PROTECTION OF RETAIL INVESTORS THROUGH THEIR EMPOWERMENT

REGULATION OF INVESTMENT COMPANIES IN THE EUROPEAN UNION, THE UNITED KINGDOM AND THE UNITED STATES OF AMERICA

By-

Alexandra Horváthová

Submitted to Central European University

Department of Legal Studies

In partial fulfillment of the requirements for the degree of

Doctor of Juridical Science

Supervisor: Professor Tibor Tajti

Budapest, 2015

This thesis contains no materials accepted for any other institutions and no materials previously written and/or published by another person unless otherwise acknowledged.

s/ Alexandra Horváthová

ABSTRACT

Institutionalization in the financial markets has intensified in the 21st century on both sides of Atlantic Ocean. While in the United States almost every second retail investor has been investing with investment companies for a long time, in the universal bank-dominated European Union the interest of retail investors in investment companies is rather at its inception. Given the increased importance of investment companies, it is of a concern how little attention have the most developed legal systems paid to the protection of the "retail investors" while revisiting their financial regulatory frameworks after the 2008 global financial crisis. Accordingly it is the central aim of this thesis to fill this gap.

Since most of the retail investors invest in mutual funds (US) or UCITS (EU), these two paradigm forms of investment companies are in the center of analysis. This thesis by using quantitative and qualitative research methods tries to answer the pivotal question of whether appropriate level of retail investor protection is offered in the European Union in contrast to what is available in the United States. In order to answer these questions four investor-protection tools will be scrutinized from a comparative perspective: 1) the disclosure systems; 2) the fiduciary duties of investment companies and their advisers; 3) the powers of the supervisory agencies; and finally 4) the system of private securities litigation. Through the scrutiny of these four building blocks of the regulatory systems of the US and EU – supplemented by the United Kingdom as EU's leading financial center – this thesis unveils existing regulatory insufficiencies and suggests improvements in order to provide adequate protection for retail investors, which currently remains absent.

The first proposal arises from the observation of a shift in the applied “consumerist” policy in connection with the investment company regulation in the EU and the UK. The approach to treat investors as consumers incapable of informed decision-making, who require strong paternalistic interference from a regulator will not secure greater protection of retail investors, which the policy-makers call for. Instead, the regulators should focus on strengthening the four above stated regulatory building blocks in the light of retail investor empowerment regulatory approach reflecting investor’s autonomy and ability of learning and individual risk assessment.

The second proposal of this thesis is the application of the law of fiduciary duties known from trust law to investment companies and their advisers, in order to safeguard the interests of retail investors. Even though disclosure has been one of the foundational pieces of securities regulation, in case of investment companies it becomes less efficient as retail investors fully surrender their control over their investments to investment companies and their advisers. Trust law fiduciary duties impose higher fiduciary responsibilities than corporate law and thus are more effective in curtailing opportunistic behavior of investment companies and their advisers. Yet any rules are useless without efficient enforcement. Therefore, **the third proposal** of this thesis stems from the necessity of developing efficient enforcement of investors’ rights. It is the claim of this thesis that two aspects of enforcement should be strengthened: besides a powerful enforcement agency, retail investors should be empowered and provided with private right of action, not only individually but also collectively. This applies especially to the questions of the potential impact of the introduction of securities class actions in the EU.

ACKNOWLEDGEMENTS

First of all I would like to thank my supervisor Professor Tibor Tajti, whose comments, suggestions, questions and hesitations in voice were of invaluable importance for developing the structure and argumentation of this thesis. I am very much grateful for his strong patience, omnipresent availability and long-lasting support. Thanks to you Professor I have learned and grown.

I wish to thank the members of the doctorate committee for their willingness to review and evaluate my work. I am especially indebted to them for providing me with additional comments and suggestions, which I believe will greatly contribute to my future work.

The research for this thesis has also greatly benefited from my stays in the United Kingdom and the United States. This was possible due to the support of the Central European University, Oxford University and Cornell Law School. I would like to thank Professor Wolf-Georg Ringe for hosting me at the Law Faculty, University of Oxford. I am especially thankful to Professor Charles K. Whitehead who has been of a great support and provided me with a practical insight into my topic during my stay at the Cornell Law School. Moreover, I would like to thank the entire CEU Legal Department, including the faculty, visiting faculty and the staff as well as my colleagues who were of a great help and inspiration to me in the last four years.

Finally, I would like to thank my family and friends whose encouragement, support and love have been fundamental for my work and me. Thank you.

TABLE OF CONTENTS

List of Abbreviations

AMF	*Autorité des marchés financiers* (financial authority in France)
AUT	Authorized Unit Trust
AIFM Directive	Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No1095/2010 O.J. L174/1
BaFin	Bundesanstalt fur Finanzdienstleistungsaufsicht (Federal Financial Supervisory Authority of Germany)
BHCA	Bank Holding Company Act of 1956
Brussel I	Council Regulation (EC) No 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, O.J. L12/01
CCF	Common Contractual Fund
CEO	Chief Executive Officer
CESR	Committee of European Securities Regulators
CFPB	Consumer Financial Protection Bureau
CIS	Collective Investment Schemes
CJEU	Court of Justice of the European Union
COBS	Conduct of Business Sourcebook
COLL	Collective Investment Schemes Sourcebook
Companies Act of 1844	Joint Stock Companies Registration Act of 1844
CRA	Credit Rating Agency
Dodd-Frank Act 2010	Dodd-Frank Wall Street Reform and Consumer Protection Act
ECMH	Efficient Capital Market Hypothesis
EMBIG	J.P. Morgan's Emerging Markets Bond Index Global
ESA	European Supervisory Authorities
ESC	European Securities Committee
ESFS	European System of Financial Supervision
ESMA	European Securities and Market Authority
ESRB	European Systemic Risk Board
EP	European Parliament
EU	European Union
FACC	Face – Amount Certificate Company
FCIT	Foreign and Colonial Investment Trust
FDIC	Federal Deposit Insurance Corporation
Fed	Federal Reserve Board
FCA	Financial Conduct Authority
FCP	Fond commun de placement

FOS	Financial Ombudsman Scheme
FSA	Financial Services Authority (predecessor of FCA in UK)
FSCO	Financial Stability Oversight Council
FSCS	Financial Services Compensation Scheme
FSMA 2000	Financial Services and Markets Act 2000
FSO	Financial Services Ombudsman
GLBA	Gramm-Leach-Bliley Act of 1999
GLO	Group Litigation Order
IAA 1940	Investment Advisers Act of 1940
ICA 1940	Investment Companies Act of 1940
ICC	Investment Company Institute
IOSCO	International Organization of Securities Commissions
KapMuG	Kapitalanleger-Musterverfahrengesetz
LSE	London Stock Exchange
MAR	Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on Market Abuse (Market Abuse Regulation) and Repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC O.J. L173/1
MiFID	Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on Markets in Financial Instruments Amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and Repealing Council Directive 93/22/EEC O.J. L145/1
MiFID II	Directive 2014/64/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU O.J. L 173/349
MiFIR	Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Regulation (EU) No 648/212 O.J. L173/84
NRSROs	Nationally Recognized Statistical Rating Organizations
NSMIA 1996	National Securities Markets Improvement Act of 1996
NYSE	New York Stock Exchange
OEIC	Open-Ended Investment Companies
OIEA	The Office of Investor Education and Advocacy
PUHCA 1935	Public Utility Holding company Act of 1935
RDC	Regulatory Decisions Committee
Remedies Act of 1990	Securities Enforcement Remedies and Penny Stock Reform Act of 1990
SA 1933	Securities Act 1933
SAI	Statement of Additional Information
SEA 1934	Securities Exchange Act of 1934

SEC	Securities and Exchange Commission
SIB	Securities and Investment Board
SLUSA	Securities Litigation Uniform Standards Act of 1998
SSC	South Sea Company
TEU	Treaty of the European Union
TFEU	Treaty of the Functioning of the European Union
TTF	Tax Transparent Fund
TR	Trade Repositories
UCITS	Undertakings for Collective Investment in Transferable Securities
UCITS IV	Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS) O.J. L302/32
UCITS V	Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions O.J. L257/186
UCITS 1985	Council Directive 85/611/EEC of 20 December 1985 on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS) O.J. L375/3
UCITS MC	UCITS Management Company
UK FSA 2012	UK Financial Services Act 2012
UIT	Unit Investment Trust
US	The United States of America

INTRODUCTION

"Concordia res parvae crescent, discordia maximae dilabuntur."[1]

["In harmony small things grow, dissention dissolves the greatest."]

In 2008 the financial crisis, considered the worst since the Great Depression,[2] showed how the world's economies are interconnected and interdependent. The bankruptcy of one financial house has had a domino effect with unforeseen consequences that are devastating for all[3] – states, financial institutions, national or international corporations as well as **retail investors.**[4] Reflecting on Bardach and Kagan observation that *"catastrophes are probably the most important catalyst of new regulation;"*[5] legal systems around the world started to revamp their regulatory frameworks of financial markets.[6] The crisis has unleashed an avalanche of new financial markets regulation. A number of initiatives addressing bank capital and liquidity,[7] credit rating agencies,[8]

---

[1] Attributed to the Roman historian Sallust.

[2] Nouriel Roubini, Kenneth Rogoff and Nariman Behravesh have agreed that the 2008 financial crisis is the worst since the Great Depression, *see* David Pendery, *Three Top Economists Agree 2009 Worst Financial Crisis Since Great Depression; Risks Increase if Right Steps are Not Taken,* Reuters, Feb. 27, 2009, *available online at:* <http://www.reuters.com/article/2009/02/27/idUS193520+27-Feb-2009+BW20090227>/ *last visited* Dec. 3, 2014. Although some refer to the financial crisis in 2008 as the one between 2007-2009 or as one of 2009, it is the identical one.

[3] *See e.g.* Warwick J. McKibbin & Andrew Stoeckel, *The Global Financial Crisis: Causes and Consequences* (Working Paper in International Economics No. 2.09, Lowy Institute, November 2009) or Murillo Campello *et al.*, *The Real Effects of Financial Constraints: Evidence from a Financial Crisis,* 97 J. FIN. ECON. 470 (2010) (Showing that companies had to substantially cut their spendings and were unable to borrow externally, which caused them to miss on many attractive investment opportunities).

[4] **In the thesis I interchangeably use both terms "retail investor" and "investor".** In case I refer to other than retail investor, *e.g.* a professional, institutional or accredited investor – I always include the adjective.

[5] EUGENE BARDACH & ROBERT A. KAGAN, GOING BY THE BOOK: THE PROBLEM OF REGULATORY UNREASONABLENESS 23 (Transaction Publishers 2d ed. 2003).

[6] *See generally* EILÍS FERRAN ET AL., THE REGULATORY AFTERMATH OF THE GLOBAL FINANCIAL CRISIS (Cambridge University Press, 2012) [hereinafter "FERRAN ET AL."].

[7] Basel III as a global and voluntary regulatory standard on bank capital adequacy, stress testing and market timing is scheduled to be introduced by the members of Basel Committee on Banking Supervision from 2013 until 2019.

[8] The EU adopted the Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on Credit Rating Agencies O.J. L146/1. Although credit rating agencies were governed by the Credit Rating Agency Reform Act of 2006, the Dodd-Frank Wall Street Reform and Consumer Protection Act enhanced the enforcement mechanisms of the

remuneration in financial institutions,[9] and alternative investment fund managers have been adopted since 2008 or are underway in all three analyzed jurisdictions.[10] However, all these new regulatory measures often repealing the older generation of regulation neglect the one market participant who may have suffered the greatest losses of all – the **retail investor**.[11] The policy responses have focused on systemic protection and sustainability of the financial markets, while overlooking the need for increased protection of retail investors, who have become an important component of any well-run capital market.

Looking at the economics of the markets, correlation between capital market development and long-term economic growth has acceptance in academic literature, in policy statements issued by numerous international organizations as well as by practitioners.[12] Furthermore, the relationship between financial intermediation and

---

Securities and Exchange Commission and added number of requirements on the Nationally Recognized Statistical Rating Organizations [hereinafter "NRSROs"].

[9] The remuneration in financial institutions has been only EU initiative. The EU Commission adopted new standards to increase transparency in bankers' pay and risk profiles applicable to all types of financial institutions, including banks and investment companies.

[10] In the EU, the Commission adopted a Directive on Alternative Investment Fund Managers – covering diverse types of alternative investment funds, which have been unregulated under the EU law, including hedge funds or private equity funds. In the US, under the Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the advisers of hedge funds have to register with the SEC.

[11] *See* Niamh Moloney, *How to Protect Investors. Law, Policy and the Financial Crisis in* CURRENT LEGAL PROBLEMS 2010-2011 376 (George Letsas & Colm O'Cinneide eds., 2011) (Stating that the European Commission estimated that assets invested in the retail financial products fell in value from €10 trillion at the end of 2007 to around €8 trillion at the end of 2008, *see* European Commission, *Communication on Packaged Retail Investment Products* (2009) (Com(2009) 204) (PRIPS Communication) 1). *See also* Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets,* 96 VA. L. REV. 1025, 1026 (2009) [hereinafter "Langevoort, *Institutionalization of the Securities Markets*"].

[12] *See e.g.* Ross Levine & Sara Zeros, *Stock Markets, Banks, and Economic Growth,* 88 AM. ECON. REV. 537 (1998) (finding that stock market liquidity is positively and significantly correlated with current and future rates of economic growth, capital accumulation, and productivity growth); *see also* Ross Levine, *Stock Markets, Growth, ad Tax Policy,* 46 J. FIN. 1445 (1991) (Arguing that stock market liquidity is essential for economic growth); Bengt Holmstrom & Jean Tirole, *Market Liquidity and Performance Monitoring,* 101 J. POL. ECON. 678 (1993) (Authors argue that liquid stock markets can increase incentives for investors to get information about companies and thus improve corporate governance); William C. Dudley & Glenn R. Hubbard, *How Capital Markets Enhance Economic Performance and Facilitate Job Creation* (Global Market Institute, Goldman Sachs, November 2004) (stating that well-developed capital markets generate many economic benefits, including job facilitation and improved macroeconomic stability); *See also* presentation by Gerard Caprio (Director, Financial Sector Policy and Strategy Department, in the World Bank's Financial Sector Vice Presidency) maintaining that there is a

economic growth has also been extensively researched and considerable evidence has been shown that these two phenomena are closely connected.[13] According to the definition provided by the OECD, "financial intermediation" is *"[a] productive activity in which an institutional unit incurs liabilities on its own account for the purpose of acquiring financial assets by engaging in financial transactions on the market; the role of financial intermediaries is to channel funds from lenders to borrowers by intermediating between them."*[14] One type of financial intermediary is an **investment company**.[15]

An **investment company**[16] in general is a financial intermediary through which investors pool their money to expand and diversify their financial assets. Investment companies invest in a broad list of securities, including stocks or bonds as well as in other financial products. They specialize in fast and efficient distribution of capital on markets and facilitate their clients with essential financing, either for their businesses or households.[17] They supplement banks as financial intermediaries and ensure effective

---

clear causal link between finance and development; *Finance For Growth: Policy Choices in Volatile World; available online at:* <http://www1.worldbank.org/finance/assets/images/financeforgrowth_english.pdf>/ *last visited* Dec. 8, 2014.

[13] This issue had been studied by number of scholars, *see generally* RAYMOND W. GOLDSMITH, FINANCIAL STRUCTURE AND DEVELOPMENT (Yale University Press, 1969), RONALD I. MCKINNON, MONEY AND CAPITAL IN ECONOMIC DEVELOPMENT (Brookings Institution, 1973) or Marco Pagano, *Financial Markets and Growth: An Overview* 37 EUR. ECON. REV. 613 (1993).

[14] *Available online at:* < http://stats.oecd.org/glossary/detail.asp?ID=972>/ *last visited* Dec. 7, 2014.

[15] Others are banks or insurers.

[16] For the uniformity of the used terms throughout the entire thesis the term "investment company" will be used, even though, in the European Union, the more common term is "investment trust".

[17] *See* 2014 Investment Company Fact Book (Investment Company Institute, 54th ed. 2014) [hereinafter "2014 INVESTMENT COMPANY FACT BOOK"]. In 2013 the US-registered investment companies managed $15 trillion of assets, while on the worldwide scale they managed $30 trillion. Moreover, in 2013 investment companies held 29% of US corporate equities. These data serve only for exemplification of the size and growth of investment companies in the US Data were provided by the 2014 INVESTMENT COMPANY FACT BOOK, prepared by Investment Company Institute. According to the European Fund and Management Association, at the end of September 2014, UCITS net assets in EU were of €7,807 billion. Unfortunately, there are no data on the entire EU securities market available. Nevertheless, from the given data, it is evident that even though EU is not on the same level as US investment companies, it is a developing industry and therefore the regulation adopted on the EU level should encourage investment companies in their future growth. These data were gathered by European Funds and Asset Management Association (EFAMA) which is a representative association for the European investment management

allocation of funds throughout financial markets.[18] Investment companies offer many advantages to retail investors. Retail investors benefit from economies of scale as they can access a wide spread of investments,[19] portfolio diversification[20] and professional advice. The transaction costs for individual investors are lower in comparison to formation of an individual portfolio as thousands of investors share the costs instead of one.[21] Any retail investor, who holds capital to invest, has a number of reasons to entrust his funds with an investment company in order to financially prosper and possibly diversify his or her estate. Retail investors, by combining their assets and creating large investment pools under the auspices of professional management, are able to earn higher profits and diversify risk. Small investors can also participate and combine their petty investments with an extensive pool of financial assets and thus enjoy the same level of management proficiency and protection. As different types of investment companies are active on the market with distinctions concerning their legal form, entrance requirements, and management, plus the level of risk and possible investment returns, investors can choose the most suitable investment vehicle for their purpose. But from the moment that an investor invests with an investment company, it

---

industry and through its 26 member associations and 56 corporate members approximately EUR 13 trillion in assets. Their statistics are *available at:* <http://www.efama.org>/*last visited* Dec. 13, 2014.

[18] For more on capital markets and their role for economic progress *see* Arav Ouandlous, *Capital Markets and Economic Development: A Framework for Newly Liberalized Economies*, 8 J. BUS. & ECON. RESEARCH 9 (2010).

[19] In general the "economies of scale" is the cost advantage that arises with increased output of a product. The inverse relationship between the quantity produced and per-unit fixed costs are also present in case of investment companies. Investors in investment companies by purchasing a unit/share in an investment company, they indirectly purchase shares of other companies that the investment company holds in its portfolio. However, the economies of scale are not only used by the investors, but also by the investment companies themselves http://www.forbes.com/2009/02/05/mutual-fund-startup-intelligent-investing_0206_mutual_fund.html s, *see* Michael Maiello, *Mutual Funds: Economies of Scale*, FORBES, June 2, 2009, *available online at:* < http://www.forbes.com/fdc/welcome_mjx.shtml>/ *last visited* Jan. 5, 2012.

[20] Irrespective of the size of the investor, asset diversification is one of the principles of investing. *See* Harvey E. Bines, *Modern Portfolio Theory and Investment Management Law: Refinement of Legal Doctrine,* 76 COLUM. L. REV. 721, 794 (1976) ("As should be apparent by this point, the most powerful device for reducing risk in a portfolio is diversification.").

[21] Portfolio diversification in simple terms is "a spread of the activities of a firm or a country between different types of investment products or different markets." *See* OXFORD DICTIONARY OF ECONOMICS (3[d] ed. 2003).

is the investment company that becomes fully in control of this investment. However, for investors to comfortably entrust their investments into the hands of investment intermediaries, a reliable and efficient regulatory framework that would safeguard their investments has to be in place.

1. Thesis Statement

The last thirty years have brought a rapid shift toward institutionalization in the financial markets on both sides of Atlantic Ocean. While in the US almost every second retail investor invests in investment companies, in the EU investment companies remain often overlooked by the retail investors. However, there are several signals that indicate that in recent years there has been a shift in this field and more and more retail investors in the EU have become interested in the investment companies.[22] Nonetheless, it is not only investors who have been neglecting the investment companies, but also regulators – leaving the unsophisticated and less experienced investors unprotected. Even though since the financial crisis the most developed systems of investment company regulation have been revisiting their regulatory frameworks, it is of the concern how little attention they have paid to the protection of the retail investors.

Focusing on two types of investment companies – **mutual funds** and **UCITS** – that represent the most common investment vehicles in the US and the EU, including the UK – I first analyze their historical regulatory evolution. Considering the diverse paths that these financial intermediaries have taken in different legal systems, one becomes aware that the development of a sector-specific regulation targeting investment companies has been greatly influenced by economic crises. Subsequently, the politicians are under great time pressure to on one hand calm the public and at the same

[22] In many countries in the Continental Europe, this drive towards institutional investors and the capital markets is to a great extent is due to the recent practices of universal deposit-taking banks.

time heal the market. Secondly, in the light of IOSCO Objective and Principles of Securities Regulation,[23] I have specified **four building blocks**, necessary for investor protection, namely: a) disclosure systems, b) law on fiduciary duties, c) enforcement agencies, and d) private securities litigation. Based on these four corner stones of securities regulation I analyze and compare the existing regulatory framework of investment companies in the EU, UK and US. By critically assessing these four pillars, this thesis unveils existing regulatory insufficiencies and suggests regulatory improvements in order to provide adequate protection for retail investors, which currently remains absent.

Observing the increased endeavor of the EU and its Member States to strengthen the trust and participation of ever-wider segments of the general population on the financial markets, their policy statements together with regulatory measures started to apply a new protection policy. There are two ways how one characterizes an individual who accesses household investment market: either as a “retail investor” or a “consumer of financial products and services” [hereinafter “**consumer**”]. In the UK this policy change started to arise already before 2008, while in the EU only after 2008. The EU pre-financial-crises policy papers and regulation referred to “investor” or “retail investor”, while the present speak rather of “consumers”.[24] This shift in terminology

[23] Objectives and Principles of Securities Regulation (IOSCO, May 2003), *available online at*: < https://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>/ *last visited* Feb. 10, 2015.

[24] In para. 77, 156 and 166 Preamble of the Directive 2014/65/EU of the European Parliament of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Directive 2002/92/EC and Directive 2011/61/EU O.J. L/175 [hereinafter “MiFID II”], the MiFID II indicates directly the “consumer protection” aspiration. The same is applicable for para. 50 Preamble of the Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2015 on Markets in Financial Instruments and Amending Regulation (EU) No 648/2012 O.J. L/173 [hereinafter “MiFIR”]. Furthermore, also the Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 Amending Directive 2009/65/EC/ on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS) as Regards Depositary Functions, Remuneration Policies and Sanctions [hereinafter “UCITS V”] refers *e.g.* in article 107(3) to consumer protection. Moreover, also the Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 Establishing a European Supervisory Authority (European Securities and Markets Authority) Amending Decision No 716/2009/EC and Repealing Commission

indicates a substantial policy change, which although never explicitly stated, has taken place. I emphasize that the change is present in the policy materials and legislation, but not yet in the courts' rulings. The EU by following the approach taken by the UK has decided to provide retail investors with greater protection through a consumer-driven model.[25] While before 2008, EU investor protection policy was focusing on investor; the new directives and regulations adopted after 2008 indicate "**consumerisation**" in the EU regulation and subsequent replacement of the empowered, autonomous retail investor by a vulnerable consumer. By comparing and analyzing these two key notions, their behaviors and the respective policy objectives of their protection, I argue that the "consumerisation" of the UK and the EU regulation will be detrimental to retail investors protection as the application of the general consumer law is not a suitable approach in case of investment companies regulation. Instead, retail investors should be more empowered through greater substantive and procedural rights. Only through **investor empowerment** – typically in terms of informed and active investor decision-making, investor autonomy and deeper investor engagement – can a regulator provide greater individual investor protection.

In the light of this recognition I move to assess the existing regulatory framework – focusing on four building blocks: a) disclosure systems, b) law on fiduciary duties, c) enforcement agencies, and d) private securities litigation. My second argument stems from analyzing the disclosure mechanism applied for investment companies. Although the disclosure provides investors with information, based on which they should be able to make an informed decision, which is admittedly in line with the empowerment approach, in the case of investment companies, the provided information is exclusively

Decision 2009/77EC [hereinafter "ESMA Regulation"] indicates both consumer and investor protection; *see* Article 8(1)(h), 8(2)(i), 9 ESMA Regulation.

[25] Although it has not been clearly stated whether the UK regulation has influenced the EU, one may assume so given that the UK has always maintained the most competitive capital market in the EU.

connected to the selection process of an investment company. From the moment, when an investor invests in an investment company and pools his/her financial resources with others, the investor transfers all management decisions to others, namely to the director and adviser of an investment company. The only control, which remains in the hands of an investor, is the ability to withdraw his/her investment – the redemption right. However, the enjoyment of this right comes usually too late. Therefore, it is my claim that the investment companies together with their investment advisers should owe meticulous fiduciary duties to their investors. The most scrupulous fiduciary duties can be found in the trust law, which imposes higher fiduciary responsibilities than corporate law. Thus, by applying the fiduciary duties known in trust law on the investment companies and their advisers, their opportunistic behavior would be easier constrained and subsequently enforced. Therefore, a greater protection of retail investors could be secured.

In addition, apart from the imposed duties and rights, a powerful supervisory agency, comparable to the Securities Exchange Commission, should be in place in the EU. As the history shows, it is insufficient for an enforcement agency to merely advise and guide the market participants, as it is the present case of the European Securities and Market Authority. An agency, irrespective of political differences, has to be in a position to efficiently oversee and enforce the laid down rules. Otherwise, the protection of retail investors is greatly endangered. As Ronald Reagan correctly observed, while *"[f]ree men engaged in free enterprise"* will succeed in building better nations, *"free enterprise is not a hunting license."*[26] Therefore, regulatory tools that are able to stop the "hunting" should be in place. In addition to powerful enforcement agencies, in the line with the investor empowerment regulatory approach all investors who entrust

[26] RONALD REAGAN, A TIME FOR CHOOSING: THE SPEECHES OF RONALD REAGAN, 1961-1982 93-94 (Regnery Gateway, 1983).

their finances in hand of investment companies should be provided with tools that would enable them to sufficiently protect themselves. Only then a balance between the parties can be achieved. I argue that retail investors by embracing their empowerment would become more conscious of and more active about their investment decisions and concomitant rights and therefore regulators should create incentives pointing in that direction. This applies especially to the questions of the potential impact of the introduction of private securities litigation and in particular securities class action in Europe.

2. Retail Investor Empowerment

In the title of this thesis I call for protection of retail investors through their empowerment. Yet what is actually the investor empowerment that I refer to? The first article that spoke of "investor empowerment" in connection with the securities regulation was that of Professor Roberta Romano in 1998.[27] She called for empowering the investors by forming a competitive regulatory regime among the states in the US.[28] She claimed that extending the internal affairs rule to state securities fraud claims would have a beneficial effect for investors and their choice of the best regulatory environment. However, in this thesis I do not use the notion of investor empowerment in this sense.

The investor empowerment concept that I apply reflects a longstanding tradition of investor autonomy, ***caveat emptor*** [29] and personal responsibility of investors,

---

[27] *See* Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998).
[28] *Id.* at 2405.
[29] *See* Julia Black, *Involving Consumers on Securities Regulation.* Report for the Taskforce to Modernize Securities Regulation in Canada 15 (2006), *available online at:* < http://www.lse.ac.uk/collections/law/staff%20publications%20full%20text/black/Involving%20Consumers%20in%20Securities%20Regulation%20-%20Taskforce%20report.pdf >/ *last visited* June 12, 2014 [hereinafter "Black, Canada Report"].

including retail investors. It reflects regulator's choice to equip and to encourage retail investors to not only invest, but also oversee and enforce their rights, which a regulator vests in them. The empowerment approach is implied in the inclusion of public awareness and public assertiveness.[30] The investor empowerment model entails greater rights to be provided to the investors, which mirror the duties of the investment companies or other financial intermediaries. Given the size and the speed of the markets, which have lost their national character a long time ago, the national or regional enforcement agencies alone are not in a position to safeguard all the investors anymore. A term used in a different setting, which is greatly similar to the one of "empowered investors" is the "activist shareholder". In 1932, eminent corporate scholars Adolph Berle and Gardiner Means described a phenomenon that has since then raised concern of many: "**the separation of ownership from control**" in the American public corporation:[31]

> *"Since direction over the activities of a corporation is exercised through the board of directors, we may say for practical purposes that control [over the corporation] lies in the hands of the individual or group who have the power to select the board of directors.*
>
> *…*
>
> *When the largest single [shareholder] interest amounts to but a fraction of one percent / the case in several of the largest American corporations / no stockholder is in a position through his holdings alone to place important pressure upon the management.*

---

[30] NIAMH MOLONEY, HOW TO PROTECT INVESTORS: LESSONS FROM THE EC AND THE UK 54-56 (Cambridge University Press, 2010) [hereinafter "MOLONEY, HOW TO PROTECT INVESTORS"].
[31] *See* ADOLF A. BERLE & GARDINGER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 7 (Transaction Publisher, 1932) [hereinafter "BERLE & MEANS"];

…

Where ownership is sufficiently sub-divided, the management can thus become self-perpetuating body."[32]

Individual interests of shareholders in public corporations were so small that it did not make sense for any single of them – alone – to take an active role in corporate affairs.[33] Similar is the case of investment companies where the investors fully surrender their control to the investment company and its advisers. Nevertheless, their participation remains essential. Capable and informed investors can be enrolled as disciplining actors in the regulatory process, monitoring the market, exerting competitive pressure, but also as accepting responsibility for their actions and inactions.[34] Furthermore, empowered and informed investors can become agents for enforcement agencies and the regulators, providing them with valuable information, which allows them to take more effective actions.[35]

For greater investor protection, regulators should apply the empowerment model, where they vest additional rights to retail investors, which they should oversee and enforce vis-à-vis the investment companies. I elaborate on this issue in the II chapter and when analyzing and comparing the existent regulatory tools applied in the chosen jurisdictions, I perceive retail investors as active capital suppliers to the market, who are able to recognize and realize their rights and duties rather than as passive consumers.[36]

[32] *Id.* at 66, 78, 82.
[33] *Id.* at 76.
[34] *See* Tony Williams, *Empowerment of Whom and for What? Financial Literacy Education and the New Regulation of Consumer Financial Services*, 29 LAW & POL'Y 226, 243 (2007).
[35] MOLONEY, HOW TO PROTECT INVESTORS, *supra* note 30, at 59.
[36] *See* Roberta Karmel, *Reconciling Federal and State Interests in Securities Regulation in the US and Europe,* 28 BROOK. J. INT'L L. 495 (2003) [hereinafter "Karmel, *Reconciling*"].

3. Scope of the Thesis: Mutual Funds & UCITS

Given the fact that different types of investment companies are present on the markets worldwide, it is fundamental to stipulate which are the paradigms for the present analysis. In this thesis I focus on two most popular types of investment vehicles among the retail investors, namely the American **mutual funds** and **UCITS,** their European kin.[37] Even though they arise from different legal systems, mutual funds and UCITS are functionally equivalent and therefore their comparison remains coherent.

Mutual funds are regulated by the Investment Company Act of 1940 [hereinafter "ICA 1940"] together with other types of investment companies.[38] The basic definition of investment company pursuant to the ICA 1940 refers to any issuer of securities, which is "engaged," "holds itself out as being engaged," or "proposes to engage" primarily in the business of investing, reinvesting, or trading in securities.[39] The definition of "security" is broad and includes virtually any financial security or financial instrument.[40] An entity that seems to be an investment company, may however qualify

[37] In the US almost a half of the households invests in the mutual funds *see* the 2014 Investment Company Fact Book, *supra* note 17. For the UCITS *see* European Commission Press Release, *Commission Proposes Legislation to Improve Consumer Protection in Financial Services,* July 3, 2012; *available online at:* <http://europa.eu/rapid/press-release_IP-12-736_en.htm?locale=en>/ *last visited* Dec. 8, 2014 ("UCITS have proved successful and are widely used by European retail investors"). According to the UK Financial Conduct Authority [hereinafter "FCA"], at the end of 2009 the assets under management of UCITS funds were slightly above €5 trillion, representing 75% of all investment fund assets in Europe. Moreover, total investment fund assets represented 55% of the EU's GDP at the end of 2009 and about 10% of European households' financial assets. *See* HM Treasury, Transposition of UCITS IV: Consultation Document 5 (December 2010).

[38] Investment Company Act of 1940, Pub. L. 76-768, Aug. 22, 1940.

[39] 15 U.S.C. §80a-3(a)(1)(A) (2012) "…[i]nvestment company" means any issuer, which is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities.

[40] 15 U.S.C. §80a-2(a)(36) (2012). "Security" means any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security (including a certificate of deposit) or on any group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

for an exclusion from the definition of an investment company under the ICA 1940. The ICA 1940 excludes from the definition of an investment company any issuer that is not making or proposing to make any public offering and whose securities are held by fewer than 100 beneficial owners.[41] Furthermore, the ICA 1940 excludes any issuer that is not making or proposing to make any public offering and whose securities are held exclusively by "qualified purchasers,"[42] who are deemed to be in a position to efficiently protect themselves.

The ICA 1940 divides investment companies into **three** primary classes: (1) "face-amount certificate company;"[43] (2) "unit investment trust"[44] and (3) "management company".[45] Unit investment trusts represent a small part of public offerings to

[41] 15 U.S.C. §80a-3(c)(1) (2012), "…Notwithstanding subsection (a) of this section, none of the following persons is an investment company within the meaning of this subchapter:
(1) Any issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than one hundred persons and which is not making and does not presently propose to make a public offering of its securities."

[42] *See* section 3(c)(7) ICA 1940 (2012); A "qualified purchaser" is (i) any natural person (including any person who holds a joint, community property, or other similar shared ownership interest in an issuer that is excepted under section 80a-3(c)(7) of this title with that person's qualified purchaser spouse) who owns not less than $5,000,000 in investments, as defined by the Commission;
(ii) any company that owns not less than $5,000,000 in investments and that is owned directly or indirectly by or for 2 or more natural persons who are related as siblings or spouse (including former spouses), or direct lineal descendants by birth or adoption, spouses of such persons, the estates of such persons, or foundations, charitable organizations, or trusts established by or for the benefit of such persons;
(iii) any trust that is not covered by clause (ii) and that was not formed for the specific purpose of acquiring the securities offered, as to which the trustee or other person authorized to make decisions with respect to the trust, and each settlor or other person who has contributed assets to the trust, is a person described in clause (i), (ii), or (iv); or
(iv) any person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis, not less than $25,000,000 in investments." 15 U.S.C. §80a-2(51)(A) (2012).

[43] 15 U.S.C. §80-4(1) (2012) "Face-amount certificate company" means an investment company which is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or which has been engaged in such business and has any such certificate outstanding.

[44] 15 U.S.C. §80-4(2) (2012) "Unit investment trust" means an investment company which (A) is organized under a trust indenture, contract of custodianship or agency, or similar instrument, (B) does not have a board of directors, and (C) issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities; but does not include a voting trust.

[45] 15 U.S.C. §80-4(3) (2012) "Management company" means any investment company other than a face-amount certificate company or a unit investment trust.

investors, while face-amount certificate companies have become obsolete.[46] An investment company, which has a separate management from investors, is considered a "management company". There are two types of "management companies": "open-end" or "closed-end". The "open-end" management companies are commonly known as "**mutual funds**". Mutual funds typically continuously offer their shares for sale while the closed-end company's shares are traded only in securities markets like other companies' shares.[47] Moreover, a specificity of mutual funds is that they redeem outstanding shares at any time when presented by an investor. The number of mutual fund's shares is usually not fixed as new shares are sold and issued shares are redeemed continuously during the existence of a mutual fund. Furthermore, a management company may be "diversified" or "non-diversified". If a management company is "diversified," (i) at least seventy-five percent of its total assets are securities (broadly defined) and cash and (ii) within this seventy-five percent basket, the securities of any issuer do not amount to more than five percent of the value of the fund's total assets or ten percent of the outstanding voting securities of that issuer.[48] All other management companies are considered non-diversified. Diversification is considered to be a fundamental principle of investment practices of investment companies. It is an established method of reducing the risk indigenous in all investing.[49]

[46] *See* LOUIS YUROW ET AL., MUTUAL FUNDS REGULATION AND COMPLIANCE HANDBOOK §4:2 (2014), *available at* WestlawNext.
[47] ICA 1940, 15 U.S.C. §80a-5(a) (2012) (1) "Open-end company" means a management company which is offering for sale or has outstanding any redeemable security of which it is the issuer.
(2) "Closed-end company" means any management company other than an open-end company.
[48] ICA 1940, 15 U.S.C. §80a-5(b) (2012) "Diversified company" means a management company which meets the following requirements: At least 75 per centum of the value of its total assets is represented by cash and cash items (including receivables), Government securities, securities of other investment companies, and other securities for the purposes of this calculation limited in respect of any one issuer to an amount not greater in value than 5 per centum of the value of the total assets of such management company and to not more than 10 per centum of the outstanding voting securities of such issuer.
[49] Diversification is also perceived as a regulatory means of mitigating the market risk. The leverage controls, which can mitigate the impact of market volatility, are already built in the US mutual funds and the EU UCITS. Mutual funds have to state whether they are diversified or non-diversified, *see* ICA 1940, 15 U.S.C. §80a-5(b) (2012); For the UCITS *see* Articles 53-57 UCITS IV and UCITS V.

The functional equivalent of a mutual fund in the EU is the Undertakings for Collective Investment in Transferable Securities [hereinafter "UCITS"]. **UCITS** can be perceived as European mutual funds marketed and sold in all EU countries. The original UCITS directive, EC Directive 85/611/EEC [hereinafter "UCITS I"] was introduced in 1985 as a part of a collective effort towards establishing a single European market for financial services. The three main objectives of UCITS I were (1) to create a free market for investment funds, (2) to promote competition between funds domiciled in different Member States, and (3) to ensure a more effective and uniform investor protection. At the end of 2013, UCITS funds managed approximately EUR 6.9 trillion in assets.[50] However, UCITS are not only sold in the EU, but also all over the world, in Asia, Latin America and the Middle East.[51]

Since 1985, the UCITS have undergone a substantial development – from simple funds to funds permitted to use and invest in diverse investment instruments, including derivatives or cash. For this reason, the EU has adopted number of amending directives. The biggest reforms were introduced with the UCITS III in 2002 that significantly increased the range of UCITS investable assets.[52] The subsequent UCITS IV introduced several modifications in the UCITS regulatory landscape, including merger of UCITS and master-feeder structure, management company passport or the Key Investor Document.[53] The last recast directive was adopted on July 23, 2014 – the UCITS V,

[50] There are around 35,000 UCITS registered in EU. In 2013, they were distributed in 86 countries. *See* PRICE WATER HOUSE COOPERS, DISTRIBUTING OUR KNOWLEDGE: FUND DISTRIBUTION: UCITS AND ALTERNATIVE INVESTMENT FUNDS, *available online at:* <http://download.pwc.com/ie/pubs/2014-pwc-ireland-distribution-knowledge-12-05-2014-1.pdf>/ *last visited* Nov. 28, 2014.
[51] *See* HM Treasury, Transposition of UCITS IV: Consultation Document 5 (December 2010).
[52] Directive 2001/108/EC of the European Parliament and of the Council of 21 January 2002 Amending Council Directive 85/611 EEC on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS), with regard to Investment of UCITS [hereinafter UCITS III].
[53] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment and Transferable Securities (UCITS) [hereinafter "UCITS IV"].

which Member States should transpose by **March 18, 2016**.[54] In nutshell, this directive introduced new rules on UCITS depositaries – as a reaction to Bernard Madoff and Lehman Brothers scandals, which revealed material discrepancies in depositary duties and liabilities across Member States. In the text of this thesis, I will primarily refer to UCITS V and in case of a difference between UCITS IV and UCITS V I will draw the attention of the reader to it. It is fair to say that the UCITS recast directives are usually adopted after a scandal or a problem occurs.

UCITS V allows a fund to be sold in all EU Member States. UCITS IV and V[55] define UCITS as an undertaking: *"(a) with the sole object of collective investment in transferable securities or in other liquid financial assets referred to in Article 50(1) of capital raised from the public and which operate on the principle of risk-spreading; and (b) with units which are, at the request of holders, repurchased or redeemed, directly or indirectly, out of those undertakings' assets. Action taken by a UCITS to ensure that the stock exchange value of its units does not significantly vary from their net asset value shall be regarded as equivalent to such repurchase or redemption."*[56] Since the UCITS I, the definition of UCITS has not been substantially modified,[57] which shows that the UCITS definition is sufficiently flexible and thus well-functioning. The recasting directives were rather restrictive and introduced additional details as to *e.g.* what kind of securities may the UCITS invest in, how to facilitate mergers of UCITS funds or how to remove administrative barriers for cross-border marketing of UCITS.

[54] Article 2 UCITS V.
[55] UCITS V is an amending directive to the former UCITS IV and the EU Member States should comply with UCITS V by March 18, 2016.
[56] Article 1(1) UCITS V.
[57] The original definition of UCITS I was: " For the purposes of this Directive, and subject to Article 2, UCITS shall be undertakings: - the sole object of which is the collective investment in transferable securities of capital raised from the public and which operate on the principle of risk-spreading, and – the units of which are, at the request of holders re-purchased or redeemed, directly or indirectly, out of those undertakings' assets. Action taken by a UCITS to ensure that the stock exchange value of its units does not significantly vary from their net asset value shall be regards as equivalent to such re-purchase or redemption." *See* Article 1(2) UCITS I.

In the UK, UCITS directives have been implemented through a combination of primary legislation materialized in the Financial Services and Markets Act 2000 [hereinafter "FSMA 2000"], secondary legislation implementing the EU directives[58] and FCA's Handbooks on: (1) Collective Investment Schemes [hereinafter "COLL"] and (2) Conduct of Business Sourcebook [hereinafter "COBS"].[59] UCITS IV was implemented in the UK on July 1, 2011 by way of the Undertakings for Collective Investment in Transferable Securities Regulations 2011[60] and changes to the FSA Handbooks. Given the fact that UCITS V should be transposed only by March 16, 2016, the UK has not yet commenced the transposition procedure. UCITS can be established in the UK in **three forms**, namely: authorized unit trust scheme (AUT), authorized contractual scheme (ACS) and investment company with variable capital (ICVC), which is often referred to as Open-Ended Investment Company (OEIC).[61] They all represent a functional equivalent to a US mutual fund. Considering that the investment fund industry has a long-established history in the UK and has been regulated before the UCITS scheme was introduced, the UK has its own peculiarities. The regime in relation to collective investment schemes is unusual, in that it constitutes a form of product regulation, meaning various types of securities and investments as opposed to advice regulation.[62] Moreover, the OEIC although being of a limited liability, is not subject to the Companies Act 2006. OEICs are constituted by an instrument of incorporation that must comply with the OEIC Regulation.[63] For the purposes of this thesis, unless

[58] *E.g.* Credit Rating Agencies Regulation 2010 (SI 2010/906); FSMA 2000 (Collective Investment Schemes) Order 2001 (SI 2001/1062); FSMA 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulation 2001 (SI 2001/995); Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).
[59] *Available online at:* < http://www.fshandbook.info/FS/>/ *last visited* Dec. 3, 2014.
[60] Undertakings for Collective Investment in Transferable Securities Regulations 2011 SI 2011/1613.
[61] *See* Collective Investment Schemes Sourcebook 12.1 [hereinafter "COLL"]. These types can operate not only as UCITS schemes, but also as qualified investors schemes or non-UCITS retail schemes.
[62] BANKING LITIGATION 397 (David Warnt & Nicholas Elliott QC eds., 2005) [hereinafter "BANKING LITIGATION"].
[63] Open-Ended Investment Companies Regulations 2001 (SI 2001/228).

considerable differences between the three forms of the investment vehicles arise, I will refer to them as "UK funds".

In summary, the approach to the regulation of investment companies in the chosen jurisdictions is fairly similar. However, differences exist. For example, while EU harmonizes laws in the area of collective investment schemes, it provides no broad definition of investment company, as does the ICA 1940. The ICA 1940 provides first an "umbrella provision" that covers all investment companies and only subsequently refers to several exceptions from this definition.[64] The purpose of presenting a broad definition of an investment company has been to cover all entities issuing or engaged in the investment business.[65] Yet given that the investment industry develops quite speedily, certain exemptions might or might not be provided for (*e.g.* hedge funds or private equity funds). This mismatch should always be reckoned with.

The EU, on the other hand, defines diverse investment vehicles individually. This, in other words means, that if a new investment company emerges, no sector-specific regulation will apply to it until specifically addressed by a new generation law. Currently on the EU-level EU recognizes **four** types of investment companies, namely UCITS, European Venture Capital Funds,[66] Alternative Investment Funds[67] and European Social Entrepreneurship Funds.[68] However, with the adoption of the AIFM Directive, the EU undertook a similar regulatory approach as one in the ICA 1940. The

[64] *See e.g.* 15 U.S.C. §80a-a-3(b),(c) (2012).
[65] In addition the definition of "security" is crucial to determine the scope of the ICA 1940. *See* Steven Bradford, *Expanding the Investment Company Act: The SEC's Manipulation of the Definition of Security,* 60 OHIO ST. L.J. 995, 998 (1999).
[66] *See* Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds O.J. L115/1.
[67] *See* Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No1095/2010 O.J. L174/1 [hereinafter "AIFM Directive"].
[68] *See* Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European Social Entrepreneurship Funds O.J. L115/18.

AIFM Directive "covers" all collective investment undertakings, which are not UCITS.[69] As the ICA 1940, the AIFM Directive once covering everything but the UCITS, provides exemptions,[70] and thus creates a universal directive for investment companies, other than UCITS. Thus, the current regulatory status of investment companies in EU and US is similar; most importantly all investment companies fall under the regulation unless an exception is provided.

4. The Legal Systems in the Purview of this Thesis

Although the US federal regulation of investment companies has been developing since 1930's while the EU has been promoting the integration of its securities markets only since 1979, they share common regulatory goals. Both regulatory frameworks aim to provide namely for: investor protection, allocative efficiency of the capital market, financial stability and economic growth.[71] Yet their respective regulatory methods and resulting frameworks differ. In order to assess, which regulatory systems and the idiosyncratic regulatory tools are more efficient and better protect investors, three legal systems are compared: the **EU**, the **UK** and the **US**.

The EU and the US constitute the **two central legal systems** for the research while the UK serves the purposes for the analysis of the transposition of the EU regulatory measures. Even though the EU consists currently of 28 Member States, which implement directives, sometimes with substantial differences, the EU directives continue to represent the key legislative instrument in the area of EU securities law. Therefore, I find it important to also take into consideration the transposition and

[69] Article 4 (1) AIFM Directive.
[70] Article 3 AIFM Directive.
[71] On the US *see e.g.* JOHN C. COFFEE JR. & HILLARY A SALE, SECURITIES REGULATION: CASES AND MATERIALS 1-9 (Foundation Press, 11th ed. 2009) [hereinafter "COFFEE & HILLARY"]; For EU *see e.g.* NIAMH MOLONEY, EC SECURITIES REGULATION 27-31 (Oxford University Press, 2d ed. 2008) [hereinafter "MOLONEY, EC SEC. REG. 2ND ED"].

subsequent application of these directives. Given that the UK maintains the most developed capital market among all the EU Member States, it is presumably in the best position to offer an insight into how the EU legislation could be transposed and implemented on a national level.

Additional reason for comparing the EU and the US is their diverse regulatory design, which in the context of multi-state institutional system represents almost polar opposites. The US regulation of investment companies at the federal level is based on a legislative framework made of a set of key statutes applied uniformly through the entire US,[72] having a single regulator the Securities and Exchange Commission [hereinafter "SEC"] with rulemaking, interpretive, supervisory and enforcement authority at the federal level. Considering the relevance of the **US state law** (blue-sky laws) in connection to investment companies, they used to represent a significant expense and administrative burden until 1996. However, in 1996 the National Securities Markets Improvement Act of 1996 [hereinafter "NSMIA 1996"] was adopted.[73] The NSMIA 1996 has had a major impact on **state securities regulation** by abrogating wide range of state regulatory authorities.[74] In particular, it eliminated by preemption any state-imposed substantive requirements for (1) nationally traded securities,[75] (2) securities issued by an investment company, which is already registered under the ICA 1940,[76] (3) securities sold to qualified purchasers,[77] and (4) securities issued under certain types of exempt offerings.[78] However, the federal preemption is not complete and states still

[72] *See* section 1.2.2.
[73] National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat 3416 (1996).
[74] *See* Kevin A. Jones, *The National Securities Markets Improvement Act of 1996: A New Model for Efficient Capital Formation,* 53 ARK. L. REV. 153, 155 (2000).
[75] 15 U.S.C. §77r(b)(1) (Supp. IV 1998).
[76] 15 U.S.C. §77r(b)(2) (Supp. IV 1998).
[77] 15 U.S.C. §77r(b)(3) (Supp. IV 1998).
[78] 15 U.S.C. §77r(b)(4) (Supp. IV 1998).

may require notice filings, collect fees, and enforce state antifraud laws.[79] Yet for the purposes of this thesis, the US state law is analyzed only in the IV chapter in connection with the state law applicable to the formation of a mutual fund and the fiduciary duties stemming therefrom. Considering that the US federal law has not introduced any specific legal form for mutual funds, it is the state law, which regulates the fund's governance and operation in areas that the ICA 1940 is silent.

On the other hand, in the EU there are several sets of legislative acts in each and every Member State. The regulation of investment companies on the EU level relies on many directives of the European Parliament and Council, which are by their nature only binding to their effect and leave the Member States to choose the form and method of implementation.[80] The scant amount of regulation[81] – as directly applicable legislative instruments of the EU – that has been adopted in the EU within the field of securities regulation is usually subject specific,[82] unifying technical standards[83] or implementing regulations.[84] Therefore, the final regulatory products might substantially differ among the Member States and thus the UK serves as a model of the EU Member State law. In addition, the UK has maintained the most active capital market among the EU Member

---

[79] *See* YUROW *supra* note 46, at §3:13

[80] *See* PAUL CRAIG & GRÁINNE DE BÚRCA, EU LAW: TEXT, CASES AND MATERIALS 85 (Oxford University Press, 4th ed. 2007) [hereinafter "CRAIG & DE BÚRCA 4TH"].

[81] Here I refer to "regulation" as one type of a regulatory measure under the Union law.

[82] *See e.g.* Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on Short Selling and Certain Aspects of Credit Default Swaps O.J. L86/1.

[83] *See e.g.* Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012, on OTC Derivatives, Central Counterparties and Trade Repositories O.J. L201/1, which lays down clearing and bilateral risk-management requirements for over-the-counter derivative contracts, reporting requirements for the performance of activities of central counterparties and trade repositories.

[84] *See e.g.* MiFIR, which establishes uniform requirements in relation to (a) disclosure of trade data to the public; (b) reporting of transactions to the competent authorities; (c) trading of derivatives on organized venues; (d) non-discriminatory access to clearing and non-discriminatory access to trading in benchmarks; (e) product intervention powers of competent authorities, ESMA and EBA and powers of ESMA on position management controls and position limits; (f) provision of investment services or activities by third-country firms following an applicable equivalence decision by the Commission with or without a branch.

States and has influenced to a great extent the EU regulation in the field of financial services.[85]

5. Methodological Aspects

This thesis – comparing three legal systems – provides a comparative legal analysis. The six interconnected chapters apply diverse research methods, including both qualitative and quantitative.[86] The **qualitative research** has been conducted mainly by following these legal methods:

- *Doctrinal research and analysis* – analysis and comparison of relevant legal acts, court decisions and literature;
- *Problem and policy research* – considering social factors involved and the social impact of current regulation and practice of investment companies.[87] For this purpose, research and analysis of financial newspapers and magazines was carried out to show actual state and day-to-day developments in capital markets as this specific area of law evolves generally faster than the general pace of the submission procedure of peer reviewed legal journals.[88]

In addition to the legal methods, behavioral theories and outcomes of several empirical researches were used and are referred to. Further, statistical data acquired by banks,

[85] *See e.g.* EUROPE ECONOMICS, EU FINANCIAL REGULATION: REPORT FOR BUSINESS FOR BRITAIN 6-10 (June 17, 2014), *available online* at: < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/388827/Business_for_Britain_Evidence.pdf>/ *last visited* Mar. 1, 2015.

[86] Generally on research methods in law *see* RESEARCH METHODS OF LAW (Mike McConville & Wing Hong Chui eds. 2007).

[87] Some may refer to this as "socio-legal research" *see* CAROLIN MORRIS & CIAN MURPHY, GETTING A PHD IN LAW 35 (Hart Publishing, 2011) ("Socio-legal scholars often characterize their approach as the difference between 'law in books' and 'law in action'").

[88] *See* FINANCIAL SERVICES LAW 385 (Michael Blair QC & George Walker, eds., 2d ed. 2006) ("Increased global competition and the commoditization of investment and other products has contributed to a fast changing landscape which is perhaps at its most dynamic in the investment firms sector of financial services.") [hereinafter "BLAIR & WALKER"].

financial bodies and regulatory institutions (*i.e.* ESMA, EIB, SEC, IOSCO, CEPS, ECB, FCA) serve as supportive materials throughout the entire thesis. Even though numerous economic models are referred to and clarified in footnotes, this thesis does not attempt to canvas any new economic models and fully relies on the existing economic scholarship. In the fifth chapter, **quantitative research** also has been applied through *secondary analysis*, analyzing the cases that the SEC brought since 2009. The data set was collected through the WestlawNext research database. The relevant parts describe in detail the research process. All chapters **analyze and compare** specific segments of legal frameworks of investment companies and relevant case law and **draw conclusions** therefrom.

The comparative and interdisciplinary character of this thesis raises number of challenges. Even though this thesis applies **terminology** that is common to international publications in this field, due to the comparison of three jurisdictions, where the US and the UK belong to common law family and the EU represents a *sui generis* legal system – a number of legal concepts have to be clarified throughout the thesis. Given the broad scope of this thesis, it is necessary for the reader to understand the meanings of a term in different jurisdictions and its consequences to its application. To these, the thesis continuously draws the reader's attention.

6. Significance and Challenges of Research

To the knowledge of author, a comparative research of investment companies' regulation in the selected jurisdictions in this format and scope has not been yet conducted and therefore the novelty of this research is assured. Comparing and analyzing the regulation of investment companies in the time of their re-evaluation and reformation should prove to be beneficial not only for scholars seeking similarities and differences among various legal systems and regulatory frameworks, but also for anyone who wishes to learn from the development that these three legal systems have undertaken. The protection of retail investors in connection of investment company regulation is important also for legal systems that have not yet introduced a regulatory framework, as once investment companies are introduced in the markets, where they were not present before, they tend to grow rapidly.[89]

I believe that the **timing** and **relevance** of this research are the most appropriate looking back to the 2008 financial crisis. The adaptability channel stresses that legal systems differ in their ability to evolve with changing conditions.[90] The financial crisis in 2008 represents such a changing condition – and only legal systems that are able to adapt efficiently to minimize the gap between the needs of the economy and the legal system's abilities can foster financial development more efficiently than more rigid systems, which are usually the civil law legal systems.[91]

Since it is necessary to recognize functions and relationships between diverse legal concepts, I have started my thesis with a historical chapter, which helps to understand also the factual events that have influenced the development of the regulation of investment companies. Accurate knowledge of historical facts and trends as wars or crises is crucial for the comparison, in order to realize their impact on the development of economies and legal systems.[92] In addition, also reflecting on the policy

---

[89] For instance, in countries like Spain and Italy mutual funds were not present in the market before 1992. In five years, until 1997 the growth rate went up to 8000%. *See* Rogér Oten & Mark Schweitzer, *A Comparison Between the European and the US Mutual Fund Industry,* 28 MANAGERIAL FIN. 12, 16 (2002).

[90] *See generally* FRIEDRICH HAYEK, THE CONSTITUTION OF LIBERTY (University of Chicago Press, 1960).

[91] *See generally* JOHN H. MERRYMAN, THE CIVIL LAW TRADITION: AN INTRODUCTION TO THE LEGAL SYSTEMS OF WESTERN EUROPE AND LATIN AMERICA (Stanford University Press, 1985).

[92] *See e.g.* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE, xvii-xxiii (Aspen Publishers, 3d ed. 2003). [hereinafter "SELIGMAN, TRANSFORMATION OF WALL STREET"] *See also* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance,* 114 YALE L.J. 1521 (2005) (reflecting on the relationship between historical events and the creation of law) and Daniel Berkowitz et al., *The*

rationales helps to understand the aim of the regulation and its subsequent application. To these, I have used numerous policy materials and existing jurisprudence. Concerning the analysis of the EU's regulation of investment companies, the existing case law is highly limited and therefore only policy statements and briefs together with relevant guidelines can enlighten the desired goals of a regulator. Furthermore, given the "age" of the regulation of investment companies in the US and the UK vis-à-vis the EU, there are only few authors outside of the US and the UK who analyze the regulation of investment companies or the securities regulation in general. Therefore, majority of the secondary materials comes from the US or the UK, from the reference works of renowned authors to articles in law journals and reviews.

Ultimately, my aim for this thesis is to serve the quest for "better law" and to compare solutions offered by selected legal systems to universal problem, which the protection of retail investors indisputably is.[93] It is necessary to see the regulation of investment companies in context – historical and economic – in order to understand the aim of the existence of these investment vehicles. Although only few fully comprehend investment companies and how they actually function, those in control of the retail investors' investments should not misuse it, as investment companies should primarily serve the retail investors, who should be protected by virtue of efficient and enforced regulation.

Transplant Effect, 51 AM. J. COMP. L. 163, 180 (2003) (demonstrating how historical events have had a more meaningful impact on the success of legal systems that has the origin of a legal system).

[93] *See* MAX SALOMON, GRUNDLEGUNG ZUR RECHTSPHILOSOPHIE 34 (Berlin-Grünewald, 1925), *("Rechstwissenschaft is nicht eine Wissenschaft von den Rechtsnormen, sondern von den Rechtsproblemen*"). Later the notion for functional comparative law of legal problems, became largely discussed by Josef Esser in his book GRUNDSATZ UND NORM IN DER RICHTERLICHEN RECHTSFORTBILDUNG (1956), who claimed that different legal systems find similar legal solutions by different means and therefore universal principles of law can be found and formulated as a system with its own terminology. Later, number of legal scholars as Allois Troller, James Gordley or Konrad Zweigert saw different laws as different responses to the same universal problems. For a literature review on functional method in comparative law, *see* Ralf Michaels, *The Functional Method of Comparative Law* in THE OXFORD HANDBOOK OF COMPARATIVE LAW 339-382 (Oxford University Press, 2006).

CHAPTER I BRIEF HISTORY OF INVESTMENT COMPANIES

"History has particular value when it helps us avoid a repetition of past mistakes."[94]

It is fundamental to start a complex topic as regulation of investment companies with a historical overview clarifying the rationales of the regulation in the EU, UK and US. This chapter illuminates the crucial milestones of investment companies and introduces a roadmap of their regulation since their birth until now. The historical chapter of investment companies shows their different evolutionary paths on two sides of the Atlantic Ocean in different time periods. The aim of this chapter is to show a concise and complex chronicle of important events, legislative acts, scandals and political decisions, which all affected the development of investment companies, their regulation, structure and organization.

This chapter is divided into three parts based on the legal system analyzed. Each subchapter is organized chronologically. Given the fact that the first pooling investment activities took place during the times of colonial expansion, the UK is analyzed as the first one. Many mistakenly believe that the philosophy of securities regulation originated in the US under the direction of the New Deal, while disregarding the significant mark of the British ancestry.[95] Only after the investment trusts were "brought in" the US by the first English immigrants in the eighteenth century,[96] has the industry started to develop. After providing an in-depth analysis of the history of investment companies' evolution and their encompassing regulation in

[94] There are number of quotes on history and the ability or inability to learn from it. Philosophers, historians, politicians as Edmund Burke, David Hume, Immanuel Kant or Machiavelli presented views that it is both possible and desirable to learn from history. I personally concur and thus start with my own quote, which I believe will become true for those reading this thesis.
[95] *See* Bernard J. Kilbride, *The British Heritage of Securities Legislation in the United States*, 17 SW. L.J. 258, 258 (1963).
[96] *See* STUART BANNER, ANGLO-AMERICAN SECURITIES REGULATION, CULTURAL AND POLITICAL ROOTS, 1690-1860 122 (Cambridge University Press, 2002) [hereinafter "BANNER"].

the US, the focus turns back to the Europe, more precisely to the EU. In the last part I analyze the formation of the investment company regulation on the EU-level by offering an insight into the unique interplay of the EU and the national lawmaking.

1.1.The History of Investment Companies in the United Kingdom

Historical survey into the development of investment companies and their subsequent regulation has to start with the UK where the securities market was built already back in late seventeenth century as a consequence of international trade formation. The first investment company was formed in the late seventeenth century.[97] According to K. Geert Rouwenhorst, *"a Dutch merchant and broker … invited subscription from investors to form a* ***trust****… to provide an opportunity to diversify for small investors with limited means."*[98] This trust – "Eendraght Maakt Magt" was established by Abraham van Ketwich and sold 2,000 shares to investors whose funds were then collectively invested in *"bonds issued by foreign governments and banks and in*

[97] Prior to modern investment vehicles as investment trusts or later investment companies, there were number of "investment vehicles" with a joint interest in a pool of non-financial assets. The first type was a contract of survival covering life annuities, in particular tontines. These date back to 205 b.c. and were common later in the Middle Ages in France or Northern Europe, *see* Geert K. Rouwenhorst, *The Origins of Mutual Funds* 2-3 (Yale ICF Working Paper No. 04-48, 2004). These "investment vehicles" had much in common with the investment trust, which were founded later in 17th century; *see generally* Shaw Livermore, *Investment Trusts in 1930,* 3 J. Bus. U. Chi. 432 (1930), (on investment trusts and their development in the US before 1930) or Hugh Bullock, The Story of Investment Companies (Columbia University Press, 1959); *see generally* Jeremy atack & Larry Neal, The Origin and Development of Financial Markets and Institutions: From the Seventeenth Century to the Present (Cambridge University Press, 2009) [hereinafter "Atack & Neal"].describing how in Netherland the endowment funds of orphanages, hospitals and other welfare institutions started to invest in securities market in order to become self-supporting in the 17th century; Moreover, authors also discuss the reason why "trusts" as form of organization was chosen.

[98] *See* William N. Goetzmann & K. Geert Rouwenhorst, The Origins of Value 254 (Oxford University Press, 2005). On the Amsterdam exchange, more than one hundred different securities were regularly traded, most of them were bonds issued by the Dutch central and provincial government. However, soon enough other governments started to issue their bonds in Amsterdam, namely Austria, England, France, Russia, Spain or Sweden. There was only limited amount of shares traded, and thus of the Dutch East India Company, the Dutch West India Company or the Bank of England. For more on the beginning of Dutch capital market *see* James C. Riley, International Government Finance and the Amsterdam Capital Market 1740 – 1815 (Cambridge University Press, 1980). *See generally* Larry Neal, The Rise of Financial Capitalism: International Capital Markets in the Age of Reason (Cambridge University Press, 1990).

plantation loans in the West Indies.”[99] Later, stockbrokers[100] and subsequently investment companies have spread through the entire western part of Europe.[101]

In the UK, the first large business entities were formed either by a royal charter or by a special act of Parliament.[102] Only these had the privilege to explore, colonize and trade across the sea and ocean. The companies that did not engage in activities considered to be of great public importance usually used unincorporated joint stock

---

[99] *See* GOETZMANN & ROUWENHORST, *id*, at 254; the Eendraght Maakt Magt business suffered a loss by the outbreak of the Fourth English War in 1780. In 1782 it had to suspend the redemption of its shares and lower dividend payments. By the end of 18th century the Eendraght Maakt Magt has disappeared from the Amsterdam stock exchange, *see* Geert K. Rouwenhorst, *The Origins of Mutual Funds* 2-3 (Yale ICF Working Paper No. 04-48, 2004).

[100] In England, together with stockbrokers, who took commission in exchange for buying or selling stocks another occupation arose – “stock-jobbers”. Stock-jobbers were perceived as professional speculators, who while acting as brokers bought or sold stocks on their own name and account. *See* VICTOR E. MORGAN & W. A. THOMAS, THE STOCK EXCHANGE: ITS HISTORY AND FUNCTIONS 212 (HarperCollins Distribution Services, 2d ed. 1969). In Thomas Shadwell’s play The Volunteers, or the Stock-Jobbers from 1693, a stock-jobber explains its role on the new market by stating that he does not care whether the fanciful enterprise, in which he invests will succeed or go bankrupt. “It’s no matter whether it turns to use or not; the main end, verily, is to turn the Penny in the way of Stock-Jobbing, that’s all.” For more on development of security trading in England, *see generally* BANNER, *supra* note 96; “English trusts undoubtedly performed a social service in distributing capital where it was more needed than at home after 1870” *see* Livermore, *supra* note 97, at 442.

[101] In Belgium it was in 1822 when King William of the Netherlands established the Société Générale de Belgique, a collective investment enterprise that initially invested in foreign government loans. In Switzerland an investment company was established in 1849 under the name “Société Civile Genèvoise d’Emploi de Fonds”. In France in 1852 the Credit Mobilier joint stock company effectively operated a closed-end investment company. In London in 1860s, upon the enactment of the English Companies Act in 1862 investment companies as London Financial Association and the International Financial Society formed a pool of investors’ funds but have failed in a short time. In 1868 the UK’s Foreign & Colonial Company set up its “Foreign and Colonial Government Trust”, defining the term “investment funds”: “Vehicles which provide the investor of moderate means with the same advantage as large capitalists in diminishing risk in foreign and colonial stock by spreading the investment over a number of stocks.” By 1886 there were twelve investment trusts trading on the London Stock Exchange. In Germany the first investment company *“Zickertische Kapitalverein”* was established only in 1923, For more on the very early history of investment companies, *see* GEORGE W. EDWARDS, THE EVOLUTION OF FINANCE CAPITALISM (Longmans, Green & Co., 1938); E.C. HARWOOD & ROBERT L. BLAIR, INVESTMENT TRUSTS AND FUNDS FROM THE INVESTOR’S POINT OF VIEW (Great Barrington, 1937); HERMAN E. KROOSS & MARTIN R. BLYN, A HISTORY OF FINANCIAL INTERMEDIARIES (Random House, 1971) and RAY RUSSELL, AN INTRODUCTION TO MUTUAL FUNDS WORLDWIDE (Wiley, 2007).

[102] *See* TREATISE ON THE LAW OF CORPORATIONS §2:2 (2014), *available at* WestlawNext [hereinafter “TREATISE ON THE LAW OF CORPORATIONS”]. Among the companies that were granted charters of incorporation in order to develop foreign trade were the Russia Company in 1555, the East India Company in 1600, the African Company in 1619, the Bank of England in 1674, and the South Sea Company in 1711. These companies also performed colonization and governmental functions as well, namely in the case of East India Company, which became a ruling power in India, *see generally* JOHN P. DAVIS, CORPORATIONS, A STUDY OF THE ORIGIN AND DEVELOPMENT OF GREAT BUSINESS COMBINATIONS AND OF THEIR RELATIONS TO THE AUTHORITY OF THE STATE 224-226 (BeardBooks, Reprinted 2000).

companies with contractually created quasi-corporate characteristics.[103] These became highly popular in the seventeenth and eighteenth century – a time period when the securities market started to emanate in the UK.[104] Even though in the beginning the securities market was perceived with concerns and little trust,[105] it had grown and developed. By the early eighteenth century investing in securities was popular among everyone with enough money to participate.[106] Promoters and directors of both, the chartered and unincorporated companies, foisted suspicious schemes on the investing public.[107] By 1720, financial innovations and speculations were a common part of the English financial world.[108] In 1720 the first stock market crash in the British history – known as the South Sea Bubble or the South Sea Scheme – took place. As a consequence of the South Sea Bubble crash, the first securities regulation was introduced.

1.1.1. South Sea Bubble – the First Crash

The South Sea Company [hereinafter "SSC"] was a British joint stock company chartered in 1711 that had the exclusive right to trade with the Spanish colonies in South America. SSC financed its activities through issuing shares to holders of £9 million[109] of government debt in exchange for their public securities.[110] This meant

[103] *See* TREATISE ON THE LAW OF CORPORATIONS, *supra* note 102, at §2:2.
[104] *See* BANNER, *supra* note 96, at 14.
[105] Investing has not been perceived as the most "honest" form of business. Some saw it as usury. However, by the eleventh century at the latest, canon law recognized that investment in a *societas* or another form of business entity in the Middle Ages was not usury, as long as the investor bore some risk of losing his investment. *See* JOHN T. NOONAN, JR., THE SCHOLASTIC ANALYSIS OF USURY 133-53 (Harvard University Press, 1957). Even later in sixteenth and seventeenth century, the government used to receive constant reports of "the greedy and insatiable covetous desires and appetites of the breeders, broggers, engrossers, graziers, victualers and forestallers." *See* PAUL L. HUGHES & JAMES F. LARKIN, TUDOR ROYAL PROCLAMATIONS 526 (Yale University Press, 1964).
[106] *See* PAUL LANGFORD, A POLITE AND COMMERCIAL PEOPLE: ENGLAND 1727-1783 642-643 (Oxford University Press, 1989) or BANNER, *supra* note 96, at 37-39.
[107] *See* TREATISE ON THE LAW OF CORPORATIONS, *supra* note 102, at §2:2.
[108] *See* BANNER, *supra* note 96, at 40.
[109] According to the Purchasing Power Calculator, the relative value of £9 million of 1711 would be today at around £121 billion. Calculator is *available online at:* <http://www.measuringworth.com>/ last visited Dec. 3, 2014.

that the SSC's only assets were a trade monopoly of uncertain value and a big part of national debt. Following the foundation of the Mississippi Company (later renamed to Company of the West),[111] the SSC in 1720 issued £31 million[112] in new shares in exchange for that amount of government debt.[113] As a consequence of this "swap" the value of SSC's shares rose from £130 to £173 only in February 1720. The value of SSC's shares continued to rise and in two months it reached £342 notwithstanding the aftermath on the UK market due to the collapse of the stock market in France. The value of SSC's shares doubled in two months and nearly tripled in six. SSC fueled by public debt and spreading rumors about new investment possibilities in the New World continued to grow and by the end of June 1720 the SSC's shares reached the price of £950.[114] Unfortunately, after a rise often comes a decline. This was also the case of SSC. In September 1720, the SSC' shares fell to £310 dragging with them the price of shares of other enterprises. By November, one Londoner reported that, *"[t]his town is in a very shattered condition, eleven out of the twelve Judges are dipped in South Sea: Bishops, Deans and Doctors, in short everybody that had money. Some of the Quality are quite broke."*[115]

---

110 *See* Christopher Reed, *Damn'd South Sea: Britain's Greatest Financial Speculation and its Unhappy Ending*, HARV. MAGAZINE, *available online at:* <https://harvardmagazine.com/1999/05/damnd.html>/ *last visited* Dec. 2, 2014.

111 The Mississippi Company had the exclusive right to trade with the French possessions in North America, and although the company was never profitable, in 1717 John Law, a Scottish financier acquired the company. Law refinanced the company by accepting French government debt in exchange for newly issued shares. *See* BANNER, *supra* note 96, at 41.

112 According to the Purchasing Power Calculator, the relative value of £31 million of 1720 would be today at around £418 billion. Calculator is *available online at:* <http://www.measuringworth.com>/ *last visited* Dec. 8, 2014.

113 *See* ATACK & NEAL, *supra* note 97, at 110-119.

114 *See* BANNER, *supra* note 96, at 43-44.

115 Quoted in JOAN JOHNSON, PRINCELY CHANDOS: JAMES BRYDGES 1674-1744 61 (A. Sutton, 1984).

After the South Sea Bubble, all stock jobbers became "public enemies".[116] For some, they represented crafty men who had undertaken to delude the world by a little "*hocus pocus"*.[117] Only few had realized that the manipulation of SSC's stock prices was the work of the SSC's directors, dispersing bogus information, and that the stock jobbers played only a secondary role. The directors of the SSC were able to "shape" the information in a way that everyone desired to be a part of the "great" SSC. As an example, during the SSC time of fame, on a single day, 1000 persons bought the SSC's shares "for caring on an undertaking of great importance, but nobody to know what it is."[118] The House of Lords appointed a committee to investigate the matter, which concluded that all directors' actions were undertaken with the purpose to increase prices of the stocks.[119] By June 1720 the Parliament enacted a statute that would later be called **the Bubble Act**,[120] which is perceived to be the first securities regulation ever adopted in the world.[121]

1.1.2. The Bubble Act – the First Unsuccessful Response

The objective of the Bubble Act was to prevent incautious people from investing in fraudulent projects. The Bubble Act declared that any company formed after 1725 and operating without a charter would be considered a public nuisance, and thus its

[116] The mood of the general public has been best depicted by the literature. For an overview, *see* Thaddeus Seymour, *Literature and the South Sea Bubble* (University of North Carolina, Ph.D. dissertation 1955).
[117] *See* BANNER, *supra* note 96, at 50.
[118] *See* VIII WILLIAM SEARLE HOLDSWORTH, A HISTORY OF ENGLISH LAW 214 -215 (Sweet & Maxwell, 5th ed. 1942).
[119] *Id.* at 54. Some of the directors themselves had purchased "refuses" – call options – at prices higher that the market price in order to raise the price of stocks. Directors also issued new stock at high prices and as the stocks were declining, directors declared more dividends.
[120] The official title of the Bubble Act was following: "An Act for Better Securing Certain Powers and Privileges Intended to Be Granted by His Majesty by Two Charters for Assurance of Ships and Merchandizes at Sea, and for Lending Money Upon Bottomry; and for Restraining Several Extravagant and Unwarrantable Practices therein Mentioned". *Id.* at 75.
[121] *See* LAURENCE GOWER, MODERN COMPANY LAW 28 (Stevens, 1954) in Kilbride, *supra* note 95, at 261.

transactions would be voided and a company would incur *"praemunire"*.[122] However, it did not focus on the nature of the information provided by the companies or the fiduciary duties of the stock jobbers when selling securities. It solely prohibited unincorporated companies from acting as a corporate body without legal authority and from pretending that their shares were transferable. Yet as a regulatory product, the act was incoherent and caused uncertainty and weakening of the UK's financial system.[123] The Bubble Act was not well drafted and failed to clearly define those practices and offenses it sought to prevent.[124] Moreover, it did not cure the lost trust of British public and raised unnecessary doubt about the validity of issued transferable shares of legitimate unincorporated companies. Eventually, in 1825 the Bubble Act was repealed.[125] Only later by the adoption of the Joint Stock Companies Act in 1844 UK companies were entitled to incorporate and register without any specific Parliamentary legislation.[126]

1.1.3. Importance of the Joint Stock Companies Registration Act of 1844: Introducing Disclosure Obligation

The Joint Stock Companies Registration Act of 1844 [hereinafter "Companies Act of 1844"], entitled "An Act for the Registration, Incorporation, and Regulation of Joint Stock Companies," was the first companies act under which a joint stock company could be officially registered and incorporated in England.[127] From then on the UK companies, merely by registering could enjoy "all the features of incorporation –

[122] Section 19 of the Bubble Act. "Praemunire" in English law meant a non-capital offense against the king and his government. *See* BLACK'S LAW DICTIONARY (9th ed.).
[123] *See* TREATISE ON THE LAW OF CORPORATIONS, *supra* note 102, at §2:2.
[124] *See* ARMAND BUDINGTON DU BOIS, THE ENGLISH BUSINESS COMPANY AFTER THE BUBBLE ACT 1720-1800, 203 (Commonwealth Fund, 1938).
[125] *Id.*
[126] *See* Kilbride, *supra* note 95, at 26l; referring to LAURENCE GOWER, MODERN COMPANY LAW 39 (Stevens, 1954) stating, that "If the legislature had intended the Bubble Act to suppress companies they had succeeded beyond their reasonable expectations; if as seems more probable, they had intended to protect investors from ruin and to safeguard the South Sea Company, they failed miserably."
[127] 127 & 8 Vict., ch. 110.

separate personality, free transferability of shares, and hierarchical management structure – with but one exception: limitation of liability."[128] This exception was eliminated in late 1850's, when the UK provided corporations, including banks, with limited liability.[129] The Companies Act of 1844 also enacted modern prospectus requirement.[130] Gladstone, the chairman of a Select Committee on Joint Stock Companies, stated in his report the following:

> *"Periodical accounts, if honestly made and fairly audited, cannot fail to excite attention to the real state of a concern; and by means of improved remedies, parties to mismanagement may be made more amenable for acts of fraud and illegality. The early publication, resulting from registration of ... prospectus and circulars, will doubtless be useful in controlling ... undertakings at their outset…."*[131]

The Companies Act of 1844 was essential for the UK. It lagged behind in encouraging corporate development due to the Bubble Act, which made it difficult for British entrepreneurs to avail themselves of a corporate form.[132] Although the regulation of prospectuses was only in its infancy,[133] the importance of investor protection was already declared. However, the investor protection was neither in those days on the first place. In 1877 the UK Parliament due to the difficulty of the registration and filling requirements at those times removed these obligations as they

[128] *See* RON HARRIS, INDUSTRIALIZING ENGLISH LAW: ENTREPRENEURSHIP AND BUSINESS ORGANIZATION, 1720-1844 283 (Cambridge University Press, 2000).
[129] *See* ATACK & NEAL, *supra* note 97, at 235.
[130] *See* Kilbride, *supra* note 95, at 262.
[131] *See* The Report of the Select Committee on Joint Stock Companies, 7 B.P.P. (1844), as cited by Frankfurter, *The Federal Securities Act,* FORTUNE MAGAZINE 53, Aug. 1933 in Kilbride, *supra* note 95, at 263.
[132] *See* ATACK & NEAL, *supra* note 97, at 226-227.
[133] The act did not define the term "prospectus" but used the word in the same sense as circular, handbill or public notice. Neither the contents of the prospectus were specified. However, already in 1844, the companies were required to submit semiannually a "full and fair" balance sheet signed by at least three directors and "confirmed" by the auditors. *See* Companies Act of 1844 §4, 35, 39 or 41.

