulation No. 5386 of December 1994, adopted by virtue of Arts. 2 and 9 of the Law no. 1/1991 on rules of conduct for financial intermediaries that came into effect on January 1st, 1995 (See II Sole 24 Ore of December 13, 1994, p. 30). As mentioned earlier (above), the secondary normative authority of the CONSOB is circumscribed by the framework of principles to comply with, and objectives to be inspired from. Regulation No. 5387/91 (replaced by Regulation No. 8850 of December 9, 1994) points to such rules of professional conduct which may as criteria assist to

establish and distinguish what is professionally correct from what is not as a standard from which intermediaries have to abstain "as any conduct which may extend an advantage to a client at the expense of another" /our translation/ (Art. 3(1)(b). As to professional skill or professionalism, Art. 3(2) of the Regulation states that an intermediary should be in possession of knowledge of transferable stocks object of the services and also knowledge of the economic and financial situation of the issuers, and that such knowledge shall be "adequate to the type of service to be rendered". The same statement has been repeated by Art. 3(d) of the Regulation no. 8850 /1994. The new Regulation seems to be a detailed repetition of the dispositions of the Law no. 1/1991. An exception is Art. 11 that confirms the differences between institutional and private investors already made by Art. 13 of Regulation no. 5387/1991. Accordingly, most of the articles of the new Regulation are not applicable to institutional investors. Art. 23 authorizes the intermediary to communicate by telephone to the clients the refusal to execute an order. A synthetic core of information is required by Art. 25.

e.1 Duties relative to Cooperation by the Intermediary

They are contained in Art. 6(d) and (f) of Law 1/91. The "know your customer rule", by the way found also in the French system, laid down in Art. 6 of Law 1/91 shows once more a strong affinity of rules in the Italian system with rules of professional conduct laid down in the British system.¹⁸⁵ The way the rule in the Italian system is drafted betrays a generic approach.¹⁸⁶ The more creative provisions of the Regulation are undoubtedly found in the texts of Arts. 5 and 13.¹⁸⁷ The provisions in question, not found in Law No. 1/1991, are considered to be the product of creative work by the CONSOB.

Art. 5 of Regulation No. 5387/91 made the determination of remuneration in favour of intermediaries conditioned by criteria of "congruity and reasonableness" and has ruled out any form of return to payments of commissions. In this way the CONSOB has effected a substitution of defined rates with a liberal system which takes into consideration expenses, taxes, standardised fees of the firm as publicised and not higher than fees when publication is requested. As has been underlined,¹⁵⁰ no upper limits for claims for remuneration from clients have been set, but rather a control on information supplied to clients in due legal form has been introduced. The choice of substituting a liberal system of remuneration to a schedule of fixed fees has to do with the globalisation of the markets, involving high levels of investment and professional skills, high standards of efficiency among the operators, resulting in minor margins of profits per single transaction.

In difference to the British system, the Law No. 1/1991 does not contain a provision consenting to adjust the rules of professional conduct to the characteristics of the clients with regard to their preparation background, experience and other relevant factors. Art. 11 of the CONSOB Regulation no. 8850/1994 provides instead the non-applicability, unless various contractual arrangements exist, of some of the rules of the Regulations with respect to "qualified" clients. The CONSOB has in substance deprived whole categories of persons from the protection given by the rules on professional conduct, in the absence of an explicit intention on the part of the legislator. The logic underlying and justifying this situation seems to be essentially that there is no need to extend the application scope of rules beyond their range of utility and necessity. The rationale of Arts. 13 and 11 is a very

clear one: they deal with a distinction of professional operators from non-professional investors, whereby the protective system provided by the law applies only to the latter. The specific professionalism of some of investors defined as "institutional" or "professional" renders superfluous the application of the standards in question, and through Arts. 13 and 11 the CONSOB has laid down a clear distinction between "qualified" and "non-qualified" investors, a distinction not found in Law No. 1/1991. In adopting the contents of Arts. 13 of the two Regulations, the CONSOB has been clearly inspired by the British and EC experience. The ISD has definitively consecrated the distinction between professional and not professional investors.

f. System of Control

Regarding the system of control, the Law No. 1/91 has adopted a mixed system: legislative and administrative, whereby the administrative components have assumed an enormous significance. Therewith, for the first time in Italy basic administrative considerations have prevailed over basic judicial ones. This does not mean that judicial control has been wholly excluded.¹⁰⁷

Opting for administrative control is a product of a statutory regulation crisis generated by the unsuitability of a specific statutory regulation concerning a complex and changing reality of legal relationships. Preference of administrative control is essentially conditioned by the possibility of administrative authorities to intervene generally and preventively in a manner clearly preferable to traditional judicial intervention in individual cases without leading to good general results. As has been remarked in general, control systems can be distinguished in terms of three main types: (i) legislative, (ii) judicial and (iii) administrative. Obviously, with

reference to legality and legitimacy sanctioned by Arts. 97 and 101 of the Italian constitution, primary input at the legislative level is necessary, but such input may take the form of extremely detailed and rigid specific precepts with no margin of appreciation, in individual cases, to assess the validity of contractual clauses laid down by law or of general statutory rules for control without indicating the purpose, the criteria and the procedural dimensions of the intended control, nor equip administrative or judicial authorities with any adequate margin of autonomy of assessment and eventually the burden of control is still left to be carried by administrative or judicial organs. It is generally accepted that detailed statutory regulation may be precise and clear as a text, but it may introduce into the system elements of rigid contrasting and unable to keep pace with rapid evolution and rapid and variegated changes in legal relationships in modern society. The questions, problems and challenges which the latter generate cannot be relatively quickly overcome by amending the less fortunate parts of the existing law. In such situations it is expected that judicial intervention may be helpful.

In Italy there is a notable resistance to the approach that legislative texts (of positive law) should contain general clauses providing for a type of "dynamic equilibrium" and leaving their adaptation to the needs of evolving social relationships without continuous resort to legislative adjustments which may not prove to be the right approach at the right time. It is, however, right to argue that while general legislative clauses respond to the needs of flexibility, they may at the same time conjure up the risk of generating judicial decisions which may inter se be inconsistent and unhomogeneous. Administrative controls may vary too. Italy seems to be

currently moving towards a logic of intervention of the "regulatory" type, but the existing challenge in the discussions is distorted by the backwardness of judicial remedies in diametrical contrast to administrative remedies. The distortion is a product of the fact that not only supporters of the pro-administrative remedies camp but also supporters of the judicial remedies camp have failed and are failing to consider the possibilities of strengthening traditional individual and other judicial remedies which no longer seem to be satisfactory, with collective and preventive judicial remedies which would prove to be very effective. In any case, techniques of autonomous administrative control at private, administrative or mixed levels will continue to presuppose a predetermined legislative foundation not only for providing for legality, but also for outlining the scope of the autonomy of the competent authorities.

Currently, even though legislation has opted for a mixed control with administrative dimensions, there is still a margin for judicial control.¹⁷⁰

g. A Statute for the Rights of Investors

Some authors¹⁷¹ have proposed drafting a statute for the rights of investors to enable them to make knowledgeable choices among diverse forms of investment in stocks, with due consideration of the comprehensive diversification of offers on the market and of risks connected with portfolio choices. It is argued that such a statute has political legitimacy already found in the Italian constitution. Art. 41 should also be valid for firms operating within the financial economy. Not to be eventually neglected are the fundamental contents of Art. 47 of the Constitution, which qualifies savings (and investments) as social assets and also as macroeconomic concepts not only in relation to the interests of the individual citizens but also to the collective interests

of an investing family. These interests require and merit protection guaranties which in Italy are as yet far from having the scale and contents which are enshrined in Italian constitutional teleology.¹⁹²

h. Results: critical Remarks

h.1 Results

While in 1993 the Italian stock exchange index had been marked by an increase of 37 per cent compared with the situation of 1992,¹⁹³ the CONSOB as a monitoring and inspection authority had initiated 57 investigations and 47 audits. In five cases related to SIMs, it had made corresponding reports to the judicial authorities. In six cases the activities of SIMs were suspended or authorisations withdrawn. In four cases the CONSOB recommended to the Ministry of Finance to apply administrative measures provided for under Arts. 11(12) and 13(3) of the Law No. 1 of 1991.¹⁹⁴ On March 31, 1993, it laid down the definition of what constitutes a "censurable fact" (fatto censurabile) with reference to the activities of auditing companies.¹⁹⁵ The penal authorities received, from the CONSOB, reports on 127 cases.¹⁹⁶ From the public the CONSOB received 600 individual petitions, of which about ten per cent were anonymous.¹⁹⁷ Concerning the Ferruzzi affair, it submitted to the competent Procurators of the Republic criminally relevant complaints and declined to give its approval to the auditing report prepared by Price Waterhouse. It also approved the Montedison decision for revoking an assignment to Price Waterhouse: it declined to approve a Ferruzzi Finanziaria decision which would have confirmed the assignment of auditing to Price Waterhouse. On September 14, 1993, the TAR rejected an application for revoking the annulment of the requested assignment of auditing to Price Waterhouse, thus confirming once more the decision to withdraw the

assignment.¹⁹⁸ In spite of its monitoring and supervisory activities the CONSOB is of the opinion that its competences to act and intervene are of little incisive impact because it lacks power to ask directly civil judicial authorities to act.¹⁹⁹

h.2 Critical Remarks

The Law No. 1/1991, awaited with many expectations, has generated doubts and perplexity. Art. 6 enables rules to coexist side by side; general standards of conduct affecting diligence, correctness and professionalism are followed by rules of specific duties, such as that of publishing an informative document or of using a written contract. Then comes a reference to a more general duty to inform (Art. 6(e)). Art 8 governing the management of assets provides for dealing with specific tasks, such as depositing transferable assets in accounts designated as managed on behalf of third parties (Art. 8(f)), or prohibiting a firm from entering into obligations on behalf of a client beyond the limit of managed assets (Art. 8g)). Art. 9 in turn enunciates objectives which are to inspire the establishment of rules of conduct. These rules shall in turn have the task to specify, subsequently, the purpose and modality for the fulfillment of the intended duties. Minervini²⁰⁰ has made the observation that proper coordination has not been achieved between rules laid down directly, on the one hand, and objectives preestablished as linked to the regulatory activities of the CONSOB on the other. The intended system evidently aims at avoiding that the rules of correct conduct and diligence are applied by judges, with due regard to the margin of unpredictability and uncertainty always associated with judicial decisions.²⁰¹ It should also be noted that the Law no. 1/1991 sanctions the absolute domination which banking intermediaries can deploy: there is good reason for "a definitive feeling

that the newly created system is strongly bankocentric.²⁰² Furthermore the legislator has not defined the specific contents of CONSOB's inspection powers, as the law restrictively attributes to the CONSOB a competence "to effect inspections". Therefore, the general rules governing administrative procedures shall apply, that is, without endowing the CONSOB with special competences or powers.²⁰³ It has additionally been observed that no attention has been given to self-regulation of the professions, be they with respect to standards of conduct or with respect to professional organisation and discipline on the markets.²⁰⁴

It may in conclusion be asked, as Maisano does,²⁰⁵ whether investors' protection has been considered to be excessive as to scope and rigour. It can be fundamentally stated that the preliminary phase of (investor protection) cannot be said to be excessive; the regime of intermediation on the stock markets does not provide for the publication of contractual provisions, a matter which in turn is prescribed by standards governing the transparency of banking transactions. Art. 6.1(d) of the Law No. 1/1991 and Art. 6 of the CONSOB Regulation No. 5387/91 limit themselves to establishing that the intermediaries shall request a client to supply information on his financial situation and on his investment plans. This information is to be attached as an appropriate descriptive document to the contract, unless the client declines to supply the requested information. In this case an appropriate written statement, signed by the client, is to be appended to the contract. All this does not amount to much in terms of investor protection.

The requirement that a contract should be in written form also cannot be considered to be excessive and inappropriate. The prerequisite of minimum contents of a

contract is of fundamental importance for securing transparency. Independently from this important point, the intermediaries have at their disposal an ample margin of autonomy. For example, the contract shall indicate the mode of rescinding it, but the determination of the mode is left to the parties and therewith ultimately to the intermediaries ; CONSOB Regulation No. 5378/91 and Regulation no. 8850/1994 (art 7(c)) (G.U. no. 295 December 1994) lay down clearly that a contract shall also indicate the manner in which it may eventually be modified, but again this is a point exposed to determination by the intermediaries ; the generic provision of rules affecting contractual amendments can prove to be extremely insidious, because it may involve an implicit recognition that a unilateral amendment may be admissible; as to fees for the intermediaries, the new rules do not prescribe transparency, but only their determination within maximum limits laid down by the CONSOB, wherewith an ample margin for initiative by the intermediaries may exist.

Concerning conflicts of interest, again as a non-excessive standard, the Law No. 1/1991 has sanctioned the rule that information between persons involved in diverse activities shall not be communicated. This represents a standard of elementary but insufficient precaution for impeding most serious abuses.²⁰⁴ The new Regulation No. 8850/1994 (art 4) (G.U. no. 295 December 1994) has confirmed that the prohibition of operating in conflict of interest can be overcome by a written authorisation of the client.