"found to be very burdensome to the promoters of such companies."[134] Given the fact that the Sea Bubble Act froze the company formation efforts for several decades, the UK Parliament found the growth of companies of greater importance than the need for investor information. Yet in less than thirty years, the Companies Act of 1900 remedied the situation and reintroduced the requirement of prospectus disclosure. From then on, wealthy individuals or small partnerships started to bolster new enterprises in the UK.[135] With certain obstacles, little by little, a stock market in the UK started to revive and new type of investment intermediary – investment trust was formed.

1.1.4. First Investment Trusts

The first managed investment company appeared in the UK in 1868 – the Foreign and Colonial Investment Trust [hereinafter "FCIT"], which today would be perceived as a closed-end fund.[136] The FCIT successfully identified a missing niche-market at the time – a wholesale investment in diversified portfolios by wealthier individuals. The FCIT invested in bonds of foreign governments and diversification was assured by a promise in the trust's prospectus that **no more than 10% of trust assets** were to be invested in any particular security.[137] During the period from 1880 to 1913, FCIT delivered attractive returns to their investors at very modest costs.[138] The investment trust model became soon popular and by 1913, there were sixty-one investment trusts

[134] Companies Act of 1844, 10 & 11 Vict., c. 78, §4 (1847).
[135] *See* EDWARD VICTOR MORGAN & WILLIAM ARTHUR THOMAS, THE STOCK EXCHANGE: ITS HISTORY AND FUNCTIONS 42 (Elek Books, 1962).
[136] The FCIT did not allow its investors to redeem their shares. *See* David Chambers & Rui Esteves, *The First Global Emerging Markets Investor: Foreign & Colonial Investment Trust 1880-1913*, 52 EXPLORATION IN ECON. HIST. 1, 4 (2014).
[137] *See* Elaine Hutson, *The Early Managed Fund Industry: Investment Trusts in 19th Century Britain,* 14 INT'L REV. FIN. ANALYSIS, 439, 446 (2004).
[138] FCIT's investments averaged to a total return of 5.3% per annum, better off in comparison to the 2.2.$ return on British consols. *See* David Chambers & Rui Esteves, *The First Global Emerging Markets Investor: Foreign & Colonial Investment Trust 1880-1913,* 52 EXPLORATION IN ECON. HIST. 1, 3 (2014).

quoted on the London Stock Exchange [hereinafter "LSE"], with a combined market capitalization of close to £90 million.[139] However, already at those times different investment vehicles were present. There were (1) the "average trusts," focused on delivering long returns with low average – as FCIT as well as (2) the "financial trusts," more speculative vehicles, aiming for high returns[140] which emerged in the 1880's but failed during the Baring crisis.[141]

However, what were the reasons that these investment vehicles appeared in the second half of the nineteenth century and why did they become popular among investors? Few economic historians have attributed the emergence of investment funds to (1) falling yields in the British governmental bond market and to (2) series of speculative periods and subsequent panics on the financial markets during the first half of the nineteenth century.[142] Given decreased yields in the governmental bonds, series of speculations took place between the 1820's and 1840's as investors sought higher returns in order to retain the living standard that they enjoyed before the

---

[139] *Id.* The value of to £90 million in 1913 would today be at around to £7 billion; Calculator is *available online at:* <http://www.measuringworth.com>/ *last visited* Jan. 2, 2015. *See also* Edward Victor Morgan & William Arthur Thomas, The Stock Exchange: Its History and Functions 97 (Elek Books, 1962) (The London Stock Exchange at those times had more than ten separate markets, including the markets for colonial stocks, Indian railroads, American and Canadian railroads or foreign government stocks, South African mines and a group of Australian, British Columbian and West African mines).

[140] The financial trusts could be compared to today's hedge funds.

[141] *See* David Chambers & Rui Esteves, *The First Global Emerging Markets Investor: Foreign & Colonial Investment Trust 1880-1913,* 52 Exploration in Econ. Hist. 1, 4 (2014). Baring crisis is the most famous sovereign debt crisis of the nineteenth century, which affected Argentina and the UK. For more details about the crisis *see* Kris James Mitchener & Marc D. Weidenmier, *The Baring Crisis and the Great Latin American Meltdown of the 1890s* (Santa Clara University and NBER, 2006), *available online at:* < http://eml.berkeley.edu/~webfac/eichengreen/e211_fa06/Mitchener.pdf>/ *last visited* Jan. 1, 2015.

[142] At the beginning of the nineteenth century, the British consols yielded between four and five percent. During the century the consol yield trended downward and by the end of the nineteenth century it was close to two percent. As yield declined, the British government conducted number of debt conversions, where the existing bonds were swapped for new bonds bearing lower coupon rates. These conversions substantially reduced the incomes of people relying on the interest from government bonds. *See* Hutson, *supra* note 137, at 444-445. *See also* Charles P. Kindelberger, Manias, Panics and Crashes (John Wiley and Sons, 3[d] ed. 1996); Edward Victor Morgan & William Arthur Thomas, The Stock Exchange: Its History and Functions 42 (Elek Books, 1962) and Wiliam Howard Steiner, Investment Trusts, American Experience (Adelphi, 1929).

government bond conversions.[143] Arthur Scratchley analyzed the key incentives of the investors and explained the appeal of investment trusts:

> *"The introduction of an entirely new form of investment within the last six years has undoubtedly met the requirements of a large class of persons, and has probably been the means of profitably employing money which would otherwise have been employed in some less secure manner… The investors to whom these trusts are chiefly a boom are that very numerous class who require a return of more than 4 percent on their capital, but to whom a practically secure income is also of the utmost importance… The investment which can now be purchased to pay 4 or 5 percent are of quite a different character than that required by the class of persons who want absolute security with a higher rate of interest than they know how to obtain. There are, indeed, a certain number of securities which may be purchased to pay 5 percent… but there is risk attached to them…"*[144]

Simplifying the stated, general public was looking for a low-risk and stable income during the times when the government bonds yielded low returns. It had been recognized that only wealthier investors were able to survive all the speculations and panics while holding a spread of investments. Yet investors of smaller means sought to diversify their investment in order to reduce possible risk. Investment funds seemed to provide the solution. Given that the British companies regulation in the nineteenth century was still in its infancy[145] and investment funds could not diversify among the British companies, most of the investment trusts focused on foreign securities – including the FCIT – as shown by its name. Another aftermath of the unsuccessful

[143] *Id.*
[144] *See* ARTHUR SCRATCHLEY, ON AVERAGE INVESTMENT TRUSTS 6-7 (Shaw and Sons, 1875).
[145] *See* section 1.1.3.

Bubble Act and ongoing crisis of companies' regulation in the eighteenth and nineteenth century in the UK was that the limited liability companies had a severely damaged reputation. As a consequence, the early investment funds were established as **trusts** rather than companies in order to avoid any deceiving similarity to unpopular "companies".[146] However, due to the ruling in *Sykes v. Beadon* in 1879,[147] according to which the common law trust "of more than twenty persons for the acquisition of gain" became illegal for bigger investment funds,[148] number of funds responded by incorporating under the Companies Act of 1862. Although the judgment was later reversed, many of the investment funds remained joint-stock companies, which were however unable to provide their investors with the redemption right. Thus, not all investment funds became companies and one – the Submarine Cable Trust – initiated a successful repeal of the *Sykes v. Beadon* on the grounds that the investment trust was a trust established under the general law of trusts and therefore no registration under the Companies Act of 1862 was required.[149]

While London remained the main center for the investment trust development, trusts were established also in Scotland. Robert Fleming who discovered the investment potential of the US founded the First Scottish American Investment Trust in 1873. The fund specialized in American securities, particularly railroad bonds.[150] It invested capital for about 500 investors starting with about £1 million and doubling this amount by 1875.[151] By 1886, there were twelve investment trusts trading on the LSE, including the American Investment Trust or the Foreign American and General

[146] *See* C. H. Walker, *Unincorporated Investment Trusts in the Nineteenth Century*, 4 ECON. HIST. 341, 341 (1940).
[147] Sykes v. Beadon [1879] 11 Ch D 170.
[148] *See* OLIVER PIERS STUTCHBURY, THE MANAGEMENT OF UNIT TRUSTS 2 (Shaw and Sons,1964).
[149] *See* Smith v. Anderson [1880] 15 Ch D247.
[150] *See* Hutson, *supra* note 137, at 446-447.
[151] *See* JERRY W. MARKHAM, FINANCIAL HISTORY OF THE UNITED STATES, VOLUME I 323 (M.E. Sharpe, 2002) [hereinafter "MARKHAM, FINANCIAL HISTORY VOL. I"].

Trust.[152] After introducing the investment funds in different parts of the UK, the fever spread directly to the US.

1.2.The History of Investment Companies in the United States

Investment trusts operated in the US as well as in the UK under distinct enterprise forms, some incorporated as companies and some as trusts under the classical English trust law,[153] where "the primary object to be attained by a trustee in the matter of investing the funds confined to his control is their safety."[154] Yet the first investment trusts, as trusts, that emerged in the late eighteenth century in the US had as their prime objective **speculations** and their own interests instead of the interests of their beneficiaries[155] – as was the case in the UK. The unstable political situation in the eighteenth and nineteenth century in the US only contributed to uncertain markets and untrustworthy investment trusts.[156] After the States ratified the US Constitution in 1788, securities prices began to rise.[157] However, neither the ameliorating economic situation shook away the speculators[158] and for a long time the securities market

[152] *Id.* at 324.
[153] *See* Leland Rex Robinson, *Investment Trusts*, 3 J. BUS. U. CHI.279, 289 (1930); *see also* James J. Saxon & Dean E. Miller, *Common Trust Funds*, 53 GEO. L.J. 994, 994 (1965).
[154] In re Estate of Cook, 20 Del. Ch. 123, 125, 171 A 730 (1934), in John H. Langbein & Richard A. Posner, *Market Funds and Trust-Investment Law*, 1 AM. BAR FOUNDATION RESEARCH J. 1, 4 (1976).
[155] There are number of reasons why speculations were omnipresent on the market. First, the English "methods" were still influencing the behavior on the market. Second, given the American War of Independence (1775 – 1783) and high indebtedness together with low revenues through taxation, the American market was flooded with paper currency, issued with both states and the Continental Congress, in order to solve the currency issues, but caused a steady depreciation in the value of the American currency instead. Third, after the events during 1790-1792, which encompassed (a) a boom in securities trading once the federal government assumed the states' debts and the (b) 1792 crash of stock prices *see* BANNER, *supra* note 96, at 122-131, DAVID THOMAS KONIG, LAW AND SOCIETY IN PURITAN MASSACHUSETTS 74 (University of North Carolina Press, 1979) & Geert K. Rouwenhorst, The Origins of Mutual Funds, Yale ICF Working Paper No. 04-48, 12 (2004).
[156] Some authors refer to the financial revolution executed by the Federalists, led by Alexander Hamilton in the early 1790s as the beginning of the US modern financial system. For more *see* ATACK & NEAL, *supra* note 97, at 212-213. *See generally* EDWIN J. PERKINS, AMERICAN PUBLIC FINANCE AND FINANCIAL SERVICES 1700 – 1815 (Ohio State University Press, 1997) and ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA, Chapter XIII (Library of America, 1835).
[157] *See* STANLEY ETKINS & ERIC MCKITRICK, THE AGE OF FEDERALISM: THE EARLY AMERICAN REPUBLIC, 1788 – 1800, 138-39 (Oxford University Press, 1993).
[158] Speculators repeatedly asked Hamilton, appointed Secretary of the Treasury, and his Assistant Secretary William Duer, for an investment advise, expecting some insights into the monetary policies

would continue to be identified with political corruption and luxury, [159] notwithstanding the fact that the US went through number of political turmoils during the nineteenth century.

Similarly to the UK, it took some time until the investment fund industry had gained the trust of the public and until the public started to invest in these types of investment vehicles. Although the investment funds begun to form after 1890's,[160] historians do not agree which investment trust was the first founded.[161] This is due to the fact that at this time there was no available definition and all entities that pooled

---

of the government, *see* ROBERT F. JONES, THE KING OF THE ALLEY: WILLIAM DUER, POLITICIAN ENTREPRENEUR, AND SPECULATOR, 1768 – 1799, 128-31 (American Philosophical Society, 1992). Hamilton while being uncertain whether there was anything legally inadmissible answering those questions, recognized the possible political liabilities and refused to provide any information, *see* Hamilton to Lee, Dec. 1, 1789, Syrett *et. Al., Papers of Alexander Hamilton*, IV, 1, however his assistant Duer had no moral or legal reservation, *see* Duer to Hamilton, August 16, 1791, Syrett *et al., Papers of Alexander Hamilton*, XXVI, 618. Instinctively, Duer was not the only source of insider information. In the late 1790's, American politics was full of corruption, where the members of Congress were often themselves owners of securities and voted in a way that advanced their own interests.

[159] *See* BANNER, *supra* note 96, at 158; The first stock markets started to operate in 1789, but trading was very sporadic until 1792, when the government bonds and corporate stocks became actively traded. Yet the regulation was very limited. After the stock market crash in 1792, the two states with leading securities markets, New York and Pennsylvania tried to prohibit certain kinds of speculative trading. In Pennsylvania, the bill to prevent the practice of stockjobbing was modeled after the English statute of 1734 – the Barnard's Act. This bill would have regulated the stock at auction or voided all contracts for sale of stock, which the seller did not possess at the time of sale if it passed. Though, the legislators were not successful and the bill was never adopted. On the other hand, in New York a bill regulating the trading and stock jobbing had been promptly adopted and *"contracts to sell shares of government debt or corporate stock one did not own on the contract date were void and hence unenforceable in the state's courts."* For more on the actual text of the bill, *see* N.Y. Laws, 15th Sess., c. 62 paras. 1, 5, 6 (April 10, 1792). *See generally* BANNER, *supra* note 96, at 172-180 and Stuart Banner, *The Origin of the New York Stock Exchange, 1791-1860*, 27 J. LEGAL STUD. 113 (1998) [hereinafter "Banner, *The Origin of New York Stock Exchange"*]. On the 1792 Crash *see* David J. Cowen, *The First Bank of the United States and the Securities Market Crash of 1792,* 60 J. ECON. HIST. 1041, 1043-1045 (2000).

[160] *See* SETH C. ANDERSON, INVESTMENT MANAGEMENT AND MISMANAGEMENT: HISTORY, FINDINGS, AND ANALYSIS 23 (Springer, 2006).

[161] The historians part as to which investment trust / company was the first one set up in the US given that number of investment trusts started as insurance companies; an example of this type of company was the Massachusetts Hospital Life Insurance Company [hereinafter "MHLIC"], which was in 1818 originally charted as an insurance company. But in 1823 the MHLIC first accepted and pooled funds and used its trust powers to invest money and repay the investors in periodical annuities. In addition, in a case of death the trustee were repaid their deposits and gains. For more *see* HERMAN E. KROOSS & MARTIN R. BLYN, A HISTORY OF FINANCIAL INTERMEDIARIES 58-59 (1971). Other historians refer to the New York Stock Trust founded in 1889 or to the Boston Personal Property Trust of 1893 or even to the latest the Alexander Fund established in Philadelphia in 1907, which offered small investors a diversified portfolio of securities, *see* SETH C. ANDERSON, JEFFERY A. BORN & OLIVER SCHNUSENBERG, CLOSED-END FUNDS, EXCHANGE-TRADED FUNDS AND HEDGE FUNDS: ORIGINS, FUNCTIONS, AND LITERATURE 8-9 (Springer, 2010).

funds of smaller investors, invested on their behalf and distributed the profit were considered as investment trusts.

As the US economy boomed in 1920's so did the investment industry, which caught the interest of small investors, who wished to diversify their security holdings and limit their risk exposure.[162] Nonetheless, the speculative character of the investment trusts remained, as they focused primarily on capital appreciation rather than on the investor's return.[163] Despite all the warnings, the industry grew and people invested more and more money.[164] While in 1923 the investors entrusted investment trusts less than $15 million, in 1924 the sum was already over $75 million.[165] The trend continued and by 1925 the entire sum invested in investment trusts doubled and they held capital of $150 million.[166] In two years the market grew ten times. Continuing this growth, the market capitalization of the investment companies listed on the NYSE[167] at the end of 1926 reached $586 million, with a market value of $525 billion.[168] Hence, in three years in the US there was 3,900% increase of the invested

---

[162] *See* Jerry W. Markham, *Mutual Fund Scandals – a Comparative Analysis of the Role of Corporate Governance in the Regulation of Collective Investments*, HASTINGS BUS. L. J. 67, 72 (2006) [hereinafter "Markham, *Mutual Fund Scandals*"]. The investment trusts were organized similarly as nowadays "closed-end management companies". "Closed-end fund" is legally known as a "closed-end company" which represents one of three basic types of investment companies. The two other basic types of investment companies are mutual funds and unit investment trusts (UITs). Each of these types of investment companies are described and analyzed in detail in the second chapter. For some of the traditional and distinguishing characteristics of closed-end companies, *available online at:* <http://www.sec.gov/answers/mfclose.htm>/*last visited* June, 12 2012.
[163] *See* MARKHAM, FINANCIAL HISTORY VOL. I, *supra* note 151, at 142-143.
[164] The investment industry in the 1920's promised higher earnings and dividends. *See* Eugene N. White, *The Stock Market Boom and Crash of 1929 Revisited*, 4 J. ECON. PERSPECTIVES 67 (1990).
[165] *See* Fletcher, Stock Exchange Practices, S. Rep. No. 73-1455, at 334 (1934) in Markham, *Mutual Fund Scandals*, *supra* note 162, at 73.
[166] *See* EDWARD C. HARWOOD & ROBERT L. BLAIR, INVESTMENT TRUSTS AND FUNDS FROM THE INVESTOR'S POINT OF VIEW 30 (1937).
[167] The New York Stock Exchange [hereinafter "NYSE"]. For more on the history of the NYSE, *see* Banner, *The Origin of New York Stock Exchange*, *supra* note 159.
[168] *See* Nicholas Molodovsky, *Building a Stock Market Measure: A Case Story*, 23 FIN. ANALYSTS J. 43, 43 (1967). For a comparison, the market capitalization of NYSE in 2014 was 16.6 $ trillion.

funds with investment trusts. By 1928 a new investment vehicle was established every day.[169]

Before the Stock Market Crash of 1929[170] investment companies held more than $3 billion with more than 500,000 investors.[171] Almost all of these investment companies were organized as closed-end funds, yet those investment companies that were able to survive the Crash of 1929 to greater extent than the closed-end funds were open-end mutual funds. Subsequently the open-end mutual funds started to dominate the market.[172] After the Stock Market Crash of 1929 the largest investment companies on the US market – the American Founders Corporation and the United Founders Corporation – had to merge in order to survive the downturn, as their stock price dropped from $30 to 38 cents.[173] The Goldman Sachs Trading Corporation's stocks fall from $326 to $1.75 between 1929 and 1932.[174]

The causes and reasons of the "Great Crash" had been analyzed and discussed in the same way as the financial crisis in 2008 (often referred to as "Credit Crunch"). Academics, professionals and politicians wanted to find out what caused the collapse of the market. Unlike most market crashes, the one in 1929 was not an event of one day but a series of events through one week, from Wednesday, October 23rd until Thursday, October 31st. During these eight days, a total of nearly 70.8 million shares

169 Investment Company Act of 1940 and Investment Advisers Act of 1940, S. Rep. No. 76-1755 at 3 (1940) in Markham, *Mutual Fund Scandals*, *supra* note 162, at 74.
170 Often also referred to as Wall Street Crash.
171 *See* DIANA B. HENRIQUES, FIDELITY'S WORLD 56-63 (Scribner, 1995). (Taking into consideration inflation rates, today $3 billion would be around $40 billion).
172 The first open-end fund was formed in 1924 in Boston - the Massachusetts Investors' Trust.
173 American Founder Corp was a worldwide investment trust incorporated in Maryland and had one of the biggest phenomenal growths in the 1920's. In 1922, one share was worth $10. Between November 30, 1928 and November 30, 1929, its assets rose from $44,000,000 to $129,000,000. For more see available online < http://www.stocklobster.com/1328.html>/ *last visited* June 15, 2012.
174 S*ee* MARKHAM, FINANCIAL HISTORY VOL. I, *supra* note 151, at 155; *see also* TIM MCNEESE, THE GREAT DEPRESSION 1929 – 1938, 19 – 25 (Chelsea House Publishers, 2010), DAVID F. BURG, THE GREAT DEPRESSION 7 -11 (Facts on File, 2d ed. 2005).

were traded – more than in a month prior to March 1928.[175] It has been often assumed that the main reasons for the crash were the overheated economy caused by huge number of new security offerings,[176] abuse of unregulated investment trusts by major commercial banks, high level of brokers' loans and the under- or overvaluation of common stock.[177] According to Galbraith, the heat on the market was co-initiated by "men and women, individuals and institutions [who believed] that all will be better, that they are [all] meant to be richer."[178] Thus, the stock meltdown was caused not only by eager and speculative companies, brokers and investment companies, but also by irrational investors believing that the prices can go only higher and despite warnings they continued to invest.

After the Stock Market Crash and the subsequent Great Depression, which lasted during the 1930s, the United States was challenged both politically and economically.[179] New regulatory approach had to be introduced. The States' Blue

---

[175] *See* Maury Klein, *The Stock Market Crash of 1929: A Review Article*, 75 BUS. HIST. REV. 325, 325-326 (2001). *See generally* JOHN K. GALBRAITH, THE GREAT CRASH 1929 (Houghton Mifflin Company, 1954) or MILTON FRIEDMAN & ANNA JACOBSON SCHWARTZ, A MONETARY HISTORY OF THE UNITED STATES 1867 – 1960 334-341 (Princeton University Press, 1963) [hereinafter "FRIEDMAN & SCHWARTZ"] (Both describe the stock market crash in great detail from economic perspective taking into consideration also number of historic and political events that took place in this period).

[176] *See* Bruce W. Nichols, *Legislative History of the Glass-Steagall Act*, in THE GLASS-STEAGALL ACT: BANKS AND THE SECURITIES BUSINESS 15 (Martin E. Lowy & Cantwell F. Muckenfuss eds. 1984), GEORGE J. BENSTON, THE SEPARATION OF COMMERCIAL AND INVESTMENT BANKING: THE GLASS-STEAGALL ACT REVISITED AND RECONSIDERED 43 (1990), Maury Klein, *The Stock Market Crash of 1929: A Review Article*, 75 BUS. HIST. REV. 325 (2001) or Paul W. Garrett, *The Jazz Age*, FIN. N. AM. REV. (Feb. 1930).

[177] *See* IRVING FISHER, THE STOCK MARKET CRASH – AND AFTER (New York 1930). Irving Fisher from Yale University was the first analyst who compiled a useful list of causes of the crash while being the only one at the time claiming the undervaluation of the stocks, while majority of economists believed that it was the other way around. More on the discussion whether the stocks were over- or undervalued *see* Ellen R. McGrattan & Edward C. Prescott, *The Stock Market Crash of 1929: Irving Fisher Was Right!* (National Bureau of Economic Research, Working Paper No. 8622, December 2001). Later, in 1991 Harold Bierman Jr., by analyzing several types of data, also refuted that the stocks were overpriced, *see* HAROLD BIERMAN JR. THE GREAT MYTHS OF 1929 AND THE LESSONS TO BE LEARNED (Praeger, 1991). Other researching the Great Crash, notable J. K. Galbraith, argued that even though the crash took place in 1929, the fundamental signs of unstable market were present long before, as the closed-end investment companies excessively traded for several years, see JOHN K. GALBRAITH, THE GREAT CRASH 1929 90 (Houghton Mifflin Company, 1954).

[178] *See* JOHN K. GALBRAITH, THE GREAT CRASH 1929 xii-xiii (Houghton Mifflin Company, 1954).

[179] Between 1929 and 1933, the national income dropped by half; the production, sales and commodity prices suffered devastating cuts. The stock prices declined by 80% from $80 billion to $16 billion. In

Sky laws[180] did not sufficiently protect the market and investors, and thus the federal securities regulatory system had to be employed.

1.2.1. Blue Sky Laws

Before the federal government adopted securities regulation, majority of the States had already in place law governing the investment trusts concerning their in-state operations. The first set of rules regulating the sale of certain types of securities was passed in Georgia in 1904.[181] Notwithstanding that there had been even earlier at least partial regulations of securities trading containing provisions on such issues as the maximum capital stock issuances, records requirements or the prudent investor rule, the Georgian act was the first integrated one.[182]

1930 26,355 business failed and more than five thousand banks collapsed. The monetary system completely collapsed. *See* BARRY CUSHMAN, THE GREAT DEPRESSION AND THE NEW DEAL 5-6 (Michael Grossberg & Christopher Tomlins eds., in THE CAMBRIDGE HISTORY OF LAW IN AMERICA, Vol. 3, 2008). On the effects of the effects of the 1929 Stock Market Crush *see generally* Michael A. Bernstein *The Great Depression as Historical Problem,* 16 OAH MAGAZINE OF HISTORY 3 (Fall, 2001), Ben S. Bernanke, *Non-Monetary Effects of the Financial Crisis in the Propagation of the Great Depression* 73 AM. ECON. REV. 257 (June 1983) or Eugene N. White, *The Stock Market Boom and Crash of 1929 Revisited,* 4 J. ECON. PERSPECTIVES 67 (Spring, 1990). Moreover, the political situation escalated, as President Hoover was not successful with his introduced policies and lost the elections in 1932, *see* BARRIE A. WIGMORE, THE CRASH AND ITS AFTERMATH: A HISTORY OF SECURITIES MARKETS IN THE UNITED STATES, 1929 -1933, 89-100 (Greenwood Press, 1985) or Michael E. Parrish, *The Great Depression, the New Deal, and the American Legal Order,* 59 WASH. L. REV. 723, 723-34 (September 1984). On President Hoover's pre- 1929 Crash Policies, *see generally* Robert H. Zieger, *Herbert Hoover, the Wage-Earner, and the "New Economic System" 1919 – 1929,* 51 BUS. HIST. REV. 161 (Summer, 1977).

[180] According to the BLACK'S LAW DICTIONARY, the Blue Sky law is a state statute establishing standards for offering and selling securities, the purpose being to protect citizens from investing in fraudulent schemes or unsuitable companies. Such a statute typically includes provisions for licensing brokers, registering securities, and formal approvals of the offerings by the appropriate government agencies. The origin of the term "Blue Sky law" is still uncertain. According to Thomas Mulvey, the explanation for this term is that it referred to the fact that the security sellers in Kansas would "sell building lots in the Blue Sky in fee simple" if they could; *see* Thomas Mulvey, *Blue Sky Law,* 36 CAN. L. TIMES 37, 37 (1916). On the other hand, a well-known investment banker claimed that this term referred to the idea that the "maker of bad paper might just as well be capitalizing the Blue Sky and selling shares therein." *See* Warrn S. Hayden, *Blue Sky Laws and Their Relations to the Investment Banker,* in PROC. OF THE ORGANIZATION MEETING AND THE FIRST ANN. CONVENTION OF THE INVESTMENT BANKERS' ASS'N AM. 139, 139 (1912).

[181] *See* Investment Companies, Business of Regulated, Part I, Title 6, No. 592, Act and Resolutions of General Assembly of the State Georgia, 1904, 74-79. Approved on August 13, 1904. *in* John B. McFerrin, *Blue Sky Laws of the Southeastern States*, 17 SOUTHERN ECON. J. 302, 302-303 (1951).

[182] *See* Gerald D. Nash, *Government and Business: A Case Study of State Regulation of Corporate Securities: 1850 – 1933*, 38 BUS. HIST. REV 144, 146-47 (1964).

The act adopted by the State of Georgia regulated the licensing of investment companies and required them selling "investment securities of any kind on the partial payment, installment or any other plan or payment, and providing for the redemption and retiring of the same or any part thereof" to deposit in a trust at least $25,000 or not less than 75 per cent of the amount collected in payments. In addition, investment companies were obliged to submit a statement of assets and liabilities together with an annual income statement with the Comptroller General.[183]

Yet the majority of scholars assign the first place of Blue Sky law to Kansas,[184] where in 1911 a more coherent and compact State securities law was adopted.[185] Kansas introduced the first comprehensive licensing scheme, where all entities selling securities in Kansas had to obtain license from the bank commissioner and regularly file reports of their financial standing.[186] Moreover, the investment companies were also required to file reports on their business plan and a copy of all contracts, bonds or other securities they intended to sell in Kansas. The submitted information included the name and location of an investment company, the actual financial condition

---

[183] *See* John B. McFerrin, *Blue Sky Laws of the Southeastern States*, 17 SOUTHERN ECON. J. 302, 302 (1951). Comptroller General usually overlooked the State accounting office which is an independent office ensuring the fiscal and managerial accountability of the State government. In other States different constitutional officer administered securities statutes: Treasurer, Secretary of State, Bank Commissioner or Attorney General.

[184] The proponent of the Kansas Blue Sky law was a Commissioner of Banking Joseph Norman Dolley, who was criticizing the regulatory system, which could not protect the Kansas widows who were a target of fraudulent securities salesmen and that under his estimates, people invested as much as six million dollars in worthless securities per year in Kansas. *See* Mark A. Sargent, *State Disclosure Regulation and the Allocation of Regulatory Responsibilities*, 46 MD. L. REV. 1027, 1040 n. 67 (1987) and Joseph Norman Dolley, *Blue Sky Law*, 77 AM. BANKER 1705, 1705 (1912). An early article describing the Kansas Blue Sky law stated, "Here is a lesson from Kansas that the whole country may learn with profit to itself." *See* Isaac F. Marcosson, *Barring Out the Stock Thieves: How Kansas Has Set an Example to the Other American States in Her System of Safeguarding the Money of Her People*, MUNSEY'S MAGAZINE, February 1912, at 674.

[185] Act of March 10, 1911, ch. 133, 1911 Kan. Sess. Laws 210. For the overview of Kansas Blue Sky laws, *see* Rick A. Fleming, *100 Years of Securities Law: Examining a Foundation Laid in the Kansas Blue Sky*, 50 WASHBURN L.J. 583 (2011).

[186] *Id.* §§ 6-8. Under §1 the exempted entities were state and national banks, trust companies, building and loan associations, real estate mortgage companies, and nonprofit corporations. Moreover, the statute excluded number of securities as federal, state, municipal bonds and notes secured by mortgages in Kansas.

together with its list of properties and liabilities.[187] Kansas Blue Sky law was a merit-based regulation and the bank commissioner was authorized to ban any investment company from securities selling after document inspection. A ground for such official forbiddance was "unfair, unjust inequitable or oppressive" provision in investment company's documents or proposed securities or insolvency of the investment company or if it "d[id] not intend to do a fair and honest business, and … d[id] not promise a fair return on the stocks, bonds or other securities."[188] Moreover, the authority signed up to the bank commissioner allowed him to scrutinize the investment company and if found in "unsafe, inequitable or unauthorized manner," file for bankruptcy proceeding.[189] The Kansas Blue Sky law set the pattern and was instantly followed by other States and in two years twenty-three States adopted some form of securities regulation.[190] By 1933, when the first federal securities laws were adopted, every State in the US except Nevada had enacted a Blue Sky law.[191]

---

[187] *Id.* §§ 2. Within the first year and half more than 1,500 companies applied for registration. Out of the all applications 75% were mining, gas, oil and stock selling schemes of a fraudulent nature, another 12% were highly speculative and only the remaining 13% were legitimate investment opportunities; see C. A. Dykstra, *Blue Sky Legislation*, 7 AM. POL. SCI. REV. 230, 230 (1913).

[188] *Id.* § 5.

[189] *Id.* § 11.

[190] *E.g.* Louisiana and South Carolina (1912), Arkansas, Florida, Tennessee, Georgia, North Carolina (1913), Alabama (1915), Mississippi and Virginia (1916), Kentucky (1920)

[191] *See* Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws,* 70 TEX. L. REV. 347, 365 – 370 (Dec. 1991), where the authors discuss the interest of number of different types of businesses to adopt the Blue Sky legislation. Among the biggest supporters were the small bankers and state banks, given that in early 20th century it was them, who provided most of the financing, as it is still the case of the EU. Moreover, farmers and small businesses also supported Blue Sky laws in order to enhance their access to credit being in constant need for temporary credit, mainly between planting and harvest. It was also probably due to this fact that Kansas, being a farmer state, was one of the very first states, which adopted the Blue Sky legislation. On the other hand the biggest opponents of the Blue Sky laws were investment bankers, bond issuers and bigger banks. *See also* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET 377 - 380 (rev. ed. 1995). Although New York was also in those time the center of securities trading, it had a peculiar securities regulation. New York did not have embodied securities regulation in a form that the other states had, it vested all the rights into the hands of the Attorney General who in case of questionable transactions could impede and inquire the companies issuing stocks, bonds and other securities. The Attorney General could also require foreign corporations offering securities in New York to furnish information and produce books; *see Blue Sky Laws*, 79 COLUM. L. REV. 84-85 (1924). *See generally* B. Rogers, *Blue Sky Laws* 87 A.L.R. 42 (1933).

Even though the Blue Sky laws had been adopted by all States,[192] some questioned their legality and constitutionality.[193] In several cases these attacks have been successful,[194] whereas in others not.[195] Finally, in 1917 the US Supreme Court settled the confusion and in a series of three decisions upheld the constitutionality and validity of these statutes.[196] However, due to the Wall Street Crash of 1929 and the subsequent political tension, the US Congress decided to adopt additional level of regulation – the **federal securities legislation**. The US Congress aimed to fill the regulatory gaps that states could not due to their jurisdictional limits and constrained authority.[197] Nevertheless, the US Congress expressly stated that the State securities laws should remain in effect to preserve for investors the protection afforded by state securities laws.[198] In addition, the US Congress exempted various types of securities

[192] On the process of adoption of the Blue Sky laws through the US *see* Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347, 377 - 380 (1991).

[193] The constitutionality was questioned on the following grounds: deprivation of property without due process, denial of equal protection of the laws or undue restraint and burden upon interstate commerce. For more on the constitutionality of the state Blue Sky laws applied to interstate commerce *see* Russel A. Smith, *State "Blue-Sky" Laws and the Federal Securities Acts,* 34 MICH L. REV. 1135, 1145 – 1155 (1936).

[194] In case of Michigan, in Alabama & New Orleans Transportation Co. v. Doyle, 210 F. 173 (E.D. Mich. 1914), the federal court condemned the Michigan Blue Sky law for its excessiveness as in court's opinion it not only prohibited fraudulent practices but the state prohibited the sale of securities that were "honest, valid and safe". Courts further abolished Blue Sky laws for their interference with free flow of interstate commerce, as in case of Iowa; *see* William R. Compton v. Allen, 216 F. 537, 549 (S.D. Iowa1914).

[195] In North Carolina, the court stated that the state has sufficient power to adopt securities law as "co reasonable and just a regulation of the prevention of fraud and imposition." *See* State v. Agey 171 N.C. 831 99 S. E. 726. (1916).

[196] Hall v. Geiger-Jones Co., 242 US 539 (Ohio statute); Merrick v. N. W. Halsey & Co., 242 US 568 (Michigan) & Caldwell v. Sioux Falls Stock Yards Co., 242 US 559 (South Dakota).

[197] *See* H.R. REP. NO. 85, 73d. Cong., 1st Sess. 10-11 (1933); FEDERAL SECURITIES ACT: HEARINGS ON H.R. 4314 BEFORE THE HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE, 73d Cong., 1st Sess., 101 (1933). The Blue Sky Laws provided significantly more protection to investors that the common law remedies for deceit, creative promoters developed schemes to "elude the reach of process through the use of interstate facilities." *See* Manning Gilbert Warren III, *Reflections on Dual Regulation of Securities: A Case Against Preemption,* 25 B.C.L. REV. 495, 515-516 (1984). Furthermore, as Justice Douglas noted in the Traveler's Health Ass'n v. Virginia, the states were unable to acquire jurisdiction over companies that "operated beyond the borders, established no office in the state, and had no agents, salesmen, or solicitors to obtain business for it within the state." *See* Traveler's Health Ass'n v. Virginia, 339 U.S. 643, 653 (1950).

[198] *See* 15 U.S.C § 77r and 15 U.S.C. §78bb.

and securities transactions, leaving these for the States to regulate and oversee.[199] Thus, the US in the field of securities regulation created a dual system, including both the federal securities laws and the State Blue Sky laws.[200] Yet concerning the regulation of investment companies, the two regulatory sets do not generally collide.[201]

1.2.2. The New Deal Package

The Stock Market Crash of 1929 left the US paralyzed.[202] President Hoover adopted a number of aid programs as a farm aid and other agricultural programs to fight hunger, unemployment and empty factories.[203] However, these efforts proved to be insufficient.[204] In 1932, Franklin Delano Roosevelt fueled his presidential campaign with promises to consolidate the economy and repress Wall Street's financiers.[205] Roosevelt succeeded in the presidential battle. President Roosevelt's administration,

---

[199] These exemptions included for example the state and local government securities, insurance policies and annuity contracts issued by corporations subject to state supervision. For a detailed overview, *see* Manning Gilbert Warren III, *Reflections on Dual Regulation of Securities: A Case Against Preemption*, 25 B.C.L. REV. 495, 519-523 (1984).

[200] Later in 1956 the Uniform Securities Act 7A U.L.A. 561 was introduced, *available online at:* <http://www.nasaa.org/wp-content/uploads/2011/08/UniformSecuritesAct1956withcomments.pdf>/ *last visited* 28th September 2013. The Uniform Securities Act represents a model statute for the States. The 1956 version was adopted by thirty-seven jurisdictions, while the most recent revision of 2002 was adopted by fifteen jurisdictions. For a detailed analysis of the Uniform Securities Act *see* Student Symposium, *Blue Sky Laws*, 17 W. RES. L. REV. 1098 (1965-1966).

[201] On the coexistence of the two regulatory sets, *see* Roberta S. Karmel, *Blue-sky Merit Regulation: Benefit to Investors or Burden on Commerce?* 53 BROOK. L. REV. 105, 107-113 (1987-1988); Daniel J. Barrison, *State Blue Sky Laws: An Alternative to the Federal Securities Laws and State Common Law in Third-Party Accountant Malpractice Cases*, 57 TEMP. L.Q. 601, 642–646 (1984) and Daniel J. Morrissey, *The Road Not Taken: Rethinking Securities Regulation and the Case for Federal Merit Review*, 44 U. RICH. L. REV. 647, 678–686 (2010).

[202] "Between September 1, 1929, and July 1, 1932, the value of all stock listed on the New York Exchange shrank from total of nearly $90 billion to just under $16 billion – a loss of 83 percent." *see* SELIGMAN, TRANSFORMATION OF WALL STREET, *supra* note 92, at 1. Moreover, extensive number of banks were becoming insolvent every year, in 1930, there were over 1,300 failures, in 1931 – 2,00 failures and in 1932 there were almost 1,500 failures, reaching the peak in 1933 with around 4,000 banks breakdowns, *see* ROBERT A. DEGEN, THE AMERICAN MONETARY SYSTEM 62-63 (Lexington Books, 1987).

[203] *See* Rexford G. Tugwell, *The New Deal in Retrospect,* 4 W. POL. Q. 363, 376 (1948). For extensive description of Hoover's actions and his critique of the New Deal *see* HERBERT HOOVER, THE CHALLENGE TO LIBERTY (C. Scribner's sons, 1934).

[204] Some believe that Hoover was afraid to intervene with the financial leaders, given that they were the major supporters of his party. *See* SELIGMAN, TRANSFORMATION OF WALL STREET, *supra* note 92, at 5.

[205] For more *see* PAUL K. CONKIN, THE NEW DEAL 20-49 (Harlan Davidson, 2nd ed., 1975).

supported by academia as well as industry,[206] immediately started preparing a series of federal regulations, presidential executive orders with the main "3 Rs": Relief, Recovery & Reform – the **New Deal**.[207] Within the New Deal measures, President Roosevelt focused not only on fiscal policy, banking and monetary reform or securities regulation but also on social security reform, tax reform and labor law reform.[208]

Early in the legislative process of the New Deal, President Roosevelt clearly stated that the legislative methodology of the federal securities law should not be based on *"approving or guaranteeing"*.[209] The new system *"[s]hall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public."*[210] Consequently, new acts were

---

[206] Advisers of President Roosevelt were known as "Brains Trust", who in the first 100 days in office helped President Roosevelt to enact 15 major laws. On the Brains Trust *see* James M. Landis, *The Legislative History of the Securities Act of 1933,* 28 GEO. WASH. L. REV. 29, 30 (1959) and Daniel J. Morrissey, *The Road Not Taken: Rethinking Securities Regulation and the Case for Federal Merit Review,* 44 U. RICH. L. REV. 647, 679–680 (2010).

[207] The name "New Deal" originated in the Roosevelt's speech when he accepted the Democratic nomination for president, "*Throughout the nation men and women, forgotten in the political philosophy of the Government, look to us here for guidance and for more equitable opportunity to share in the distribution of national wealth…I pledge myself to a new deal for the American people. This is more than a political campaign. It is a call to arms." In* The Roosevelt Week, TIME, July 11, 1932. Roosevelt presumably borrowed the phrase from the title of Stuart Chase's book A New Deal published in February 1932. The New Deal besides influencing the economy of the US, generated far-reaching changes in the US legal and constitutional order by dramatic growth in the size, responsibility and power of the federal government. On the constitutional change *see generally* HARRY N. SCHEIBER, THE NEW DEAL LEGACY AND THE CONSTITUTION: A HALF-CENTURY RETROSPECT, 1933 – 1983 (University of California Press, 1984). PROCEEDINGS OF A CONFERENCE AT BOALT HALL SCHOOL OF LAW, University of California, Berkley, April 16, 1983 (1984); MICHAEL GROSSBERG & CHRISTOPHER TOMLINS, THE CAMBRIDGE HISTORY OF LAW IN AMERICA, Volume 3: The Twentieth Century and After (1920-), chapter 8; FRIEDMAN & SCHWARTZ, *supra* note 175, at 420-424 or Gavin Wright, *The Political Economy of New Deal Spending: An Econometric Analysis,* 56 REV. OF ECON & STATISTICS 30, 30 (1974).

[208] In 1933 after the 4th March, when President Roosevelt took the oath of office and became the 32nd President of the United States, in the first 100 days, concerning the capital market law, he enacted Emergency Banking Act (9th March) Government Economy Act (20th March), Abandonment of Gold Standard (19th April), Securities Act (27th May) Home owners Loan Act (13th June), Glass-Steagall Banking Act (16th June). For the whole list of the New Deal legislation *see* http://rooseveltinstitute.org/policy-and-ideasroosevelt-historyfdr/new-deal / last visited 19th September 2012.

[209] H.R. REP. NO. 73-85, at 2 (1933). The original draft of the securities legislation was premised on a merit standard as the Blue Sky laws.

[210] *Id.* Roosevelt's regulatory philosophy had been expressed later *in* LOUIS BRANDEIS, OTHER PEOPLE'S MONEY AND HOW BANKERS USE IT (1914).

introduced.[211] Listed are those, which directly affected the business of investment companies:

- The Securities Act of 1933[212] [hereinafter "SA 1933"] often referred to as "truth in securities law" required corporate issuers to fully disclose when selling securities in an effort to diminish the speculative excesses of the 1920s.[213] The purpose of the registration is to fully inform the investors of financial and other significant information concerning the publicly offered securities. And prohibit misrepresentation, deceit and other fraud in the sale of securities.[214]
- The Securities Exchange Act of 1934[215] [hereinafter "SEA 1934"] established the Securities and Exchange Commission with broad authority over capital market participants.[216] The SEA 1934 requires registration of securities prior to listing and trading on exchange as well as registration of broker-dealers, national securities exchanges, and associations of securities dealers.
- The Glass-Steagall Act [217] [hereinafter "GSA"] divided banks between investment and commercial, thus reshaped the investment industry. After the Stock Market Crash, thousands of banks failed, as they were unable to return

[211] On the legislative history of the securities regulation in 30's *see generally* James M. Landis, *The Legislative History of the Securities Act of 1933,* 28 GEO. WASH. L. REV. 29 (1959-1960) and Elisabeth Keller & Gregory A. Gehlmann, *Introductory Comment: A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934,* 49 OHIO ST. L.J. 330 (July 1988). The SA 1933 was amended substantially in 2000 when the Commodity Futures Modernization Act of 2000, focusing on futures contracts, was signed into a law.
[212] 15 U.S.C. § 77a *et seq.*
[213] *See* A. C. Pritchard and Robert B. Thompson, *Securities Law and the New Deal Justices,* 95 VA. L. REV. 841, 846 (2009).
[214] On the analysis Securities Act *see* Laylin K. James, *The Securities Act of 1933*, 32 MICH. L. REV. 624 (1933-1934) or George E. Bates & William O. Douglas, *The Federal Securities Act of 1933,* 43 YALE L.J. 171 (1933).
[215] 15 U.S.C. §78a *et seq.*
[216] On the analysis and history of the Exchange Act *see* John E. Tracy & Alfred B. MacChesney, *The Securities Exchange Act of 1934*, 32 MICH. L. REV. 1025 (June 1934).
[217] Banking Act of 1933 (Glass-Steagall Act), Pub. L. No. 73-65, 48 Stat. 162 (codified as amended in scattered sections of 12 USC.).

the deposits of their customers due to their own unsuccessful investing on the stock market.[218] Since the GSA, the commercial banks and their holding companies and affiliates,[219] were forbidden to undertake investment banking activities, whereas the investment banking companies (Section 21) were forbidden to accept any deposits and thereby act like commercial banks.[220]

- By the Bank Holding Company Act in 1956 the US Congress even extended the separation of investment and commercial banks by displacing banks from the underwriting of insurance products.[221] Thus limiting their spectrum of business.[222] However the new age of product innovation in 1970's and increased competition had been wiping the dividing line between the investment and commercial banks.[223] Subsequently, also the Comptroller of

---

[218] Over 11,000 banks had failed or had to merge, reducing the number by forty percent, from 25,000 to 14,000. *See* GEORGE J. BENSTON, THE SEPARATION OF COMMERCIAL AND INVESTMENT BANKING 1 (1990).

[219] *See* section 16, 20 and 32 of the GSA. The relevant part of Section 16 of GSA reads: "*The business of dealing in securities and stock by the [national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the [national bank] shall not underwrite any issue of securities or stocks. Provided that the [national bank] may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. In no event shall the total amount of the investment securities of any one obligor or maker, held by the [national bank] for its own account, exceed at any time 10 per centum of its capital stock account paid in and unimpaired and 10 per centum of its unimpaired surplus fund… The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply to obligations of the United States, or general obligations of any State or of any political* ***Subdivision*** *thereof.*"

[220] According to Professor Benston, there were several rationales why the GSA had been adopted. Firstly, the securities activities of banks "presented significant risk of loss to depositors and federal government". Secondly, the banks "were subject to conflicts of interests and other abuses, thereby resulting in harm to their customers," Thirdly, "[e]ven if there were no actual abuses, securities-related activities are contrary to the way banking ought to be conducted." Fourth, the securities industry "[w]ants to bar those banks that would offer securities and underwriting services from entering their markets." Fifth, "[s]ecurities activities are risky and should not be permitted to banks that are protected with the federal 'safety net'." Sixth, "banks get subsidized federal deposit insurance which gives them access to cheap deposit funds, thus having unfair competitive advantage over non-bank competitors." Seventh, "commercial banks" competitive advantage would result in their domination or takeover" of other securities/investment firms." *See* GEORGE J. BENSTON, THE SEPARATION OF COMMERCIAL AND INVESTMENT BANKING 13-15 (Oxford University Press, 1990) [hereinafter "BENSTON, THE SEPARATION OF COMMERCIAL AND INVESTMENT BANKING"].

[221] Bank Holding Company Act of 1956, Pub. L. No. 84-511, 70 Stat. 133.

[222] *See generally* Note, *The Bank Holding Company Act of 1956*, 9 STAN. L. REV. 333 (1957).

[223] *See* KERRY COOPER & DONALD R. FRASER, BANKING DEREGULATION AND THE NEW COMPETITION IN FINANCIAL SERVICES 2-17 (1984) and Allen N. Berger, Anil K. Kashyap & Joseph M. Scalise, *The*

the Currency started to undertake several measures in order to relax the line and in consequence it became difficult to continue maintaining the distinction of the financial institutions imposed by GSA and Bank Holding Company Act. Ultimately in 1999, after number of interpretations and exemptions,[224] the Gramm-Leach-Bliley Act [hereinafter "GLBA"] repealed the GSA.[225]

In addition, although beyond the scope of this chapter, it is important to mention the other acts adopted by US Congress, which form the full picture of the New Deal package, namely the Banking Act of 1933,[226] the Public Utilities Company Act of 1935,[227] and the Trust Indenture Act of 1939.[228]

Yet the prime focus of this thesis lies in the analysis of the Investment Companies Act of 1940[229] [hereinafter "ICA 1940"] and the Investment Advisers Act

---

Transformation of the US Banking Industry: What a Long, Strange Trip It's Been, 1995 BROOKINGS PAPERS ON ECON. ACTIVITY 55, 68-70 (1995).

[224] US governmental organizations used different methods for circumventing the GSA. The Federal Reserves expanded the commercial banking powers through the techniques "bootstrapping" in order to expand permissive non-banking activities, which were also encouraged by judicial decisions. On the other hand the Comptroller of the Currency authorized in 1969 banks to operate collective investment trusts (*e.g.* the First National City Bank registered a fund under the ICA 1940, where the bank acted as the managing agent of the trust, *see* Investment Co. Institute v. Camp, 91 S.Ct 1091 (1971)). For more on the methods of bypassing the GSA before the Gramm Leach Bliley Act, *see* Jonathan Zubrow Cohen, *The Mellon Bank Order: An Unjustifiable Expansion of Banking Powers,* 8 ADMIN. L.J. AM. U. 335 (1994) and Joseph Jude Norton, *Up Against 'The Wall': Glass-Steagall and the Dilemma of a Deregulated ('Regulated') Banking Environment,* 42 BUS. LAW. 327 (1987).

[225] 15 U.S.C. § 6801a *et seq.*

[226] Pub. L. 73-66. The Banking Act of 1933 established the Federal Deposit Insurance Corporation Main task of FDIC was to restore the trust in the US capital market system through the protection of deposits from insolvency. By almost any doubt, the FDIC has been successful and the US population had regained the confidence into the US banks and other financial institutions. After the 1929 also many banks with sound assets and sound business practices had found themselves in difficulties, as they had to face sudden and massive deposit withdrawals. If there had been sufficient time and people would not fear losing all they money, many banks would not have been forced to shut their doors. Financial panic as seen after the Stock Market Crash in 1929, has not occurred since the deposit insurance legislation had been adopted. *See* Archie K. Davis, *Banking Regulation Today: A Banker's View*, 31 L. & CONTEMP. PROBS. 639, 642 (1966). At the time of the adoption of Banking Act of 1933, there were only 14 states, which had adopted insurance plans for the deposits. The federal deposit insurance program had a legislative history since 1886; as there were 150 proposals made in Congress between 1886 and 1933. However, it took the collapse of the whole system until the program had been accepted. For more on the history of FDIC see THE HISTORY OF THE FDIC 1933-1983, *available online at*: < http://www.fdic.gov/bank/analytical/firstfifty/chapter1.pdf>/*last visited* June 12, 2012.

[227] 15 U.S.C. §79a *et seq.*

[228] 15 U.S.C. §77aaa *et seq.*

[229] 15 U.S.C. §80a-1 *et seq.*

of 1940[230] [hereinafter "IAA 1940"]. The ICA 1940 and IAA 1940 are companion statutes, designed to prevent fraud and deceit by persons engaged in the business of investment advisory services[231] that were the final pieces of the federal securities laws from the New Deal package.[232]

1.2.3. Investment Company Act of 1940

The ICA 1940 had been adopted after an extensive study of SEC authorized by Section 30 of the Public Utility Holding Company Act of 1935[233] [hereinafter "REPORT"] that "*directed the SEC to make intensive study of investment trusts*[234] *and investment companies [...].*"[235] The study showed that the disclosure requirements already adopted through the SA 1933 and the SEA 1934 were insufficient.[236] Thus,

---

230 15 U.S.C. § 80b-1 *et seq.*

231 The Investment Advisers Act of 1940 is designed to regulate those who give investment advice about securities to others. The IAA 1940 requires registration of all advisers. The IAA1940 does not specify in great detail all the rules governing the way advisers conduct their business but broadly prohibits fraud and holds the advisers to meticulous fiduciary standards. In case of any type of conflict of interest, the advisers are required to fully disclose the conflicts to their clients and to SEC. For more on the Investment Advisers Act of 1940 *see* Philip A. Loomis, Jr., *The Securities Exchange Act of 1934 and the Investment Advisers Act of 1940,* 28 GEO. WASH. L. REV. 214 (1959-1960), Fred. B. Lovitch, *The Investment Advisers Act of 1940 – Who is an "investment adviser"?* 24 U. KAN. L. REV. 67 (1975-1976), Barry P. Barbash & Jai Massari, *The Investment Advisers Act of 1940: Regulation by Accretion* 38 RUTGERS L.J. 627 (2007-2008) or Seth Chertok, *A Comprehensive Guide to Title IV of the Dodd-Frank Act 2010 and the Rules Promulgated Thereunder,* 12 U.C. DAVIS BUS. L.J. 125 (2012).

232 On the historical excursion and analysis of the ICA *see generally* Alfred Jaretzki Jr., *The Investment Company Act of 1940*, 26 WASH U.L.Q. 303 (1940-1941) (Jaretzki represented closed-end companies before the House Committee on Interstate and Foreign Commerce), Checie C. Bosland, *The Investment Company Act of 1940 and Its Background*, 49 J. POL. ECON. 477 (1941) and Richard B. Tolins, *The Investment Company Act of 1940*, 26 CORNELL L. Q. 77 (1940-1941).

233 *See Investment Trusts and Investment Companies,* REPORT OF THE SECURITIES AND EXCHANGE COMMISSION, pursuant to § 30 of the Public Utility Holding Co. Act of 1935 [hereinafter "REPORT"]. The REPORT was made under general supervision of Commissioner Robert E. Healy, with Paul P. Gourrich as the director of the study. The SEC study took about four years, cost over $500,000, and involved a research of 1,272 investment trusts and companies between the years 1927-1935. The public examination alone resulted in 33,00 pages of written transcript and the Final report to Congress had about 5,300 pages. For more *see* CLIFFORD E. KIRSCH, THE FINANCIAL SERVICES REVOLUTION 382 (McGraw-Hill, 1997) and Bosland, *supra* note 232, at 478.

234 By 1936 the term of "investment trust" had been fully substituted by the "investment company" given the successful recommendation by the Investment Bankers Association as the term "trust" deemed to misleading implications for the investors, *See* Fletcher, Stock Exchange Practices, S. Rep. No. 73-1455, at 339 (1934) *in* Markham, *Mutual Fund Scandals*, *supra* note 162, at 73.

235 *See* Warren Motley, Charles Jackson Jr. & John Barnard Jr., *Federal Regulation of Investment Companies Since 1940*¸ 63 HARV. L. R. 1134, 1137 (1950).

236 *See* HEARINGS ON S. 3580 BEFORE SUBCOMMITTEE OF THE SENATE COMMITTEE ON BANKING AND CURRENCY, 76TH CONG., 2[ND] SESS. 38-39 (1940) [hereinafter "SENATE HEARINGS 76[TH] CONG."], (statement of SEC Commissioner Healy) ("It should hardly be necessary to point out that existing

the ICA 1940 placed additional substantive burdens on all aspects of the business of the investment companies. It had been seen as "*the most intrusive financial regulation known to man or beast*".[237]

In the REPORT, the SEC estimated that from 1927 to 1936 around 1,100 new investment trusts and companies were formed, while only about 560 remained in existence due to the ongoing depression.[238] Concerning the number of investors, by the end of 1935 there were 2,100,000 investors who invested in investment trust securities.[239] The investment industry became large and very powerful and investment companies started to influence the entire US market.[240] Thus, the issue of the regulation of investment companies was highly essential for the federal securities regulation. Unfortunately, the detailed REPORT showed also a long roll of abuses present in the fund industry.[241] One of the most prevalent abuses found by the SEC was "self-dealing" between directors and officers on one hand and between the investment trusts and companies, on the other.[242] The insiders would hold securities

---

legislation is not adequate to meet the problems presented by the investment company… The disclosure principle embodied in SA 1933 and SEA 1934 is a sound principle, but it has its limitations."). *See also* Paul F. Roye, *Remarks Before American Law Institute/American Bar Association Investment Company Regulation and Compliance Conference* on Oct. 16, 2003 *in* Markham, *Mutual Fund Scandals*, *supra* note 162, at 76.

237 *See* REPORT.

238 Out of these entities, there were 404 management companies, 87 were of the fixed type, 55 were of the installment investment type selling trust certificated to the public based on the installment plan, five were companies selling "face-amount certificates and 17 were commingled trust funds, operated by banks and trust companies to permit diversification of those funds that were too small to attain their own individuality.

239 REPORT, Part II chap. ii, p. 29.

240 The SEC reported that 151 investment companies affected 1,250 securities or portfolio purchases involving 162 million dollars from related interest between 1929 and 1935. *See* REPORT, Part II chap. ii, p. 22.

241 *See* REPORT, Part II chap. ii; Summarized in_Richard B. Tolins, *The Investment Company Act of 1940*, 26 CORNELL L. Q. 77, 84-92 (1940-1941) as follows: the five major abuses, could be classified into five groups: (1) Removal of funds from the control of the investors; (2) Conflict of interest of the management, (3) Pyramiding, (4) Excessive management charges and hidden fees, and (5) Misuse of control of the management.

242 The purpose of the ICA 1940 to eliminate abuses in the securities industry was repeatedly stressed in number of later cases, *see e.g.* SEC v. Fifth Avenue Coach Lines, Inc. 289 F. Supp. 3, 30 (1967) (*"purpose of Investment Company Act is to prevent abuses which may grow out of the unregulated power of management to use large pool of cash."*), Herpich v. Wallace, 430 F. 2d 792, 816 (1970) (ICA 1940 was intended to provide comprehensive regulatory scheme to correct and prevent certain

and made the investment trust to repurchase it at a profit to those in control and to the disadvantage to the investment trust itself.[243] Another type of abuse occurred when the control of an investment company changed without knowledge or consent of the investors whose interest was thereby directly affected.[244]

When analyzed closely, one discovers that the abuses were usually intertwined and existed simultaneously. Even if some of the cases show only poor investment judgment, in most of them a clear and intentional fraudulent action can be detected. The abuses were carried out by the management and advisers of the investment company, which held the control over the funds, had sole discretion over the investment decisions and maintained extensive information advantage over the investors. "The investment company [has] bec[o]me the instrumentality of financiers and industrialists to facilitate acquisition of concentrated control of the wealth and industries of the country."[245] The SEC brought to the attention of the US Congress other cases involving fraud and mismanagement from 1937 and 1938, several years after the SA 1933 and the SEA 1934 had been already in full effect.[246] Thus an act focusing directly on the investment companies and their advisers seemed unavoidable.

During the Senate Hearings, the SEC tried to show a close correlation between the abuses and the losses incurred by the investment trusts or companies, while the

---

abusive practices in management of investment companies for protection of persons who put up money to be invested by such companies on their behalf); SEC v. Advance Growth Capital Corporation et al. 470 F. 2d 40, 42 (1972) ("The Investment Company Act is a comprehensive regulatory scheme designed to prevent abusive practices by those in control of investment companies"); Independent Investor Protective League v. SEC, 495 F.2d 311, 313 (1974) ("Investment Company Act of 1940 was primarily designed to protect existing investors in an investment company's securities"); Option Advisory Service Inc. v. SEC, 668 F. 2d 120, 121 (1981) ("Purpose of Investment Company Act of 1940 is to remedy certain abusive practices in management of investment companies, for protection of persons whose money is invested in such companies.")

[243] *See* Bosland, *supra* note 232, at 506.

[244] *Id.* at 506-508.

[245] *See* STOCK EXCHANGE PRACTICES: REPORT OF THE COMM. ON BANKING AND CURRENCY, S. REP. NO. 1455. 73d Cong., 2d Sess. 333 (1934) [hereinafter "PECORA HEARING"].

[246] REPORT, Part II chap. ii, p. 22.

investment companies' representatives insisted that abuses were connected to the losses only to a limited extent.[247] Ultimately, the SEC convinced the US Senate and Congress that the existent regulation concerning investment companies is insufficient and another regulatory piece is crucial in order to limit the abuses and protect the investors and the market.[248] At the end, the ICA 1940 was adopted with help and cooperation of the investment industry as a piece of national legislation in the "interest of investors".[249] Legislators applied diverse methods of regulation in the ICA 1940, starting with registration and disclosure requirements, following with corporate governance rules along with prudential rules and completing the act with direct prohibition of certain fraudulent practices. Concerning the relationship between the investment company and its investors, besides the minimum voting control of investors over the investment policy and management control over the company, no direct power tools over the investment company were provided to the investors.

Nevertheless, the ICA 1940 was proclaimed as a "success". The renewed investor confidence was demonstrated by the increased investment companies' net asset value, which in 1971 reached a level of $55 billion.[250] Thus, the growth of investor interest and participation was obvious. Different parties became interested in the practices and the use of funds of investment companies. The first undertaken study of the mutual fund industry was carried out by the University of Pennsylvania's

---

[247] SEC representatives stated that the total losses from 1927 to 1935 were around 3 billion dollars, while the industry representatives claimed only half of this figure, *see* SENATE HEARINGS 76TH CONG. at 9808 et seq. and HEARINGS BEFORE A SUBCOMMITTEE OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE OF THE HOUSE OF REPRESENTATIVES ON H.R. 10065, 76th Cong., 3d Sess. (1940) 76 *et seq.*

[248] It was estimated that by 1939, one of ten investors in the US was a participant in an investment trust or an investment company. *See* H.R. Doc. No. 70, 76th Cong., 1st Sess. (1939), Pt. Two Ch. V, pp. 370-371.

[249] HEARINGS BEFORE A SUBCOMMITTEE OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE OF THE HOUSE OF REPRESENTATIVES ON H.R. 10065, 76th Cong., 3d Sess. (1940) 62, 63.

[250] In 1940 it was $450 million; *see* The Investment Company Institute, THE EVENING BULLETIN 37 (May 19, 1971).

Wharton School in 1962 in **WHARTON REPORT**[251] that was subsequently followed by the **SEC SPECIAL STUDY**.[252] These studies uncovered numerous ambiguous practices of mutual funds, including the amount of charged management fees,[253] allocation of brokerage business[254] or conflict of interest between fund investors and advisers in respect to fund share-selling practices.[255] Given that the SEC aimed to increase the effectiveness of the control over the industry and provide greater investor protection, it concluded that non-affiliated directors *"can and should play an active role in representing the interests of shareholders… where the interests of the professional managers* [do] *not coincide with those of the company and its public investors."*[256]

After four years of legislative consideration, in 1970 the ICA 1940 and the IAA 1940 were significantly amended.[257] The 1970's amendments provided for additional protection of investors through more powerful "independent directors,"[258] as the "watchdogs" of investors.[259] They were supposed to oversee the management activities of a fund and approve the advisory contract.[260] The 1970 amendments targeted also the liability of investment advisers and the investment company as well.[261] Yet even forty-four years after the 1970 amendments, the issues concerning the amount of different fees directly or indirectly payable by investors, relevance of

---

[251] *See* WHARTON SCHOOL OF FINANCE & COMMERCE, A STUDY OF MUTUAL FUNDS, H.R. REP. NO. 2274, 87th Cong., 2d Sess. (1962) [hereinafter "WHARTON REPORT"].
[252] *See* SEC, Report of Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963) [hereinafter "SEC SPECIAL STUDY"].
[253] *See* WHARTON REPORT, *supra* note 251, at 490-494.
[254] *Id.* at 35.
[255] *Id.* at 31.
[256] *See* SEC, REPORT ON PUBLIC POLICY IMPLICATIONS OF INVESTMENT COMPANY GROWTH, H.R. REP. NO. 2337, 89th Cong., 2d Sess. 148 (1966).
[257] Pub. L. No. 91-547, 84 Stat. 1413. This was the most extensive amendment to the ICA 1940.
[258] The terms as "unaffiliated" or "disinterested" directors are also used.
[259] *See* William J. Nutt, *A Study of Mutual Fund Independent Directors,* 120 U. PA. L. REV. 179, 230 - 264 (1971).
[260] 15 U.S.C. §80a-15(c) (1970). Section 15(c) requires that a majority of independent directors to approve investment advisor and principal underwriting contract.
[261] 15 U.S.C. §80a-36(b) (1970). Section 36(b) expressly imposed a "fiduciary duty" upon the adviser with respect to its compensation. Furthermore, there have been other substantial changes to the ICA 1940 and IAA 1940, *e.g.* the mutual fund advisers had to register under the IAA 1940.

independent directors and the scope of the liability of the investment company and its advisers remains the concern of the regulators and investors.

All essential features and aspects of the ICA 1940 and IAA 1940 together with other acts and bills on federal level[262] contributed to the proper functioning of investment companies and their further regulation are described and analyzed into greater detail in the subsequent chapters of this thesis.

1.2.4. Rise of Mutual Funds

Although the ICA 1940 recognizes four types of investment companies, after the Stock Market Crash, one specific type began to dominate the investment market – the **mutual fund**. Mutual funds have grown exponentially since their emergence in 1930s.[263] Investors preferred mutual funds due to number of reasons, including their diversification, liquidity and tax treatment.[264] Investors were able to diversify their portfolio by investing purely in one investment vehicle. Moreover, due to the new tax scheme for undistributed corporate profits enacted by President Roosevelt in 1936, the investment companies organized as corporations were supposed to distribute all their profits or pay higher taxes.[265] This raised a wave of opposition from the

[262] Other regulations and bills as for example Regulation D, Regulation S, US National Futures Association Rules, US Commodity Exchange Act, US Employee Retirement Income Security Act of 1974, Reg. FD or Blue Sky laws.

[263] The first mutual fund was introduced in 1924. In contrast to a closed-end fund, it could redeem its shares at a shareholder's request and continuously offered new shares based on a price based on the current net asset value. The first three mutual funds started in Boston and under auspices of Edward G. Leffler who first came up with the distinguishing characteristics of this new type of fund. The price of mutual funds fall when the Great Depression begun but far less than the price of close-end funds. *See* MATTHEW P. FINK, THE RISE OF MUTUAL FUNDS: AN INSIDER'S VIEW 10-18 (Oxford University Press, 2008) [Hereinafter "FINK"].

[264] Other reasons for investing in mutual funds are the divisibility or affordability. *See e.g.* SEC, Invest Wisely: An Introduction to Mutual Funds, *available online at:* < http://www.sec.gov/investor/pubs/inwsmf.htm>/ last visited Oct. 25, 2014.

[265] *See generally* Benjamin Graham, *The Undistributed Profits Tax and the Investor,* 46 YALE L. J. 1 (1936).

investment industry.[266] However, mutual funds were not concerned. In the words of Merill Griswold, mutual funds saw the President's proposal as a blessing that could solve all their tax issues.[267] Under the new approach, mutual funds were only a conjunction between the investors of a fund and the securities. And thus, should be ignored for tax purposes and shareholders should be treated as if holding the securities directly.[268] In other words, the idea of a pass-through taxation was established and applied on mutual funds.[269] Naturally, this new perception had to meet the minds of the President and the US Congress. After a short and bright conversation with all interested parties, the Revenue Act of 1936 was enacted.[270] The new legislation

---

[266] *See* FINK, *supra* note 263, at 26. For the beginning of mutual funds *see* Natalie R. Groh, The 'Boston-Type Open-End Fund'- Development of a National Financial Institution: 1924-1940 (Harvard University, PhD dissertation 1977).

[267] *See* Merill Griswold, Taxation of Investment Companies and Their Shareholders, 11th draft, 6th January 1958 *in* FINK, *supra* note 263, at 27-28. Under the Revenue Act of 1926 the term "corporations" included "associations, joint-stock companies and insurance companies, and since the *Morrissey v. Commissioner* investment companies became fully treated as "associations". *See* Revenue Act of 1926 §2(a)(2), Pub. L. No. 69-20, 44 Stat. 9,9 together with the Morrissey v. Commissioner, 296 U.S. 344 (1935), where the US Supreme Court agreed that the investment companies and mutual funds were organized to make a profit and therefore should be treated as associations under the Tax Code. Consequently, they become taxed in the same manner as corporations. President Roosevelt proposed the changes to the Tax Code, as it has "done little to prevent an unjust concentration of wealth and economic power. *See* 79 Cong. Rec. 9657 (1935) as a message from the President, June 19, 1935. *See generally* JOHN F. WITTE, THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX 100 (University of Wisconsin Press, 1985), which discusses the policies behind the new Tax Code.

[268] If a mutual fund's income would be taxed as an income of an ordinary corporation, it would be taxed three times. Income received in a form of a dividend would be taxed twice. First time by the portfolio company and second time when received by the mutual fund. After, the income would have been taxed again when distributed to shareholders. According to the new approach, only the investors would have been taxed and mutual funds would become pass-through entities. Not all mutual funds were qualified to become the pass-through entities. Mutual fund had to comply with the diversification requirement and subchapter M's portfolio restrictions. *See* Mark J. Roe, *Political Elements in the Creation of a Mutual Fund Industry,* 139 U. PA. L. REV. 1469, 1480-1483 (1991) [hereinafter "Roe, *Political Elements*"]. *See generally* BORIS I. BITTKER & JAMES S. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS (Warren Gorham & Lamont, 7th ed. 2000).

[269] According to the BLACKS' LAW DICTIONARY (9th ed. 2009) pass-through taxation is the taxation of an entity's owners for the entity's income without taxing the entity itself.

[270] 26 U.S.C. §§ 851-852 (2013); the main purpose of the Revenue Act of 1936 was to ensure that the excluded mutual fund would be an investment company and not some other kind of business entity. It had to gain at least 95 percent of its income from dividends (today it is 90 percent), interests and gains on the sale of securities. According to the Revenue Act of 1936, the "regulated investment company" means any domestic corporation (1) which, at all times during the taxable year – (A) is registered under the Investment Company Act of 1940, as amended, as a management company or unit investment trust, or (B) has in effect an election under such Act to be treated as a business development company, or (2) which is a common trust fund or similar fund excluded by section 3(c)(3) of such Act from the definition of "investment company" and is not concluded in the definition of "common trust fund" by

proved to be effective,[271] as the net asset value of mutual funds in the US in 1940 was around $0,5 billion but in ten years it grew to over $2,5 billion and by 1960 to over $17 billion.[272] Furthermore, the mutual fund industry had grown also in terms of number of funds[273] and shareholders owning assets.[274] In 1960, there were already approximately 5 million shareholder accounts in existence, while the small investors in the "middle" and "lower middle" income groups already started discovering the mutual funds" investment opportunities.[275]

The potential of mutual funds as a vehicle for raising capital was undisputed. The question thus was how to draft the legislation in order to serve best the purpose.

---

section 584(a). Further the §851 sets out the limitation, as to the type and value of assets the investment company invests in.

[271] The new legislation boosted the confidence of investors in the mutual fund industry. Between 1941 and 1945 the assets of mutual funds have tripled. *See* Paul F. Roye, Director, Division of Investment Management, US SEC, Remarks at the Securities Law Developments Conference: Mutual Funds – A Century of Success, Challenges and Opportunities for the Future (Dec. 9, 1999).

[272] *See* ARTHUR WEISENBERGER, INVESTMENT COMPANIES 108 (1961). According to a research, irrespective of the growth of the industry, the success of a mutual fund was mostly based on luck and past performance results showed no consistent predictive value. Between 1945 and 1964 a research was carried out, which showed that there was only very little evidence that any individual investment fund was able to do significantly better than one based on a random choice. Further, on average the funds were not sufficiently successful even to recoup their brokerage expenses, *see* Michael C. Jensen, *Problems in Selection of Security Portfolios: the Performance of Mutual Funds in the Period 1945 – 1964*, 23 J. FIN. 389 (1968) and Robert S. Carlson, *Aggregate Performance of Mutual Funds, 1948 – 1967*, 5 J. FIN. QUANTITATIVE ANALYSIS 1 (1970).

[273] *See* IDS FINANCIAL SERVICES, INVESTING IN THE FUTURE: A CENTURY OF IDS 63 (1994).

[274] In 1958, according to a research a typical holder of fund shares was somehow above 50 years of age, held fund of value of $4,000 owned over $8,000 of general market securities and had a bond and savings bank account of close to $3,500 and insurance of around $10,000. A typical investor would hold fund shares in more than one fund. Analyzing 100 typical investors, 30 would be women and 70 men, where out of those men 45 were likely to be professionals or in executive-administrative positions. *See* NATIONAL ASS'N OF INVESTMENT COMPANIES, THE MUTUAL FUND SHAREHOLDER (1958) *in* Nathan D. Lobell, *Rights and Responsibilities in the Mutual Fund*, 70 YALE L. J. 1258, 1261 (1961).

[275] NATIONAL ASS'N OF INVESTMENT COS., REPORT (1960); in 1960, the eighteenth United States Census had been carried out and by 1st April 1960, the total US population was 179,323,175. Naturally, 5 million shareholder accounts does not necessarily mean that precisely 5 million people had invested in mutual funds, but for the comparison, number 5,000,000 is still relatively high which means that also the general population was investing in mutual funds and was using the services of investment companies. By June 30, 1961, the number of accounts had risen to 5,100,000. During October 1961, 36, 898 new investment plans were opened in comparison to 28,747 in October 1960. The 1959 TIME cover story praised mutual funds for having: "taken the specialized world of Wall Street and put it within reach of every man with enough money to buy a fund share…The shares are bought by maids and wealthy dowagers, by doctors and factory workers, by labor unions and clergymen. No amount is too large…or too small…. Ten years ago, most people had never heard of mutual funds; now, the term is a household word." in TIME, *The Prudent Man*, June 1, 1959, 74-75.

Besides ICA 1940, it was the Revenue Act of 1936, which set up the economic foundations for the mutual fund business. Firstly, thanks to the ICA 1940, mutual funds were perceived as safe and governmentally overseen entities. Majority of the mutual fund investors were unsophisticated and in order to attract more of them, at least a partial governmental assurance was required.[276] That partial assurance was the ICA 1940. Secondly, the tax exemption under the Revenue Act of 1936 for mutual funds was conditional upon fragmentation of portfolios up to five percent (5%). Thus, the mutual funds would not be in a "real" business, but rather would be only carrying on a business.[277] The primary rationale behind this tax exemption was that the legislators, influenced by the industrial (non-investment) lobby were afraid of the mutual funds taking over the control in corporations in which they acquired the stocks. Hence, they needed to motivate mutual funds through tax benefits not to focus on controlling the corporations but on diversifying their portfolios.[278] In addition, industries feared a formation of cartels. Therefore, no more than twenty-five percent (25%) of the mutual fund could be invested into the stock of a single company. Nor could twenty-five percent (25%) go into the stock of two or more controlled companies, which were engaged in same or similar business.[279] Thirdly, pursuant to the Bank Holding Company Act of 1956[280] [hereinafter "BHCA"] the multi-bank

[276] *See* Roe, *Political Elements*, *supra* note 268, at 1490-1491.
[277] In simple terms through the diversification of mutual fund portfolios limited to 5%, they were not perceived as companies in a specific business, *e.g.* mining, automotive or food business in comparison to the company groups. *Id.* at 1482-1483.
[278] After the Stock Exchange Crash in 1929, the market was Anti-Wall Street and all financial institutions were perceived as devil. The industrial world deemed mainly the banks as a national threat. Numerous hearings were held by the Congress, out of which the PECORA HEARING is one of the most knows. For more on the perception of Wall Street by Americans, *see* FERDINAND PECORA, WALL STREET UNDER OATH – THE STORY OF OUR MODERN MONEY CHANGERS (1939).
[279] *See* Revenue Act of 1942 §170(a), Pub. L. No 77-753, 56 Stat 798, 878 (codified at I.R.C.§ 851(b)(4)(B) (1988)) *in* Roe, *Political Elements*, *supra* note 268, at 1492.
[280] Bank Holding Company Act of 1956, Pub L. No. 84-511, 70 Stat. 133.A bank holding company was originally defined as a corporation that owned two commercial banks as subsidiaries. This definition was later modified to a corporation that owned one commercial bank as a subsidiary; *see* Bank Holding Company Act Amendments of 1970, Pub. L. No 91-607, §101, 84 Stat. 1760, 1760-1763 (codified as amended at 12 USC. § 1843(c)(8).

holding companies were prevented from engaging in activities where there were no financial services.[281] By preventing bank holding companies from engaging in non-financial activities and securities business and plus as they were strictly prohibited from insurance business, their activities were substantially limited and the field of influence for investment companies was therefore enlarged. [282] Banks and investment companies were to extensive scale competitors, nonetheless GSA together with the BHCA paralyzed banks from the securities business and gave the investment companies an advantage of a freed, though regulated market until the Gramm-Leach-Bliley Act.