On June 7, 1994, the CONSOB celebrated 20 years of its existence. Even if the Italian economy is founded rather on the existence of small and medium sized enterprises, the influence of the public sector and public intervention continues to be strong compared with

the influence of private initiative.²⁰⁷ The modest dimension of the institutional investors is a most relevant factor which completes the picture as to the backwardness of the Italian financial markets.²⁰⁸ As in France for the COB, the main problem in Italy is that of delineating the correct or proper insertion of the CONSOB within the ambit of the (financial) constitutional scene of the Italian state. The legitimacy and the constitutional significance of the CONSOB, alongside other authorities, is currently a question which cannot be easily evaded.²⁰⁹ This concerns legal entities which make politics to the extent they govern markets, determine their existence and their functioning. They have their respective competences which may exist to the extent they govern markets, determine their existence and their functioning. They have their respective competences which may exist separately from state competences, that is, independently from the state and on a scale which is larger than that of the state at the level of the EC legal order.²¹⁰ It has been rightly noted that the legitimation of CONSOB's powers is derived from EC legal sources: the CONSOB is considered to be an institution operating at an EC level, and as such it may directly invoke EC Directives as sources of the law it shall apply (on the basis of Art. 4(d), law of January 27, 1992, No. 89). Therewith the CONSOB may be defined also as an institution resting on EC foundations. As has been rightly said, the coordinated vigilance of the CONSOB in Italy and of the corresponding bodies in the other EC member states constitutes the first stage of a process of constitutional development towards an administrative system of supranational dimensions. Hence, corresponding thereto, the CONSOB is an institution which has a key role to play in the EC wide process of integration of financial markets.²¹¹

4. Investor Protection in the United Kingdom

a. "Private" and "institutional" Investors

The first question considered in Gower's Green Paper was why it is necessary to protect investors. Referring to the saying that if they burn their fingers, that is their fault, Gower underlined that "this robust affirmation of laissez-faire principles has long since been rejected and it has been recognised that it is the investors' own fault only /emphasis added/ if they were in a position to judge the extent of the risk."²¹²

Since 1938 the Prevention of Fraud (Investment) Act has prohibited dealing in securities except by persons who have obtained a licence from the DTI. A member of a recognised stock exchange or recognised association of dealers in securities was not required to obtain a licence. The prevention of Fraud (Investment) Act has been essentially by its name and terms an anti-fraud statute, as emphasised by Section 13 of the Act. It has made it a crime for any person to induce another to enter into an investment transaction by misleading, false or deceptive statement, promise or forecast or by any dishonest concealment of a material fact. Although the wording reflects an apparently wide provision, it has been rarely used and has to some extent been emasculated by restrictive interpretation.²¹³ The new rules introduced later in the Act lacked too any real sanction other than an unlikely disciplinary jurisdiction vested unenthusiastically in the DTI.²¹⁴

The new system anchored in the FSA 1986 had to strengthen and render effective investor protection which the Prevention of Fraud (Investment) Act had not succeeded to guarantee. Under the FSA, with standards of investor protection, SROs are required, as an example, to have rules and other provisions affording "an adequate level" of protection for investors. Moreover, again as an

example, standards of regulation in general terms require SROs to have "adequate arrangements and resources for the effective monitoring and enforcement of compliance with its rules". As Large has observed,²¹⁵ these requirements do not help a recognised body to know, with any precision, what it is expected to achieve, because

i) Their vagueness makes a measurement of performance difficult;

ii) They do not provide an adequate basis for holding the regulator to account for performance; and accordingly,

iii) they do not provide an adequate basis for supervision by the SIB. As such they do not provide an adequate basis for the SIB to hold a recognised body accountable for its performance.

It has been ironically observed that "The deregulatory impetus on both sides of the Atlantic together with the 'New Right' philosophy of 'popular capitalism', leading to the development of the equity-owning democracy' changed the 'paternalistic' tradition utterly /... / At the same time, former protectionist concepts enforced by statutory authority and punishable with imprisonment would be replaced by self-regulatory bodies who would oversee rules intended to ensure compliance with such nebulous concepts as 'best practice' and the voluntary avoidance of conflicts of interest, all the while being financed by the very practitioners they regulated. As a recipe for incomprehension and inactivity, it had few equals, and so it quickly proved."²¹⁶ Investor protection cannot be left to an unprecise concept. "It cannot be directed at totally eliminating market risk." It is concerned, however, with ensuring that risk is identified and managed and appropriately disclosed for providing a clear market for risk investment."²¹⁷ In other words, the main problem of

investor protection consists in reasonable balance between the extent of protection to be afforded to the customer. Complete protection is impossible to achieve, too burdensome, and unfair to finance and probably counter-productive. Overprotection may permit bad practice while over-regulation may inhibit innovation and product development. As to the extent of the duty of care owed by business through its advisors and salesmen, clearly honesty, probity, integrity and fair dealing are essential, equally that degree of competence which is necessary to avoid gross or persistent negligence; but there is a limit to the degree of competence that may be realistically achieved through regulation.²¹⁸

With the Big Bang in 1986, the strategy of investor protection has been radically changed. It is now based on an increasingly marked distinction between "institutional" (or "professional" or "business") investors, on the one hand, and "private" investors on the other. There has been increasing recognition for such a distinction since the early days of the FSA, comparable with similar developments in France and Italy as examples. The distinction is based on the consideration that the informed professional, regularly active in the market, is less in need of protection than the private individual. The professional investor too needs a regulatory framework governing the conduct of business, but this will be different, and in many respects lighter in touch, than a regulatory framework appropriate to the private investor.²¹⁹

These differences have been recognised in the formulation of the Core Rules, with the result that specific rules, such as those dealing with suitability and best advice, do not apply to business transacted between professional investors. The same rationale lies behind the 1989 amendment by the UK Parliament to the FSA

to limit the right of action under Section 62 to private investors.

"Private investor", as a person not carrying on investment business, is within the meaning of the Financial Services (Conduct of Business Rules 1987), not a professional investor. The term "private investor" is defined by the FSA Regulations 1991(S1 n. 400) in the following terms:

"For the purposes of s.62(1) of the Act, the expression "private investor" means an investor whose course of action arises as a result of anything he has done or suffered

(i) in the case of an individual, otherwise in the course of carrying out an investment business,

(ii) in the case of any other person, otherwise than in the course of carrying on business of any kind, but does not exclude a government, local authority or public authority"

Thus, employees of investment businesses, as they do not themselves carry on investment business, would be "private investors". Furthermore, a human person is a private investor whether he/she carries on other types of business or not. Even a human person who does not carry on investment business will be a private investor if he/she acts outside the course of that investment business. As an example, an investment advisor who does not carry on the business of actually dealing in investment would be a private customer insofar as he/she did occasionally deal in investments; or a permitted person²²⁰ who does not carry on the investment business of investment management would be a private customer insofar as he/she occasionally managed management investment for, let us assume, a family trust. The term "private investor" covers any other kind of person "acting otherwise than in the course of carrying on

business of any kind". Thus, legal persons such as corporations are only "private investors" insofar as they act outside the course of any business.

b. "Private Investor" and "Private Customer"

The two terms should be compared. The Core Rules divide the customers into two classes : (a) private and (b) non-private customers, with half of the Rules applying to private customers only. The definition of a private customer is given in the FSA Glossary 1991. Not every person for whom investment business is done will be a customer. A glossary excludes a market counterparty as well as a beneficiary under a trust. Market counterparty is itself so defined that, as an instance, one broker or broker-dealer with another will be regarded as a market counterparty of the other unless one or the other of them (or both) is (are) dealing as an agent to an identified principal.²²¹ A government local or public authority can never be a "private customer" or a "private investor".

The term "private customer" includes any individual who is not acting in the course of carrying on investment business. So all natural persons investing for themselves (or for their families or otherwise) but not by way of business are covered. For individuals the only exception is where an individual himself is acting in the course of carrying on investment business. Thus, as an example, a solicitor in sole practice with a certificate from the relevant Law Society would be excluded as regards actions in the course of carrying on investment business. A private customer also includes the so to speak "small business investors".²²² These are companies or partnerships or trustees who are not excluded by a definition of "ordinary business investor". If by virtue of size a company or partnership etc. is an ordinary business investor, then it will be a non-private

customer, if it is a customer at all.

Moreover Core Rule 39 enables the precise border between private customer and non-private customer to be adjusted slightly by one or more of the SROs where the customer is sufficiently experienced to waive private customer protection and gives his informed consent.²²³ A comparison between the SIB conduct of business rules and the Core Rules indicates the extent to which protection previously more widely conferred has now been restricted at core rule level to private customers.²²⁴ Sir Clucas explains²²⁵ that the term "private investor" is the same as defined by the Core Rules which includes within it small business investors. In the PIA's Approach to Regulation²²⁶ the private customer is defined as:

- a) a customer who is an individual and who is not acting in the course of carrying on investment business; or
- b) unless he is reasonably believed to be an ordinary business investor, a customer who is a small business investor.

The ISD Directive has introduced the figure of "indirect customer": where a firm is executing an order it is the nature of the investor from whom the order originates (whether private, professional etc) that must be considered in determining how conduct of business rules should be applied, not the intermediary with whom the firm may be dealing directly.²²⁷

c. The Personal Investment Authority (PIA)

The formation of the PIA aimed at completing the process of distinction and separation between "institutional" and "private" investors. This may be interpreted as a "segregation" of private investors. Be that as it may, private investors have in the last decade contributed to personal investment business as a matter of significant national importance. However, with it has grown the possibility of risk(s), with respect to which

the PIA as a new SRO is expected to bring together the regulation of investment business activities carried on for private customers.²²⁸ For this purpose the scope of functions of the PIA comprises the sale of life insurance, pensions and unit trusts to the private investor.²²⁹ Sir Clucas has made clear that the term "private investor" is employed in the sense of "private customer" as defined by the Core Rules, and includes small business investors while the term "professional investor" covers that class of customer commonly referred to as the "institutional investor".²³⁰ Sir Clucas uses the term "customer" to indicate the responsibility of the governing body "to safeguard the interests of consumers".²³¹

In October 1991, concerning the retail sector, the SIB had invited Sir Kenneth Clucas to examine whether it would be feasible and appropriate to set up a new SRO for the retail sector. The study of the scope, structure and organisation of a new retail SRO, focusing in particular on the regulation of the marketing and selling of pooled investment products, were to have regard to :

(i) the continued delivery of high standards of investor protection ;

(ii) the continued availability to consumers of a wide choice of financial advice ;

(iii) the importance of self-regulation, that is, of those who are regulated, for having sufficient responsibility for and commitment to the development and implementation of regulation ;

(iv) the importance of cost-effective regulation.²³²

The Clucas Report on Retail Regulation Review, published by SIB in March 1992, proposed to divide the SROs into two categories and reduce their number from existing four to the following three ;

(i) A new SRO, called PIA, for the "private

investor" ;

(ii) IMRO for fund management ; and

(iii) SFA for exchange related activities.

The last two were conceived as SROs for the "institutional" investors, with a division between them on the basis of functions. Consequently, LAUTRO and FIMBRA would cease to exist. IMRO would lose between 20 and 30 per cent of its members to the new SRO, while SFA would lose a few members to the new SRO and gain some from FIMBRA.²³³ The new SROs would ensure a proper balance between the interests of the organisation or its members, on the one side, and the interest of the public on the other.

According to the Clucas Report, in the interest of self-regulation, the proportion of seats filled by practitioner members should not fall below two-thirds; as principal providers of the SRO funds, the product providers should have a majority among the seats filled by practitioners ; the number of persons appointed to represent the public interest should be such as to enable them, in combination with either the product providers or the independent practitioners to constitute an overall majority and, at least initially, the chairman should come from outside the industry.²³⁴ The role of the public interest members was assessed to be crucial, as such members should effectively hold the balance between the two main groups. The Report also proposed to adopt a special voting system in which, instead of one vote per member, the number of votes would be calculated by reference to the number of the registered individuals of the firms. It was moreover proposed that the chairman and the public interest members be appointed by the governing body itself. The governing body would also have competence to remove both the chairman and the public interest members from the board. In both instances the

board would act with the agreement of SIB.²³⁵ This proposal could lead to anomalous situations with the dependence of the PIA on the SIB for exercising its powers to remove the chairman or the public interest members; or through a position of pre-eminence for the various public interest members. These assumedly represent generally the big economic and financial groups of the City in London. Such a powerful position for such groups to influence dismissals is not foreseen, or should it be assumed as implicitly given or intended?

The proposal that the chairman and the public interest members can be ad nutum removed from the board also appears to be insidious, because the fear of dismissal could inhibit the process of expressing the board's will, although for dismissal, SIB's agreement is foreseen as necessary.

The Report proposed also that the enforcement of the rules through the process of monitoring should be the responsibility of a single organisation within the SRO and not be divided by reference to type of membership.

Costs incurred by the PIA are of two kinds : costs of regulation and the cost of meeting claims for compensation. The Clucas Report underlined that "although not all costs are capable of being passed on to the investors, so far as the product providers are concerned, the majority of them can be and are." It is the inability of intermediaries, who are paid by commission, to pass the costs on that has been the principal cause of FIMBRA's financial difficulties.²³⁶

After the publication of the Clucas Report a new company, the Personal Investment Authority Limited, the PIA, was formed on December 13, 1992 with the intention of preparing an application for recognition as an SRO. The board of PIA was drawn from representatives of prospective classes of PIA members, and includes also

public interest representatives.²³⁷

In April 1993, the PIA, in a report on standards, underlined the necessity that "Business and their staff must have regard to investor protection. This obligation stems from the right to do business in an area reserved by Parliament to those who are considered 'fit and proper'. Business thus have the prime responsibility to ensure their staff deal with customers in an honest and competent manner. Business regard for the interest of investors could develop naturally into a more general concern to act in the public interest, one of the hallmarks of a profession."²³⁸ "The regulator should act, as far as possible to prevent malpractice occurring rather than to discover it after the event. The regulator and business should develop and refine performance indicators that provide evidence of the reliability and quality of service to customers. The results should be made public."²³⁹ In discussing the relevant framework there was a view that "PIA should restrict its scope and activity to the effective monitoring of clear standards directed essentially at honesty and solvency. Those holding this view have maintained that too detailed an involvement in the area of competence by the regulator is costly and difficult to regulate. Quality of service is better left to the industry where competition, media and customer expectations will ensure that adequate standards continue to develop in the wider context; innovation and creativity may be discouraged to the disadvantage of /the/ financial services industry both nationally and internationally. The majority, however, expressed support for the development of a model on the lines outlined."²⁴⁰ One can but agree with this approach. As to the description of the new regulatory regime, a few points deserve emphasis as to

-- no change in primary legislation ;

-- Responsibility for each member of the PIA should be allocated to a specific member of the PIA staff, as the "monitoring officer" that should be in charge of monitoring data supplied by the members and of investigating any material fluctuations in any regulatory concern arising from the data.²⁴¹ To ensure an open and direct relationship with all members the PIA should nominate a monitoring officer to be responsible for each member;

-- The PIA should publish a guide to ethical behavior for investment advisors. The guide should explain how SIB's 10 principles will apply as ethical standards for personal investment salesmen and advisors.²⁴²

-- The PIA should publish a charter for investors, establishing an outline for the personal investment market, the investor's rights and the standards of service he/she should expect.²⁴³ The charter should include (i) SIB's principles and their application to PIA members; (ii) the compensation mechanisms available to an investor; and (iii) the question of the cost of regulation and compliance.

As to elected members, the criteria for assessment and comments on recommendations contained in the Clucas Report referred to (i) honesty and solvency, (ii) competence, (iii) conduct of business, (iv) complaints, (v) control environment and compliance regime, and (vi) reporting to the regulator.²⁴⁴

Responsibility for authorising the business (and their principals) as forming the potential membership of PIA is quite complex. Insurance companies and friendly societies derive their authorisation, particularly as regards solvency and honesty, primarily from statutes other than the FSA. PIA's rules of honesty are thus primarily directed at principals for firms other than insurance companies and friendly societies. As to

solvency, PIA's rules on it will directly cover all firms excluding insurance companies and friendly societies. The Report looked carefully at the question of financial security of businesses and has required that a business must have sufficient working capital so that it does not come under such financial pressure that controls and objectives are threatened in the quest for the next sale.