1.2.5. The Gramm-Leach-Bliley Act

Despite the regulation (GSA and BHCA), the commercial banks were not fully isolated from the securities business and did engage in it. [283] Commercial banks undertook brokerage activities. The US Supreme Court held in *Securities Industry Association v. Board of Governors of the Federal Reserve System*[284] that Regulation Y[285] of the Federal Reserve Board permits bank holding companies and national banks to engage in discount brokerage service.[286] At the same time, Regulation Y also allowed bank holding companies in "incidental activities" connected to discount

[281] *See* Lawrence J. White, *The Gramm-Leach-Bliley Act of 1999: A Bridge Too Far? Or Not Far Enough?* 43 SUFFOLK U. L. REV. 937, 940 (2010).
[282] For more on the US Banking Industry from 1970s until 1994 *see* Allen N. Berger *et al.*, *The Transformation of the US Banking Industry: What a Long, Strange Trip It's Been, in* 1995 BROOKINGS PAPERS ON ECONOMIC ACTIVITY 55 (1995).
[283] *See* Jonathan R. Macey, *The Business of Banking: Before and After Gramm-Leach-Bliley*, 25 J. CORP. L. 691, 709 (2000). *See also* section 1.2.2.
[284] Securities Industry Association v. Board of Governors of the Federal Reserve System 468 US 207, 221 (1984). Charles Schwab was a discount broker but operated nationwide which had opened the doors of commercial banks to participate broadly on securities market with discount brokers.
[285] Regulation Y was a Federal Reserve action regulating corporate bank holding company practices as well as certain practices of state-member banks. Regulation Y outlines several bank holding company transactions which require Federal Reserve approval (definition from Investopedia). The Comptroller of the Currency and the Federal Reserve Board have the overlapping authority over the commercial banks securities activities.
[286] *See* Note, *A Banker's Adventures in Brokerland: Looking through Glass-Steagall at Discount Brokerage Services*, 81 MICH L. REV. 1498, 1499 (1983).

brokerage services, and the sale of saving bonds, travelers' checks or money orders of certain face amount.[287] The Federal Reserve Board originally defined "incidental" as generating less than five percent of the company's gross revenue and that does not occupy more than five percent of the total market.[288] This definition was partially affirmed in *Securities Industry Association v. Federal Reserve System*.[289]

Furthermore, commercial banks were allowed to underwrite and deal in federal, state and municipal securities.[290] In connection to these securities, commercial banks could provide portfolio advice[291] and issue short-term debt instruments.[292]As long as commercial banks had the approval of the Comptroller, they could also hold[293] on their own account investment securities[294] and could purchase shares in open-ended mutual funds.[295] Most importantly, bank holding companies could finance, organize and manage a closed-end fund.[296] For all these reasons, starting already in the 1970's, the commercial banking industry began strong lobbying to repeal the GSA in order to

[287] *See* David M. Eaton, *The Commercial Banking-Related Activities of Investment Banks and Other Nonbanks*, 44 EMORY L. J. 1187, 1197 (1995).
[288] *See* BENSTON, THE SEPARATION OF COMMERCIAL AND INVESTMENT BANKING, *supra* note 220, at 9.
[289] 839 F.2d 47 (2nd Cir. 1988). The Court of Appeals rejected the 5 percent threshold of market test but affirmed the 5 percent gross profit test. In 1996, the Federal Reserve Board raised the threshold from 10 percent to 25. For more *see* CARL FELSENFELD, BANKING REGULATION IN THE UNITED STATES 168.5-168.6. (Juris Pub., 4thed. 2001).
[290] 12 USC. §24 in id at 1198.
[291] 12 C.F.R. §225.25(b)(4)(iii) in id.
[292] Indus. Ass'n v. Bd. of Gov. of the Fed. Reserve Sys., 807 F. 2d 1052 (D.C. Cir 1986).
[293] There are different types and layers of bank supervision agencies in the United States. The Comptroller governs national banks, the Federal Reserve Board governs state member banks and bank holding companies and the Federal Deposit Insurance Corporation (FDIC) regulates state banks that are not members of the Federal Reserve System.
[294] 12 USC. §24 in id. at 1199. The Comptroller defined "investment security" as a "marketable obligation in the form of a bond, note, or debenture which is commonly regarded as an investment security and not predominantly speculative in nature." *See* William M. Isaac & Melanie L. Fein, *Facing the Future – Life Without Glass-Steagall*, 37 CATH. U. L. REV 281, 335 (1988).
[295] *See* David M. Eaton, *The Commercial Banking-Related Activities of Investment Banks and Other Nonbanks* 44 EMORY L. J. 1187, 1199 (1995).
[296] 12 C.F.R. §225.25(b)(4). For the first time, the Comptroller had authorized in 1970 First National City Bank of New York to establish and operate a mutual fund. However, investment banking industry fearing competition, filed suit seeking review of this authorization. The Supreme Court decided that Comptroller essentially conferred a power, which was not permitted under the Glass-Steagall Act [Inv. Co. Inst v. Camp, 401 US 617, 628 (1971)]. Ten years after this decision, the Supreme Court in Board of Governors of Federal Reserve System v. Investment Co. Institute, that the bank holding companies can after approval, advise closed-end investment companies as such advice did not involve directly sale or distribution of securities by the bank [450 US 46, 71 (1981)].

gain access to the entire securities industry and thus enhance its international competitiveness.[297]

After twenty years of sweat and effort by industry lobbyists, the Gramm-Leach-Bliley Act of 1999 [hereinafter "GLBA"] was signed into law on 12th November 1999.[298] It had formally repealed several parts of the GSA[299] and by amending the BHCA allowed **affiliations** among banks, investment companies and insurance companies. Banks could openly transform their bank holding companies into financial holding companies, which could engage in investment banking through non-bank subsidiaries.[300] Some commentators have praised the new act,[301] while others did not

[297] Some believe that it was the Citicorp-Travelers Merger, which was the final impulse to the US Congress to amend the law and allow the merger of commercial and investment banking. The Citicorp-Travelers Merger at that time represented the largest corporate combination, creating the world's biggest financial-services company operating in more than 100 countries; *available online at*: <http://www.nytimes.com/1998/04/07/news/07iht-citi.t.html> *last visited* June 10, 2012. In order to carry out this merger, the BSA would need to be amended, as this merger would be precisely a commercial-investment banking union. For more on the impact of this merger on the legislators *see* Laura J. Cox, *The Impact of the Citicorp-Travelers Group Merger on Financial Modernization and the Repeal of Glass-Steagall*, 23 NOVA L. REV 899, 922-926 (1999) or Robert W. Dixon, *Note: the Gramm-Leach-Bliley Financial Modernization Act: Why Reform in the Financial Services Industry Was Necessary and the Act's Projected Effects on Community Banking*, 49 DRAKE LAW REV. 621, 676 (2001).

[298] 15 USC. §§ 6801-6809, 6821-6827. it was also called the Financial Modernization Act of 1999.

[299] It had repealed the Sections 20 and 32 of the GSA, which had prevented commercial banks from being affiliated with investment banks.

[300] As of the Nov. 24, 2014 there were 485 financial holding companies registered in the US, see http://www.federalreserve.gov/bankinforeg/fhc.htm#location_href / *last visited* Dec. 9, 2014. In 2010 there were 534 financial companies registered in the United States. This means that in one and half year either forty-nine banks decided to change the form or some of them have gone bankrupt or the foreign banks decided to leave the US market. Until now the question why the number has decreased remains unanswered.

[301] See for example Paul J. Polking & Scott A. Cammarn, *Overview of the Gramm-Leach-Bliley Act*, 4 N.C. BANKING INST. 1, 1 (2000) describing GLBA as one of the most important legislative pieces since 1930s. *See also* Clinton Signs Legislation Overhauling Banking Laws, N. Y. TIMES, Nov. 13, 1999. Senator Phil Gramm, who sponsored the act, said: "We have a new century coming, and we have an opportunity to dominate that century the same way we dominated this century. Glass-Steagall, in the midst of the Great Depression, came at a time when the thinking was that the government was the answer. In the era of economic prosperity, we have decided that freedom is the answer." [And not even after 10 years we discovered that neither absolute freedom is the answer (author's note)].

consider it to be of immense importance as it only formalized what has been already happening.[302] Regardless of form, majority of them favored the consequences.[303]

Despite the greater competition in the securities market,[304] by virtue of GLBA, the mutual fund industry expanded and banks started to use mutual funds as a part of their securities and banking services.[305] From the perspective of the investment company industry, the GLBA did not cause any extensive harm; yet unconstrained regulation from a macroeconomic perspective might have contributed to the Credit Crunch in 2008.[306]

1.2.6. The 2008 Financial Crisis & 2010 Dodd-Frank Act[307]

The financial crisis of 2008 – the Credit Crunch – represents one of the biggest financial crises in history of capital markets, which affected almost every economy in the world.[308] Several blame the stock market, investment bankers or brokers, their

[302] *See generally* Jonathan R. Macey, *The Business of Banking: Before and After Gramm-Leach-Bliley*, 25 IOWA J. CORP. L. 691, 692 (1999-2000) or Randall Smith & Deborah Lohse, *Financial Firms Already Know How to Avoid Barrier Rules*, WALL ST. J., Oct. 22, 1999.

[303] GLBA is in a principle functional regulation as it allocates the SEC regulatory authority over the activities of each "functionally regulated subsidiary" of a financial holding company, *see* Jonathan R. Macey, *The Business of Banking: Before and After Gramm-Leach-Bliley*, 25 IOWA J. CORP. L. 691, 710-11 (1999-2000). Despite the Supreme Court's decision in *Investment Company Institute v. Camp.*, 401 U.S. 617 (1971) [finding that operation of investment fund violated the GSA restriction on issuance, sale and distribution of securities] by 1993 banks were all selling the mutual funds, *see* Penny Lunt, *How Are Mutual Funds Changing Banks?* A.B.A. BANKING J., 31 (1993). Commercial banks sold mutual funds directly to customers as separate broker affiliates through different firms. Thus, even before the GLBA, banks were already in the business of selling securities. There was a separate business, where sixteen firms were operating mutual funds for banks as Concord Holding Corp. or Dreyfus, *see* JERRY W. MARKHAM, A FINANCIAL HISTORY OF THE UNITED STATES, FROM THE AGE OF DERIVATIVES INTO THE NEW MILLENNIUM (1970-2001) 239-40 (Sharpe, 2001).

[304] The need for increased competition was claimed to be as well one of the reasons for adopting the GLBA, *see* Jolina C. Cuaresma, *The Gramm-Leach-Bliley Act* 17 BERKELEY TECH. L.J. 497, 497-498 (2002).

[305] *See* FINK, *supra* note 263, at 142.

[306] On how the GLBA contributed to the world financial crisis in 2008, *see* Joseph K. Grant, *What the Financial Services Industry Puts Together Let no Person Put Asunder: How the Gramm-Leach-Bliley Act Contributed to the 2008-2009 American Capital Market Crisis,* 73 ALB. L. REV 371 (2010) and Lawrence J. White, *The Gramm-Leach-Bliley Act of 1999: A Bridge Too Far? Or Not Far Enough?* 43 SUFFOLK. U. L. REV. 937, 945-946 (2009-2010).

[307] Pub L. No. 111-203, §201 et seq., 124 Stat 1375 (2010) (codified at 12 USC. §5381 et seq.).

[308] There are numerous books and articles, devoted to the analysis of the reasons of the Credit Crunch, *see* CHARLES BROWNELL, SUBPRIME MELTDOWN: FROM US LIQUIDITY CRISIS TO GLOBAL RECESSION (CreateSpace Independent Publishing Platform, 2008); ROBERT J. SHILLER, THE SUBPRIME SOLUTION:

greed and excessive risk taking, some the credit rating agencies, the insurance companies, the mortgage boom, government-sponsored enterprises and securitization, while others believe that it is all due to the novel types of securities as swaps, CDOs, CDS, CMOs and others.[309] Most presumably, everyone is partially right and the origins of the crisis lay in the US housing mortgage policy since late 1980s, followed by urge of banks to free their accounts and sell their mortgages to investment companies, which subsequently created numerous new financial instruments, in order to outsource risk management to less-regulated entities, including hedge funds.[310] Nevertheless, one should not forget that the world economy, with the US on its peak, had experienced continuous growth for decades and it comes naturally that after augmentation comes recession. Yet the causes of the 2008 financial crisis are not the focus of this thesis.

Concentrating on the investment companies that participated in the described process, part of them was also the first one hit by the crisis and saved by the US government.[311] Thus, one might say that investment companies and investment banking lay in the heart of the credit crunch.[312] However, they are not the only one to blame and therefore the only way how to move on is to find the loopholes in the

---

HOW TODAY'S GLOBAL FINANCIAL CRISIS HAPPENED, AND WHAT TO DO ABOUT IT (Princeton University Press, 2008); JOE NOCERA & BETHANY MCLEAN, ALL THE DEVILS ARE HERE: UNMASKING THE MEN WHO BANKRUPTED THE WORLD (Penguin, 2010); TOMASZ BIELECKY & DAMIANO BRIGO & FREDERIC PARAS, CREDIT RISK FRONTIERS: SUBPRIME CRISIS, PRICING AND HEDGING, CVA, MBS, RATINGS AND LIQUIDITY (Bloomberg Press, 2011); GEORGE SOROS, FINANCIAL TURMOIL IN EUROPE AND THE UNITED STATES: ESSAYS (PublicAffairs, 2012) and many others.

[309] The period leading to the financial crisis was a period of euphoria, never ending housing prices and low debt levels. Everything was possible. People who would never qualify for any type of mortgage were able to buy houses, start business, etc. For more on the period before the credit crunch *see* Ronnie Cohen & Shannon O'Bryne, *Burning Down the House: Law, Emotion and the Subprime Mortgage Crisis*, 45 REAL PROP. TR. & EST. L. J. 677, 685-97 (2011) or generally *see* ROBERT J. SHILLER, THE SUBPRIME SOLUTION: HOW TODAY'S GLOBAL FINANCIAL CRISIS HAPPENED, AND WHAT TO DO ABOUT IT 48 – 52 (2008) or Arthur E. Wilmarth, Jr. *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 CONN. L. REV. 963 (2009).

[310] *See* Charles K. Whitehead, *Reframing Financial Regulation,* 90 B.U. L. REV. 1, 4 (2010).

[311] *See e.g.* Ellen Keleher, *Almost 20 Money Market Funds Bailed Out*, FIN. TIMES, Oct. 20, 2013.

[312] More on the fault of investment companies, *see* Arthur E. Wilmarth, Jr. *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 CONN L. REV. 963 (2009).

regulation. Only by remedying the existing regulatory misconceptions and forming a new legislative framework, which would assure market discipline and restrain the market participants from abusive practice can the states restore a functional financial system.[313]

As a reaction to Credit Crunch, the US Congress adopted the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 [hereinafter "Dodd-Frank Act 2010"] on 21st July 2010, effective from 21st July 2011. Many characterize this Act as the most significant legislative change in the US regulatory framework since the 1930s.[314] The 2010 Act was adopted as a panacea to heal the US market and address all the failures in the legal framework, which have caused the Credit Crunch.[315] However, its effects remain uncertain.[316]

In connection to the area of oversight of investment companies, the Dodd-Frank Act 2010 has created the Financial Stability Oversight Council [hereinafter "FSOC"], which is composed of existing regulators and is expected to ensure the stability of the

---

[313] FINANCIAL SERVICES AUTHORITY, THE TURNER REVIEW: A REGULATORY RESPONSE TO THE GLOBAL BANKING CRISIS 41-42, 45-47 (2009), *available online*: <http:// www.fsa.gov.uk/pubs/other/turner_review.pdf >/ *last visited* June 12, 2012 [hereinafter "Turner REVIEW"].

[314] *See, e.g.*, Viral Acharya et al., *A critical assessment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010*, VoxEU.org (Nov. 24, 2010), ("In the US, the Dodd-Frank Act 2010 passed earlier this year represents the most sweeping set of reforms to the US financial sector since the Great Depression."), available online: <http://www.voxeu.org/index.php?q=node/5692>/ *last visited* June 17, 2012. As Professor Whithead states, the financial regulation is often reactive as it seeks to seal up leaks instead of applying a different method to regulation than the reactive approach; *see* Whitehead, *Reframing Financial Regulation, supra* note 310, at 42.

[315] For better understanding of what Dodd-Frank Act 2010 represents and includes, here are some of its critical areas:
Systemic Risk and Financial Stability;
Consumer Protection with Authority and Independence;
Derivatives Market Reforms;
Limitation of Large, Complex Financial Companies;
Reform of the Federal Reserve;
Greater Oversight of Credit Rating Agencies;
Hedge Fund Reforms;
Insurance Reforms.

[316] *See generally* Edward F. Greene, *Dodd-Frank: a lesson in decision avoidance*, 6 CAP. MARKETS L. J..29 (2011).

US national financial system.[317] The FSOC, among other duties, identifies all systematically important non-bank financial companies doing business in the US in order to control the **systemic risk** and eventually prevent the collapse of a financial institution if it becomes “too-big-to-fail”.[318] The issue of systemic risk has become an even bigger and more pressing issue after the 2008 financial crisis, as the US financial sector has become more concentrated than ever.[319] Furthermore, the crisis revealed that the supervision and financial regulatory framework in the US[320] was inadequate to effectively handle the risks posed by new financial instruments and products, which have emerged as a result of financial innovation of the preceding decade.[321] US regulatory system in times of computerized trading and model-driven financial engineering continued to rely on the principles and models laid down more than sixty

[317] The FSOC is a 15-member council with ten voting members, consisting of nine federal financial regulatory agencies and one independent member with insurance expertise: The Secretary of the Treasury, who serves as the Chairperson of the FSOC, the Chairman of the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Director of the Consumer Financial Protection Bureau, the Chairman of the Securities and Exchange Commission, the Chairperson of the Federal Deposit Insurance Corporation, the Chairperson of the Commodity Futures Trading Commission, the Director of the Federal Housing Finance Agency, the Chairman of the National Credit Union Administration Board, and an independent member appointed by the President of the United States and confirmed by the Senate for a six year mandate. In addition there are 5 non-voting members who serve as advisors: The Director of the OFR (Office of Financial Research), the Director of the Federal Insurance Office, a state insurance commissioner selected by the state insurance commissioners, a state banking supervisor chosen by the state banking supervisors, and a state securities commissioner designated by the state securities supervision. All the state non-voting members serve for two years in the FSOC. For more on the organization of the FSOC and annual reports and final rules *available online*: <http://www.treasury.gov/initiatives/fsoc/Pages/default.aspx>/ *last visited* June 10, 2012.

[318] Chairman of the Federal Reserve Ben Shalom Bernanke has in his testimony before the Financial Crisis Inquiry Commission defined a “too-big-to-fail” company a “firm is one whose size, complexity, interconnectedness, and critical functions are such that, should the firm go unexpectedly into liquidation, the rest of the financial system and the economy would face severe adverse consequences.”

[319] There are two main reasons. First, the collapse of Lehman Brothers, Washington Mutual, Indy Mac and second, the mergers as Bear Sterns and JPMorgan Chase, Merill Lynch and Bank of America and Countrywide lead to creation of huge financial intermediaries which cover all areas of financial industry, from classical commercial banking, through investment banking, securitization and even insurance.

[320] *See* TURNER REVIEW.

[321] *See e.g.* Congressional Oversight Panel, Modernizing the American Financial Regulatory System: Recommendations for Improving Oversight, Protecting Consumers, and Ensuring Stability (2009), available online at: < *http://cop.senate.gov/documents/cop-012909-report-regulatoryreform.pdf*.>/ *last visited* June 17, 2012.

years ago.[322] Dodd-Frank Act 2010 aims to address all these issues and more.[323] Unfortunately, the US Congress did not opt for a conceptual and innovative change of the fundamental principles and structure of the financial framework but rather decided to address all the issues, which have been indicated as problematic, in one immensely huge act,[324] which renders the ability to understand the act much more demanding.

1.3. The History of Investment Companies in the European Union

One of the fundamental objectives of the European Union is to form a single internal market with the free movement of goods, services, people and capital.[325] Financial services form a significant part of the internal market. A properly **integrated financial services market** is a market where capital can move freely through the entire area and can be freely raised in any place. The free movement of capital includes the possibility of moving capital from one place to another without any kind of restriction or barrier; it implies also the possibility of investing capital anywhere

[322] *See* US Gov. Accountability Office, GAO-09-216, Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated US Financial Regulatory System (2009).
[323] *Supra note* 315.
[324] There have been many critics raised against the form of the new regulation, as the financial regulation in the United States is already highly fragmented and to certain extent as well chaotic. For more on fragmentation *see* CARL FELSENFELD, BANKING REGULATION IN THE UNITED STATES 29-36 (Juris Publishing, 2[d] ed. 2006).
[325] Until 1986, the EU official treaties and materials referred to a term "common market". In 1957, when the European Economic Community was founded, the Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11 [hereinafter "Treaty of Rome"], expressly stated in the article 3(c), that the activities of the Community shall include "[t]he abolition, as between Member States, of obstacles to freedom of movement for persons, services and capital." Currently *see* Article 26 TFEU. Following the words of Dennis Swan, *"economic integration can take various forms and these can be ranged in a spectrum in which the degree of involvement of participating economies, one with another, becomes greater and greater. The Free trade area is the least onerous in terms of involvement. It consists in an arrangement between states in which they agree to remove all customs duties (and quotas) on trade passing between them. Each party is free, however, to determine unilaterally the level of customs duty on imports coming from outside the area. The next stage is the customs union. Here tariffs and quotas on trade between members are also removed but members agree to apply a common level of tariff on goods entering the union from without. The latter is called the common customs, or common external tariff. Next comes the common market and this technical term implies that to the free movement of goods within the customs union is added the free movement of the factors of production – labour, capital and enterprise. Finally, there is the economic union. This is a common market in which there is also a complete unification of monetary and fiscal policy. There would be a common currency which would be controlled by a central authority and in effect the member states would become regions within the union."* For more *see* DENNIS SWANN, THE ECONOMICS OF COMMON MARKET: INTEGRATION IN THE EUROPEAN UNION 11-12 (Edward Elgar Pub., 7[th] ed. 1992).

investors prefer within the internal market. In addition, the investment services shall be generally available everywhere and investors shall be entitled to choose a service provider they prefer, irrespective of their residence or citizenship.

The European Union has implemented several forms and methods how to reach the single internal market since its foundation in 1957.[326] However, its formation had been for long postponed. Only the Single European Act clearly set the date for establishing the single internal market by the **end of 1992**.[327] Yet this did not take place and the EU continues to struggle with its longed-for goal.[328] To achieve the single market, the EU has been using two primary regulatory tools: extensive access deregulation – removal of regulatory barriers[329] and harmonization.[330] By contrast to the US, which chose the commonality approach, the EU decided for the **minimum**

---

[326] Today's European Union has developed throughout number of stages. The European Union, which is the current official name of the economic and political union of twenty-eight Member States, was founded in 1957 by the Treaty of Rome, which at that time founded the European Economic Community [hereinafter "EEC"] with six Member States. Until the year 1986, when the Single European Act, the first major revision of the Treaty of Rome, was signed, there were six new Member States in the EEC. The Single European Act codified the objective of establishing the "Single market" by Dec. 31, 1992. The EU, as it is referred to today, was formally established in 1992 by the Treaty of the European Union (known as the Maastricht Treaty). Consequently number of treaties was adopted, which provided the EU and its respective bodies with more extensive powers. Lastly, the Treaty of Lisbon was signed on Dec. 18, 2007, which amended the current two treaties, which form the constitutional basis of the EU. For a brief overview of the historical events, *available online:* < http://europa.eu/about-eu/eu-history/index_en.htm>/ *last visited* Oct. 20, 2013. The abbreviation "EU" is used in this thesis also for all forms of the European Union since its foundation in 1957, when it was referred to as European Community (EC).

[327] *See* Section II, Article 13 of the Single European Act O.J. EC No. L. 169/1 [hereinafter "Single European Act"].

[328] Mario Monti in his report on the relaunch of the single market clearly stated "achieving a deep and efficient single market is a key factor determining the EU's overall macroeconomic performance." *See* Report by Mario Monti to the President of the European Commission: *"A New strategy for the Single Market"* 9 (June 9, 2010). *See also* the Single Market Act I and II, *available online at:* < http://ec.europa.eu/internal_market/smact/index_en.htm>/ *last visited* Oct. 22, 2013.

[329] The access deregulation has to be distinguished from the "prudential deregulation". Access deregulation is on one hand the removal of regulatory barriers, as exchange and capital market controls and on the second hand the facilitation o foreign participation in domestic market. On access and prudential deregulation *see generally* George J. Stigler, *Public Regulation of the Securities Markets,* 37 J. BUS. 117 (1964) and Edward L. Rubin, *Deregulation, Reregulation and the Myth of the Market,* 45 WASH. & LEE L. REV. 1249 (1988).

[330] Harmonization is closely connected to deregulation and reregulation. It reduces inconsistencies between jurisdictions. Once, the markets are brought closer together, harmonization completes the regulatory circle by reducing the regulatory disparities and unifying the regulatory approach and standard. *See generally* Roger M. Kubarych, *International Regulatory Harmonization: The Economic and Financial Environment,* 14 BROOK. J. INT'L L. 839 (1988) or Wulf-Henning Roth, *The European Economic Community's Law on Services: Harmonisation,* 25 COMMON MKT. L. REV. 35 (1988).

standard method,[331] where the Member States of the EU follow the same general regulatory principles and legal concepts, if adopted on the EU-level. And as a consequence under the mutual recognition principle,[332] each Member State accepts adherence to the other Member State's rules as sufficient in its own jurisdiction.[333] Applying the minimum standard method in the EU has enhanced the general competitiveness, while also the poorly regulated markets have incentives to advance their regulatory system in order to gain access to other jurisdictions. At the same time, the minimum standard does not prevent other Member States from setting higher standards within their own jurisdiction.[334] In theory, the EU can reach in a long run a balanced yet innovative system, where Member States continue to compete with one another. One jurisdiction may inspire the other Member States in their regulatory approach and efficiency. Yet in the field of investment companies, the EU has adopted a variety of directives, which are subsequently followed by detailed implementing directives, thus limiting the Member States' scope of directives' transplantation. Nevertheless, the EU should not only continue to closely oversee the process of consistent transplantation but also of a uniform enforcement.

Further in this chapter, the establishment and development of the EU single financial market will be described and its keystones analyzed. This analysis serves as

[331] *See* Manning Gilbert Warren III, *Global Harmonization of Securities Laws: The Achievements of the European Communities*, 31 HARV. INT'L L. J. 185, 191 (1990) [hereinafter "Warren, *Global Harmonisation*"] and Karel Lannoo & Mattias Levin, *Securities Market Regulation in the EU: Everything You Always Wanted to Know About the Lamfalussy Procedure* 2-3 (CEPS Research Report in Finance and Banking, No. 33, May 2004) [hereinafter "Lannoo & Levin 2004"].

[332] For more on the mutual recognition process in the financial law *see* Pierre-Hugues Verdier, *Mutual Recognition in International Finance*, 52 HARV. INT'L L.J. 55, 71-81 (2011).

[333] *See* RAINER GROTE & THILO MARAUHN, THE REGULATION OF INTERNATIONAL FINANCIAL MARKETS: PERSPECTIVES FOR REFORM 90 (Cambridge University Press, 2006) [hereinafter "GROTE & MARAUHN"]. The minimum standard method has been applied in other regulatory areas, namely the Basel banking regulations.

[334] *See* Ethiopis Tafara & Robert J. Peterson, *A Blueprint for Cross-border Access to US Investors: A New International Framework*, 48 HARV. INT'L L. J. 31, 67 (2007).

the basis for farther discourse on the investment companies and their regulation in the EU.

1.3.1. Early Development: Single Internal Market

Although the EU has one of the largest international financial centers – London and the oldest stock exchange[335] – widespread individual holding of securities became common only since late 1980's. Even in the UK, which was considered the European financial center, less than three percent of the population owned company shares at that time.[336] There are number of reasons why the individual ownership of securities only started to develop about fifty years later than in the US.[337] Nevertheless, it remains to be the fact that except in the UK, securities regulation in Europe before 1980 could be best described as "virtually non-existent".[338]

Prior to 1986, the year of the adoption of the Single European Act, the process of creation of the single internal market in financial services had been advanced both

[335] The stock exchange in Amsterdam was founded in 1611 and became the main trade center soon afterwards. *Available online at:* < http://www.beursvanberlage.nl/1611/>/*last visited* Oct. 22, 2013.

[336] *See* Francis W. Neate, The Developing Global Securities Market 57 (Wolters Kluwer Law & Business, 1987).

[337] Among the most frequent reasons listed are the following: the two world wars and persisting iron curtain, which put the Europe into lengthy economic distress; the European governments imposed strict capital market control; bank lending was offered predominantly over securities in corporate finance; and given the divided region, which consisted of number of relatively small individual countries, the number of listed companies was very limited. For more *see* Warren, *Global Harmonisation*, *supra* note 331, at 194.

[338] *Id.* at 194-195. Although the company law and banking law was fairly well developed, the small amount of functioning stock exchanges was purely self-regulating with very little government oversight. At the same time, there were no enforcement agencies, which would oversee the securities market and any action of entities advising and facilitating individual's investments. Moreover, regulation covering any registration of investment companies, disclosure obligations or prohibition of insider trading or other manipulative practices was novel to majority of the countries in Europe. In 1981, when the Public Offer Prospectus Directive (Directive 89/298, Council Directive Coordinating the Requirements for the Drawing-up, Scrutiny and Distribution of the Prospectus to be Published When Transferable Securities are Offered to the Public, 32 O.J. Eur Comm. L 124/8) only five members of the European Community, namely Belgium, France, Ireland, Luxembourg and the United Kingdom required prospectus disclosure to investors in public offerings of securities. On Comparison of UK and US financial system in 18th and 19th century *see generally* Atack & Neal, *supra* note 97, at 215-230.

by legislative and judicial means,[339] which unfortunately proved to be extremely slow and often inefficient.[340] The difficulties lied mainly with the legislative mechanism, as Article 100 of the Treaty of Rome required Council unanimity for the adoption of legal measures, which would directly affect the establishment or functioning of a common market.[341] The "all-or-nothing" harmonization and a duty of never ending consultation with a number of EU bodies rendered the Council practically inoperable and inflexible and therefore the aim of a single market almost unattainable.

From the perspective of fundamental freedoms and general principles of the EU law, the single market in financial services has been primarily based on the EU's free movement of capital and services, which finds its regulatory basis tightly connected to the free movement of goods. Historically, the EU **firstly** tried to impose controls over Member States' derogations from free movement of goods.[342] Later, the same principles became applicable for the free movement of services and capital. Moreover, hand in hand with the EU freedoms go the general principles of the EU law as subsidiarity and proportionality.[343] Hence, any development, political or regulatory, is inherently slower and more complicated than in the US.[344]

---

[339] *See* CRAIG & DE BÚRCA 4TH, *supra* note 80, at 606.
[340] *See* Lannoo & Levin 2004, *supra* note 331, at 7.
[341] The Article 100 of the Treaty of Rome stated: "The Council shall acting unanimously on a proposal from the Commission, issue directives for the approximation of such provisions laid down by law, regulation or administrative action in Member States as directly affect the establishment or functioning of the common market. The Assembly [European Parliament] and the Economic and Social Committee shall be consulted in a case of directives whose implementation would, in one or more Member States, involve the amendment of legislation.
[342] *See* CRAIG & DE BÚRCA 4TH, *supra* note 80, at 597.
[343] Under the general principle of subsidiarity, the EU may only act if the necessary powers for the intended action have been transferred by Member States to the EU. Currently, based on the Articles 2, 3 and 4 of TFEU, EU has either exclusive competence or shared competence. Under the principle of proportionality, which reflects the well-established case law of the CJEU, EU (and its organs and institutions) firstly has to ask whether it is necessary to act in certain or to establish a specific new body in order to achieve the objectives defined by the Treaties.
[344] *See* Alasdair Smith & Helen Wallace, *The European Union: Towards a Policy for* Europe, INT'L AFF. 430 (1994).

In 1968, the European Commission, on the basis of Art. 100 of the Treaty of Rome set out to harmonize various technical aspects of goods produced in EU Member States. Producing around ten directives a year was inefficient and time-consuming.[345] Realizing the insufficient market access, the European Commission in 1983 introduced the **Mutual Information Directive of 1983**,[346] which was built on the mutual recognition principle established by the case law of the CJEU.[347] This directive imposed an obligation on Member States to inform the European Commission before it adopted any legally binding regulation setting a technical specification, except where it transposed European or international standards.[348] Furthermore, the decision 3052/95/EC[349] imposed an obligation on Member States to notify the European Commission if it was about to take any steps to prevent goods lawfully produced in another Member State from its market.[350]

In 1986, with the adoption of the Single European Act, which introduced the qualified majority voting instead of unanimity as the basis for adopting measures aimed at achieving the internal market, it became easier to implement new legislative measures. Under the same act, the EU had six years to complete the internal market

---

[345] It is believed that there were many reasons behind the failure to improve market access, notably i) the unanimity requirement for agreeing on legislative acts, ii) excessive ambitions of uniformity at Community level and iii) a lack of political interest by member state ministers; *see* Lannoo & Levin 2004, *supra* note 331, at 10.

[346] Council Directive 83/189/EEC of 28 March 1983 Laying Down a Procedure for the Provision of Information in the Field of Technical Standards and Regulations [1983] O.J. L109/8.

[347] The legal principle knows as "mutual recognition" has been established by the Case 120/78 Rewe-Zentral Ag v Bundesmonopolverwaltung für Branntwein [1979] E.C.R. 1979-00649 (1979). This principle is one of the core principles of the Union law as it declares that products or services that have been lawfully produced or marketed in one member state are to be granted a free access throughout the internal market without any kind or restrictions, neither quantitative nor qualitative.

[348] *See* Stephen Weatherill, *Compulsory Notification of Draft Technical Regulations: The Contribution of Directive 83/189 to the Management of the Internal Market*, 16 YEARBOOK EUR. L. 129 (1996).

[349] Decision 3052/95/EC of the European Parliament and of the Council, established a procedure for the exchange of information on national measures derogating from the principle of the free movement of goods within the Community [1995] O.J. L321/1.

[350] *See* CRAIG & DE BÚRCA 4TH, *supra* note 80, at 597.

and remove any remaining barriers to the movement of goods, persons, services and capital, including financial services by the end of 1992.[351]

1.3.2. Introducing UCITS

The first major step towards a single securities market was undertaken the same year as the Single European Act was passed. The adopted directive enabled fund managers to operate certain investment funds – "**undertakings for collective investments in transferable securities**" [hereinafter "UCITS"] through the entire EU.[352] UCITS could in its functional approach be compared to open-ended investment companies: mutual funds.[353] UCITS is a pooled form of investment, which is managed by a fund and invested in shares or bonds, depending on the investment strategy of a fund. Ninety percent of the fund's assets had to be invested in transferable securities, while no more than five percent of the UCITS's assets could be invested in the transferable securities issued by the same body.[354] Further commonality between UCITS and

[351] The provisions of the Single European Act were based on the Commission White Paper: Completing the Internal Market, COM (1985) 310 final (June 28-29, 1985). The White Paper called for removal of all physical, technical and fiscal barriers to the free movement of goods and services between and among the Member States. For more on the White Paper and the Single European Act *see* Stephen Woolcock, *Competition among rules in the single European market in* ANTHONY I. OGUS (ED.), REGULATION: LEGAL FORM AND ECONOMIC THEORY (Hart Publishing, 2004).

[352] Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulation and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) O.J. L 375 (1985) [hereinafter "UCITS 1985"]. Member States were required to implement the UCITS 1985 no later than October 1st, 1989 (article 57(1) of the UCITS 1985).

[353] Under the Section 2 of the Article 1 of the UCITS 1985, UCITS shall be undertakings (1) the sole object of which is the collective investment in transferable securities of capital raised from the public and which operate on the principle of risk-spreading and (2) the units of which are, at the request of holders, re-purchased or redeemed, directly or indirectly, out of those undertakings' assets. Action taken by a UCITS to ensure that the stock exchange value of its units does not significantly vary from their net asset value shall be regarded as equivalent to such re-purchase or redemption. Moreover, the UCITS could be constituted under the law of contract, law of trust and as well under some other law (as investment company).

[354] The term "transferable securities" was not clearly defined by the UCITS 1985. The Preamble of the UCITS 1985 only stated concerning the UCITS that "[t]he sole object of which (of UCITS) is investment in transferable securities (which are essentially transferable securities officially listed on stock exchanges or similar regulated markets)." Thus the term could have been interpreted widely. Today the EU remedied the past ambiguities and the Council Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) O.J. L 302/32 [hereinafter "UCITS IV"] in Article 2 (1)(n) defines transferable securities as:

mutual funds is that there are no limitations as to the number of shares that can be issued, whereas the shares are redeemable.[355]

The UCITS 1985 harmonized the rules of the Member States for authorization, structure, disclosure obligations, activities and supervision for these funds. Given the mutual recognition, the UCITS could have been registered and authorized in any Member State as well as marketed anywhere in the EU with submitting simple notification to the host Member State.[356] Unless, the host Member State found that the UCITS had breached its marketing rules, the UCITS could be marketed within two months after notice had been provided.[357] The UCITS 1985 was the first directives of its kind adopted in the EU and in many respects ambiguous.[358] At the time, the UCITS 1985 contained only minimum rules, while being focused on mutual recognition of the UCITS in the EU.[359] The UCITS 1985 granted several powers of oversight to Member States rather than to the individual investors.[360] This regulatory approach could be rationalized given the investors' inexperience and lack of understanding of securities markets at the time and thus, the necessity to oversee the UCITS in the EU.[361] Yet the oversight and enforcement was kept in the hands of Member States and their respective and highly distinctive bodies, while the EU had

(i) shares in companies and other securities equivalent to shares in companies (shares); (ii) bonds and other forms of securities debt (debt securities); (iii) any other negotiable securities which carry the right to acquire any such transferable securities by subscription or exchange.

[355] *See* Article 37 UCITS 1985. On the closer analysis of UCITS 1985 *see Money Go Round: What UCITS Are*, DAILY TELEGRAPH, Feb. 3, 1990 at 34 and Tim Dickson, *UCITS Will Help Remove Barriers*, FIN. TIMES, Oct. 31, 1987, at XVI, Patrick J. Paul, *The European Community's UCITS Directive: One Model for United States Regulatory Change in a Globalized Securities Market,* 25 VAND. J. TRANSNAT'L L. 61, 83-86 (1992).

[356] Section II of the UCITS 1985.

[357] Article 46 UCITS 1985.

[358] The UCITS 1985 did not address number of concerns connected to the management of an investment company, as affiliated transactions, pricing or use of fund assets for distribution

[359] *See* MOLONEY, EC SEC. REG. 2ND ED, *supra* note 71, at 236.

[360] *E.g.* under the UCITS 1985, it was the home Member State who had to approve the choice and replacement of a UCITS's management company and depositary or even the change of UCITS' organizational documents. *See* Article 4(2) UCITS 1985.

[361] *See* the Preamble UCITS 1985.

not anyhow specified its nature and scope as opposed to the US, where the law on the enforcement of the federal securities law forms the central piece of the securities regulation. Indisputably, it is the enforcement agency, which carries out the primary goal of any securities regulation – the investor protection. However, one has to keep in mind that the UCITS 1985 was only the **first** directive in the field of securities regulation followed by other directives adopted thereafter.[362] From the types and sequence of adopted laws in the EU and the US one can extrapolate that from the beginning of regulation of investment companies in the US and EU, the regulatory approach and the dynamics of each respective regulation essentially differ.

This UCITS 1985 opened doors for managers of investment undertakings to offer their services in all markets of the EU. Afterwards, in 1989 the Prospectus Directive was adopted which regulated basic harmonization of the information the investment companies were obliged to provide when offering securities to the public and possibly raising capital through the entire EU.[363] Despite widespread public support, the internal market was not successfully completed by 1992 and the following years have not contributed very much towards the formation of internal market of financial services,[364] and thus a new plan had to be adopted.

1.3.3. Financial Services Action Plan & Lamfalussy Process

In 1999, the European Commission adopted the Financial Services Action Plan [hereinafter "FSAP"], a policy program aiming to **complete** the single financial

[362] For all subsequent directives and regulation adopted with the purpose of creating the single market in financial services *see* MANNING G. WARREN, EUROPEAN SECURITIES REGULATION 1-11 (Kluwer Law International, 2003), GROTE & MARAUHN, *supra* note 333, at 122-130; Warren, *Global Harmonisation, at* 195-209; Patrick J. Paul, *The European Community's UCITS Directive: One Model for United States Regulatory Change in a Globalized Securities Market,* 25 VAND. J. TRANSNAT'L L. 61, 78-87 (1992); Caroline Bradley, *Deregulation of Financial Services Activity in Europe after 1992,* 11 OXFORD J. LEGAL STUD. 545, 551-556 (1991).
[363] Directive 89/229/EEC.
[364] *See* GEORGE A. BERMAN ET AL. CASES AND MATERIALS ON EUROPEAN UNION LAW 543 (West Academic Publishing, 2nd ed. 2007).

market after the introduction of the Euro and establishment of **monetary union**.[365] The FSAP was a plan for adopting all necessary legislative measures to support a single, integrated financial market by the year 2005. The FSAP consisted of a set of forty-two measures designed to create a single market in financial services.[366]

It is without any doubt that the FSAP contributed towards the integration of securities market in EU.[367] A majority of the FSAP measures took the form of directives, which required transposition into the law of each Member State.[368] Some of the directives replaced earlier ones, which were regarded to be outdated, some were already under negotiation when the FSAP was adopted, and the others revised earlier proposals.[369] Concerning the general effect of the FSAP, the extensive EU harmonization eliminated Member State self-regulation,[370] and thus certain countries, which regulation was self-regulatory in nature, mainly in connection with the enforcement agencies, as in the case of Germany, had to significantly adjust their national regulatory framework.[371] At the beginning of the harmonization process the

---

[365] European Commission, *Financial Services: Implementing the Framework for Financial Markets: Action Plan* (COM (1999) 232).

[366] FSAP is far-reaching and includes legislative measures covering securities offerings, taxation, of cross-border occupational pensions, prevention of fraud. After the adoption of the proposed directives and regulation, the EU Commission published a report on the economic evaluation of the FSAP in all of three sectors: banking, securities and insurance. The report is *available online at:* < http://ec.europa.eu/internal_market/finances/docs/actionplan/index/090707_economic_impact_en.pdf >/*last visited* June 17, 2012, [hereinafter "FSAP Report"]. There had been also other reports and inquires carried out, e.g. empirical Financial Integration Monitor, first published in 2003 which tracked progress towards financial integration under the FSAP.

[367] *See* DAN PRENTICE & ARAD REISBEG, CORPORATE FINANCE LAW IN THE UK AND EU 398 (Oxford University Press, 2011) and Niamh Moloney, *Financial Market Regulation in the Post-Financial Services Action Plan Era*, 55 INT'L & COMP. L. Q. 982, 982-983 (2006).

[368] On the process of transposition of EU directives *see generally* PAUL CRAIG & GRÁINNE DE BÚRCA, EU LAW: TEXT, CASES AND MATERIALS 200-216 (Oxford University Press, 5th ed. 2011).

[369] *See* Paul Richards, *The EU Financial Services Action Plan: A Guide*, BANK OF ENGLAND Q. BULL. (2003). On the FSAP *see generally* Luca Enriques & Matteo Gatti, *Is There a Uniform EU Securities Law After the Financial Services Action Plan*, 14 STAN. J.L. BUS & FIN 43 (2008) [hereinafter "Enriques & Gatti"].

[370] *See* JEAN-PIERRE CASEY & KAREL LANNOO, THE MIFID REVOLUTION 200 (Cambridge University Press, 2009) [hereinafter "CASEY & LANNOO"].

[371] Most European states lacked governmental "competent authorities" supervising the securities market and it was often a banking authority, which was responsible for the supervision but lacked the knowledge and experience on the securities markets; *see* EILÍS FERRAN, BUILDING AN EU SECURITIES

state of the national regulation of the Member States was considerably diverse and forming an integrated EU financial market with liquid and efficient securities market was full of challenges.[372]

Alongside the FSAP, the Committee of Wise Men on the Regulation of European Securities Markets, chaired by Baron Alexandre Lamfalussy [373] was appointed, in order to assess the state of integration of the European securities market [hereinafter "Lamfalussy Committee"].[374] The difference between the FSAP and the **Lamfalussy Committee** was that the FSAP set out a roadmap on substantive harmonization, while the Lamfalussy Committee assessed the legislative process in the EU and proposed a new lawmaking process – the "Lamfalussy process".[375]

In February 2001, the Lamfalussy Committee submitted their final report [hereinafter "Lamfalussy Report"].[376] The Lamfalussy Report pointed to the inability of the EU to adopt quickly and effectively all necessary measures.[377] The existing legislative process was described as "too slow, too rigid, complex and ill-adapted to

MARKET 31 (Cambridge University Press, 2004) [hereinafter "FERRAN, BUILDING AN EU SEC. MARKET"].

[372] *See* MOLONEY, EC SEC. REG. 2ND ED, *supra* note 71, at 7 and Harry McVea, *The EU Financial Services Action Plan and Its Impact on Corporate Finance in* CORPORATE FINANCE LAW IN THE UK AND EU 403 (Dan Prentice & Arad Reisberg eds., 2011).

[373] Baron Lamfalussy was believed to be one of very few people outside of the politics who has an eponymous legislative process. *See* P. Norman, *Brussels Wise Men 'Satisfied' With Reform,* FIN. TIMES, June 2, 2003.

[374] The Council (in its Economic and Finance ministers formation (ECONFIN) appointed the committee in July 2000. The establishment of this Committee to look at radical opinions for the development of the single securities market was the brainchild of Laurent Fabius, the French minister of finance, *A Ragbag of Reform,* ECONOMIST 93, March 3, 2001.

[375] For analysis of the Lamfalussy process *see generally* DAN PRENTICE & ARAD REISBEG, CORPORATE FINANCE LAW IN THE UK AND EU, ch.14 (Oxford University Press, 2011); FERRAN, BUILDING AN EU SEC. MARKET, *supra* note 371, ch.1 & ch.3; MOLONEY, EC SEC. REG. 2ND ED, *supra* note 71, ch.7; Niamh Moloney, *Confidence and Competence: The Conundrum of EC Capital Market Law,* 4 J. CORP. STUD. 1 (2004) or Lannoo & Levin 2004, *supra* note 331.

[376] FINAL REPORT OF THE COMMITTEE OF WISE MEN ON THE REGULATION OF EUROPEAN SECURITIES MARKET, *available online at*: <http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf>/ *last visited* 18th June 2012 [hereinafter "Lamfalussy Report"].

[377] *Id*, at 17-18.

the pace of global financial market change,"[378] with the average time for adoption of a measure under the co-decision procedure amounting to **two years**.[379]

The outcome of the Lamfalussy Report was a new and reformed **architecture** of legislative process with four layers and divided legislation into two groups: on the one hand the "high-level framework provisions," and on the other the more detailed "implementing measures".[380] At this time the Lamfalussy Report did not suggest creating a pan-EU oversight and enforcement agency. Imprudently, it left the enforcement of newly adopted laws for the Member States.[381] The only agencies that were recommended on the EU-level were the European Securities Committee [hereinafter "ESC"] and the Committee of European Securities Regulators [hereinafter "CESR"].[382] The entire report emphasized the importance of transparency and consultation not only within the level itself but also between different levels. The Lamfalussy Committee sought to address problems of decision-making process under the co-decision procedure[383] by unconventionally calling for yet more committees and delegation of decision-making.

---

[378] *Id.,* at 7. For description and analysis of EU legislation process at the time of rendering the Lamfalussy Report *see* Alexandra Gatto, *Governance in the European Union: A Legal Perspective,* 12 COLUM. J. EUR. L. 487, 500-508 (2006) and Thomas König, *Analysing the Process of EU Legislative Decision-Making: To make a Long Story Short…,* 9 EUR. UNION POL. 145 (2008).

[379] Specific reference was made to a well-known 12-years negotiation period of proposed Takeover Directive (Common Position No 1/2001 OJ2001 C23/1).

[380] At the Level 1, the "high-level framework provisions" are adopted (in form of directives or regulations). Level 2 should adopt detailed technical "implementing measures" are adopted under accelerated delegated legislative procedure by the European Commission. At the Level 3, the implementation process by national authorities would take place while Level 4 represents the enforcement by the European Commission together with the Member States.

[381] *See* Niamh Moloney, *The Lamfalussy Legislative Model: A New Era for the EC Securities and Investment Services Regime,* 52 INT'L &COMP. L. Q. 509, 511-512 (2003) and FERRAN, BUILDING AN EU SEC. MARKET, *supra* note 371, at 61-91.

[382] The objective of Level 2 legislation is to ensure that the attempt to modernize the securities legislation would not be hampered as in the usual political process, but would rather accelerate through rapid and flexible procedures controlled by technocrats, *see* DAMIAN CHALMERS, GARETH DAVIES AND GIORGIO MONTI, EUROPEAN UNION LAW: TEXT AND MATERIALS 809 (Cambridge University Press, 2006).

[383] The main essence of the co-decision procedure is to put EP and the Council of EU on equal footing in the sense that both of them have to approve a proposal in order to become a formal and binding

Ultimately, the Lamfalussy Report was officially endorsed by March 2001 to Stockholm European Council. At the time, it also received a favorable reception from the financial industry participants as well as the regulatory organizations,[384] yet was not in a position to prevent the 2008 financial crisis. European Commission enthusiastically established the mechanisms applying the "Lamfalussy model" as it was aware that its influence would increase through the new comitology procedure.[385] **CESR** started to operate on 7th June 2001.[386] CESR performed number of functions, including participation on the legislative process in order to develop EU consistency in securities practice and supervisory policy.[387] Concerning the investment companies, CESR was the only institution that **guided** the industry and gave practical advice on scope and application of the EU regulatory measures.[388]

Despite the fact that the full adoption and implementation of the FSAP and Lamfalussy Model indisputably increased the regulatory power of the European Commission[389] and might have proven successful to reform the EU system into more

---

decision. The co-decision procedure before the Lisbon Treaty had been an exception but now as defined by Article 294 of TFEU it became the "ordinary legislative procedure". More on the decision-making process in EU *see* JOHN PETERSON & ELIZABETH BOMBERG, DECISION-MAKING IN THE EUROPEAN UNION 35 (Palgrave Macmillan, 1999) or *generally see* ARNE NIEMANN, EXPLAINING DECISIONS IN THE EUROPEAN UNION (Cambridge University Press, 2006).

384 *See Labouring with Lamfalussy,* ECONOMIST 97, June 16, 2001.

385 *See* Niamh Moloney, *The Lamfalussy Legislative Model: A New Era for the EC Securities and Investment Services Regime,* 52 INT'L &COMP. L. Q. 509, 518 (2003).

386 CESR was not a legal personality under Union law but only a non-profit association under French law. It worked like a small committee in Paris where its members had meetings periodically. CESR had no strong executive, but only a small secretariat with a number of permanent employees. CESR had no binding powers and acting as a collective actor it had no independent, overriding choice over its preferences, *see* PIERRE SCHAMMO, EU PROSPECTUS LAW: NEW PERSPECTIVES ON REGULATORY COMPETITION IN SECURITIES MARKETS 20-28 (Cambridge University Press, 2011).

387 *See* FERRAN, BUILDING AN EU SEC. MARKET, *supra* note 371, at 7. The CESR was believed to be a predecessor of a future European Securities Exchange Commission, *see* GROTE & MARAUHN *supra* note 333, at 128.

388 Among many, CESR issued guidelines on passporting mechanism of UCITS and MiFID or it also published reports on inducements and investment advice, which were subsequently distributed to the investment companies. The emphasis of the CESR consultation task was stipulated on many occasions, *see* FERRAN, BUILDING AN EU SEC. MARKET, *supra* note 371, at 84.

389 Some observed the European Commission as a "policy entrepreneur", which selects the policies that promote its own interest and presents them in ways that restrict the choices available to Member States until it reaches its goal, *see* SIMON HIX, THE POLITICAL SYSTEM OF THE EUROPEAN UNION 266-7 (Palgrave Macmillan, 2d ed. 2005).

effective and more flexible, it did not happen instantly. In 2000, the CJEU in the *Tobacco Advertising*[390] ruled that the single market competencies of the EU do not confer a general power to regulate the single market.[391] Hence, the CJEU sent a warning signal to all EU authorities and bodies on the limitation of the core single market competences. Even though the report from December 2003 found that the new model was *"proving to be a viable instrument for improving the efficiency and speed of financial market legislation and regulation in the EU*",[392] level 1 and 2 were implemented and to certain extent working, however level 3 and 4 which addressed supervisory and enforcement issues have not been even set into practice until 2008.[393] However, due to the financial crisis in 2008 and its impact on the European market, the European Commission together with the European Council received sufficient political capital in order to "promptlier" address all necessary legislative changes in the financial sector.[394]

[390] Case C-376/98 Germany v. Parliament and Council [2000] E-8500.
[391] The EU adopted legislation restricting the advertising of tobacco products based on the Article 95 of the EC Treaty. Germany successfully challenged this legislation on the grounds that Article 95 does not give the EU unlimited powers to harmonize national laws of Member States. Germany referred to proportionality as the EU may legislate those specific areas, which are necessary to ensure proper operation of the internal market.
[392] *See* SECOND INTERIM REPORT MONITORING THE LAMFALUSSY PROCESS 1 (Inter-Institutional Monitoring Group, Dec. 2003).
[393] *See* the Review of the Lamfalussy Process, Communication from the Commission of 20 November 2007, *available online at:* < http://ec.europa.eu/internal_market/finances/docs/committees/071120_final_report_en.pdf >/ *last visited* Oct. 22, 2012, where the European Council invited the European Commission to clarify the role of the Lever 3 committees by April 2008 and Niamh Moloney, *Time to Take Stock on the Markets: Financial Services Action Plan Concludes as the Company Law Action Plan Rolls Out,* 53 INT'L &COMP. L. Q. 999, 1008 (2004).
[394] *See EU Must Unite to Tackle Roots of Financial Crisis: Brown*, AGENCE FRANCE PRESSE, Oct. 15, 2008 & *EU Pushes for Reforms to Global Financial System*, DEUTSCHE WELLE, Oct. 16, 2008 (where the British Prime Minister Gordon Brown, with French President Sarkozy and German Chancellor Merkel urged EU to tackle the financial crisis), Karel Lannoo, *Unlocking Europe's Supervisory Borders,* W.S.J. Oct. 28, 2008 (highlighting the need for more integrated structure for financial supervision in the EU); *EU Eyes More Regulation in Answer to Crisis,* AGENCE FRANCE PRESSE, Nov. 4, 2008 (critique on the EU calling for global financial regulation while it alone "remains largely a hodge-podge of national rules and authorities).

1.3.4. The EU Influence on the UK: Financial Services and Markets Act 2000

Before a unifying statutory framework was adopted in the UK in 2000 - the Financial Services and Markets Act 2000 [hereinafter "FSMA 2000"][395] - the financial services were regulated under a dispersed array of legislation, including:

- Insurance Companies Act 1982 and the regulation and guidance notes given under it;
- Financial Services Act 1986 and the regulation and guidance notes given under it;
- Banking Act 1987 and the regulation and guidance notes given under it;
- Mutual legislation, including the regulatory provisions of Building Societies Act 1986, Friendly Societies Acts 1974 and 1992, and Credit Unions Act 1979 together with Industrial and Provident Societies Act 1965; and
- Various free standing regulation made under European Communities Act 1972.[396]

The rationale behind the UK government's decision to substitute the existing regulation under **one statutory framework** was to produce a more coherent and proportionate approach to regulation.[397] The UK wished to introduced a single enforcement agency the Financial Services Agency [hereinafter "FSA"] comparable

[395] The FSMA 2000 was enacted on June 14, 2000 after an extended consultation period. The first draft of the legislation was produced in July 1998 in a form of a package of Consultation Paper issued by the HM Treasury. In less than a year, on June 17, 1999 the official bill was introduced to the House of Commons and subsequently went into Committee stage in July 1999 and was carried over from one Parliamentary session to the next and began its Report stage in January 2000. All in all 2,750 amendments were considered with 1,500 being adopted during over 200 hours of Parliamentary debate. The bill finally received Royal Assent on June 14, 2000. BLAIR & WALKER, *supra* note 88, at 5-6.
[396] *E.g.* Banking Co-ordination (Second Council Directive) Regulation 1992 SI 1992/3218 as amended or the Investment Services Regulations 1995 SI 1995/3275 as amended.
[397] *See* BLAIR & WALKER, *supra* note 88, at 53.

to the US SEC.[398] The effect of the EU regulatory activities in the field of financial services was that all EU Member States were required to transpose and implement the regulation in order to complete the European Internal Market in financial services. The EU directives were premised on the European continental model of universal banking, which was different from the one in the UK. The Capital Adequacy Directive,[399] set capital requirements for market risk for both banks and investment companies. Thus raising the issue of competitiveness between banks and other investment intermediaries, given that the same directive would be implemented and subsequently enforced by different regulators.[400] Moreover, given the development of the industry in the UK, prior to election in 1997, there have been several debates held that targeted the issue of overlapping and under-lapping jurisdictions of the enforcement agencies in the UK and a coherent transposition of EU directives. The Labor policy handbook, *New Labour, New Life for Britain,*[401] promised to "reform and strengthen the regulatory system" and to "simplify both the structure and the nature of the system so that it commands the confidence of both the public and the industry."[402] As such, the new government introduced a new regulatory framework over the entire financial services industry overseen by a regulator encompassing both prudential and business conduct regulation.[403]

1.3.5. The 2008 Financial Crisis & the EU: Enforcement Agency Finally?

[398] In the UK the predecessor of FSA was the Securities and Investment Board [hereinafter "SIB"] which was responsible for regulation of securities and investment business in the UK under the Financial Services Act 1986. The SIB was a private limited company, to which statutory functions were delegated by the Secretary of State.
[399] Council Directive 93/6 on the Capital Adequacy of Investment Firms and Credit Institutions, 1993 O.J. L 141/1.
[400] *See* Heidi M. Schooner & Michael Taylor, *United Kingdom and United States Responses to the Regulatory Challenges of Modern Financial Markets,* 38 TEX. INT'L L.J. 317, 331 (2003).
[401] LABOUR PARTY, NEW LABOUR, NEW LIFE FOR BRITAIN (1996).
[402] *Id.*
[403] *See* section 5.2.

Shortly after the outbreak of the financial crisis in 2008, the European Commission appointed Larosiére group in order to research and evaluate the situation of EU single financial market and formulate the **recommendations** on the improvement and reform accordingly.[404] Larosiére group published a report on the changes of EU institutional framework in February 2009 with a primary focus on **prudential supervision**.[405] Experts in Larosiére group defined eight issues having a detrimental effect on the supervision.[406] They proposed reforming the supervisory structure on both macro and micro level. Firstly, creating macro-prudential supervision by establishing a European Systemic Risk Board [hereinafter "ESRB"] and secondly on the micro level transforming the Level 3 committees (CESR, CEBS, CEIOPS) into new European Supervisory Authorities [hereinafter "ESAs"] as the executives of greater European System of Financial Supervision [hereinafter "ESFS"].[407] To achieve greater efficiency and cooperation on the European financial market, new legal and technical rules have to be developed to ensure fast and effective mechanisms for cooperation and consistent application of regulation.[408]

The Larosiére report suggested the transformation of CESR into European Securities and Markets Authority [hereinafter "ESMA"] with broadening its legal supervisory powers when proposing the establishment of a new financial supervisory

---

[404] It was a group of high-level experts in finance, under the chairmanship of Jacques de Larosière.

[405] European Commission, *Mandate for the high-level expert group on financial supervision in the EU' annexed to the Report of the high-level group on financial supervision in the EU*, Brussels 25th February 2009, 69, *available online at*: < http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf >/ *last visited* June 18, 2012 [hereinafter "Larosiére Report"].

[406] Amongst these issues there are: (1) an absence to macro prudential risks; (2) an absence of means to alert policy actors to macro-prudential risks; (3) supervisory malfunctions at national level; (4) inadequate mechanisms for challenging the measures of national authorities having cross-border implications; (5) insufficient cooperation and frankness between national authorities; (6) national authorities with inadequate powers; (7) insufficient resources for Level 3 committees and (8) insufficient legal powers for them to take common decisions. *Id*, at 39-42.

[407] *Id.* at 47.

[408] *See* Nicolette K. de Sevres & Lorenzo Sasso, *The New European Financial Markets Legal Framework: a Real Improvement? An Analysis of Financial Law and Governance in European Capital Markets From a Micro- and Macro-economic Perspective*, 7 Cap .Markets L. J. 30, 31 (2012).

framework and authority in Europe.[409] It was expected that ESMA would have a direct impact on cross-border fund managers as well as enforcement powers over the national supervisors.[410] Although greater powers were forecasted for ESMA, the Larosiére report failed to analyze the balance of powers as a constitutional principle, which was upheld by the CJEU in many decisions.[411] ESMA's legal status, powers and ability to protect investors will be discussed in the fifth chapter of this thesis.

1.4. Conclusion: What Does the History Reveal?

The analysis of history shows that the investment companies arose as people were searching for low-risk and long-term reliable investments. Pooling numerous investments together and managing diversified portfolios was an idea that got many less wealthy interested. Investment companies became successful as they sustained growth wherever they emerged. The managed investment fund industry was largely a British creation until it was taken over by the US, where it remarkably expanded during the 1920's. Everyone started to invest in these new intermediaries and even

---

[409] On Jan.1, 2011 CESR was replaced by supposedly more powerful supervisory authority ESMA, which formed a new stage on the evolutionary road towards greater centralization of EU supervision. ESMA in comparison to CESR has a legal personality under EU law and forms an EU body as the European Central Bank. ESMA's principal is to ensure a proper implementation of EU rules in the financial area. *See* Articles 2(1) and 5(1) ESMA Regulation. For more on ESMA and its powers, structure, tasks and functions *see* PIERRE SCHAMMO, EU PROSPECTUS LAW: NEW PERSPECTIVES ON REGULATORY COMPETITION IN SECURITIES MARKETS 36-54 (Cambridge University Press, 2011).

[410] *See* Baptiste Aboulian, *Europe to Get Cross-Border Supervisor*, FIN. TIMES, June 14, 2009.

[411] The Larosiére Report based on the situation on the market in 2008 simply concluded that broader powers are necessary on EU level but it did not sufficiently consider the EU case law. CJEU's case law on delegation of powers is very broad, *see* Case 9/56 Meroni v. High Authority [1958] ECR 133, Case 98/80 Romano v. Institut national dássurance maladie-invalidité [1981] ECR 1241, Case C-102/91 Knoch v Bundesanstalt für Arbeit [1992] ECR I-04341, Case 21/87 Borowitz v. Bundesversicherungsanstalt für Angestellte [1988] ECR 3715, Case C-301/03 P Carmine Salvatore Tralli v. European Central Bank [2005] ECR I-4071. Based on these decisions there is a very broad margin of appreciation and the CJEU tends to incline more towards what is agreed upon by Member States than what is necessary by the economy or situation at the very moment. The most important document in the EU are the Treaties as the ultimate source of Union law and as in *Meroni* if the delegated powers are more extensive that those that belonged to the delegating authority, the delegation was not permissible. This principle is also a part of the current Treaties, *see* Article 5(2) of the TEU according to which the EU can only act within the scope of the powers which are vested in it by the Treaties (*see also* the Article 13(2) TEU). Hence, based on the EU case law there are number of constrains on the nature and scope of powers which can be delegated to ESMA. For more details *see* section 5.2.

though the Stock Market Crash of 1929 and its aftermath brought about the most serious crisis in the history of capital markets, they continued to attract the public. Moreover, the New Deal's regulatory framework has later allowed the investment company industry to reach the skies. Even today after the financial crisis in 2008, the investment companies remain the number one choice of retail investors in the US.

However, the investment companies' success story is not only being written in the US but also in other countries, including the Member States of the EU, where the investment companies have begun to attract more and more retail investors. Keeping in mind that the EU aspires to establish a common market also in financial services, the part of the regulatory framework should be formed by protective mechanism for retail investors, who often become exposed to deceptive and fraudulent practices of those in control of investment companies. This was the case in the eighteenth century and so is in the twenty-first. Directors of the SSC were able to "shape" the information in a way that everyone desired to be a part of the "great" SSC – similarly almost 300 years later – when everyone craved to become a part of the "Madoff wonder." People's creativity and zest for fortune will never evaporate but a regulator should limit them to the extent they undermine the interests of others, namely the interests of their own investors. This should be carried out by regulation.

Even though bulletproof regulation has not been yet founded, the regulators should not surrender. Financial crises reveal the gaps of the regulatory frameworks and the mistakes of the regulators. These should be deeply scrutinized. In this thesis, I focus on the protection of retail investors who continue to be in the center of attention of investment companies and therefore should be also of the regulators. First, I depict on investigating who the retail investor is in order to understand his/her needs for protection. From then on I examine the strengths and weaknesses of investor protection through the analysis of building blocks of the existing regulatory framework in the chosen legal systems.

Notwithstanding the historical differences when drafting the securities regulation in the EU, UK and US - they all share the key policy objectives.[412] These objectives have been emphasized in legislation, governmental materials as well as in academic articles. They encompass investor protection, capital formation, markets' integrity as well as fairness.[413] These policy objectives often operate in a state of symbiosis and dependency.[414] Yet when necessary, some of these objectives are emphasized more often than the other. After the recent financial crisis, which has originated in the subprime mortgage sector of the US housing market,[415] the new term often conjugated in connection with the restoration of public trust in financial markets was "**consumer protection**". The trust and reliance in the financial intermediaries as well as the governments were substantially damaged not only in the US, but also all over the world.[416] Since then, the regulators have been facing the task of rebuilding the **trust**

[412] IOSCO laid down the three main objectives: (1) Protection of investors; (2) Ensuring that market are fair, efficient and transparent and (3) Reduction of systemic risk; *see* Objectives and Principles of Securities Regulation, IOSCO (May 2003). For more on IOSCO and its regulatory philosophy, *see* Antonio Marcacci, *IOSCO and the Spreading of a US – Like Regulatory Philosophy around the World*, 25 EUR. BUS. L.REV. 759, 768-781 (2014).

[413] In case of the US, *see* Karmel, *Reconciling*, *supra* note 36.

[414] *See* JERRY W. MARKHAM & RIGERS GJYSHI, RESEARCH HANDBOOK ON SECURITIES REGULATION IN THE UNITED STATES 283 (Edward Edgar Publishing Limited, 2014). ("US federal securities regulation exists as a means of encouraging capital formation in business through the promotion of the two core values: investor protection and the maintenance of fair securities trading markets.").

[415] On the financial crisis 2007-2008 *see e.g.* ALAN S. BLINDER, AFTER THE MUSIC STOPPED: THE FINANCIAL CRISIS, THE RESPONSE AND THE WORK AHEAD (Penguin Books, 2013); HAL S. SCOTT, THE GLOBAL FINANCIAL CRISIS (Foundation Press, 2009); Donald C. Langevoort, *Global Securities Regulation After the Financial Crisi*, 13 J. INT'L ECON. L. 799 (2010) [hereinafter "Langevoort, *Global Securities Regulation*"]; John C. Coffee, Jr. *The Political Economy of Dodd-Frank: Why financial Reform Tends to Be Frustrated and Systemic Risk Perpetuated*, 97 CORNELL L. REV. 1019 (2012); Charles K. Whitehead, *Regulating for the Next Financial Crisis*, 24 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 3 (2011); Adam J. Levitin & Susan M. Watcher, *Explaining the Housing Bubble*, 100 GEO. L. J. 1177 (2012) or Charles A. E. Goodhard, *The Background to the 2007 Financial Crisis*, 4 J. INT'L ECON. & ECON. POL. 331 (2008).

[416] Journalist, economists and sociologist have observed general decline of public trust in financial markets; *See e.g*: Daniel Henninger, *In Government We Trust?* WALL ST. J., Aug. 20, 2009, at A11 or Elizabeth Warren, *Wall Street; s Race to the Bottom*, WALL ST. J., Feb. 9, 2010 at A19. Even nowadays, the trust is not fully rebuilt, *see* Diana Mackay, *Mainstream retail is damaged, but not dead,* FIN. TIMES, June 1, 2014. *See* Luigi Guiso, *A Trust-Driven Financial Crisis: Implications for the Future of Financial Markets* (EUI Working Papers ECO 2010/07). In this working paper, Luigi Guiso analyzes the disappearance of trust after the financial crisis, using the data acquired by the Northwestern University and the University of Chicago, known as Financial Trust Index Survey

and **confidence** of the investing public.[417] Both legal systems, in their launched regulatory revisions, elevated the objective of restoring the trust of investors to the position of a top priority believing that only with the increased number of retail investors and their investments can capital formation be rebooted.[418]

As observed by many, capital markets are dependent on trust.[419] Trust is essential for any well-functioning society and economy.[420] More so in case of

(FTIS). The FTIS has been carried out since 1975, and although there have been swings in numbers, it experienced its historical minimum during the Financial Crisis in 2008-2009. In the US only five percent reported having full trust in banks, brokers, mutual funds or the stock market as opposed to thirty percent before the crisis. Similar survey has been conducted after the financial crisis also in Italy or Austria, revealing similar outcomes. Even the CEO of Deutsche Bank famously declared that he no longer believed in the market's self-healing power; *see* Josef Ackermann, comments at *The Structure of Regulation; Lessons from the Crisis of 2007,* LSE Financial Markets Group and Deutsche Bank Conference (London, 3rd March 2008).

[417] Among other challenges is the reduction of systemic risk, which has been perceived as one of the central problem that was unveiled by the 2008 Financial Crisis, *see* Hal S. Scott, *The Reduction of Systemic Risk in the United States Financial System,* 33 HARV. J.L. & PUB. POL'Y 671 (2010). Systemic risk in simple terms is a domino effect of institutions' failures. A failure of one significant financial institution can cause or contribute to the failure of other and that one to another until the simultaneous failure of several major financial institutions. Causing thus a complete market failure. This occurred also during the 2008 Financial Crisis in the US.

[418] In May 2014, the European Commission adopted a Communication – A reformed financial sector for Europe. Before, in June 2010, the European Commission adopted Commission Communication – Regulating financial services for economic growth, which contains a detailed package of legislative measures for the financial services sector. On the US approach towards investor protection *see* SEC Article: *The Investor's Advocate: How the SEC Protects Investors Maintains Market Integrity and Facilitates Capital Formation, available online at*: < http://www.sec.gov/about/whatwedo.shtml#.U5r8wtyAqKs>/ *last visited* May 25, 2014. Since 2008, the US adopted two new pieces of regulation, namely the Dodd-Frank Act 2010 and the Jumpstart Our Business Startups (JOBS) Act. Among other actions, in October 2011, the leaders of G20 adopted ten High-Level Principles on Financial Consumer Protection, which was prepared by the OECD and the Financial Stability Board [hereinafter "FSB"], *available online at:* <http://www.oecd.org/daf/fin/financial-markets/48892010.pdf>/ *last visited* May 27, 2014; *see also* Bill Bradley, *Five Ways to Restore Financial Trust,* WALL ST. J., Feb. 19, 2009, at A19 ("Restoring trust in the financial system is the key to solving the current economic crisis.").

[419] Also Joseph Stiglitz, a Nobel economist, reflecting on the recent Financial Crisis stated, "financial markets hinge on trust, and that trust has eroded." *See* Joseph E. Stiglitz, *The Fruit of Hypocrisy,* GUARDIAN, Sep. 16, 2008, *available online at:* < http://www.theguardian.com/commentisfree/2008/sep/16/economics.wallstreet >/ *last visited* Jan. 2, 2015. A UCL London Professor Hosking by analyzing the history of capitalism also emphasizes trust as a necessity for a productive economy; *see* Geoffrey Hosking, *Trust and Financial Markets,* THE EUR. FIN. REV., Oct. 21, 2014, *available online at:* < http://www.europeanfinancialreview.com/?p=3523>/ *last visited* Jan. 2, 2015. *See also* Bernard S. Black, *Information Asymmetry, the Internet, and Securities Offerings,* 2 J. SMALL & EMERGING BUS. L. 91, 92-93 (1998) [hereinafter "Black, Information Asymmetry"]; Paul S. Adler, *Market, Hierarchy, and Trust: The Knowledge Economy and the Future of Capitalism,* 12 ORG. SCIENCE 215 (2001); *See* Prentice, *Whither Sec. Regulation*, at 1500-1503 (2002) [hereinafter "Prentice, *Whither Sec. Regulation*"] or Ronald J. Colombo, *The Role of Trust in Financial Regulation,* 35 VILLANOVA L. REV. 577, 598-600 (2010).

securities regulations, the presence of regulatory tools strengthening the trust is crucial. In the US, from the formation of the federal securities legislation in the 1930s until the adoption of Dodd-Frank Act 2010, it has been understood and acknowledged that the maintenance of trust - especially the trust of investors – is superior in the capital market.[421] The same understanding can be found in the EU policy statements and regulations.[422] Since the adoption of the Action Plan in 1999 regulatory framework,[423] the EU has fiercely promoted investor protection in the field of financial law.[424] Thus, in the light of the 2008 financial crisis, it is now the task of the regulators to restore trust in their capital markets and secure all investors with such conditions that would provide them with confidence to return to the markets.[425]

---

[420] As observed by Professor Barber, trust is "one essential source of social order". *See* BERNARD BARBER, THE LOGIC AND LIMITS OF TRUST 166 (Rutgers University Press, 1983).

[421] *See* Ronald J. Colombo, *Trust and the Reform of Securities Regulation,* 35 DEL. J. CORP. L. 829, 830 (2010) [hereinafter "Colombo, *Trust and the Reform*"].

[422] *See* Directive 2014/64/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU O.J. L 173/349 [hereinafter MiFID II], Article 4 of the Preamble stating "The financial crisis has exposed weaknesses in the functioning and in the transparency of financial market…[i]n order to increase transparency, better protect investors, **reinforce confidence,** address unregulated areas, and ensure that supervisors are granted adequate powers to fulfill their tasks. *See also* Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC O.J. L 173/1 [hereinafter "MAR"], Article 2 of the Preamble stating "An integrated, efficient and transparent financial market requires market integrity. The smooth functioning of securities markets and public confidence in markets are prerequisites for economic growth and wealth." *See also Commission Staff Working Document: Economic Review of the Financial Regulation Agenda,* at 138, COM (2014) 279 final (May 15, 2014); *See also* EUROPEAN CAPITAL MARKET INSTITUTE, FINAL REPORT OF THE EUROPEAN INVESTORS' WORKING GROUP: RESTORING INVESTOR CONFIDENCE IN EUROPEAN CAPITAL MARKETS (March 2010).

[423] *Financial Services: Implementing the Framework for Financial Markets: Action Plan,* at 10 (COM (1999) 232). "Regulatory and structural problems which prevent financial service suppliers and consumers from mutually benefiting in a climate of trust and legal security must be tackled head on."

[424] FINAL REPORT OF THE EUROPEAN INVESTORS' WORKING GROUP, RESTORING INVESTOR CONFIDENCE IN EUROPEAN CAPITAL MARKETS 3-4 (European Capital Markets Institute in partnership with CFA Institute Centre for Financial Market Integrity, March 2010, 2d ed.). *See also* Niamh Moloney, *Large-Scale Reform of Investor Protection Regulation: the European Union Experience,* 4 MACQUARIE J. BUS. L. 147, 155 (2007) [hereinafter "Moloney, *Large-Scale Reform*"].

[425] *See e.g.* Arlene McCarthy, *New Parliament Must 'Restore Confidence and Trust in Markets,* THE PARLIAMENT MAGAZINE, May 1, 2014, *available online at:* < https://www.theparliamentmagazine.eu/articles/news/new-parliament-must-restore-confidence-and-trust-markets>/ *last visited* Jan. 3, 2015.

Unfortunately, the EU has undertaken an inappropriate course of actions in order to achieve this goal. As is shown in this chapter, focusing on the regulation of investment companies, the EU has altered the policy in connection with securities regulation from "investor protection" to "consumer protection." One rationale for this change is the need for investors' return and reinforcement of their trust. EU citizens have been pampered with the EU protective consumer policies and by suggesting that the same policies are applicable in the case of investment companies, they might be more willing to come back and invest.