Concerning competence, PIA's rules will cover all involved in advertising and selling, including staff of insurance companies and friendly societies, and, where applicable, principals. Lastly, as transitional arrangements to follow in approving members of existing SROs who wish to join the PIA, the Report has provided that "all prospective members of the PIA need to satisfy the criteria set by the PIA for admission" and that "there will be no automatic transfer for members of existing SROs."²⁴ Thus, no one challenges the necessity of the PIA as an institution, even if critique and complex remarks have been submitted: "the existence of PIA /... / is inevitable because FINBRA is incapable of maintaining an independent existence without continued external funding; while its members, whose deprecations cause the largest hole in the investors compensation fund, need to be able to find another body who will accept the responsibility for their regulation in order to allow them to continue in business. The life companies on the other hand have found it in their interest to maintain a separate source of business introduction apart from that provided by their tied agencies /... / Both sides will maintain their incestuous relationship all the time it is advantageous to them to do so." "The history of investor protection since the passing of the Financial Services Act 1986 is riddled with examples of investment industry prevarication over important reforms and shot through with illustrations of conflicts of interest. The

proposal for the putative PIA shows no signs of deviating from this well-worn path." "The concept of PIA is little more than another cynical public relations exercise in the reconciliation of the conflicts of interest /... / foisted on the regulators and the investing public by the large insurance companies. There is little wonder that banks and the building societies have grave doubts about being forced to link up with it as, for them, nothing has changed."²⁴⁶ In February 1994 have been published the PIA's approach to Regulation²⁴⁷ and the Memorandum and Articles of Association.²⁴⁸

Art 4.25 of the PIA Approach to Regulation contains the "Four-eyes" Principle: No firm will be eligible for inclusion in a category which would permit it to hold client's money or assets, or to act as portfolio manager, unless it is managed by no less than two independent individuals who are engaged in the day-to-day conduct of investment business. This is a new regulatory requirement which the Authority considers to be necessary for the protection of investors.

Art. 9.1 of the memorandum states that the Board shall consist of no more than 21 natural persons appointed as Practitioner Directors and as Public Interest Directors and a Chairman appointed by the Board. The Board shall determine from time to time the precise number of Board to be appointed in each category provided that at all times the number of Practitioner Directors shall be equal to the total of the Public Interest Directors and the Chairman.

The Board with the consent of the SIB resolves by a vote of not less than 80% of the members of the Board then in office (excluding the Board member concerned) to remove the Chairman or a Public Interest Director - p. 21 (Art. 9.16. (10)).

The Board resolves by a vote of not less than 80% of the

members of the Board then in office (excluding the Board Member concerned) to remove a Practitioner Director (pag. 22). (Art. 9.16 (11))

The Members of the Board hold office until the conclusion of the fourth annual general meeting following the date of their appointment or reappointment unless reappointed (pp.13 e 14) (Arts. 9.5., 9.8. and 9.10.)

Every Member of the General Meetings shall have one vote (Art. 7.1 pag. 9)

In the case of an equality of votes, the chairman of the meeting shall be entitled to a second or casting vote (Art. 6.10. p. 9)

The SIB's recognition of PIA as long as July 17, 1994 represents a victory of self-regulation on statutory Regulation. Indeed, several institutions were openly critical of the two-tier system and would prefer statutory Regulation.²⁴⁹

Smaller Financial advisors are worried about the cost of PIA membership and describe it as an "expensive irrelevance".²⁵⁰

It is here submitted that with PIA's constitution the process of segregation of the investor has moved to a higher level of sophistication. The front of investors, now divided into two blocks, is certainly more vulnerable, not only numerically. Above all, the private investor is more vulnerable as he/she no longer can count on the allegiance of the "institutional" investor and thus is deprived of his most powerful sophisticated partner of defence. The first phase of the move toward separation has been concluded with the division between the categories of investors, effecting, as already said, the isolation of the private investor.

d. The Three Tiers of Regulation

i. The new Settlement

The amendment of the FSA in 1990 enabled SIB to put

in place a new three-tier rule structure, as a so to speak new settlement. It was intended to extend a wider latitude for the rule-making of the SROs and RPBs, with SIB's corresponding function prevailing at a strategic level, so to speak one step removed from the front line. The innovation was welcomed by the industry,²⁵¹ with its three tiers of regulations :

-- At the top SIB that lay down a small number of general principles a breach of which would lead to disciplinary action by regulators, without enabling an aggrieved investor to sue ;

-- A middle tier for core rules establishing the common regulatory requirements of the system and usable for the purpose of claims by investors as well as for disciplinary standards ;

-- A third tier of detailed rules tailored by the individual bodies to the business of their members. The SROs establish the specific of their own rule books relating to their special fields of operation. In propounding their rules, the SROs are obliged to take into account the cost, to those affected, of complying with the relevant rules.

Thus, rules of conduct rested on a three-layered structure with principles at a top tier; core conduct of business rules at the middle tier; and the detailed rules shaped by the individual regulatory bodies found at the third tier.

On the basis of Section 63 of the FSA SIB is authorised to designate rules in respect of members of SROs. This provision, used for core rules, can be used by SIB to prescribe rules if an SRO is unable or unwilling to introduce new rules.²⁵²

SROs and RPBs complemented first-tier principles and (for the SROs) core rules with their own third-tier rules and guidance as necessary to satisfy SIB that they had an

acceptable package of regulatory standards to provide for adequate investor protection. Each SRO operated on the basis of its own, very detailed set of rules. These had to comply with the core rules laid down by SIB. With respect to RPBs, SIB did not have the power to designate rules for their members as such power would result in an "anomalous situation" with regard to the existence of the RPBs in a traditionally so to speak autonomous sphere of self-regulation unconnected with financial business.²⁵³

ii. The Ten Principles

They came into effect in April 1990 as a universal statement of general standards expected to be honoured by all authorised firms, requiring high standards of integrity and fair dealing.

The 10 principles have a very wide field of application concerning every firm authorised to operate under the FSA 1986, be it by virtue of membership of a self-regulating organisation (SRO), or, as in the case of many solicitors, accountants, actuaries and investment brokers, by virtue of a certificate issued by the relevant professional body (RPB). The rules apply also to firms directly regulated by SIB.²⁵⁴ There are, however, some inherent limitations affecting the scope of application of the 10 rules. The most important of them are related to investment business. They are silent on the question of territorial application. There is, however, an implied limit in that the principles shall apply to a firm if it is authorised under the FSA 1986.²⁵⁵ The principles are to apply to an overseas operator of an UCTS scheme²⁵⁶ only in relation to marketing in the UK.

The application of the 10 principles is specifically limited with reference to a so-called "regulated insurance company" to the marketing of life policies and the management of investments involving pension funds

(see Schedule 10 to the FSA 1988, para. 4.). Furthermore, this restriction to marketing and pension funds management is applied to the regulation of friendly societies.

The principles were adopted for achieving three goals ;

- Encapsulate, express and build upon best practice ;
- Be readily understood by all involved in the financial markets ; and
- Be sufficiently general to apply readily to new situations.²⁵⁷

Being general in nature, the principles do not give rise to actions for damages against firms. Beyond it, failure to comply with application of a principle is a ground for taking disciplinary action or the exercise of intervention powers; but such failure does not of itself give rise to any right of action by investors or other persons affected, nor failure to comply affect the validity of a transaction. In general, the principles are enforceable (i) by the regulator only, but not by the investor ; (ii) as a matter of regulatory discretion and not as a matter of right ; and (iii) if it seems likely to be in the public interest, for the maintenance and improvement of standards, as a higher priority than redress. Four types of discipline are set out in Section 47A(4) of the FSA.²⁵⁸ They are, however, only relatively rarely available, because very many of the firms concerned are authorised by an SRD or by certification by an RFB. As a result, in most cases the powers of the SRD and RFB will be more relevant.

The disciplinary action set out statutorily provides for the withdrawal or suspension of authorisation under Section 28 or the termination or suspension of authorisation under Section 33. These two powers, available to the SIB, are relevant only where the person

concerned is authorised directly by the SIB itself (Section 25), or the person concerned is a so-called "Europerson", that is, a person authorised, pursuant to Section 31, to carry on investment business in the UK by virtue of being authorised in another member state of the European Community (now the EU). The SROs or RPBs may exercise their disciplinary powers also for issuing a disqualification direction under Section 59. All in all, it can be said that a wide power is available to the SIB in respect of any individual, because the fact that an individual is in or works for a firm authorised by an SRO or RPB does not remove SIB's jurisdiction. The latter shall be exercisable only if it appears to the SIB that the person concerned is not a fit and proper person to be employed in investment business of a general or of a particular kind. Therefore, although all 10 principles are specifically directed at firms, breach of them by a person, in his capacity as the alter ego of a firm, or as employed or appointed representative, will necessarily make them relevant to this form of disciplinary action.

Disciplinary action anchored statutorily as to "making a public statement" under Section 60 is restricted to a narrow class of firms authorised by virtue of Section 22 (insurance companies), Section 23 (friendly societies not a member of a SRO), Section 24 (operators or trustees of UCITIS scheme from another EU member state), Section 25 (persons directly authorised by the SIB, and Section 31 (already mentioned "europersons". Generally speaking, the power of the SIB extends only to those regulated by it in the conduct of their investment business, with an exception applying to insurance companies, irrespective of the circumstance whether they are members of the relevant SRO (LAUTRO) or not.

The SIB may apply for an injunction, interdict or other order under Section 61, in proceedings where there

is a reasonable likelihood that a person will contravene or has contravened any provision related to the 10 principles. The court may make an injunction (interdict in Scotland) averting or prohibiting the contravention.²⁵⁷ It is possible that a firm or individual not carrying on any investment business could be made the subject of an order under Section 61 if the Court were satisfied that there had been a breach of a principle by an authorised firm, and that someone else had been "knowingly concerned" in the contravention.

The power of intervention under Section 47A can be unleashed not least with due regard to the desirability of protecting investors. The exercise of this power is referable to tribunal and the action can be taken immediately.²⁶⁰

As to the various SROs and RPBs, they have taken action to enable their disciplinary and intervention systems to take account of breaches of principles. This has generally been done by making the principles a matter of direct obedience and relevant to the "fit and proper" test. However, in the case of some of the SROs, it is possible to foresee that a breach of a principle might be relevant in the context of consumer redresses, whether in the course of the disciplinary system itself or in other ways.²⁶¹

1) On June 21, 1990 SIB made the Five Core Rules for Financial Supervision expressed at a high level of generality. They were different from the core rules because they did not give rise to civil liability.²⁶² These rules were designed so as to apply to all SRO members, save for the insurance companies, friendly societies, and those not subject to any financial supervision rules.

2. In January 1991 SIB made and deregulated forty conduct of business rules, generally known as Core Rules.

Made by the SIB they are situated at the middle tier of the regulatory system. Expanding the 10 principles, they apply directly to firms regulated by the SROs.

Situated at the middle tier level, the core rules can be invoked for the purposes of claims by investors as well as for disciplinary purposes. They are, unlike principles, enforceable under Sections 62 and 62A of the FSA 1986. They give rise to civil liability in the same way as the conduct of business rules made by an SRO.

A so-to-speak polarisation rules has been proposed by the SIB as a safeguard for investors for guaranteeing the independence of intermediaries active in the field of life assurance and unit trusts. The purpose of polarisation has been to clarify the legal status of persons offering assurance, in such a way that a client may know whether he is dealing with a representative of a company limited to the sale of a determined series of products, or whether he has to do with an intermediary who is totally independent and is acting as an agent for client. The introduction of this rule was accompanied by an ample debate in Parliament.²⁶³ R.B. Jack²⁶⁴ has rightly observed that specifically with respect to this rule the Director General of Trade has lost the battle. In spite of the danger pointed out by the Director General to the effect that the application of such a rule could generate distortions in competition, the Secretary of State preferred to give precedence to the protection of investors. Lloyds Bank was first in the application of the polarisation rule.²⁶⁵

The core rules were brought into force for members of IMRO and SFA, but in view of the expected recognition of a new SRO for retail investment business, they have not been brought into force for the members of LAUTRO and FIMBRA or for firms directly regulated by the SIB itself. In October 1991 SIB made two sets of Client Money

Regulations, the Financial Services (Client Money) Regulation 1991 (CMRs) and the Financial Services (Client Money) (Supplementary) Regulation 1991 (SCRMs), which came into force on 1 January 1992. The CMRs were deregulated so as to apply to all SROs; the SCRMs were not deregulated for members of IMRO and SFA.

v. The Rules of the Third Tier

SROs and RPBs complemented the principles and (for the SROs) the core rules with their own "third tier rules" and guidance as necessary to satisfy the SIB, that they had a package of regulatory standards which would provide adequate investor protection. Each SRO had its own very detailed set of rules complying with the core rules laid down by the SIB. They were tailored by the individual regulatory bodies to the business of their respective members. Firms had to comply with the requirements set by the respective regulatory body and to make sure that individuals within their firms acted accordingly. The SIB itself had the task to ensure that the third-tier rules were in line with the core rules. Some have wondered asking whether this aspect of the New Settlement was a mirage.²⁶⁶

4. The Report of May 1993 by A. Large, SIB's Chairman, explained the need for SIB to put greater emphasis on its role as guardian of standards of investor protection and to adopt a more restrained approach to the exercise of its formal legislative powers, so as to allow the recognised bodies more latitude in their use of rules and other mechanisms for securing practical observance of the requisite standards. Accordingly the report concluded that SIB should designate rules only when this would be clearly more efficient and effective for the system than rule making by individual bodies, and looked forward to the dedesignation of the existing core rules.

Then, the Financial Services (Dedesignation) Rules

and Regulations 1994 that came into force on 1 December 1994, dedesignated the Core Rules (with two limited exceptions of Rule 5 (3) and Rule 36), the CMRS (with certain exceptions) and the SCRMS and core financial rules (completely).

6. Dedesignation is based on:

- (i) SRO rule changes will be made only after appropriate consultation, with SIB and externally;
- (ii) Where significant changes to the substance of dedesignated rules and regulations is contemplated, the SRO will spell out the standard of investor protection it is proposing to adopt, and SIB will need to be satisfied with the standards envisaged;
- (iii) SIB will look to the SRO to demonstrate that, though a combination of rules and other delivery mechanisms, coupled with effective enforcement, those standards will be maintained;
- (iv) the setting of standards on issues which straddle a number of recognised bodies will be done in a way that is sensitive to the interests of the recognised bodies concerned and to the value of reasonable coherence in the system as a whole; and
- (v) any changes to the rules will take account of the requirements of EC directives and jurisprudence.