By recognizing the change of the language from "investor" to "consumer" in policy statements, legislative or scholarly materials, I realized that there is only limited legal scholarly work that would analyze and accurately define the "object" of the regulator's protection in case of investment company regulation. In other words, who is the paradigm "**retail investor**" who should be protected and what are his/her characteristics? Consequently, is there a difference between a consumer and an investor or are they ultimately the same and thus today the "retail investor" has *de facto* become a consumer?

This chapter tries to answer these questions in the following way. First, I observe and analyze the change in policy and language in both the EU and the US. I have found that in the US, there is a **distinction** between the use of consumer and investor protection policies in financial law while in the EU these two are used **incoherently**. In addition, in the UK the "consumerisation" of the financial law has been already embraced by the regulator whereas starting to cause confusion. For the time being the UK courts have not been provided with a clear-cut case where the consumerisation would be clearly visible. However, in the light of recent decisions, one might see the courts' "consumer train" coming. Thus, I focus on the policy and regulatory conversion and question the incentives behind it in the UK. At the same time I scrutinize the EU plans to softly introduce a **paradigm change** in the field of financial regulation, including the investment company regulation. By such approach, the financial services regulation might be in the near future *de facto* incorporated into the "multi-level" system of consumer protection in the EU. I argue, given the "consumerist spirit" of the EU that the main rationale of this policy shift is linked to the present need of reestablishing trust and confidence to the capital market among the general public, while not fully realizing its possible consequences.

Furthermore, before analyzing the effect of consumerisation on the regulation of investment companies, I scrutinize the two notions involved: "investor" and "consumer" and try to delineate their differences and argue that regulators should not interchange them *stricto sensu*. Subsequently, I consider also the differences between the investor and consumer policies. Once the two notions are well understood I analyze the possible repercussion of counterfeit alteration of the applied policy in case of investment company regulation, namely: legal uncertainty, policy incoherence and the possible application of EU consumer *acquis* and intrinsically the empowerment of consumer advocates. In the third subsection of this chapter, I compare the classification of investors in the US and the EU and introduce alternative approaches in order to provide a greater understanding of who a **retail investor** is and what is the relevance of investors' diverse level of experience and financial literacy for ensuring more efficient investor protection. I argue that before scrutinizing existing regulatory tools of investor protection, which the subsequent chapters carry out, regulators should understand who the prime object of the regulation is – who is the retail investor? Otherwise how are they able to understand who should they protect? Ultimately, I come to the conclusion that for providing greater investor protection, retail investors should be perceived as active capital suppliers to the market, who are able to recognize and realize their rights and duties rather then as passive consumers, who should be protected from everyone, including themselves.

2.1. Changing Policy and Narrative: From Investor to Consumer?[426]

In this section the question analyzed is whether there is a shift in the applied policy for investor protection in regulation of investment companies and if answered affirmatively what are the incentives behind. An argument can be made that different types of regulatory treatment can be suggested depending on whether the notional target of the intervention is an "investor" or a "consumer".[427] First, the US policy and regulatory language after the 2008 financial crisis is assessed and afterwards the EU is scrutinized with the aim to identify the rationales for the post-financial crisis terminology and policy modification.

2.1.1. Investment Companies Regulation in the US: Survival of "Investor"

One of the new magic formulas for regulatory remodeling after the 2008 financial crisis of the US Government was *"to protect consumers and investors from financial abuse."*[428] Journalists and academics seized this phrase and launched it in their work among the public.[429] Thus, suddenly besides the term "investor," a "consumer"

[426] Robert Cover, in his seminal article "Nomos and Narrative", explains the interconnection of narrative with the normative universe. The term "narrative" provides the background for legal rules. It represents the corner stone for any interpretation as it shows the context, in which the rules had been formed. The narrative has a strong normative role. *"In this normative world, law and narrative are inseparably related. Every prescription is insistent in its demand to be located in discourse – to be supplied with history and destiny, beginning and end, explanation and purpose." See* Robert M. Cover, *Nomos and Narrative,* 97 HARV. L. REV. 4, 5-9 (1983-1984).

[427] *See* Niamh Moloney, *The Investor Model Underlying the EU's Investor Protection Regime: Consumers or Investors?* 13 EUROP. BUS. ORG. L. REV. 169, 173 (2012) [hereinafter "Moloney, *Investor Model*"].

[428] President Obama proposed several regulatory reforms in a White Paper with the title "Financial Regulatory Reform: A New Foundation". *See* Department of the Treasury, Regulatory Reform: A New Foundation: Rebuilding Financial Supervision and Regulation 7 June 17, 2009. This White Paper among others set an objective of "protecting consumers and investors from financial abuse".

[429] *See e.g.* Arthur E. Wilmarth Jr., *The Financial Services Industry's Misguided Quest to Undermine the Consumer Financial Protection Bureau,* 31 REV. BANKING & FIN. L. 881, 881 (2011) or Adam J.

became part of the story, the story of financial law, but ultimately not of the securities regulation, at least **not** in the US.[430] The US Congress, after tensely discussing the new consumer protection aspect of the regulation,[431] adopted the Dodd-Frank Act 2010, the title of which is itself telling. The US Congress clearly emphasized the objectives of this act; first it was to **reform** the Wall Street and second to **protect consumers**, given that these two were the outcries of the public after the 2008 financial crisis.[432] President Obama, when signing the Dodd-Frank Act 2010 into a law, declared that the statute would form *"the strongest consumer financial protections in history."*[433] Following some academic suggestions,[434] the Obama administration further established the Consumer Financial Protection Bureau [hereinafter as "CFPB"].[435]

Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream,* 26 YALE J. ON REG. 143, 143 (2009). *See also* Tom Braithwaite & Kevin Sieff, *US Consumer Protection Deal Near,* FIN. TIMES, March 11, 2010 or Clive Crook, *US Financial Reform Ignores Wider Terrain,* FIN. TIMES, March 21, 2010.

[430] Contrary to the statement of Professor Coffee an Sale who refer to Consumer Protection as one of the main objectives of securities regulation, *see* COFFEE & HILLARY, *supra* note 71, 1st chapter.

[431] The most debated issue was the formation of a new agency and the distribution of authorities among the newly established agencies and the old ones. *See e.g.* Tom Braithwaite, *Dodd Proposes Consumer Role for the Fed*, FIN. TIMES, March 2, 2010 or Tom Braithwaite, *Dodd Determined to Create Consumer Bureau,* FIN. TIMES, April 21, 2010.

[432] After the financial crisis in 2008, a general opposition was formed against the governmental bailouts and generally against the functioning of the Wall Street, *e.g.* Occupy Wall Street. Number of journalists or even well known investors as Warren Buffet stated clearly that the Wall Street, as the "face" of the investment world needed to change. *See e.g.* John Cassidy, *What Good is Wall Street?* NEW YORKER, Nov. 29, 2010 or interview with Warren Buffett: Wall Street Not "Evil But Needs "Carrots" and "Sticks", *available at*: < http://www.cnbc.com/id/33412615>/ *last visited* April 12, 2013.

[433] President Barack H. Obama, Remarks on Signing the Dodd-Frank Wall Street Reform and Consumer Protection Act (July 21, 2010), *available online at:* < http://www.whitehouse.gov/the-press-office/remarks-president-signing-dodd-frank-wall-street-reform-and-consumer-protection-act>/ *last visited* May 1, 2014.

[434] From the perspective of individual investors, the closest proposal that can help rebuild trust is the creation of a consumer protection agency; *see e.g.* Oren B. Gill & Elizabeth Warren, *Making Credit Safer,* 157 U. PA. L. REV. 1, 6 (2008) or Luigi Guiso, *A Trust-Driven Financial Crisis: Implications for the Future of Financial Markets* 15 (EUI Working Papers ECO 2010/07).

[435] Title X of the Dodd-Frank Act 2010; *see* the website of the CFPB at: < http://www.consumerfinance.gov>. President Obama when establishing the CFPB, clearly stated that CFPB will operate as "*a new consumer watchdog with just one job: looking out for people – not big banks, not lenders, not investment houses –looking out for people as they interact with the financial system."* President Barack H. Obama, Remarks on Signing the Dodd-Frank Wall Street Reform and Consumer Protection Act (July 21, 2010), *available at*: <http:// www.whitehouse.gov/the-press-office/remarks-president-signingdodd-frank-wall-street-reform-and-consumer-protection-act>/ *last visited* April 15, 2013. Similarly, the Senate committee explained the mission of CFPB as to *"help*

Although the full title of Dodd-Frank Act 2010 is sensible, it is also misleading. The Dodd Frank Act 2010 is cutting through numerous areas of financial regulation of the US. Yet it does not apply the notion of "consumer" in all spheres of its scope, particularly not in the regulation of investment companies, which is mainly governed by the ICC 1940 and ICA 1940. Under Title X of the Dodd-Frank Act 2010, the CFPB has a mandate to *"regulate the offering and provision of consumer financial products or services under the Federal consumer financial laws."*[436] Under the statute, CFPB is given the authority to adopt rules implementing the federal consumer financial protection laws,[437] while the Federal Trade Commission keeps its authority to adopt rules under the Federal Trade Commission Act of 1914. They both adopt and enforce regulations prohibiting unfair or deceptive acts or practices.[438] Distinguishing this institution from others, the CFPB covers all nonbank consumer mortgage loan originators, mortgage brokers and their services as well as the mortgage loan modification and foreclosure service providers. In other words, what is crucial for this thesis is that the CFPB covers **exclusively** the mortgage and loan service providers, not the investment companies in general.[439]

Undoubtedly, the US **has acknowledged** the need to **broaden** the protection of consumers in the field of financial services, namely mortgages, credit cards, consumer loans or student loans. Nevertheless, irrespective of general outcry and terminology

protect consumers from unfair, deceptive, and abusive acts that so often than them in unaffordable financial products." *See* S. REP. NO. 111-176, at 11 (2010). In the literature, it is also referred to as Consumer Financial Protection Bureau (CFPB).

436 Sec.1011 (a) of the Dodd-Frank Act 2010.

437 Sec.1021 (a) of the Dodd-Frank Act 2010, "The Bureau shall seek to implement and, where applicable enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive."

438 *See* THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION §1.2[3][D][4], 118.160 (2014), *available at* WestlawNext [Hereinafter "HAZEN, TREATIES ON THE LAW OF SECURITIES REGULATION"].

439 For more on advantages and disadvantages of CFPB *see* Hal S. Scott, *A General Evaluation of the Dodd-Frank US Financial Reform Legislation,* 25 J. I. B. L. R. 477, 478-479 (2010).

used in newspapers and magazines, the policy shift has not taken place in the securities regulation (including the regulation of investment companies). However, it is necessary to mention that initial press reports suggested that a new US consumer protection agency would take over the regulation and oversight of mutual funds, in recognition of its importance to retail investors.[440] Yet without much of discussion, the SEC ultimately retained its authority over mutual funds. Nevertheless, the mere consideration of new regulatory agency oversight has shown that there has been a dissatisfaction of the SEC's performance.[441]

2.1.2. Consumer PreEminence in the EU: Mixed and Unclear Concepts

As in the case of the US, recognizing the loss of investor trust led the EU officials to change their policy perspectives as well.[442] Even the Internet when searching for "investment services in EU" redirects one to "consumer affairs" at the website of the European Commission.[443] Although the EU has not adopted any specific legislation, which would have directly referred to "consumer protection" in its title, it has amended the key regulation of investment companies, namely UCITS IV and MiFID.

[440] *See* Zachary A. Goldfarb *et al., U.S. May Add New Financial Watchdog,* WASH. POST, May 20, 2009, at A01.
[441] *See* Barbara Black, *Protecting the Retail Investor in an Age of Financial Uncertainty,* 35 U. DAYTON L. REV. 61, 76 (2009).
[442] Speech of European Consumer Commissioner Meglena Kuneva, April 27, 2009 on Restoring Consumer Trust in Retail Financial Services, Speech of Commissioner Barnier, July, 12, 2010 on Commission Proposes Package to Boost Consumer Protection and Confidence in Financial Services. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Reformed Financial Sector for Europe 3 (May 15, 2014) ("Enhancing transparency, responsibility and consumer protection to secure market integrity and restore consumer confidence").
[443] *Available online:* < http://ec.europa.eu/consumers/archive/rights/fin_serv_en.htm >/ *last visited* Nov. 10, 2014. In addition also a financial reporter noticed a language dilemma, *see* Phil Davis, *Protecting Investors Proves Tricky,* FIN. TIMES, March 20, 2001.

After the financial crisis, MiFID II[444] together with MiFIR and UCITS V[445] were adopted, but are not yet enforceable.[446]

Notwithstanding that MiFID II, besides referring to investor and consumer, uses a third term – "client", MiFID II and MiFIR indicate directly in their preambles "consumer protection" aspiration. In the preamble of MiFID II, it is stated, *"to further protect consumers, it is also appropriate to ensure that investment firms do not remunerate or assess the performance of their own staff in a way that conflicts with the firm's duty to act in the best interests of their clients…"*[447] Moreover, the MiFID II clearly states its objective to protect consumer by: *"This Directive respects the fundamental rights and observes the principles recognized in the Charter, in particular the right to the protection of personal data, the freedom to conduct business, the right to consumer protection…"*[448] There are further passages in both acts, where the drafter adopted the word "consumer", together with "client" and "investor"[449] as does the new UCITS V.[450]

ESMA Regulation also stipulates both consumer and investor protection objective. While it is the task of the ESMA to "*foster investor protection*,"[451] ESMA has powers to *"develop common methodologies for assessing the effect of product characteristics and distribution processes on the financial position of financial*

---

[444] They were adopted on June 12, 2014.
[445] On July 23, 2014 the EU adopted UCITS V.
[446] Member States are expected to transpose MiFID II by July 3, 2016 and UCITS V by Mar. 18, 2016. MiFIR will apply from Jan. 3, 2017.
[447] Para. 77 Preamble MiFID II.
[448] Para. 166 Preamble MiFID II.
[449] *E.g.* Para. 156 Preamble MiFID II or para. 50 Preamble MiFIR.
[450] *E.g.* Article 107 (3) UCITS V. Reflecting on consumer protection agencies for UCITS investors, the UCITS states that "Member States shall provide that one or more of the following bodies, as determined by national law, may, in the interests of consumers and in accordance with national law, take action before the courts or competent administrative bodies to ensure that the national provisions for the implementation of this Directive are applied: (a) public bodies or their representatives; (b) consumer organizations having a legitimate interest in protecting consumers; or (c) professional organizations having a legitimate interest in protecting their members."
[451] Article 8(1)(h) ESMA Regulation.

market participants and on consumer protection."[452] Further, ESMA Regulation lays down specific tasks related to consumer protection and financial activities.[453] Dismantling the sequence of these sections, one may come to a conclusion that consumer protection forms a part of the greater investor protection. This could subsequently mean that a consumer is one type of investor, which until now was commonly referred to as "retail investor". Yet on its website ESMA refers to retail investors instead of consumers.[454] This again shows confusion between the applied legal terminology as well as between regulation and its application. Moreover, there have been also several institutional changes on the EU level. The Commission's Internal Market Directorate General is currently responsible for all financial services regulation. However, the Directorate General Consumer Protection and Health has recently brought the household investment markets into its domains.

In conclusion, not only policy speeches and materials, but also diverse EU legislation refers directly to "consumer protection" besides emphasizing "investor protection."[455] However, what is it that the regulators wish to confer with their unclear statements? Does this mean that consumer protection is different than investor protection in the financial services setting, including investment company regulation? Or does consumer protection encompass greater protection than does the investor protection or does it form a substantial part therefrom? Neither the legislative materials, nor any secondary text clarifies this differentiation in their text. Of course,

[452] Article 8(2)(i) ESMA Regulation.
[453] Article 9 ESMA Regulation. Among some is collecting, analyzing and reporting on consumer trends, but also contributing to the development of common disclosure rules.
[454] *Available online at:* <http://www.esma.europa.eu/page/Retail-investor-information>/ *last visited* Jan. 2, 2015.
[455] In the EU, the laws liberalizing securities trading while tightening investor protection have been adopted since 1990's, first in the field of corporate law, and only later in the field of capital markets law. On general overview *see* INVESTOR PROTECTION IN EUROPE: CORPORATE LAW MAKING, THE MIFID & BEYOND 70-75 & 164-165 (Guido Ferrarini & Eddy Wymeersch eds., 2006), [hereinafter "INVESTOR PROTECTION IN EUROPE: CORPORATE LAW MAKING, THE MIFID & BEYOND"].

in the EU regulatory policies it is difficult to assign clear regulatory models and objectives, given the complex array of institutional, political and market dynamics that shape them.[456] Yet the referral to consumer policy in connection with the regulation of investment companies indicates either a more interventionist and paternalistic approach or a possible future application of EU consumer law on investment companies. However, in order to see the application of the EU measures in practice, the UK case becomes relevant.

2.1.3. Investor Became Consumer in the UK

The direct impact of the consumer-driven regulatory atmosphere is visible in the UK financial regulation.[457] Already in 2000 has consumer been brought in the financial regulation with the extensive regulatory revision, as the FSMA 2000 was adopted. The FSMA 2000 identified four regulatory objectives,[458] out of which one was "the protection of consumers."[459] After the financial crisis with the adoption of the Financial Services Act 2012,[460] which amended the FSMA 2000, Bank of England Act 1998 and the Banking Act 2009, the protection of consumers was repeatedly emphasized. The UK FSA 2012 unfolds around consumer protection, laying down three main operational objectives of the UK Financial Conduct Authority [hereinafter

---

[456] *See* STEPHEN WEATHERILL, EU CONSUMER LAW AND POLICY 85 (Elgar European Law, 2005) [hereinafter "WEATHERILL, EU CONSUMER LAW AND POLICY"].
[457] *See* JOANNA BENJAMIN, FINANCIAL LAW 571 (Oxford University Press, 2007) [hereinafter "BENJAMIN, FINANCIAL LAW"].
[458] Formerly, the objectives were enumerated under Part 1, s.3-6 of the FSMA 2000, including (1) Market confidence, (2) Public awareness, (3) The protection of consumers and (4) The reduction of financial crime. After the financial crises a fifth regulatory objective was inserted – (3a) Financial stability.
[459] Section 5 FSMA 2000, which states the following: "*(1) The protection of consumers objective is: securing the appropriate degree of protection for consumers.(2) In considering what degree of protection may be appropriate, the Authority must have regard to—(a) the differing degrees of risk involved in different kinds of investment or other transaction; (b) the differing degrees of experience and expertise that different consumers may have in relation to different kinds of regulated activity; (ba) any information which the consumer financial education body has provided to the Authority in the exercise of the consumer financial education function;] (c) the needs that consumers may have for advice and accurate information; and (d) the general principle that consumers should take responsibility for their decisions.*"
[460] Financial Services Act 2010 [hereinafter "UK FSA 2012"].

"FCA"],[461] which are (1) consumer protection objective, (2) integrity objective, and (3) competition objective.[462] Contrary to the ESMA, the FCA directly on its website uses the term "consumer" instead of "investor," thus it is the FCA that protects "consumers" when investing in investment companies.

Furthermore, in 2001 the FSMA 2000 established the Financial Ombudsman Scheme [hereinafter "FOS"] and the Financial Services Compensation Scheme [hereinafter "FSCS"]. Under the FSO, the Ombudsman has the power to determine complaints *"… by reference to what is, in the opinion of the ombudsman fair and reasonable in all the circumstances of the case*."[463] The role of the FOS, as an alternative to the civil courts, is to quickly resolve disputes on the basis of what is fair and reasonable under the circumstances with minimum formality.[464] As one may recall, the concept of ombudsman has been broadly applied in the EU Member States in order to safeguard consumer protection. The original – Swedish concept – refers to a guardian of the people's rights against abuses and malfunctions by government.[465] On the other hand, in connection with the FSCS,[466] the FCA is supposed to *"[b]y rules establish a scheme for compensating persons in cases where relevant persons*

[461] FCA substituted in April 2013 the Financial Services Authority [hereinafter "FSA"], which was formerly known as the quasi-judicial authority responsible for the regulation of the financial services industry in the UK. The FSA responsibilities were split between two new agencies, FCA and the Bank of England. The Bank of England has macro-prudential responsibility for oversight of the financial system, while the day-to-day supervision is divided among three bodies, the Financial Policy Committee, the Prudential Regulatory Authority and the FCA. Under 1F UK FSA 2012, the FCA is overseeing "strategic markets", which are defined as the financial markets (although not defined in the UK FSA 2012), markets for regulated financial services (1H(2)) and the markets for services that are provided by unauthorized persons in carrying on regulated activities without contravening the general prohibition.

[462] Chapter 1, 1B(3) UK FSA 2012.

[463] FSMA 2000, Part XVI, sec 228 (1).

[464] Memorandum of Understanding between the Financial Services Authority and the Financial Ombudsman Services 1 (2013) *available online at:* <http://www.financial-ombudsman.org.uk/about/MOU_with_FCA-APRIL2013.pdf >/ *last visited* Jan. 7, 2015.

[465] Translation from Swedish means "representative". For more on the development of the concept *see* Benny L. Kass, *We Can, Indeed, Fight City Hall: The Office and Concept of Ombudsman,* 53 A.B.A. J. 231 (1967).

[466] FSMA 2000, Part XV, the Financial Services Compensation Scheme.

are unable, or are likely to be unable, to satisfy claims against them.'[467] This set of rules is included within the FCA Handbook as Compensation (COMP) Sourcebook.[468] The relevance of FSCA for consumers is that in case an authorized firm goes insolvent, consumers are able to claim compensation through FSCS.[469] In case they invest with an authorized investment company, consumers are able to claim maximum £50,000. However, consumers (investors) are naturally not protected against a poor investment decision. Thus, in the light of the above stated, where consumers (investors) are simultaneously protected by an ombudsman and a compensation scheme, it seems that the investors have already become consumers. However, what are the effects of this change besides the additional layer of protection? Before laying down the consequences for the consumers (investors) of this change, I expand on the rationales that have let or might have let the UK and EU to this situation in the light of the changing narrative of the investment company law as one should always perceive the regulatory changes closely in the light of the economic and societal ones.

2.1.4. Putting the Shift in Context: First Changing the Narrative

The law of investment companies has evolved greatly in the last twenty-thirty years. In the 1990s, the computerization and globalization of the world markets brought new

467 FSMA 2000, Part XV, sec. 213(1).

468 The FCA Handbook sets ot the FCA's regulatory and other provisions made under powers given to the FCA under sec. 138G FSMA 2000*;* The Handbook is *available online at:* <http://fshandbook.info/FS/html/handbook/COMP>/ *last visited* Feb. 20, 2015.

469 COMP 5.5. states that *"Protected investment business is (1)designated investment business carried on by the relevant person with, or for the benefit of, the claimant (so long as the claimant has a claim), or as agent on the claimant's behalf; (2) the activities of the manager or trustees of an AUT, provided that the claim is made by a holder; (3) the activities of the ACD or depositary of an ICVC, provided that the claim is made by a holder; (4) the activities of the authorized contractual scheme manager or depositary of an ACS, provided that the claim is made by a holder; provided that the territorial scope condition in COMP 5.2.2.R is satisfied and, for a firm acting as the manager or depositary of a fund, one of the conditions in COMP 5.5.3. is satisfied."*

regulatory challenges.[470] The number of retail investors, who became interested in investing in investment companies, has radically grown.[471] All the markets were going up and everyone wanted to be part of this success. Yet the 2008 financial crisis hit and as everyone who wished before to have their share on success, had to face their share on losses.[472] With the decline of stock prices, declined also the trust of investors.[473] Since then regulators have been confronted not only to patch the holes in the regulation but also to rebuild the trust.

Yet what do we know about trust and how can a regulator rebuild it? Scholars define this term in different ways. Tamar Frankel defines it as *"believing that others tell the truth and will keep their promises."*[474] Lynn Stout and Margaret Blair provide more detailed definition of trust as *"a willingness to make oneself vulnerable to another, based on the belief that the trusted person will choose not to exploit one's vulnerability."*[475] It is exactly the "vulnerability", which is perceived as a character of one of the parties – the one who trusts. In this case it is the investor. On the other hand as Hill and O'Hara depict, trust is also predictive, it reflects a rational assessment that

---

[470] New actors and financial products, which were unknown to markets and regulators, have formed and evolved, including hedge funds, alternative trading systems or complex derivatives and securitization products. *See* Stijn Claessens, *Current Challenges in Financial Regulation* 4-7 (World Bank, Working Papers, 2007).

[471] The participation of non-institutional investors is analyzed and discussed in economic literature, *e.g.* John Y. Campbell, *Household Finance,* 4 J. FIN. 1553 (2006) or Alessandro Bucciol & Raffaele Miniaci, *Household Portfolio Risk,* REV. FIN. (2014) (to be published) (authors analyze household portfolio risk using the data of the US Survey of Consumer Finances form 1998 to 2010).

[472] *"If prices go down, we will have problems – problems in the sense of spillover to other areas. While I haven't seen such spreading yet, I expect to."* Former FED Chairman, Alan Greenspan, in his speech, March 2007, as reported by Bloomberg.com. For data on economic consequences of Credit Crunch, *see* Bulent Gokay, *The 2008 World Economic Crisis: Global Shifts and Faultlines, available online at:* <http://www.globalresearch.ca/the-2008-world-economic-crisis-global-shifts-and-faultlines/12283>/ *last visited* May 28, 2014 or Andrew K. Rose & Mark M. Spiegel, *Cross-Country Causes and Consequences of the 2008 Crisis: Early Warning* (Federal Reserve Bank of San Francisco, Working Paper, July 2009). Generally on the regulatory responses to the 2008 Credit Crunch, *see* FERRAN ET AL, *supra* note 6.

[473] *See* the development of "The TRust Index", *available online at:* < http://thomsonreuters.com/site/trust/>/ *last visited* Jan. 5, 2015.

[474] *See* TAMAR FRANKEL, TRUST AND HONESTY: AMERICA'S BUSINESS CULTURE AT A CROSSROAD 49 (Oxford University Press, 2008).

[475] *See* Margaret M. Blair & Lynn Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law,* 149 U. PA. L. REV. 1735, 1739-1740 (2001).

the person in whom trust is placed *"will behave in a way that is not harmful regardless of his character type."*[476] This trust was completely shattered after the events in 2008.

Accordingly, comes the task for a regulator to restore trust in capital markets as the trust in investment companies directly arises from it.[477] In the light of the above stated definitions of trust, the question is how to persuade the investors to expose themselves (again)?[478] The answer is to reduce investors' vulnerability through adjusted or novel regulatory tools by reflecting on the flaws of the former – a "better regulation."[479] After the 2008 financial crisis regulators in order to rebuild and strengthen the trust had to employ **additional regulatory measures**,[480] more visible ones. A stimulus that the majority of investors could perceive – an introduction of a consumerist narrative.

In the EU and the US there has been an alteration in the language how regulators begun to communicate with the investors. Government officials started to refer repeatedly to a term, which although used before, became the **key term** for the

---

[476] *See* Claire A. Hill & Erin Ann O'Hara, *A Cognitive Theory of Trust,* 84 WASH. U. L. R. 1717, 1725 (2006).
[477] *See* Colombo, *Trust and the Reform*, *supra* note 421, at 849; Professor Colombo in his article goes deeper in the psychology of trust, recognizing diverse types of trusts, as "affective trust" and "cognitive trust". He emphasizes that one of the principal tasks of the policymakers is to carefully assess the nature of the specific trust relationship, which they wish to strengthen.
[478] The European Capital Markets Institute [hereinafter "ECMI"] laid down six objectives which should be pursued by the EU institutions in order to restore investors' confidence, namely: (1) investor protection; (2) better transparency; (3) market integrity; (4) market efficiency; (5) quality of supervision; and (6) competitiveness of EU markets. *See Restoring Investor Confidence in European Capital Markets* 4 (European Investors' Working Group, March 2010).
[479] EU bodies have the tendencies to call for "better regulation". *See e.g. A Comprehensive EU Responses to the Financial Crisis: Substantial Progress Towards a Strong Financial Framework for Europe and a Banking Union for the Eurozone* (European Commission, Memo, 17 Dec. 2013); *See also* HOWARD DAVIES & DAVID GREEN, GLOBAL FINANCIAL REGULATION: THE ESSENTIAL GUIDE 30-31 (Polity Press, 2008). On regulatory tools applied in the field of financial law *see* Niamh Moloney, *Financial Services and Markets in* THE OXFORD HANDBOOK OF REGULATION 437, 437-455 (Robert Baldwin et al. eds., 2010).
[480] For a greater detail on the undertaken regulatory measures in the EU and US, *see generally* FERRAN ET AL, *supra* note 6.

retail investment industry –"consumer". [481] By constantly referring to the consumer in speeches, in policy writings and in regulation consumer has become part of the post-crisis story – part of a (possibly) new narrative for the financial law.

Legal narrative is a complex mosaic. Part of it is formed by a legal tradition, which includes not only legal rules, but also language and "mythos", as Professor Cover calls it.[482] These myths are the narratives, in which the legal rules are located and thus they establish a paradigm for behavior.[483] In addition to legal tradition that determines the narrative, it is also the case law, where a reference is made to the narratives in course of legal reasoning. In the EU context, narrative can be also found in recitals to EU legislation. Moreover, narrative also appears in industry documentation and in explanatory reports to legislative acts, where the purpose and expected impact of legal rules are explained. "Consumer" started to appear in many of these as well.

Some may argue that looking for a specific word as "consumer" appears to be nitpicking and that my interpretation may not be justified in the light of the intentionalist or the textualist interpretation.[484] In addition, some may claim that there is no support in court decisions that would suggest this change and court's reading of the regulatory text in the consumerist narrative. Alternatively some could argue that the consumerist approach towards investor protection has been long present in EU

[481] In number of speeches, during public events, the high rank officials referred to protection of consumers. Among many *see* Speech of Ben S. Bernanke, April 17, 2009 on Financial Innovation and Consumer Protection, Speech of Attorney General Eric Holder at the Financial Fraud Enforcement Task Force Press Conference, November 17, 2009 (… [w]e will promote the integrity of our markets preserve taxpayers' resources, and protect the vast majority of consumers, investors, and companies that play by the rules and adhere to the law).
[482] *See* Robert M. Cover, *Nomos and Narrative,* 97 HARV. L. REV. 4 (1983-1984).
[483] *Id.* at 9.
[484] On textualism, *see* Caleb Nelson, *What Is Textualism?,* 91 VA. L. REV. 347, (2005), *see generally* John F. Manning, *Textualism as Nondelegation Doctrine*, 97 COLUM. L. REV. 673 (1997).

law as the previous MiFID I and UCITS IV also referred to consumer in their text in connection with administrative sanctions and consumer disputes.[485]

Concerning the first two objections, in the above stated text different examples were provided which when combined, display a certain picture, picture of change in narrative. The regulators by changing the policy objective of the financial regulation from investor to consumer clearly proclaim a change. However, they proclaim this change without clearly stating the essence of it, which leaves the market participant uncertain. The UK's full shift to "consumer protection" instead of "investor protection" also shows the change in the approach. Although, it may take some time for judiciary to reflect on the investor *v.* consumer issue, both at national and at EU-level, one should not disregard the changes in the regulators' policies. In connection with the third objection, there have been some signs of introducing the consumerist narrative in the EU and UK even before the 2008 financial crisis. Several academics have also recognized this trend.[486] Professor Joanna Benjamin observed the consumerist narrative in the general EU financial law when analyzing diverse narratives in the UK financial law.[487] She stated that the consumerist narrative in

---

[485] *See* Articles 51-53 MiFID and Articles 100 & 107 UCITS IV.

[486] The term "investor-consumer" can be found in number of academic articles, *see e.g.* Moloney, *The Investor Model, supra* note 427; Emilios Avgouleas, *The Harmonisation of Rules of Conduct in EU Financial Markets: Economic Analysis, Subsidiarity and Investor Protection,* 6 EUR. L.J. 72, 78 (2000); John Armour, *Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origins Hypothesis* (ECGI Working Paper Series in Law, Working Paper 108/2008, May 2008); Olha O. Cherednychenko, *The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights,* 33 J. CONSUM. POLICY 403, 404 & 408 (2010) (referring to the retail investor as consumer in connection with investment services); MOLONEY, HOW TO PROTECT INVESTORS, *supra* note 30, at 39-41.

[487] *See* BENJAMIN, FINANCIAL LAW *supra* note 457, chapter 27 (She devoted to this issue one chapter in her Financial Law Book already in 2007) and Joanna Benjamin, *The Narratives of Financial Law,* 30 OXFORD J. LEG. STUD. 787, 799-800 (2010) [hereinafter "Benjamin, *Narratives*"] (in her article, Professor Benjamin analyzes three sources of narrative in financial law in the UK, namely the arm's-length narrative, fiduciary narrative and consumerist narrative. The source of the consumerist narrative in the UK she finds in the European legislation).

financial law is against the other two narratives, the arm's-length[488] and fiduciary narrative,[489] present in general financial law, given that they reflect on different social values and have diverse regulatory ambitions.[490] Although she claims that the consumer-protection objective does not necessarily establish the protection under general consumer law, but rather the "appropriate degree" of protection,[491] I argue in the following parts of this chapter that this might ultimately change. Furthermore, Professor Moloney also analyzed in her article the emergence of the consumer protection policy in the EU financial regulation after 2008.[492] Although in 1972 the European Community has introduced the expansion of – at that time European Community's – consumer protection policy during the EC summit in Paris,[493] she observes that it was **only a reaction** to the 2008 financial crisis to encompass also the financial regulation **under** the EU consumer protection.[494] Moreover, with the transfer of the regulatory competence from Member States to EU, the change of the object of protection took place. According to Professor Moloney, the post-crisis EU protection policy focuses on consumer instead of a "retail investor".[495]

In order to shed additional light on this policy change and answer whether investor policy could be substituted by consumer policy, I analyze the two key notions: investor and consumer in the following part. I compare these two concepts

[488] It is the dominant narrative in financial law based on the laws of supply and demand, stemming out of the classical theory of contract law in the mid-19th century, emphasizing the freedom and sanctity of contract. *Id.* at 792-96.
[489] The fiduciary narrative, which is contrary to the arm's length, given that it is based on the altruism, which is fundamentally at odds with the commercial side of financial law, found its way into the financial law through representation. Given that the structure of financial market facilitates representation by intermediaries, who enter into dealings instead of their clients, the law recognizes their fiduciary obligation. *Id.* at 797.
[490] *Id.* at 806.
[491] Professor Joanna Benjamin uses the FSMA 2000 as an example, where a consumer protection objective is stated in the section 5 of the act. *Id.*
[492] *See* Moloney, *Investor Model*, *supra* note 427, at 171.
[493] *See* A CASEBOOK ON EUROPEAN CONSUMER LAW 7 (Reiner Schulze *et al.* eds., 2002).
[494] *See* Moloney, *Investor Model*, *supra* note 427, at 172.
[495] *Id*.

and elaborate whether their standing under regulation and their "behavior" on the market is similar or different, and therefore whether their respective protection policies share the object of the protection and could be considered identical or not.

2.2. Investor v. Consumer

It is demanding to identify the "paradigm" individual who invests in investment companies. The debate on the appropriate definition is not a new one, yet both academics and regulators have failed to come forward with a single commonly accepted definition of an investor. Instead, they continue to rely purely on an ordinary understanding of this term.[496] One of the reasons, why it is difficult to define the term "investor" is that it is used in numerous spheres of law besides the financial law, including international investment law, environmental law or real estate law, and therefore it is a very inclusive term.

Before analyzing the three legal systems and their respective regulatory definitions, I consider the two definitions of Black's Law Dictionary, which state that an "**investor**" is *"(1) [a] buyer of a security or other property who seeks to profit from it without exhausting the principal, [and] (2) [b]roadly a person who spends money with an expectation of earning a profit."*[497] The first description provides a thin concept and the second one a thick one, including natural and legal persons. Based on the Black's definition, the main feature of an investor is "expectation of earning a profit", when purchasing a security or other property. Yet this is a very general description. Thus, some try to narrow down the concept by using adjectives, as "retail" or "institutional", given that they realize that there is more than one type of investor. However, how and based on what should a regulator differentiate between

[496] *See* Black, *Involving Consumers on Securities Regulation*, *supra* note 29.
[497] BLACK'S LAW DICTIONARY (9th ed. 2009).

diverse types of investors; should it be age, wealth, knowledge or experience? How should a regulator specify the classification requirements in order to establish an efficient investor protection regime?[498]

On the other hand, the term "**consumer**" is more specific. The Black's Law Dictionary defines "consumer", as *"A person who buys goods or services for personal, family, or household use, with no intention of resale; a natural person who uses products for personal rather than business purposes."*[499] A consumer purchases goods or services with no intention of resale and is always a natural person.

Comparing these two terms, in the light of the Black's Law Dictionary definitions, investor may be both a legal and natural person, who is acquiring a financial instrument with an intention. Investor when buying a financial instrument or other property expects earning a **profit**, while consumer's primary intention lies in the **utilization** of the bought product or service. There is overlap between these two notions, as a financial instrument could be perceived as a product usable for personal purpose. It is a matter of interpretation, how one construes these two notions and whether financial services become a product in a sense of consumer law. As stated previously, in the light of the changed narrative, such interpretation might be approaching, but is deficient.

As analyzed in the previous subchapters,[500] in connection with the regulation of investment services in the EU and UK, including the investment companies, there has been a shift in the approach and an ordinary individual who invests in investment companies became a consumer. Therefore, this part is devoted to the analysis of the notion of "investor" and "consumer" in EU, US and UK. To show the differences in

---

[498] *See* section 2.3.
[499] BLACK'S LAW DICTIONARY (9th ed. 2009).
[500] *See* sections 2.1.2. & 2.1.3.

these two notions, not only regulatory or court interpretations of these terms are employed, but if available, also the outcomes of behavioral research, which explores the cognitive processes of investors and consumers, are applied.

2.2.1. Diverse Notions

Given the different understanding of the notions of consumer and investor in the three legal systems, the analysis will be carried out separately for each of them.

2.2.1.1. US

The securities regulation in the US provides no definition of "investor".[501] The only definition provided in the SA 1933 is about a specific type of investor – the "**accredited investor**".[502] The concept of "accredited investor" was injected into the SA 1933 in 1980 in connection with private placement of securities of small businesses.[503] Since the recent regulatory changes, the SEC began a comprehensive review of the definition of accredited investor.[504] The examination of development of this term is provided in a following subsection.

---

[501] Here the author refers to the SA 1933, SEA 1934, ICA 1940, IAA 1940, Securities Investor Protection Act of 1970, Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 or Jumpstart Our Business Startups Act of 2012.

[502] Under the SA 1933 an "accredited investor" is (i) a bank as defined in section 3(a)(2) whether acting in its individual or fiduciary capacity; an insurance company as defined in paragraph (13) of this subsection; an investment company registered under the Investment Company Act of 1940 or a business development company as defined in section 2(a)(48) of that Act; a Small Business Investment Company licensed by the Small Business Administration; or an employee benefit plan, including an individual retirement account, which is subject to the provisions of the Employee Retirement Income Security Act of 1974, if the investment decision is made by a plan fiduciary, as defined in section 3(21) of such Act, which is either a bank, insurance company, or registered investment adviser; or (ii) any person who, on the basis of such factors as financial sophistication, net worth, knowledge, and experience in financial matters, or amount of assets under management qualifies as an accredited investor under rules and regulations which the Commission shall prescribe.

[503] The stated purpose was *"Congressional concern that small businesses should have an adequate market to raise capital and that investors should not be unnecessarily impeded from purchasing securities of small businesses." See* S. REP. NO. 96-958, at 45 (1980); *See also* Theodore Parnall, Bruce R. Kohl & Curtis W. Huff, *Private and Limited Offerings After a Decade of Experimentation: The Evolution of Regulation D,* 12 N. M. L. REV. 633, 670 (1982).

[504] *See e.g.* Larissa Lee, *The Ban Has Lifted: Now Is the Time to Change the Accredited-Investor Standard,* 214 UTAH L. REV. 369 (2012); *See also* Jim Hamilton, *White Details Scope of Staff Study of Accredited Investors Definition,* SEC TODAY, Nov. 29, 2013.

Given that no general definition of investor can be found, not even in the case law,[505] shows that from the perspective of US regulator there is **no need** for such definition as everyone using the services of investment companies is deemed to be an investor, unless he or she is an accredited one. This rationale is also supported by and argument that the US securities regulation unfolds around the **object** of the relationship between parties – security – disregarding the nature of the parties.[506] This however shows that in the US the character of parties, whether they are or are not consumers in connection with the securities regulation has been perceived as completely irrelevant.

However, to certain extent this approach has changed. As stated previously, the Dodd Frank Act 2010 adopted consumer-driven policies in connection to consumer credit and begun to take into consideration the nature of the involved parties – consumers. It is necessary to emphasize that this shift only took place regarding the consumer credit, such as consumer mortgage, lending or leasing contracts. For these types of contracts, excluding the SA 1933 or ICA 1940 or IAA 1940, the Dodd Frank Act 2010 defines the term consumer as, *"an individual or an agent, trustee, or representative acting on behalf of an individual."*[507] Thus, where the nature of the parties is perceived essential, the US regulator does specify their character. Yet in case of the US securities law, which is deemed to revolve around investor protection,[508] the definition of an "investor" has not been recognized important.

[505] Concerning the case law, either the courts deemed helpful or necessary to specify who is an investor. The only line, in which the courts decided was to differentiate between the public and private offering as it was the condition for registration SEC v. Ralston Purina Co., 346 U.S. 119 (1953) where the US Supreme Court found that the private offering exemption was badly defined in the Act and attempted to clarify its scope.
[506] Under the Howey test, not only a security, as defined by the SA 1933, is regarded as a security, but also investment contracts are. *See* SEC v. W. J. Howey, Co., 328 U.S. 293 (1946).
[507] Sec. 1002(4) of Dodd-Frank Act 2010 (2014).
[508] On the centrality of investor protection in securities regulation in the US *see generally* Stephen Choi, *Regulating Investor Not Issuers: A Market-Based Proposal,* 88 CAL. L. REV. 279, 280 (2000)

2.2.1.2. EU

On the EU-level the situation does not differ and the EU does not incorporate any definition into its regulation.[509] Along with mixing the terms investor, client and consumer, the EU has recently used in addition the notion of the "mass affluent"[510] to assess the cost and benefit of the MiFID investor protection reforms.[511] This again shows that the EU mingles the key terminology causing confusion for the market participants and therefore legal uncertainty. The difficulty of providing classification of different types of investors in the EU, due to the wide and continuing diversity in investment patterns of investors in the Member States,[512] does not justify the terminological confusion and the EU's inability to coherently apply one set of terminology.

On the other hand, the EU faces also a number of challenges with defining "consumer" even in the context of consumer law. Until recently, there were different notions of "consumer" among Member States and within the EU consumer *acquis*.[513] However, as of June 13, 2014 the new umbrella Directive on Consumer Rights replaced number of other consumer directives. The Directive on Consumer Rights applies to any contract concluded between trader[514] and consumer, while also applying to contracts for the supply of water, gas, electricity or district heating,

[hereinafter "Choi, *Regulating Investors Not Issuers*"]; Michaler D. Guttentag, *Protection form What? Investor Protection and the JOBS Act*, 13 U.C. DAVIS BUS. L.J. 207, 212-218 (2013) (analyzing the securities laws, court decision and commentary on Federal Securities Regulation) or Elizabeth Pollman, *Information Issues on Wall Street 2.0*, 161 U. PA. L. REV. 179, 221-26 (2012).

[509] None of the key securities directives or regulations provides a definition of "investor" or "client", as in MiFID II, the regulators refer more often to "client" as to "investor".

[510] Mass affluent is a group of individuals with liquid assets of around $100,000 to $1,000,000.

[511] *See* Commission Staff Working Paper, Impact Assessment of MiFID II, Oct. 20, 2011.

[512] As shown by the BME Consulting, *The EU Market for Consumer Long-Term Retail Savings Vehicles. Comparative Analysis of Products, Market Structure, Cost, Distribution Systems, and Consumer Savings Patterns* 15 (2007).

[513] *See* CASES, MATERIALS AND TEXT ON CONSUMER LAW 29 (Hans W. Micklitz *et al.* eds., 2010).

[514] Again a new term: "Trader" means "any natural person or any legal person, irrespective of whether privately or publicly owned, who is acting, including through any other person acting in his name or on his behalf, for purposes relating to his trade, business, craft or profession in relation to contracts covered by this Directive." *See* Article 2(2) of Directive on Consumer Rights.

including by public providers.[515] Thus, the new EU Directive on Consumer Rights defines consumer by using two methods: (1) defining a "consumer" and (2) defining also those transactions, where the weaker party is deemed to be a consumer.

Furthermore, the subject matter of the Directive on Consumer Rights is broad and it *"aims to contribute to the proper functioning of the internal market by approximating certain aspects of the laws, regulations and administrative provisions of the Member States concerning contract concluded between consumers and traders."*[516] However, realizing the overlap between other areas of the EU law, the Directive on Consumer Rights expressly states that it should **not apply** to several areas, **including** the contracts for financial services.[517] So, why does the EU continue to use the term "consumer" in connection with financial services – even in the recently adopted directives and regulations? Why doesn't the EU clearly differentiate the terminology between consumer and investor in order to reduce the possible space for misinterpretation and mistake by Member States or by public? One of the possible explanations is the influence of the UK over the EU financial regulation.

2.2.1.3. UK

In London as the financial center of the EU,[518] both the government and the FCA also fail to provide a definition of "investor"[519] as the **shift** to "consumer" took place with the adoption of the UK FSMA in 2000, when the UK fully replaced the term

[515] Article 3 Directive on Consumer Rights. Under this directive, consumer means *"any natural person who, in contracts covered by the directive, is acting for purposes which are outside his trade, business, craft or profession." See* Article 2(1) Directive on Consumer Rights.
[516] Article 1 Directive on Consumer Rights.
[517] Article 3(3)(d) Directive on Consumer Rights.
[518] According to the UK HM Treasury, the Investment Management Industry is a key part o the UK's financial sector, and of 2013 they were managing £4.9 trillion of funds and earning and £12 billion a year for the UK, *see* HM Treasury, *The UK Investment Management Strategy* 5, *available online at:* < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/258952/uk_investment_management_strategy_amended.pdf>/ *last visited* June 15, 2014.
[519] There is no definition of "investor" in the FSMA 2000, in the Open-Ended Investment Companies Regulations 2001 No. 1228.

"investor" with "consumer". Under the UK FSMA 2000, the notion of "consumer" was expanded and includes a broad spectrum of people who fall under the definition means a person who (a) uses, have used or may use regulated financial services or services that are provided by persons other than authorized persons but are provided in carrying on regulated activities, (b) has relevant rights or interests in relation to any of those services, (c) has invested, or may invest, in financial instruments, or (d) has relevant rights or interests in relation to financial instruments.[520] This definition includes both natural and legal persons, while the definition under the Directive on Consumer Rights, refers to a consumer who is **only** a natural person. Thus, the UK has opted for a broader reach of the otherwise protective regulation.

More importantly, the new umbrella Directive on Consumer Rights expressly states that it should **not be applied** to financial services contracts – irrespective whether concluded with a natural or legal person.[521] The UK transposing bill - the Act 2013 No 3134 on Consumer Protection - complies with the Directive and explicitly excludes contracts "for services of a banking, credit, insurance, personal pension, investment or payment nature" from its application.[522] Accordingly, the general consumer protection law should not be applicable in case of those who invest in investment companies. Despite this clear exclusion, regulators continue to refer to investors as to "consumers." Thus, the question is whether the courts could hypothetically expand on the application of the general consumer law in the UK?

[520] *See* Chapter 1, 1C (3) UK FSMA 2000.
[521] Article 3(3)(d) of Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on Consumer Rights, Amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and Repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council O.J. L 304/64 [hereinafter "Directive on Consumer Rights"].
[522] Section 6 2013 No. 3134 Consumer Protection.

The general consumer momentum in England in connection with building laws came in late 1980's and the beginning of 1990's.[523] In English case *Murphy v. Brentwood District Council,*[524] the House of Lords dealt with the notion of "consumer protection". Even though the House of Lords dismissed the case, it emphasized the **connection between consumer protection law and the social need** as the foundation for **expanded** protection of individuals.[525] In other words, according to the House of Lords additional regulatory protection for individuals is necessary when there is a necessity for the protection of **basic social needs**.[526] In the case at hand, the basic social need was housing. However, (theoretically) once a court recognizes that the "investment" became a basic social need, the consumer protection law could become applicable on all kinds of investments.

In similar vein argues **also** Professor MacNeil.[527] In his book he analyzes the 2009 case *Maple Leaf Macro Volatility Master Fund v Rouvroy and Trylinski,*[528] which involved a hedge fund and a corporation. The dispute related to a contract between parties that encompassed also services of credit and payment nature. For the purposes of this thesis – the **note** of the court should be of interest. Given that one of

[523] One of the first cases which have been highly litigated was the case Smith v Eric S. Bush [1990] 1 AC 831, HL. In this case negligent surveyors were liable under the *Hedley Byrne* doctrine, which has been expanded due to the fact that the surveyors knew that the house buyers would rely on their reports and thus assumed responsibility.

[524] Murphy v. Brentwood District Council, [1990] 2 All ER 908, HL (This case dealt with the liability of a local authority for non-supervising compliance on house construction, one of the questions that Lords were asked was to set a boundary line for liability in connection with a consumer protection. The House of Lords had to weight the protection available under statutory law versus common law, and to decide whether to broaden or restrict the common law doctrine. However, in connection with consumer protection, it adopted a clear approach that the consumer protection rules have to be adopted by the Parliament, and it was not the duty of courts to expand on the existing principles).

[525] Murphy v. Brentwood District Council, [1990] 2 All ER 908, at 945, the social need was perceived to be the need for housing. The claimant appellant was a houseowner, who had bought the house from its builders. Beside the fact the design of the house was negligent, so was the Council when approving it. The claimant thus suffered economic loss, for which he sued

[526] *See* John A. Hayes, *After Murphy: Building on the Consumer Protection Principle,* 12 OXFORD J. LEGAL STUD. 112, 119 (1992).

[527] IAIN G. MACNEIL, AN INTRODUCTION TO THE LAW ON FINANCIAL INVESTMENT 449 (Hart Publishing, 2d ed. 2012) [hereinafter "MACNEIL"].

[528] Maple Leaf Macro Volatility Master Fund v Rouvroy and Trylinski, [2009] EWHC 257.

the parties argued the application of the Unfair Terms in Consumer Contract Regulation 1999,[529] the court held in the light of the decision in *Bryen & Langley Ltd v. Boston*[530] that under the existing circumstances *"the terms under challenge had not been imposed on the consumer,"* and therefore there could be no issue of unfairness.[531] This decision shows that UK courts **do consider** the consumer aspect in connection with financial market disputes and in future may possibly even extend the application of the general consumer protection law. However, for the time being they have not been provided with a clear-cut case where they could reveal their approach towards consumer *v.* investor battle. Ultimately, there are only signals that suggest that it might be a question of time until the general consumer protection law begins to apply to broad range of investment relationships in the UK, including investing in investment companies.

2.2.2. Difference between Investor and Consumer: Risk Taking

Even though the UK regulator completely interchanges consumer with investor, there is one major distinction between the two: **omnipresent risk**. When an investor invests in any type of an investment company he/she **always** undertakes certain amount of risk given the nature of "business" the investment company is involved in. Even though that risk can be minimal, it is **enduring component** of investors' investment decision. Naturally, some may argue that also a consumer when purchasing a car on installments is also taking risk, which is true. But by the same token, anytime a person concludes any transaction for services or goods, certain element of risk is present. However, in connection with investment one cannot outcontract the risk even if he/she would like to. The risk is inherent in the nature of the business; while when

[529] A UK bill which transposed the Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts O.J. L95/29.
[530] Bryen & Langley Ltd v Boston, [2005] EWCA (Civ) 973, [44].
[531] Maple Leaf Macro Volatility Master Fund v Rouvroy and Trylinski, [2009] EWHC 257. [273].

consumer purchases services or goods, this inherent risk element is absent. One has to understand that the risk element in the investment is **quintessential** as it used to differentiate an investment as a business activity from usury. Going back in history, in the Middle Ages investing was somewhere in the middle between usury and "honest" business. The differentiating factor under canon law was that investor bore some risk of losing his investment.[532] Under English law as well, *"[I]f the interest and principal are both in hazard, it is not then usury."*[533] Even today, when an investor invests and all behave according to the law, the element of risk is present.

Today investment companies as mutual funds or UCITS are perceived as low-risk investments. However, they themselves invest in different types of financial instruments, including equity-based investments or debt instruments, and many others and therefore are exposed to various-degree risks, which each and every investment involves. Thus, consequently all investors who invest in investment companies bear some portion of this risk, regardless whether knowingly or not. The risks associated with a particular investment can be classified as:

- Uncertainty of income (referred to also as project or business risk);
- Default risk (risk, which arises in connection with debt instruments, when there is always the possibility that a loan will not be repaid in due date);
- Interest rate risk (risk that an investment's value will change due to a change in the absolute level of interest rates, which affects the value of bonds more directly than value of stocks);[534]
- Inflation risk (it is the risk over the future real value of the investment).[535]

---

[532] *See* NOONAN, *supra* note 105, at 133-153.
[533] *See* Roberts v. Tremayne, Cro. Jac. 507, 508, 79 Eng. Rep. 433, 434 (K.B. 1618) *in* A. W.B. SIMPSON, A HISTORY OF THE COMMON LAW OF CONTRACT 517-18 (Clarendon Press, 1975).
[534] Definition of Interest Rate Risk on Investopedia, *available online at:* < http://www.investopedia.com/terms/i/interestraterisk.asp>/ *last visited* Jan. 5, 2015.

With any type of investment instrument a risk of its return is inherent. It is not a risk whether the goods comply with the provided description, when if not one may return or exchange them. In case of investment, there is no guarantee in respect of either return of capital or income,[536] which is not the case with consumer goods. The regulators are fooling themselves if they believe that they can provide extensive protection for investors that would **completely** set aside the risk element in an investment decision, which however to certain extent they do imply by referring to the investors as consumers. Moreover, the greatest risk is that the consumers will start to believe that they are actually protected and their investments are secure. Such protection is simply inconceivable due to how the financial markets function and under no circumstances should the regulators even imply such possibility, which unfortunately happens if investors become "weak" consumers.

2.2.3. Similar Behaviors: Causing the Confusion

Before drawing final conclusions, I look at the investor – consumer discourse from a different angle – behavioral economics - whether commonalities or differences can be observed. [537] Behavioral economics is one of the tools corporate law as well as securities law scholars should have in their kit.[538] The primary claim of behavioral

[535] *See* JANETTE RUTTERFORD, INTRODUCTION TO STOCK EXCHANGE INVESTMENT 40-45 (Palgrave Macmillan, 3d ed. 2007).
[536] *See* MACNEIL, *supra* note 527, at 5.
[537] New disciplines including behavioral economics or law are greatly based on empiricism, whether based on sociological investigations or psychological experiments, a part of new legal literature often includes or refers to a set model, which has been experimentally tested. As an overview of literature on behavioral economics and law, *see* Cristine Jolls et al., *A Behavioral Approach to Law and Economics,* 50 STAN. L. REV. 1471 (1998); Grant M. Hayden & Ellis E. Stephen, *Law and Economics after Behavioral Economics,* 55 U. KAN. L. REV. 629 (2006); Maurice E. Stucke, *Rise of Behavioral Law and Economics,* 13 TRANSACTIONS 309 (2012); Lawrence A. Cunningham, *Behavioral Finance and Investor Governance* 59 WASH. & LEE L. REV. 767 (2002); Langevoort, *Institutionalization of the Securities Markets*, *supra* note 11; Stephen J. Choi & A.C. Pritchard, *Behavioral Economics and the SEC*, 56 STAN. L. REV. 1 (2003) or Russell Korobkin, *What Comes after Victory for Behavioral Law and Economics,* 2011 U. ILL. L. REV. 1653 (2011).
[538] *See* Stephen M. Bainbridge, *Mandatory Disclosure: A Behavioral Analysis,* 68 U. CIN. L. REV. 1023, 1058-1059 (2000), where Professor Bainbridge notes that "[f]or corporate and securities law

economics relevant for lawyers and regulators is that public policy cannot always be based on the assumption of rational choice and any scholar should take into account cognitive errors and decision-making biases.[539] And these should be taken in consideration to all types of investors. In this thesis I fully rely on the results of empirical studies carried out by others,[540] although the analysis and conclusions are mine.

The original aim for this section was to research whether there was a difference in the behavior of investors and consumers, and if yes what the reasons were. Presuming that consumers are perceived as a weaker party, what behavioral biases render them weaker, in connection to investment environment, to substantiate the application of consumerist approach towards the investor protection? However, the outcome of my inquiry rendered to be different. In simple terms, the behavioral economics shows, that irrespective whether it is a sophisticated or less sophisticated investor or an enforcement agency, the investment biases remain similar.[541] The financial crisis in 2008 serves as a direct proof. In addition, the research shows that

---

scholars behavioral economics probably is the most exciting intellectual development of the last decade" [hereinafter "Bainbridge, *Mandatory Disclosure*"].

[539] *Id.* at 1058 or Jennifer Arlen, *Comment: The Future of Behavioral Economic Analysis of Law*, 51 VAND. L. REV. 1765, 1768 (1998). However, sufficient caution should be kept in mind with applying the behavioral economic analysis on the current legal framework and behavior of investors as applied to the US capital markets, the behavioral economics offer only limited support for the drafted legal framework. Moreover, given the fact that the behavioral research is generally based on limited number of participants, it remains somehow haphazard collection of not necessarily connected evidence, *see* John D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74 N.Y.U. L. Rev. 630, 715 (1999) and Gregory Michell, *Why Law and Economics' Perfect Rationality Should Not Be Traded for Behavioral Law and Economics' Equal Incompetence,* 91 GEO. L. J. 67, 72 (2002).

[540] Some call behavioral law and economics a future of the legal academia *see* Kent Greenfield, *Using Behavioral Economics to Show the Power and Efficiency of Corporate Law as Regulatory Tool,* 35 U. C. DAVIS L. REV. 581, 583 (2002). It is not only the scholars who started to include it their work the behavioral perspective, but also for instance the EU takes into consideration behavioral economics. In November 2010, a report on Consumer Decision-Making in Retail Investment Services: A Behavioral Economics Perspective was completed. The report is based on online survey of 6,000 consumers in eight EU Member States. This report identifies a distinctive number of cognitive and social biases that play a role in consumer investment decisions.

[541] In addition to irrationalities of investors, it is also necessary to take into consideration the irrationalities and biases of enforcement agencies and governments, which as well may suffer from overconfidence, confirmation bias or bounded search. However, this aspect is evaluated in the following chapter, which directly deals with the enforcement agencies.

investment decisions cannot be generalized within one specific group of investors according to their experience and financial literacy. In other words, behavioral research was unable to principally differentiate between the nature of investment decision that investor type A [of x years of experience, relevant education and background]; investor type B [of y years of experience (where y<x) with less relevant education and background] and investor type C [with no experience, no relevant education and background] take.

According to empirical behavioral research, psychologists have specified several biases in the investor-decision-making-process. First, investors tend to rely on heuristics, which means that the investors ignore part of the information instead of assessing all information.[542] They prefer satisfaction: finding a good-enough solution instead of optimization, finding the best solution.[543] Second is the hindsight bias, which tends to occur in situations where a person believes that some past event was clearly obvious, whereas in fact, it was not.[544] It is not only the psychologists or behavioral economists who take this bias into consideration, but the presence of the

[542] Originally it was the cognitive scientist Herbert A. Simon who proposed that human judgments are based on heuristics. *See e.g.* Herbert A. Simon, *The Logic of Heuristic Decision Making,* 54 BOSTON STUD. PHIL. SCI. 154 (1977).

[543] More on heuristics *see* Gerd Gigerenzer, *Why Heuristics Work*, 3 PERSPECTIVES ON PSYCHOLOGICAL SCIENCE 20, 20 (2008). Harry Markowitz received in 1990 a Nobel Prize in Economics for his work on optimal asset allocation. He assessed how to invest money in N assets. Markowitz proved that there is an optimal portfolio that maximized the return and minimizes all the risk. However, he himself did not invest his money according to his award-winning theory, but he rather relied on a simple heuristic, the 1/N rule, according to which one allocates money equally to each of the N funds. Later it was proved that both optimization and heuristic model might bring good results, *see* Victor DeMiguel, Lorenzo Garlappi & Raman Uppal, *1/N*, EFA 2006 Zurich Meetings, *available online at:* <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=911512>/ *last visited* June 15, 2013.

[544] Professor Amos Tversky and Daniel Kahneman in early seventies as first identified the hindsight bias. Investors place too great weight on events that did not take place in predicting the probability of events, while giving too little weight to important events. *See* Amos, Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases,* 185 SCI. 1124, 1124 – 30 (1974). *See also* Baruch Fischhoff, *Hindsight Is Not Equal to Foresight: The Effect of Outcome Knowledge on Judgment Under Uncertainty*, 1 J. EXPERIMENTAL PSYCHOL: HUM. PERCEPTION & PERFORMANCE 288, 288 (1975).

hindsight bias became also part of legal and economic discussions.[545] Third, investors tend to become overconfident and overoptimistic if lacking experience and being successful with their investments at the beginning during a short period of time.[546] Forth, it is the endowment effect, which signifies that due to loss aversion, people value more what they possess than what they do not.[547] Moreover, investors tend to weigh losses about twice than the gains and therefore investors often stick to their actual investment strategies and behavior than to revalue and change them.[548] Fifth, it is the confirmation bias, according to which an investor even if understanding that his/her decision under relevant data was wrong, tends to justify it with less persuasive reasons.[549] Therefore, once a person commits to an investment strategy, there is strong motivation to resist evidence, which proves otherwise.[550] Finally, it is the famous herd

---

[545] *See* Lisa Pollack, *The Formula that Wall Street Never Believed In,* FINANCIAL TIMES, June 15, 2012 or Dam McCrum, *Charles Schwab Agrees $119m settlement,* FINANCIAL TIMES, Jan. 12, 2011, which shows that the SEC itself refers to hindsight bias within its litigations.

[546] *See* Brad M. Barber & Terrance Odean, *Boys Will Be Boys: Gender, Overconfidence, and Common Stock Investment* 116 Q.J.E. 261, 261 (2001) or more generally LARS KLÖHN, KAPITALMARKT, SPEKULATION UND BEHAVIORAL FINANCE 116 (Duncker und Humblot Verlag, 2006); Not only retail investors may become overconfident and overoptimistic, but also the sophisticated investors may start to take higher risks or not sufficiently evaluate the imminent risk. Managers in investment intermediaries were overconfident before 2008 when they invested in such securities despite understanding entirely their design and character, *see* Gerald Spindler, *Behavioural Finance and Investor Protection Regulation,* 34 J. CONSUM. POLICY 315, 324 (2011). On the other side, here was research that showed a statistically significant decline in analyst forecast errors based on the experience increase, *see* Michael B. Mikhail, Beverly R Walther & Richard Willis, *The Development of Expertise: Do Securities Analysts Improve their Performance with Experience?,* 35 J. ACCT. RES. 131 (1997).

[547] Generally on endowment effect *see* Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, *Experimental tests of the endowment effect and the Coase Theorem,* 98 J. Pol. Economy 1325 (1990).

[548] *See* William Samuelson & Richard Zeckhauser, *Status Quo Bias in Decision Making,* 1 J. RISK & UNCERTAINTY 7 (1988). The inability to change the investment strategy was researched extensively with investors investing in pension plans, *see* Brigitte C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) participation and savings behavior,* 6 Q.J.E. 1149 (2001).

[549] If an investor likes *e.g.* Apple Inc. as a company because of its identity and corporate thinking, he/she may dismiss negative information as irrelevant and inaccurate due to the fact that his/her own personal beliefs are invested in the investment decision. For more on the confirmation bias *see* Robert Forsythe, *et. al., Anatomy of an Experimental Political Stock Market,* 82 AM. ECON. REV. 1142 (1992).

[550] *See* Donald C. Langevoort, *Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation,* 97 NW. U. L. REV. 135, 142 (2003) [hereinafter "Langevoort, Taming the Animal Spirits"]. This bias is also called a status quo bias, which has been well documented in experimental economics and psychological literature, *see* Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases,* 74 WASH. U.L.Q. 347, 359-362 (1996) & Russel B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics,* 88 CAL. L. REV 1051, 1115 - 1119 (2000), which summarize and describe the carried-out studies.

behavior, which has been deeply affecting the entire financial sector.[551] Herding occurs when an investor follows the "main stream", which is being represented by a peer group, either other friends/family/other investors, while ignoring his/her own information and judgment with regard to the merits of the underlying decision.[552] There is a natural tendency of individuals to simplify their own decision-making process by relying on decision of others or on a decision taken by those, who are perceived to have better information.[553]

In addition to the above stated biases and irrationalities there are other relevant behavioral effects and phenomena. One of the most influential is the information overload, also known as the "curse of knowledge". It is the trend of last couple of years that legislators burden the investment companies with extensive disclosure obligation[554] to remedy the negative effects stemming from information asymmetry between the investment companies and the investors, whereas the investors are unable

---

[551] *See* Spindler, *supra* note 546, at 324.

[552] *See* Kahan, *supra note* 550, at 455-456.

[553] Here it is important to note, that a recent study of herding in international equity markets found only limited evidence of investor herding in developed financial markets, while finding the opposite on emerging markets. *See* Ajay Khorana, Eric C. Chang & Joseph W. Cheng, *An Examination of Herd Behavior in Equity Markets: An International Perspective* (1999), *available online at:*< http://papers.ssrn.com/sol3/papers.cfm?abstract_id=181872>/ *last visited* June 16, 2013. The same evidence was found by Gong-Meng Chen, Kenneth A. Kim, John R. Nofsinger & Oliver M. Rui, *Behavior and Performance of Emerging Market Investors: Evidence from China* (2004), *available online at:* <http://www.google.com/url?sa=t&rct=j&q=.%20nofsinger%20%26%20oliver%20m.%20rui%2C%20behavior%20and%20performance%20of%20emerging%20market%20investors%3A%20evidence%20from%20china&source=web&cd=1&ved=0CCsQFjAA&url=http%3A%2F%2Fciteseerx.ist.psu.edu%2Fviewdoc%2Fdownload%3Fdoi%3D10.1.1.202.7314%26rep%3Drep1%26type%3Dpdf&ei=d9LAUe__H8vn4QTM4YHoDQ&usg=AFQjCNGbhM3SzH9hYSES_UBMLXw_20HDew&sig2=yrJ5VPMfShJD1xbvV9g4ow&bvm=bv.47883778,d.bGE >/ *last visited* June 16, 2013. The study analyzed data of 46,969 individual investor brokerage accounts.

[554] *See* SEA 1934 §§5-7, 15 U.S.C. §§77e-77g, Article 19(3) of MiFID is the core disclosure provision, which together with Articles 12, 13, 19, 24 of Commission Regulation (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information of the prospectus in a durable medium other than paper or by means of a website, O.J. L176/1, require investment companies to provide appropriate information "in a comprehensible" form to investors or potential investors about the investment firm and the services provided. More on mandated disclosure *see* Omri Ben-Shahar & Carl E. Schneider, *The Failure of Mandated Disclosure,* 158 U. PA. L. REV. 647, 688 (2010) & Moloney, *Large-Scale Reform*, *supra* note 424, at 162-163.

to absorb such quantity of information and subsequently assess their quality.[555] Yet for what purpose if the regulator decided to apply on the investor the consumerist approach and treat him/her as someone with no or very limited financial education, that consequently renders him/her unable to evaluate the provided information.[556] Hence, *"[o]ne must be careful to avoid the fallacy that if some information is good, more must be better."*[557]

Moreover, the empirical research also shows that the investors do not "consume" the information, which is provided to them by the investment company, but they only "consume" the confidence, which is therefore of particular importance in many ways and in respect of a great number of people.[558] Thus, irrespective of the extent of a disclosure, it might be argued that the "consumers" will not critically asses the information given, but they would rely on the confidence that an investment company provides in relation to their given explanations and abilities. However, it has to be emphasized that these biases were only revealed in connection with taking an investment decision.

However, as Judge Richard Posner,[559] though acknowledging the importance of behavioral economics and the work of the above stated scholars,[560] highlights that

---

[555] *See* Spindler, *supra* note 546, at 322. On information overload from behavioral perspective *see* Melvin A. Eisenberg, *Text Anxiety,* 59 CAL. L. REV. 305 (1986). According to Miller's "magical seven", seven is roughly the number of items people can keep in their short-term memory; *see* George A. Miller, *The Magical Number Seven, Plus or Minus Two: Some Limits on Our Capacity for Processing Information,* 63 PSYCHOL. REV. 81, 90 (1956).

[556] Given that also the professional investors as investment companies, based on the evidence of Credit Crunch 2008, are often unable to realize the complex risks that resulted *e.g.* from the asset-backed derivatives, one may question the ability to assess this kind of risk by non-professional investor.

[557] *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 299 (Harvard University Press, 1991) [hereinafter "EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE OF CORPORATE LAW"].

[558] *See* Susanne Kalss, *Die rechtliche Grundlage kapitalmarktbezogener Haftungsanspüche*, 8 ÖBA 641, 650 (2000).

[559] Judge Richard A. Posner is a judge of U.S. Court of Appeals for the Seventh Circuit, and a Senior Lecturer at the University of Chicago Law School. He is also recognized as one of the most influential jurists and legal scholars, who greatly influenced the development of law and economics; *see* David Campbell, *Welfare Economics for Capitalists: The Economic Consequences of Judge Posner,* 33

there are additional factors, affecting the financial behavior and behavior of investors, as **risk** and **uncertainty**,[561] which I have already emphasized. Thus, while the work of Kahneman[562] brings certainly a new light into financial law and investor protection, it only complements what is already known and does not rebuild it from square one. The proof being that irrespective of the behavioral finance the Efficient Capital Market Hypothesis continues to be applied as the theory best describing the behavior of the market,[563] even though some have criticized it.[564]

All the above described and analyzed behavioral biases, including the heuristics, hindsight bias, or overconfidence can be associated with both – investors or consumers. However, the same biases would be most probably present with any natural person who would take a loan in order to start up his or her business. He or she would probably tend to see only the positive signs for taking such opportunity and believe in success rather than failure, and yet he or she would not be perceived as a consumer just due to the lack of experience or knowledge. Investment management bears in itself a certain portion of risk taking as any kind of business – without risk,

---

CARDOZO L. REV. 2233, 2234 (2012) or Frank J. Vandall, *Judge Posner's Negligence-Efficiency Theory: A Critique,* 35 EMORY L.J. 383, 383 (1986) (characterizing Judge Posner as the "most prolific and most cited law and economic scholar", already in 1986).

[560] Although he also emphasized that before the contemporary behavioral economists, there were economists, such as Frank Knight, John Maynard Keynes, Robert Shiller, and Andrei Schleifer, who offered the first insights into the psychology of financial markets; *see* Richard A. Posner, *Behavioral Finance Before Kahneman,* 44 LOY. U. CHI. L.J. 1341, 1341 (2013).

[561] *Id,* at 1345 (In 1920, Frank Knight and John M. Keynes elaborated on two different notions. One being "risk" and the other "uncertainty". In simple terms, "risk" is a future event to which a quantitative probability of occurring can be attached and "uncertainty" is an event where no probability can be attached. Thus, given that uncertainty is intractable to cost-benefit analysis, the "rational" response of the market cannot be calculated, leaving in effect something out of any analysis and any rational.).

[562] Professor Kahneman, who is a psychologist winning a Nobel Prize in Economic Science for integrating the insights of his psychological research into economy. He created a "map of bounded rationality, by exploring the systematic biases that separated the beliefs that people have and the choices that they make from the optimal beliefs and choices assumed in rational agent models, see Daniel Kahneman, *Maps of Bounded Rationality: Psychology for Behavioral Economics,* 93 AM. ECON. REV. 1449, 1449 (2003).

[563] On Efficient Capital Market Hypothesis *see* section 3.1.1.

[564] Including George Soros, Jeremey Grantham or Justin Fox.

even minimal, there is no profit. In the *Levitin v. Paine Webber, Inc.*,[565] the court stated that the decision to invest in stocks is a decision to forego safer interest-bearing opportunities in order to seek out higher returns. Therefore, arguing that retail investors are notoriously biased and thus hindering their own interest, by virtue of which they should be protected to the fullest extent – as consumers are – is erroneous.

The behavioral biases, knowledge limitation and the consumption of confidence have been present at the market forever and will be present as long as people take the investment decisions. One can most presumably limit these by virtue of knowledge and experience, but as shown by the above stated research even this is not bullet proof.

2.2.4. Risks Inherent to the Consumerist Approach

Interchanging policy and terminology where it is inappropriate can cause similar effects as Gunther Teubner's "legal irritants".[566] Legal institutions cannot be simply moved from one context to another, *"like the transfer of a part from one machine into another."*[567] There is a reason why certain terms are used in certain fields of laws. A legal term does not only represent a word with a meaning ascribed to it under grammatical rules of any language, but each legal term brings with its own legal environment in which it has been cultivated.

It is hard to assess all possible consequences of the consumerist approach towards the retail investment market, but the prognoses are skeptical.[568] The possible risks encompass legal uncertainty, policy incoherence and possible empowerment of

[565] Levitin v. Paine Webber, Inc. 159 F.3d 698, 702 (2d Cir. 1998).
[566] *See* Gunther Teubner, *Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences*, 61 MODERN L. REV. 11 (1998) [hereinafter "Teubner, *Legal Irritants*"].
[567] *See* Otto Kahn-Freund, *On Uses and Misuses of Comparative Law in* SELECTED WRITINGS (Otto Kahn-Freud, 1978).
[568] *See* Paul Farrow, *Will the New Financial Conduct Authority Protect Consumers?* THE TELEGRAPH, January 13th, 2012.

consumer advocates. Presence of multiple policies within one field of law causes legal uncertainty as parties become unable to predict the interpretation of the core notion and the rights and duties ascribed to them.[569] Regulator either undertakes the consumerist approach or the investor empowerment approach. The investor empowerment approach calls for legislative measures, which support the investor in his or her active participation in identifying, demanding and assessing the financial services.[570] The investor empowerment reflects a tradition of investor autonomy and individual risk assessment in financial market regulation,[571] rather than being treated as incapable of informed consent to risk and require strong paternalistic interference from a regulator.

There is an additional risk of consumer groups' empowerment, which can dramatically change the market climate.[572] Here I provide an example; only couple of days after the Directive on Consumer Rights came in force in June 2014, the UK government and the FCA came under a pressure from consumer groups. Contrary to the exemption of financial services from the scope of the Directive on Consumer Rights,[573] the consumer groups required the FCA to immediately halt the premium rate calls of consumers when contacting or consulting their financial services firms.[574] This meant that the premium-rate (expensive) phone lines for help or complaints at banks or investment companies were to be outlawed. Thus, even though excluded, both under the EU and UK law, the consumer groups were publicly pressuring the

---

[569] *See* Benjamin, *Narratives*, *supra* note 487, at 807.
[570] *See* MOLONEY, HOW TO PROTECT INVESTORS, *supra* note 30, at 200.
[571] *See* Howell E. Jackson, *Regulation in a Multisectored Financial Services Industry: An Exploration Essay',* 77 WASH. U. L. Q, 319, 333 (1999).
[572] *See* Black, Canada Report, *supra* note 29, at 7; Professor Black in her report prompts for direct involvement of "consumers" in shaping the securities regulation in Canada. One of the forms of consumers' engagement is through the consumer advocates, who may communicate the interests and needs of retail investors to regulators. She states that the advocacy groups in Canada should become active in shaping the securities regulation, as are the groups in Australia, UK and EU as at the time there were no such groups present in Canada.
[573] *See* Article 32 of the Preamble of the Directive on Consumer Rights.
[574] *See* Adam Palin, *EU Law Set to Improve UK Consumer Protection*, FIN. TIMES, June 12, 2014.

FCA to take action, which in the end it did.[575] Thus, the question is whether under the continuous and omnipresent pressure of consumer activists and groups the consumer *acquis* might gain a strong influence over the financial services in the UK and potentially elsewhere in the EU.

Moreover, in the light of the analysis, both terms "consumer" and "investor" are sufficiently broad to cover all natural persons, and in some instances even legal persons. The interchangeability of these two terms is however undesired given that there is a radically different set of laws applying to one and the other. If a regulator wishes to only stress greater protection for investors, switching in terminology is prejudicial also for investors, who might not understand the extent to which they should be treated as consumers. For example, in case of banks, the EU after the 2008 financial crisis, in order to "restore consumer confidence", decided to change the existing European rules to further improve protection for bank account holders and consumers through deposit guarantee schemes.[576] Thus, a consumer who does not differentiate between different financial intermediaries, might be under impression that given that he/she is the consumer, an investment-insurance scheme for consumers should be also in place in case of investment companies, as is the case with banking and saving.[577] Even if *ignorantia juris non excusat* consumers, the terminological and regulatory confusion does. Thus, where is the line? What is the differentiating factor between consumers and investors? If a regulator starts to treat the investors as consumers, then not only should the general consumer law be applicable by the argument of analogy, but also additional protection should be

[575] *See* Adam Palin, *FCA Moves to Ban Premium Complaint Lines,* FIN. TIMES, Dec. 12, 2014.