7. SIB believes that the Core Rules, the Client Money Regulations and the core financial rules by and large embody a sensible level of investor protection, and dedesignation should not be taken as a sign that SIB no longer subscribes to the standards that were built into these rules and regulations.

Dedesignation will, however, have an impact on SIB's enforcement powers. Before dedesignation, SIB could take action against an SRO member for breach or potential breach of a designated rule or regulation under section 61(1) FSA. After dedesignation SIB is able to proceed

only if the SRO in question is unable or unwilling to take the appropriate action itself (section 61(2) FSA).

vi. The Regulatory Rules and Common Law and Equitable Rights

Among the powers conferred by the FSA on the Secretary of State for Trade and Industry (now HM Treasury) and delegated to the SIB is, as a very important one, the power to make rules and regulations governing authorised persons' conduct in the fields of business, financial resources, clients' money and unsolicited calls. This raises the question of the relationship between the regulatory rules, on the one hand, and the general law in the form of common law and equitable rights. The question may involve a big problem. For example, the fear is that compliance with the rules made by the SIB and by the SROs may not necessarily absolve firms from liability under the general law on tort (delict in Scotland) or contract, or for breach of fiduciary duty. This means that a firm may expose itself to liability under the invariable more onerous obligations obtaining under general law. "The most widely held view today is that the general law is not abrogated unless the FSA makes express provision for the modification of common law and equitable rights". The result is a double layer: the rules made under the legislation and behind these fiduciary duties and other common law rules.²⁴⁷ In April 1992 an interim consultation paper (No. 124, HMSO) was published by the Law Commission on fiduciary duties and the regulatory rules. The relationship between the regulatory rules and the general law is still being considered by the Law Commission, albeit Professor David Hayton underlined the problems of interface between certain rules and the law of trusts in a report commissioned by the SIB and IMRO over six years ago. Given the regulatory jungle which now

exists, it is not surprising that sooner or later the relationship of regulatory and disciplinary proceedings and civil and criminal proceedings would come before the courts.²⁶⁹

From "Equivalence" to "Adequate" Investor Protection

The emergence of investor protection in the UK has been shaped and characterised by "re-thinkings", "re-assessments" not least related to a pragmatism that best solutions may be best found and adjusted by coping with an evolving situation and its challenges, as in English case law tradition, instead of trying to shape it in final details through a priori meticulous regulation. In the sphere of investor protection, for a better understanding of developments since the 1980s, it is important to remember that prior thereto stock market regulation was from the beginning based on a liberal or laissez-faire approach, in which the market participants played a major role, and this tradition favoured the application of a corresponding principle expressed and sublimated in the notion of self-regulation.

After the FSA 1986 a first re-thinking or re-assessment amending the FSA resulted in the Companies Act 1989, changing the "equivalence" test into the "adequacy" test for protecting investors. The FSA initially provided investors with a protection at least "equivalent" to that provided by the SIB. Under the equivalence test the SIB needed to be satisfied that the rulebooks of the SROs or RPBs provided protection at least equivalent to that provided by the SIB rulebook (Schedules 2 and 3, FSA). Requirements for the recognition of SROs and RPBs provided that their rules had to afford investor protection at least equivalent to that afforded by the rules and regulations at the time established by and in force for the SIB. In its short history the "equivalence" process conditioned that for initial recognition, the

SROs and the RPBs should have their own rulebooks for their own members in the light of an initial rulebook of the SIB covering the whole investment business. The result was that the rulebooks of the SROs, inspired after the original core rulebook of the SIB, were considered to be complex, hardly clear, very long, too detailed with legalistic formulations. The City in London, as an establishment with firm roots in tradition linked with practical experience, put up a compact front against the "equivalence" test. "A common view within the financial services sector was that SIB should have produced a much briefer set of rules, merely setting out general principles which SROs could take into account in formulating their own more detailed rules. This theory is strengthened by the fact that core rules have to apply to all the SROs which cover a wide range of different financial services".²⁴⁷ The rulebooks drafted under great time pressure and subject to considerable legal influence were widely perceived by the industry as too legalistic and detailed. The continuing pressure on the part of the firms and recognised bodies, for clarification, modification and explanation led in November 1988 to a proposal for a new approach to SIB's Conduct of Business Rules, and the Companies Act 1989 amended the FSA introduction to a New Settlement between the SIB, on the one hand, and the SROs and RPBs on the other. The three-tier system of regulation was adopted in a political climate favouring greater flexibility. It was influenced by SROs and RPBs favouring the recognition of the "adequacy" test and the abandonment of the "equivalence" test.

The new adequacy test substituted a broad judgement to be delivered on the adequacy of the level of investor protection. It responded to the question whether the SRO's rules, taken together with the SIB's core rules and

principles provide adequate protection for investors. Therewith the test to be applied by the SIB to the rulebooks of SROs and RPBs revolved around "adequacy" instead of "equivalence", thereby providing a greater margin of flexibility.

The concept of adequacy applies to both rules and procedures. Adequacy is not simply established at the point of recognition but goes further and must continue to be maintained. The assessment by the SIB of an individual SRO's or RPB's adequacy in meeting recognition standards is therefore defined as an ongoing process which the SIB assesses in a similar way.

In respect of rules the SIB will be concerned to verify that the rules of an individual RPB continue to provide an adequate level of investor protection. This will be looked at in the context of other rulebooks to ensure that similar standards apply to all constituencies. While the FSA provides that core rules by the SIB shall not apply to the RPBs, all RPBs have, nonetheless, to ensure in their rulebooks that the requirements of the core rules are adequately reflected in them. Of material relevance is the point that when legislating, the SIB, the SROs and the RPBs are to be required now to take into account costs of compliance in deciding how best a given investor protection objective should be achieved.

f. Action for Damages : From Section 62 to Section 62A of the Financial Services Act

The second "re-thinking" of the British legislator has concerned the restriction affecting private investors' right to bring an action for damages under Section 62 of the FSA that concerns an action for damages for breach of certain rules and regulations made under the FSA.²⁷⁰

It is here submitted that the affected restriction

entails possibly incalculable damage involving a division within the category of investors, weakening the position of the "private investors".

The contraventions actionable under Section 62 are many and various. The core conduct of business rules, unlike the principles, give rise to civil liability in the same way as the conduct of business rules made by an SRO. This means that the core rules would be enforceable by a civil action under Section 62. Actions apply, in addition, to breaches of restrictions on business or dealing with assets (section 71(1)); violations of certain authorised unit trust provisions (Section 91(4) and 95); failure to furnish information as requested by the SIB (sections 104(4) and 178(5)); violation of certain provisions relating to the insurance business (Section 130(7)); banking business (Section 185(6)); and violation of the Rules of Friendly Societies (Schedule 11(22) (41)); contraventions of prospectus rules as to a false or misleading prospectus (SS 171(6)); or breach of a DTI notice limiting a foreign power to conduct investment business in the UK (Section 185(6)).

From the start Section 62 in its original version caused much controversy and generated much opposition. Young feared that Section 62 "might cause a flight of international investment business from London to financial centres overseas".²⁷¹ Section 62 was also blamed for the fact that the original rule books were too long and legalistic. As they in effect imposed duties, breaches of which were actionable, the original draftsmen sought to define the duties in question very precisely. Had they not done so, it would have been left to the courts to define the precise scope of the liability in question. This would encourage litigation and give the courts greater control over the liabilities imposed. The relevant business community of the City in London

considered Section 62 to be a weapon too powerful in the hands of the business investor, and called for remedies. In consequence of such strong reactions the implementation of Section 62 was postponed as far as breaches of the SRO and RPB rulebooks were concerned. Section 62, rendering the SIB's rulebook actionable, was brought in the meantime into force on December 1st 1987; Section 62 to the extent it pertained to SRO and RPB rulebooks, was brought into force only on October 3, 1988. Independently therefrom, the Government announced their intention to amend Section 62, and in September 1990 the DTI published a consultative document on "Defining the Private Investor". After two and a half years,²⁷² the Companies Act 1989, which came into force on April 1st, 1991, amended Section 62 of the FSA 1986 by adding Section 62A.

The new Section 62A confined the right to bring an action for damages under Section 62 to private investors only: "No action in respect of a contravention to which s62 applies shall at the suit of a person other than a private investor". The SFA 1986 (Restriction of the Right of Action) Regulations drew a distinction between individuals and other investors in the sense that they provided for the case when an individual would be treated as a private investor and therefore will fall within the scope of Section 62A.

Effectively, Section 62A curtailed the availability of Section 62, providing that civil liability under Section 62 for breach of rules and regulations made under the FSA, which include, for instance, the conduct of business rules by the SIB and the rules of any of the SROs under the Act such as LAUTRO, FIMBRA and TSA (The Securities Association) shall not be available except at the suit of private investors. Thus, within the space of three years the Government had given access to a civil

action to the victim of a contravention of the CBRs and then cancelled it before it was ever invoked and before its availability had been delineated properly in the court.²⁷³

The restrictions of the rights of action under Section 62 was very welcome for the City of London. The reason for the restriction of the right of action to private investors was a matter of fervent concern expressed by both practitioners and institutions to the DTI, with reference to the apparent breadth and considerable vagueness of the original Section 62. The DTI proved sensitive to the concern, and Lord Young summarised the position of the proposed amendment to the original Section 62 by stating that "Section 62 would lead to an excessively litigious approach /... / I have therefore decided to legislate to remove the right to sue under Section 62 from practitioners and professional investors".²⁷⁴ Part of the interested expert authors observed more cautiously that it was feared it would encourage an undesirable litigious climate in financial services dealings. Such fears were probably exaggerated as Section 62 merely adds a cause of action to others likely to exist already at common law.²⁷⁵ Moreover, there was emphasised reference to some problems which the introduction of Section 62A may generate, as the definition of private investor has essentially relied on the old legal chestnut of what constitutes "carrying on business". The relevant DTI document stated that "most charities and similar bodies do not carry on any form of business and would therefore retain their s 62 rights for all purposes". The Institute of Chartered Accountants expressed disquiet as to this aspect of the DTI definition document. It was felt that in fact charities and similar bodies may well "carry on business". The implication is that trustees for a class of persons who

might not sue individually, such as pension fund managers or charitable businesses, will be included in the definition of private investor for the purposes of Section 62A. It has also been observed²⁷⁴ that one must question whether Section 62A goes far enough and how fair its operation might prove to be. As it stands, the right of action is restricted to "private investors" acting other than in the course of investment business. Furthermore, any other person, such as a company but not including governments, local and public authorities, will only be eligible to take an action as a "private investor" where the loss incurred by them arose other than in the course of carrying on business of any kind. The effect of this is that a small company which, for example, subscribes for securities or unit trusts and does so other than in a professional capacity, will still fall outside the ambit of Section 62A, together with much larger or sophisticated or financially experienced undertakings, purely on the basis that it operates for the purpose of carrying on a business. At the same time, all private individuals will fall within the definition of "private investor" other than where they carry on investment business, irrespective of any special skill or knowledge they may possess. The term "private customer" used for the core rules extends to certain small businesses, that is, companies, partnerships or trustees which do not satisfy certain size requirements. Thus, a small company acting in the course of its business may be a "private customer" for the purposes of the SIB rulebook but would not be a "private investor" for the purposes of Section 62A. It is unfortunate that these differences in definition and terminology have arisen between the SIB's new rulebook and the Section 62A regulations. Although the two concepts, "private customer" and "private investor" are used in different contexts -- the SIB's

rulebook being concerned with the matter of according greater protection to "private customers" and the Section 62A regulations being concerned with limiting the extent to which actions may be brought for breaches of the financial services regime -- it is not obvious why the Section 62A regulations did not confine Section 62 actionability to those persons who are treated by the SIB as "private customers". If such persons are regarded by the SIB as deserving greater protection, then the DTI could and should have well taken the view that they also are deserving of being able to bring an action under Section 62. In the event, the Section 62A regulations use slightly different criteria in drawing the limits of Section 62 actionability than the SIB rulebook in drawing the limits of its greater protection for certain investors. It should be, lastly, noted that the three justifications given for the introduction of Section 62A have been (i) simplification of the rulebooks; (ii) deterring "excessive litigation" and (iii) withholding the option of section 62 from those who could be expected to use other more suitable remedies. One may remark that the rulebooks could have well undergone simplification without the restriction in Section 62A. In reality, since the promulgation of the Conduct of business Regime in 1987, there have been very few instances where Section 62 has been pleaded in out-of-court dealings and no reported cases are known in which it has been invoked and successfully argued in court. This may suggest that the Government, in making the change, was attempting to restrict sizeable claims rather than truly unwarranted claims.²⁷⁷ It may be also added that one of the motives behind the introduction of Section 62A may be that of splitting the until then compact front of investors.

The failure on the part of investors to make use of Section 62A was recently referred to by Andrew Large in

the following terms: "it is intriguing to me, in this neglect, to note that Section 62 has very rarely been used, to our knowledge, to seek redress where a private investor has lost out in consequence of a breach of an FSA rule".²⁷⁹

g. Investigation and Enforcement

i. Compliance and Enforcement

Compliance has an essentially preventive meaning, as it is primarily concerned with ensuring that things do not go wrong. Firms have to comply with the requirements set by the regulatory bodies and to make sure that individuals within their firms act accordingly. Recognised bodies have to comply with the standards set by the SIB and the SIB has to comply with the requirements of designation under the FSA.

Enforcement is essentially a reactive response to violation of a rule. It generally becomes relevant once compliance has failed. Enforcement is one of the means to achieve investor protection from undue risk or abuse of counterparty insolvency and, where losses do occur, to maximise recovery of private investors' assets within reasonable cost.