[576] *See* Commission proposed package to boost consumer protection and confidence in financial services, Bank release, July 12, 2010, *available online at:* < http://europa.eu/rapid/press-release_IP-10-918_en.htm?locale=en>. The recast Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2016 on deposit guarantee schemes was adopted O.J. L173/149.

[577] In the UK, there is the Financial Services Compensation Scheme, which protects deposits, if a bank, building society or credit union becomes insolvent up to £85,000 per person.

provided, *e.g.* purchase of insurance, public provision to mitigate adverse selection, precautionary intervention and subsidizing private insurance through the tax code.[578] Otherwise, for the purposes of preservance of legal certainty, regulator should differentiate between the two.

2.3. Classification of Investors

Although the consumerist approach in the EU law is from my perspective an erroneous policy philosophy, it is indisputable that there are diverse types of investors. Taking into account investors' financial literacy, investment experience or ability of bearing a financial loss. Therefore, a regulator should recognize the capabilities or incapabilites of investors in order to understand the extent to which they should be protected. Yet making a distinction among different classes of investors is a demanding task. The US and the EU introduced certain objective and subjective criteria according to which they classify the investors.

2.3.1. Current Regulation in the US: Wealth as Standard

The US regulation of investment companies, as stated above, differentiates between two types of investors: the "accredited investor" and the non-accredited investor.[579] An accredited investor is in a better position to protect himself or herself in comparison to the non-accredited investors. An accredited investor as a natural person[580] is

[578] John Y. Campbell, *et al.*, *Consumer Financial Protection*, 25 J. ECON. PERSPECTIVES 91, 93 (2011).
[579] Section 4 of Securities Act 1933, 15 U.S.C. §77d (2012) or Regulation D, 17 C.F.R. §§230.501-508 (2007).
[580] Under the 501 Definition of accredited investor, an accredited investor may be a bank or any savings and loan association or other institution defined in section 3(1)(5)(A) of the 1933 Securities Act and other entities as insurance company or investment company or a business development company and others. However, in this section of the chapter, it is the individual investors who are in the center of attention.

"(1) Any natural person whose individual net worth, or joint net worth with that person's spouse exceeds $1,000,000 or (2) any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess od $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year."[581]

The SEC's goal was to provide a clear and objective standard to determine whether an investor has *"sufficient knowledge and experience in financial and business matters to enable that purchaser to evaluate the merits and risks of a prospective investment, or to hire someone who can."*[582] Thus, the SEC adopted these two thresholds, one being the "net worth" and one being "income". SEC simplistically relied on wealth as a proxy for determining whether an investor is capable of bearing the risk.[583]

Even if the wealth-based proxy reflects on the investor's ability to bear the risk of loss, which it not always does,[584] the rules nowhere reflect on the "sufficient knowledge and experience" part. The US securities regulation has been based on the philosophy of differentiating between the investors who need protection and those who can "fend for themselves".[585] Furthermore, it excludes poor, but sophisticated investors. The SEC has become to recognize the flaws of the definition and currently

[581] Rule 501(a), 17 C.F.R. §§230.501(a). *See* ROBERT J. HAFT & PETER M. FASS, FEDERAL SECURITIES LAWS AND TAX-ADVANTAGED SECURITIES, §6.:26 (2014), *available at* WestlawNext. Regulation D – Accredited Investors (online).

[582] Release No. 33-8766, 72 Fed. Reg. 400, 405. For background on the history of the regulation, *see e.g.* Manning G. Warren III, *A Review of Regulation D: Present Exemption Regimen for Limited Offerings Under the Securities Act of 1933,* 33 AM. U. L. REV. 355 (1984) [hereinafter "Warren, Review of Regulation"] or Troy A. Paredes, *On the Decision to Regulate Hedge Funds: The SEC's Regulatory Philosophy, Style, and Mission,* 2006 U. ILL. L. REV. 975 (2006).

[583] *Id.* at 997.

[584] It is possible that the investor in the moment of investing might be actually insolvent, *see* Warren, Review of Regulation, *supra* note 582, at 382.

[585] *See* Langevoort, *Global Securities Regulation*, *supra* note 415, at 806.

the SEC reviews whether the net worth and annual income should be used as tests to determine whether a natural person is an accredited investor.[586] The SEC's Investor Advisory Committee has also pointed out that the current "accredited investor" definition might be under-inclusive.[587] For this reason the SEC's Investor Advisory Committee has recommended changes to the accredited investor definition that take into account other ways of measuring financial sophistication. These recommendations include assessing an individual's specialized work experience, investment experience, licensing, or other professional credentials.[588]

2.3.2. Current Regulation in the EU & the UK: MiFID Classification

The EU praises its suitability regime. MiFID has introduced a three-type investor classification: (1) retail, (2) professional and (3) eligible counterparty,[589] which should create a real level playing field for all European stakeholders.[590] The client classification is the starting point for the conduct-of-business rules under MiFID. According to the Annex II of MiFID II, *"Professional client*[591] *is a client who possesses the experience, knowledge and expertise to make its own investment decisions and properly assess the risks that it incurs."* MiFID II distinguishes between **two** types of "professional investors". Firstly, those investors, who are

[586] *See* Hamilton, *supra* note 504. Before this revision, there have been several SEC proposals on revision of this definition, *e.g.* Securities Act Release No. 33-8766, 72 Fed. Reg. 400 (proposed Jan. 4, 2007).

[587] Recently, the Commissioner Luis A. Aguilar stated in his public statement that *"*Potential investors who most people would consider to be financially sophisticated, such as a Chartered Financial Analyst or a graduate professor of corporate finance, may not have the income or the accumulated net worth to be eligible to be "accredited investors," but they may actually be better able to protect their own interests.*" See* Luis A. Aguilar, Commissioner SEC, Revisiting the "Accredited Investor" Definition to Better Protect Investors, Dec. 17, 2014, *available online at:* < http://www.sec.gov/news/statement/spch121714laa.html#.VLF434dzZD8>/ *last visited* Jan. 6, 2015.

[588] *See* Recommendation of the Investor as Purchaser Subcommittee and the Investor Education Subcommittee: Accredited Investor Definition 3, *available online at:* < http://www.sec.gov/spotlight/investor-advisory-committee-2012/accredited-investor-definition-recommendation.pdf>/ *last visited* Jan. 6, 2015.

[589] *See* CASEY & LANNOO, *supra* note 370, at 46.

[590] *Id.* at 45.

[591] The MiFID uses the wording of a "client" not "investor", however for the consistency of the terminology, the term "investor" will be used.

directly considered to be professionals (*ab initio professional investors*)[592] and those investors who may be treated as professionals on request (*ad petitio professional investors*), which as to the substantive criteria have to satisfy at least two of the following: (1) investor has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters; (2) the size of the investor's financial instrument portfolio, defined as including cash deposits and financial instruments exceeding EUR 500,000; (3) investor works or has worked in the financial sector for at least one year in a professional position,[593] which requires knowledge of the transactions or services envisaged.[594]

Once, an investor satisfies any of the two from the stated requirements, there are certain procedural steps to be fulfilled, which make sure that the investor understands that he or she is waiving certain benefits and realizes the consequence of this choice.[595] However, in connection to criterion 1, neither MiFID II nor MiFIR defines or explains what is to be understood as a transaction of "significant size" or "relevant

[592] *See* Annex II(I) of MiFID II, *e.g.* credit institutions, investment firms, insurance companies, collective investment schemes and management companies, commodity and commodity derivatives dealers or other large undertakings with specific balance sheet total (of EUR 20,000,000) or net turnover (of EUR 40,000,000) or own funds (EUR 2,000,000) or national or regional governments and other institutional investors whose main activity is to invest in financial instruments including entities dedicated to the securitization of assets or other financing transactions. In addition to professional investors, the MiFID acknowledges the third category – "eligible counterparties", which are not subject to certain conduct-of-business provisions of the MiFID.

[593] Here, a question arises, what is a "professional position", however it is neither MiFID II or MiFIR nor any regulatory opinion *e.g.* from ESMA, which would specify what position could be understood as "professional position". However, according to Marc Kruithof & Walter Van Gerven in case of a small entity, such investor should hold a position, where he/she is authorized to carry out transaction on the behalf of the entity, *see* Marc Kruithof & Walter Van Gerven, *A Differentiated Approach to Client Protection: The Example of MiFID* 13 (Financial Law Institute, Univeristeit Gent, Working Paper 2010-07, June 2010).

[594] *See* Annex II(II)(1) of MiFID II.

[595] A written statement of an investor is required, where he/she states that he/she wishes to be treated as a professional investor, either generally or in respect of a particular investment services or transaction. To this statement an investment company attaches clear written warning of a list stipulating the rights that an investor may lose, so the investor is aware of the consequences of changing his/her status; *see* Annex II.(II)(2) of MiFID, Moreover, if a *ad petitio professional investor* cannot be presumed to possess financial market knowledge and experience comparable to that of *ab ignitio professional investor*, an extra protection granted to retail investor is considered valid, unless the investment company is reasonably assured that in connection to the nature of the transaction, the investor is capable of making his/her own investment decision while understanding the attached risks; *see* Annex II.(II)(1) of MiFID.

market".[596] In addition to MiFID II and its classification of investors, EU law[597] recognizes one additional type of investor – "qualified investor"[598] in case of publishing a prospectus when securities are publicly offered. It is undisputed that this class of investors, which was named illogically, as it corresponds to the "*ad petitio professional investors*", is an unnecessary confusion for both investors as well as investment companies and again contributes to the shattered legal certainty.

The differences in the approach are **obvious**. The US looks at the objective standard of wealth, while the EU tries to take into consideration the experience and knowledge of the investor. The fact how this assessment is carried out is an additional question, given that the process is subjective. However, based on his or her request every investor can be treated as a retail client (retail investor) under MiFID II. Moreover, by requiring two out of three prerequisites creates the option also for those investors, who at the given moment lack sufficient wealth or income, but yet possess the knowledge and experience. Intuition might tell that the rationale behind the US approach is simply the classical free market policy thinking, where the size of the capital is decisive. However, also this is currently under revisions. Thus, from the perspective of classification of investors, although the EU standards are to certain

[596] Neither ESMA in its consultation papers explains these two terms. ESMA clarified the meaning of "significant size" to the purposes of Article 13 of the Alternative Investment Fund Managers Directive, but not in connection with MiFID.
[597] Besides the MiFID, it is also the Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading and Amending Directive 2001/34/EC [hereinafter "Prospectus Directive"], which harmonized the rules relating to the information that has to be provided to the public when securities are initially issued and offered to the public. The Prospectus Directive in Article 3(2)(a) states that no obligation to publish a prospectus if the securities are offered solely to "qualified investors".
[598] Under Article 2(1)(e) of the Prospectus Directive a "qualified investor" is generally a legal entity operating on the financial market, national or regional government, bank or international and supranational institution, certain SMEs or in connection to natural person, *"subject to mutual recognition, a Member State may choose to authorize natural persons who are resident in the Member State and who expressly ask to be considered as qualified investors if these persons meet at least two of the criteria,"* which are as a matter of fact the same as in the case of "*ad petitio professional investors*".

extent subjective and one can surely bypass them by filling out an A4 form, those investors who believe that they are sufficiently sophisticated and are able to bear the risk may always decide so and for everyone else than *ab initio* professional investors there is a default "retail investor" protection.

In the UK, the FCA must have regard to *"the differing degrees of experience and expertise that different consumers may have in relation to different kinds of regulated activity."*[599] FSMA 2000 took over the MiFID classification and while securing the appropriate degree of protection for consumers FCA differentiates among retail clients, professional clients and eligible counterparties in the Conduct of Business Sourcebook.[600] As is the case under MiFID, any professional client or eligible counterparty may require a higher level of protection – as for retail clients.[601] According to the case law, failure to categorize investors correctly may in itself form a breach of regulatory rules, but as long as the firm has followed the requirements applicable to a transaction with the relevant category, such mistake is perceived merely as a procedural.[602] Furthermore, administering classification of investors is perceived as part of the reasonable care.[603] The test, whether a firm under MiFID did or did not comply with the duty to correctly classify investors under the COB *"[i]s not whether the Defendants had acquired any particular degree of knowledge about the customer's experience and understanding, in any given field of activity, but rather whether they have taken reasonable care in the circumstances."*[604]

[599] Sec. 5(2)(b) FSMA 2000.
[600] *See* COBS 3.3.
[601] *See* COBS 3.7.
[602] *See* Spreadex Ltd v Sanji Sekhon [2008] EWHC 1136 (Ch).
[603] *See* Wilson v MF Global UK Ltd [2011] EWHC 138 (QB) [24] ("The test is whether reasonable care has been taken to determine that the client had sufficient experience and understanding to be classified as an intermediate customer").
[604] *Id.* para. 46.

Great advantage for the investment firms, including the UCITS management companies [hereinafter "UCITS MC"], as well as for the investors in the UK is the active cooperation and guidance from the FCA. The FCA provides direct help to the market participants in their daily activities on the market.[605]

2.3.3. Additional Classification Standards: Alternative Proposal

The classification of investors in the EU, UK and US is not flawless and as stated the US accredited investor classification is currently under review.[606] There are few alternative approaches, which for the time being might seem too abstract to implement. Yet the perspective that they offer might serve useful for further consideration.

2.3.3.1. Information-Based Assessment

According to Professor Choi, in his article on regulating investors instead of issuers, he presents investor classification according to the information they possess.[607] He divided investors into four groups: (1) issuer-level investors (2) intermediary-level investors (3) aggregate-level investors and (4) unsophisticated investors.[608]

As the respective titles of the given classes are revealing, Professor Choi compares the level of information possessed by individual investors to those held by other institutions on the market. The first time is the "issuer-level" investors, who hold the same amount and quality of information as the individual issuers. They are

[605] FCA in its own words is committed to forming a principles-based regulatory architecture and their constant engagement with improvement of their own guidance contribute to a stable environment. For more on the FCA, *see* section 5.3.
[606] The US academics have been criticizing this approach for long period of time and the SEC itself proposed a new or expanded definition of "accredited investor" several times. For historical overview on how the definition of "accredited investor" evolved, *see* Wallis K. Finger, *Unsophisticated Wealth: Reconsidering the SEC's "Accredited Investor" Definition Under the 1933 Act,* 86 WASH. U. L. REV. 733, 737 -744 (2009). *Generally see* C. Edward Fletcher, III, *Sophisticated Investors Under the Federal Securities Laws*, 1988 DUKE L. J. 1081 (1988), which discusses the distinctions between sophisticated and unsophisticated investors.
[607] *See* Choi, *Regulating Investors Not Issuers, supra* note 508.
[608] *Id.* at 284.

well informed and able to protect their own interests. Therefore, the level of necessary protection provided by the regulator can be lowered or totally dissolved and instead of them, pure contractual relationship could be introduced.[609] If the investors retained the same quantity and quality of information as issuers, the dependence of investors on investment companies as intermediaries would be reduced.[610] However, according to Professor Choi those investment companies that retain good reputation would retain their business.[611] Afterwards come less informed investors. The "intermediary-level" investors, who are not as well informed as "issuer-level", but possess the knowledge on the range of securities market intermediaries. [612] The third layer of investors is the "aggregate-level" investor, which would in line with Professor Choi argument closely cooperate with highly visible organizations (HVOs), as he calls them.

The HVOs would be a professional organization formed by investment companies, exchanges or brokers.[613] These HVOs would serve as intermediaries, but the trading relationship would be reversed; it would not be the investors looking for the investment with certain issuers or intermediaries, but the issuers and intermediaries would first have to obtain the approval of an HVO in order to deal with investors. Only afterwards a trade could take place. This pre-approval would allow

---

[609] *Id.* at 285.

[610] *See* Donald C. Langevoort, *Information Technology and the Structure of Securities Regulation,* 98 HARV. L. REV. 747, 757 (1984).

[611] There could be also a debate what is a reputation and how can this reputation be completely misleading. The scandal of Bernard Madoff is as one of the recent failures of the reputation and investors' reliance thereon, when people asked him desperately wanting to enter the fund: *"What, I'm not goof enough for you?" see* Emma Jacobs, *Master of putting in a good word on sentences* FIN. TIMES, June 13, 2013.Further Professor Choi elaborates that for the first-comers, relying purely on reputation would not be satisfactorily and they would thus prefer certain types of regulatory oversight, *see* Choi, *Regulating Investors Not Issuers*, *supra* note 508, at 286. More on the effects of reputation as a market force *see* Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance,* 89 J. POL. ECON. 615, 618 - 625 (1981).

[612] *See* Choi, *Regulating Investors Not Issuers, supra* note 508, at 290-291.

[613] Among HVOs Choi includes (1) organizations aggregating the interests of several intermediaries and (2) nationally-known individual intermediaries seeking to provide necessary protection for "aggregate-level" investors, *e.g.* the New York Stock Exchange (NYSE), National Association of Securities Dealers (NASD) or the American Stock Exchange (AMEX) and other as we know now self-regulatory organizations; *see* Choi, *Regulating Investors Not Issuers*, *supra* note 508, at 296-297.

the HVOs to be in a position to impose private regulatory constraints on other market participants as they are in a better negotiating position than any individual aggregate-level investor.[614] Thus, even for professional or accredited investors, as set up by current regulation, Professor Choi suggests an additional self-regulatory organization, which would create additional intermediary between an investor and an issuer. Such institution resembles a union. The more, if as Professor Choi proposes that this HVO could hypothetically focus more on the interests of their investors than on their own profit. However, this is also the idea behind trusts, where the trustee should concentrate on the profit making for the beneficiary not for himself/herself.

The "unsophisticated" investors form fourth and the last group of investors, which should be the main object of securities law protection.[615] Under the theory of Professor Choi, it would be as well the HVO advising unsophisticated investors, while limiting them to invest only in passive index mutual funds through the HVO.[616] Thus, the approach is not only to protect them by creating an additional organization, but also limiting their investment options.[617] The question, which has not been answered, is how market would react to the position of the passive index mutual funds. Moreover, creating additional intermediary might not serve the purpose of greater protection, as was shown by the credit rating agencies.

In the light of the proposal of Professor Choi, the question is whether and to what extent a government wants to intervene. There may be a minimal intervention or extensive intervention policy rationales. A liberalist would most probably choose the

[614] *Id.* at 298-299.
[615] *See* Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and Protection of Investors*, 70 VA. L. REV. 669, 694 (1984) [hereinafter "Easterbrook & Fischel, Mandatory Disclosure"].
[616] *See* Choi, *Regulating Investors Not Issuers*, *supra* note 508, at 300.
[617] Also Professor Ronald Colombo suggest classification of securities, in which investors can invest, *see* Ronald J. Colombo, *Merit Regulation Via the Suitability Rules*, 12 J. INT'L BUS. & L. 1, 11-15 (2013).

minimal intervention as was suggested in 2003 in the SEC-Spitzer[618] settlement – Global Settlement of Conflicts of Interest between Research and Investment Banking[619] concerning investor education via providing investors with additional materials to improve their sophistication. More paternalistic governments might implement different tools in order to provide for safer capital market,[620] by addressing information asymmetries, protecting investors from fraudulent behavior of investment companies and other market participants or by increasing the potential liability of managers and directors of investment companies and the investment companies themselves.

The main reason for including the outcome of Professor Choi's theory concerning the diversification of investors is not to propose the same assessment of investors, as does Professor Choi, but rather to invite an information-based evaluation of investors. Different categories of investors would be created based not only on their knowledge and experience, as it is the case of the EU regulation or their ability to handle financial losses, as in the US, but to include the appraisal of the availability of the information an investor might possess. However, the question, which professor Choi in his article failed to answer, is how could regulators and/or investment

[618] Eliot Spitzer served as New York State Attorney General, who was well known chasing New York investment companies for non-transparent practices, while alienating not only them but as well the SEC. In 2002 he started number of investigations of investment companies' financial analysts, which culminated on May 21, 2002 with Settlement Agreement between the Attorney General of the State of New York and Merrill Lynch, Pierce, Fenner & Smith and ten other major investment companies. Spitzer was many times accused of building his path towards Congress, which he eventually reached in 2007 when he served as 54th Governor of New York State. However, his political career has not lasted long due to scandal that he got involved in. More on Spitzer's actions as Attorney General; *see* Jonathan R. Macey, *Wall Street in Turmoil: State-Federal Relations Post-Eliot Spitzer* 70 BROOK. L. REV. 117, 124-132 (2005).

[619] *Available online at:* < http://www.finra.org/Industry/Enforcement/DisciplinaryActions/2003GlobalSettlement/>/ *last visited* June 20, 2013.

[620] *E.g.* by creating general public market, where companies wishing to trade their securities have to engage in registered public offering, which is present both in the US as well as in EU. More on the public offering process, *see* JAMES D. COX, ROBERT W. HILLMAN & DONALD C. LANGEVOORT, SECURITIES REGULATION: CASES AND MATERIALS 117-259 (Aspen Publishers, 6th ed. 2009) [hereinafter "COX, HILLMAN & LANGEVOORT"].

companies assess the quality and quantity of knowledge the investors holds. Moreover, isn't the possession of information time-delicate? An investor today may hold information as an issuer in connection to specific investment product, but tomorrow have no information at all. Thus, I believe that Professor Choi's article indicates rather towards the knowledge and experience assessment, without which one cannot even understand the information.

Furthermore, investment companies do carry out certain aspects of the HVO organizations. According to Professor Choi, HVO should protect the investors and their interests should be put prior to their owns. One of the possible applications of this proposal is to erase additional intermediary and through regulation emphasize this duty of investment companies, which they as trusts used to perform.

Moreover, the proposed "self-tailored" regulation as a solution, allowing issuers to subject themselves to selected level of public regulation and thus choosing the level of disclosure and liability regimes[621] is to great extent similar to what MiFID II already offers. It gives the investor the ability to choose between different levels of protection. Ultimately, one may not agree with the idea of self-tailored regulation, however it has to be borne in mind when assessing the extent of the oversight in case of professional or more experienced investors that "*the securities laws were not enacted to protect sophisticated businessmen from their own errors of judgment,*"[622] but for those investors who actually need the protection.

[621] On costs and benefits of self-tailored system *see* Stephen J. Choi, *Market Lessons for Gatekeepers*, 92 NW. U. L. REV. 916, 951-958 (1998) and on possibilities on handling all the criticism of self-tailored regulatory regime, *see* Choi, *Regulating Investors Not Issuers*, *supra* note 508, at 288-290.
[622] Judge Irving R. Kaufman *in* Hirsch v. du Pont, 553 F.2d 750, 763 (2d Cir. 1977).

2.4. Conclusion: Who is Retail Investor?

There are as many investors as there are people. All investors when investing suffer from numerous behavioral biases to diverse extent, depending on their knowledge, experience, personal characteristics as well as their background and environment. Does this however mean that the regulator should take them into account when forming investor classification? I believe no. Looking back to the history, the US Congress, when adopting the securities regulation in 1930's, held an extensive discussion on the **object** of the protection and who represents an **"average investor"**. Representative Chapman said that investors are **uninformed** and **credulous** as *"they have little if any technical knowledge concerning the value of securities. They know nothing about the financial structure of the corporations, which issue securities. The average investor does not know to read or interpret a balance sheet, even when he has all the facts before him, which went into the make-up of the balance sheet."*[623] And yet the US retail investment industry together with the investors has flourished ever since.

The investors of 21st century dispose with greater general knowledge and also with access to information and yet in the EU there is the shift to treat them as consumers. There is also markedly less call and support for financial literacy as a main pillar of retail investor protection policy.[624] This is however an unfortunate change, as it starts to treat consumer as a weaker party, who needs the public sector to intervene paternalistically and who is unable to learn. As shown, in the investment company environment the investor and consumer notions are not the same and not interchangeable. Consumer policy, which is more paternistical and calls for more

---

[623] *See* 77 CONG. REC. 2935 & 2947 (1933).

[624] ECON Committee, Workshop on Consumer Protection (February 2009, PE 416.213) Briefing Notes.

precautionary, *ex ante* approach is logically inconsistent with the functioning of the markets. Moreover, the referral to both policies may harm both the investors as well as the industry due to the legal uncertainty, policy incoherence and possible empowerment of consumer advocates. Instead regulators should undertake a different course of action: they should **empower the investors**. This would call for legislative measures, which support the investors in their active participation in identifying, demanding and overseeing the financial services.

Retail investors are not consumers and they should not be treated like them. The EU should be extra-cautious not to mix different notions and policies and not to apply the consumer law where it is not necessary, as it ultimately may have negative effect on formation of pro-investor oriented environment. The consumerist approach towards the regulation of investment companies might be perceived as a more precautionary and intervening, which for some might seem reasonable in the post-crisis period.[625] Yet a conceptual change raises number of issues, which include legal uncertainty, policy incoherence and problems of interpretation,[626] which all serve precisely the contrary purpose than the consumer or investor protection should.

Thus, in conclusion a retail investor for the purposes of proposing enhanced regulation of investment companies should be everyone who is not a professional (according to the MiFID). Along with the claim that to provide **reasonable** protection, the regulation should be drafted in "investor empowerment spirit" for investors to actively participate. The regulatory framework should "nudge" investors to be active in their decision-making as well as responsibility taking. The tools how to keep these two policy objectives in balance through regulation are analyzed in the

[625] *See* Moloney, *Investor Model*, *supra* note 427, at 189.
[626] *See* Teubner, *Legal Irritants*, *supra* note 566, at 19-20. The courts in and of the European Union could possibly later adopt the principles of general EU consumer law on a legal relationship, which in its core is not consumerist.

subsequent chapters through introducing broad fiduciary model for the investment companies and those who control the investment of investors as well as through employing efficient private right of action, which currently is present neither in the US nor in the EU.

CHAPTER III IN THE LIGHT OF DISCLOSURE[627]

The title of the thesis speaks about "protection of retail investors through investor empowerment." In the first chapter the discourse of history and development of investment company regulation was presented. The policy rationales of securities regulation were described and analyzed with a focus on investment companies, observing that today, securities regulation has become highly complex. It regulates diverse participants, as issuers, investors or investment companies and their respective behavior.[628] In the second chapter, one of the objects of the protection – investor – was analyzed with the aspiration to understand who or what is it that the regulator should protect.

In this chapter, the main focus is disclosure of **information** – what kind of information – do the investors obtain before and during their relation with investment companies. The question that I attempt to answer is whether and to what extent do the investors become empowered by a prospectus disclosure. The first discourse leads to inquiry of the **objectives** of the securities regulation – as disclosure remains the central piece of the contemporary securities regulation. The subsequent question however is what its relevance in connection to investment companies is. The ICA 1940 and UCITS V require the publication of simplified prospectus, a full prospectus, annual reports and half-yearly reports.[629] Yet this information does not anyhow display in the price of mutual funds, UCITS or UK funds' shares. Why is then the

[627] When formulating the title of this chapter, one of the well-known quotes of the US Supreme Court Justice Louis D. Brandeis served me as an inspiration, "[P]ublicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman." This quote refers to the benefits of openness and transparency, which I believe should form the cornerstone of the securities regulation.
[628] *See* MOLONEY, EC SEC. REG. 2ND ED, *supra* note 71, at 3 and RÜDIGER VEIL, EUROPEAN CAPITAL MARKETS LAW 17 (Hart Publishing, 2013) [hereinafter "VEIL"].
[629] *See* section 3.3.

disclosure important for investment companies and for their respective investors? The essential idea behind disclosure in connection with investment companies is that the investors are able to make informed decisions concerning their investments. Although disclosure is perceived as the cure to market problems as information asymmetry, market efficiency or the agency problem, in connection with investment companies its relevance is distinctive. After analyzing how disclosure as a regulatory tool heals the existing market problems, I focus explicitly on the regulation of investment company prospectus in the light of its relevance for retail investors. The prospectus of investment company is the key material based on which the investors decide whether or not to invest with an investment company. However, realizing the limitations of retail investors' vis-à-vis the business specificities of the daily investment activities of investment companies, I pose a question whether the disclosure is sufficient to protect retail investors. My conclusion is negative. Disclosure aims to resolve the information asymmetry that forms a substantial part of the regulation rationale. Yet in case of investment company – investor relationship, procurement of information is only the beginning of the investor protection framework. Investors become informed about the nature and risk of their investments, but the nature in which investment companies control and manage investors' investments is much more important (Chapter IV). At the same time, once an investor is provided with information it is of an utmost importance to what extent and how can investors "control" their own investment through enforcement (Chapter V and VI).

3.1. Disclosure as a Key Policy Rationale for Securities Regulation

The objectives of regulation are generally emphasized either directly by a regulator itself when adopting a law[630] or by an enforcement authority or a court. Although there is a constant debate on ways of interpretation, it is safe to say that distinctly stipulated legislative goals provide additional guidance for interpretation of any kind of regulation.[631] Yet they are only rarely stated clearly, and one has to search for them.

As far as the US securities regulation is concerned, legislators, judges and scholars have stipulated different goals and objectives.[632] When the US Congress enacted the SA 1933 and the SEA 1934, the purpose of securities regulation was "simple" – to **protect investors by ensuring "fair and honest" markets**.[633] With the adoption of the ICA 1940 and IAA 1940, the proclaimed aim of these acts was to

---

[630] In case of the United States, it is always highly recommended to read the hearings of Senate and Congress, and their subcommittees to understand the policy rationales behind the adopted legislative measures, *e.g.* HEARINGS ON S. 3580 BEFORE SUBCOMMITTEE OF THE SENATE COMMITTEE ON BANKING AND CURRENCY, 76TH CONG., 2[d] Sess. 38-39 (1940) (statement of SEC Commissioner Healy) *("It should hardly be necessary to point out that existing legislation is not adequate to meet the problems presented by the investment company… The disclosure principle embodied in SA 1933 and SEA 1934 is a sound principle, but it has its limitations.")*. The EU emphasizes the legislative aims usually in the recitals to the directives and regulations.

[631] *See* Victoria F. Nourse, *A Decision Theory of Statutory Interpretation: Legislative History by the Rules*, 122 YALE L. J. 70, 72 (2012). In civil law countries, it is often the rule that with the act a summary of a legislative intent is published, which aims to help in the interpretation of the act. In the United States, there is no similar custom. Therefore, one can use transcripts from the hearings in Senate and Congress to see the claimed purpose of those congressmen or senators who are introducing the act. Therefore, in the US there is a constant debate on what is the legislative intent, whether it is the intent of the drafter or of those who have submitted the act or of all of those who have voted for the act. In 1930 Max Radin in his Harvard Law Review Article wrote that there is no such thing as "legislative intent", *see* Max Radin, *Statutory Interpretation*, 43 HARV. L. REV. 863, 872 (1930); Justice Scalia, as one of the contemporary advocate of textualism and originalism, often criticizes the "imaginary" congressional intent as there is no one specific intent of the US Congress, *see* ANTONIN SCALIA, A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW 31 (Amy Gutmann ed., 1997); Therefore, in connection with the US, it should be emphasized that the term "legislative intent" must be further specified. *See generally* HENRY HART & ALBERT SACKS, THE LEGAL PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATION OF LAW (Foundation Press, 2006).

[632] The Black's Law Dictionary does not recognize the term "legislative goal" or "legislative objective" and works with the term "legislative intent" defined as "the design of plan that the legislature had at the time of enacting a statute". Another term used is "intention of the legislature"; "intent of the legislature"; "congressional intent" or "parliamentary intent". *See* BLACK' LAW DICTIONARY (9[th] ed. 2009).

[633] 15. U.S.C. § 78b (1976) *in* Gary F. Goldring, *Mandatory Disclosure of Corporate Projections and the Goals of Securities Regulation*, 81 COLUM. L. REV. 1525, 1526 (1981).

prevent fraud and deceit by persons involved in the business of investment advisory services.[634] In *Basic Inc. v. Levinson* the US Supreme Court stated that the purpose of securities regulation was to "*facilitate an investor's reliance on the integrity"* of the stock markets.[635]Additionally after the financial crisis in 2008, the Dodd-Frank Act 2010's principal goal was to minimize systemic risk.[636]

Fair and honest markets were also the principal goal of regulation in the **UK**, whereas the term "fraud" was its detonator. In 1939 the UK adopted the Prevention of Fraud (Investments) Act,[637] which aimed to **prohibit a number of frauds** involving the sale of securities. The Prevention of Fraud (Investments) Act 1939 prohibited two criminal offenses.[638] First, any person who induced another to enter into a contract relating to the purchase or disposal of securities or other property by making a misleading, false, deceptive or reckless statement, promise, or forecast was guilty of deceptive inducement.[639] Second, the act prohibited any unauthorized distribution of circulars concerning the purchase or disposal of securities or other property.[640] In 1958 the Act was substantially amended.[641]

---

[634] The IAA 1940 is designed to regulate those who give investment advice about securities to others. The IAA 1940 requires registration of all advisers. The IIA1940 does not specify in great detail all the rules governing the way advisers conduct their business but broadly prohibits fraud and holds the advisers to meticulous fiduciary standards. In case of any type of conflict of interest, the advisers are required to fully disclose the conflicts to their clients and to SEC. For more on the Investment Advisers Act of 1940 *see* Loomis, *supra* note 231; Lovitch, *supra* note 231; Barbash & Massari, *supra* note 231 or Chertok, *supra* note 231.

[635] *See* Basic Inc. v. Levinson, 485 U.S. 224, 246 (1988).

[636] *E.g.* under the Dodd-Frank Act 2010, the newly-established FSOC is tasked with identifying risks to US financial stability, either resulting from material financial distress or the failure of a bank holding company or nonbank financial firm, or arising outside the financial marketplace, and responding to emerging threats to the stability of the US financial system. *See* Dodd-Frank Act 2010 §§111, 112(a)(1).

[637] Prevention of Fraud (Investments) Act, 1939.

[638] For more on the Prevention of Fraud (Investments) Act in UK *see* Graham F. Pimlott, *The Reform of Investor Protection in the U.K. – An Examination of the Proposals of the Gower Report and the U.K. Government's White Paper of January, 1985,* 7 J. COMP. BUS. & CAP. MARKET L. 141, 143-144 (1985).

[639] Section 12 of Prevention of Fraud (Investments) Act, 1939.

[640] Section 13 of Prevention of Fraud (Investments) Act, 1939.

[641] Prevention of Fraud Investment Act, 1958 6 & 7 Eliz. 2 45.

The **EU** policy rationales for regulation of securities market are similar with those in the US and UK. Goals as assuring the smooth functioning of securities markets and public confidence,[642] efficient market allocation[643] or investor (consumer) protection[644] have been repeatedly emphasized. Additionally, scholars have stressed also such aims as decreasing the cost of the capital,[645] correction of market failures,[646] or even more radical ones – as expanding investor opportunity.[647] The EU securities regulation is regarded as justified where diverse market participants interact and externalities as **fraud** or **systemic risk** may occur.[648] The EU aims to constitute an environment with accurate, transparent, comprehensive and timely information, which should be monitored and enforced.[649]

Although the goals of the securities regulation are generally understood and agreed upon to a great extent,[650] they continue to evolve and change in the light of the developments on and needs of the market (and additional regulation). As all of the regulatory frameworks, also securities regulation constantly reflect the changing political, economic and social dynamics, and therefore a moment, when one could

---

[642] *See* Recital 2 MAR.
[643] *See* Recital 10 Prospectus Directive.
[644] *See* Recital 4, 42 MiFID II.
[645] *See* John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement,* 156 U. PENN. L. REV. 229, 231-232 (2007) [hereinafter "Coffee, *Law and the Market*"].
[646] *See* Jeff Schwartz, *Reconceptualizing Investment Management Regulation,* 16 GEO. MASON L. REV. 521, 522 (2009) ("The central idea behind the welfare-economics inquiry is that society fares best when markets are competitive. Regulation is therefore justified to the extent it corrects for failures in the market that hinder competition and does so in cost-effective manner.").
[647] *See* Jasmin Sethi, *Another Role for Securities Regulation: Expanding Investor Opportunity,* 16 FORDHAM J. CORP. & FIN. L. 783, 787-788 (2011) ("What is missing from an analysis of the role of securities regulation is a social welfare justification that is distinct from market efficacy altogether." …"Expansion of opportunity may appear novel as a goal justifying financial regulation, but it should not.").
[648] *See* MOLONEY, EC SEC. REG. 2ND ED, *supra* note 71, at 27.
[649] *See* VEIL, *supra* note 628, at 19 and Emilios Avgouleas, *What Future for Disclosure as a Regulatory Technique? Lessons from Behavioural Decision Theory and the Global Financial Crisis,* in: IAN G. MACNEIL & JUSTIN O'BRIEN, THE FUTURE OF FINANCIAL REGULATION 205 (Hart Publishing, 2010) [hereinafter "Avgouleas in MACNEIL & O'BRIEN"].
[650] *See generally* James J. Park, *The Competing Paradigms of Securities Regulation,* 57 DUKE L. J. 625 (2007) and Eric J. Pan, *Understanding Financial Regulation,* 2012 UTAH L. REV. 1897 (2012).

specifically enumerate regulator's goals is impossible to achieve.[651] Nevertheless, it is necessary to try to determine these goals in order to deconstruct them and consider the legal problem or problems, which lie behind them. In other words, why is it that the regulation is necessary to secure smooth functioning of securities markets, allocative efficiency and investor protection? What are the reoccurring problems that regulators try to solve in different ways? Once, these legal problems are correctly depicted, only then could possible solutions be considered and analyzed. Looking back to the history of the evolution of securities regulation – the reoccurring problem - was "**fraud**". As shown the rationale behind adopting the Blue Sky legislation and the New Deal securities acts in the US as well as the Prevention of Fraud (Investments) Act of 1939 in the UK was the fight against fraudulent securities deals and behavior on the market.[652]

3.1.1. ECMH & Fraud **as** Disclosure-Detonators

Besides fraud as a common element on the market – what are the other present elements? Scholars and regulators have always strived to understand the market and its natural powers. Of all developments in financial economics in 20th century, the theory that achieved the widest acceptance among legal scholars was the efficient capital market hypothesis [hereinafter "ECMH"].[653] The ECMH was believed to have

651 *See* Robert Baldwin, Martin Cave & Martin Lodge, *Introduction: Regulation – The Field and the Developing Agenda, in* THE OXFORD HANDBOOK OF REGULATION 6-7 (Robert Baldwin *et. al.* ed., 2010).

652 *See e.g.* MICHAEL E. PARRISH, SECURITIES REGULATION AND THE NEW DEAL 3-5 (Yale University Press. 1970); The purpose of the SA 1933, as stated in its preamble is "to provide full and fair disclosure of the character of securities sold in interstate commerce and foreign commerce and through the mails, and to prevent fraud in the sale thereof, and for other purpose." Furthermore, the Senate Committee on Banking and Commerce stated that the "purpose of the bill is to protect the investing public and honest business. The basic policy is that of informing investors of the facts concerning securities to be offered for sale in interstate and foreign commerce and providing protection against fraud and misrepresentation. " S. REP. NO. 47, 73RD CONG., 1ST SESS. 1 (1933).

653 *See* Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency,* 70 VA. L. REV. 549, 549 (1984) [hereinafter "Gilson & Kraakman"].

also a strong empirical support.[654] Despite certain anomalies, numerous studies demonstrated that the capital market responds efficiently to variety of information.[655] The central claim of the ECMH is that in an efficient market the prices "fully reflect all available" information[656] - all available information about securities traded in the principal securities markets becomes **impounded** into stock prices.

ECMH became a working tool for many legal scholars,[657] a premise for a major revision of the disclosure system administered by the SEC and also a reference for the courts.[658] The US Supreme Court has also characterized the market as "efficient".[659] Ultimately, the ECMH transformed from a theory into a doctrine.[660] Nevertheless, the economics literature continues to develop new theories, including behavioral economics or Capital Asset Pricing Model [hereinafter "CAPM"], which without going into a great detail, challenge the generally accepted ECMH and pose new questions for the regulators.[661] The economic theories naturally form a basis for the regulatory approaches, including the mandatory disclosure mechanism, but none of

---

[654] *See* Michael C. Jensen, *Some Anomalous Evidence Regarding Market Efficiency,* 6 J. FIN. ECON. 95, 95 (1978). Professor Jensen famously stated *"there is no other proposition in economics which has more solid empirical evidence supporting it than the Efficient Market Hypothesis."*

[655] *See e.g.* JAMES H. LORIE & MARY T. HAMILTON, THE STOCK MARKET: THEORIES AND EVIDENCE 80 (R.D. Irwin, 1973) or Paul A. Samuelson, *Proof That Properly Anticipated Prices Fluctuate Randomly,* 6 INDUS. MGMT. REV. 41 (1965) and naturally Eugene Fama's seminal review article, Eugene Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work,* 25 J. FIN. 383 (1970) [hereinafter "Fama, *Efficient Capital Markets*"].

[656] *See* Gilson & Kraakman, *supra* note 653, at 554.

[657] *See* Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited,* 140 U. PENN. L. REV. 851, 851-852 (1992) [hereinafter "Langevoort, *Theories, Assumptions*"]

[658] Judge Frank Easterbrook in his opinion without any qualification wrote that "[t]he SEC believes that markets correctly value the securities of well-followed firms, so that new sales may rely on information that has been digested and expressed in the security's price." In Wielgos v. Commonwealth Edison Co., 892 F.2d 509, 510 (7th Cir. 1989).

[659] *See* Basic Inc. v. Levinson, 485 U.S. 224 (1988), where the court stated that "[t]he market price of shares traded on well-developed markets reflects all publicly available information"

[660] *See* Langevoort, *Theories, Assumptions, supra* note 657, at 853.

[661] For more on these theories and how they challenge the ECMH *see e.g.* Lawrence A. Cunningham, *Capital Market Theory, Mandatory Disclosure, and Price Discovery,* 51 WASH. & LEE L. REV. 843 (1994) hereinafter "Cunningham, Capital Market Theory"]; Langevoort, Theories, Assumptions, *supra* note 657, or Lynn A. Stout, *Inefficient Markets and the New Finance,* (UCLA, Law & Economics Research Paper Series, Research Paper No. 05-11; *available online at:*< http://papers.ssrn.com/sol3/papers.cfm?abstract_id=729224>/ *last visited* Nov. 18, 2014.

them has become carved in stone. As proved many times, people are extremely creative and therefore even the economists should take into equation much larger number of elements and interactions.

However, the discourse into the ECMH was not purposeless. Given that the ECMH has affected and continues to influence the securities regulation and policies,[662] the question that the regulators are posing is what behavior precludes attaining the "efficient market". As the essential component of the ECMH is that the "available" information is "all" and "true", it is the market participants' fraudulent behavior that impedes the regulatory objectives of an efficient securities market.[663] Thus, as it has been before the emergence of the ECMH doctrine, fraud continues to be omnipresent on the markets.

Fraud prevents smooth functioning of a competitive market by decreased transparency and greater informational asymmetry, and thus increases the cost of the capital. Fraud reduces allocative efficiency of the market, as one is unable to rely on the "accuracy" of stock prices,[664] and moreover it generates distrust on the market, which is greatly based on **trust**. Yet unfortunately it occurs on all levels when investing and trading with securities and it affects retail investors in countless forms. I use the term "fraud" as a common denominator also for deceit, misfeasance and manipulation.[665] In essence, fraud is a knowing misrepresentation made to induce

[662] *See e.g.* Gilson & Kraakman, *supra* note 653, at 549-550 (Arguing that the ECMH has become in the United States "the context in which serious discussion of the regulation of financial markets takes place").
[663] It has been a subject of debates of economists and lawyers what construes an efficient or a functioning securities market. There are several theories asserting the efficiency of securities markets or of capital markets. One of such theories is the Efficient Capital Market Hypothesis [hereinafter "ECMH"], which has been explained for the first time by Paul Samuelson in 1965, *see* Samuelson, *supra* note 655.
[664] *See* Easterbrook & Fischel, Mandatory Disclosure, *supra* note 615, at 673.
[665] *See* BLACK'S LAW DICTIONARY (9th ed. 2009), Fraud is "1. A knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment; 2. A misrepresentation made recklessly without belief in its truth to induce another person to act; 3.

action by an individual who as a result of relying on that misrepresentation suffers harm.[666] Fraud is a concept designed to adapt to evolving behavior that it targets.[667] Fraud's perpetuation is built on its ability to continuously re-emerge in new "shape" and thus it is almost impossible for a regulator to define or destroy.[668] Therefore, a regulator came up with an idea how to prevent it – through **disclosure**. However, in case of an investment company – investor relationship disclosure has its peculiarities and limitations, which are analyzed in the following sections.

3.2. Disclosure as a Regulatory Tool

As stated, contemporary securities regulation has made disclosure the central element of its regulatory armory.[669] The same is applicable in case of retail investors, where the disclosure remains the central element of protection.[670] Disclosure as a regulatory method is perceived as an "elixir healing information asymmetry,"[671] which impedes

---

Unconscionable dealing; esp., in contract law, the unfair use of the power arising out of the parties' relative positions and resulting in an unconscionable bargain."

[666] *See* Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341-42 (2005). In the US, the federal securities law requires the showing of scienter or the proof that the misrepresentation was carried out knowingly. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 212 (1976), whereas in some states, as in New York, where the Martin Act is in place in order to fight securities fraud, does not require to prove the scienter. *See* People v. Federated Radio Corp., 154 N.E. 655, 658 (N. Y. 1926).

[667] *See* Samuel W. Buell, *Novel Criminal Fraud*, 81 N.Y.U. L. REV. 1971, 1972-73 (2006), where Professor Buel claims that the instability in the law of fraud is structural given the constant and rapid pace of economic innovation. Therefore, the fraud law will always confront new economic practices that have not been defined as fraudulent before.

[668] *See* Stonemets v. Head, 154 S.W. 108, 114 (Mo. 1913) "Fraud is kaleidoscopic, infinite. Fraud being infinite and taking on protean form at will, were courts to cramp themselves by defining it with a hard and fast definition, their jurisdiction would be cunningly circumvented at once by new schemes beyond the definition."

[669] *See* COFFEE & HILLARY, *supra* note 71, at 4 and Avgouleas in MACNEIL & O'BRIEN, *supra* note 649, at 205.

[670] This statement is applicable both for EU and US. For EU *see* NIAMH, MOLONEY, EU SECURITIES AND FINANCIAL MARKETS REGULATION 247 (Oxford University Press, 2014) [hereinafter "MOLONEY, EU SEC. REG. 3RD ED"] ("Notwithstanding the depth and range of the UCITS rulebook, disclosure remains a central element of the regulatory scheme"); MOLONEY, HOW TO PROTECT INVESTORS, *supra* note 30, at 288 or VEIL, *supra* note 628, at 210 and for the US *see e.g.* SEC SPECIAL STUDY (*supra* note 252) in which there was stated that "The keystone of the entire structure of Federal securities legislation is disclosure."

[671] *See e.g.* Robert E. Verrecchia, *Essays on Disclosure*, 32 J. ACCT. & ECON. 97, 164-172 (2001) (finding that disclosure reduces information asymmetry and at the same time lowers cost of capital); or Michael Welker, *Disclosure Policy, Information Asymmetry, and Liquidity in Equity Markets*, 11 CONTEMP. ACCT. RES. 801, 801 (1995) (finding empirical data proving that "a well-regarded disclosure policy reduces information asymmetry and hence increases liquidity in equity markets").

market efficiency and harms investors.[672] It is recognized that disclosure has positive effect on market in general. There is a plethora of academic works[673] arguing for applying disclosure provisions in securities regulation for ensuring market efficiency[674] or solving the agency problems.[675] Majority of these works are a combination of legal and economic analyses, where legal professionals rely on empirical research of economists. Although notably Professors Stigler and Benston have through the 1980's extensively criticized the disclosure mechanism in the US,[676] other scholars have efficiently rebutted their claims[677] and today the disclosure-

[672] On the general background for disclosure-based regulation in connection with the securities laws, *see* Paula J. Dalley, *The Use and Misuse of Disclosure as a Regulatory System,* 34 FLA. ST. U. L. REV. 1089, 1109-1113 (2007). Professor Dalley enumerates 6 purposes: (1) Providing information in an existing market, (2) Regulating Lawful Conduct, (3) Providing Information for Government Operations, (4) Improving Management or Firm Performance, (5) Increasing Public Awareness and (6) Other purposes, depending on the area of law, where the disclosure is introduced.

[673] First concerns about the corporate disclosure, as a regulatory method, were widely expressed by late 19th century. The *New York Times* on Dec. 9, 1885 reported that dissatisfied shareholder of the Broadway and Seventh-Avenue Railroad Company had been questioning the management. The reason for this inquiry had been the issuance of $500,000 of bonds without any substantiated reason. [The New York Times (1885). In 1902, the U.S. Steel according to the *Financial Chronicle* had issued the fullest and frankest earning statement ever submitted outside of an annual report by a great industrial concern. On the public observations of unsatisfactorily disclosure *see* John Pound, *Proxy Voting and the SEC: Investor Protection Versus Market Efficiency,* 29 J. FIN. ECON. 241, 247 - 248 (1995).

[674] The importance of disclosure for market efficiency has been argued and contra-argued many times. Some academics believe that disclosure has a direct effect on securities prices, as they should "fully reflect" all available information and thus on the efficient capital market hypothesis *see* Fama, *Efficient Capital Markets, supra* note 655, which is considered to be a seminal paper, where Professor Fama argued for a direct correlation between the information and stock prices.

[675] Agency problem is connected to the passivity of investors. Once investors invest in an investment company, the directors have no further desire to disclose the state and development of the investments of an investment company. On agency problem in case of disclosure *see generally* Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems,* 62 U. CHI. L. REV. 1047, 1048-49 (1995) [hereinafter "Mahoney, Mandatory Disclosure"] (Professor Mahoney contends that the principal aim of mandatory disclosure is to address certain agency problems that arise between different market participants. He also claims that the mandatory disclosure mechanism was not a New Deal innovation, but it has evolved sooner from the common law rules on agents). *See also* Paul M. Healy & Krishna G. Palepu, *Information Asymmetry, corporate disclosure and the capital markets: A review of the empirical disclosure literature*, 31 J. ACCOUNTING & ECON. 405, 409-410 (2001) [hereinafter "Healy & Palepu"].

[676] *See e.g.,* Stigler, *supra* note 329. George J. Benston, *The Costs and Benefits of Government-Required Disclosure: SEC and FTC Requirements in* CORPORATIONS AT THE CROSSROADS: GOVERNANCE AND REFORM 37-69 (Deborah DeMott ed. 1980); George J. Benston, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934,* 63 AM. ECON. REV. 132 (1973).

[677] For an overview of these counterclaims, *see* Joel Seligman, *The Historical Need for a Mandatory Disclosure System*, 9 J. CORP. L. 1 (1983).

challenge debate has been suppressed.[678] Consequently, disclosure as a regulatory tool continues to be applied in different places within the securities regulation.[679] For the purposes of this thesis, I will assume that the general legal and economic consensus that the disclosure is justifiable for market wellbeing and protection of retail investors is correct. And although there is a debate along the line of the mandatory *versus* voluntary disclosure, in this thesis the referral to disclosure indicates mandatory disclosure.[680]

Disclosure in simple terms is *"**the act or process of making known something that was previously unknown.**"*[681] The model for the use of disclosure as a regulatory device for capital markets was established in the US by the New Deal securities acts. SA 1933 was designed to achieve "truth in securities" by full and fair disclosure. One year after, the SEA of 1934 has provided a whole new framework of disclosure regarding traded securities.[682] In the US, the massive disclosure system has been linked to the possible risk that small investors might withdraw their capital.[683] In connection with the investment companies, disclosure of the nature and activities of

---

[678] *See* Reinier H. Kraakmann, *Disclosure and Corporate Governance: An Overview Essay in* REFORMING COMPANY AND TAKEOVER LAW IN EUROPE 96 (Guido Ferrarini & et. al., eds., 2004) (Professor Kraakman stated that today the group arguing against mandatory disclosure represents a "minority strand").

[679] Simplifying the process, where disclosure as a regulatory mechanism is applied, both in the US and EU, there are three stages; (1) the obligation to disclose of issuers at the initial sale of securities, (2) the obligation to disclose resting on issuers if they have securities, which continue to be traded, and (3) obligation to disclose imposed on parties, other than issuers, which participate on trading, as broker dealers, investment advisers or investment companies. On the history of the disclosure requirements in the US, *see* Robert L. Knauss, *A Reappraisal of the Role of Disclosure,* 62 MICH. L. REV. 607, 610 – 616 (1964).

[680] For articles on voluntary disclosure and its relevance for the information asymmetry, *see e.g.* Ronald A. Dye, *Mandatory Versus Voluntary Disclosures: The Cases of Financial and Real Externalities,* 65 ACCOUNTING REV. 1 (1990); Michael J. Fishman & Kathleen M. Hagerty, *Mandatory Versus Voluntary Disclosure in Markets with Informed and Uninformed Customers,* 19 J. L. ECON. & ORG. 45 (2003) or Grace Pownall & Gregory Waymire, *Voluntary Disclosure Credibility and Securities Prices: Evidence From Management Earnings Forecasts,* 27 J. ACCOUNTING RESEARCH 227 (1989).

[681] *See* BLACK'S LAW DICTIONARY (9th ed. 2009).

[682] On historical development of "the truth in securities" concept *see* Milton H. Cohen, *"Truth in Securities" Revisited,* 79 HARV. L. REV. 1340 (1966).

[683] *See* EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE OF CORPORATE LAW, *supra* note 557, at 226.

investment companies, as the underlying purpose, was also highlighted when the ICA 1940 was adopted.[684]

3.2.1. Specificities of Disclosure in the EU and the UK

The EU investment companies are obliged to provide information on type of business they operate and their organizational structure,[685] as well as on the financial instruments that they offer. It has been broadly believed that investment decision is good only if it is informed.[686] Thus, the idea behind the disclosure is that investors should be informed about their investment before making any investment decision.[687] Although individual Member States had already maintained disclosure systems,[688] the EU has adopted a disclosure regime in its securities regulation only in 1979 with the adoption of Securities Admission Directive.[689] After the FSAP in 1999, the EU disclosure regime for the intermediated and product-based transactions has greatly developed,[690] and disclosure became a dominant regulatory mechanism for investor-

[684] *See* 86 Cong. Rec. 2844-47 (Mar. 14, 1940) (statement of Sen. Robert F. Wagner on S. 3480).
[685] Article 7(2) MiFID II.
[686] *See* John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 747-751 (1984) (Professor Coffee argues that investors require a substantial amount of information for at least two reasons: (1) a means of diversification and (2) for risk assessment and portfolio revision). *Generally see* Easterbrook & Fischel, Mandatory Disclosure, *supra* note 615 and Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998).
[687] *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976), citing H.R. Rep. No. 73-85, at 1-5 (1933). The US Congress enacted the SA 1933 *"to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing."* For more *see* SEC. & EXCH. COMM'N, DISCLOSURE TO INVESTORS: A REAPPRAISAL OF FEDERAL ADMINISTRATIVE POLICIES UNDER THE '33 AND '34 ACTS (the Wheat Report) 10, 49 (1969) [hereinafter "Wheat Report"]. The Wheat Report emphasizes the key purpose of the disclosure-based regulation to provide investors and speculators access to information.
[688] In the UK the recognition of the role of disclosure has a long history. In the English common law, from the mid-eighteenth century, disclosure was applied in insurance contracts. Later, the Companies Acts from 1844 imposed a disclosure obligation on the issuer when offering shares to public, *see* MACNEIL, *supra* note 527, at 35.
[689] The first disclosure provisions in the Securities Admission Directive, the Securities Admission Prospectus Directive and the Half Yearly Report Directive contained only provisions for primary markets, *see* VEIL, *supra* note 628, at 218.
[690] *See* MOLONEY, HOW TO PROTECT INVESTORS, *supra* note 30, at 288.

investment company relationship.[691] However, most disclosure provisions are laid down in directives, which require implementation by the Member States, granting them discretion with regard to specific wording, which may cause certain discrepancies in the approach and extent of disclosure obligation of Member States.[692] Therefore, besides understanding the EU regulatory tools, it is necessary to consult also the national transposing legislation. The UK disclosure requirements for the UK funds are principally contained in the Collective Investment Schemes Sourcebook (COLL).[693] It imposes obligation on the UK funds' prospectuses, reports, accounts as well as the simplified prospectus and key investor information. The aim of the FCA is to safeguard that the provided information to the investors is clear and that they reveal main features and risks of investment company.[694]

Currently, the specific feature of the EU disclosure regime is that it is twofold,[695] as **MiFID II does not fully apply to UCITS**.[696] MiFID II is a horizontal directive, which is cutting through the entire financial services industry, but insurance industry.[697] The product disclosure is a primarily function of UCITS V, which is based on prescriptive asset-allocation rules and portfolio-shaping rules. The rules

[691] *See* Moloney, Large-Scale Reform, *supra* note 424, at 156 and MOLONEY, HOW TO PROTECT INVESTORS, *supra* note 30, at 304.
[692] Today, the EU has broadly applied its disclosure regime, *see e.g.* MiFID; UCITS IV Directive, Directive 2003/71 of the European Parliament and of the Council of 4 November 2003 on the Prospectus to Be Published When Securities are Offered to the Public or Admitted to Trading and Amending Directive 2001/34/EC, O.J. L 345/64; Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC O.J. L390/38 [hereinafter "Transparency Directive"] or MAD
[693] *See* Section 4: 4.2. includes Pre-sale notifications; 4.5. Reports and accounts; section 4.6 Simplified Prospectus provisions and section 4.7. Key investor information and marketing communication.
[694] *See* FCA, Pre-sale Disclosure (May 1, 2013), *available online at:* < http://www.fca.org.uk/firms/being-regulated/meeting-your-obligations/cobs/disclosure>/ *last visited* Jan. 10, 2015.
[695] The MiFID I has been adopted 19 years after the adoption of the first UCITS Directive and therefore for a long time, management companies were regulated only very lightly.
[696] For a discussion on MiFID – UCITS relationship, *see* section 4.2.2.
[697] *See* Christel M. Grundmann-van de Krol, *The Markets in Financial Instruments Directive and Asset Management*, *in* LIABILITY OF ASSET MANAGERS 25 (Danny Busch & Deborah DeMott eds. 2012) [hereinafter "LIABILITY OF ASSET MANAGERS"].

under UCITS V are considerably more paternalistic than the disclosure requirements under the US securities regulation.[698] The UCITS (except the structured UCITS) may be traded on an execution only basis test, which means that the UCITS MCs do not have to apply intermediary assessment of the adequacy and suitability of its product (UCITS) for its retail clients, but **only** the best execution principle.[699] Only in case, where an investor contracts with a third-party, will the disclosure mechanism of MiFID II apply.[700] MiFID II requires that investment companies, providing services with respect to "financial instruments" within MiFID's scope, present investor with disclosure, including marketing communication, which is "clear, fair and not misleading".[701] Further, a specified pre-contractual disclosure allows investors to "reasonably understand the nature and risks of the specific type of financial instrument that is being offered" and to take decisions on an informed basis.[702]

Before analyzing and comparing the specificities of the disclosure systems of investment companies, I reflect on the generally accepted rationales of disclosure through the lens of a retail investor. The question is whether the disclosure as a regulatory tool is an efficient concept for a retail investor.

3.2.1.1. Curing Information Asymmetry: Supplementing Contract

When two parties enter into a transaction, they both hold information that might be unavailable to the other. There are number of reasons why different people have

---

[698] *See* MOLONEY, EC SEC. REG. 2ND ED, *supra* note 71, at 235.
[699] *See* Karel Lannoo & Mirzha de Manuel Aramendía, *Game Change in Asset Management in* GLOBAL ASSET MANAGEMENT: STRATEGIES, RISKS, PROCESSES AND TECHNOLOGIES 288, 298 (Michael Pinedo & Ingo Walter eds., 2013) [hereinafter "GLOBAL ASSET MANAGEMENT"]; *see also* DIEGO VALIANTE & KAREL LANNOO, MIFID 2.0: CASTING NEW LIGHT ON EUROPE'S CAPITAL MARKETS 155 (Report of the ECMI-CEPS Task Force on the MiFID Review) or MOLONEY, HOW TO PROTECT INVESTORS, *supra* note 30, at 168.
[700] Additional Prospectus Directive covers disclosure with respect to structured securities, direct investments and execution-only sales. The Transparency Directive together with the Implementing Directive 2007/41/EC introduced specific requirements regarding disclosure and storage of "regulated information".
[701] Article 19(2) MiFID II.
[702] Article 19(3) MiFID II.

different information,[703] yet in case of investment companies and retail investors, the extent of informational asymmetry depends not only on parties' ability to gain the information, but also to **correctly evaluate** them. First, investment companies pool vast amount of information, assess them, simplify them and only afterwards provide their investors with plain, yet already interpreted, summary of the information – in form of a **prospectus**.

The information asymmetry between an investment company and an investor could be explained in the "market of lemons" theory. A Nobel Prize winner George Akerlof designed the theory of the "market of lemons",[704] where in simple terms the seller has information about the quality of a product, which is unavailable to the buyer. Akerlof demonstrated, that due to the asymmetric information, the dishonest dealings would drive the honest dealings out of the market.[705] According to number of subsequent studies, it has been shown that the compulsory information has a positive influence on the "market of lemons problem"[706] as well as on the optimal contract, which would provide incentives for full disclosure of privately held information.[707]

[703] On information asymmetry, the reasons thereof and the possibility of overcoming them, *see* the work of Professor Stiglitz, namely Joseph E. Stiglitz, *Information and the Change in the Paradigm in Economics,* 92 AM. ECON. REV. 460, 469-474 (2002).
[704] *See* George A. Akerlof, *The Market for "Lemons" Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON 488 (1970). Akerlof's model has been developed with the example of case of automobile market. Naturally, Akerlof was not the only one who devoted his work to information asymmetry. In 1973, Michael Spence continued Akerlof's ideas in his article, *see* Michael Spence, *Job Market Signaling,* 87 Q. J. ECON. 355 (1973); where he focuses on the information asymmetry within a job market. Spence claims that hiring is an investment decision under uncertainty, as the signaling costs may be manipulated. Later, Rotschild and Stiglitz research the effects of imperfect information using insurance market as their model. *See* Michael Rotschild & Joseph Stiglitz, *Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information,* 90 Q. J. ECON. 629 (1976). Further, there are papers which speak about the effect of the asymmetric information, as on the bargaining process, *see* Williams Samuelson, *Bargaining Under Asymmetric Information,* 52 ECONOMETRICA 995 (1984); or on mergers and acquisitions *see* Robert G. Hansen, *A Theory for the Choice of Exchange Medium in Mergers and Acquisitions,* 60 J. OF BUS. 75 (1987).
[705] *See* Akerlof, *id. at* 495.
[706] *See e.g.* Stewart Myers & Nicholas Majluf, *Corporate Financing and Investment Decisions When Firms Have Information that Investors Do Not Have,* 13 J. FIN. ECON. 187 (1984); Alan D. Mithios, *The Impact of Mandatory Disclosure Laws on Product Choices: An Analysis of the Salad Dressing Market,* 43 J. L. & ECON. 651 (2000) or Bernard S. Black, *The Legal and Institutional Preconditions*

Greater the information asymmetry, higher the transactional costs. [708] Unfortunately, those higher transactional costs in case of an investment company-investor relationship, would be borne by the investor. Higher the additional costs for the investor, lower the number of investors willing to invest and thus less money in the pool – and subsequently on the market.[709] Given that the investment companies together with any regulator wish to expand the size of the capital market, their first task is to decrease the information asymmetry.[710]

A regulator has to regulate and oversee the problem of information asymmetry between several participants on the market. Focusing on the investment company-investor relationship, the investment company is an additional element between the information flow between the market and investor. **Investment company can in theory facilitate or block this flow**. Investment companies were originally formed as intermediaries, which by pooling the investments of many retail investors had the resources to engage in the necessary information inquiry and market monitoring on

for Strong Securities Markets, 48 UCLA L. REV. 781 (2001) [hereinafter "Black, Legal and Institutional Preconditions"].

[707] *See* Healy & Palepu, *supra* note 675, at 408. For more on the optimal contract and its mitigation of misevaluation problem, *see* DAVID M. KREPS, A COURSE IN MICROECONOMIC THEORY, Ch. 17 & 18 (Princeton University Press, 1990).

[708] On the effects of information asymmetry *see* Gilson & Kraakman, *supra* note 653, at 565-568. For empirical evidence on the effects, *see* Healy & Palepu, *supra* note 675.

[709] There have been several scholars who argued that the Internet would influence the securities trading. Professor Coffee claimed that the Internet would revolutionize securities regulation, both positively and negatively, through opening new trading venues, anonymous statements, which may influence the trading, or through possible Internet frauds and other ways. But he mainly hoped that at least the Internet would decrease the informational asymmetries; *see* John C. Coffee, Jr. *Brave New World?: The Impact(s) of the Internet on Modern Securities Regulation*, 52 BUS. LAW. 1195, 1196-97 (1997); Professor Black on the other side did not believe that the Internet would reduce the information asymmetry costs; *see* Black, Information Asymmetry, *supra* note 419, at 95. Even today it is hard to assess to what extent the Internet influenced or changed the securities trading, but one thing is certain, the Internet sites offering information have not replaced any of the investment intermediaries.

[710] The information asymmetry represents one of the barriers of effective use of capital on the capital markets, *see* Black, Legal and Institutional Preconditions, *supra* note 706, at 786-788 and Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation,* 55 DUKE L. J. 711, 727 (2006).

behalf of their investors,[711] and thus **advance** the information flow between the market and investors. Thus, the question is how to regulate the transfer of the information collected by the investment companies – the primary information, and deliver its assessment to the investors. One possible solution to the first question – on how to regulate the transfer of the information – could be in a form of a **contract**, where retail investors would negotiate their terms. The freedom of contract theory promotes individual autonomy to structure and engage in agreements. Yet the information asymmetry undermines the freedom of contractual justification in a sphere, where a party – the retail investor – does not understand complexities of the contract itself.[712] Moreover, even if a retail investor understood the contract, he/she is in no or limited control over it. It is acknowledged that retail investors have extremely narrow negotiating power, if any, as they usually agree to adhesion contract[713] instead of bargaining for an individual one.[714] This limited control over their contractual rights and duties however supports the approach of those who suggest that retail investors are *de facto* consumers. However, this is only one feature they share,

[711] Disclosure obligations for the public companies is in the US regulated by the Securities Act of 1933, which requires for fillings, prospectus delivery, exemptions, and related matters. Furthermore, the Exchange Act of 1934 addresses the issue of antifraud liability under the Rule 10b-5, which to great extent influences the disclosed information. The SOX 2002 reformed the auditing standards in the US and notably accelerated the time for reporting deadlines. Thus, there is a complex regulatory approach to the object [which corporations are under the disclosure obligation] and subject [what information has to be disclosed], but all the provisions are not compressed into one act or statute, which is not necessarily desirable situation. In the EU, there are also number of directives, which cover the disclosure obligation as the Prospectus Directive, Transparency Directive and Market Abuse Directive. The EU through the maximum harmonization tried to reduce the scope for diversity at national level in case of Prospectus Directive. However, the other two directives, the Transparency Directive and the Market Abuse Directive are not "maximum harmonization" directives, which may affect the extent of obligations required in different Member States. For more *see generally* FERRAN, BUILDING AN EU SEC. MARKET, *supra* note 371, 2nd chapter.

[712] According to the Library of Congress report, studies consistently show that American investors lack basic financial literacy and are not able to understand the fundamental financial concepts such as inflation or compound, diversification or the differences between bonds and stocks. *See* Financial Literacy Among Retail Investors in the United States 5-6 (Federal Research Division, Library of Congress, 30 Dec. 2011).

[713] Black's Law Dictionary "adhesion contract" or http://www.law.cornell.edu/wex/adhesion_contract_contract_of_adhesion

[714] CESR advised that the MiFID level 2 regime should include detailed coverage of investor-firm contractual requirements, but the Commission subsequently rejected this approach, *see* Markets in Financial Instruments Directive: Feedback Statement on 1st Mandate Advice 37-39 (CESR, 2005).

together with many small and medium size companies, which also have limited negotiating powers vis-à-vis large multinational corporations.

Furthermore, information asymmetry is **also** present in contracts.[715] Depending on the type of a contract, different parties have diverse information and accordingly bear certain information costs. There is no unified division of powers and obligations of the contractual parties.[716] In the case of investment contract, asymmetry contributes to investors' risks, against which they try to contract.[717] But in case of retail investors, they can either take or leave the adhesion contract. Usually, the retail investor takes it as he/she has no other real option. In case of those investors who invest considerable amount of money, and thus are of a greater than "retail" importance, their negotiable power may differ. Moreover, a retail investor is unable to bear additional information costs, besides the fees of investment companies. When signing a contract with an investment company, it is the investment company, which should be responsible for obtaining additional information.

Contract without any statutorily intervention is unable to remedy informational asymmetry given the lack of retail investors' knowledge and bargaining power. By providing default rules concerning investment companies' obligations, the law offers

[715] *See* Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law,* 113 YALE L. J. 1, 69-71 (2003).
[716] There is only limited number of articles devoted to the information asymmetry in contracts, and if so, they focus on a specific type of a contract. *See e.g.* Benito Arruñada et al., *Contractual Allocation of Decision Rights and Incentives: The Case of Automobile Distribution,* 17 J. L. ECON. ORG. 257 (2001); Samuel Issacharoff, *Contracting for Employment: the Limited Return of the Common Law,* 74 TEX. L. REV. 1783 (1996); Richard L. Hasen, *Efficiency Under Informational Asymmetry: the Effect of Framing on Legal Rules,* 38 UCLA L. REV. 391 (1990) (on the informational asymmetry between sellers and consumers) or Charles J. Corbett & Christopher S. Tang, *Designing Supply Contracts: Contract Type and Information Asymmetry,* 17 INT'L SERIES OPERATIONS RESEARCH & MGMT. SCI. 269 (1999). Parties generally are afraid to innovate in contractual terms and strictly follow what has been accepted by the industry and interpreted by the courts, *see* Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate")*, 83 Va. L. Rev. 713, 722 (1997).
[717] *See* Frank B. Cross & Robert A. Prentice, *The Economic Value of Securities Regulation,* 28 CARDOZO L. REV. 333, 355 (2006).

some real efficiency, which is generally present whenever there are standard form default rules instead of contract. The default rules save effort and time and substitute the expertise of the parties, namely of an investor, in drafting contracts. They help to assure that the key terms are not omitted and do not impose a burden on the parties, namely on the investment company to include the default rules in any contract. As a consequence, these rules ensure that the involved parties are unable to freely deviate from the duties that the law prescribes.[718]

Nevertheless, the playing field between the investor and the investment company will be never even. The information asymmetry will be always present due to the complex nature of the investment services and products. Thus, the ultimate question is **how to minimalize information asymmetry**. One regulatory tool is indisputably through default contractual rules, whereas the second tool is standardizing disclosure of relevant – material – information. What construes "material" information in case of investment companies is analyzed further.[719] However, one aspect, which needs to be assessed before comparing the information obtained by investors is, whether disclosure can solve the resistant agency problem between investors and investment companies.

3.2.2. Curing Agency Problem: Not in Case of Investment Company

Inherently intertwined with the information asymmetry are the agency problem and the agency costs. Agency problem in simple term arises whenever the welfare of one party – principal (retail investor) – depends upon actions taken by another party –

[718] *See* Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595, 601-608 (1997) (Analyzing the fiduciary obligations under the law of trust and agency). Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209, 1242-1251 (1995) [hereinafter "Frankel, *Fiduciary Duties as Default Rules*"] and Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. REV. 434, 449-450 (1998) (discussing the limitation of waivers of rights to fiduciary duties) [hereinafter "Hansmann & Mattei"].

[719] *See* section 3.3.4.

agent (investment company). Agency costs, which are results of agency problem, represent the additional costs for the investors to minimize the information advantage of an investment company.[720] The regulatory concern is – how to motivate an investment company and those in control of it to act in the best interest of investors[721] and not to act opportunistically.[722] One solution is through disclosure obligation and another is to standardize their behavior through broad fiduciary obligations and liability.[723] Given that the disclosure obligation in case of investment companies is inefficient, they should be governed by broad standard of fiduciary obligations.

Professor Mahoney in his seminal article claimed that the principal purpose of mandatory disclosure is to help reduce the cost of monitoring promoters' and managers' use of corporate assets for self-interested purposes.[724] In his article he focused on the relationship between corporate promoters and investors and between corporate managers and shareholders. He claimed that the disclosure of the future of the business is more important than disclosure of past as the historical information is already reflected in the price of shares.[725] However, in case of investment companies – mutual funds, UCITS and UK funds – this is not the case as the value of their shares

[720] *See* COFFEE & HILLARY, *supra* note 71, at 7 and VEIL, *supra* note 628, at 215. Jensen and Meckling define agency costs as "the sum of monitoring expenditures by the principal, bonding expenditures by the agent, and residual losses not prevented by either monitoring or bonding." *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,* 3 J. FIN. ECON. 305, 308 (1976).

[721] The economist firstly observed the agency problems and formed the theory, *see* Eugene F. Fama, *Agency Problems and the Theory of the Firm,* 88 J. POL. ECON. 288 (1980), Fama's theory was formed on the theory of firm by Alchian-Demsetz, who stated that "The essence of the classical firm is identified here as a contractual structure with: 1) joint input production; 2) several input owns; 3) one party who is common to all the contracts of the joint inputs; 4) who has the right to renegotiate any input's contract independently of contracts with other input owners; 5) who holds the residual claim; and 6) who has the right to sell his central contractual residual status. The central agent is called the firm's owner and the employer", *see* Armen A. Alchian & Harold Demsetz, *Production, Information Costs and Economic Organization,* 62 AM. ECON. REV. 777, 794 (1972).

[722] The term opportunistically has fraudulent or deceptive element, *see* OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 47-9 (The Free Press, 1985), who describes the term "opportunism" as a self-interested behavior that involves some element of guile, deception, misrepresentation, or bad faith.

[723] *See* chapter IV.

[724] *See* Mahoney, Mandatory Disclosure, *supra* note 675, at 1048.

[725] *Id.* at 1050.

is derived from the value of underlying assets held in fund's investment portfolio and not of the past performance. Therefore, disclosure will not directly affect the price of the fund's shares.[726] But at the same time the historic performance in functionally efficient markets is likely to be an unreliable indicator of investment company's future performance.[727]

Thus, given the fact that the past information is no sign for success of an investment company, how can the disclosure of future information solve the agency problem? How can the information stated in its prospectus affect and limit the future behavior of the investment company and those in its control? Here follows the analysis of individual legal systems.

3.2.2.1. Investment Policy Statement (US)

The exclusive business activity of an investment company is generally the investing on behalf of its investors based on its investment strategy or policy, which effectively represents a contract between an investment company and its investors. Usually the information that investors obtain is primarily focused on the future investment strategy or investment policy of the investment company.[728] However, if investment companies are not required to commit themselves to a **specific** investment policy or allocation of assets, what value does this information enjoy?

---

[726] *See* Bevis Longstreth, *The Profile: Designer Disclosure for Mutual Funds,* 64 BROOK. L. REV. 1019, 1033 (1998) (ECMH "has no application to mutual fund shares because there is no active trading market for mutual fund shares.").

[727] Joseph A. Franco, *A Consumer Protection Approach to Mutual Fund Disclosure and the Limits of Simplification,* 15 STAN. J. L. BUS. & FIN. 1, 41 (2009). *See also* BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET: THE TIME TESTED STRATEGY FOR SUCCESSFUL INVESTING 186-1877 (W.W. Norton & Company, 8th ed. 2003) ("[a]lthough funds may have very good records for certain short time periods… there is no way to predict in advance how funds will perform in any given future period").

[728] Investment strategy or investment policy usually forms a part of the prospectus, which is provided to the investor. It explains the way in which a fund allocates and manages its resources to achieve its investment objectives. The strategy or policy usually includes (1) goals for net asset value, (2) asset allocation, (3) investment restrictions (if a fund is investing only to a specific industry) and (4) whether derivatives may be bought, *see* Investopedia, Shauna Carther, *Digging Deeper: The Mutual Fund Prospectus, available online at: http://www.investopedia.com/articles/mutualfund/04/032404.asp.*

Taking into consideration the investment policy statements of some of the best performing mutual funds in the US,[729] which are available on the Internet, the portfolio investment policies are generally divided first of all into two parts: **fundamental** and **non-fundamental**. The goal of the fundamental policy, which usually cannot be altered without shareholder approval, is often to provide the manager with sufficient investment flexibility.[730] The non-fundamental part of investment policy may be changed at the discretion of the fund's board. Some policies are further split into (1) asset allocation policy, (2) diversification policy, (3) rebalancing and (4) other investment policies.[731] Many investment policies are written in a non-specific language, providing the investment company with extensive leeway for interpretation. Some investment policies, at the end of the prospectus, state that the changes in investment objectives are "non-fundamental and may be changed by the Board of Trustees **without** shareholder approval".[732] Many of the funds, try to contract out their possible obligation to pre-approve major investment decisions by their investors, which amounts to changing the investment strategy.

However, according to a study, which analyzed the N-SAR forms of 9,525 registered investment companies in the US between 1994 and 2000,[733] managers are commonly prohibited of undertaking certain investment practices, as (1) borrowing, (2) purchasing securities on margin, (3) short-selling, (4) holding individual equity

[729] Such as PIMCO Long Duration Total Return Fund or some of the Vanguard funds.

[730] *See* Andres Almazan *et. al., Why Constrain Your Mutual Fund Managers?* 73 J. FIN. ECON. 289, 293 (2004).

[731] I analyzed the prospectuses of PIMCO Total Return, one of the biggest mutual funds on the US market, which has publicly available prospectus, *available online at:* < http://pe.newriver.com/summary.asp?cid=PIMCOLL&cusip=693390700&doctype=pros&oldurl=%2FRegulatory%2FExternal%20Documents%2FPIMCO_Bond_Funds_Statutory.pdf > *last visited* Aug. 14, 2014 [hereinafter "PIMCO Funds Prospectus"].

[732] *See e.g.* PIMCO Funds Prospectus at 83.

[733] Question 70 of the N-SAR form, which registered investment companies must file twice a year, solicits information from mutual fund managers about investment practices allowed under their investment policy statements. The form requires a manager to respond "yes" or "no" to two questions about each of different investment practices.

options, (5) trading in equity index futures or (6) purchasing restricted securities.[734] The authors of this study maintain a hypothesis that **investment policy constraints** are an important part of the optimal contract between investors and managers, and complement other regulatory devices, which oversee the actions of investment companies. However, when comparing the performance of high-constraint and low-constraint funds, there are no economically or statistically significant return differentials.[735] This has been interpreted as the capability of investors to adopt set of policy restrictions necessary to produce an optimal investment contract.[736]

Concerning the regulation for **changing** the investment policy of the investment company, both the ICA 1940 and UCITS V provide space for maneuvering. Although section 13 of the ICA 1940 has a title: "changes in investment policy," the content does not address the substantive changes of the investment policy.[737] It is claimed that the purpose of this section was not to provide investors with power to control major business decisions, but to prevent any **fundamental** change in the **character** of the business.[738] Yet it does not in any way affect the "real" investment strategy, which is left completely in the hands of the investment company.[739]

---

[734] A restricted security is a security that is acquired in an unregistered, private sale from an issuer or an affiliate of an issuer. *See* Almazan, *supra* note 730, at 294.
[735] The authors have contained in their research factors as fund size, investment style or portfolio turnover and variations in the level of policy restrictions. *See* Almazan, *supra* note 730, at 312-319.
[736] *Id.* at 319.
[737] 15 U.S.C. §80a-1, sec. 13; According to this section, no registered investment company shall, unless authorized by the vote of a majority of its outstanding voting securities (1) change its sub-classification from open-end to closed or vice versa, or from a diversified to a non-diversified investment company; (2) the investment company may not borrow money, issue senior securities, underwrite securities, purchase or sell real estate or commodities, make loans, except in accordance with the recitals of policy contained in its registration statement or (3) deviate from its policy as to concentration of its investment in particular industry or group of industries, which it has elected to treat as such, nor (4) change the nature of its business so as to cease to be an investment company.
[738] *See* Jaretzki, *supra* note 232, at 317.
[739] Studies of mutual fund manager behavior report clear evidence of strategic changes in mutual fund portfolios, *see e.g.* Wayne Ferson & Rudi Schadt, *Measuring Fund Strategy and Performance in Changing Economic Conditions,* 51 J. FIN. 425 (1996), finding that managers rebalance in anticipation of changing economic conditions or Mark Grinblatt, Sheridan Titman & Russ Wermers, *Momentum*

3.2.2.2. UCITS Specificities

In the EU and UK, according to UCITS V and to the COLL respectively, the investors' prospectus should indicate in which types of assets a UCITS is authorized to invest as defined in Article 50 of UCITS V.[740] This approach is an opposite to the one in the US, where the investment policy states in which securities a manager **cannot** invest. As new financial instrument are created very often, the standard in the EU provides greater constraint on the investment company than in the US. UCITS V – in the light of the modern portfolio theory – lays down restrictive diversification rules for the investment policy, designed to ensure appropriate risk spreading across the asset portfolio.[741] Nevertheless, neither under UCITS V nor under the COLL investors have control over the investment policy or its change. The only control that they have in case of change of investment policy is their redemption right, notwithstanding the fact that investor usually realize it too late.

Although the disclosure in the context of investment company and retail investor is able to reduce the information asymmetry to certain extent, it is not very efficient with tackling the agency problem, unless the investment policy is highly specific and restrictive. Generally, retail investors have no control over the investment policy of the firm. The only control which they possess is in connection to first, investing in such investment company, based on their already existing investment policy statement and second, to redeeming their investment. This regulatory approach – not to provide control to the investors - is present in the US, the UK and in the EU regulation. The rationale behind this decision might be that capital markets are very

---

Strategies, Portfolio Performance and Herding: A Study of Mutual Fund Behavior, 85 AM. ECON. REV. 1088 (1993) identifying herding behavior of mutual fund managers.

[740] Article 70 UCITS V. Under Article 50 UCITS V, UCITS shall comprise only of the stated securities. The following articles specify the quantitative limits of the acquired securities. On the contents of the UK funds *see* COLL 4.2.5R.

[741] *See* MOLONEY, EC SEC. REG. 2ND ED, *supra* note 71, at 257.

sensitive and changes may happen instantly, which requires the ability of an investment company to adjust promptly. Furthermore, a manager can unilaterally change allocations across asset classes and therefore, has an inherent advantage in terms of implementing market-timing strategies.[742] The only way, in which an investment company may adjust to market fluctuation, is through prompt change in investment policy. This approach definitely serves the objective of ensuring investor protection better than to allow for the investors' control over the investment policy. Nevertheless, this approach does not protect investors from agency problems, which therefore have to be handled differently, in my opinion - through imposition of broad fiduciary duties on the investment companies.

3.3. Investment Company Prospectus: Relevance & Understanding

"Never invest in a product that you don't fully understand."[743]

In the light of the above stated discourse of the policy rationales of regulation through disclosure, this part closely analyzes on one hand the regulatory requirements towards the **content** of disclosure in the EU, UK and the US, and on the other hand it tries to assess the **relevance** of such information from the perspective of a retail investor.

The **amount**, **diversity** and **speed** of available information have exponentially grown over the past years. Thus, one should ask the question whether this information boom serves its purpose, and retail investors have become more informed and knowledgeable or whether, the improved access to information only has made the investors more vulnerable and influenceable?[744] Looking at the market and number of

---

[742] *See* Nishant Dass *et al.*, *Allocation of decision rights and the investment strategy of mutual funds*,110 J. FIN ECON. 254, 255 (2013).

[743] *Invest Wisely: Advice From Your Securities Industry Regulators*, SEC, *available online at:*< https://www.sec.gov/investor/pubs/inws.htm>/ *last visited* Feb. 20, 2014.

[744] *See* Donald C. Langevoort, *Technological Evolution and the Devolution of Corporate Financing Reporting*, 46 WM. & MARY L. REV. 1, 7-10 (2004).

successful "fails" of "sound" investor decisions, which are the best proofs, it is my firm belief that one should stress the quality of the information over the quantity. As already concluded, the ultimate aim of prospectus of investment companies is to provide investors with sufficient amount of information to make informed decision and allow them to identify those investment products and services that meet their needs and risk attitude. Unlike other disclosure instruments, as of publicly traded companies, disclosure by investment companies to retail investors does not address market efficiency dynamics, but focuses particularly on the individual decision-making.[745]

The following analysis reflects the regulation of the investment companies' prospectus disclosure and also the amendments to the disclosure as to its length and language. For easier reading and understanding, this subchapter is divided into smaller sections. However, for a greater perspective, the analysis of compared legal systems is carried out jointly.

3.3.1. General Requirements: Mutual Funds' N-1A and UCITS Prospectus

In the US under the SA 1933[746] and ICA 1940,[747] the investment companies have an obligation to inform their investors through a prospectus. The definition of "prospectus" is unified across the securities laws and is to be found in the SA 1933.[748]

[745] *See* Gilson & Kraakman, *supra* note 653.

[746] 15 U.S.C. §77j(a) (2012).

[747] 15 U.S.C. §80a-22 (2012).

[748] 15 U.S.C. §77b(a)(1) (2014): "The term 'prospectus' means any prospectus, notice, circular advertisement, letter or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security; except that (a) a communication sent or given after the effective date of the registration statement (other than a prospectus permitted under subsection (b) of section 77j of this title) shall not be deemed a prospectus if it is proved that prior to or at the same time with such communication a written prospectus meeting the requirements of subsection (a) of section 77j of this title at the time of such communication was sent or given to the person to whom the communication was made, and (b) a notice, circular advertisement, letter, or communication in respect of a security shall not be deemed to be a prospectus if it states from whom a written prospectus meeting the requirements of section 77j of this title may be obtained and, in addition, does no more than identify the security, state the price thereof, state by whom orders will be executed, and contain such

The SEC has designated **Form N-1A** as the form of registration statement for mutual funds[749] and Form N-2 for closed-end funds.[750] The Form N-1A specifies, which information is required in a prospectus.[751] The prospectus of an investment company should be the primary source of information for investors concerning the investment objectives and strategies, applicable fees, investment companies' past performances, directors, advisers as well as financial information.[752]

3.3.1.1. Evolution of Prospectus in the US

In 1983, the SEC launched a simplification phase for mutual fund prospectuses and divided N-1A into two parts. The first part is the formal prospectus, which satisfies the prospectus delivery requirements under Section 5 of SA 1933.[753] The second part of the prospectus is formed by the statement of additional information [hereinafter

---

other information as the Commission, by rules or regulations deemed necessary or appropriate in the public interest and for the protection of investors, and subject to such terms and conditions as may be prescribed therein, may permit." On the detailed analysis of prospectus *see* HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES LAW HANDBOOK §26:12 (WestlawNext Online Database, updated May 2014).

[749] *Available online at:* < http://www.sec.gov/about/forms/formn-1a.pdf>/ *last visited* April 18, 2014. Section 8(a) of the ICA 1940 permits a mutual fund to register under the ICA 1940 by form of notification, and the SEC has adopted a form N-8A as the form of Notification of Registration, which for most funds, is only one or two pages long. Afterwards, according to the section 8(b) all registered investment companies have to file a registration statement (N-1A for mutual funds) within three months after filling the Notification of Registration (N-8A).

[750] 17 C.F.R. §274.11A (2012).

[751] In 1993, the N-1A registration form was amended to require a disclosure on fund managers, a discussion of the factors and strategies of fund and a graph indicating the fund's performance to an index of the over-all market in last ten-year period. *See* ICA 1940 Rel. IC-19382, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) 85, 123 (SEC April 6, 1993). Moreover, in 2009, the SEC expanded the disclosure obligation for mutual funds and requires a disclosure of performance data in an interactive downloadable format. *See* Interactive Data for Mutual Fund Risk/Return Summary, SA 1933 Rel. No. 33-9006, SEA 1934 Rel. No. 34-59391, Trust Indenture Act Rel. No. 39-2462, ICA 1940 Rel. No. IC-28617, 2009 WL 330271 (SEC Feb. 11, 2009).

[752] In 1996, the US Office of the Comptroller of the Currency (OCC) and the SEC conducted a research regarding the usefulness of the mutual fund prospectus. Although according to results, investors did consult the prospectus before making a decision, they considered the prospectus to be only the fifth best source of information. *See* OCC & SEC, REPORT ON THE OCC/SEC SURVEY OF MUTUAL FUND INVESTORS, Executive Summary (June 26, 1996). However, 10 years later, according to ICI 2006 investors survey, only thirty-four percent of mutual fund investors consult the fund prospectus, *See* ICI, Understanding Investor Preferences fort Mutual Fund Information 12 (2006), *available online at:*< http://www.ici.org/pdf/rpt_06_inv_prefs_full.pdf >/ *last visited* Aug. 3, 2014.

[753] Under Section 5 of the SA 1933 all issuers must register non-exempt securities with the SEC. Section 5 regulates the timeline and distribution process for issuers who offer securities for sale. The actual registration process is laid out in Section 6.

"SAI"], which is a more detailed document available to investors upon request.[754] The reason behind this bifurcation of disclosed documents was according to the SEC, the need of **simplifying** and **shortening** the prospectus.[755] Nevertheless, the SEC stressed the minimum disclosure threshold, where the prospectus must *"clearly disclose the fundamental characteristics of the particular investment company."* [756] In implementing this new philosophy of disclosure, the SEC emphasized disclosing information as risk/return summary, fee table, fund objective, fund policy, and basic purchase and sale of information.[757]

In 1983, the SEC also addressed the issue of incorporation by reference. A prospectus with reference could be seen as a combination of those two documents – the prospectus and the referenced one, and therefore evaluated in terms of more than one document. Or, they could be evaluated as two distinct documents and the accuracy of each document would be assessed individually. Naturally, these two views carry different civil liability implications for fund.[758] The SEC realized that there is a risk of "hide and seek" and investors might not inspect the reference. Therefore, the SEC tried to balance between simplifying disclosure and preserving the integrity of disclosure, and adopted a permissive approach, allowing the mutual funds

[754] 17 C.F.R. §§239.15A & 274.11A (2012).
[755] The SEC sought to emphasize the reference to the essential information about the fund that would be most useful to average investor. The SEC's approach could be regarded as a "less is more" philosophy that sought to eliminate non-essential information in hope that the average investor would be able to use the key information more effectively in making fund decision. *See* Franco, *supra* note 727, at 17-21.
[756] *See* Registration Form Used by Open-End Management Investment Companies, Investment Company Act Release No. 12,927, 48 Fed. Reg. 814 (Jan. 7, 1983).
[757] The 2009 Disclosure Initiative amended Form N1-A. Currently it includes 12 items in addition to the front and back covers.
[758] The materiality of disclosure is a separate and very complex issue, which will be reflected upon later.

to incorporate by reference information found in the statement of additional information.[759]

After 1983 and 1998, when certain changes of disclosure system have been adopted, [760] the SEC in 2003 adopted additional disclosure requirements for investment companies relating to disclosure controls and procedures, codes of ethics and audit committee financial experts.[761] However, in 2009, the SEC launched 2009 Disclosure Initiative,[762] which layered the disclosure mechanism into two separate documents: Form N-1A and a new summary prospectus. Since then, mutual funds satisfy their prospectus delivery obligations under the SA 1933 by sending or giving a summary prospectus and providing the statutory prospectus (Form N-1A) online.[763]

3.3.1.2. UCITS Prospectus

The EU regulation works with the same concept of disclosure in form of prospectus and periodical reports as the US.[764] The Prospectus Directive[765] and UCITS V[766] refer to prospectus, which they however do not define. Both directives only specify the

---

[759] *See* Registration Form Used by Open-End Management Investment Companies, Investment Company Act Release No. 12,927, 48 Fed. Reg. 37,930 (Jan. 7, 1983).
[760] *See* section 3.3.3.
[761] SEC Release No. 33-8238; 34-47986; IC-26068; File Nos. S7-40-02; S7-06-03, on Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports (Jan. 23, 2003).
[762] *See* Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Investment Company Act Release No. 28,585, 74 Fed. Reg. 4570-73 (Jan. 26, 2009) [hereinafter "New SEC Prospectus Delivery 2009"] (codified at 17 C.F.R. § 230, 232, 293 and 274 (2009)).
[763] New SEC Prospectus Delivery 2009, at 4560. According to the N-1A SEC form, the information required in a prospectus have to be the following: (1) Risk/Return Summary: Investment Objectives/Goals; (2) Risk/Return Summary: Fee Table; (3) Risk Return Summary: Investments, Risks, and Performance (4) Management; (5) Purchase and Sale of Fund Shares; (6) Tax Information; (7) Financial Intermediary Compensation; (8)Investment Objectives, Principal Investment Strategies, Related Risks, and Disclosure of Portfolio Holdings; (9) Management, Organization, and Capital Structure; (10) Shareholder Information; (11) Distribution Arrangements; and (12) Financial Highlights Information.
[764] Article 68(1) UCITS V states: "An investment company and, for each of the common funds it manages, a management company, shall publish the following; (a) a prospectus; (b) an annual report for each financial year, and (c) a half-yearly report covering the first six months of the financial year."
[765] The Prospectus Directive does not define "prospectus" as does the SA1933, but it defines what it shall contain in Article 5.
[766] Articles 68-75 and Annex I - Schedule A, prescribe the content of a prospectus.

information a prospectus should contain[767] and the fact that the prospectus must contain the information necessary for the investor to make an informed judgment of the investment proposed to them.[768] The difference between the two directives is that the Prospectus Directive is a maximum harmonization directive,[769] while UCITS V is not a maximum harmonization directive, and neither were the former UCITS directives.[770] There is an extensive literature devoted to the maximum versus minimum harmonization concept in the EU law, thus it is sufficient to briefly state the possible consequences of different regulatory approaches.[771]

First, legal uncertainty has negative effects on both the EU common market as well as on the markets of individual Member States. As long as the European Commission is not specific within the wording of a directive, each directive has to be assessed and interpreted whether it is a maximum or minimum harmonization directive.[772] Thus, on one hand, it leaves the investment companies open to possible multiple or conflicting disclosure requirements or liability for incorrect or misleading statements.[773] And on the other, given the mutual recognition and home Member State

[767] Annex I – Schedule A UCITS V.
[768] Article 69(1) UCITS V.
[769] Although the Prospectus Directive was not formally promulgated as a maximum harmonization directive in its recitals, it is perceived to be a maximum harmonization directive, *see* Carsten Gerner-Beuerle, *United in Diversity: Maximum Versus Minimum Harmonization in EU Securities Regulation,* 7 CAP. MARKETS L. 317, 324 (2012).
[770] Recital 8 UCITS V.
[771] *See e.g.* MOLONEY, EC SEC. REG. 2ND ED, *supra* note 71, at 27-31 and John Armour, *Who Should Make Corporate Law? EU Legislation versus Regulatory Competition,* 58 CURRENT LEGAL PROBS. 369 (2005).
[772] The Advocate General in *Spector Photo Group* Opinion went even further as she stated, that it is not possible to assess the minimum versus maximum harmonization as of the entire directive but only of each provision separately. AG Kokott adopted a teleological approach as it is *"the wording and the spirit and the purpose of the provision in question"*, which need to be analyzed before declaring a specific provision of minimum or maximum harmonization effect. *See* Case C-45/08 Spector Photo Group NV and Chris Van Raemdonck v Commissie voor het Bank-, Financie- en Assurantiewezen (CBFA) [2009] ECR I-12073 para. 76.
[773] Those investment firms that operate internationally may be held responsible pursuant to a multitude of jurisdictions, which leads to increased compliance costs. *See* Carsten Gerner-Beuerle, *United in Diversity: Maximum Versus Minimum Harmonization in EU Securities Regulation,* 7 CAP. MARKETS L. 317, 338-40 (2012). *See generally* Francisco Garcimaríín, *The Law Applicable to Prospectus Liability in the European Union,* 10 L. & FIN. MARKETS REV. 449 (2011).

control over the disclosure requirements, in case of investing in a UCITS of other Member State, investors might be left blind sighted as the disclosure requirements might ultimately differ from one Member State to another.[774]

Moreover, in the EU, the two systems of prospectuses are not unified, as is the case of the US, where the SA 1933 applies *mutatis mutandis* also to the prospectuses of investment companies. The Prospectus Directive applies to public offers and the admission of a variety of financial instruments to regulated markets and to the closed-end UCITS, but not to the UCITS.[775] The UCITS regime and Prospectus Directive regimes have developed independently. Nevertheless, the choice of the same term for two different documents is beneficial neither for the regulatory system itself nor for the market participants due to possible confusion. Furthermore, there are substantial differences in the content of prospectuses under Prospectus Directive and under UCITS V.[776] The Prospectus Directive focuses more on the substantive information connected to the offered investment tools, while UCITS V emphasizes in its prospectus possible risks connected to investing, investment policy of the UCITS and the UCITS structure itself.[777] Needless to say, UCITS prospectus is a subject to National Competent Authority approval.[778] In the UK it is the FCA approving the prospectus.

[774] However, it is hard to assess whether the maximum harmonization rules better protect investors than minimal harmonization rules. Plus, given that there has been no empirical research carried out, there are no data supporting one or the other way of harmonization.

[775] UCITS, which shares are, at the holders' request repurchased or redeemed, and in their structure resemble mutual funds are excluded. For those investments, to which the Prospectus Directive does not apply, *see* Article 1(2) Prospectus Directive.

[776] Compare Annex 1 [Minimum Disclosure Requirements for the Share Registration Document] of Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements O.J. L149/1 and Annex 1 UCITS V.

[777] Article 69 (1) UCITS V, second sentence reads: *"The prospectus shall include, independent of the instrument invested in, a clear and easily understandable explanation of the fund's risk profile."*

[778] Article 5 UCITS V.

In addition to the risk statement, the prospectus of UCITS has to contain information necessary for the investor to make an informed judgment of the investment proposed.[779] The UCITS regime has evolved since its adoption in 1985 from an arcane original model, based on extensive disclosure, to an evidence-based model, designed to support informed decision.[780] Schedule A of UCITS V sets out extensive requirements covering the common fund, the management company and the investment company. The requirements range from elemental information as address, date of establishment of the fund or incorporation of the company up to the detailed information concerning the details of the types and main characteristics of the units. Information must be also provided on how UCITS assets are valued and how the sale, issue, redemption and repurchase price of UCITS units are determined. Today, UCITS V specifies the content and also the form in which the content should be delivered to the investor. All information in the UCITS prospectus have to be distributed in a clear, concise, and easily understandable way to allow the investor to make an informed judgment in the light of all possible risks.[781] Unlike the Prospectus Directive, UCITS V does not impose any minimum requirements concerning sanctions or remedies in case of false or misleading disclosure. Although the audit control oversees the quality of the information contained in the annual report, UCITS V itself does not protect investors against incomplete, misleading or false disclosure. In the UK the COBS states additional requirements for the UCITS prospectus, including relevant pieces of information on (1) designated investments and

[779] Annex 1 UCITS V.
[780] MOLONEY, HOW TO PROTECT INVESTORS, *supra* note 30, at 312.
[781] Article 69 UCITS V.

investment strategies and (2) costs and associated charges.[782] The costs and associated charges have to reflect also the exit and entry commissions.

3.3.2. Easy to Read & Understand

Besides the requirements concerning the specific content of the prospectus, the information provided should be easy to read and understand, given that it serves for investor to make an informed investment decision. Yet the information provided by the prospectuses is extensive and often incomprehensible given the contained liability for omission of relevant information.[783] Thus, investment companies try to include sometimes-excessive amount of information in order not to be held liable.[784]

Realizing the complexity of disclosure information under US securities laws, the SEC adopted in the beginning of 1998 rules requiring disclosure documents to be written in "plain English".[785] This rule applies to both corporate issuers and investment companies. The SEC in 1998 published a handbook to help securities lawyers in writing in plain English, where the SEC explained a plain English

[782] COBS 14.3.11.
[783] SEC, REPORT OF THE ADVISERY COMMITTEE ON THE CAPITAL FORMATION AND REGULATORY PROCESSES 33 (July 24, 1996) stated clearly that the prospectuses are "documents that are difficult to read, hard to understand, [and] prepared with litigation in mind…."
[784] In the US, in 1986 the Court of Appeals for the Second Circuit decided Luce v. Edelstein, 802 F.2d 49 (2d Cir. 1986), where it considered the adequacy of unreasonably optimistic cash and tax benefit projections. Given the fact that these projections were accompanied with a statement indicating that they were necessarily speculative and not sure to be realized, the court responded that *"We are not inclined to impose liability on the basis of statements that "bespeak caution"."* Since then this idea developed to a legal principle, known as the "bespeak caution" doctrine. As court in the case In re Donald J. Trump Casino Sec. Litig., 793 F. Supp. 543, 549 (D.N.J. 1992) stated, "[t]he essence of the doctrine is that where an offering statement, such as a prospectus, accompanies statements of its future forecasts, projections and expectations with adequate cautionary language, those statements are not actionable as securities fraud." Thus, the bespeak caution doctrine represents a defense for an investment company when making projections as long as it contains sufficient cautionary language or risk disclosure. *See also* Donald C. Langevoort, *Disclosures that "Bespeak Caution"*,49 BUS. LAW. 481 (1994).
[785] *See generally* Plain English Disclosures, Securities Act Release No. 7497, Exchange Act Release No. 39593, Investment Company Act Release No. 23011, [1998 Transfer Binder], Fed. Sec. L. Rep. (CCH) (January 28, 1998). Under the Plain English Rule – Rule 421(d), one must comply substantially with six basic principles: (1) short sentences; (2) definite, concrete, everyday language; (3) active voice; (4) Tabular presentation or bullet lists for complex material, whenever possible; (5) no legal jargon or highly technical business terms; and (6) no multiple negatives.

document as one, which *"[u]ses words economically and at a level the audience can understand."*[786] Yet the SEC has not provided the interpretation of "at a level the audience can understand", given the fact that it's a substantial assessment. Understanding of each investor is different from material perspective, thus it is only possible to help investors to understand through simplified structure of anyhow complex document.[787]

3.3.3. Summary Prospectus: Kiss, but Tell All

On the wave of simplification, both the EU and US came to similar conclusion on necessity to introduce a compressed form of prospectuses for investors.[788] The original prospectuses were presumed to be too long and complicated and often too difficult for investor to understand and consequently decide whether to invest or not.[789] The SEC's quest for compression of prospectus let in 1998 to adoption of Securities Act Rule 498,[790] which permitted a new kind of summary prospectus of mutual funds, called "profile".[791] The profile had nine standardized elements and was limited to a couple of pages. Before, the SEC released the Old Rule 498, the SEC had carried out a careful consultation with industry and created several prototypes.[792]

[786] A PLAIN ENGLISH HANDBOOK: HOW TO CREATE CLEAR SEC DISCLOSURE DOCUMENTS 5 [SEC, 1998], *available online at:* < https://www.sec.gov/pdf/handbook.pdf>/ *last visited* April 16, 2014.
[787] *See* William O. Douglas, *Protecting the Investor*, 23 YALE REV. 521, 523-24 (1934) (The disclosure will achieve its purposes only if its recipients can process and understand the disclosed information).
[788] On the relevance of the information, *see e.g.* Prentice, *Whither Sec. Regulation, supra* note 419; Bainbridge, Mandatory Disclosure, *supra* note 538; Stephen J. Choi & Jill E. Fisch, *How to Fix Wall Street: A Voucher Financing Proposal for Securities Intermediaries*, 113 YALE L.J. 269 (2003).
[789] *See e.g.* Don Phillips, SEC Interactive Data Roundtable 26 (June 12, 2006), available at: < http://www.sec.gov/spotlight/xbrl/xbrlofficialtranscript0606.pdf >/ *last visited* Oct. 15, 2014. The SEC itself recognizes the complexity of mutual fund's prospectus; *see* New SEC Prospectus Delivery 2009 9. The EU recognizes the "information overload" as well in its Communication from the Commission to the European Parliament and the Council on 30 April 2009, COM (2009) 204 final.
[790] 17 C.F.R. §230.487 (2009) [hereinafter "Old Rule 498"].
[791] New Disclosure Option for Open-End Management Investment Companies, Securities Act Release No. 7513 (Mar. 13, 1998), 63 Fed. Reg. 13, 968 (Mar. 23, 1998).
[792] *See* Proposed New Disclosure Option for Open-End Management Investment Companies, Securities Act Release No. 7399 (Feb. 27, 1997), 62 Fed. Reg. 10, 943-46 (Mar. 10, 1997), describing the effort of mutual fund industry and the cooperation with the SEC while preparing the profile prospectus. For

Nevertheless, the profile disclosure failed as the industry rejected its use as a general offering document because of significant liability concerns. The industry itself feared that the disclosure might be viewed as incomplete and misleading.[793]

The failed profile prospectus project proved instrumental in preparing the 2009 Disclosure Initiative. In 2009 the SEC adopted a new rule on new prospectus delivery option for mutual funds.[794] According to the amendments, a mutual fund satisfies its obligation to deliver an investor a prospectus under section 5(b)(2) of the SA 1933 by sending or giving "key information" directly to investors in the form of a "summary prospectus" and providing the statutory prospectus on an Internet Web site.[795]

The UCITS Directive also requires a simplified prospectus, a "key investor information document" [hereinafter as "KIID"].[796] The KIID is a simplified and compact form of a prospectus, which should contain only "key information for investors about essential characteristics of UCITS".[797] Before KIID was adopted, the UCITS III initially introduced a "simplified prospectus" in 2004.[798] Similarly to the US, the simplified prospectus was to provide a "clear and easily understandable"

---

an opposite view on the statutory legitimacy of radical forms of simplification for average investor, *see* Longstreth, *supra* note 726.

[793] *See* New SEC Prospectus Delivery 2009, at 4570-4573.

[794] *See* New SEC Prospectus Delivery 2009.

[795] 15 U.S.C. 77j(a).

[796] Articles 78 – 82 UCITS V. Further specification has been provided by the Commission Regulation (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper of by means of a website O.J. L176/1 [hereinafter "KIID Regulation"]. On the history of the introduction of KIID, *see* Lachlan Burn, *KISS, but tell all: short-form disclosure for retail investors,* 5 CAP. MARKET L. J. 141, 144-147 (2010). In connection with closed-end investment companies, where the Prospectus Directive is applicable, the prospectus should also include a summary, which *"shall, in brief manner and in nontechnical language, convey essential characteristics and risks associated with the issuer, any guarantor and the securities, in the language in which the prospectus was originally drawn up."* Article 5(2) Prospectus Directive.

[797] Article 78 (1) & (2) UCITS V.

[798] Directive 2001/107/EC of the European Parliament and of the Council of 21 January 2002 Amending Council Directive 85/611/EEC on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS) with a View to Regulating Management Companies and Simplified Prospectuses O.J. L41/20.

explanation of the UCITS risk profile by an elusive notion of the "average investor", who should be able to understand such information. But the simplified prospectus was adopted before any pre-testing and essentially it only shortened the lengthy prospectus disclosure without redefining the presentation of format of the document. Thus, learning from this experience before adopting the KIID, the EU undertook a testing and empirical assessment managed by CESR and European Commission.[799] In 2006 the Commission initiated a workshop with wide range of stakeholders discussing from policy issues the questions of design of a prospectus, including how to differentiate the KIID from a marketing document, structure, cost disclosure, risk disclosure and others.[800] An active discussion was held between various affected groups in order to understand what is it that the investor needs to know.

Comparing the final products of **prospectus simplification** in the EU and US, they are two different types of legal document. Although summary prospectus and KIID aim for simplification of information for investors, the KIID, a two-sided A4 "key investor document" is a pre-contractual information leaflet,[801] with constrained civil liability attached to it.[802] While summary prospectus together with online information in the US is a full substitute for the original prospectus, and is subject to liability under Sections 12(1)(2) and 17(1)(2) of the SA 1933,[803] and nothing removes, or diminishes that liability.[804] Thus, the EU KIID seems to be slightly controversial, given its limited liability. Moreover, in light of investor protection, the

---

799 For further details, *see* MOLONEY, EU SEC. REG. 3RD ED, *supra* note 670, at 250.
800 *See* Press Release CESR/07/241 and Press Release CESR/07-205.
801 Article 79 (1), 80 (3) UCITS V.
802 *"Member Stats shall ensure that a person does not incur civil liability solely on the basis of the key investor information, including any translation thereof, unless it is misleading, inaccurate or inconsistent with the relevant parts of the prospectus."* Article 79(2) UCITS V. In case of closed-end investment companies, the same is applicable for the Summary of a prospectus, Article 6(2) Prospectus Directive.
803 Section 12(1)(2) of SA 1933 refers to untrue statement of material fact or omission of a material fact of prospectus or oral communication. Section 17(a)(2) is a general antifraud provision.
804 New SEC Prospectus Delivery 2009.

double standardization may cause uncertainty and confusion, as in cross-border investment, only the KIID has to be translated into the official language of the UCITS's host state,[805] which means that this might be the only information that the investor is provided with.

Ultimately, both legal systems are trying to simplify the information for an investor in order to help him/her to decide whether to invest. Yet the question whether the summary prospectus is sufficient for investors to decide whether or not to invest in an investment company has not been fully answered by empirical research.[806]

3.3.4. Materiality of Prospectus

Although the laws in EU and US define what a prospectus should contain, the story of prospectuses is not fully covered. Under the US federal securities laws any material misstatement in connection with a securities transaction is considered illegal.[807] Even though UCITS V itself does not impose any minimum requirements concerning sanctions or remedies in respect of false or misleading statements, the former MAD and current MAR does.[808] The first EU-level directive against market abuse – the MAD was adopted in 2003. The newly adopted MAR becomes enforceable on July 2016. MAR as well as MAD imposes *ad hoc* disclosure requirements concerning any material events.[809]

[805] Article 94(1)(b) UCITS V.
[806] There are some experiments ongoing, but the outcome is not completely clear, *see* John Beshears *et al.*, *How Does Simplified Disclosure Affect Individuals' Mutual Fund Choices? In* EXPLORATIONS IN THE ECONOMICS OF AGING 75-96 (University of Chicago Press, 2011) (In the conclusion, the authors argue that the Summary Prospectus although reducing the time for reading, does not change, let alone improve, portfolio choices).
[807] *See, e.g.* SEA 1934 Rule 17 C.F.R. § 240.10b-5 (2012) ("It shall be unlawful for any person… [t]o make any untrue statement of a material fact… in connection with the purchase or sale of any security.").
[808]. *See* MAR. MAR repealed the former MAD.
[809] Article 7 MAR & Article 6 (1) MAD.

MAR is a cross-sectional regulation, establishing a common regulatory framework on insider dealing, unlawful disclosure of inside information and market manipulation, which is referred to as “market abuse”. MAR applies to diverse financial instruments as well as to any transaction,[810] order or behavior concerning any financial instrument inside or outside of a trading venue.[811] In comparison to MAD, MAR very extensively defines market abuse behaviors, as inside information,[812] insider dealing,[813] market soundings or [814] market manipulation.[815] Moreover, besides authorizing ESMA to develop and implement technical standards with regard to the MAR and obliging it to publish collected information of different trading venues, accepted market practices, investment recommendations and statistics, the enforcement of the provisions continues to lie in the hands of competent authorities of Member States.

Although materiality is of a great importance for the “truth on the market” quest, the doctrine of materiality is fairly complex and a regulator should not be deprived of help of courts. In the US, such help has been provided,[816] while in the EU and UK less so. Although the UK courts have not yet develop a “materiality doctrine” *per se* as did the courts in the US, several court decisions have taken “materiality” into consideration.[817] Given that no consistent doctrine has been formed, the following analysis is based purely on the US case law.

[810] Article 2(1) MAR.
[811] Article 2(3) MAR.
[812] Article 7 MAR.
[813] Article 8 MAR.
[814] Article 11 MAR
[815] Article 12 MAR.
[816] *Infra* note 821.
[817] *See e.g.* Bonner & Ors v. Cox & Ors [2005] EWCA Civ 1512 or Voisin and Abacus v Matheson Securities [2000] UR 144. The most relevant case was one decided by Irish Supreme Court Fyffes Plc v. DCC Plc & Ors [2007] IESC 36, which analyzed the materiality or price sensitivity of the information that was contentious.

3.3.4.1. Materiality through US Lens

Given the perplexity of what is material and what is not on the market, US courts have not subjected materiality to an explicit test.[818] They have determined that the meaning of "material" has to be assessed jointly with the surrounding circumstances and in totality of all publicly available information, given that the issue of materiality is always a mixed question of law and fact.[819] According to the US case law, the fact is "material", if there is *"a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information available*".[820] Thus, finding of materiality depends on whether a reasonable investor would consider the information to be important in making a decision. From other perspective, a complaint may not be dismissed on the ground that the alleged misstatements or omissions are not material

---

818 *See* Basic, Inc. v. Levinson, 485 U.S. 224, 236, 108 S.Ct. 978, 987-988, 99 L.Ed.2d 194, 211 (1988), materiality depends on the facts and is to be determined on a case-by-case basis. The Supreme Court in this case cited the Report on the Advisery Committee on Corporate Disclosure to the Securities on Exchange Commission, 95th Cong., 1st Sess., 327 of the House Committee on Interstate and Foreign Commerce*: "The materiality concept is judgmental in nature and it is not possible to translate this into a numerical formula. The Committee's advice to the [SEC] is to avoid this quest for certainty and to continue consideration of materiality on a case-by-case basis as disclosure problems are identified."*

819 There is a great number of case law in the US, where the courts assess the materiality of the disclosed information. The first case in which the US Supreme Court defined "materiality" was the TSC Industries, INC., v. Northway, Inc. 96 S.Ct. 2126 (U.S. 1976). According to some commentators, the first case of the US Supreme Court was the Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970), where the court assessed the materiality of omitted information and the issue before the court was causation.

820 *See* Basic, Inc. v. Levinson, 485 U.S. 224, 449, 108 S. Ct. 978, 985, 99 L.Ed.2d 194, 211 (1988). *See also, e.g.,* Matrixx Initiatives, Inc. v. Siracusano, 131 S.Ct. 1309, 179 L.Ed.2d 398 (2011), where the investors were successful in bring the action against pharmaceutical company due to its failure to disclose material information regarding one of the company's products; New Jersey Carpenters Health Fund v. Royal Bank of Scotland Groups, Plc., 709 F.3d 109 (2d Cir 2013), where investor filed putative class action alleging that registration statement and prospectus for mortgage-backed securities contained material misstatements and omissions because those documents reported standards for underwriting mortgages, which have been abandoned. The court found that the misstatements of underwriter's guidelines were not so obviously unimportant that they were immaterial as matter of law; In re AOL, Inc. Repurchase Offer Litigation, Fed. Sec. L. Rep. (CCH) P 97609, 2013 WL 4441516 (S.D.N.Y. 2013), where the investors were generally aware of the alleged nondisclosure and for this reason in the total mix of circumstances, the alleged misstatements were not material.

unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance.[821]

Deconstructing the doctrine provided by the case law, there are two main parts. First is the notion of a "reasonable investor". Second is the qualitative assessment of the provided information. Concerning the first element, under the current US case law, there is no specific definition of a "reasonable investor" in connection with the securities laws.[822] In connection to the second chapter of this thesis, a question whether a retail investor is "reasonable" could be posed. Notwithstanding the behavioral economics, in both EU and US, the retail investor would be perceived as "reasonable". In the EU, even the "consumer" is perceived as a reasonable, well-informed and circumspect consumer.[823]

Concerning the second element of the assessment - provided information - even if technically accurate, can still be materially misleading if significant facts are hidden or buried in the disclosure document, *e.g.* prospectus; and thus not readily apparent to an average reader.[824] Courts would consider placing material relevant information into footnotes or appendices as "burying" the facts. As a consequence, a court could consider the disclosure to be false or misleading if due to the "buried facts" the

---

[821] *See* Ganino v. Citizens Utils. Co., 228 F.3d 154, 162 (2d Cir. 2000), *see also e.g.* ECA v. JP Morgan Chase, 553 F.3d 187, 197 (2d Cir. 2009), United States v. Gaudin, 515 U.S. 506, 512, 115 S.Cy. 2310, 132 L.Ed.2d 444 (1995); Dodona I, LLC. v. Goldman Sachs & Co., 847 F. Supp. 2d 624, (2012); In the New Jersey Carpenters Health Fund v. Royal Bank of Scotland Groups, Plc., 709 F.3d 109 (2d Cir 2013), the court found that even the mortgage underwriter's guidelines were material as a matter of law. Contrary, the company's reporting results based on a statistical methodology was not materially misleading for failure to use allegedly better statistical methodology, *see* In re Rigel Pharmaceuticals, Inc. Securities Litigation, Fed. Sec. L. Rep. (CCH) P 97000, 2012 WL 385112 (9th Cir. 2012).

[822] *See* Piambino v. Bailey, 610 F.2d 1306 (5th Cir. 1980) comparing a reasonable investor to a the standard of a reasonable person in tort law; "At what audience should disclosure be aimed? Is the literature elicited by the Commission's requirements intended primarily to aid the unsophisticated? Is it, on the contrary, designed to assists the assiduous student of finance who searches for every clue to the intrinsic value of securities? Or should the Commission strive to meet the needs of a hypothetical "reasonable" investor of "reasonable" sophistication?" *see* the Wheat Report 51-52.

[823] *See* European Commission, *A Summary of the Written Contributions on the Green Paper on Retail Financial Services* 21 (2007).

[824] *See* HAZEN, TREATIES ON THE LAW OF SECURITIES REGULATION, *supra* note 438, at §12.9.

overall significance of the disclosure became obscured.[825] Furthermore, also the cautionary language will not result in complete elimination of liability for material factual defects.[826]

In the light of the case law in the US, there are certain statements that would clearly seem to be material and some, as those of opinion, general prediction, or puffing, which would be regarded as immaterial.[827] The exceptions from the materiality test are further expanded by the "bespeaks caution" doctrine[828] or by the "truth-in-the-market" doctrine.[829] The list of exceptions is fairly broad and professionals yearn for more certainty in the materiality test and ask for more quantitative measures or even a bright-line test.[830] Yet the US Supreme Court only provides a general materiality test, which is then taken and further interpreted by lower courts within smaller sub-doctrines of materiality.[831] The sub-doctrines of

[825] *See* Plain English Disclosure 22. The "buried facts" doctrine was introduced in the Plain English Disclosure. *See also e.g.* Kohn v. American Metal Climax, Inc. 487 F.2d 255 (3d Cir. 1972).
[826] *See* Berson v. Applied Signal Technology, Inc., 527 F.3d 982 (9th Cir. 2008).
[827] *See* Kapps v. Torch Offshore, Inc., 379 F.3d 207 (5th Cir 2004), where the omission of the downward trend in natural gas prices was not considered material; Majer v. Sonex Research, Inc., 541 F. Supp.2d 693 (E.D.Pa. 2008), where the mere puffery was not actionable under the materiality doctrine.
[828] Under the "bespeaks" doctrine, the optimistic forecasts or projections in a prospectus are not fraudulent if accompanied by specific disclaimers of the possible risk associated with the investment. *See* Moorhead v. Merrill Lynch, 949 F.2d 243 (8th Cir. 1991) and Sinay v. Lamson & Sessions Co., 948 F.2d 1037 (6th Cir. 1991), where court stated that the projections or estimates are not actionable under securities laws if accompanied by cautionary statements.
[829] Misleading statements are not actionable if the market participants already know the truth. *See* In re Corning, Inc. Sec. Litig., 349 F. Supp. 2d 698 (S.D.N.Y. 2004) holding that potentially negative news of study were not to be disclosed given that they had already reached the market. *See* Cunningham, Capital Market Theory, *supra* note 661, at 849-850 (1994), discussing the origin and rational of the doctrine.
[830] *See* Dale A. Oesterle, *The Overused and Under-Defined Notion of "Material" in Securities Law,* 14 U. PA. J. BUS. L. 167, 188 (2011) & COX, HILLMAN & LANGEVOORT, *supra* note 620, at 40; looking at a legal memorandum on Regulation FD, the Sidley & Austin, law firm recommends, that, "Given the imprecision of this standard, it is impossible to state for certain what types of information will be considered "material" and what types will not. It seems likely, however, that information regarding certain topics will nearly always be material." Then the memorandum enumerates the topics. *Available online at:* < http://www.sidley.com/files/News/73834e5b-2894-4f77-ab21-46dad2c27adc/Presentation/NewsAttachment/082a6d25-fb44-4d07-95d7-487f1b7fc0b8/SEC%20September%202000.pdf> /*last visited* Feb. 18th, 2014.
[831] *See e.g.* Stephen M. Bainbridge & G. Miu Gulati, *How do Judges Maximize? (The Same Way Everybody Else Does – Boundedly): Rules of Thumb in Securities Fraud Opinions,* 51 EMORY L.J. 83 (2002), criticizing the lower federal court judges for their lack of interest and understanding of

materiality then compete against each other and race towards the assessment by the US Supreme Court.[832] Thus, the US Supreme Court continues to deal with the open materiality doctrine.[833] Some academics believe that this segmentation of the doctrine weakens the general test and harms the investors.[834] However, I believe that open definitions allow the regulator and the court to better reflect upon a dynamic doctrine, which the materiality indisputably is.

3.4. Why Retail Investor Cannot Have It All [in Disclosure]

Whether due to the limited ability of the investors to comprehend the complexities of capital market or due to the limited amount of time that any retail investor devotes to the analysis of the capital market each evening, the scope of the information provided to the investors of investment companies is in simple terms restricted. In addition there are certain limitations of the disclosure that lie also in the **character** of the investment industry by itself, including the portfolio allocation activities, which cannot be disclosed to the fullest. In this subchapter I will briefly address additional aspects of the investment industry, which substantiate the general claim that a disclosure represents only a limited regulatory tool for investment protection.

3.4.1. Timing Particularities

On September 3, 2003 New York State Attorney General Eliot Spitzer announced that mutual fund managers were using widespread illegal trading schemes, which caused

securities laws. As a response, Professor Langevoort wrote an article defending judges and explaining that the further subdivision of a very general test is completely regular in common law, *see* Donald C. Langevoort, *Are Judges Motivated to Create "Good" Securities Fraud Doctrine?,* 51 EMORY L.J. 209 (2002).

[832] *See* Adam Liptak, *Supreme Court Rules Against Zicam Maker*, N.Y. TIMES, Mar. 23, 2011, at B5, quoting Professor Ronald J. Allen explaining how the Supreme Court "provided only limited guidance to companies and lower courts."

[833] One of the last cases discussed by the US Supreme Court was the Matrixx Initiatives, Inc. v. Siracusano, 131 S.Ct. 1309 (2011), which involved the materiality of reports on the alleged adverse effects of homeopathic cold remedies.

[834] *See* Oesterle, *supra* note 830, at 191, providing a comparison between numbers of scholarly works on the formation of sub-doctrines of the materiality doctrine.

the investors to lose billions of dollars a year.[835] These illegal schemes entailed late trading and market timing. Late trading involves placing orders after market closes at 4 p.m. EST, but receiving the price determined as of 4:00 p.m. that day.[836] Late trading allows trader (*e.g.* mutual fund) to profit from market events that occur after 4:00 p.m. EST but are not yet reflected in that day's price.

On the other hand, market timing involves a specific trading technique, which takes advantage of inefficiencies in mutual fund share pricing.[837] This technique entails trading in international stock mutual funds. Generally, the prices of international funds set at 4:00 p.m. EST, are partially based on closing prices of Asian stocks, which were determined more than ten hours earlier. In the event that the US market rises sharply, it is a good bet that Asian markets will rise the next day. Thus, will the prices of international funds. Being aware of this, a trader (*e.g.* mutual fund) buys shares in an international fund right before 4 p.m. EST in the US and sells the shares at a profit the next day.[838]

Although late trading is illegal, market timing is not *per se*. *De facto* market timing may turn out to be a lucrative strategy,[839] even though there is a risk that market timing can dilute the value of other mutual fund investors' investment through the market timer's exploitation of pricing inefficiencies.[840] Market timing *can "disrupt the management of the mutual fund's investment portfolio and cause the targeted mutual fund to incur costs borne by other investors to accommodate frequent*

[835] Press Release, Office of New York State Attorney General Eliot Spitzer, State Investigation Reveals Mutual Fund Fraud (September 3, 2003).
[836] SEC v. JB Oxford Holdings, Inc., Litigation Release No. 18850, 83 S.E.C. Docket 1988 (Aug. 25, 2004).
[837] *Id.* at 2.
[838] *See* Karen Damato, *"Timing" at Mutual Funds Can Cost 2% a Year,* WALL ST. J., Sept. 19, 2003, at C1.
[839] *See* Tomas Landon Jr., *S.E.C. Putting Mutual Funds Under Scrutiny on Late Trading,* N.Y. TIMES, Sep. 5, 2003, at C1.
[840] *See* BLOOMENTHAL & WOLFF, *supra* note 748, at §20:28.

buying and selling of shares by the market timer."[841] Ultimately, even if market timing is not illegal, together with late trading mutual fund may benefit from these practices, but at the expense of the investors.[842] Thus, most mutual funds discourage market timing and have public written policies to that effect.[843]

These cases on late trading and market timing show not only a technical specificity of the investment company's every-day investment decision making that an investor is not aware of, but they also show that the investment industry continues to advance. Years and years after the first established investment companies, investment companies and those who control them still continue to uncover space for individual gain.

3.4.2. Too Much or Too Little Information

The technology advancement of the industry however does not only affect the investment companies, but also the investors. Some investors may purely rely on the raw and unassisted data publicly available while following the "herd" of investors and completely disregard or cease to rely on professional advice.[844] This technology advancement takes place at the same time as the markets and the financial instruments become more complex and thus harder to comprehend.[845] Although this independent

---

[841] *See* SEC v. JB Oxford Holdings, Inc., Litigation Release No. 18850, 83 S.E.C. Docket 1988 (Aug. 25, 2004).

[842] *See* Complaint, S.E.C. v. Security Trust Company, N.A., Grant D. Seeger, William A. Kenyon, and Nicole McDermott, (D. Ariz., Nov. 24, 2003).

[843] *See* Tom Lauricella, *Two-Tier System: For Staid Mutual Fund Industry, Growing Probe Signals Shake-up*, WALL ST. J., Oct. 20, 2003, at A1.

[844] *See* Langevoort, *Taming the Animal Spirits, supra* note 550, at 154. The food industry however shows a little opposite approach in information disclosure. IT is important that the information is in the same format for two different items and placed where investor sees it at the time of decision, *see* KIP W. VISCUSI & WESLEY A. MAGAT, LEARNING ABOUT RISK: CONSUMER AND WORKER RESPONSES TO HAZARD INFORMATION 18-26 & 33-38 (Harvard University Press, 1987). Moreover, information about single facts is more useful than a wide range of information and it has been proven that in some cases, the rating systems are more useful than raw data; *see* J. Edward Russo et al., *Nutrition Information in the Supermarket*, 13 J. CONSUMER RES. 48, 62-65 (1986).

[845] *See generally* Rovert P. Barlett, III, *Inefficiencies in the Information Thicket: A Case Study of Derivative Disclosures During the Financial Crisis,* 36 J. CORP. L. 1 (2010), this study shows the complexity of the financial instruments on the market, while it simultaneously criticizes the disclosure

approach might prove risky, it is risky only for those particular investors who rely purely on raw data. As such, unless carried out by considerable majority of investors, this behavior represents risk neither for other investors nor for the market, and therefore should not necessarily be of a concern for a regulator.

Contrary to the voluntary exposure to unlimited amount of information, a simple experiment showed surprising results when comparing the investment decision taken after reading a full-length prospectus or a summary prospectus. John Beshears, an assistant professor of business administration at Harvard Business School, experimentally examined how a "reasonably" well-educated group of investors – white-collar staff at Harvard Business School – used various disclosure vehicles in making portfolio allocation decisions, which is a similar activity to the one a retail investor carries out when choosing an investment company, with which he or she invests.[846] According to the results of the research, those investors who decided based on the summary prospectus did no better or worse than those investors who relied on the full prospectus. Ultimately, those who used the summary prospectus gained as they spent less time with such activity. This simple experiment does not necessarily mean that a full prospectus is useless. Yet it shows that those additional information than those used in the summary prospectus most presumably do not affect the retail investors as such when making a decision.

3.5. Conclusion: Prospectus as an Opening Act

Disclosure has been, is and most presumably will be the central piece for the securities regulation because as many say information is the power. All three legal

inefficiency of these instruments given the inability of the investors to efficiently process the disclosure.

[846] *See* John Beshears *et al.*, *How Does Simplified Disclosure Affect Individuals' Mutual Fund Choices?* (NBER WORKING PAPER 14589, April 2009).

systems formed their regulatory framework on a theory, where the information is essential and fraud or any kind of deceit should be eliminated. Yet the purpose of a disclosure in case of investment companies slightly differs. First, the disclosure does not in any way affect the price of the investment company's shares. Secondly, the primary aim of a disclosure (in simple terms) is to inform the investors about the investment strategy and policy, the fees, risks encompassed in the investment and conditions of their right to redeem their shares. However, what is the value of information that one cannot employ? Investment companies by revealing the nature of their investment policy allow investors to select among funds and contribute to promoting more rational investment decision. Yet even if they decide for an investment company at the beginning, as shown in this chapter, they have no power of changing the investment strategy or policy, which essentially determines the risk degree they have undertaken. Therefore, investors' investment becomes fully in control of the investment company. Moreover, the language of the investment policy is often very broad, which makes it extremely hard for an investor to argue fraudulent misstatement or omission of facts in the prospectus. Plus keeping in mind the new wave of simplification of the prospectuses and the control division, investor protection in a form of disclosure is highly limited. Therefore, a disclosure obligation is only an opening act for the entire investment, which from then on should be managed by investment companies and their advisers, to whom broad fiduciary duties are imposed.

CHAPTER IV FIDUCIARY DUTIES: WHO PROTECTS THE RETAIL INVESTOR?

Fiduciary duties lie in the center of the regulation of investment companies. The investment companies together with their advisers represent the **fiduciaries**, in whose hands the investors entrust their money and who from that moment on fully control investors' investments. Even though the statutory provisions in the US and UK speak directly of a fiduciary relationship between investment companies and their investors as well as between investment advisers and their clients, its **nature** is unclear. As Justice Brennan of the US Supreme Court stated already in 1942, *"to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To **whom** is he a fiduciary? What **obligations** does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?"*[847]

Even though more than sixty years have passed since the decision in *Chenery Corp.*, the statement of Justice Brennan has survived up to the present time. In order to assess who protects retail investors and what does that protection entail, one should carry out a thorough analysis along the line of the Justice Brennan statement, and ask: *"what obligations does an investment company and those in control of investments – investment advisers – owe as fiduciaries?"*[848] I start my inquiry into fiduciary duties with defining the duties of directors (US), managers (EU) and advisers of investment companies (US and EU) in order to determine who has on one hand the day-to-day **governance** control over an investment company and who on the other hand has *de*

[847] *See* SEC v. Chenery Corp., 318 U.S.80, 85-86 (1942).

[848] There is a continuing ambiguity over the fiduciary obligations not only of investment companies, their advisers, but also of broker-dealers. *See* Arthur B. Laby, *Fiduciary Obligations of Broker-Dealers and Investment Advisers,* 55 VILL. L. REV. 701, 705 (2010) [hereinafter "Laby, *Fiduciary Obligations*"].

facto continuous **control over investors' investments**.[849] For this purpose, I compare the structure of investment companies in the EU and the US in order to identify where exactly lays the control over investment decisions. After unveiling the formalistic canvas of the investment companies, I find that in case of US mutual funds it is the investment advisers who *de facto* control investors' investments instead of the investment companies. In the EU the control depends on the preservation or delegation of management powers. The UCITS MC may either maintain its management powers or pass them on a third entity – usually an investment adviser. In case of an OEIC in the UK, the delegation of control mechanism over investment is carried out similarly to the UCITS.[850] For this reason, the statements made in connection with UCITS apply also for UK OEIC, unless stated otherwise. Since I analyze the internal structure of investment companies and the division of control of investment decisions, research and scrutiny of company, trust and some *lex specialies* ought to be made as well. Thus, I include also the analysis of the key investment adviser regulation; namely IAA 1940, MiFID II and MiFIR as well as relevant company and trust laws.

After detecting gaps in the current regulation and observing the limitations of investor protection in connection to the fiduciary duties owed by investment companies and their advisers, I claim that in order to attain greater investor protection, investors should be protected under a broader fiduciary standard. I provide several

[849] By using the term "control", I refer to the factual decision power over the investment.

[850] *See* Alastair Hudson, *The Future of Company Law: New Fiduciaries, New Britain,* 21 COMPANY LAW. 95, 96 (2000). The OEIC has to fulfill so called "property condition" that requires that the scheme property is both own beneficially by a body corporate and is managed by (or on behalf of) that the body is spread and its investors obtain the benefit of that management; *see FSMA* 2000, Part XVII c. 236(2), which states the following: *"The property condition is that the property belong beneficially to, and is managed by or on behalf of, a body corporate having as its purpose the investment of its funds with the aim of – (a) spreading investment risk; and (b) giving its members the benefits of the results of the management of those funds by or on behalf of that body." See also* FINANCIAL SERVICES LAW 868-869 (George Walker & Robert Purves, eds. 3d ed. 2014) [hereinafter "WALKER & PURVES"].

policy justifications to corroborate this statement and to show the underlying rationales. To provide a model for the "broad standard", I resort to trust law, given the direct role this branch of law has played during the evolution of investment company law; both in the US and the UK as shown in the first chapter. As long as the nature of the relationship remains unaltered, irrespective the form it has taken, the substantive rights and duties should be sustained.[851] Consequently, I claim that investment companies and advisers should owe the fiduciary duties known from trust law to the investors, as by imposing higher level of liability on investment companies and their advisers greater level of investor protection can be achieved.

4.1. Who is Who: Director, Manager versus Adviser

Terms as "director", "manager" or "adviser" are often used interchangeably by scholars and in other types of materials notwithstanding that according to US investment company regulation, there is a difference in their powers and duties, and therefore each term has its own distinct meaning; what prompts for precise referencing. As EU law is based on a distinct nomenclature, terminology should be clarified before starting the substantive analysis. First I take a look at the US, which refers to "director" and "adviser" and from thereon I move to the EU regulatory terminology, which applies the term "manager" instead of a director. However, there are additional nuances, which are explained in the following text.

In the US, two main terms in connection with the governance and management of an investment company are applied. One is the "**director**" and the other is the "**adviser**" of an investment company. They are regulated under two different statutes

[851] On the nature of fiduciary relationship, *see* Frankel, *Fiduciary Duties as Default Rules*, *supra* note 718, at 1215-1219.

and both of them carry out different types of activities in connection with the investment company.

The ICA 1940 imposes substantive rules upon the investment company's internal governance structure. "**Directors**" are those who carry out the day-to-day governance of the investment companies. The term "**director**"[852] refers to person with discretion to oversee the investment company irrespective of its legal form.[853] In other words, persons with discretion to supervise (internally) the investment company – directors, agents or trustees – all fall under the definition of a director.[854] Once an investment company is established, the directors enter into a contractual arrangement for management services with the organizers of the investment company, which is usually a brokerage house or an investment banking firm – an investment adviser.[855] Although the nature of directors' activities is more "governance" than "managerial" as they **do not manage the business** of the investment company – "investing," but only oversee it, the literature inaccurately continues to refer to the term as if they were "managing" the investment company.[856] Given the variations of legal forms of investment companies, they are subject to not only the rules of the ICA 1940, but also to additional standards of conduct imposed by common law and state statutory law –

[852] 15 U.S.C. §§80a-2(a)(12) (2012), "Director" means any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated, including any natural person who is a member of a board of trustees of a management company created as a common-law trust. Generally on the directors and other personnel

[853] *See* TAMAR FRANKEL, THE REGULATION OF MONEY MANAGERS: THE INVESTMENT COMPANY ACT AND THE INVESTMENT ADVISERS ACT 2 (volume 2, Aspen Publishing, 1998) [hereinafter "FRANKEL, THE REGULATION OF MONEY MANAGERS"].

[854] The investment companies that have affixed portfolio do not have directors (*e.g.* Unit Investment Trust), *see* 15 U.S.C. §80a-4(2) (2012).

[855] *See* Clarke Randall, *Fiduciary Duties of Investment Company Directors and Management Companies under the Investment Company Act of 1940*, 31 OKLA. L. REV. 635, 636 (1978) [hereinafter "Randall, *Fiduciary Duties of Investment Company Directors*"].

[856] *See e.g.* FRANKEL, THE REGULATION OF MONEY MANAGERS, *supra* note 853; *Randall, Fiduciary Duties of Investment Company Directors*, *supra* note 855 or Lawrence M. Greene, *Fiduciary Standards of Conduct under the Investment Company Act of 1940*, 28 GEO. WASH. L. REV. 266 (1959-1960).

depending on the corporate form under which the investment company is established.[857]

Under the ICA 1940, no person may serve as a director of a registered investment company unless elected by the holders of the company's securities – the investors.[858] This section applies to every registered investment company with exceptions only for certain common law trusts and unit investment trusts, which by definition do not have a board of directors.[859] The rationale behind this section of the ICA 1940 is that the investors entrust their finances in the hands of others – the directors – and therefore they should be in a position to elect them.[860] The SEC rigorously observes compliance with this section, as it is perceived to be one of the key control mechanisms in the hands of the investors,[861] even though it has been shown it is not bulletproof.

For even greater protection of investors, another type of director has been introduced by regulation – "**independent director**" – whose task is to oversee all the

[857] As expressly noted in the Supreme Court decision Burks v. Lasker, the ICA 1940 was not intended to supplant the "entire corpus of state corporation law". *See* Burks v. Lasker, 441 U.S. 471 (1979).

[858] 15 U.S.C. §§80a-16 (2012), "*No person shall serve as a director of a registered investment company unless elected to that office by the holders of the outstanding voting securities of such company, at an annual or a special meeting duly called for that purpose; except that vacancies occurring between such meetings may be filled in any otherwise legal manner if immediately after filling any such vacancy at least two-thirds of the directors then holding office shall have been elected to such office by the holders of the outstanding voting securities of the company at such an annual or special meeting. In the event that at any time less than a majority of the directors of such company holding office at that time were so elected by the holders of the outstanding voting securities, the board of directors or proper officer of such company shall forthwith cause to be held as promptly as possible and in any event within sixty days a meeting of such holders for the purpose of electing directors to fill any existing vacancies in the board of directors unless the Commission shall by order extend such period. The foregoing provisions of this subsection shall not apply to members of an advisory board.*
Nothing herein shall, however, preclude a registered investment company from dividing its directors into classes if its charter, certificate of incorporation, articles of association, by-laws, trust indenture, or other instrument or the law under which it is organized, so provides and prescribes the tenure of office of the several classes: Provided, That no class shall be elected for a shorter period than one year or for a longer period than five years and the term of office of at least one class shall expire each year.

[859] 15 U.S.C. §§80a-16(c) (2012) "The foregoing provisions of this section shall not apply to a common-law trust existing on the date of enactment of this title under and indenture of trust which does not provide for the election of trustees by the shareholders…."

[860] The investors elect directors in accordance with sec. 16(a) ICA 1940 (2012).

[861] *See* FRANKEL, THE REGULATION OF MONEY MANAGERS, *supra* note 853, at 27.

other non-independent directors.[862] ICA 1940 precludes independent directors from having certain affiliations or relationships with the fund's adviser in order to preserve its independence.[863] The SEC has described the independent director as fulfilling a "critical role" in preventing actions, which would take any advantage of the investors of an investment company.[864] Since the adoption of the institution, the powers of independent directors have been expanded several times.[865] The independent directors serve primarily as "watchdogs" over the non-independent directors, the investment advisers and their investment advisory contracts.[866] Although today, at least forty percent (40%) of the directors have to be independent, [867] the question of loyalty and

---

[862] *See* CCH MUTUAL FUNDS GUIDE 4-7 (Wolters Kluwer, 1999).

[863] *See* section 2(1)(19)(B) 15 U.S.C. 80a-2(a)(19)(B) (2012) (laying down the types of affiliations and relationships that render a director an "interested person" of a fund's adviser or principal underwriter).

[864] *See* Interpretive Matters Concerning Independent Directors of Investment Companies, Investment Company Act Release No. IC-24083, 64 Fed. Reg. 59,877 (Nov. 3, 1999). A court has characterized independent directors as performing "a vital function" in safeguarding the investors; *see* Papilsky v. Berndt, No 71 Civ. 2534 (S.D.N.Y. June 24, 1976).

[865] In 1970 the US Congress changed and extended the supervisory powers of independent directors, as the criteria adopted in 1940 did not seem to furnish sufficient protection for the investors, *see* Larry D. Barnett, *The Regulation of Mutual Fund Boards of Directors: Financial Protection or Social Productivity*, 16 J.L. & POL'Y 489, 498 (2008). In 1999, the SEC proposed rules designed to enhance the independence of directors, which have been adopted in 2001. *See* Role of Independent Directors of Investment Companies, Sec. Exch. Act Rel. No. 34-43786, 2001 WL 6738 (SEC, Jan. 2, 2001). According to the executive summary, "First, we are proposing to require that, for funds relying on certain exempting rules: (a) independent directors constitute either a majority or a super-majority (two-thirds) of the fund's board of directors; (b) independent directors select and nominate other independent directors; and any legal counsel for the fund's independent directors be an independent legal counsel. Second, we are proposing rules and rule amendments that would: (1) prevent qualified individuals from being unnecessarily disqualified from serving as independent directors; (2) protect independent directors from the costs of legal disputes with fund management; (3) permit us to monitor the independence of directors by requiring funds to keep records of their assessments of director independence; (4) temporarily suspend the independent director minimum percentage requirements if a fund falls below a required percentage due to an independent director's death or resignation; and (5) exempt funds from the requirement that shareholders ratify or reject the directors' selection of an independent public accountant, if the fund establishes an audit committee composed entirely of independent directors. Finally, we are proposing to require funds to provide better information about directors, including: (i) basic information about the identity and business experience of directors; (ii) fund shares owned by directors; (iii) information about directors' potential conflicts of interest; and (iv) the board's role in governing the fund's operations."

[866] S.REP.NO. 184, 91st Cong., 1st Sess. 32 (1969).

[867] 15 U.S.C. §80a-10(a) (2012).

efficient oversight of the governance of investment companies in the US is still heavily discussed, and will be dealt with in the following parts of this chapter.[868]

For the purposes of this section, it is necessary to fully comprehend the difference between governance and investment management, since sometimes terms as managing and governing together with director and manager are interweaving in scholarly works. Furthermore from a comparative perspective, in some legal systems different legal terminology may be applied, which may refer to distinct course of actions and regulation. One has to realize what it is exactly that the **director** governs, irrespective of the fact that he/she signs a "managerial contract" and is referred to as a "director". Given the fact that the director's work focuses on the internal management of an investment company and its employees, the terms more suitable for describing his/her activities are "**governance"** and/or "**supervision**". In practice, investment company directors represent the investment company outwardly, who continually oversee activity of their employees, if there are any and annually reconsider and reevaluate investment advisory contracts. [869] The decision of actual investing – managing the investment - is however in the hands of others – the investment advisers.[870]

"**Investment adviser"** to an investment company has the *"contractual authority to direct the functions and activities of the investment company to the extent*

[868] *See e.g.* Lyman Johnson, *A Fresh Look at Director "Independence": Mutual Fund Fee Litigation and Gartenberg at Twenty-Five,* 61 VAND. L. REV. 497, 502-507 (2008) or William A. Birdthistle, *Investment Indiscipline: A Behavioral Approach to Mutual Fund Jurisprudence,* 2010 U. ILL. L. REV. 61 (2010).
[869] 15 U.S.C. §80a-15(a) (2012). For more discussion on the duties of investment company director, *see* Michael J. Radmer, *Duties of Directors of Investment Companies,* 3 J. CORP. L. 61 (1977), Comment, *Duties of the Independent Director in Open-End Mutual Funds,* 70 MICH. L. REV. 696 (1972) or Barnett, *supra* note 865.
[870] *See* Randall, *Fiduciary Duties of Investment Company Directors*, *supra* note 855, at 638.

of portfolio selection."[871] Although the definition of an investment adviser is one of the most extensive and longest in the IAA 1940,[872] in practice the majority of investors do not understand the role of an adviser to an investment company.[873] An investment adviser signs an investment advisory contract with an investment firm.[874] From then on, the adviser is **actively managing** the portfolio of the investment company – the investments of all the investors. By the virtue of management delegation, adviser thus becomes a fiduciary that owes fiduciary duties to the investment company.[875]

[871] *See* Joseph F. Krupsky, *Role of Investment Company Directors,* 32 BUS. L. 1748 (1977). *See also* FRANKEL, THE REGULATION OF MONEY MANAGERS, *supra* note 853, at 102-130.

[872] 15 U.S.C. §§80b-2 (11) (2012) "Investment adviser" means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities; but does not include (A) a bank, or any bank holding company as defined in the Bank Holding Company Act of 1956 [12 U.S.C. § 1841 et seq.] which is not an investment company, except that the term "investment adviser" includes any bank or bank holding company to the extent that such bank or bank holding company serves or acts as an investment adviser to a registered investment company, but if, in the case of a bank, such services or actions are performed through a separately identifiable department or division, the department or division, and not the bank itself, shall be deemed to be the investment adviser; (B) any lawyer, accountant, engineer, or teacher whose performance of such services is solely incidental to the practice of his profession; (C) any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor; (D) the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation; (E) any person whose advice, analyses, or reports relate to no securities other than securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States, or securities issued or guaranteed by corporations in which the United States has a direct or indirect interest which shall have been designated by the Secretary of the Treasury, pursuant to section 3(a)(12) of the Securities Exchange Act of 1934 [15 U.S.C. § 78c(a)(12)], as exempted securities for the purposes of that Act [15 U.S.C. § 78a et seq.]; (F) any nationally recognized statistical rating organization, as that term is defined in section 78c(a)(62) of this title, unless such organization engages in issuing recommendations as to purchasing, selling, or holding securities or in managing assets, consisting in whole or in part of securities, on behalf of others;;2 (G) any family office, as defined by rule, regulation, or order of the Commission, in accordance with the purposes of this subchapter; or (H) such other persons not within the intent of this paragraph, as the Commission may designate by rules and regulations or order.

[873] *See* ANGELA HUNG ET AL., INVESTOR AND INDUSTRY PERSPECTIVES ON INVESTMENT ADVISERS AND BROKER-DEALERS (Rand Institute, 2008) [hereinafter RAND REPORT] According to the RAND REPORT in 2008, investors found it difficult to identify the business practices of investment advisers and did not understand the differences in the services provided by investment firms and investment advisers. Often, they also interchange advisers with brokers.

[874] *See* 15 U.S.C. §80b-5 (2012)*; generally see* R.G.C., *Mutual Funds and the Investment Advisory Contract,* 50 VA. L. REV. 141 (1964).

[875] "The Investment Advisers Act of 1940 thus reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline as investment adviser – consciously or

As opposed to the US, the nomenclature of UCITS V speaks of a "manager" and a "managing company" when referring to the person who actually makes the investment decisions. Usually, although not always, the management company forms an internal part of the investment company.[876] Many Member States allow delegation of management of the fund to another entity,[877] which is referred to as an "**investment firm**," but given its nature of business for the purposes of this thesis I will refer to it as an "**UCITS investment adviser**". The structure of the UCITS investment company under the EU law is fairly different from the US. Nevertheless, the question is the same as in the case of US: **Who manages the investment?** As stated above, there are two options. If the UCITS retains the management company internally, then it is the UCITS's MC that manages the investment.[878] If an external UCITS investment adviser manages the UCITS, the investment adviser falls under the MiFID regime.[879] To find out whether a UCITS is governed by a UCITS MC or a UCITS investment

unconsciously – to render advice which was not disinterested. *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191-192 (1963).

[876] Article 2(1)(b) UCITS V defines management company as "a company, the regulate business of which is the management of UCITS in the form of common funds or of investment or of investment companies (collective portfolio management of UCITS).

[877] *E.g.* France, Spain, Italy, UK, Ireland, *see* BLOOMENTHAL & WOLFF, *supra* note 748.

[878] By virtue of Article 6(3)(a) UCITS V, according to which the UCITS's management company may in addition to the governance of the UCITS also provide management of portfolios of investments, investment advice or safekeeping and administration in relation to units of collective investment undertakings. *See also* MOLONEY, HOW TO PROTECT INVESTORS, *supra* note 30, at 153-154. (However, Professor Moloney does not distinguish between the management and governance of the UCITS).

[879] Article 4(1)(1) MiFID II defines investment firms as "any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis. Member States may include in the definition of investment firms undertakings, which are not legal persons, provided that (1) their legal status ensures a level of protection for third parties' interests equivalent to that afforded by legal persons; and (b) they are subject to equivalent prudential supervision appropriate to their legal form. However, where a natural person provides services involving the holding of third party funds or transferable securities, that person may be considered to be an investment firm for the purposes of this Directive and of Regulation (EU) No 600/2014 only if, without prejudice to the other requirements imposed in this Directive, in Regulation (EU) No 600/2014, and in Directive 2013/36/EU, that person complies with the following conditions: (1) the ownership rights of third parties in instruments and funds must be safeguarded, especially in the event of the insolvency of the firm or of its proprietors, seizure, set-off or any other action by creditors of the firm or of its proprietors; (b) the firm must be subject to rules designed to monitor the firm's solvency and that of its proprietors; (c) the firm's annual accounts must be audited by one or more persons empowered, under national law, to audit accounts; (d) where the firm has only one proprietor, that person must make provisions for the protection of investors in the event of the firm's cessation of business following the proprietor's death or incapacity or any other such event."

adviser, an investor has to control the authorization document from the authorizing Member State, which is available online.[880] However, the question is how many of the investors are (1) aware of such internal structure and (2) investigate whether the UCITS is governed by a UCITS MC or a UCITS investment adviser. Although the most important questions for a regulator is, whether this delegation should be even relevant for the protection of investors and how to ensure a high quality of investment management? The answer is to apply the same level of fiduciary duty on those who manage investment, irrespective whether it is a UCITS MC itself or a UCITS investment adviser. This is analyzed further in this chapter.

Yet in conclusion to the applied terminology in connection to the governance and management of investment companies, there are few differences in the EU and the US. In case of the US, directors elected by the investors carry out only governance and supervisory functions while external investment advisers manage their investments. In the EU, two different models may be put in place: either the UCITS has its own management or it outsources it to an external entity. In the following part, the analysis of the existing fiduciary duties of the parties who manage the investments (who control the investments) is scrutinized.

4.2.Nature of Fiduciary Duties Owed to Investors Today

This sub-chapter is divided into three parts according to the legal system analyzed. The question is what is the **character and scope of the fiduciary duties** owed to the investors by investment companies and their advisors, if any? First I start with the US and subsequently I move to the analysis of EU and UK.

[880] ESMA is in the process of creation a central online registry for the authorized UCITS in EU, however for the moment one has to very with the national enforcement bodies. ESMA provides direct links to these registries (Cyprus does not administer such website), *available online at*: <http://www.esma.europa.eu/page/UCITS-Management-Companies.>/ *last visited* Jan. 6, 2015.

4.2.1. US: Why Are Investment Advisers Part of the Story?

Generally, an investment company itself employs only limited number of employees.[881] When looking at the practice, how an investment company is established, it is initially an investment adviser who sets up the investment company. The investment adviser provides its expertise, initial capital and organizational expenses at the beginning for the investment company, which economically represents only a pool of funds.[882] The investment adviser, as a creator of the fund, is responsible for the primary selection of the officers and directors of the fund.[883] Many policy decisions, including the terms of the advisory contract in the first place, are under the control of the adviser, not of the officers or directors of the fund.[884] And although the ICA 1940 requires investors and independent directors' **approval** for the advisory contract, the adviser remains often in full control of the investment decisions.[885] Thus, although ICA 1940 regulates the corporate governance in

[881] Depending on the size and the form of the investment companies. A mutual fund bears greater management and administrative burden than other types of investment companies, as the sales and redemption of shares are on a continuous basis. *See* Victoria E. Schonfeld & Thomas M.J. Kerwin, *Organization of a Mutual Fund*, 49 BUS. LAW. 107, 112-113 (1993).

[882] Investment professionals who wish to engage in investment management industry, in form of forming a mutual fund, have been most presumably already engaged in investment management business. They would first form a management company A and subsequently would form the mutual fund B, owning its initial shares. Afterwards, while fully controlling the management company A and the mutual fund B, they would enter into a contract under which the company A undertakes to serve the mutual fund B as investment adviser or manager for a fee. Afterwards, the mutual fund B starts to offer shares to the public and the company A will continue to invest the money of the fund in the light of the formerly concluded contract. On a description of organization of mutual funds, *see* Nathan D. Lobell, *The Mutual Fund: A Structural Analysis*, 47 VA. L. REV. 181, 184-186 (1961) [hereinafter "Lobell, *The Mutual Fund*"] or Schonfeld & Kerwin, *supra* note 881, at 114-117.

[883] *See* John C. Coates IV & Glenn Hubbard, *Competition in the Mutual Fund Industry: Evidence and Implications for Policy*, 33 J. CORP. L. 151, 158 (2007); Randall, *Fiduciary Duties of Investment Company Directors*, *supra* note 855, at 638.

[884] *See* Alan W. Rottenberg, *Developing Limits on Compensation of Mutual Fund Advisers*, 7 HARV. J. ON LEG. 309, 310 (1970). In the mid-1960's extensive studies were carried out by the Wharton School of Finance and the SEC concerning the control of investment advisers over the funds. One of the possible solutions represented by the study was to broaden the powers of independent directors, which will be discussed later in this chapter. For more *see* WHARTON REPORT, *supra* note 251.