The British system attributes to the control authority a series of administrative and investigative powers (sections 64-71 of the FSA) as well as sanctioning competences resulting up to the withdrawal of the authorisation (Section 28 FSA).²⁷⁷ The FSA enables under Sections 12 (for SROs), 20 (RFBs), 37 (RIEs), 39 (RCHs) the SIB to go to the High Court to seek compliance orders where it believes a recognised body is not meeting the terms of its recognition or has failed to comply with any other obligation to which it is subject under the FSA. The FSA enables the SIB, furthermore, to make an order revoking the recognition of a (recognised) body. They have been seen as something like a nuclear weapon,

cumbersome, and in the case of de-recognition powers, not necessarily appropriate for use in relation to a particular limited shortfall in standards.²⁸⁰

In the area of enforcement, unlike that of rules and recognition, the FSA provides for a division of powers between the SIB, on the one hand, and the recognised bodies on the other, rather than parallel or overlapping powers.²⁸¹ Some powers, for example, of investigation (Section 105) or to petition for compulsory winding up (Section 72) are entrusted only to the SIB. They may be used at the request or with the consent of the recognised body, or in the case of Section 105, if the body is unable or unwilling to act. Conversely, the SIB does not have the punitive power, for example, to impose a fine, over firms regulated by a recognised body. The initial reason for it was to obtain a clear distinction between public law bodies on the one hand and private law bodies on the other, and to create strong second-tier bodies. Large is of the opinion that such a division of powers leaves room for doubt.²⁸²

The SIB believes that itself and the SROs are provided with a substantial armoury of regulatory sanctions.²⁸³ The SROs can issue warnings or reprimands, impose fines, suspend and, as an ultimate sanction, even withdraw authorisation from their members. The SIB has similar powers over the firms it regulates. In respect of SIB regulated firms and members of SROs the SIB can, in appropriate cases, initiate civil proceedings for injunctions to prevent breaches of rules and safeguard investors' money, and can, under certain circumstances, petition the Court for the winding up of companies, and for administration orders under insolvency legislation.²⁸⁴ With respect to firms which should be authorised but operate without authorisation, the SIB has powers of initiating criminal prosecution and can

institute civil proceedings for injunctions to stop such firms trading and to restore clients' money. The penalty for the relevant offence can include up to two years imprisonment and/or an unlimited fine.²⁸⁵ The SIB has in addition formal powers of investigation with criminal sanctions in the event of obstruction, and can disqualify individuals from employment in the investment industry.²⁸⁶

The SIB is responsible for investigating and responding both to complaints about its own directly regulated business (DRBs) and complaints about all regulators operating under the FSA, including itself. Under the FSA (schedule 7, para 5), the SIB has responsibilities to assist other regulators outside the FSA system, both within the UK and internationally. The SIB has also an interest in effective enforcement on areas where the authority to prosecute and in some instances to investigate, lies with other institutions, for example, with reference to insider dealing or market malpractice prosecutions. These responsibilities and interests give the SIB a significant role in co-ordinating investigations and enforcement across boundaries between the financial services system, on the one hand, and other systems on the other, for example, with respect to cases arising out of home income plans, where in addition to firms regulated within the financial services system, also banks, building societies and law firms acting outside their capacity as authorised firms are involved.

SIB's enforcement role has been rightly considered weaker than its role in rules and policy making. The SIB has preferred to limit its involvement in matters of financial fraud, for example, by not requesting the DTI to delegate to it powers to prosecute market manipulation offenses under Section 47 of the FSA. It is clear that

enforcement is a crucial element in investor protection and a regulatory system is difficult to enforce all the time effectively. One of the crucial points provoking the modification of the old system, based essentially on the Prevention of Fraud (Investment) Act 1958, was the failure to enforce the relevant provisions of the Act.²⁸⁷ A succession of scandals, symptoms of malaise in an agonising system have been decisive factors in inducing the end of the old system. The new system, expected to reach a prompt, effective and vigorous prosecution of securities law violations, "has not thwarted commercial fraud, nor created an aura of effectiveness".²⁸⁸ It is still widely perceived as failing to "catch the crooks" and to prosecute effectively those who have been caught. The Roskill Committee of the Police Fraud Squads has reported that the public no longer had confidence in the ability of the criminal justice system to bring perpetrators of serious fraud expeditiously and effectively to book. The Committee has expressed the view that the public was probably justified in its view.²⁸⁹

It may be currently asked whether the situation is radically different. New scandals and above all their size and significance have inspired a lack of confidence in the ability of the system to deliver a regime which provides effective deterrents against fraud and other malpractice and, beyond it, appropriate retribution where wrongdoing occurs. The effectiveness and therewith the credibility of any regulatory system depends to a great extent on the sanctions which reliably underpin it.

Financial services enforcement has three principal elements:²⁹⁰

(a) Prevention, including screening and the elimination from financial services industry of all obviously unsuitable firms and individuals ;

(b) Information gathering, consisting of the

creation of an effective monitoring and reporting system extending from within the firm itself to the self-regulating body up to the SIB ; and

(c) Deterrence, including prompt prosecution and sanctioning of violators.

Prevention is pursued primarily and prophylactically through authorisation of investment business. Once a self-regulating organisation is authorised, it bears the principal responsibility for its own governance through the promulgation of its governing rules and discipline of its members. Monitoring and information gathering powers force firms to create procedures that will contribute to compliance. The full framework expected to achieve investor protection under the SFA 1986 comprises:²⁷¹ (i) entry vetting, (ii) authorisation only for those fit and proper, (iii) setting out in principles and rules behavior required of authorised firms, (iv) insisting on compliance by firms with the principles and rules, (v) procedures for proper handling of investor's complaints, (vi) enforcement against non-complaint firms, (vii) compensation for private investors suffering irrecoverable losses.

The SIB's powers do not for the most part extend beyond the defined boundaries of investment business, and the SIB's own enforcement activities lie within these boundaries. Matters outside them are referred to other relevant authorities, often to the DTI.²⁷² Therewith it may be implied that there are other legal requirements of significance to investors, arising under other spheres of law, company law as an example, and within the SFA Sections 47 and 57 apply to the statements and conduct of any person, that is, not just to those of persons carrying on investment business. Beyond the financial services system, different bodies involved in matters of significance for investors' interests include the

Treasury, with responsibility for insider trading and market manipulation; the DTI, with powers of investigation and prosecution; the Bank of England, with responsibilities under the Banking Act; the Stock Exchange as a market surveillance authority; the SFO for serious fraud cases. Within the financial services system, the SIB has certain powers of investigation, of supervision of the RIEs, and of SROs concerned with on-and-off exchange trading. It goes without saying that all are interested in ensuring efficiency in the spheres of compliance and enforcement.²⁷³ There is, however, concern at the multiplicity of the parties involved both inside and outside the system, as all inevitably have different and differing priorities. In its Report for 1991/1992, the SIB expressed concern at the complexity of the law and the fragmentation of powers among institutions involved in prosecuting financial fraud, indicating that the situation would make success uncertain.²⁷⁴ SIB's priority is to stop always any continuing abuse or risk of abuse, and, whether it believes there has been theft or other serious crime, to refer the matter to the appropriate criminal prosecutor. Beyond it, the SIB is not a prosecuting agency for anything other than the offence of conducting investment business without authorisation.²⁷⁵ It is responsible for following up any indication that a person or firm may be carrying on invest business without the authorisation. This activity of the SIB is often referred to as "policing the perimeter".²⁷⁶

In detecting "perimeter" contraventions, the SIB's role in investigating and prosecuting unauthorised investment business does not extend to prosecuting fraud which accompanies the most serious cases of such "perimeter" contraventions. The SIB's policy has thus far given priority to stop the offending activity and seek a

court injunction or restitution of investment in unauthorised business.²⁹⁷ The SIB carries out also some enforcement work, with respect to "authorised" firms, that is, those within the perimeter or boundary of the system and authorised to be active.²⁹⁸

The SROs and RPBs, to whom the vast majority of authorised firms belong as members, have in their rules substantial enforcement powers over their respective members.

8. Results ; Critical Remarks

1993/1994 enforcement continued to be a significant SIB activity, as reflected by increasing case figures.²⁹⁹ Fraud cases referred for criminal investigation decreased from 61 in 92/93 to 42 in 93/94. Of 217 cases referred for criminal investigation from 1988 to 1994, 67 are still under criminal investigation.³⁰⁰ To improve the efficiency and effectiveness of its own and other enforcement work, the SIB has initiated a Shared Intelligence Service, of great significance with due regard to the saying that God and the devil are in the details.

Enforcement in SIB's work is entrusted to a specialist team of some 20 staff members, with additional external resources used for the largest investigations and on litigation and trusteeships.³⁰¹ In 1993/94 the total number of case files opened was 457,³⁰² in 1992/93 it had been 410.³⁰³

In a period of five years in the early 1990s, the SIB and the recognised bodies have encountered over 150 cases where the investment business abuse has been sufficiently serious to warrant referral to the police or the Serious Fraud Office; trials have been completed in 63 of these cases with convictions obtained against more than 90 per cent of the defendants.³⁰⁴

In spite of above positive results mentioned by the

SIB in its report for 1992/1993, severe criticisms and grave doubts have been expressed on the incapacity of the enforcement system in eliminating fraud and therewith defending investors' interests and also the national as well as the international reputation and competitive position of London as a traditionally very important centre for investment activities. Large³⁰⁵ recognises that in the field of enforcement the FSA is not an ideal instrument, and that if, in practice, the present powers prove to be inadequate to achieve a fully efficient two-tier system, he will not hesitate to advise the Chancellor of the Exchequer accordingly. He underlined that the SIB has not sufficiently used its power under Section 59 of the FSA to bar individuals from the industry.³⁰⁶

On February 28, 1994 SIB used the power under section 59 of the FSA for the first disqualification of unfit individuals.³⁰⁷ This relates to Mr Roger Levitt. The SIB stated that under s 59 the SIB Board was not permitted to refer to the disqualified person by name. Mr Levitt was sentenced to only 180 hours Community service. It has been pointed out³⁰⁸ that "the naming of those who have broken the rules has long been the big gun of the more competent and braver self-regulators"

Why it has taken SIB so long to adopt the use of these powers, is a question which will no doubt continue to remain unanswered.³⁰⁹

Furthermore Large observed that SIB has not so far used its power enshrined in Section 60 of the FSA to criticise authorised persons publicly. The power in question is limited at present to persons directly authorised by the SIB, presumably on the ground that other bodies could and would take and include a similar power in their rules to make similar statements publicly about their members. The result is that the statutory

power is available only for a very small part of the regulated universe;³¹⁰ and it may be prosaically wondered if hesitation or inhibition to use the power of "public exposure" has also to do with the otherwise commendable spirit of solidarity which members and "boys" belonging to the same institutions and social or professional positions have cultivated and maintained in business and other spheres of human and professional activity. Large has also explained that the SIB cannot and should not confine itself to being the setter of standards;³¹¹ it should give greater priority to prosecution and should work even more closely than hitherto with criminal prosecutors to achieve greater speed and efficiency, for example, through the use of plea bargaining.³¹² In summary, Large does not see the SIB's role in seeking to take on the recognised bodies' enforcement role. Recognised bodies should take the lead in their own enforcement cases.³¹³ He does not see SIB's enforcement role taking it further into areas of criminal prosecution, that is, beyond the involvement it currently has in policing the perimeter and in preparing other cases for transmission to the prosecuting authorities.³¹⁴

More serious are observations by Fishman: "The inability of British authorities successfully to uncover and prosecute commercial fraud has long been notorious. The prosecutorial structure has been altered and reorganised under the new framework of investor protection with little apparent result". "FSA has made only superficial changes in the mechanism of prosecution."³¹⁵ He envisages that "SIB should be solely responsible for the investigation and prosecution of commercial fraud and compliance with reporting requirements. It would still oversee the enforcement efforts of SROs and other authorised bodies who would refer matters to it for prosecution."³¹⁶ Lastly, he

concludes that "it is time to recognise that self-regulation within a statutory framework has failed. In its stead should be created a mixed system of governmental and self-regulation headed by a governmental body similar in authority to the SEC. The most sensible future role of the SIB may be as the Government's compliance, investigative and enforcement arm or as a separate, independent governmental agency. Enforcement should be apolitical." "All enforcement duties should be removed from DTI. Special courts should be created to handle sophisticated commercial fraud. This would allow judges involved in such cases to develop the expertise needed."¹⁷

All the above critical remarks may be justified, but they do not touch, at least, explicitly, the fundamental question of "dosage" or combination between statutory foundations, self-regulatory aspects and other so to speak components which together should constitute a reliable network of, if possible, multiple checks and double controls in order to produce a feasibly foolproof system, in which time itself would be if not of then part of the essence for catching any "behavioral deviation" before it could cause damage to investors and/or the markets. Even if such a system were possible and feasible, what would be its "qualitative" requirements, for example, for securing the required expertise of the relevant judicial authorities in understanding the legal and no less non-legal technical sides of a given case, the expertise of administrative personnel able to read and interpret correctly the visible and invisible signs of possible mischief before it is committed; how to motivate intermediaries so that they beyond the boundaries of legal and institutional monitoring and control will be deontologically convinced that honesty would be the best policy; how to make the punitive system

into one with a message that it does not pay to commit mischief; how to educate investors and other would-be investors into knowledgeable and reliably critical participants in and contributors to the quality of the market, not least the small investors among them as members of an investors' democracy; how to protect investors not as individuals in actions but as a class of participants in economic and financial life worthy of more articulate protection. Referring to the financial sides of what has been critically hinted above, it may be asked what the cost of its operability and effectiveness would be: who would pay for it: the taxpayer, the investors themselves, the participants in and operators of the market(s)? An adequate system of investor protection may seem to involve a gargantuan task, but such are its demands; or else the imperative limits and limitations of the existing system should be admitted and recommended, with a hint of the adage that even the informed investor may after all burn his fingers. The domestic enlargement of financial markets and their globalisation at an international level indeed generate new challenges for establishing adequate mechanisms of market as well as investor protection, not only with standards of least common denominators.

5. Synoptic Comparison of Regulatory Bodies

The main similarities and differences between COB, CONSOB, and SIB can be summarised as follows:

- i) in all three cases the regulatory bodies were constituted under strong governments: Charles de Gaulle in France, Bettino Craxi in Italy and Margaret Thatcher in the UK;
- ii) All three bodies have been inspired by the American SEC and still now look at the SEC for solutions to their problems. The EC too can be claimed to be creating an EC-SEC system;
- iii) The Big Bang has stimulated competition between the three bodies and, above all, between COB and SIB as a positive expression of economic development and as a search for better solutions in the financial fields. This competition has forced the national financial markets to adjust themselves to challenges from other national markets for attracting capital. An important aspect of the competitiveness of the national markets of the EC member states has to be investor protection. In such a competition atmosphere, with no barriers to the free movement of capital between member states, there will be a need to maintain adequate standards as a common denominator for the EC as a whole;
- iv) The Italian system seems to be the weakest of the three, because of exposure to political influence and interference. The French and the British systems seem to be better insulated, at least apparently, against such influences and interferences.
- v) All three financial systems are exposed to risks. The systems based on state regulation have to resist to temptations of bureaucratic arrogance, hyper-regulation, sclerotisation and excessive intrusion or interference in operational and organisational selections of intermediaries. A system based on self-regulation is

exposed in turn to a risk of corruption and capture. There has been an extensive discussion in the USA on the problem of regulatory capture, that is, the effective control of the regulator by the regulated. In fact, it has been argued that "with self-regulation, regulatory capture is there from the outset"³¹⁸ An "inevitable tendency for the Regulators to seek an easy cohabitation with regulated" has been observed "but there is a cost: the high risk that the regulated will capture the Regulators."³¹⁹ "More serious still is the possibility that a captured regulated system may become a cartel which operates in the interest of established major firms within the regulated industry."³²⁰ Against the danger of corruption and capture it has been suggested, as a remedy, an association in a system of tripartitism. "Business regulation is often modelled as a game between two players".³²¹ "Tripartitism is a process in which relevant public interest groups (PIGs) become the fully fledged third player in the game between the regulatory agency and the firm. As third player in the game, the PIG can directly punish the firm. PIGs can also do much to prevent capture and corruption by enforcing a norm of punishing regulators who fail to punish noncompliance".³²² Tripartitism is defined as "a regulatory policy that fosters the participation of PIGs in the regulatory process in three ways. First, it grants the PIG and all its members access to all the information that is available to the regulator. Second, it gives the PIG a seat at the negotiating table with the firm and the agency when deals are done. Third, the policy grants the PIG the same standing to sue or prosecute the regulatory statute as the regulator."³²³

Such a tripartitism, in a simple form, has been applied in France, where powers are granted to the associations of investors. Art. 12 of the Law n. 88-421

of June 23, 1989 has recognised to consumer associations the right to sue under civil law;

vi) The structure of the financial system is, like much else in France and Italy, more centralised than in the UK. This is due to their civil law tradition roots;

vii) In spite of the division of powers principle introduced by the French Revolution (1789) the COB has been invested with most relevant powers, especially in the judicial field;

viii) The main tools used in the field of investor protection are self-regulation and deontology. In France beside deontology, self-regulation has been largely adopted. The French experience demonstrates that self-regulation processes can be controlled by the regulatory body and can supply, too, a re-enforcement and a centralisation of its powers. The French system seems to prove that a larger participation of financial intermediaries in the self-regulation processes does not necessarily reduce the regulatory body's powers but perhaps it does the contrary.

ix) Lastly, the presence of women in the regulatory body Boards has not been remarkable. Actually there are two women on the SIB's Board (Rosalind Gilmore and Donagh McDonald) both named in december 1st, 1993. On the COB's Board has been elected a woman until November 21, 1994. No women have been members of the CONSOB's Board.

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2. A. Cerrei and A. Mazzioni, La Tutela del Socio e delle Minoranze, in Riv. Soc., vol. 38 (1993), p. 16.
3. P. Clarotti, The Completion of the Internal Financial Market: Current Position and Outlook in EC Financial Market Regulation and Company Law, M. Andenas and S. Kenyon-Slade eds, (1993), p. 8.
4. H.D. Assmann, La Responsabilità da Prospetto, in Il Diritto delle Società per Azioni, (1993), p. 641.
5. Ibidem.
6. G. Ferrarini, La Responsabilità da Prospetto, in Trattato delle Società per Azioni, G. E. Colombo and G.B. Portale eds. (1993), p. 291.
7. H.D. Assmann, op. cit., (note 4 above), p. 647; Command Papers 7779 (1985), pp. 5,6.
8. Justice Brandels, Other people's money, New York 1932, p. 92.
9. H.D. Assmann, op. cit., (note 4 above), p. 663.
10. Ibidem, p. 670.
11. Ibidem, p. 675, note 69.
12. Ibidem, p. 667, note 72.

13. Azioni Risarcitorie nei confronti delle Società di Revisione negli Stati Uniti, *News in Riv. Soc.*, vol. 38, 1993, p. 1469 ff.

14. H.D. Assmann, *op. cit.*, (note 4 above), p. 677.

15. *Ibidem*, p. 679.

16. *Ibidem*, p. 680.

17. The Eurolist project is based on three conditions: i) a capitalisation of more than a billion of Ecus; ii) a volume of transactions over 250 millions of Ecus and iii) a true international activity. See COB Report 1993, p.38.

18. E. Lomnicka, *The Internal Financial Market and Investment Services*, *op. cit.*, (note 3 above), p. 86.

19. Art. 1 : - Client money and instruments must be protected, especially in the event of the insolvency of a firm or of its proprietors, seizure, set-off or any other action by creditors of the firm or of its proprietors;

- The natural person must be subject to rules designed to monitor its solvency and that of its proprietors;
- The natural person's annual accounts must be audited;
- Sole trade must make provision for the protection of investors in the event of the firm's cessation of business following the death or incapacity of the sole trader, or any other similar event.

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21. G. Di Marco, Enti Creditizi, Società e Valori Mobiliari: Novità dalla CEE, in *Le Società* n. 9 (1993), p. 1275.
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23. *Ibidem*, p. 99.
24. E. Lomnicka, *op. cit.*, (note 18 above), p. 81.
25. SIB Discussion Paper on Implementation of the ISD and CAD, July 1994, p. 40.
26. P. Ashall, *op. cit.*, (note 22 above), p. 92.
27. *Il Sole 24 Ore*, January 20, 1994, p. 25.
28. M.C. Capponi, Commento in *Le Società* n.8 (1993), p. 1123.
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32. SIB Discussion Paper on Implementation of the ISD and CAD, July 1994, p. 33.
33. P. Ashall, *op. cit.*, (note 22 above), p. 94.

34. *Ibidem*, p. 99.
35. L. Garzaniti and D. Poppe, *op. cit.*, (note 20 above), p. 52.
36. P. Ashall, *op. cit.*, (note 22 above), p. 101.
37. E. Lomnicka, *op. cit.*, (note 18 above), p. 82.
38. L. Garzaniti and D. Poppe, *op. cit.*, (note 20 above), p. 44.
39. A. Alcock, UK Implementation of European Investment Services Directives in *The Company Lawyer*, vol. 15, no. 10 (1994), p. 300.
40. A. Babeau, Les Comportements d'Epargne des Français d'un Siècle à l'Autre in *Journal des Caisses à Epargne*, june 1982, p. 11 ff.
41. P. Fleriot, Introduction in *Les Entretiens du 25 Anniversaire de la COB "quels actionnaires pour l'entreprise?"*, Bulletin COB n. 265 (1993), p. 7.
42. *Ibidem*, p. 8.
43. *Ibidem*, p. 7.
44. COB Report 1993, p. 98.
45. M. Lobbano, *op. cit.*, (chap 3 note 1), p. 248.
46. *Ibidem*, p. 249.

47. F. Perier, *Abrégé de Déontologie des Activités Financières*, in *Revue de Droit Bancaire et de la Bourse*, n. 18, (1990), p. 58.

48. Art. 4.1 of the Ordinance of 1967 provides as follows: "Pour l'exécution de sa mission, la commission peut prendre des règlements (...) prescrivant des règles de pratique professionnelle qui s'imposent aux personnes faisant publique appel à l'épargne ainsi qu'aux personnes qui, à raison de leur activité professionnelle interviennent dans les opérations sur des titres placés par appel public à l'épargne ou assurent la gestion individuelle ou collective de portefeuilles de titres".

49. See the report of the working group chaired by Gilles Brac de La Perrière, published by the COB, September 1989, p. 10.

50. See also the *Rapport Général du groupe de déontologie des activités financières*, published as a Supplement to the COB Bulletin Mensuel n. 212, March 1988, pp. 19-23.

51. See note 49 above, p. 10.

52. F. Perier, *op. cit.* (note 47 above), p. 59.

53. *Ibidem.*

54. *Ibidem.*

55. *Ibidem*, p. 60.

56. *Ibidem.*

57. COB Report 1991, p. 203.

58. C. Ducouloux-Favard, II Commento in *La Società* no. 11 (1994), p. 1589.
59. COB Report 1991, p. 208.
60. COB Report 1992, p. 189.
61. *Ibidem*, p. 191.
62. *Ibidem*, p. 191.
63. M. Lobuono, *op. cit.*, (chap. 4, note 3), p. 250.
64. *Ibidem*, p. 251.
65. C. Hannoun, *op. cit.*, (chap. 4 note 3), p. 441.
66. M. Lobuono, *op. cit.*, (chap. 3 note 1), p. 251.
67. Cour de Cassation, Civ. 1, May 4, 1982, in *Dalloz*, 1983, p. 378.
68. A. Tunc, *op. cit.*, (chap 5, note 2), p. 138.
69. Bulletin mensuel COB n. 246, June 1991, p. 3.
70. Tunc, *op. cit.*, (chap. 5, note 2), p. 136.
71. G. Alpa in a note on the Commission des Opérations de Bourse (COB) and on the reform of the functioning of the market *op. cit.*, (chap. 5, note 21), p. 1162 ff. distinguishes the regulated mode of producing a prospectus in terms of three stages:
 - 1) An initial phase (art. 6 of the Ordinance), in which the COB controlled a prospectus preliminarily in terms of

the requirements laid down in Arts. 6-7 of the Ordinance of 1967. In our translation Art. 6 states that "A company appealing for public investment in exchange for shares or bonds shall first issue a document destined to supply information to the public on the organisation, financial situation and state of activities of the company".

2) The intermediate phase in which the COB, subsequent to the introduction of an EC Directive on the approximation of standards relative to the preparation of the prospectus for admission to stock market official listing, replaced initial provisions by virtue of a guideline of February 2, 1982;

3) The current phase, in which beside requirements laid down in phase 2 (see above), standards applicable to the simplified procedure, of "rapid approval" are used as introduced by Guideline of July 31, 1987.

72. G. Alpa, op. cit., (chap 5, note 21), p. 1157.

73. P. Balzarini, Note d'information: un'istruzione della COB in Riv. Soc. 1983, vol. 29, pp. 727 ff.

74. Law of 24 July, 1966, annexe 2 amended into annexe 3 in the Law of June 3, 1985.

75. G. Alpa, op. cit., (chap. 5, note 21), p. 1167.

76. As pointed out by Alpa (op. cit, chap, 5 note 21, p. 1167) in connection with the Amrep affair, and the judgement of the Tribunal de Paris on May 6, 1986, in Gaz. Pal. December 7-9, 1986, jur. p. 6 with notes by J.P. Marchi and comments by Bouzat, in riv. trim. dr. com., 1987, p. 266.

77. A. Tunc, op. cit., (chap. 5 note 2), p. 136.

78. COB Report 1993, p. 109.
79. COB Report 1993, p. 109.
80. COB Report 1993, p. 9.
81. COB Report 1992, p. 107.
82. *Ibidem*, p. 184.
83. COB Report 1993, p. 12.
84. See D. Vatel, *op. cit.* (chap 5, note 76) and COB Report 1992, p. 185.
85. *Ibidem*.
86. *Ibidem*, p. 105.
87. COB Report 1993, p. 199.
88. *Ibidem*, pp. 199-200.
89. *Ibidem*, p. 201.
90. COB Report 1992, p. 87.
91. *Ibidem*.
92. COB Report, 1991, p. 97.
93. See Arts. 1,5,7,10,21, and 28 of the Regulation 91.02.
94. COB Report 1992, p. 88.

95. *Ibidem*, p. 97.
96. *Ibidem*, p. 92; see also Art. 3 of the Regulation 92.02.
97. COB Report 1992, p. 99.
98. *Ibidem*.
99. COB Report 1990, p. 49.
100. *Ibidem*, p. 50.
101. COB Report 1992, p. 35.
102. Bulletin mensuel of the COB, April 1990, n. 235, p. 7.
103. See Riv. Soc., 1990, p. 1119.
104. The "Clubs d'investissement" created in the USA at the end of the last century were instituted in France by 1988 principally in small cities and in the country. Actually there are about 15.000 clubs with 200.000 members. See COB Report 1993, p. 101.
105. See Le Revue Française, n. 258, April 1992, p. 32.
106. COB Report 1992, p. 78.
107. A. Tunc, *op. cit.*, (chap. 5, note 2), p. 138.
108. COB Report 1990, pp. 27-28.
109. COB Report 1992, p. 180.

110. COB Report, 1993, p. 195.
111. COB Report 1992, p. 165 and COB Report 1993, p. 32.
112. See COB Report 1993, p. 32.
113. Ibidem,
114. Ibidem.
115. COB Report 1992, p. 165.
116. COB Report 1993, p. 36.
117. See Les actions de la COB pour la protection de l'épargne, as COB Document, January 22, 1993.
118. D. Branger in an interview published in Marchés des Techniques Financières, April 1992, n. 39, p. 27.
119. The Companies Act 1989 has replaced Section 62, which enabled to bring compensation actions by private investors as well as by institutional investors, with the new Section 62A which limits to private investors the right to have access to a compensation action (section 193).
120. J. Mamert, Les Nouveaux Règlements de la COB et l'Information des Epargnants in Les Entrétiens de la COB "L'information et l'Epargnant", published by the COB, p. 36.
121. J.L. Beffa, op. cit., (note 120 above), p. 34.
122. D. Branger, op. cit., (note 120 above), p. 86.

123. H. de La Bruslerie, *Réflexions sur la Déontologie des Activités Financières*, in *Revue d'Economie Financière*, 1988, pp. 18 ff.

124. Art. 41 lays down that the exercise of private economic initiative is free, provided that it does not conflict with social utility and does not detrimentally affect (public) security, freedom, human dignity. Programmes and suitable controls shall be determined by law to see that public economic activity is directed toward and coordinates with social objectives.

Art. 47 states, in a more specific way, that the Italian Republic promotes and protects savings in all their forms; it regulates and controls credit operations; it favours the use of popular savings for the acquisition of housing property, to cultivate immovable property and to direct and indirect investment in the form of shares in the big undertakings of production in Italy.

125. G.E. Colombo, *op. cit.*, (note 1 above), p. 19.

126. G. Cammarano, *L'impresa di intermediazione finanziaria nella nuova legislazione*, in *Riv. Soc.* vol. 38 (1993), p. 1174.

127. P. Marchetti, *Politica del Diritto*, n. 1, (1988).

128. See *La Riforma delle Società di Capitali in Italia* Progetti e documenti, 1966, p. 3.

129. P. Ferro-Luzzi, *Sulla sospensione di amministratori e sindaci*, in *Riv. Soc.* vol. 38 (1993), p. 1226.

130. F. Carbonetti, *I contratti di intermediazione mobiliare*, Milano, (1992), p. 68.

131. F. Annunziata, *Regole di Comportamento degli Intermediari e Riforme dei Mercati Finanziari*, (1999), pp. 351-352.

132. *Ibidem*, p. 382.

133. *Ibidem*.

134. *Ibidem*, p. 382, note 239.

135. *Ibidem*, p. 384.

136. *Ibidem*, p. 385.

137. *Ibidem*, p. 386.