[885] Generally, one can observe two main types of structure and relationship between the adviser and company in the industry. The first is when the investment advisers (*e.g.* Fidelity or Vanguard) control thousands of mutual funds, which they later sell to individual investors, while they continue to maintain certain portion of the ownership or even a controlling interest in the company. In such case, portfolios are managed overall by the investment advisers. The second type of structure is, when

investment companies by addressing the composition of a fund's board of directors, the selection process, the length of directors' tenure, and the oversight over the relationship between directors and advisers by independent directors,[886] the dominant position of the adviser over the fund is a "fact of life".[887] The adviser's control over the fund is formed and tends to be strong and enduring.[888]

This organizational and governance specificities of investment companies, their unique structure has been described as a "**business incest**" or as a "**corporate anomaly**".[889] Investors have to rely on directors and independent directors of the investment fund, who have to oversee the relationship with the fund adviser and enforce their rights, as at the end of the day it is the investment adviser, who makes the investment decisions.[890] Thus, those who should supposedly control are in fact controlled.

---

investment companies outsource the management of their portfolios to external adviser, which has neither ownership nor a controlling interest in the company. *See also* Laby, *Fiduciary Obligations, supra* note 848, at 728-730.

[886] *See* Norman H. Knickle, *The Investment Company Act of 1940: SEC Enforcement and Private Actions,* 23 ANN. REV. BANKING & FIN. L. 777, 784 (2004).

[887] Investment advisers in simple terms provide portfolio management services. Investment advisers can exercise control over the investment decisions of their clients – investment companies and consequently place even overvalued securities in their portfolios. In certain cases, advisers may subject the accounts of their clients to unsafe leverage in hopes of improving investment performance. *See* HARVEY E. BINES & STEVE THEL, INVESTMENT MANAGEMENT LAW AND REGULATION 121 (Aspen Publishers, 2nd ed. 2004). *See* FRANKEL, THE REGULATION OF MONEY MANAGERS, *supra* note 853, at 206 and RAND REPORT at 40.

[888] Concerning the testimony by number of industry executive, and one former SEC Commissioner emphasized the adviser's dominant position vis-à-vis the fund, as they create the fund, operates it in effect as a business. Many of the questioned, stated that "it is our fund, we run it, we manage it, we control it." *See* Investment Company Act Amendment of 1967: HEARING ON H.R. 9510 AND H.R. 9511 BEFORE THE SUBCOMM. ON COMMERCE & FIN. OF THE H. COMM. ON INTERSTATE AND FOREIGN COMMERCE, 90th Cong. 674 (1967) in John P. Freeman, et al., *Mutual Fund Advisory Fees: New Evidence and a Fair Fiduciary Duty Test,* 61 OKLA. L. REV. 83, 88 (2008).

[889] *See* Note, *The Mutual Fund and its Management Company: An Analysis of Business Incest,* 71 YALE L. J. 135 (1961).

[890] *See* Note, *Recognition of Legislative Intent in Judicial Interpretation of Investment Company Act of 1940,* 40 GEO. WASH. L. REV. 890, 895 n. 15 (1972), "They [industry insiders] also made the point that the investment adviser created the fund, and operates it in effect as a business. Many of them stated that 'It is our fund, we run it, we manage it, we control it,' and I don't think there is anything wrong in them saying it. They were just admitting what is a fact of life. The investment adviser does control the fund." In the EU, the same scenario is applicable, *see* BENJAMIN, FINANCIAL LAW, *supra* note 457, at 213.

Looking at the structure of an investment company, there are two levels where investor protection comes in play (chart 1). The first is the direct relationship of the investor and the investment company, while the second is the relationship between investor and the adviser. Even if there is no direct contractual connection between investors and advisers, it is them who keep the control over the investment of the fund, and thus ultimately of the investment of investors.

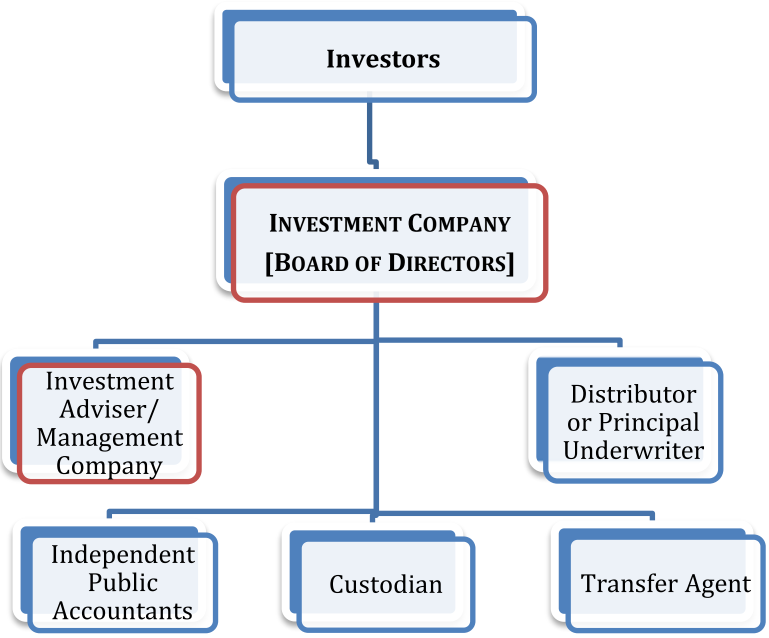

Chart 1

After the rapid growth of mutual funds in 1950' and 1960', the US Congress realized the close relationship between the investors and the investment adviser and added a new section 36(b) to former section 36 ICA 1940.[891] The new section 36(b) ICA 1940 introduced a **direct** fiduciary duties upon investment advisers in connection with their

[891] 15 U.S.C. §80a-35(b) (2012) ("For the purposes of this subsection, the investment adviser of a registered investment company shall be deemed to have fiduciary duties with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser."). The US Congress acted after the recommendation of SEC in Public Policy Implications of Investment Company Growth, *see* SENATE COMM. ON BANKING & CURRENCY, INVESTMENT COMPANY AMENDMENTS ACT OF 1969, S. REP. NO. 184, 91st Cong., 1sr Sess. 1,4, (1969) [hereinafter "1969 SENATE REPORT"].

receipt of compensation, which they owe to the investors.[892] Although according to the ICA 1940-set up, it should be the board of directors that safeguards the investors from any external exploitation of the investment adviser,[893] in reality, there are several **conflicts of interest** between the board of directors and advisers, which yield directors' protection questionable. Even though the directors have theoretically the ability to negotiate, demand or otherwise argue for investors' interest, they lack real powers and incentives.[894]

If directors are too demanding and pressing against the investment company organizer – the investment adviser – the investment company may be not created in the first place. Furthermore, during the life of the investment company – directors have the ultimate power to terminate the advisory contract and seek a new firm to advise it. However, this power has rarely been used and even in those situations[895] advisers were able to find their way back and restore their control over the investment company.[896] In other words, advisers hold greater bargaining power than the directors. This ultimately renders the board of directors as safeguards for investors controllable and inefficient and therefore, the party most exposed – investors – should be in a position to enforce their rights independently from the directors. But what exactly are

[892] Fiduciary character of this duty was upheld in the Supreme Court decision in SEC v. Capital Gains Research Bureau, 375 U.S. 180, 191 (1963).

[893] *See* Burks v. Lasker, 441 U.S. 471, 485 (1979), where the Court writes that the welfare of shareholders was "entrusted" by Congress to the non-interested directors and thus implies that Congress did not trust the interested directors to prevent the exploitation of shareholders.

[894] *See* John C. Coates IV & Glenn R. Hubbard, *Competition in the Mutual Fund Industry: Evidence and Implications for Policy,* 33. J.CORP. L. 151, 158 (2007).

[895] *See* Stephen Tate, The Role of Independent Directors in Mutual Fund Governance 24 (Harvard Law School, 2000).

[896] In 1997, the board of directors of Navellier Aggressive Small Cap Equity Fund fired its adviser – Louis Navellier. However, in the proxy fight, Navellier was able to force the fund to rehire him and pressure the independent directors to resign. Moreover, Navellier and several other investors filed a lawsuit alleging fiduciary breach against directors for a non-renewal of an investment advisory contract. Ultimately, the court decided that the independent directors acted within their discretion. *See* Catherine Hickey, *Navellier Presses on Amid Lawsuits and Small Cap Woes,* MORNINGSTAR MUTUAL FUND, March 3, 1999.

the investors' rights in conjunction with the fiduciary duties of an investment company and an adviser?

4.2.1.1. Investment Companies and Their (Inconclusive) Fiduciary Duties

The former section 36 of the ICA 1940 construed only a general liability provision of fund's directors. It referred to the "*gross misconduct or gross abuse of trust*" of persons affiliated with investment companies and it *"authorized the SEC to seek specific injunctive relief in the event of a breach of this duty."*[897] It contained express language, which provided **only** for SEC action,[898] as section 36(a) ICA 1940 does today.[899] Yet the interpretation of the wording of former section 36 supported an **implied private right of action for investors.**[900] In light of the case law, the fiduciary duties of the investment company – investor relationship have been repeatedly acknowledged and investors were in a position to enforce it.[901] However, after the regulatory change in 1970 and the adoption of the section 36(b) ICA 1940 in 1970, the investors lost their entitlement to a direct right of action against the

---

897 *See* Note, *Private Rights of Action Against Mutual Fund Investment Advisers: Amended Section 36 of the 1940 Act*, 120 U. PA. L. REV. 143, 144 (1971).

898 Section 36 authorized the SEC to bring an action against certain persons affiliated with investment companies for *gross misconduct or gross abuse of trust* within five years prior to when suit was filed; *see* Pub. L. No. 768, ch. 686 § 36, 76th Cong., 3d Sess. (Aug. 22, 1940), 54 Stat 841.

899 *See* 15 U.S.C. §80a-36(a) (2012).

900 Former section 36 ICA 1940 has been read by several courts to imply a private right of action for the investors, *see* Moses v. Burgin, 445 F.2d 369 (1st Cir. 1971), Tanzer v. Huffines, 314 F. Supp. 189 (D. Del. 1970). The most cited case for the existence of the private right of action is the Brown v. Bullock, 194 F. Supp. 207 (S.D.N.Y.), which contained an extensive review of the legislative history of section 36. In this case the court stated that the section 36 held a "reservoir of fiduciary obligations" designed to protect the investors of mutual fund from many subtle abuses that were not separately defined in the statute, at 239. *See also* Clarke Randall, *supra* note 855, at 649.

901 *See e.g. Aldred Inv. Trust v. SEC*, 151 F.2d 254, 260 (1945) or *Brown v. Bullock* 194 F. Supp. 207 (1961), where the court stated that ICA 1940 in effect codifies the fiduciary obligations placed upon officers, directors and investment advisers of investment companies. Moreover, in case of violation of fiduciary duties created by the ICA 1940, directors may be held liable in federal courts. Further *see Breswick & Co. v. United States*, D.C.S.D.N.Y 1955, 124 F Supp. 132, 138, according to which it was one of the purposes of ICA 1940 to protect investors against the managers of investment companies.

investment company, with which they directly contract, but gained one against the investment advisers.[902]

Returning to the fiduciary duties owed today by an investment company – under section 36(a) ICA 1940 – officers, directors, and members of any advisory board, investment adviser, depositor, or principal underwriter – owe fiduciary duties to the investors.[903] Unfortunately, the nature and character of the fiduciary duties owed by all these officers, including the investment advisers, has not been defined by a regulator and as one circuit court stressed section 36(a) ICA 1940 represents a "reservoir of fiduciary obligations" available to deal with misconduct that is not specifically addressed in the ICA 1940 itself.[904]

The legislative history of section 36(a) ICA 1940 provides only limited guidance as to the nature of this "reservoir of fiduciary obligations". In 1970, the wording of this obligation changed from *"gross misconduct or gross abuse of trust"* into *"conduct which violates prevailing standards of fiduciary duty involving personal misconduct."* However, why this change took place remains a mystery. Neither the Senate Committee, nor courts have provided much help.[905] Although courts acknowledge the fiduciary duties owed by investment companies, their scope has not been defined even though some early circuit court decisions explored the issue

[902] *See* 15 U.S.C. §80a-36(b) (2012).
[903] 15 U.S.C. §80a-35(a) (2012) ("The Commission is authorized to bring an action in the proper district court of the United States, or in the United States court of any territory or other place subject to the jurisdiction of the United States, alleging that a person who is, or at the time of the alleged misconduct was, serving or acting in one or more of the following capacities has engaged within five years of the commencement of the action or is about to engage in any act or practice constituting a breach of fiduciary duty involving personal misconduct in respect of any registered investment company for which such person so serves or acts, or at the time of the alleged misconduct, so served or acted."). *See also* Philip H. Newman, *Boards of Directors of Registered Investment Companies,* SU011 ALI-CLE 221 (2012).
[904] *See* Steadman v. SEC, 603 F.2d 1126, 1141-1142 (5th Cir. 1979).
[905] The change of the wording was necessary because "the highly punitive overtones of the existing section, together with the injunctive penalty, seriously impairs the ability of the courts to deal flexibly and adequately with wrongdoing by certain affiliated person of investment companies." *See* S. REP. NO. 91-184, at 36 (1969).

of the fiduciary relationship.[906] All three cases arose out of the brokers' commissions for executing trades for the funds, which the board of mutual fund failed to reclaim and thus was liable under section 36(a) ICA 1940.[907] In 1971, in the *Moses* decision, the plaintiff asserted that the mutual fund failed to recover portion of the brokerage commission, and thus was liable under section 36(a) ICA 1940 for the breach of its fiduciary duties. In the later case of *SEC v. Advance Growth Capital Corp.* in 1972, a court in a footnote stated that *"[w]e are aware ... that the provisions of the ICA impose fiduciary obligations of the* ***highest order*** *upon persons who control investment companies."*[908] However, the court failed to determine what the "highest order" meant.

Given that courts have not yet provided any test for specifying the scope of fiduciary duties under 36(a) ICA 1940 and there is no federal law of fiduciary duties,[909] the only option is to turn to the state law.[910] When a federal court hears a case on the breach of section 36(a) ICA 1940, it has three options. The **first** one is to fully adopt the state law on the issue.[911] The **second** one is to formulate an independent federal doctrine by drawing analogy to the state law.[912] And the **third** one is to refer to the interpretation of the fiduciary duties under common law,[913] which is based on the law of trusts. All three approaches bring not only different

---

906 *See* Moses v. Burgin, 445 F.2d 369 (1st Cir. 1971); Fogel v. Chesnutt, 533 F.2d 731 (2d Cir. 1975) and Tannenbaum v. Zeller, 552 F2d 402 (2d Cir. 1977).

907 For details on all three cases, *see* William K. Sjostrom, Jr., *Tapping the Reservoir: Mutual Fund Litigation Under Section 36(a) of the Investment Company Act of 1940*, 54 U. KAN. L. REV. 251, 263-268 (2005).

908 *See* SEC v. Advance Growth Capital Corp. 470 F.2d 40, 55 n. 21.

909 *See* Santa Fe Indus. V. Green, 430 U.S. 462, 478-479 (1977). The US Supreme Court refused to recognize a federal law of fiduciary duty.

910 Also the Investment Company Institute stated that: *"Directors have the fiduciary duty to represent the interest of the fund's shareholders and are subject to state law duties of loyalty and care." Available online at:* < http://www.ici.org/pubs/faqs/faq_fund_gov_idc>.

911 *See* CHARLES ALAN WRIGHT & MARY KAY KANE, LAW OF FEDERAL COURTS 421 (Hornbook Series 6th ed. 2002)

912 *Id*.

913 *See* James N. Benedict et al., *Recent Developments in Litigation Under the Investment Company Act of 1940,* ALI-ABA Course of Study (2007).

outcomes but seem arbitrary and thus do not serve the purpose of providing uniform and predictable level for investor protection. This shows that the objective of investor protection has not yet become so as to make federal courts provide a uniform interpretation. As a result, the level of investor protection continues to be substantially different from state to state.[914]

In addition to the unclear standard of the fiduciary duties of investment companies, recent case law shows an antagonistic environment for implied private actions under section 36(a) ICA 1940,[915] leaving the investors with even less protection, as it is solely the SEC that can bring a suit. Thus, even if other securities regulations allow private litigation,[916] none of these reflect to full extent the unique investment company organization, where an investor almost blindly entrusts his/her wealth into the hands of an investment company, whereas he/she cannot even protect his/her investment.

4.2.1.2. Relevance of State Law: Fiduciary Duties of Directors

As stated above, when the courts decide on claims touching upon the fiduciary duties of directors or generally on issues of corporate governance of the investment

[914] *See* Sjostrom, *supra* note 907, at 273-286.

[915] As it is the chapter V is devoted to the investors' remedies, a quick note to the private right of action under section 36(a) ICA 1940. *See e.g.* Olmsted v. Pruco Life Ins. Co. of New Jersey, 283 F.3d 429 (2002) (Where the court stated among many other things, that although majority of courts interpreting ICA 1940 have recognized implied private rights of action to enforce many sections for the benefit of a special class, today it is not the case.); Belikoff v. Eaton Vance Corp., 481 F.3d 110 (2nd Cir. 2007) ("the text and the structure of the ICA reveal no ambiguity about Congress's intention to preclude private rights of action to enforce §§34(b), 36(a), and 48(a). Thus, plaintiff's appeal to certain language reflecting a contrary intent in a 1980 post-enactment legislative committee report is unavailing, for such material is out of bounds."); Smith v. Oppenheimer Funds Distributor, Inc., 824 F. Supp. 2d 511 (S.D.N.Y. 2011) (Under section 36(a) ICA 1940 there is no implied remedy). *See also* HAZEN, TREATIES ON THE LAW OF SECURITIES REGULATION, *supra* note 438, at §20.10.

[916] Under the SA 1933, due to the distribution of investment company's own securities and the sections 11 and 12(a)(2) for material misstatements or actionable omissions. Another avenue for plaintiff may be the section 415 of the IAA 1940, taking advantage of broad description of fiduciary obligations imposed on advisers by the case law. On private right of action *see generally* Knickle, *supra* note 886.

company, they have to look into state law.[917] A mutual fund can be established as a corporation, a business trust or as a limited partnership,[918] which brings into the analysis of directors' fiduciary duties the necessity of discussing what is offered by state law. Mutual funds are usually organized under Delaware or Massachusetts law due to the flexibility that they offer concerning governance as well as for tax purposes.[919] Given that Delaware is the leading US jurisdiction in the field of corporation law, its view of directors' fiduciary duties is particularly instructive.

In Delaware, the directors are deemed to be **fiduciaries** in the light of the Supreme Court of Delaware decision, where it clearly stated, that

> *""[c]orporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its shareholders… Thus, directors are required to demonstrate both their utmost good faith and the most scrupulous inherent fairness of transactions in which they possess a financial business or other personal interest which does not devolve upon the corporation or all stockholders generally."*[920]

[917] *See* Burks v. Lasker 441 US 471 (1979). *See also* Kamen v. Kemper Financial Securities Inc., 500 US 90 (1991) (where the court found that state law controls question of board demand).
[918] *See e.g.* John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce,* 107 YALE L.J. 165, 171 (1997) or Barnett, *supra* note 865, at 507.
[919] In Delaware a business trust is an unincorporated association governed by a board of trustees, which under the state law, if permitted by a trust declaration can take most actions without ratification of the investor. *See* Dell. Code Ann. Tit. 12, §3806 (Supp. 2012), *available online at*: < http://delcode.delaware.gov/title12/c038/sc01/index.shtml>/ *last visited* Sep. 2nd, 2014. Moreover, Maryland or Delaware do not require the annual meetings of their shareholders, decreasing the costs and attention from the fund as well as from the investors *aka* shareholders. In Maryland, mutual funds set up as corporation may redeem common shares without any obligation to pay corporate franchise tax. For more on the form of organization of a mutual fund, *see* Schonfeld & Kerwin, *supra* note 881, at 114-116.
Since the adoption of the Tax Reform Act of 1986, the partnership form has not been very attractive.
[920] Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1280 (Del. 1989).

In the light of this doctrine, the failure of a director to fulfill fiduciary duties renders the offending director liable for damages that stem from his/her failure.[921] However, under the Delaware General Corporation Law, company's certificate of incorporation may contain a provision limiting director's liability for a breach of fiduciary duties as long as the provision does not limit the liability for breach of the **duty of loyalty** or **good faith**.[922]

In case a mutual fund opts for a business trust form, the directors are deemed to have fiduciary duties to the holders of beneficial interests in the trust,[923] which include both **duty of care** and a **duty of a loyalty**.[924] Although the Delaware statute on business trusts allows the documents governing the trust to change or remove fiduciary duties of a trustee, it does not allow to "eliminate the implied contractual covenant of **good faith** and **fair dealing**."[925] In addition pursuant to the section 17 ICA 1940, even if the investment company seeks to limit the liability of the directors or trustees, such circumspection would not be successful given that section 17 ICA 1940 prohibits any charter, bylaws or any other provisions to limit the liability of directors or officers.[926] Therefore, the only direction in connection with the nature and scope of fiduciary duties of mutual funds, one should find in the provisions of ICA 1940. In conclusion, the directors of mutual funds in the US, in the light of Delaware

[921] *See* FRANKLIN A. GEVURTZ, CORPORATION LAW 301 (WestGroup, 2000).
[922] DEL. CODE ANN. TIT 8, §102 (b)(7) (2014).
[923] *See* Sjostrom, *supra* note 908, at 274 ("[S]tate courts have generally analogized the duties of trustees of business trusts to those of directors of corporations."].
[924] Cede & Co. v. Technicolor, Inc. 634 A.2d 345, 367 (Del. 1993).
[925] *See* DEL. CODE ANN. Tit 12, §3806(c).
[926] 15 U.S.C. §§80a-17(h) (2012), which states: "After one year from the effective date of this title, neither the charter, certificate of incorporation, articles of association, indenture of trust, nor by the by-laws of any registered investment company, nor any other instrument pursuant to which such company is organized or administered, shall contain any provision which protects or purports to protect any director or officer of such company against the liability to the company or to its security holders to which he would otherwise be subject by reason of willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of this office."

state law, irrespective whether set up as a corporation or a business trust, are subject to three obligations, namely duty of care, duty of loyalty and good faith.

4.2.1.3. Investment Advisers and Their (Ineffectual) Fiduciary Duties

Investment advisers provide investment companies with investment management services under an investment advisory contract.[927] Although ICA 1940 and IAA 1940 successfully eliminated the blatant investment practices which disturbed the capital markets in the US before the New Deal,[928] the continued presence of investment management delegation to another legal entity – investment adviser – remained a source of problems. As investment directors delegated management of investments to a different entity, the question concerning terms and fees of such "delegation" under contract have been raised.[929] Although the purpose of introducing independent directors within the corporate governance structure of an investment company was to oversee this delegation, they have not been perceived as efficient, as the investment advisers continue to hold control over the entire investment company and its personnel even after its establishment.[930] The amount of advisory fees[931] was litigated intensely.[932]

---

[927] Advisory contract must be approved by the investors and is subject to periodic negotiations, *see* 15 U.S.C. §§80a-15(a). For a detailed analysis of investment advisory contract, fees for advisory and other services that the adviser renders, *see* FRANKEL, THE REGULATION OF MONEY MANAGERS, *supra* note 853, CHAPTER XI.

[928] *See* SECURITIES EXCHANGE COMMISSION, PUBLIC POLICY IMPLICATIONS ON INVESTMENT COMPANY GROWTH, H. R. REP. NO. 2337, 89th Cong., 2d Sess. (1966) [hereinafter "SEC POLICY REPORT 1966"] at 1, 5, 71; *see also* Comment, *Mutual Funds and Independent Directors: Can Moses Lead to Better Business Judgment?*, 1972 DUKE L. J. 429, 434 (1972).

[929] Under the former section 36 ICA 1940, the investors had an implied private right of action, notwithstanding the express terms of the section. *See e.g.* Brown v. Bullock, 194 F. Supp. 207 (S.D.N.Y. 1961) or Esplin v. Hirschi, 402 F.2d 94 (10th Cir. 1968).

[930] *See* Randall, *Fiduciary Duties of Investment Company Directors*, *supra* note 855, at 639. One of the first studies, which undertook to research the relationship between fund and adviser, was the WHARTON REPORT in the mid-1960', which showed a lack of confidence in the regulatory reliance upon the independent directors, at 33. Afterwards, the SEC POLICY REPORT 1966 analyzed the weaknesses of the independent directors as the sole watchdogs over the directors and advisers, and stated these following reasons for their failure: "(1) the dependence of unaffiliated directors upon affiliated directors for guidance in fund policy matter; (2) lack of time attributed to and lack of compensation received from the affiliated directors; and (3) the inability to terminate or even threaten to terminate the

Thus, after the WHARTON REPORT and SEC POLICY REPORT 1966 were presented to the Congress, there have been long discussions on what legislative steps should be taken.[933] Naturally the industry representatives were against any further regulation.[934] Yet due to the scandals at the time, several amendments to the ICA 1940 were adopted, including the new well-known section 36(b) ICA 1940.[935] In *Gartenberg* the court held that in order to determine whether an adviser **breached** its fiduciary duties, a court should look at the fee and determine whether *"the fee is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining."*[936] The

---

advisory contract and to contract with other parties for the same services." at 130-131 of SEC POLICY REPORT 1966.

[931] The IAA 1940, except for performance fees, does not specifically address or regulate the types and amounts of fees charged by the adviser to its client, here being the investment company. The IAA 1940 relies on the duty of adviser to disclose the amounts that it charges. Generally, the adviser may charge the following fees: (1) Asset-based fee, which is an annual management fee, based on the value of the assets under management (1-1.5%), paid on a quarterly basis; (2) Commissions, received on the sale of load mutual funds; (3) Flat fee, which is an annual retainer for all advisory work; (4) Hourly fee, based on time spent with client's investments or (5) Formula fees, which takes into account a client's income and total net worth, plus also the complexity of client's matters. There might be also other types of fees, individually agreed upon. All of the fees, the way of their calculation should be clearly stated in the investment advisory contract. *See* THOMAS P. LEMKE & GERALD R. LINS, REGULATION AND COMPLIANCE FOR INVESTMENT ADVISERS §2:9 (2014), *available at* WestlawNext.

[932] *See e.g.* Saminsky v. Abbott, 40 Del. Ch. 528, 185 A.2d 765 (1961) (an action by shareholders was brought in order to recover the profits which were allegedly withdrawn from the fund through excessive management fees and expense charges); Saxe v. Brady, 40 Del. Ch. 474, 184 A.2d 602 (1962) (Plaintiff claimed that a fee structure of 1/2 of 1% of average daily net asset was "unreasonable, excessive and an illegal waste and spoliation of the fund's assets.") However, many of the cases were unsuccessful as plaintiffs did not have specific provision in the ICA 1940 and could only rely on equitable principles and show the excessiveness by comparison with other funds, which were to certain extent carrying out same practices.

[933] According to Senate Report No. 91-184 of May 21st, 1969, the purpose of the added new section 36(b) to the ICA 1940 was to provide a judicial remedy for breach of a fiduciary duty with respect to compensation of payments paid by the investment company, or by its security holders, to the adviser or to an affiliated person of such adviser. Furthermore, the report stated that the section 36(b) authorizes an action only against the recipient of the compensation or payments. Importantly, "an award of damages against any recipient is limited to actual damages resulting from the breach of fiduciary duty and may not exceed the amount of the payments received by such recipient from the investment company or its security holders." *See* S. REP. 91-184, S. REP. NO. 184, 91st Cong., 2nd Sess. 1970,

[934] On a detailed history of this process *see* Randall, *Fiduciary Duties of Investment Company Directors*, *supra* note 855, at 653-658.

[935] 15 U.S.C. §80a-35(b) (2012) "..[t]he investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services or of payments of a material nature, paid by such registered investment company, or by the security holder thereof, to such investment advice or any affiliated person of such investment adviser…"

[936] Courts should consider six factors, which are (1) the nature and quality of services provided to fund shareholders; (2) the profitability of the fund to the adviser-manager; (3) fall-out benefits; (4)

excessiveness of the fee depends on the connection between the fee and the rendered services.[937] In practice, to be successful in claiming excessive fees under 36(b) ICA 1940, a complaint should not simply allege in a conclusory manner that the fee was excessive, but rather it should allege facts that would support claim that the fee at issue is excessive.[938] Although this section has been perceived as promising for the investors to enforce their rights, since the adoption of this section, no investor was successful in such a claim.[939]

Furthermore, the most recent decision of the US Supreme Court in *Jones v. Harris*,[940] which could have had a wide-ranging effect on the industry, had limited even more the extent of the fiduciary duties under the section 36(b) ICA 1940.[941] The US Supreme Court affirmed the Gartenberg standard that makes it difficult to prove any violation under the section 36(b) ICA 1940 except fraud and misconduct, and thus potentially closed the door for future attempts to expand the fiduciary duties under this section beyond the narrow type of wrong.[942] The decision on many places referred to the role of independent directors who are in a position to supervise the

---

economies of scale; (5) comparative fee structures; and (6) the independence and conscientiousness of the trustees.) *See* Gartenber v. Merrill Lynch Asset Mgmt., 694 F.2d 923, 928 (2[d] Cir. 1989); *see also* Amron v. Morgan Stanley Ind. Advisors Inc., 464 F.3d 338, 340 (2d Cir 2006) and Moses v. Burgin, 445 F. 3d 369 (1[st] Cir. 1971) (In this case the plaintiff complained of various breaches of fiduciary duty imposed by the ICA 1940 and the common law. The Court of Appeals held that the mutual fund's investment adviser and its underwriter were liable for gross misconduct as they failed to disclose to the fund's unaffiliated directors the possibility of recapturing the portion of brokerage commissions, the fund was obliged to pay on purchases and sales of securities. Plaintiff's argument was that the general principles governing the fiduciaries in the area of self-dealing are present as well in the ICA under the Section 36. Furthermore, the decision stated that "A fiduciary is under no duty to engage in legally doubtful experiments virtually unsupported by customs or convention or court decision." at 57).

937 *See* Kratz v. Prudential Investments Fund Management LLC, 305 F.3d 140, 143 (3d Cir. 2002).

938 *See* Migdal v. Rowe Price-Fleming Intern., Inc., 248 F.3d 321, 325 (4[th] Cir. 2001). *See also* Anne E. Melley, *Receipt of Compensation; Fiduciary Duty*, 45 AM. JUR. 2D INVESTMENT COMPANIES ETC. §17 (2014), *available at* WestlawNext.

939 *See e.g.* Sean M. Murphy, *Recent Developments in Litigation Involving Mutual Funds and Investment Advisers*, SS016 ALI-ABA 943, 947 (2010).

940 Jerry N. Jones, et al., Petitioners, v. Harris Associates L.P., 559 U.S. 335 (2010).

941 For detailed analysis of Jones v. Harris, *see* James F. Koehler & Wesley P. Lambert, *The Supreme Court's Review of Jones v. Harris Associates and §36(b) claims under the Investment Company Act of 1940 – A Prospective and Analytical View,* 12 DUQ. BUS. L.J. 63 (2009).

942 *See* Murphy, *Recent Developments in Litigation*, *supra* note 939, at 948.

contract and approve the adviser's compensation,[943] which is theoretically true but in reality it is not.

The US Supreme Court failed to look into the economic reality of the structure and management of an investment company.[944] The investment company itself is only a "shell entity" shielding a pool of funds in the hands of advisers. Even if no court in the US has ever engaged in searching for "economic reality" in case of investment companies, it is the investment advisers who should be directly responsible to the investors, not only for the fees they charge but also for the quality of advice they provide. Yet by the virtue of the formalistic division between the investment company and the adviser, which in reality does not exist, advisers owe theoretically investors **only** the *"fiduciary duty with respect to the receipt of compensation for services,"* which has never been enforced and therefore could be perceived as futile. Investors under the ICA 1940 have *de facto* no direct or indirect right of action neither against investment nor against the investment adviser, which would allow them to protect their investment.

In case of fiduciary duties of investment advisers, no questions arise under state law. Advisers operate solely under a federal fiduciary standard through application of the IAA 1940. When determining advisers' fiduciary duties, courts **only** have to consult federal cases.[945]

[943] Jerry N. Jones, et al., Petitioners, v. Harris Associates L.P., 559 U.S. 335, 344 (2010).
[944] In the field of securities laws, the courts often refer to the economic realities of the transaction in connection to determining whether a particular instrument is investment contract. In other words one should assess what is behind the form. *See e.g.* United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 838 (1975) or Landreth Timber Co. v. Landreth, 471 U.S. 681, 685 (1985).
[945] *See* Laird v. Integrated Res., Inc., 897 F.2d 826, 837 (5th Cir. 1990) ("[C]oncerning entanglement with state law, because our holding encompasses a developed federal standard it does not require reference to state corporate and securities law or the state law of fiduciary relationships.").

However, besides section 36(b) ICA 1940, there is a second level for analysis – section 206 IAA 1940, which lies down the fiduciary duties owed by an investment adviser towards its "**client**".[946] Again, who is the client? Scholars almost automatically assume that the client is the investment company, with which the adviser has the contractual relationship. However, again applying the economic reality test, *de facto* the investors are the clients, as the investment company represents only a shell entity. An alternative solution to introducing a new provision in the ICA 1940 in connection to the private right of action against investment advisers could be to expand on the definition of "client" under section 206 IAA1940 and include under this term the individual investors, as the end it is them who invest their money. If the investment company is actually only a shell of a pool of investments,[947] which outsources its management and often does not even have employees, shouldn't the adviser, who actively and on day-to-day basis manages the fund's investment, owe the fiduciary duties to the investors directly?

Early in 1963 the US Supreme Court stated that investment advisers are deemed fiduciaries vis-à-vis their clients, and the IAA 1940 reflects a congressional

---

[946] 15 U.S.C. §80b-6 (2012),"It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly-- (1) to employ any device, scheme, or artifice to defraud any **client** or **prospective client**; (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any **client** or **prospective client**; (3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a **client**, or acting as broker for a person other than such **client**, knowingly to effect any sale or purchase of any security for the account of such **client**, without disclosing to such **client** in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the **client** to such transaction. The prohibitions of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction; or (4) to engage in any act, practice, or course of business, which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative."

[947] Zell v. InterCapital Income Securities, Ind., 675 F.2d 1041, 1046 (9th Cir. 1982), where the court stated that "[a] mutual fund is a "mere shell," a pool of assets consisting mostly of portfolio securities that belong to the individual investors holding shares in the fund." Later, also the US Supreme Court referred to this decision in Burks v. Lasker, 441 U.S. 471 (1979). Also a US Supreme Court recent case Jerry N. Jones, et al., Petitioners, v. Harris Associates L.P., 559 U.S. 335 (2010) included the same referral.

recognition *"of the delicate fiduciary nature of an investment advisory relationship."*[948] Although, in the *Santa Fe* case Justice White in his dissenting opinion claimed that the IAA 1940 should be viewed as setting a **federal fiduciary standard** for investment advisers,[949] this perspective has not been supported by others[950] and courts together with scholars continue to claim that the IAA 1940 has not imposed fiduciary duties on investment advisers.[951] Thus, it seems that in case of fiduciary duties of investment advisers towards the investors, the case law is not the answer and the legislator should step in.

Given the financial crisis in 2008, the Dodd-Frank Act 2010 had a potential to refine fiduciary duties of adviser under IAA 1940, as it called the SEC for a **study of existing legal and regulatory standards of care of advisers**.[952] The SEC was authorized to promote rules requiring investment advisers to "*act in the best interest of the* ***customer*** *without regard to the financial or other interest of the adviser providing the advice."*[953] In regard to this task of the SEC, one may again observe a change of language, where a client became a customer; second, there is an inclination towards broadening the fiduciary standard *"without regard to the financial or other interest of adviser"*. For this purpose, the introduction of a broader fiduciary standard applicable to investment advisers would fulfill this assignment. The SEC should consider the actual functioning of an investment company – its corporate anomaly -

---

[948] *See* SEC v. Capital Gains Res. Bureau, Inc., 375 U.S. 180, 191 (1963).
[949] *See* Santa Fe Industries v. Green, 430 U.S. 462, 471 n.11 (1977).
[950] *See* Arthur B. Laby, *SEC v. Capital Gains Research Bureau and the Investment Advisers Act of 1940*, 91 B.U. L. REV. 1051, 1066 – 1081 (2011).
[951] *Id.* at 1103-1104.
[952] *See* section 913 Dodd-Frank Act 2010. The initial draft legislation prepared by the Senate Banking Committee proposed to bring broker-dealers under IAA 1940. *See* SENATE COMMITTEE ON BANKING, HOUSING & URBAN AFFAIRS, 111TH CONG. RESTORING AMERICAN FINANCIAL STABILITY ACT: CHAIRMAN'S MARK TEXT (2009), *available at* http://www.banking.senate.gov/public/_files/Comittee_Report_S_Rept_111_176.pdf.
[953] These rules also require disclosure of any material conflicts of interest. *See generally* Dodd-Frank Act 2010 section 913.

and functionally approach the duties and subsequent liabilities of the investment advisers.

In conclusion, based on the above analysis, although investment companies together with their advisers owe fiduciary duties to their investors, these duties are not further defined or clearly interpreted. Therefore, the nature of the fiduciary duties remains obscure, both for the investment companies and their advisers as well as for the investors. Furthermore, these investors in the US do not have private right of action against investment companies or against the investment advisers, which renders the duty and obligations stemming therefrom unenforceable and therefore completely fruitless.

4.2.2. EU: Is UCITS V enough?

Before analyzing the type of duties that the investment companies owe to the investors in the EU, it is necessary to establish what is their source. Even after the adoption of UCITS V and MiFID II, there remains a considerable confusion as to how these two directives interact.[954]

MiFID II as a horizontal directive is cutting through the entire financial services industry (except the insurance industry) being generally applicable to investment firms and regulated markets.[955] Given the fact that MIFID II defines investment firm very broadly, the UCITS MC corresponds with this definition.[956] Yet MiFID II **exempts** UCITS, together with their MCs and depositaries from its application.[957] The

[954] *See* CASEY & LANNOO, *supra* note 370, at 140.
[955] *See* LIABILITY OF ASSET MANAGERS, *supra* note 697, at 25.
[956] *See* GLOBAL ASSET MANAGEMENT, *supra* note 699, at 296-297.
[957] Article 2(1)(i) MIFID II [2(a)(h) MiFID I]. *See also* recital 34 MiFID II [recital 15 MiFID I]. Recital 34 MiFID II, "It is necessary to exclude from the scope of this Directive collective investment undertakings and pension funds whether or not coordinated at Union level, and the depositaries or managers of such undertakings, since they are subject to specific rules directly adapted to their activities."

former MiFID I extended also to UCITS MCs, when they provided **ancillary** investment services, as investment advice or individual portfolio management.[958] However, the new MiFID II did not take over this provision of MiFID I. Unfortunately, the ESMA Discussion Paper on MiFID II and MiFIR does not shed any light on the interweaving of MiFID II and UCITS V, leaving the participants uncertain.[959]

Even though MiFID II failed to clearly **bring under** its scope the UCITS MCs, MiFID II continues to apply to the UCITS MCs by virtue of other provisions in MiFID II and its Annexes.[960] Under MiFID I all UCITS benefited from a blank categorization as "non-complex" financial instruments[961] and even though MiFID II was expected to address the increasing complexity of the UCITS,[962] it did so only to a limited extent.[963] Given that UCITS may be designed as very complex financial instruments, MiFID II begun to recognize also "structured UCITS".[964] Leaving aside this differentiation, which has been criticized since its adoption,[965] the focus in this section is the scope of MiFID II's application on the UCITS.

[958] Article 66 MiFID. *See* Jean-Pierre Casey, *Shedding Light on the UCITS-MiFID Nexus and Potential Impact of MiFID on the Asset Management Sector* 1 (ECMI, 2008) or CASEY & LANNOO, *supra* note 370, at 141 or GLOBAL ASSET MANAGEMENT, *supra* note 699, at 297.

[959] UCITS are also exempted from MiFIR and from transaction reporting. *See* European Securities and Market Authority, Discussion Paper: MiFID II/MiFIR 441, 22nd May 2014, ESMA/2014/548. Also, according to the European Commission Memo, the UCITS are not included under MiFID II; *see* Markets in Financial Instruments Directive (MiFID II): Frequently Asked Questions (15 April 2014), *available at*: <http://europa.eu/rapid/press-release_MEMO-14-305_en.htm?locale=en>/ *last visited* Sep. 9, 2014.

[960] Article 4(1)(1) and (1)(2) and Annex 1, Section A and C MiFID II. The same was the case with UCITS III, *see* MOLONEY, EC SEC. REG. 2ND ED, *supra* note 71, at 285.

[961] Article 19(6) MiFID I.

[962] *See* GLOBAL ASSET MANAGEMENT, *supra* note 699, at 297.

[963] Article 25(4)(a)(iv) MiFID II.

[964] Structured UCITS are formally defined as "UCITS which provide investors, at certain predetermined dates, with algorithm-based payoffs that are linked to the performance, or to the realization of price changes or other conditions of financial assets, indices or reference portfolios or UCITS with similar features". *See also* Peter Snowdon & Simon Lovegrove, *MiFID Review,* 94 COMPLIANCE OFFICER BULL. 1, 7 (2012).

[965] *See* Jürgen Vandenbroucke, *(Non-)complexity Through The Eyes of MiFID,* 37 EUR. J. LAW. ECON. 477, 479 (2014).

The UCITS (except the "structured UCITS") can be traded on an **execution only basis test**.[966] In simple terms this means that UCITS MCs do not have to apply intermediary assessment of the adequacy and suitability of its product (UCITS) for its retail clients, but "only" the best execution principle.[967] Although no official materials rationalize this exclusion, the logic behind is clear. An investor already chooses a UCITS, which is perceived as a retail-investor-friendly product,[968] and therefore the UCITS MC does not advice on further investment of the investor. The UCITS MC is only able to invest in financial products in accordance with its prospectus and UCITS V. In practice however, the investors often, when purchasing UCITS, do not contract directly with the UCITS MC, but with a third-party network, such as an **independent adviser**.[969] Whereas to these MiFID II and its - "know-your-customer" rule - applies.[970] Nevertheless, given that the UCITS MC, similarly to the investment adviser of a mutual fund, actively manages UCITS, what is the fiduciary standard that applies to the management company under UCITS V? Is the best execution rule sufficient to secure the interest of UCITS investors?

According to the thematic review of the best execution released in July 2014 by the UK's FCA,[971] many investment firms, which are obliged to deliver best execution to the retail and professional investors, have failed to properly grasp this principle and

[966] The best execution policy in simple terms means that an investment firm has to take all reasonable steps to obtain the best possible result for their clients "best execution". *See* Article 27 MiFID II; Under this Article, *"Member States shall require that investment firms take **all sufficient steps** to obtain, when executing orders, the possible result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order. Nevertheless where there is a specific instruction from the client the investment firm shall execte the order following the specific instruction." See also* CESR, *Best Execution under MiFID: Questions and Answers* (CESR/07-320, May 2007).
[967] *See* GLOBAL ASSET MANAGEMENT, *supra* note 699, at 298; *see also* VALIANTE & LANNOO, *supra* note 700, at 155 or MOLONEY, HOW TO PROTECT INVESTORS, *supra* note 30, at 168.
[968] *See* MOLONEY, HOW TO PROTECT INVESTORS, *supra* note 30, at 166.
[969] *See* MOLONEY, EC SEC. REG. 2ND ED, *supra* note 71, at 327-328.
[970] On know your-custome rule *see e.g.* CASEY & LANNOO, *supra* note 370, at 48.
[971] *See* THEMATIC REVIEW: BEST EXECUTION AND PAYMENT FOR ORDER FLOW (Financial Conduct Authority, July 2014), *available online at:* < http://www.fca.org.uk/static/documents/thematic-reviews/tr14-13.pdf>/ *last visited* Mar. 8, 2015 [hereinafter "THEMATIC REVIEW, FCA"].

do not understand which activities are covered by the obligation to provide best execution.[972] The review shows that investment firms believe that as long as they were able to keep their investors, they must have been offering the best execution.[973] However, the FCA stated that reliance on the investors was insufficient to prove their compliance with the best execution principle.[974] Thus, although the best execution obligation requires investment companies to take all reasonable steps to obtain the best possible result, taking into account factors as price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of an investment order,[975] these rules without any further specification remain open-ended in nature. This means, that there is always a space for interpretation and hypothetically wrong application from the side of an investment company.

4.2.2.1. No Fiduciary Duties under UCITS V

Realizing that the different abbreviations might take the reader away from the ability to picture what kind of entity the UCITS is, I should remind that a UCITS is almost indistinguishable from a mutual fund, having incorporated the UCITS MC managing the UCITS in a form of a common fund or of an investment company.[976] UCITS V lays down the obligations regarding the UCITS MCs in its chapter III. The majority of these obligations are **formalistic**, concerning the authorization of the UCITS MC and the ongoing submission of information to the "competent authorities" – Member

[972] *See* Sophia Grene, *The Cinderella to Banking's Ugly Sisters*, FIN. TIMES, August 10th, 2014
[973] *See* THEMATIC REVIEW, FCA, *supra* note 971, at 25 ("This reliance on client scrutiny was underpinned by the frequent assertion by firms that best execution was a commercial imperative, without which clients would switch their business to competitors.").
[974] *Id.*
[975] *See* CESR, *Best Execution under MiFID: Questions and Answers* (CESR/07-320, May 2007).
[976] Article 2(1)(d) UCITS V.

States' enforcement authorities.[977] According to UCITS V, the Member States' enforcement authorities should provide for control mechanism on conflicts of interest of employees or the management of UCITS and the UCITS MC's adherence to its prospectus and the investment policies defined therein.[978] Furthermore, UCITS V emphasized the need to minimize the risk of conflict of interest between the UCITS MC and its clients, between two of its clients, between the UCITS and clients of the UCITS MC, or between two UCITS.[979] But besides the conflict of interest rules, Article 14 UCITS V lays down the general principles of conduct of the UCITS MC, which are to great extent identical with those set by MiFID II – *to act honestly, fairly, with due skill, care and diligence…in the best interests* of the UCITS.[980] Similarly to the US, UCITS V does not refer to investors towards which the MC should act in this manner. It refers solely to the UCITS – the pool of investments and not to its investors – who should be protected.

It is a further aggravating factor that, on one hand, the nature of the UCITS MC – investor relationship and, on the other hand, the duties owed by the UCITS MC are unclear. According to Professor Moloney, the UCITS managers are not placed under any fiduciary obligation to the UCITS investor,[981] at least that has not been declared yet. Given that UCITS V is yet to be transposed by the Member States (UCITS IV has

[977] Although in case of the EU directives when referring to the enforcement agencies of the Member States speak about "competent authorities", in order to provide a uniform language throughout the thesis, I will refer to them as "enforcement authorities".
[978] Article 12(1)(a) UCITS V, which states that Member States *"[s]hall require that each company: (a) has sound administrative and accounting procedures, control and safeguard arrangements for electronic data processing and adequate internal control mechanisms including, in particular, rules for personal transactions by its employees or for the holding of management of investments in financial instruments in order to invest on its own account and ensuring, at least, that each transaction involving the UCITS may be reconstructed according to its origin, the parties to it, its nature, and the time and place at which it was effected and that the assets of the UCITS managed by the management company are invested according to the fund rules or the instruments of incorporation and the legal provision in force."*
[979] Article 12(1)(b) UCITS V.
[980] Compare Article 14(1) UCITS V with Article 24 MiFID II.
[981] *See* MOLONEY, HOW TO PROTECT INVESTORS, *supra* note 30, at 163.

already been transposed and there are no substantial differences on this matter), the Member States may further specify the nature of the relationship between the UCITS MC and the investor (which is highly improbable). However, this leads to unsystematic interpretation and different level of investor protection through the EU Member States, which is contrary to the Recital 3 of UCITS V.[982] Moreover, taking into consideration the lack of investors' private action through the courts, CJEU might not ever be in a position to decide on the characterization of the relationship between the investor and UCITS MC or its substance. Therefore, the harmonization of the interpretation of the type of relationship between investors and UCITS MC might never be achieved and therefore no uniform level of investor protection under the UCITS V could be expected. In many respects, the situation in the EU is similar to the one in the US where neither the courts nor the US Congress had decided on the nature of the fiduciary duty of the investment company and its advisers. In the following part, the Member States' fiduciary standard for investment companies in the UK and Slovakia is being analyzed in order to show the contrasting level of investor protection within the EU.

4.2.2.2. Different Duties of Investment Companies in Member States: Missing Unified Interpretation at the EU-Level

First of all it is necessary to emphasize that several Member States of the EU have introduced the law of capital markets into their legal systems only recently.[983] Unlike the UK or France, which have more than a century-long experience of operating capital markets, the newly entered Member States are only getting acquainted with

[982] "National laws governing collective investment undertakings should be coordinated with a view to approximating the conditions of competition between those undertakings at Community level, while at the same time **ensuring more effective and more uniform protection for unit-holders**." (emphasis added).
[983] Referring mainly to those countries that entered the EU in and after 2004.

this idea. Therefore, defining the nature of a basic relationship, which is statutorily and economically recent and very technical, might represent a great challenge without appropriate guidance. Irrespective how unimportant the interpretation of fiduciary duty may seem, the extent to which it can influence the level of protection available in each Member State is far-reaching and thus its omission is startling.

In the UK, investors investing in investment companies, including UCITS, always have the benefit of fiduciary duties.[984] Investors of AUTs are protected by the fiduciary duties of trustees towards beneficiaries. Investors of OIECs are protected by duties arising under general law and not the Companies Act 2006 even though they have a governance structure of a company.[985] The fiduciary duties under general law were developed in case law by analogy to the duties of trustees.[986] Furthermore, in some scenarios the duties of an investment company may arise concurrently in contract, at law or at equity.[987] Additionally, there are public codes of practice or professional codes of conduct in general or the FCA COBS.[988] Moreover, in the UK, where a statute or judicial precedent has established a rule that became to operate as a matter of general application in relation to particular classes of contractual relationships, it is said that these general rules subsequently become terms implied into contract of that particular class, by operation of law.[989] In this way the case law

[984] BENJAMIN, FINANCIAL LAW, *supra* note 457, at 224.
[985] *Id.* at 225.
[986] *Id.* at 222.
[987] *See* LIABILITY OF ASSET MANAGERS, *supra* note 697, at 338.
[988] *See e.g.* GERAIN THOMAS & ALASTAIR HUDSON, THE LAW OF TRUSTS 52.18 (Oxford University Press, 2004) (where they state that the appropriate and objective measurement of the scope of the investment duty of n authorized and regulated trustee is provided by he FSA (former FCA) conduct of business rules).
[989] *See* GERARD MCMEEL, THE CONSTRUCTION OF CONTRACTS 10.01-10.08 (Oxford University Press, 2007) (citing the decision Equitable Life Assurance Society v. Hyman [2002] 1 AC 408, 458, where Lord Stein concerning the "general default rules" that these may be more fully described as terms "implied by law in sense of incidents impliedly annexed to particular types of contracts. From then on such standardized terms operate as general default rules.

becomes a lighthouse in the sea of fiduciary duties and investment companies become aware what is expected of them.

Concerning the standard of fiduciary duties owed by investment advisers, the general rules stem from law of agency.[990] Every professional agent (adviser) acting for a reward (fee) is under a duty to exercise such skill, care, and diligence, as is usual or necessary in or for the ordinary or proper conduct of the profession.[991] In addition to general agency duties, an agent will have implied fiduciary duties that arise under the equity. The elemental principle is that a person who assumes responsibility to serve the interest of another, to the exclusion of his/her own interest, owes a duty of loyalty as a fiduciary as far as that another person is entitled to expect it.[992] Thus, under the UK statutory law, an investment adviser owes to an investor the duty of care, skill and diligence, while under its law of equity it owes in addition a duty of loyalty. **These two combined form classical fiduciary duties under trust law**.[993]

To briefly summarize, in the UK, despite the lack of any specification under the UCITS IV or V both investment companies and investment advisers owe to an investor fiduciary duties known from trust law. [994]

In Slovakia, the Act 203/2011 on Collective Investment [995] which has transposed the UCITS IV (the UCITS V only should be transposed by March 18, 2016) governs collective investment schemes - the common fund ["podielový fond"] purely under contract law. Having an investment company under contract law

---

[990] *See* LIABILITY OF ASSET MANAGERS, *supra* note 697, at 345.

[991] *See* BOWSTEAD & REYNOLDS ON AGENCY 179-181 (Peter G. Watts ed. 19th ed. 2010).

[992] *See* Bristol and West Building Society v Mothew [1997] 2 WLR 436, [1998] Ch 1, 18; observing that a *"a fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence."*

[993] *See also* ALASTAIR HUDSON, THE LAW OF FINANCE 94-95 (Sweet & Maxwell, 2009).

[994] *See* AUTHORISED FUNDS: A REGULATORY GUIDE 6 (Investment Management Association, 2012).

[995] Act 203 of 1 June 2011 on Collective Investment, the full wording of Act No 203/2011 Coll. on Collective Investment as amended by Act No 547/2011 Coll., Act No 206/2013 Coll., Act No 352/2013 Coll., and Act No 213/2014 Coll. [hereinafter "2013/2011 on Collective Investment"].

represents one of the options under UCITS V. The UCITS itself in Slovakia has **no legal entity status** and represents a pool, which is fully managed by the UCITS MC, a joint-stock company.[996] Thus, the investors contract with a UCITS MC – a management company,[997] which manages the fund and issues fund's unit certificates.[998] Given the fact that the first act on collective investment in Slovakia was adopted only in 1999, neither academics nor judges have yet provided an analysis of the duties of the management companies. In addition, the latest entrance at the website of the Slovak Association of Management Companies, which is responsible for the complaints of investors, was in 2011 when it stated that no complaint has been filed.[999] This shows not only a limited activity of the Slovak Association of Management Companies, but also no inquiry or action from the side of Slovak investors.

The act of Collective Investment, in the third part - "Management Company" - lists very specific duties of the management company concerning its request for authorization, day-to-day business or the obligations of the senior management. Yet it speaks nowhere in its provisions of the obligations of the management company in connection with the protection of investors. In simple terms, even after the transposition of the numerous EU directives, Slovak act of Collective Investment does not within its provisions refer to investor protection at all. Moreover, given the limited experience of the investors in Slovakia with investment companies, it is highly

[996] Article 27(1) of 203/2011 on Collective Investment.
[997] Article 27(1) of 203/2011 on Collective Investment. The management company distributes securities - unit certificates – to investors, which carry a right to corresponding unit certificate in fund's assets and a right to a proportion of the returns. *See* Article 8(1) of 203/2011 on Collective Investment.
[998] Article 5(2) and (3) of 203/2011 on Collective Investment. Another specificity then arises with the type of the securities from the UCITS. They cannot be traded on the market as units or shares, but only as "other" securities, with which similar rights as with shares are connected (*see* Article 5(3) of Act on Securities and Investment Services No 566/2001 Coll.).
[999] *Available onlie at:* < http://www.ass.sk/Default.aspx?CatID=32>/ *last visited* March 3, 2015.

unlikely that the investment contracts would provide any additional protection for investors.

Obviously by comparing only two Member States in the EU, the picture is substantially incomplete. Yet even from this observation it is clear that there are significant differences in the EU, which nevertheless continues to claim to ensure uniform investor protection thought out its all Member States.[1000] Even if at the EU-level, many questions in connection with the investor protection remain unanswered, in some Member States they have not been even posed. Investment through investment companies is for many Member States and their citizens a new type of activity and only limited amount of investors participate. Thus, to believe that the questions and answers by legislators or investors will be provided at the Member State – level in short time is surreal. Subsequently, it seems that under current conditions, the only way to implement substantially broad fiduciary model is through additional regulation.[1001]

For ensuring free movement of financial services in the EU, cross-border investment activity should be encouraged. As long as different standards of protection are present depending on individual Member States, investors will not undertake a risk of investing in an investment company established in a different Member State or managed by a foreign adviser. [1002] Investors have to understand that there is a uniform standard of care in the entire EU. The unawareness of this concept in one set of

[1000] *See* Recital 3 MiFID II or Recital 8 UCITS V.

[1001] *See* Benjamin, *Narratives*, *supra* note 487, at 797.

[1002] One of the clear examples of a situation, where the interpretation of European courts had gone opposite direction is the range of the duties under the Article 19 of MiFID I. According to the decision in 2010 of German Higher Regional Court in Düsseldorf, civil courts may impose stricter duties than the MiFID lays down [*see* Higher Regional Court Düsseldorf 16 December 2010, WM 2011, 399, 400]. In contrast, the court in France are not allowed to subject asset managers to duties, which are stricter than the MiFID prescribes, given that the *contra legem* decisions in interpretation of financial rules is not allowed; *see* LIABILITY OF ASSET MANAGERS, *supra* note 697, at 69.

Member States and a multiple interpretation in other set of Member States will indisputably lead towards legal uncertainty and possible exploitation which in case of law of capital markets can not only be detrimental for the individuals, but mainly for the economic system itself.[1003] The CJEU itself tries to enhance the principles of legal certainty and legitimate expectations,[1004] but by omitting interpretation of an essential element of a system – such as the standard of care - these principles will not be accomplished.

4.3.Why Protect Investors through Uniform and Broad Fiduciary Standard?

Pursuant to the above stated analysis, the nature of the fiduciary duty owed to investors by investment companies both in the US and EU differs depending on the law under which they are established. As I have emphasized number of times, the investors fully and completely entrust their finances in the hands of investment companies while completely surrendering. Once investors invest their money into an investment company, they are unable to affect any undertaken change of the investment policy except to apply their right of redemption. Thus, one would believe in order to provide investors with some protection that regulator would contra-balance the lack of control and governance by implementing a high standard of care and loyalty upon the directors and advisers – the fiduciary duty. Yet looking at the current regulation, in most cases investment companies and advisers completely escape any liability. Therefore, both in the US and EU a uniform and broad standard of fiduciary duties should be applied on investment companies as well as their advisers in order to provide investors with sufficient level of protection. In this sub-chapter I provide

[1003] On the importance of legal certainty within the financial systems *see generally* ROGER MCCORMICK, LEGAL RISK IN THE FINANCIAL MARKETS (Oxford University Press, 2006).
[1004] *See* C-217/80 Amministrazione delle Finanze dello Stato v Salumi [1981] E.C.R. 2735, para. 8; C-21/81 Openbaar Ministerie v Bout [1982] E.C.R. 381 paras. 13 & 14 and C-34/92 Grusa Fleisch v Hauptzollamt Hamburg-Jonas [1993] E.C.R. I-4147 para. 22.

additional rationales under the notion of investor empowerment in order to substantiate my claim.

4.3.1. Boosting Investor Confidence

One of the main purposes for adopting securities regulations was to ensure investor confidence on the market. The rationale behind investors' confidence was that once investors trust the market participants, they would be willing to invest with them.[1005] The same is applicable in case of investment companies. Investors by investing with investment companies provide them, and those in control of them, with a full control over their money while trusting their expertise and promises. In case of investing with an investment company, an investor cannot constantly closely control its investment decisions as they change daily. Moreover, such control would be also costly and would undermine the benefit of this reliance.[1006]

Applying uniform and broad fiduciary duties on investment companies (and other intermediaries in general) may strengthen the confidence of investors. Facilitating trusting relationship would encourage the investors to interact with other market participants. The only argument one can assert is that the application of broad fiduciary duties may be burdensome on the investment companies and contravene the wealth-maximization, which is also one of the objectives of the securities regulation. Yet I am more inclined to claim that based on the recent events on the markets, the wealth-maximization might be only a short sighted aim while the honesty and trustworthiness of the market participants in general might be beneficial for long-term

[1005] *See e.g* MOLONEY, HOW TO PROTECT INVESTORS, *supra* note 30, at 6; Karmel, *Reconciling*, *supra* note 36, at 545; *see also* Jaretzki *supra* note 232.
[1006] *See* Tamar Frankel, *Towards Universal Fiduciary Principles* 39 QUEEN'S L.J. 391, 397-398 (2014).

goals.[1007] Maybe one of the approaches for reconstructing the law might be to impose a higher standard of morality,[1008] which is also carried out by broad standard of fiduciary duties.[1009]

4.3.2. Lost in Structure

Another present variable in possibly decreasing the level of protection of investors is the type of legal entity, under which an investment company has been established.[1010] Given the fact that the ICA 1940 and UCITS V allow choosing different legal structures for investment companies, *e.g.* limited liability company, trust or a purely contractual entity, a door for **state** company, corporate or trust law is opened.[1011] I have analyzed how the state law comes into play in the US and the outcome is to certain extent worrisome as the nature of the fiduciary duties owed to investors may differ from one state to another depending on the state law.[1012]

In the EU, the situation is similar. In order to determine the nature of the fiduciary duties owed by the UCITS MCs, a detour to the Member States jurisdictions

---

[1007] *See generally* Richmond Shell, *Opportunism and Trust in the Negotiation of Commercial Contract: Towards a New Cause of Action*, 44 VAND. L. REV. 221, 258-64 (1991).
[1008] TAMAR FRANKEL, FIDUCIARY LAW 829-830 (Oxford University Press, 2011) [hereinafter "FRANKEL, FIDUCIARY LAW"].
[1009] Judge Clark, in his dissenting opinion in Capital Gains case, invoked morality and ethics to criticize the majority decision. Stating that the defense that the Capital Gains was too small fish to cause movements in the price of the recommended securities "completely misses the point." Judge Clark emphasized that, "*A first duty of a fiduciary is loyalty to his beneficiary; if he is engaged in feathering his own interest, he cannot be giving his client that wholly disinterested advice which it is his stock in trade to provide.*" *See* SEC v. Capital Gains Research Bureau, Inc., 2nd Cir. (N.Y.) 746, 753 (1961).
[1010] *See* FINK, *supra* note 263, at 121; Fink refers to "conflict of interest prohibitions". Further on page 122 he continues stating that "[S]ince mutual funds are regulated by the ICA 1940 and, since mutual funds must be broadly held, it is not considered necessary to apply the fiduciary rules to mutual funds merely because [retirement] plans invest in their shares." Also two pension experts have noted that "[T]he mutual fund industry alone had been granted a total exemption from the fiduciary liability provisions of ERISA when it was enacted." *see* Pamela Perun & Eugene C. Steuerle, *From Fiduciary to Facilitator* 197 *in* THE EVOLVING PENSION SYSTEM: TRENDS, EFFECTS AND PROPOSALS FOR REFORM (William G. Gale *et. al. eds.*, 2006).
[1011] *See* Article 27 UCITS V, according to UCITS V, it is the Member State that has the discretion of selection of legal form. In the US, mutual funds may be organized as a corporation, association, joint stock fund or a business truest. In case of US, *see* 15 U.S.C. §80a-2(a)(8). *See also* Schonfeld & Kerwin, *supra* note 881, at 114.
[1012] *See* section 4.2.1.2.

is necessary.[1013] Even though in principle due to the direct effect and the supremacy of the EU law, laws of Member States should not be in conflict with the EU treaties, regulations or directives,[1014] the fact that UCITS V is silent on this issue, allows the Member States to take the lead. In the **UK**, notwithstanding the legal form of UCITS, it is claimed that the investors in investment companies enjoy the benefit of fiduciary duties under **trust law**.[1015] A different situation appears in Slovakia, where the UCITS are pure contractual creatures, where only the contract defines the rights and duties of the UCITS MC.[1016]

UCITS passporting allows structurally different UCITS to be marketed, sold and merged across the EU. Observing these discrepancies, why does the EU continue to provide leeway for the Member States in connection with the basic structure of funds, nature of the fiduciary duties and the linked liabilities, when it could provide clear instructions? The answer to this question is to enhance regulatory competition among the Member States.[1017] Due to regulatory competition national legislators within the scope of any directive are provided with sufficient freedom to opt for a solution that would take into account a more diverse set of interests,[1018] reduce the

---

[1013] In the EU, the company law is not unified. There have been number of directives adopted in order to harmonize Member States company laws in respect to shareholder protection, freedom of establishment of companies od promoting cross-border cooperation. Thus, one has to explore the company law of Member States.
[1014] For more on direct effect and principle of supremacy of EU law, *see* CRAIG & DE BÚRCA 4TH, *supra* note 80, at 268-304.
[1015] *See* BENJAMIN, FINANCIAL LAW, *supra* note 457, at 224.
[1016] *See* Article 1(3) UCITS V, which states that "The undertakings referred to in paragraph 2 may be constituted in accordance with contract law (as common funds managed by management companies), trust law (as unit trusts), or statute (as investment companies)."
[1017] The regulatory competition is a model premised on regulatory arbitrage and on discovery of the different features of regulatory regimes. In the EU, where national regulations differ, the regulatory competition assumes that individuals will chose products or services that meet their needs concerning quality and price, but which originate from a state with a regulatory regime that is more efficient and less costly than their domestic regime. For more on the advatages and disadvantages of regulatory competition *see* MOLONEY, EC SEC. REG. 2ND ED., *supra* note 71, at 29-30. *See also* Mark J. Roe, *Deleware Competition,* 117 HARV. L. REV. 588 (2003).
[1018] *See* WILLIAM BRATTON, JOSEPH MCCAHERY, SOL PICCIOTTO & COLIN SCOTT, INTERNATIONAL REGULATORY COMPETITION AND COORDINATION: PERSPECTIVES ON ECONOMIC REGULATION IN EUROPE AND THE UNITED STATES 14 (Oxford University Press, 1997).

costs of regulation or provide greater protection for investors. In addition, formation of different types of entities allows different tax treatment under Member States' regime, which leads to advancing the EU economy (*e.g.* UK and its TTFs).[1019] However, regulatory competition should not hinder investor protection due to favorable tax treatment or uncertain regulatory environment. If the EU Member States can by setting a different form of a legal entity restrict the scope of duties owed by an investment company to its investors, the EU has not been successful in safeguarding the investor protection. This claims stands especially as investors simply do not realize, or do not attribute attention to whether their investment company is a trust, partnership or a corporation.

4.3.3. Investors Become Able to Protect Themselves Better

Although the enforcement and oversight over the investment companies and advisers as well as the remedies of investors are analyzed in the subsequent chapter, one has to see things in context. Namely, broader fiduciary duties for investment companies and their advisers are an important method of **further empowerment of investors**. In simple terms, claiming a breach of broad duties by an investment company or an adviser is simpler for an investor to claim. Disloyal fiduciaries are not only liable for the actual loss caused to the beneficiaries, but also they account for all gains realized through their wrongdoing.[1020] Disgorgement of ill-gotten gain is well established as a

[1019] In Lichtenstein, the only possible legal form for UCITS was a stock corporation, which led to a considerable competitive disadvantage for the fund market. *See* CHARLES MULLER & ALAIN RUTTIENS, A PRACTICAL GUIDE TO UCITS FUNDS AND THEIR RISK MANAGEMENT 21 (EdiPro, 2013).

[1020] *See* HANOCH DAGAN, THE LAW AND ETHICS OF RESTITUTION 237 (Oxford University Press, 2004) (The restitutions for breach of fiduciary duty in the Anglo-American law are so entrenched that they are only rarely disputed); *See also* Emily Sherwin, *An Essay on Private Remedies,* 6 CAN. J. L & JUR. 89 (1993).

remedial consequence in the UK and US when a fiduciary obtains a benefit in breach of a duty of loyalty.[1021]

4.4. *De Lege Ferenda*: Trust Law-Like Fiduciary Duties Applicable to Investment Companies and Advisers

It has been established that the relationship between an investment company and its investor as well as between an investor and an investment adviser in the US is "fiduciary". In the EU the nature of the relationship under the existent EU law unfortunately remains ambiguous, but in the UK it is also "fiduciary." Based on the analysis in the previous parts of this chapter, I move to establish the "nature" of the fiduciary duties which both, the investment company and its adviser, should owe to investors.

The fiduciary duties should be **one and the same** and should depend neither on the legal form, seat nor place of incorporation of an investment company or its adviser. Given the complete control over the investment by an investment company and its adviser, the scope of the duties should be broad. For this reason I argue for introduction of **"trust-law like"** fiduciary duties or in other words the fiduciary duties known from trust law.

In brief, the rationales for this claim are the following. First, todays' investment companies historically arose from trusts.[1022] Secondly, fiduciary law as such stems

[1021] *See* Deborah A. DeMott, *Causation in the Fiduciary Realm*, 91 BUL. REV. 851, 855 (2011) [hereinafter "DeMott, Causation in the Fiduciary Realm"].

[1022] Trust as a legal form of an entity has been mostly used in common law countries, as it has its origin in the Middle Ages in England, *see* GEORGE G. BOGERT ET. AL., CASE AND TEXT ON THE LAW OF TRUSTS 6-15 (University Casebook, 9th ed. 2012) [hereinafter "BOGERT, TRUST"]. Thus, the law of trusts is often presumed as purely common law legal concept, as the civil law countries had strongly resisted the private trust, the legal systems offer a close substitute for the charitable trusts in the form of the charitable foundations, *see e.g.* Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 520-522 (1981). However, the law of private trust is not unknown for the civil law systems, examples of civil law trusts can be found in Lichtenstein, where the trust law has been enacted in 1926, Argentina, Chile and Colombia as well recognize their *"fideicomisos",* Italian law adopted the from trust law and, indeed, that has often been stated so by courts. Thirdly, functionally analyzing the delegation of investors' financials, the investors "entrust" their property with the investment companies and *de facto* with the investment advisers. Finally, by expanding the fiduciary duties of the key entrustors, the investors will be able to defend their claims easier and therefore join the "oversight pact" with the enforcement agencies. In the following text, I will explain and develop the first three of the arguments, while leaving the fourth argument to the next two chapters of this thesis that focuse on enforcement (both public and private).

4.4.1. Diachronic Inquiry: Trust Law as a Backbone of Fiduciary Law of Investment Companies?

The securities trading industry, its participants, including investment companies, have survived in the US and Europe for a long time without being regulated. However, from a historical perspective this does not mean that there has been no governance-rules or litigation concerning investment trusts. In the eighteenth- and nineteenth-century the English courts treated securities as a new type of property[1023] and on the relationship between the brokers or entities selling securities and their investors

notion in its civil code in 1975 or in laws of Israel or Japan. Although the law of trusts has its peculiarities, the similar institutions in civil law jurisdictions cannot replace it, even if from the functional approach, the legal concept of a trust is well known in all civil law systems. Given the fiduciary nature of the relationship, where the Spanish word *"fiduciario"* and the German "Treuhander" do not require further elaboration. For more on trusts in civil law systems, *see generally* Maurizio Lupoi, *The Civil Law Trust*, 32 VAND. J. TRANSNAT'L L. 967 (1999). Moreover, international activities have been undertaken to promote recognition by non-trust jurisdiction of trusts form in other countries, *see* Convention on the Law Applicable to Trusts and On Their Recognition, Proceedings of the Fifteenth Session 361 (1985), which was adopted at Hague in 1985.

[1023] *See* Nightingal v. Devisme, 5 Burr. 2589, 98 Eng. Rep. 361 (K.B. 1770) or for a later affirmation that securities are new types of property *see* Jones v. Brinley, 1 East 1, 102 Eng. Rep. 1 (K.B. 1800), Brachan v. Griffin, 3 Call. (3 Va.) 433, 436-39 (1803) or Ridgely v. Riggs, 4 Har. & J. (8 Md.) 358, 368 (1818).

applied familiar bodies of law - law of trusts, law of will, as well as agency or contract law.[1024]

The same was the case in the US. Even though some states in the US after the William Duer's collapse in 1792[1025] had initiated adoption of limited regulation for securities trading, focusing only on stock jobbing, one cannot say that the states did not recognize the new vehicles until the 1920's.[1026] Without a specific body of laws, the US courts resorted as well to solutions offered by classical branches of law; in particular contract- and the law of equity.[1027] The first classification of a "security" came in 1798, when a court in Massachusetts characterized shares as personal property.[1028] With the development of securities market in the US and further sophistication of the participants, first investment trusts were formed.[1029] The first recognized investment trust, MHLIC joined external funds together with internal and managed them as one. The external participants received certificates, which entitled them to receive proportionate share from the "mutual" fund.[1030] Thus, MHLIC could be designated as the first mutual fund in 1823. Since then until the adoption of the

---

[1024] On English "securities laws" *see generally* WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND I 328 (2002).

[1025] For more on Duer Panic *see* MARKHAM, FINANCIAL HISTORY VOL. I, *supra* note 151, at 110-118.

[1026] First, it was Pennsylvania, who tried to adopt an anti-stock jobbing act, but was unsuccessful. Yet New York successfully in 1792 adopted "An Act to prevent the pernicious practice of stock jobbing, and for regulating sales at public auctions", which did not only concentrated on the securities trading, but also regulated the public auctions. The only other state passing similar law was Massachusetts in 1836. For more *see* BANNER, *supra* note 96, at 172-175.

[1027] *See* Ward v. Van Duzer, 2 N.Y. Super, 162, 166 (1829), Gram v. Stebbins & Stebbins, 6 Paige Ch. 124 (N.Y. Ch. 1836) or Staples v. Gould, 9 N.Y. 520, 523 (1854), where courts were deciding on the contractual footing between brokers and investors and whether investors were able to recover losses from a transaction. In the *Staples v. Gould* case, the court applied the doctrine of *in pari delicto*.

[1028] Court held that "*a share is a right to receive a dividend on the whole concern,"* see Arnold v. Ruggles, 1 R.I. 165, 168.

[1029] Among the first investment trusts, it was the Massachusetts Hospital Life Insurance Company [MHLIC], which was first organized as an insurance company and in 1823 itch charter was amended.

[1030] *See* MARKHAM, FINANCIAL HISTORY VOL. I , *supra* note 151, at 190.

federal securities regulation, the US courts applied on these investment vehicles a specific branch of property law – the **law of trusts**.[1031]

4.4.2. Trust Law as the Basis

In the US, the RESTATEMENT (THIRD) OF TRUSTS 2003 defines a trust as *"a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to **equitable duties to deal with the property for the benefit** of another person, which arises as a result of a manifestation of an intention to create it."* [1032] There are several types of trusts, which are classified according to the way of their formation.[1033] Trust law is often catalogued as a part of property law. Yet, some question this categorization and rather place trust law somewhere between contract and property law.

There has been a related **historical debate** between Frederick W. Maitland and Austin W Scott.[1034] Frederick W. Maitland claimed that if going back to English law, the trust "*generally ha[d] its origin in something that we cannot but call an*

[1031] *See e.g.* Mechanics Bank of Alexandria v. Seton, 1 Pet. (26 U.S.) 299 (1828), Joseph Hall v. Thomas Cushing and John Mackay, 26 Mass. 395, 1830 WL 2546 or Farmers and Mechanics Bank of Frederick Cty. V. Wayman, 5 Gill 336 (Md. 1847). For more on the investment trusts in their outset *see generally* Livermore, *supra* note 97.

[1032] RESTATEMENT (THIRD) OF TRUSTS §2 (2003). In the UK, one of the major traditional texts on trust law, gives the following description of a trust, rather than a definition: "Trust refers to the duty or aggregate accumulation of obligations that rest upon a person described as trustee. The responsibilities are in relation to property held by him, or under his control. That property he will be compelled by a court in its equitable jurisdiction to administer in the manner lawfully prescribed by the trust instrument, or where there be no specific provision written or oral, or to the extent that such provision is invalid or lacking, in accordance with equitable principles. As a consequence the administration will be in such a manner that the consequential benefits and advantages accrue, not to the trustee, but to the persons called cestuis que trust, or beneficiaries, if there are any; if not, for purpose which the law will recognize and enforce. A trustee may be a beneficiary, in which case advantages will accrue in his favour to the extent of his beneficial interest." *see* LEWIN ON TRUSTS 4 (John Mowbray *et. als.* eds., 18th ed. 2008).

[1033] Trusts created by manifestation of intent by the settlor are 'express trust'; if they are formed based upon a presumed or inferred intent of the settlor, they are 'resulting trusts' and when established by the court decision, without regard to the intent of the parties, they are 'constructive trusts'. Furthermore, trusts formed by a will are called 'testamentary trusts' and those formed by lifetime transfers of property among living are 'inter vivos' or 'living trusts'. *See* BOGERT, TRUST, *supra* note 1022, at 2.

[1034] An analysis of this has been provided by John Langbain, *see* John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L. J. 625 (1995) [hereinafter "Langbein, *The Contractarian Basis of the Law of Trusts*"].

agreement."[1035] And although trust was not called a contract, it was originally regarded as an obligation.[1036] Nonetheless, it was Austin W. Scott, who had the privilege to contribute to the *Restatements of Trusts,*[1037] and was of a contrary opinion, claiming that *"[t]he creation of a use of trust… as a legal transaction [is] quite different from the creation of a contract*."[1038] There are certain proprietary features of the trust law as "asset partitioning" function,[1039] nature of the rights or publicity and transferability, which slightly distinguish trust law from contract law. [1040] Furthermore, although an agency often appears very similar to a trust, trust law is also distinguished from the agency law.[1041] Thus, trust law inclined towards the property law concept, which came to be the generally accepted position.[1042] As a consequence, the focus of these sets of rules is not the personal aspect of the relationship – meaning trustee and beneficiary, but the property itself.