138. G. Minervini, *op. cit.*, (Chap 6, note 22), p. 27.

139. G. Rossi, *op. cit.*, (Chap. 6, note 8), p. 11.

140. A. Jannuzzi, *op. cit.*, (Chap. 6, note 23), p. 492.

141. Circolare n. 37/1990, *Commento Assonime in Riv. Soc.* vol. 35, (1990) p. 349.

142. *Ibidem*, p. 356.

143. F. Annunziata, *op. cit.*, (note 131 above), p. 292.

144. *Ibidem*, p. 293.

145. *Ibidem*, p. 294, note 35.

146. *Ibidem*, p. 295.

147. Ibidem, p. 290.

148. Ibidem, p. 291, note 27.

149. On the basis of the differentiation laid down by the CONSOB in Art. 13 of the Regulation n. 5387 of July 2, 1991, "qualified operators" are specified and at the end, generically indicated as follows "and (x) any company or legal person in possession of a specific competence and experience related to operations of transferable securities expressly referred to contractually as mentioned in art. 9".

150. F. Annunziata, op. cit., (note 131 above), p. 377, note 226.

151. E. Libonati, Commento, in *Le Nuove Leggi civili*, (1984), p. 512.

152. G. Minervini, op. cit., (Chap 6, note 54), p. 136.

153. G. Alpa, *La tutela del risparmiatore in Giurisprudenza Italiana* (1990), IV, 519.

154. Cass. S.U. of January 14, 1992, in *Foro Italiano* (1992), I, p. 1421.

155. January 11, 1988, in *Le società* (1988), p. 598.

156. *Le Società - Casi e questioni*, Peat Marwick (ed.), IPSOA, p. 1.

157. *Il SOLE 24 ORE* (Italian daily), March 18, 1994.

158. For the protection of investors, the choice of approach has been in favour of rules on conduct rather than to standards of validity.

159. F. Annunziata, *op. cit.*, (note 131 above), p. 269.

160. *Ibidem*, p. 270.

161. *Ibidem*.

162. See *Dizionario della Lingua Italiana* by E. De Felice and A. Duro, voce "conforme", p. 465.

163. *Ibidem*, voce "inspirare", p. 1.51.

164. F. Annunziata, *op. cit.*, (note 131 above), p. 273.

165. *Ibidem*, p. 277.

166. G. Minervini, *op. cit.*, (Chap 6, note 54), p. 129.

167. Art. 1176 para 2 of the Italian Civil Code states that in fulfilment of obligations inherent to a professional activity, diligence shall be assessed with reference to the nature of the exercised activity.

168. A. Di Majo. *La Correttezza nell'Attività di Intermediazione Mobiliare*, in *Banca e Borsa*, parte I, (1993), p. 292.

169. F. Annunziata, *op. cit.*, (note 131 above), p. 273.

170. A. Di Majo, *op. cit.*, (note 168 above), p. 296.

171. A. Maisano. Il controllo del regolamento contrattuale, lecture for a meeting in Trapani of May, 29-30, 1992, p. 13.
172. F. Annunziata, op. cit., (note 131 above), p. 316.
173. Ibidem, p. 344.
174. Ibidem, p. 345.
175. Ibidem, p. 347.
176. Ibidem.
177. Ibidem, p. 349.
178. Ibidem, p. 127 ff.
179. Ibidem, p. 327.
180. Ibidem, p. 228.
181. Ibidem, p. 338.
182. Ibidem, p. 350.
183. Ibidem, p. 353.
184. Ibidem, p. 374.
185. Ibidem, p. 374.
186. Ibidem, p. 341.

187. Arts. 5 and 13 of the CONSOB Regulation n. 5367 of July 2, 1991.
188. G. Alpa, La trasparenza del contratto nei settori bancario, finanziario e assicurativo, in a lecture for the meeting in Trapani of May, 29-30, 1992, p. 20.
189. A. Maisano, op. cit., (note 171 above), p. 4.
190. Ibidem, p. 8
191. G. Alpa and alia, at a conference on June 22-23, 1989 in Naples. In Vita Notarile, vol. XLI, (1989), p. 384.
192. M. Bessone, Convegno at a conference on June 22-23, 1989 in Naples. In Vita Notarile, vol. XLI, (1989), p. 384.
193. CONSOB Report 1993, p. 13.
194. Ibidem, pp. 135-143-145.
195. Ibidem, p. 135.
196. Ibidem, p. 149.
197. Ibidem, p. 156.
198. On the Ferruzzi-Montedison Affair see CONSOB Report 1993 pp. 11-12-135.
199. CONSOB Report 1993, p. 12.
200. G. Minervini, op. cit., (Chap. 6, note 62), p. 129.

201. G. Minervini, Il Controllo del Mercato del Finanziario. L'alluvione delle Leggi in Giurisprudenza Commerciale (1992), p. 14.
202. G. Minervini, op. cit., (Chap 6, note 55), p. 131.
203. CONSOB Report 1993, p. 143.
204. C. Conti, La Legge sulle SIM. Aspetti di Disciplina degli Intermediari e di Regole del Mercato, in Riv. Soc. vol. 36, (1991), p. 1429.
205. A. Maisano, op. cit., (Chap. 8, note 181), p. 12.
206. Ibidem, p. 15.
207. F. Benvenuti, Verso il '93 e oltre, in Studi in Memoria di Franco Piga, vol. 2, (1992), pp. 1082-1084.
208. CONSOB Report 1993, p. 14.
209. E. Cardì, La CONSOB come Istituzione Comunitaria, in Studi in Memoria di Franco Piga, vol. 2, (1992), p. 1154.
210. Ibidem, p. 1159.
211. Ibidem, p. 1161.
212. L.B.C. Gower, op. cit., (Chap. 3, note 5), p. 4.
213. B.A.K. Rider, C. Abrams and E. Ferran, op. cit., (Chap 7, note 10), p. 7.
214. Ibidem, p. 6.

215. A. Large, *op. cit.*, (Chap. 5, note 44), p. 39.
216. R. Bosworth, Davies, *Personal Investment Authority - Different Title; Same Old Song in The Company Lawyer*, vol. 14, n. 3, (1993), p. 72.
217. A. Large, *op. cit.*, (Chap. 5, note 44), p. 2.
218. B. Jenkins: *Report on Standards. Personal Investment Authority*, April 1993.
219. K. Clucas, *Report of a Study on a New SRO for the Retail Sector in Retail Regulation Review*, March 1992, p. 23.
220. "Permitted persons" are persons who, by virtue of being granted a permission by the SIB, are not regarded as carrying on the investment business of dealing investments. Thus a permitted individual acting within the scope of his or her permission is not a "private investor" for the purposes of Section 62A actionability, even though under the FSA 1986 he or she would not be regarded as carrying on investment business. See the *Journal of Business Law*, July 1991, p. 356.
221. M. Blair, *Financial Services: The New Core Rules*, (1991), p. 44.
222. Small business investor means:
- a. a company or partnership; or
 - b. a trustee acting for a trust; which does not satisfy a size requirement enabling the company, partnership or trustee to be treated as an ordinary business investor. See K. Clucas, *op. cit.*, (note 219 above), p. 59.

223. M. Blair, *op. cit.*, (note 221 above), p. 45.
224. *Ibidem*, p. 44.
225. K. Clucas, *op. cit.*, (note 219 above), p. 25.
226. PIA's Approach to Regulation, February 1994, p. 108.
227. Implementation of the Investment Services Directive and Capital Adequacy Directive, SIB Discussion Paper, July 1994, p. 34.
228. PIA Rule Book, July 1994, para 7, p. vii.
229. PIA's predominant concern is to regulate the investment business activities described in paragraphs 3 to 5. See PIA Rule Book, *op. cit.*, (note 228 above), para 7, p. 36.
230. K. Clucas, *op. cit.*, (note 219), p. 25.
231. *Ibidem*, p. 36.
232. *Ibidem*, p. 7.
233. *Ibidem*, p. 30.
234. *Ibidem*, p. 34.
235. *Ibidem*, p. 35.
236. *Ibidem*, p. 36.
237. SIB Report 1992/1993, p. 10.

238. B. Jenkins, *op. cit.*, (note 218 above), p. 2.
239. *Ibidem*, p. 3.
240. *Ibidem*, p. 4.
241. *Ibidem*, p. 46.
242. *Ibidem*, p. 50.
243. *Ibidem*, p. 51.
244. *Ibidem*, p. 5.
245. *Ibidem*, p. 11.
246. R. Bosworth-davies, *op. cit.*, (note 216 above), p. 72.
247. See *op. cit.*, (note 226 above),
248. PIA Memorandum and Articles of Association, February 1994.
249. M. Ashe, The Continuing saga of PIA, in the *Company Lawyer* vol. 15, n. 7 (1994), p. 147.
250. J. Harris, Self-regulation Under Pressure, in the *Company Lawyer*, vol. 15 n. 5 (1994), p. 147.
251. A. Large, *op. cit.*, (Chap 5 note 44), p. 25.
252. *Ibidem*, p. 50.

253. Ibidem, p. 51. During the passage of the Companies Act 1989, it was suggested that the RPBs should be brought within the scope of the power, but this did not commend itself to Parliament.

254. M. Blair, *op. cit.*, (note 221 above), p. 30.

255. Ibidem, p. 31.

256. Ibidem, p. 41.

257. Ibidem, p. 174.

258. Ibidem, p. 35.

259. Ibidem, p. 37.

260. For more on this point, see M. Blair, *op. cit.*, (note 221), p. 39.

261. Ibidem, p. 40.

262. M. Blair, *op. cit.*, (note 221 above), p. 47, note 3.

263. House of Commons, Parliamentary Debates, Weekly Hansard, 5-8 may 1987, p. 906.

264. R.B. Jack, *op. cit.*, (Chap. 7, note 44), p. 3.

265. Financial Times, August 15, 1987.

266. A. Large, *op. cit.*, (Chap. 5, note 44), p. 25.

267. H. McVea, Fiduciary Duties and the Regulatory Rules, in Business Law Review, June 1993, p. 151.

268. Comment in *The Company Lawyer*, vol. 15, n. 9(1994), p. 258.

269. A. McGee. *op. cit.*, (Chap. 7 note 7), p. 130.

270. Section 62 of F.S.A. 1986: "a contravention of
(a) any rules or regulations made under this chapter;
(b) any conditions imposed under section 50 above;
(c) any requirements imposed by an order under section 58(3) above;

(d) the duty imposed by section 59(6) above, shall be actionable at the suit of a person who suffers loss as a result of the contravention subject to the defenses and other incidents applying to actions for breach of statutory duty.

(2) Subsection (1) applies also to a contravention by a member of a recognised self-regulating organisation or a person certified by a recognised professional body of any rules of the organisation or body relating to a matter in respect of which rules or regulations have been or could be made under this Charter in relation to an authorised person who is not such a member so certified."

271. J. Pritchard, *Investor Protection Sacrificed: the New Settlement* and s 62, part 2, in *the Company Lawyer*, vol 13, n. 11, (1992), p. 210.

272. From October 3, 1988 to April 4, 1991.

273. J. Prichard, *op. cit.*, (note 271 above), p. 213.

274. L.G. Doyle, *Financial Services: Recouping loss under the Act*, in *Business Law Review* April 1992, p. 87.

275. *Ibidem*.

276. J. Pritchard, *op. cit.*, (note 271 above), p. 211.
277. J. Pritchard, *op. cit.*, (note 271 above), p. 210.
278. A. Large, The Chancery Bar Association Spring Lecture, March 1994, reported by I.G. Macneil, FSA 1989: Does s 62 provide an effective remedy for breaches of conduct of Business Rules?, in *The Company Lawyer* vol. 15, n. 6, (1994), p. 172.
279. G. Calabi, Sulla Liberta' di Prestazioni di Servizi di Intermediazione Mobiliare: Legge SIM e Diritto Comunitario a Confronto, in *Contratto e Impresa*, (1992), p. 760.
280. A. Large, *op. cit.*, (Chap. 5, note 44), p. 50.
281. *Ibidem*, p. 52.
282. *Ibidem*, p. 53.
283. SIB, *The Background to Investor Protection* (1992), p. 7.
284. *Ibidem*.
285. *Ibidem*, p. 6.
286. *Ibidem*, p. 7.
287. L.B.C. Gower, *op. cit.*, (Chap. 7, note 31), p. 164.
288. J.J. Fishman, A Comparison of Enforcement of Securities Law Violations in the UK and US, in *The Company Lawyer*, vol. 14, n. 9, (1993), p. 163.

289. The Power of Fear, Comment in The Company Lawyer, vol. 14, n. 1, (1993), p. 2.

290. J.J. Fishman, op. cit., (note 288 above), p. 163.

291. SIB Report 1991/1992, p. 36.

292. Ibidem, p. 22.

293. A. Large, op. cit., (Chap. 5, note 44), p. 60.

294. Ibidem, p. 28.

295. SIB Report 1991/1992, p. 27.

296. FSA, Schedule 1, defines those activities which constitute "investment business" and for which authorisation is therefore necessary.

297. See Sections 6 and 61 of the FSA.

298. SIB Report 1991/1992, p. 24.

299. SIB Report 1993/1994, p. 15.

300. Ibidem, p. 19.

301. SIB Report 1992/1993, p. 23.

302. SIB Report 1993/1994, p. 15.

303. SIB Report 1992/1993, p. 23.

304. A. Large, op. cit., (Chap. 5, note 44), p. 29.

305. *Ibidem*, p. 53.
306. *Ibidem*, p. 57.
307. SIB Report 1993/1994, p. 12.
308. Comment in *The Company Lawyer*, vol. 15, n. 4 (1994), p. 98.
309. R. Bosworth-Davis, Power Granted to the SIB under FSA 1986, s 59, in *The Company Lawyer* vol. 15, n. 4 (1994), p. 120.
310. A. Large, *op. cit.*, (Chap. 5, note 44), p. 57.
311. *Ibidem*, p. 56.
312. *Ibidem*, p. 60.
313. *Ibidem*, p. 52.
314. *Ibidem*, p. 59.
315. J. Fishman, *op. cit.*, (note 288 above), p. 169.
316. *Ibidem*, p. 172.
317. *Ibidem*.
318. J. Kay, *op. cit.* (chap 3 note 11), p. 34.
319. Ch. Goodhart, *op. cit.* (chap 3, note 26), p. 23.
320. J. Kay, *op. cit.* (chap. 3, note 11), p. 34.

321. I. Ayres, and J. Braithwaite, *op. cit.* (chap 3, note 13), p. 54.

322. *Ibidem*, p. 56.

323. *Ibidem*, p. 57.

Chapter 9Conclusions

The present thesis has concentrated on the role and importance of intermediaries in investment protection in an increasingly complex and global financial markets system. Processes of de- and re-regulation of the markets have affected the redefinition of the role and importance of intermediaries, with political dimensions which have even influenced the domestic economy of the states concerned, with Italy as an example.

It is to be noted that when mention is made of the development and internationalisation of financial markets, reference is actually made to investors and their transnational access to stock markets. In such a framework it is implicit that the latter have to compete with each other in attracting investment capital. However, does the new and transnational regulation of financial markets offer adequate protection to investors?

An answer to this question depends on a comparison of the new national systems with the old ones in order to find out whether investors today are better protected than before. The pre-deregulatory system guaranteed protection to private and institutional investors without any distinction between them, essentially through (i) unlimited liability borne by financial intermediaries and (ii) fixed commissions for their services to investor clients. If the then existing system was prima facie quite satisfactory, why has it been necessary to change it in the wake of market de- and/or re-regulation?

On the way to answering the above question it is first necessary to have a look at developments on the other side of the Atlantic ocean, that is, in the USA, in order to realise that much more has been at stake than

the isolated question of investor protection. In the 1960s and 1970s a new development was promoted in the USA under the title of deregulation. It tended toward the abolition of the unlimited liability and the single capacity system. On May 1st, 1975, called "Mayday", fixed commissions for intermediaries in the USA were abolished. The purpose of deregulation in the USA was however a strategic and economic operation going far beyond matters relating to intermediaries. It pursued the objective of attracting international investment capital and intermediaries in the first place from European stock markets, especially from London, to financial markets in the USA, for which the de- and re-regulation of the USA financial markets was an apt approach using three main instruments:

- i) The abolition of unlimited liability applicable to financial intermediaries;
- ii) The abolition of fixed commissions for the services of intermediaries, and
- iii) Introduction of a more severe system for monitoring financial markets.

These developments could be considered to be a trick for attracting capital to the USA. Indeed, large amounts of investment capital and many of the internationally well-known financial intermediaries shifted the centre of their activities from different parts of the world to the USA financial markets considered to be more attractive by offering

- i) The privilege of limited liability borne by intermediaries;
- ii) The possibility for institutional investors to bargain commission rates for intermediaries' services, and
- iii) Efficient and controlled financial markets.

In Europe the financial markets in the UK were the

first to feel and fear the aggressiveness of the USA financial markets deregulation. Consequently, in 1986, for defending the reputation and position of London as the world's most important financial place and in order to stop a financial haemorrhage caused by an exodus of capital and intermediaries to the USA, the Big Bang introduced into the British system the same changes as those effected in the USA: limited liability for intermediaries, abolition of fixed commissions and the creation of a new watchdog authority in the form of the SIB. The Stock Exchange became a limited liability company whose owners had no longer unlimited liability for its debt. The Big Bang was thus a necessary and urgent answer to the challenge of deregulation in the USA.

For other European countries, especially France, the Big Bang in turn sounded an alarm. In July 1989, the French Stock Exchange finally abolished fixed commission rates on smaller brokerage transactions. Commissions on orders of more than FFr 2 million for equities and FFr 10 millions for bonds had been negotiable for several years. The results of this fundamental deregulatory step were expected to be similar to those that followed the 1975 Mayday in the USA and the 1986 Big-Bang in the UK: a price-cutting war that would drive a number of the weaker or smaller brokerage firms out of the business; sharply lower commissions for institutional investors; and no reduction in rates, or even higher commissions, for individual investors.

The ensuing deregulation in France was marked by a destructive fury against the symbols of the old stock market system. Also symbolically, during the night of July 14, 1987 the "corbeille" or place where brokers operated at the Paris stock market was dismantled and wiped away by a caterpillar machine. Le Monde of July

19-20, 1987, reported "La Bourse a troqué sa corbeille - un crime de lèse-majesté". The traditional French agents de change were so to speak guillotined out of existence and were substituted by companies, while the new UK system maintained the two categories of intermediaries: (i) physical persons and (ii) companies.

The Italian Big Bang came later, in 1991, not least because the politically weak governments were opposed by a powerful lobby of stock exchange agents.

At the level of the EC, initiatives played a stimulating and coordinating role by promoting changes in the financial markets of the major states. Deregulatory legislation by the EEC started with a draft Directive (October 5, 1972), for coordinating the requirements for the prospectus. As such, EC legislative initiative anticipated in some respects the Big Bang. As a credit to the UK, it should be noted that after she joined the ECs on January 1st, 1973, a relative acceleration in EC moves to deregulate and re-regulate financial markets in the EC became noticeable. This may be attributed to UK influence at EC level.

The new regulation of the financial markets in the EC, especially for the purpose of the present thesis in France, Italy and the United Kingdom, has been essentially marked by a distinction between the categories of (i) institutional investor and (ii) private (small) investors. This distinction was adopted by France and Italy by following the example of the UK. At the level of EC too this distinction has been adopted, by EC Directive 1993/22. A further new proposed Directive on investor protection could definitively sanction the distinction between the two investment categories, by dealing exclusively with private (small) investors.

The historical process of formation and development of the new control bodies of financial markets in itself

suggests that the current system refers more to the protection of investor's trust in the markets than to the protection of the investor himself, because there is but an "indirect" investor protection by the rules which regulate intermediaries. Investor protection is only indirect coming next to the protection of the markets, as a protection in turn effected through the regulation of financial intermediaries. The substance, the protection of investors can be currently conceived as a matter of interest complementary to promoting the protection of the markets and of competition in them; the efficiency of the intermediaries contributes to long-term stability on the markets and therewith to the protection of investors' trust in them.

It is here submitted that the actual regulatory standard refers more to the investors' trust and confidence than to investor protection, because an indirect protection exists throughout the rules that govern the financial markets and the intermediaries. Thus, investor protection is only indirect, so to speak "filtered" and as a matter of second level relevance compared with the protection of the markets effected in the first place through a control system affecting the intermediaries. In substance, the protection of investors can be currently interpreted as a matter of interest complementary to the promotion and protection of the financial markets and consequently to the protection of the trust and confidence of investors.

Concentrating specifically on investor protection and the new intermediaries, one cannot help being critical with regard to the situation of the private and small investor. The investor protection strategy, that changed radically after the Big-Bang, seems characterised by a certain ambiguity featured in the discrepancies between statements of principles and the means used for

their application. In France, Italy, and the UK can be noted a disproportion between the "declared" objectives, on the one hand, and the "achieved" objectives on the other. Even in the Investment Services and Capital Adequacy Directives investor protection assumes blurred focus. Thus, investor protection seems to be only one of the objectives of the Directives. This implies that the challenge of investor protection, particularly of small investors is not yet satisfactorily met and dealt with. The shortcoming of a policy and strategy of investor protection may be explained as derived from the fact that small and medium categories of investors, officially considered as protagonists and addressees of the system of disclosure, have turned out in reality to be but a modest component in the concrete structure of the market. The aggregate weight of presence of small and medium category investors in the market has in fact been continually a limited one, and as such it has never been able to justify a greater pre-occupation by the legislator for such investors in a situation in which the trust of the system has been a matter of much more primary importance. At the EC level, too, although the Community has repeatedly asserted its commitment to the protection of investors, an increasingly internationalised market has made wealth generation the sine qua non of securities markets. It seems that the hybrid model, for simultaneously promoting market efficiency and investor protection, with an amalgam of central intervention and provincial self-regulation, and a bifurcated regulatory structure, strikes a balance between these aspects. Then, investor protection risks to be a flag more than a reality.

The present thesis makes no claim to completeness; rather, certain aspects were purposely selected and highlighted in an effort to contribute the task at hand.

Questions have been answered, but many more have been raised. In a scientific research (or paper) it is difficult to answer all the questions in a clear, definitive manner. Much remains to be done.

TABLEAU COMPARATIF C.O.B. - S.E.C. *

S.E.C.	C.O.B. (pouvoirs résultant de la loi du 2 août)
1. Des pouvoirs d'enquête comparables	
<p>L'enquête officieuse : les services de la S.E.C. peuvent agir de leur propre initiative mais n'ont pas le pouvoir d'exiger des documents ou la comparution de témoins.</p> <p>L'enquête officielle : décision formelle de la S.E.C. qui désigne les agents chargés de mener l'enquête. Ces agents peuvent exiger leurs documents et entendre des témoins.</p>	<p>La C.O.B. peut désormais faire appel aux commissaires aux comptes ou à des experts judiciaires, sans avoir ouvert d'enquêtes, pour procéder à des vérifications.</p> <p>Les enquêteurs de la C.O.B. peuvent se faire communiquer tous documents, convoquer toutes personnes et accéder aux locaux à usage professionnel.</p> <p>La C.O.B. peut, sous le contrôle du juge, procéder à des perquisitions et saisies en tous lieux, pour la recherche des infractions relatives aux délits d'initiales et manipulations des cours.</p>
2. Des pouvoirs désormais identiques en matière civile, pénale et conservatoire	
<p>♦ AU CIVIL</p> <p>La S.E.C. peut demander aux tribunaux civils une injonction pour faire cesser toute pratique illégale ou pour faire interdire certains actes par des personnes qui causent préjudice à d'autres.</p> <p>La S.E.C. intervient auprès des tribunaux civils en qualité d'<i>amicus curiae</i>.</p>	<p>♦ AU CIVIL</p> <p>Le Président de la C.O.B. peut demander au président du tribunal de grande instance de faire cesser une irrégularité ou d'en supprimer les effets.</p> <p>La C.O.B. peut intervenir à l'appui devant les juridictions civiles.</p>

* Sources : Ministère des Finances.

S.E.C.	C.O.B. (pouvoirs résultant de la loi du 2 août)
<p>• AU PÉNAL</p> <p>La S.E.C. saisit le ministère de la Justice, qui décide ou non d'intenter une action, des infractions relatives aux règles d'appel public à l'épargne, de tout délit d'initiés, de toute fausse information ou de tout délit d'entrave.</p> <p>• Mesures conservatoires</p> <p>La S.E.C. peut demander au juge de faire bloquer temporairement les comptes bancaires ou les comptes-titres.</p>	<p>• AU PÉNAL</p> <p>La C.O.B. peut saisir le Parquet, qui décide ou non de poursuivre, des infractions relatives aux délits d'initiés, manipulations de cours, entrave au bon fonctionnement du marché.</p> <p>En outre, la C.O.B. peut exercer les droits réservés à la partie civile. (Partie de la loi du 2 août jugée non constitutionnelle.)</p> <p>• Mesures conservatoires</p> <p>La C.O.B. peut demander au juge des mesures conservatoires : mise sous séquestre des fonds et titres et consignation de sommes d'argent.</p>
<p>3. Des pouvoirs organisés différemment en matière disciplinaire et administrative</p>	
<p>• Les sanctions disciplinaires</p> <p>La S.E.C. donne un agrément aux professionnels et peut le retirer ou le suspendre. Elle peut prendre des sanctions disciplinaires (blâme, suspension, révocation) à l'égard des professionnels (personnes physiques ou morales).</p> <p>La S.E.C. peut juger en appel des sanctions disciplinaires prises par les organismes professionnels auxquels elle délègue son pouvoir.</p> <p>• Le pouvoir de transactions</p> <p>La S.E.C. n'a pas de pouvoir propre de sanction administrative, mais peut transiger en matière pénale : elle peut obtenir du procureur l'immunité à l'encontre d'un contrevenant moyennant versement volontaire d'une amende.</p>	<p>• Les sanctions disciplinaires</p> <p>La C.O.B. donne des agréments à certains professionnels et peut les retirer (O.P.C.V.M. et gérants de portefeuille).</p> <p>Le pouvoir disciplinaire reste exercé par les autorités professionnelles (Conseil des bourses de valeurs, Conseil du marché à terme, Conseil de discipline des O.P.C.V.M.) mais la C.O.B. peut demander une seconde délibération aux instances disciplinaires.</p> <p>La C.O.B. peut demander enfin au juge de prononcer l'interdiction temporaire de l'activité professionnelle.</p> <p>• Le pouvoir de sanctions administratives</p> <p>La C.O.B. n'a pas de pouvoir de transactions mais elle a un pouvoir de sanctions pécuniaires qu'elle peut infliger à toute personne qui aura contrevenu à ses règlements.</p>

Appendice B : Copy of one of the earliest prospectuses for investment in Italy, soliciting public funds in financial support of the revolt against the Austrian authorities in the Italian provinces of Lombardy and Venezia in 1848.

Un « prospetto » per l'insurrezione

Diamo inizio con questo « programma di prestito » del Governo Provvisorio di Venezia del 1848 alla pubblicazione di « prospetti » storicamente interessanti o curiosi, riservandoci di darne successivamente un commento e un inquadramento.

GOVERNO PROVVISORIO DI VENEZIA

Programma di prestito

Si apre un « Prestito Nazionale Italiano » di dieci milioni di Lire Italiane.

Questa somma verrà impiegata a sostenere l'insurrezione delle Provincie Lombardo-Venete e la difesa di Venezia, e a conservare, colla indipendenza di questa città, la libertà e l'onore di tutta l'Italia.

Il debito è assunto e garantito dalle Provincie Lombardo-Venete.

Per Venezia si obbligano i triumviri eletti con potere dittatoriale dall'Assemblea del 15 Agosto; per la Lombardia il cittadino Cesare Correnti che, in forza del suo mandato degli 8 agosto corr., rappresenta in Venezia il Comitato di difesa di Lombardia in cui si concentrarono i poteri del Governo Lombardo, il quale fino dal giorno 18 Luglio dichiarò di assumere e di garantire solidariamente col Veneto tutti i debiti che fosse necessario di contrarre per la guerra della Indipendenza Italiana.

Il prestito è diviso in 20,000 azioni al presentatore d'Italiane L. 500 ciascuna fruttanti il 5 per cento.

Chi si sottoscriverà per dieci azioni ne riceverà una gratuitamente, chi per venti, due, e così di seguito.

Gli interessi del 5 per cento si pagheranno di sei in sei mesi, al quale effetto saranno uniti alle azioni i relativi *coupons*.

Il primo pagamento d'interessi semestrali si farà il 30 giugno 1849 dalla Cassa centrale di Venezia e nelle città principali d'Italia presso le Ditte bancarie che verranno in seguito designate. Saranno in quel giorno pagati contemporaneamente gli interessi decorsi dal giorno del versamento dell'importo della azione a tutto il 31 Dicembre prossimo venturo. Il capitale verrà restituito agli azionisti in cinque rate annuali con due milioni per ogni rata. Il primo pagamento sarà fatto in Venezia il 31 Dicembre 1852. Verranno estratte a sorte ai 30 novembre di ogni anno nella Loggia di S.

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