[1035] *See* FREDERIC W. MAITLAND, EQUITY: A COURSE OF LECTURES 28 (John Brunyate rev ed., 2nd ed. 1936).
[1036] *Id.* at 110.
[1037] *See* Langbein, *The Contractarian Basis of the Law of Trusts*, *supra* note 1034, at 646.
[1038] *See* Austin W. Scott, *The Nature of the Rights of the Cestui Que Trust,* 17 COLUM. L. REV. 269, 270 (1917).
[1039] *See* Tamar Frankel, *The Legal Infrastructure of Markets: The Role of Contract and Property Law,* 73 B.U. L.REV. 389, 390-391 (1993) [hereinafter "Frankel, *Legal Infrastructure*"] (Although Professor Frankel is also more inclined to apply the laws of property, she realizes that the institutions active on the market require both the property and contract regime. The contract law must yield to the mandatory rules on property law. And the trustee is able to deal separately with creditors of the trust property and those of his/her own personal property). *See* Hansmann & Mattei *supra* note 720, at 438 & 458.
[1040] On the comparison of law of trust and contract law *see generally* Langbein, *The Contractarian Basis of the Law of Trusts*, *supra* note 1034. In some of the legal scholarship, in connection with the relationship between an investment company and an investor, the law is emphasized more than the contract law due to its clear fiduciary relationship.
[1041] "A trustee is not an agent. An agent represents and acts for his principal, who may be either a natural or artificial person…. When an agent contracts in the name of his principal, the principal contracts and is bound, but the agent is not. When a trustee contracts as such, unless he is bound no one is bound, for he has no principal. The trust estate cannot promise; the contract is therefore the personal undertaking of the trustee." *see* Taylor v. Davis, 110 U.S. 330, 334-35, 4 S.Ct. 147, 150, 28 L.Ed. 163, 165 (1884). Nevertheless, the primary legal instrument between an investor and a investment company is an investment contract, therefore in the following parts when referring to the contract or contractual relationship, the agency component is inherent; *generally see* Stewark E. Sterk, *Trust Protectors, Agency Costs, and Fiduciary Duty,* 27 CARDOZO L. REV. 2761 (2006), Eric Rasmusen, *Agency Law and Contract Formation* (Discussion Paper No. 323, The Center for Law, Economics, and Business) and Robert H. Sitkoff, *An Agency Costs Theory of Trust Law,* 89 CORNELL. L. REV. 621 (2004) [hereinafter "Sitkoff, Agency Cost Theory"].
[1042] Also Henry Hansmann and Ugo Matter argued that "it is precisely the property-like aspects of the trust that are the principal contribution of trust law." *See* Hansmann & Mattei *supra* note 720, at 469.

In general, similar **analogy** could be drawn for investment company law. An investment company holds a property interest, subject to an obligation to keep or use that interest for the benefit of an investor, which is similar to the definition of a trust.[1043] A trust as well as investment company can be also seen as an obligation of a trustee or investment company (investment adviser) to a specific person beneficiary or investor. [1044] What is also applicable to the regulation governing investment companies is that when it imposes duties and constraints on particular market participants, these rules always apply, regardless of whether the underlying contract is silent or in conflict with them, in order to protect those less experienced and knowledgable. [1045] Nevertheless, at its core, a trust involves to great extent a contractual relationship[1046] and so does the relationship between an investor and an investment company when incorporating trust, property and contract.[1047] Hence, the relationship between an investor and an investment company represents a complex set

[1043] Bogert defines a trust as "a fiduciary relationship in which one person holds a property interest, subject to an equitable obligation to keep or use that interest for the benefit of another." *See* BOGERT, TRUST, *supra* note 1022, at 2.
[1044] *See* DUNCAN SHEEHAN, THE PRINCIPLES OF PERSONAL PROPERTY LAW 20 (Hart Publishing, 2011).
[1045] For an example on where the "property" character of the securities law prevailed over the contract rules *see* Sharehon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039 (2d Cir. 1982), *cert denied*, 460 U.S. 1012 (1983), where the Sharon Steel distinguished between the "boilerplate" indenture clauses and "contractual" provisions, which were specific under a particular indenture. According to the court ruling, the "boilerplate" provisions "must be given a consistent, uniform interpretation" given that the "[u]niformity in interpretation is important to the efficiency of capital markets." Whereas participants in the capital market can adjust their affairs according to a uniform interpretation, … the creation of enduring uncertainties as to the meaning of boilerplate provisions would decrease the value of all debenture issues and greatly impair the efficient working of capital markets *Id* at 1048.
[1046] *See* Hansmann & Mattei *supra* note 720, at 446.
[1047] *See* Frankel, *Legal Infrastructure*, *supra* note 1039, at 404-405 (Professor Frankel argues that markets require aS, as there are certain conditions that facilitate the creation and maintenance of efficient markets in physical, financial or intellectual products. These conditions however must be supported by legal rules and these rules are a subset of property law. Nevertheless, in order to flourish the markets, they require both contract and property law. They both provide the main building blocks for market infrastructure).

of characteristics. At any event, regulators should take into account the essential **trust-property-contractual** trichotomy in the investment company setting. [1048]

Along these lines of trust-property-contract complexity lays also the nature of fiduciary standard to be owed by the investment companies and their advisers to their investors. The key component of investor protection regulation is the fiduciary relationship between investment companies and investors. The "fiduciary" [1049] character of this relationship reflects primarily the differences of acquired information, knowledge, and experience together with the control of investments between the parties. Although it has been emphasized that the control of investment is *de facto* in hands of investment adviser, for the purposes of simplification of control

[1048] The "corporate setting" reflects on the fact that nowadays the securities law entails to great extent corporate law. Though, it is my firm belief that the corporate law is more present in other relationships among the capital market participants then between the investment companies and investors, where the law of trust is of greater importance than the corporate law. There are number of scholars, who devoted their work on analysis of the presence of corporate law in securities regulation, *see e.g.* Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation,* 107 YALE L. J. 2359 (1998), where Professor Romano suggest allowing corporations to choose their state regulatory framework and opt out of federal securities law. Professor Romano argues that if corporations elect to be governed by legal regimes that lack effective antifraud rules, investors will simply not invest in them; at 2359-2368; *see also* Roberta Romano, *Is Regulatory Competition a Problem or Irrelevant for Corporate Governance?* 40-41 (European Corporate Governance Inst. – Law, Working Paper No. 26/2005, 2005) and Elaine A. Welle, *Freedom of Contract and the Securities Laws: Opting Out of Securities Regulation by Private Agreement,* 56 WASH. & LEE L. REV. 519 (1999); Professor Romano and Welle describe other possible solutions to the securities law, claiming that the corporate self-interest will lead towards voluntary disclosure without mandatory disclosure, emphasizing that excellent firms will "signal" their quality through a disclosure. Professor Romano asserts that her argument for regulatory competition in corporate law suggests "a need to reexamine the foundation of the federal government's role in securities regulation." Professor Romano's theory on Competitive Federalism in the area of securities regulation, where the securities laws become optional and a corporation elects which state regulation it will adhere to and whether it will or will not adhere to federal securities creates a competition for state regulators to form the best regulation. The regulatory competition is desirable as the choice of investments includes variation in legal regimes. This approach could be particularly interesting for the Member States of the EU, where the EU adopts only the minimal standard rules and leaves certain space for the Member States to provide detail regulation, and thus enhances the competition among the Member States to create the "best regulation".

[1049] According to the BLACK'S LAW DICTIONARY (9th ed. 2009) *fiduciary* is "1. A person who is required to act for the benefit of another person on all matters within the scope of their relationship; one who owes to another the duties of good faith, trust, confidence, and candor; 2. One who must exercise a high standard of care in managing another's money or property."

division, the referral from now on in this chapter, will be to the investment company.[1050]

The conclusion that lends itself to be formulated from the above – if further strengthening of the investors' position is the goal – is that the scope and extent of fiduciary duties of investment companies as well as advisers vis-à-vis investors should be fixed by a statute and accordingly interpreted by courts. Notwithstanding that fiduciaries are present in many "shoes" and in more areas of law and therefore determining the principles of the fiduciary relationships have proved elusive.[1051] This, however, should not prevent the regulator from precisely specifying the nature and extent of the fiduciary duties owed by investment companies and their advisers (or those in control of them) to investors.

4.4.3. Trust & Investment Company: Functional Equivalents

As one may remember from Chapter I of this thesis, today's investment companies have developed in the first half of the twentieth century from trusts. One of the first trusts – "Eendraght Maakt Magt" was established by Abraham van Ketwich and sold 2,000 shares to investors whose funds were then collectively invested in *"bonds issued by foreign governments and banks and in plantation loans in the West Indies."*[1052] In the US, the investment trusts became highly popular in 1920's.[1053] The

---

[1050] *See* Section 4.1.
[1051] *See* Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligations*, 1988 DUKE L.J. 879, 879 (1988) (*"Recognition that the law of fiduciary obligation is situation-specific should be the starting point for any further analysis."*) [hereinafter "DeMott, Beyond Metaphor"]; *see also* Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiducairy Duty*, 36 J.L. & ECON. 425, 425 (1993) [hereinafter "Easterbrook & Fischel, Contract and Fiduciary Duty"] (*"The many agency relations that fall under the 'fiducairy' banner are so diverse that a single rule could not cover all without wreaking havoc."*).
[1052] *See* GOETZMANN & ROUWENHORST, *supra* note 98, at 254. The Eendraght Maakt Magt business suffered a loss by the outbreak of the Fourth English War in 1780. In 1782 it had to suspend the redemption of its shares and lower dividend payments. By the end of 18th century the Eendraght Maakt Magt has disappeared from the Amsterdam stock exchange, *see* Geert K. Rouwenhorst, *The Origins of Mutual Funds* 2-3 (Yale ICF Working Paper No. 04-48, 2004).

business form of a "trust" became popular and many institutions, *e.g.* the Bank of New York or the North American Trust and Banking Company set up personal trusts to manage the joint funds.[1054] However, due to legal developments the trust character has been generally abandoned and managers shifted to other business forms that came to be available subsequently.[1055] Later, regulators acknowledged this also by adopting the ICA 1940 and kin laws in other countries. Notwithstanding the reasons of the shift in the legal form of the investment entity, due to the introduction of limited liability in companies, ownership reasons,[1056] tax reasons or the slow motion of governance of trusts, the first question is to what extent did investment companies keep the "essence" of trusts.[1057]

In a classical Anglo-American trust, there are three parties: "settlor" transfers property to the "trustee" who has the duty to administer the property for the benefit of the "beneficiary".[1058] Disregarding the formal structure of an investment company and analyzing the functioning of it, the "classical" trust scheme remained preserved in the US: "settlor" being a mutual fund, "trustee" being an investment adviser and investor remaining as "beneficiary". Although this deconstruction might sound farfetched, and there are a number of counter-arguments, including the missing shift of ownership of

---

[1053] *See* Markham, *Mutual Fund Scandals*, *supra* note 162, at 72. The investment trusts were organized similarly as nowadays "closed-end management companies". "Closed-end fund" is legally known as a "closed-end company" which represents one of three basic types of investment companies. The two other basic types of investment companies are mutual funds and unit investment trusts (UITs). Each of these types of investment companies are described and analyzed in detail in the second chapter. For some of the traditional and distinguishing characteristics of closed-end companies see http://www.sec.gov/answers/mfclose.htm /*last visited* June 12, 2012.

[1054] *See* MARKHAM, FINANCIAL HISTORY VOL. I, *supra* note 151, at 198-210.

[1055] *See* Bosland, *supra* note 232, at 506.

[1056] Although the companies' managers have the power to direct the company's use of assets, they do not have the legal ownership of the assets, *see* LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 446-452 (Simon & Schulter, 1973).

[1057] Chief Justice Rugg in 1919 in Kimball v. Whitney, 233 Mass 321, 331 (1919) noted that *"the new financial institutions and business customs changed commercial methods and practices, altered monetary usages and investment combinations."*

[1058] *See* Mauro Bussani & Ugo Mattei, *The Common Core Approach to European Private Law,* 3 COLUM. J. EUR L. 434, 438 (1998).

title, which rests with the investor and not with the investment adviser or the right to redeem the shares, one can see that the allocation of control over the funds and the competence to make the investment decisions is analogous.

It is **not** the claim of this thesis that investment companies are ***per se*** **trusts**, but rather that despite the formal reconceptualization, their relationship with investors still resembles the one of a trust and the regulator **should** take that into account when revisiting investor protection in law of investment companies.[1059] The ultimate question for the regulator should be, how to govern the relationship between the key parties.[1060] This question remains impossible to answer, unless knowing the nature and specificities of the relationship, namely the division of control. In the case of investment companies, there is a shift of *"managerialist"* form of capitalism to *"adviserist"*.[1061]

Even the US Supreme Court has recognized the similarities between investment companies and trusts in its recent *Jones v. Harris*[1062] decision referring to its established *Pepper v. Litton* case law,[1063] where the US Supreme Court *"discussed the meaning of the concept of fiduciary duty in a context that is* ***analogous*** *to that presented here, and* ***we also looked to trust law****."* There the US Supreme court

[1059] A trust as a legal person bears obvious resemblance to a corporation. It has a separate legal personality and there is a separation line between the assets of a corporation, trustees/managers and limited liability for those who hold the beneficial interest in the entity. On the comparison between a corporation and a trust, *see* Hansmann & Mattei *supra* note 720, at 472-478.

[1060] Some may believe that it is contra-productive to analyze the older laws in connection with new phenomena given that the societies have gone through a fundamental change in last fifty to hundred years and Consequently, another question stems out whether the same fiduciary standard as in the trust law could be applied in the law of investment companies, so did the culture and social mores, which affect both the substance and classification of la. For more on this discussion *see* TAMAR FRANKEL, FIDUCIARY LAW, *supra* note 1008, at 97-99.

[1061] *See generally* BERLE & MEANS; Berle & Means in their eminent research showed already in 1932 that there are no shareholders or groups of shareholders who hold the control over the large American corporations. They claimed that the locus of the control was in the hands of the directors and managers they hired. However, in case of investment companies, the analysis would go a step further, asking who holds the control over the investment, not only of a day-to-day operations, but of the investment in general. Then the answer would be – investment adviser.

[1062] Jerry N. Jones, et al., Petitioners, v. Harris Associates L.P., 559 U.S. 335, 345 (2010).

[1063] Pepper v. Litton, 308 U.S. 295 (1939).

explained: *"At issue in Pepper was whether a bankruptcy court could disallow a dominant or controlling shareholder's claim for compensation against a bankrupt corporation. Dominant or controlling shareholder, we held are "fiduciar[ies]" whose "powers are powers [held] in trust,"* for the following reasons: *"Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to show its inherent fairness from the viewpoint of the corporation and those interested therein … The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an* ***arm's length bargain.*** *If it does, equity will set it aside."*[1064] Further, the US Supreme Court stated that *"The Gartenberg approach fully incorporates this understanding of the fiduciary duty as set out in Pepper and reflects §36(b)(1)'s imposition of the burden on the plaintiff."* Thus, the US Supreme Court, even though not explicitly, has acknowledged that the fiduciary relationship has its origin in trust law and even today in its analysis it returns to it in order to decide on the rights and duties of the parties.

Moreover, in context of grammatical interpretation, the word "**trust**" comes in the picture not only in the connection with trust law, but also in relation to the investors' trust.[1065] Importance of investors' trust to the success of capital markets has been long recognized as a necessary element of a functioning market.[1066] Trust in capital markets, trust in investment companies, in brokers and generally in all

[1064] *Id.* at 306-307.
[1065] On associations between trust and fiduciary law and how trust justifies fiduciary duties, *see* Matthew Harding, *Trust and Fiduciary Law*, 33 OXFORD J. LEGAL STUD. 81 (2013).
[1066] *See e.g.* Lynn. A. Stout, *The Investor Confidence Game,* 68 BROOK L. REV. 407, 436-437 (2002) or Tamar Frankel, *Regulation and Investors' Trust in the Securities Markets,* 68 BROOK. L. REV. 438, 442 (2002), from the economists scholars on the importance of trust for the growth of the capital market *see generally* Kenneth Arrow, *The Theory of Discrimination,* in DISCRIMINATION IN LABOR MARKETS (Orley Aschnfelter & Alber Reed eds., 1973); Paul Zak & Stephen Knack, *Trust and Growth,* 111 ECON. J. 295 (2001) or Laura Bottazi, *The Importance of Trust for Investment: Evidence from Venture Capital* (National Bureau of Economic Research Paper Series, 2011).

participants of capital markets is of a key relevance. On one hand it is the behavior of market participants, which provides or should provide investors with certain assurances and encourage them to invest. However, only the factual behavior is not sufficient. Thus, regulation should come in, reflecting on the element of control and the element of trust.[1067]

4.4.4. Foundations for Fiduciary Standard is in Trust Law

> *"The term 'fiduciary' was adopted to apply to situations falling short of 'trusts', but in which one person was nonetheless obliged to act like a trustee."*[1068]

The roots of fiduciary law go back to the ancient history, to the laws of Hammurabi, Old or New Testament or Sharia.[1069] Although these laws are different from the current fiduciary standards due to the development in culture, religion and social mores, they are based on the same characteristic – the human trusting nature.[1070] Yet, why is it that investment companies should apply the fiduciary standard of trust law? In recent legal history, the concept of fiduciary relationship has its origins in the law of trusts, from which it has expanded to other fields of law.[1071] Fiduciary relationship

[1067] *See* Tamar Frankel, *Regulation and Investors' Trust in the Securities Markets,* 68 BROOK. L. REV. 439, 442 (2002) (Frankel continues that the regulation implies the government guards for interests of investors and thus reduces the very high costs that the investors would otherwise bear on monitoring their investments).
[1068] *See* Leonard S. Sealy, *Fiduciary Relationships*, 1962 CAMBRIDGE L. J. 69, 71-72 (1962).
[1069] On the historical analysis of the fiduciary laws *see* TAMAR FRANKEL, FIDUCIARY LAW, *supra* note 1008, at 79-88. For a discourse on the roman fiduciary laws, *see generally* Henry B. Hansmann *et al.*, *Law and the Rise of the Firm,* 119 HARV. L. REV. 1333, 1356-61 (2006).
[1070] *See* TAMAR FRANKEL, FIDUCIARY LAW, *supra* note 1008, at 99.
[1071] The fiduciary relationship is present in agency, corporate relationships and number of different contractual relationships. *See* TAMAR FRANKEL, FIDUCIARY LAW, *supra* note 1008, at 96. On the development of fiduciary duty *see* Easterbrook & Fischel, Contract and Fiduciary Duty, *supra* note 1051, at 429 and Brudney, *supra* note 718. The Anglo-American trust law originated in England, "as a result of the efforts of conveyances to preserve the landholdings of their clients from certain forms of feudal taxation and to increase the range of dispositions of land which their clients could legally make on death." *See* GRAHAM MOFFAT ET AL., TRUSTS LAW: TEXT AND MATERIALS 35 (Cambridge University Press, 5th ed. 2009). In the case Linden Place v. Stanley Bank 167 P.3d 374, 375 (2007), court defined the fiduciary relationship as one where *"special confidence is placed in one who, in*

itself as a definition is to great extent similar to a trust relationship. Trust relationship is an *"association based on one person's reliance on the other person's specialized training,"*[1072] and their ability to manage one's property. In case of investment companies, it is exactly what happens. Investor relies on expertise and proficiency of an investment company (and their directors and adviser). Once investor pools his/her funds with other investors in an investment company, the faith of investor's investment depends on the decisions' of the investment company alone. The subject matter may differ, but the object is identical.

Professors Easterbrook and Fischel in their article on the nature of fiduciary duties consider the **economic reasons** behind them.[1073] They come to a conclusion that fiduciary duties stem from a contract. It is a specific type of a contract, when other party hires the other's knowledge and expertise. Given that one party is an "amateur" and the other is an "expert", there are only limited things that can be put down on a paper.[1074] Instead of these contractual stipulations duty of loyalty in pursuit of the objective and a duty of care in the performance have been introduced.[1075] However, what exactly do these two duties mean? The substance of these duties varies substantially from one field of law to another, from one agency relation to another.[1076] Yet in the light of the historical roots of the investment companies,

---

equity and good conscience, is bound to act in good faith and with due regard to the interest of the one placing the confidence."

[1072] *See* BLACK'S LAW DICTIONARY (9th ed. 2009) definition of "trust relationship".

[1073] *See* Easterbrook & Fischel, Contract and Fiduciary Duty, *supra* note 1051, at 425.

[1074] *Id.* at 426. This theory supports the one of Frederick W. Maitland, who claimed that trust is *per se* an agreement. Yet given the subject of a trust – keeping the property interest and maintaining it - some basic rules from property law should be applied, and therefrom certain rules should be non-derogative and non-waivable. *See* Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians,* 65 WASH. L. REV. 1, 29-30 (1990). Moreover, fiduciary law is triggered merely by the fiduciary's consent to provide services combined with entrustment from another party. *See* Frankel, *Fiduciary Duties as Default Rules, supra* note 718, at 1224 (1995).

[1075] *Id.*

[1076] *E.g.* considering relationship between corporate manager and investor, there is no fiduciary duty to debt investors. Although the managers do owe the duty of loyalty, the duty of care is weaker, given the application of "business judgment rule", which blocks inquiry and negligent management is not policies behind the law of an investment company, extensive gap of control between the investment company and its investors complete dependency on the knowledge and sophistication of the company itself, the character of the fiduciary relationship between them should be the most extensive, and therefore trust law-like. [1077]

4.4.4.1. Duty of Care

In the US, the fiduciary duty of care under the trust law has undergone a development since its first adoption in the RESTATEMENT (FIRST) OF TRUSTS in 1923.[1078] Today the "duty of care" states that trustee is under a duty "to administer the trust as a prudent person would, in light of the purposes, terms and other circumstances of the trust."[1079] Thus, the contemporary standard of care provides for three elements, which need to be observed. It is an element of care, an element of caution and an element of skill or judgment.[1080] Specifically in connection to the structure of mutual funds in the US, where the "skill" is outsourced to the adviser, reflecting on the law of trusts, acting on

---

actionable. On the other hand, in the relationship between trustee and beneficiary, a duty of loyalty means acting for the exclusive benefit of the beneficiary and the duty of care applies as a high degree of prudence. Moreover, the common remedy is disgorgement of the trustee's gains. Although the rules are variable by contract in advance, the alteration after establishment of the trust is hard. *see* Easterbrook & Fischel, Contract and Fiduciary Duty, *supra* note 1051, at 432-434.

[1077] *See* Robert H. Sitkoff, *Trust Law, Corporate Law, and Capital Market Efficiency,* 28 J. CORP. L. 565, 572-576 (2003). Professor Sitkoff also strongly suggests the trust law as the basis for the interpretation of the relationship on the capital market.

[1078] The greatest step has been undergone in 1992, when the Uniform Prudent Investor Act 1992 [hereinafter "UPIA 1992"] has been adopted, under which trustees were allowed to use the modern portfolio theory to guide investment decisions and require risk versus return analysis. The standard of care requires the trustees to "invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust." *See generally* John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing,* 81 IOWA L. REV. 641 (1996). The UPIA 1992 implements the modern portfolio theory, which will be analyzed later in the text.

[1079] *See* RESTATEMENT (THIRD) OF TRUSTS §77. *See also* BOGERT, TRUST, *supra* note 1022, at 284. It is also a functional equivalent to tort law's objective of reasonable person standard, *See* Langbein, *The Contractarian Basis of the Law of Trusts, supra* note 1034, at 656. One has to keep in mind that the exact standard of duty of care in the US will naturally depend on the particular jurisdiction. However, the trend of nowadays is to hold trustees to a higher standard, so that they act prudently in respect to the particular circumstances of the trust as well.

[1080] In simple terms, the element of care includes initiative, effort and diligence; the element of caution requires the trustee to invest with a consideration for the safety of the capital and the regularity of the income; the element of skill or judgment requires the trustee of higher capabilities to apply them, higher skills impose a duty to exercise them. BOGERT, TRUST, *supra* note 1022, at 285.

the advice of counsel or other professional adviser may not shield the trustee from liability. In such case, the court should consider whether the trustee acted in good faith.[1081]

4.4.4.2. Duty of Loyalty

In the law of trust,[1082] the asymmetric information is closely connected with the duty of loyalty.[1083] The duty of loyalty embraces the trustee's obligation to administer the trust *solely* in the interest of the beneficiary.[1084] This duty also encompasses the "trust" aspect of the relationship, where a trustee should not attempt to gain any advantage for himself or his relatives, associates while transacting business for the trusts.[1085] Although the rule sounds straightforward, the court when deciding a case will adhere to the policy rationales behind this rule rather than formal assessing the compliance with it. It is nowhere stated that the trustee may not benefit *per se.* But the question is how. In case where the duty of loyalty might be of one's concern, the court will take into account on one hand the economic flourishing of a fund and on the other the position of trustee's self-interest and loyalty.[1086]

Nevertheless, under the trust law upon discovering a fraud, beneficiaries are entitled to terminate the trust and immediately recover funds.[1087] They are also

[1081] In re Trust of Mintz, 444 Pa. 189, 282 A.2d (1971) or In re Borden's Trust, 358 Pa. 138, 56 A.2d 108 (1948).

[1082] As for the information asymmetry in trusts *see generally* AUSTIN W. SCOTT & WILLIAM F. FRATCHER, THE LAW OF TRUSTS §170 (4th ed. 1987) or Frankel, *Fiduciary Duties, as Default Rules supra* note 718.

[1083] *See e.g.* Frankel, *Fiduciary Duties as Default Rules*, *supra* note 718, at 1244 or Melanie B. Leslie, *Trusting Trustees: Fiduciary Duties and the Limits of Default Rules,* 94 GEO. L. J. 67, 111 (2005).

[1084] *See* RESTATEMENT (THIRD) OF TRUSTS §78 (2003).

[1085] *See* BOGERT, TRUST, *supra* note 1022, at 353.

[1086] In case First Nat. Bank v. State, 77 So. 2d 653, 656 (1954) decided a case where the trustee managed number of trusts. The court stated that once the conflict of interest is present, the burden to show that the transaction was in good faith, and in the exercise of sound discretion and prudence in making it, shifts to the trustee.

[1087] *See* Crutcher et al. v. Jouce et al., 134 F.2d 809, 816 (10th Cir. 1943). In some cases, where a voluntary trust has been created, and no power of revocation has been reserved, the trust cannot be revoked by the settlor without the consent of all beneficiaries; *see* Salem United Methodist Church v.

entitled to void a transaction if the trustee profits from engaging in a conflicted transaction with trust without obtaining prior approval.[1088] Consequently, trustee must disgorge all the profits realized as a result of the transaction.[1089] The critical edge in this case is that once there is a conflict of interest, there is the shift of control. The beneficiaries hold the control over the trust; possible benefits of the trustee are fully in their hands. Even if the beneficiaries decide to affirm the transaction, they still may ask the court to reform its terms to prevent the trustee from benefiting at the trust's expense.[1090] Contrary to corporate law, a trustee who has engaged in a self-interested transaction with the trust cannot escape liability even if he/she proves that the transaction was "fair".[1091] The policy indication behind this rule is that the trustee must subordinate his or her interests fully and completely to the trust.

4.5. Conclusion: Looking Behind the Design and Form

In this chapter I analyzed the standard of care that the investment company owes to its investors. Even though the ICA 1940 asserts fiduciary duties owed to investors, by both an investment company and its adviser, the extent of this duty is still not conclusive and clear.[1092] In order to determine who holds the factual control over the investment, I first assessed the "design" of an investment company; how it is

Bottorff, 138 S.W.3d 788 (Mo. Ct. App. S.D. 2004), however in a case when settlor an beneficiary represent the same person, this issue would not have arisen. Moreover, if a settlor reserves a power to revoke the trust without specifying the method of revocation, the trust can be revoked in any form and manner which sufficiently manifests the intention of the settlor to revoke the trust, *see* RESTATEMENT (THIRD) OF TRUSTS §330 cmt. *Revocation of Trust by Settlor*.

[1088] *See* RESTATEMENT (THIRD) OF TRUSTS §78 cmt., stating that the duty of loyalty is particularly strict for the trustees even by the comparison to the standards of other fiduciary relationships.

[1089] *See* Leslie, *supra* note 1083, at 112.

[1090] *See* BOGERT, TRUST, *supra* note 1022, at 353.

[1091] *See* EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE OF CORPORATE LAW, *supra* note 557, at 104. Here the comparison between the law of trusts and corporate law is of an importance as they reflect on the governance issues. The duty of loyalty in corporation is still fairly disputed concept as to its character and parties. However, in connection to a case of self-interested transaction, after giving full disclosure in some states in the United States, a director or manager can still engage in such a transaction.

[1092] *See* OTTO LOISTL & ROBERT PETRAG, ASSET MANAGEMENT STANDARDS: CORPORATE GOVERNANCE FOR ASSET MANAGEMENT 45 (Palgrave Macmillan, 2003).

established, who creates it and where the control over the main activity of the business lie does. Given the specificities of the investment management business after looking behind the formal structure and assessing the division of control over the investment, I discovered that the investment is in *de facto* fully controlled by its adviser. The investment company is functionally only *"a shell, a pool of assets consisting of securities, belonging to the investors of the fund."*[1093] Although investment companies are separate legal entities, in the US they are in fact only "tools" held tightly in the hands of their investment advisers. In case of the UCITS, the UCITS MCs or an external investment adviser manages the fund in the same vein. Even though the investment advisers were brought under the application of ICA 1940 by virtue of section 36(b), in forty-six years its breach has been never successfully claimed.[1094] Accordingly, I came to a conclusion that investment advisers should owe fiduciary duties, as do the investment companies since it is only a shell shielding the advisers. Yet looking at the nature of the fiduciary duties owed by investment companies, one realizes the existing discrepancies, present both in the US and the EU, where it is the state law (law of the Member States) that dictates the level of the fiduciary duties depending on the legal form of the investment company. This non-conformity of the one of the most defining elements of the investor protection – fiduciary duties (the standard of care in the EU) – should be remedied in both legal systems. Regulators should provide the market participants and the courts with a uniform frame, within which rights and duties of parties would become more

[1093] *See* Zell v. InterCapital Income Securities, Ind., 675 F.2d 1041, 1046 (9th Cir. 1982). *See also* Leland E. Modesitt, *Mutual Fund A Corporate Anomaly*, 14 U.C.L.A.L.REV. 1252 (1967).

[1094] *See* James D. Cox & John W. Payne, *Mutual Fund Expense Disclosures: A Behavioral Perspective,* 83 WASH. U. L. Q. 905, 914 (2005) ("Plaintiffs are still seeking to achieve their first victory under section 36(b)"); Lyman Johnson, *supra* note 868, at 519 ("The most remarkable statistic under section 36(b) is that, thirty-seven years after its enactment and twenty-five years after *Gartenberg,* no investor has obtained a verdict against an investment adviser."); Emily D. Johnson, *The Fiduciary Duty in Mutual Fund Excessive Fee Cases: Ripe for Reexamination,* 59 DUKE L.J. 145, 148 (2009) ("The SEC has never brought suit against an investment adviser for breach of fiduciary duty regarding fees, and shareholders have lost every suit they have brought.").

predictable irrespective their place of incorporation or management seat. Realizing the historical realities of the investment company and its economic purpose and division of control I came with a *de lege ferenda* proposal for such frame: applying the fiduciary duties known in trust law on both investment companies and their advisers.

CHAPTER V ENFORCEMENT AGENCIES AND THEIR LIMITATIONS

Moving from disclosure and fiduciary duties of investment companies and their advisers, in this chapter I discuss and analyze the enforcement, specifically the enforcement powers of the SEC, FCA and ESMA - three agencies entrusted with the supervision of investment companies in the US, UK and EU respectively. Even if a regulator would embrace the proposals introduced in the previous chapters, the **enforcement** of these duties would continue to represent a substantial part of investor protection regulation, as without enforcement there is no accountability and thus no law, trust on the market or justice.

In order to assess the efficiency of enforcement agencies in the chosen jurisdictions, I start with brief introduction on their structure, their legal character and their enforcement powers. Given the fact that the SEC was formed in 1934 and its enforcement tools of present-day differ radically from those in 1934, I also reflect on the gradual development of the SEC's enforcement powers. Further, I examine how well the SEC carries out its mission of protecting investors through the enforcement actions it initiates, including both administrative and judicial actions. Considering that one cannot qualify the direct impact of all of the undertaken actions by the SEC, it suffices to focus only on the SEC actions related to enforcement of a) prospectus disclosure and b) fiduciary duties of the investment companies and their investment advisers.

Before embarking on the comparison of the SEC and ESMA, a preliminary caveat ought to be made. Namely, albeit ESMA is in essence a pan-EU authority – yet contrary to the SEC – it is not the sole agency enforcing the EU law in the sector. Alongside ESMA, each Member State has its own national supervisory and enforcement agency, thus I consider also the powers of the FCA that has replaced the former FSA on April 1, 2013 as the UK enforcement agency over investment companies. Furthermore, realizing that ESMA was established only recently (January 1, 2011), its enforcement powers might be still "under development" as they were in case of the SEC back at the time of its inception. Moreover, as no ESMA case law has developed so far, I will only compare its enforcement powers with those of the SEC – present and past. Based on this, I argue that the EU should provide ESMA with much greater enforcement powers rather than retain it as a solely rulemaking and advisory authority. Alongside this claim, I analyze the existing EU law general principles – principle of proportionality and subsidiarity – and respective CJEU jurisprudence in order to reflect whether under the existing EU law, ESMA could become an administrative body with efficient enforcement powers such as the SEC.

After analyzing the enforcement powers of all three enforcement agencies, I come to a conclusion that even though regulators apply different strategies of enforcement and empower enforcement agencies with diverse set of powers, none of the focused upon agencies provides adequate protection of investors. Even though it is not presumed that the agencies can protect everyone and all, a regulator should also recognize this fact, reflect upon it and provide the investors with measures and tools that would enable them to protect themselves, where the enforcement agency fails.[1095] Looking into history, administrative agencies came into existence because legislative bodies recognized that they were unable to achieve the desired economic and social goals by themselves.[1096] Even though at the time the existing legislature provided general policy direction, the lawmakers possessed only limited expertise on the

[1095] *See* Chapter VI.
[1096] In case of the US, the minimalist federal government outlined in Philadelphia in 1787 anticipated only a few cabinet departments to carry out the function of government. The administration of public lands was decades in the future. Since then the simple model of cabinet departments has been substituted with a rich bureaucratic ensemble. *See* Peter L. Strauss, *The Place of Agencies in Government: Separation of Powers and the Fourth Branch,* 84 COLUM. L. REV. 573, 582-583 (1984).

subject and they became unable to solve more complex technical issues.[1097] Thus, some of lawmakers' powers have been delegated to a body of experts who focused only on **one area** – to administrative agencies. Their structure, functions, powers and basic operational guidelines – all in the line with the legislative objective(s) – were fixed by enabling statutes.[1098] Even though, based on their statutory provisions, some of the agencies were more dependent than the others; they all financially relied on their founders and thus were susceptible to political changes. Therefore, in the final chapter of this thesis I argue that beside a powerful enforcement agency, direct rights of action should be provided to the investors in order to enable them to protect themselves irrespective of possible political pressures exerted on the dedicated agency. Yet before reaching that point, the three enforcement agencies are assessed.

5.1. The Securities and Exchange Commission: Strong Enforcement

The SEC was established on June 6, 1934 as the primary regulator of the securities industry.[1099] SEC is an independent federal agency organized as a commission with five commissioners, one of whom is designated as a Chairman.[1100] The primary mission of the SEC is to ensure investor protection and fair and honest securities markets.[1101] The SEC is given the authority under the SEA 1934 to regulate and require registration of securities exchanges, transfer agents, as well as brokers and

[1097] *See* FRANK A. SCHUBERT, INTRODUCTION TO LAW AND THE LEGAL SYSTEM 584 (Houghton Mifflin Company, 9th ed. 2008).
[1098] *Id.* at 584.
[1099] 15 U.S.C. §78a *et seq.* The SEC administers the following laws: SA 1933, SEA 1934, PUHCA 1935, Trust Indenture Act of 1934, IAA 1940, ICA 1940, Securities Investor Protection Act of 1970, National Securities Markets Improvement Act of 1996, Financial Services Modernization Act of 1999, and the Dodd-Frank Act 2010.
[1100] Not more than three commissioners can be members of the same political party. No commissioner may engage in any other business, vocation, or employment other than serving as a commissioner.
[1101] *See* section 2 SEA 1934; The SEC describes its mission as *"to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation." See also* US SEC, 80th Anniversary, *available online:* <http://www.sec.gov/spotlight/sec-80.shtml> or US SEC, About the SEC, What We Do, *available online:* <http://www.sec.gov/about/whatwedo.shtml#.VDK1jVaAqKs.>/ *last visited* Dec. 8, 2014.

dealers.[1102] By the adoption of the ICA 1940 and IAA 1940, the SEC gained authority over investment companies and investment advisers as well.[1103] Internally, the SEC is divided into five divisions and twenty-three offices, each of which is located in Washington, DC.[1104] In addition to the Washington office, SEC has eleven regional offices throughout the US.[1105]

Throughout its existence, the SEC has been criticized many times.[1106] Whether due to its political connections and influence exerted through its financing[1107] or due to its internal organization and need for reorganization.[1108] Yet it continues to be considered by many as a successful and steady regulator.[1109] The SEC grew

---

[1102] 15 U.S.C. §§78f, 78q, 78q-1, 78o (2012).

[1103] 15 U.S.C. §80a-30 or 15 U.S.C. §80b-203 (2012).

[1104] The five divisions of the SEC are the following: (1) Division of Corporate Finance; (2) Division of Trading and Markets; (3) Division of Investment Management; (4) Division of Enforcement and (5) Division of Economic and Risk Analysis. For general overview of the structure *see* The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation, *available online at:* <http://www.sec.gov/about/whatwedo.shtml#intro>/ *last visited* Dec. 5, 2014.

[1105] The regional offices are in: Atlanta, Boston, Chicago, Denver, Forth Worth, Los Angeles, Miami, New York, Philadelphia, Salt Lake City and San Francisco; *available online at:* < http://www.sec.gov/contact/addresses.htm>/ *last visited* Dec. 6, 2014.

[1106] *See generally* ROBERTA S. KARMEL, REGULATION BY PROSECUTION (Simon & Shuster, 1982) [hereinafter "KARMEL, REGULATION BY PROSECUTION"] (Professor Karmel, a former commissioner, in her book reflected on bureaucratic and inefficient practices of SEC. After the year 2008, SEC has been criticized for not recognized the risk of toxic securities or emergence of investment bubbles); *see* James D. Cox, *Reinventing the SEC by Staring into its Past*, 78 U. CIN. L. REV. 459, 460 (2009). In connection to the mutual fund industry, in 2003, there was a set of scandals with mutual funds concerning the market timing and late trading, *see* Paul G. Mahoney, *Manager-Investor Conflicts in Mutual Funds*, 18 J. ECON. PERSP. 161, 168-169 (2004).

[1107] "Congress generally prefers control of budgetary purse strings as a technique to control how the independent regulatory agencies function." Looking back to the history, some SEC's Chairmen have been more successful in SEC financing as the other. Arthur Levitt a chair of SEC between 1993 and 2001 has been unsuccessful in obtaining Congress's interest. The budget of SEC grew per year on average of 6% during his chairmanship, while during the previous chair Richard C. Breeden under Bush administration between 1989 and 1993 the SEC budge grew on average by 19%. The budget naturally influences the number of staff as well as the depth of investigation. *See* Joel Seligman, *Self-funding for the Securities and Exchange Commission*, 28 NOVA L. REV. 233, 234 & 238-240 (2004).

[1108] After the financial crisis in 2008 and extensive structural reform, some scholars have raised their concerns on the new structure, John C. Coffee, Jr. & Hillary A. Sale, *Redesigning the SEC: Does the Treasury Have a Better Idea?*, 95 VA. L. REV. 707, 708 (2009) [hereinafter "Coffee & Sale, Redesigning the SEC"]; *see also* Joel Seligman, *The SEC in a Time of Discontinuity*, 95 VA. L. REV. 667 (2009).

[1109] *See* Robert A. Prentice, *The Inevitability of a Strong SEC*, 91 CORNELL L. REV. 775, 800 (2006) [hereinafter "Prentice, *The Inevitability of a Strong SEC*"] or Eric J. Pan, *Harmonisation of U.S. – EU Securities Regulation: The Case of a Single European Securities Regulator*, 34 LAW & POL'Y INT'L BUS, 499, 527 (2003) [hereinafter "Pan, *Harmonisation*"]; (The SEC has received praise throughout is history as a "model agency") or John C. Coates IV, *Private vs. Political Choice of Securities* extensively in last couple of years. Today it employs 5,183 people and 4,688 FTEs.[1110] The biggest division of the SEC is the "**Enforcement Division"**, which was however created only in August 1972 (more than thirty years after its establishment). The enforcement staff carries out investigations into possible violations of the federal securities laws and subsequently, where necessary conducts the SEC' administrative proceedings as well as its civil suits in the federal courts.

Focusing on investment companies, the SEC has a special division named "**Investment Management**", which ensures compliance with regulations concerning the registration of investment companies, their sales and advertising practices.[1111] This division also oversees compliance with the IAA 1940 and PUHCA 1935. Although the Investment Management division proclaims on its website as its primary aim "*protection of investors*,"[1112] nothing in its Staff Statements on ICA 1940 Rules or IAA 1940 direct investment companies or their advisers how "they" should protect investors – contrary to what the FCA provides in its COLL and COBS guidelines.

Despite the fact that the Investment Management division is inactive on providing guidelines, let alone regulation, concerning investor protection, after the recent financial crisis, the SEC established the specialized "**Office of Investor Education and Advocacy**" [hereinafter OIEA]. [1113] OIEA receives investors'

Regulation: A Political Cost/Benefit Analysis, 41 VA. J. INT'L L. 531, 543-544 (2001) (SEC has established a record of responsiveness and resistance to bureaucratic inertia and thus *"remains a highly respected government agency, even among political constituencies otherwise inclined to doubt the value or abilities of government regulators."*). On SEC long survival, *see* David E. Lewis, *The Politics of Agency Termination: Confronting the Myth of Agency Immortality*, 64 J. POL. 89, 92-93 (2003) (observing that 62% of agencies established since 1946 in the US were terminated by 1997).

[1110] *See* U.S. SEC. & EXCH. COMM'N, FY 2015 CONGRESSIONAL BUDGET JUSTIFICATION, FY 2015 ANNUAL PERFORMANCE PLAN, FY 2013 ANNUAL PERFORMANCE REPORT 4 (2014), *available at:* <http://www.sec.gov/about/reports/secfy15congbudgjust.pdf.>/ *last visited* Nov. 28, 2014. The SEC submitted its budget request for fiscal year 2015 in the amount of $ 1.7 billion.

[1111] *See* JOHN C. BURCH, JR. & BRUCE S. FOESTER, CAPITAL MARKETS HANDBOOK §1.02 (2014), *available at* WestlawNext.

[1112] *Available online, at:* < http://www.sec.gov/investment#.VDROSVaAqKv>.

[1113] The Office of Investor Education and Advocacy was established by section 915 by the Dodd-Frank Act. OIEA has four main functional areas, (1) The Office of Policy and Investor Outreach reviews all complaints, questions and also educates investors on investment-related topics.[1114] Yet the OIEA does not act as an advocate for the investors. Although it may further inquire based on an investor's complaint, in case of commencing a proceeding, the SEC will act individually, not as a representative of investors.[1115] Furthermore, the Dodd-Frank Act 2010 also established the institution of an **Ombudsman**, similarly to the UK,[1116] who should act as a liaison in resolving problems between investors and Commission or an SRO.[1117] The SEC selected its first ombudswoman Tracy L. McNeil only on September 5, 2014. Although the formation of the OIEA and the ombudsman's office were constructive steps that may lead to better-educated and aware investors, and therefore complement the earlier investor protection scheme, which goes hand in hand with the notion of investor empowerment, the question still remains, how does the SEC protect investors directly, if at all? In other words, what are the rights and duties of the SEC in case of investors' financial harm caused by the breach of securities regulation by investment companies and their advisers?

5.1.1. Gradual Development of Enforcement Tools

The SEA 1934 has been several times amended over the years. At inception, the SEC was perceived to be more of an advisory institution[1118] helping the market participants

formal agency action that are designed for investors and ensures that all of this information is in plain English and in interactive formats; (2) The Office of Investor Advocacy responds to investors suggestions or complaints; (3) The Office of Investor Education carries out investor education programs and focuses on broadening the knowledge of investors through distribution of materials, organization of seminars or investor oriented events; (4) The Office of Public Documents answers to requests for information under the Freedom of Information Act. *Available online at*: < http://www.sec.gov/oiea>; *see also The Investor Advocate: How the SEC Protects Investors and Maintains Market Integrity* (2000).

[1114] OIEA is running a website to help the investors to understand the way how the market works, who are the market participants or what are the investors' rights; *available online at:* http://investor.gov.

[1115] *See* SEC's Office of Investor Education and Advocacy, *available online at:* <http://www.sec.gov/investor/pubs/aboutoiea.htm.>/ *last visited* Dec. 2, 2014.

[1116] *See* section 5.3.3.

[1117] *See* section 919D of the Dodd-Frank Act 2010 (2012).

[1118] The SEC's formation as a new agency constituted a major innovation with respect to the previous regime, which applied the *laissez-faire* approach towards the regulation, *see* John Hanna, *The Securities Exchange Act of 1934*, 23 CAL. L. REV. 1 (1934).

understand the complex securities regulation,[1119] similarly to ESMA today. Dominated by attorneys, the SEC interpreted and clarified the securities regulation for others.[1120] After the phase of formation and interpretation, came the historic phase in which the SEC has been gradually equipped with increasingly more powerful enforcement tools; this has not been warmly welcomed.[1121] This applies even to most recent times when, after the financial crisis of 2008, the SEC oversight has been often described as heavy-handed, overly intrusive and enforcement dominated.[1122]

When the US Congress created the SEC in 1934, it was provided with only **few enforcement tools** – injunctions in federal courts and other equitable remedies.[1123] All four major securities federal statutes[1124] contained nearly identical authorization for SEC civil injunctive actions in the federal courts to stop any existing or possible violation of the acts.[1125] Under these provisions the SEC has had the authority to seek both temporary and permanent injunctive relief in federal courts. As the case law was only developing, the SEC had to creatively formulate new forms of ancillary equitable

[1119] *See* Arthur H. Dean, *Twenty-five Years of Federal Securities Regulation by the Securities and Exchange Commission,* 59 COLUM. L. REV. 697, 707-708 (1959) (The SEC had the task of working out solutions to number of complex questions posed by various securities acts, preparing forms for registration, simplified guidelines for participants).

[1120] An often-observed phenomenon at SEC was that many lawyers would spend only few years at the agency and then turn to private sector, and therefore had strong incentives to preserve and expand the regulatory structure. *See* Nicholas Wolfson, *A Critique of the Securities and Exchange Commission,* 30 EMORY L. J. 119, 123-124 (1981).

[1121] *See generally* KARMEL, REGULATION BY PROSECUTION, *supra* note 1106.

[1122] *See* Langevoort, *Institutionalization of the Securities Markets*, *supra* note 11, at 1032. *See also* Coffee, *Law and the Market*, *supra* note 645 (Professor Coffee elaborates on measuring the enforcement based on the data on inputs and outputs. He reflects on the work of LLS&V and their examination of enforcement in their work: Rafael La Porta *et al.*, *What Works in Securities Laws?,* 61 J. FIN. 1 (2006)). Nevertheless, the SEC continues to communicate and discuss new regulation with other market participants.

[1123] *See* Barbara Black, *Should the SEC Be a Collection Agency for Defrauded Investors?,* 63 BUS. LAW. 317, 323 (2008) [hereinafter "Black, *SEC a Collection Agency*"].

[1124] SA 1933, SEA 1934, ICA 1940 and IAA 1940.

[1125] Section 20(b) of the SA 1933 states *"whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this subchapter… it may in its discretion bring an action in any district court of the United States… to enjoy such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond."* Similar provisions were included in section 21(d) SEA 1934; section 42 ICA 1940 and section 209 IAA 1940.

relief to individually tailor the remedy in order to precisely target the wrongdoing.[1126] At the beginning, the SEC had to rely on the court's equitable powers to create "ancillary remedies" in order to bolster its enforcement powers.[1127] Although the SEC justified the ancillary remedies in the light of the need to effectuate the purpose of securities laws,[1128] some perceived it as a practice leading towards legal uncertainty. Defendants could not predict how the SEC may proceed.[1129]

Yet the SEC was most of the times successful before courts. Since its formation in 1934 until the mid-1970, courts usually concurred with the opinion of the SEC, mainly due to the need of swift and rigorous development of the securities regulations.[1130] However, in the mid 1970's the US Supreme Court commenced to

[1126] *See* Harvey L. Pitt & Karen L. Shapiro, *Securities Regulation by Enforcement: A Look Ahead at the Next Decade*, 7 YALE J. ON REG. 149, 196-197 (1990). In cases of insider mismanagement, the SEC designed creative forms of relief, such as (1) the designation of special counsel – "special review person" who would conduct an investigation of the issuer of the suspect transactions; (2) the appointment of new independent director; (3) establishment of an Audit Committee to assure the appropriateness of business or (4) the incorporation into an injunction of a series of undertakings by the defendant designed to cure the particular problems revealed by an investigation.
[1127] "Ancillary remedies" or "ancillary relief" are not expressly acknowledged or authorized by federal securities statutes. Among these remedies that SEC has over the years obtained are *e.g.* disgorgement of profits, restitution, rescission of transactions, appointment of receivers, orders to act or forbear from doing, and others. On the historical previews *see e.g.* Arthur F. Matthews, *Recent Trends in SEC Requested Ancillary Relief in SEC Level Injunction Actions,* 31 BUS. LAW. 1323 (1976) or James C. Treadway Jr., *SEC Enforcement Techniques: Expanding and Exotic Forms of Ancillary Relief,* 32 WASH. & LEE L. REV. 637 (1975) or George W. Dent, Jr., *Ancillary Relief in Federal Securities Law: A Study in Federal Remedies,* 67 MINN. L. REV. 865 (1983).
[1128] *See* Dent Jr., *supra* note 1127, at 867-868. In 1980's the American Law Institute proposed Federal Securities Code to authorize courts to gran ancillary remedies. According to the section 1819(l) of the American Law Institute's Federal Securities Code (1980): "In a civil action created by the Commission, the court has the authority of a court of equity to grant appropriate ancillary or other relief, including an injunction, an accounting, a receivership of the defendant or the defendant's assets, disgorgement of profits, and restitution."
[1129] *Id.* at 926.
[1130] It was in these years, where the US Supreme Court addressed a broad range of issues, as the definition of a security, scope of antifraud provisions, insider trading or implied rights of action; *see* Thomas L. Hazen, *Symposium Introduction: The Supreme Court and the Securities Laws: Has the Pendulum Slowed?,* 30 EMORY L.J. 5, 7-8 (1981) [hereinafter "Hazen, Symposium Introduction"]. *See also* Roberta S. Karmel, *Creating Law at the Securities and Exchange Commission: The Lawyer as Prosecutor,* 61 LAW & CONTEP. PROBS. 33, 39 (1998) and Roberta S. Karmel & John P. Ketels, *Securities Commentary* 44 BROOK. L. REV. 1189, 1200 (1978). One of the most known decisions was the 1963 Supreme Court decision, SEC v. Capital Gains Research Bureau, Inc. 375 U.S. 180 (1963), where the Court dealt with registered investment advisors who failed to inform and disclose that they were purchasing securities for their own accounts (known as "scalping"). In this case the court held that the SEC injunctions against such practices were allowed even though the SEC did not fully established the fraud due to the very technical language of IAA 1940. The court stated that "Congress

generally **limit** the scope of the securities laws as well as to curtail the SEC's enforcement powers.[1131] In addition, as the Reagan administration arrived to Washington DC in 1981, a new deregulatory reform movement arrived with it.[1132] During these times, the SEC was perceived as a potential hindrance to effective capital formation and an impediment to the administration's goals focused on economic growth.[1133] The new approach of those times is, for example, properly reflected in the SEC Transition Team advice according to which the SEC's budget could be cut by 30% over three years, *"without any compromise in the mission of the Agency."*[1134]

The changed stance made the SEC focus on enforcement of insider trading cases in the 1980s – leaving issuers and big business aside while targeting rather individuals.[1135] Although in the 1980's several scandals have been publicized, they all revolved around individuals.[1136] Only the later penny stock frauds at the beginning of

---

intended the Investment Advisers Act 1940 to be construed like other securities legislation … not technically and restrictively, but flexibly to effectuate its remedial purposes," at 195.

[1131] *See* Hazen, Symposium Introduction, *supra* note 1130, at 6. *See e.g.* United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975) (Court ruled that "stock" in a cooperative housing project was not a security, even though that term was specifically listed in the statutory sections of definition of security in both the SA 1933 and SEA 1934); International Brotherhood of Teamsters v. Daniel, 439 U.S. 551 (1979) (Court decided that a compulsory, noncontributory pension plan was not a security); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (Court ruled that under rule 10b-5 a defendant must act with scienter, with intent to defraud, which required something more than mere negligence) or Aaron v. SEC 446 U.S. 680 (1980) (In this case a managerial employee of a registered broker-dealer knew about fraudulent sales practices but took no actions. Thus, the SEC commenced proceedings against the employee. The US Supreme Court found that the scienter element that it required in the Rule 10b-5 was missing. Nevertheless, the curt suggested the SEC to seek injunction under other provisions, as section 17(a)(2) or 17(a)(3) under the SA 1933.

[1132] President Reagan was elected president of the US in 1980 with promise to *"get the government off the backs of the people." See Reagan: Putting His Philosophy to Work Fast*, BUS. WK., Nov. 17, 1980, at 154 col.1. The Reagan administration aimed for a deregulation with a motto that *"incentives, not rules, should guide business conduct and that negotiation among the principals, not litigation between the lawyers, should determine disputes." See* Thomas O. McGarity, *Regulatory Reform in the Reagan Era*, 45 MD. L. REV. 253, 254 (1986).

[1133] *See* FINAL REPORT OF SEC TRANSITION TEAM, SEC. REG. & L. REP. (BNA) No. 587, at K-1 (Jan. 21, 1981).

[1134] *Id.* at K-1.

[1135] *See* Pitt & Shapiro, *supra* note 1126, at 199-212.

[1136] Among several scandals during this time, there was the junk bond scandal of Michael Milken, who was indicted for racketeering and securities fraud in 1989 or the conviction of Dennis B. Levine of Drexel Burnham Lambert who made $12.6 million in illegal trading on inside information.

1990's gained the attention of public.[1137] Penny stock operations, which were an investment hit in the late 1950's and early 1960's when investors invested in shares of dubious uranium and gold mines, made their way back to the market in late 1980's with the telecommunications revolution.[1138] The penny stock frauds were detrimental to the investors as large numbers of investors were tricked through high-pressure telemarketing technique known as "**cold calling**".[1139] Given that many investors reported penny-stock frauds, the US Congress stepped in with the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 [hereinafter "Remedies Act of 1990"],[1140] which was very much welcomed by the SEC as it broadened its enforcement powers.[1141]

The Remedies Act of 1990 authorized the SEC to seek and to impose (1) monetary penalties for violations of the SA 1933, SEA 1934, ICA 1940 and IAA 1940;[1142] and (2) cease-and-desist orders against any violator of any provision of the

[1137] *See* E. S. Browning, *School of Scandal*, WALL ST. J., December 13, 1999, at C23 (described how the frauds of 1990's were much more pervasive than the scandals of 1980's).
[1138] According to Joseph Goldstein, the head of SEC task force on penny stock fraud, *"[t]he telecommunications revolution has made penny stock fraud easier and it's becoming more and more profitable…There are more penny stock broker dealers than ever before." See Penny Stock Fraud Costing Consumers Billions,* REUTERS BUS. REP., May 9, 1989. As a result, the SEC imposed sales practice requirements on broker-dealers who recommend purchases of certain low-priced, non-NASDAQ, OTC securities to persons who are not established customers (Rule 15c2-6).
[1139] *See* The NASAA Report on Fraud and Abuse in the Penny Stock Industry: Report to the Subcomm. on Telecommunications and Fin. of the House Comm. on Energy and Commerce 21-23. (1989). On penny stock marketing techniques *see* Carolyn E. Lampe, *The Penny Stock Reform Act of 1990: A Costly Solution to a Serious Problem,* 13 GEO. MASON U. K. REV. 779, 781-784 (1991).
[1140] Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931 [hereinafter "Remedies Act of 1990"]. According to the legislative history of the Remedies Act of 1990, the Congress assumed that certain remedies were already available to the SEC in judicial proceedings, e.g. disgorgement. *See* S. REP. NO. 101-337, at 8 (1990). President Bush signed the Remedies Act of 1990 into a law on October 15, 1990.
[1141] Richard C. Breeden, the Chairman of the SEC at the time supported the act as he believed that it was consistent with the SEC actions involving securities markets; *see* Penny Stock Market Fraud (Part 2 (1990): HEARING BEFORE THE SUBCOMM. ON TELECOMMUNICATIONS AND FIN. OF THE HOUSE OF COMM ON ENERGY AND COMMERCE, 101st Cong., 2d Sess 27 (statement of Richard C. Breeden). *See generally* Lampe, *supra* note 1139.
[1142] *See* SA §20(d), 15 U.S.C. §77t (d) (2012); SEA §21(d)(3), 15 U.S.C. §78u(d)(3) (2012); ICA 1940 §42(e), 15 U.S.C. §80a-41(e) (2012) and IAA 1940 §209 (3), 15 U.S.C. §80b-9(e).

SA 1933, SEA 1934, ICA 1940 or IAA 1940.[1143] The Remedies Act required the SEC to determine the amount of the penalty in the light of the facts and circumstances of each case. US Congress adopted a three-tiered structure for determining the maximum permissible monetary penalty – taking into account the gravity of violation and the caused harm.[1144] Additionally, the Remedies Act of 1990 allowed the SEC to impose a penalty even when that was in public interest, and when a person *"has failed reasonably to supervise, ... with a view to preventing violations ... another person who commits such a violation, if such other person is subject to his supervision."*[1145] The SEC had to impose monetary penalties by utilizing a three-tiered approach similar to the structure enacted for penalties in civil actions.[1146]

The Remedies Act of 1990 changed the SEC's existing administrative authority. The act authorizes the SEC to administratively impose money penalties against regulated persons, who "willfully" committed a securities-law violation.[1147] In these administrative proceedings, after the administrative law judge renders a decision, the defendant or the SEC may appeal to the SEC, and if they are unsuccessful then they may re-appeal to a federal circuit court of appeals.[1148]

Later after the Enron crisis, the SOX in 2002 further expanded the SEC's civil enforcement authority by allowing the SEC to seek bars over directors and officers in federal courts.[1149] The SOX provided statutory support to two inherent equitable enforcement powers, which courts have acknowledged before, namely (1) power to

[1143] Cease-and-desist proceeding could be initiated against anyone who violated the acts, not only the regulated persons. Codified as amended at 15 U.S.C. §§77h-1, 78u-3, 80a-9, 80b-3).
[1144] *See* Ralph C. Ferrara *et al., Hardball! The SEC's New Arsenal of Enforcement Weapons,* 47 BUS. LAW. 33, 42-43 (1991).
[1145] *See e.g.* SEA §21B(a), 15 U.S.C. §78u-2(a) (2012).
[1146] *See e.g.* SEA §21B(b), 15 U.S.C. §78u-2(b) (2012).
[1147] *See* Remedies Act of 1990 §§102, 203, 301, 401 (codified as amended at 15 U.S.C. §§77h-1, 78u-3, 80a-9, 80b-3) (2012).
[1148] *See* SEA §21B(a), 15 U.S.C. §78u-2(a); IAA 1940 §9(d), 15 U.S.C. §80a-9(d).
[1149] SOX §1105 (codified as amended at 15 U.S.C. §§77h-1, 78u-3).

regulate professionals who practice before it[1150] and (2) to seek *"any equitable relief that may be appropriate or necessary for the benefit of investors"* in federal court.[1151] The SOX thus supported the investors. Section 308 of SOX allows the SEC, in some circumstances, to impose civil penalties on wrongdoers that would be subsequently paid to defrauded investors through **fair funds**. Fair funds represent an additional legal tool to the "disgorgement of profits," which is a unique and efficient investor-protective tool of the US system based on which an agency can refund the illegal profits to the defrauded investors.[1152]

Due to the financial crisis in 2008, the Dodd-Frank Act 2010 enhanced the SEC's enforcement options even beyond securities professionals.[1153] Currently, the SEC has the power to impose administrative monetary penalties on **any person** who violates the securities laws, and even on secondary actors who simply "cause a violation".[1154] Although the statute limits the amount of monetary penalty the SEC can administratively impose,[1155] the ability of the SEC to impose administrative sanctions greatly expanded the efficiency of many enforcement actions that had to be filed with a federal court before.[1156] Moreover, in January 2010 the SEC revised its Enforcement Manual[1157] – "**Fostering Cooperation**" – to include new provisions

[1150] SOX §602 (codified as amended at 15 U.S.C. §78d-3).
[1151] SOX §305(b) (codified as amended at 15 U.S.C. §78u-d).
[1152] SOX §, 308. Pursuant to this provision, collected monetary penalties may be directed to a fund to help compensate injured investors instead of directing them to the US Treasury.
[1153] Under the Dodd Frank Act, the SEC may (1) levy civil money penalties in cease and desist proceedings upon any violator (section 929P(a)); (2) it may institute enforcement actions against alleged aiders and abettors based on knowing or reckless conduct under the SA 1933 and the ICA 1940 (this authority existed before only under the SEA 1934 and IAA 1940, section 9(d)(1) ICA 1940) (section 9290); (3) may pursue "clawback" of excessive incentive-based compensation against a subject company executive based on unjust enrichment due to misleading financial statements which have been restated without a showing of required fault (section 954); (4) may bring collateral bars in SEC administrative enforcement proceedings; and others (section 925). *See generally* Joel Seligman, *Key Implications of the Dodd-Frank Act for Independent Regulatory Agencies,* 89 WASH. U. L. REV. 1 (2011).
[1154] Dodd-Frank Act 2010 §929P(a) (codified as amended at 15 U.S.C §78u-2(a), 77h-1(g)).
[1155] *See, e.g.* SEA §21(B)(b), 15 U.S.C. §78u-2(b) (2012).
[1156] *See* HAZEN, TREATIES ON THE LAW OF SECURITIES REGULATION, *supra* note 438, at §16.2[0][A].
[1157] It was initially adopted in 2008.

establishing a framework for evaluating cooperation by companies and individuals.[1158] To improve the quality and quantity of information that the SEC receives, it has authorized its staff to use various tools to encourage individuals and companies to report violations and provide assistance to the SEC.[1159] These cooperation tools, which were previously not available to the SEC, currently, include cooperation agreements,[1160] deferred prosecution agreements,[1161] and non-prosecution agreements.[1162] They allow the SEC to run more efficiently and target more wrongdoings than before.

For an enforcement agency, to be in a position to offer non-prosecution agreements and directly impose monetary penalties on wide range of subjects, shows clearly the immense powers the SEC has today. Although the SEC was left unarmed for a long period of time, to a great extent thanks to the support of courts and the reoccurrence of financial scandals, legislators were forced to understand the need for a more powerful enforcement agency and expanded on the authorities of the SEC. Yet for the purposes of this thesis, the right question is – notwithstanding that the SEC is

[1158] In the new SEC policy statement, the SEC identifies four general considerations, namely: (1) the assistance provided by the cooperating individual; (2) the importance of the underlying matter in which the individual cooperated; (3) the societal interest in ensuring the individual is held accountable for his or her misconduct; and (4) the appropriateness of cooperation credit based upon the risk profile of the cooperating individual. *See* ALAN R. BROMBERG, LEWIS D. LOWENFELS, & MICHAEL J. SULLIVAN, BROMBERG & LOWENFELS ON SECURITIES FRAUD §19:16 (2014), *available at* WestlawNext.

[1159] *See* MARC I. STEINBERG & RALPH C. FERRARA, SECURITIES PRACTICE: FEDERAL AND STATE ENFORCEMENT §2:2 (2014), *available at* WestlawNext.

[1160] Cooperation agreement is a formal written agreement, where the SEC Enforcement Division recommends to the SEC that a cooperator should receive credit for cooperating in investigations or related enforcement actions if the cooperator provides substantial assistance as full and truthful information and testimony. *Id.*

[1161] Deferred Prosecution Agreement is a formal written agreement, in which the SEC agrees to forego an enforcement action against another cooperator if it agrees to fully and truthfully cooperate and comply with express prohibitions and undertakings during a period of deferred prosecution. *Id.*

[1162] A non-prosecution agreement is a formal written agreement, in which the SEC agrees not to pursue an enforcement action against a cooperator if the individual or company agrees, among other things, to cooperate fully and truthfully and comply with express undertakings. *See* Lance Cole, *The SEC's Cooperation Policy: A Duty to Correct or Update?,* 41 SEC. REG. L.J. 127 (2013) (evaluating the novel SEC policies).

today equipped with broad enforcement powers – [1163] how are these used in order to protect investors, especially the clients of investment companies? Naturally, all the above-mentioned enforcement tools contribute to the general fairness and efficiency of the market. Yet by looking into case law one can unveil to what extent form investors a direct part of the SEC's story. As the two regulatory components for the enhanced investor protection are disclosure and fiduciary duties, these two are assessed hereinafter.

5.1.2. Breach of Disclosure Obligation: Investment Company's Prospectus

In the third chapter of this thesis I analyzed disclosure obligation of the investment company towards their investors. The investment companies inform their investors through a prospectus,[1164] which is believed to be an important source of information for the investors on the fundamental characteristic of a particular investment company.[1165] Although, I have concluded at the end of the chapter III that the information contained in the prospectus of investment companies is relevant for an investor only to a limited extent, prospectuses continue to represent an important source of information. Thus, the main inquiry of this section is whether the SEC protects the investors in case of **misstatements** or **omissions** of a prospectus. My focus in this section is the active or direct protection of investors in case of misstatement or omission of information in the prospectuses issued by investment companies. For this purpose I form my own dataset of cases, which I subsequently analyze.

[1163] *See generally* Paul G. Mahoney, *Securities Regulation by Enforcement: An International Perspective*, 7 YALE J.REG. 305 (1990) or Thomas L. Hazen, *Administrative Enforcement: An Evaluation of the Securities and Exchange Commission's Use of Injunctions and Other Enforcement Techniques*, 31 HASTINGS L.J. 427 (1979).
[1164] 15 U.S.C. §77b(a)(1) (2012).
[1165] *See* section 3.3.

Although the ICA 1940 by itself does not cover the specific issue of misstatement or omission of information of an investment company's prospectus, under section 8 ICA 1940 an investment company must comply with all registration requirements of the SEC.[1166] The registration system was formed in a way to prevent double standards for different regulated entities and therefore the SA 1933 incorporated the offering disclosure scheme for investment companies as well.[1167] The SA 1933 contains special rules for investment companies, including rules on prospectuses,[1168] registration statements[1169] or post-effective amendments.[1170] Furthermore, the SA 1933 also encompasses the liability provisions for material misstatements in the registration statements, including prospectuses.[1171] In addition to these provisions in the SA 1933, the SEC was empowered to create analogous periodic disclosure requirements for investment companies to substitute for the requirements in the SEA 1934.[1172] Hence, the SEC has a broad authority to oversee and enforce the provisions related to investment company prospectuses.[1173] However, is the SEC actively applying these powers? In other words, how many times did the SEC commence an administrative or court proceeding for a misstatement or omission in an investment company's prospectus? In the following part I will focus on the case law and analyze in how many cases has that occurred and to what extent has the SEC intervened in the name of the investors.

[1166] 15 U.S.C. §80a-8 (2012).
[1167] 15 U.S.C. §80a-24(a) (2012). Public offerings of securities by registered investment companies must be registered under the SA 1933, which covers the offering of securities.
[1168] 15 U.S.C. §77b-2(a)(10) (2012).
[1169] 15 U.S.C. §77b-2(a)(8) (2012).
[1170] 15 U.S.C. §77b-8(c) (2012).
[1171] 15 U.S.C. §§77k & 77l (2012).
[1172] 15 U.S.C. §§78a *et seq.* (2012). Moreover, under the section 24 of the ICA 1940 under the section 31 mandates investment companies and investment advisers to maintain all records for examination by the SEC. 15 U.S.C. §80a-30.
[1173] *See e.g.* 15 U.S.C. §78(d)(1) (2012) (authorizing SEC enforcement actions in the federal district court).

Usually the SEC brings around 500-600 enforcement actions annually, out of which roughly twenty-five percent deal with financial reporting and the duty to disclose.[1174] In 2013 alone, the SEC closed 686 enforcement actions showing a great determination towards enforcement of securities laws.[1175] The dataset that I developed examines both sets of proceedings of SEC. First, the administrative proceedings that take place solely before the SEC and second, the cases brought before federal courts. Given that there were numerous changes in the SEC policy towards investment companies' prospectuses and its enforcement powers since 2009,[1176] I will focus only on this five-year time frame by using the Westlaw Next research database, which includes both the court and administrative proceedings.[1177]

The data show the following: since 2009, there were **twelve administrative cases**.[1178] Although in all twelve cases one of the subject matters was related to a prospectus of an investment company, the SEC investigated not only the investment

[1174] *See* James D. Cox *et al.*, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 749 (2003) (Reviewing enforcement actions from 1997 until 2002).
[1175] According to the U.S. SECURITIES AND EXCHANGE COMMISSION FISCAL YEAR 2013 AGENCY FINANCIAL REPORT 17 [hereinafter "SEC 2013 Fiscal Report"].
[1176] *See* section 5.1.2.
[1177] In case of administrative proceedings, the combinations of two search phrases "investment company" & "prospectus" were run. I further specified the agency conducting the proceeding, being the SEC. The initial search yielded a dataset of 1,128 materials. I discarded those without any reference to misstatement or omission and received thirty-eight records. Out of these thirty-eight records, there were twelve administrative cases.
[1178] In the Matter of Chariot Advisors, LLC and Elliott L. Shifman, Admin. Proc. File No. 3-15433, July 3, 2014; In the Matter of Diane M. Keefe, Admin. Proc. File No. 3-13337, December 8, 2010; In the Matter of Joseph John Vancook, Admin. Proc. File No. 3-12753, November 20, 2009; In the Matter of Charles Schwa Investment Management, Charles Schwab & Co., Inc., and Schwab Investments, Admin. Proc. File No.3-14184, January 11, 2011; In the Matter of Morgan Asset Management, Inc., Morgan Keegan & Company, Inc., James C. Kelsoe, Jr., and Joseph Thompson Weller, CPA, Admin. Proc. File No. 3-13847, June 22, 2011; In the Matter of Mohammed Riad and Kevin Timothy Swanson, Admin. Proc. File No. 3-15141, December 19, 2012; In the matter of J. Kenneth Alderman, CPA, Jack R. Blair, Albert C. Johnson, CPA, James Stillman R. McFadden, Allen B. Morgan Jr., W. Randall Pittman, CPA, Mary S. Stone, CPA, and Archie W. Willis III, Admin. Proc. File No. 3-15127, December 10, 2012; In the Matter of Lisa B. Premo, Admin. Proc. File No. 3-14697, December 26, 2012; In the Matter of Fiduciary Asset Management, LLC, Admin. Proc. File No. 3-15140, December 19, 2012; In the Matter of Miguel A. Ferrer and Carlos J. Ortiz, Admin. Proc. File No. 3-14862, October 29, 2013; In the Matter of Daniel Bogar, Bernerd E. Young, and Jason T. Green, Admin. Proc. File No. 3-15003, August 2, 2013; and In the Matter of Thomas C. Bridge, James D. Edge and Jeffrey K. Robles, Admin. Proc. File No. 3-12626, September 29, 2009.

companies but also the investment advisers,[1179] which shows that these two entities are interlinked on all levels, including the formation of a prospectus. The SEC when conducting administrative proceedings usually relied on all four key securities acts.[1180]

Although the SEC under its administrative powers in most of the cases rendered either a civil money penalty or alternatively in some cases an injunction in the form of a cease-and-desist order, focusing on the investors and their interests in none of the above-stated proceedings had the SEC created **fair funds** or provided the harmed investors with any kind of financial compensation, even though disgorgements were ordered.[1181] Unless distributed to investors, the disgorgement funds go to the US Treasury.[1182] Thus, it seems that even though the fair funds represent an **efficient tool** for distribution of disgorged profits, the SEC fails to use it to compensate the financially damaged investors, unless claims of investors are substantial.[1183] Although the SOX provided the SEC with an additional tool – fair funds – they are used under the SEC's sole discretion without any specific rules.[1184] Thus, leaving the investors at the mercy of the SEC without any transparency.

[1179] *See* In the Matter of Chariot Advisors ,LLC and Elliott L. Shifman, Admin. Proc. File No. 3-15433, July 3, 2014;

[1180] It based its claims on sections 17(a) SA 1933 (2012), 10(b), 15(b) or 21C of SEA 1934 (2012), sections 9(b) or 9(f) of the ICA 1940 (2012), sections 203(e), 203(f) or 203(k) of IAA 1940 (2012).

[1181] According to the Rule 1100 of RULES OF PRACTICE AND RULES ON FAIR FUND AND DISGORGEMENT PLANS, U.S. SECURITIES AND EXCHANGE COMMISSION, MARCH 2006 *"In any agency process initiated by an order instituting proceedings in which the Commission or the hearing officer issues an order requiring the payment of disgorgement by a respondent and also assessing a civil money penalty against the respondent, the Commission or the hearing officer* ***may*** *order that the amount of the disgorgement and of the civil money penalty, together with any funds received by the Commission pursuant to 15. U.S.C. 7246(b), be used to create a fund for the benefit of investors who were harmed by the violation."* The disgorgement has been awarded in case of Fiduciary Asset Management LLC., the administrative court ordered of $644,951 and in case of Joseph John Vancook of $533,234.01.

[1182] *See* SEC v. Pardue, 367 F. Sup..2d 773 (E.D. Pa. 2005).

[1183] *See* HAZEN, TREATIES ON THE LAW OF SECURITIES REGULATION, *supra* note 438, at §16.2[4][B].

[1184] Official Committee of Unsecured Creditors of WorldCom, Inc. v. SEC, 467 F.3d 73, 77-78 (2d Cir. 2006) *"As the SEC correctly observes, even after the enactment of the Fair Fund provision, the decision remains in the hands of the SEC whether to distribute civil penalties to victims* ***at all.***

Moving from the SEC administrative proceedings to **court proceedings**,[1185] the data search yielded only one case: *SEC v. Pentagon Capital Management PLC*.[1186] In this case the SEC brought an enforcement action against a foreign investment advisor and its affiliated people for late trading and deceptive market timing,[1187] which lead to breach of the provisions on prospectuses. The district court in 2012 awarded disgorgement of $38,416,500 and third-tier civil penalty of the same value. However, the court of appeals reversed the court's imposition of joint and several liability and – based on the *Gabelli* case[1188] – remanded for reconsideration the amount of disgorgement.[1189] Given the fact that this case has not been fully settled yet, the issue of active investor protection cannot be assessed to its full extent.

In conclusion, although the number of cases involving investment companies and a misstatement or omission of information in a prospectus initiated solely by the SEC was limited, in none of these cases were the investors reimbursed. Present prospectuses of investment companies are written very carefully and considerately, and therefore bringing a claim on the grounds of misstatement or omission is difficult. Looking at the investors' reimbursement, according to the SEC website, the SEC has

[Referring to the 15 U.S.C. §7246(a) (providing that a "civil penalty shall, *on the motion or at the direction of the [SEC]*, be added to and become part of the disgorgement fund" (emphasis added).

[1185] Comparing the court to the administrative proceedings, the parties in the administrative enforcement proceedings before SEC do not have as extensive rights as they do before a court, as a right to pretrial discovery, access to jury trial, protection of evidentiary rules or a lesser standard for review upon appeal that applies to appeals from administrative orders. *See* HAZEN, TREATIES ON THE LAW OF SECURITIES REGULATION, *supra* note 438, at §16.2[0][A].

[1186] The combinations of two search phrases "investment company" & "prospectus" were run. The initial search yielded a dataset of forty-seven cases. I discarded those, which were not brought by the SEC and without any reference to misstatement or omission and received only one case SEC v. Pentagon Capital Management PLC. *See* SEC v. Pentagon Capital Management Plc., 844 F. Supp. 2d 377 (2012).

[1187] On this issue, *see* section 3.4.1.

[1188] *See* Gabelli v. SEC, 133 S. Ct. 1216 (2013) (The US Supreme Court held that the so-called "discovery rule" does not apply in securities fraudulent actions and the five-year period for SEC to commence action for civil penalties for fraud begins to run when the fraud occurs, not when it is discovered).

[1189] *See* SEC v. Pentagon Capital Management Plc, 725 F.3d 279 (2013).

established approximately 100 fair funds since their introduction by the SOX.[1190] However, it seems that they have been only formed in a number of high-profile cases,[1191] and not as a standard for all disgorgement actions of the SEC. Meanwhile, even the few fair funds became an instrument for the investment industry's campaign against the private securities class actions,[1192] as the class actions have been perceived to be the explicit tool for recovering the money for investors' losses.[1193]

5.1.3. Breach of Fiduciary Duties

The main claim of the fourth chapter was that an investment company together with its investment advisor should owe fiduciary duties to the investors under the higher standards of trust law. As stated in the fourth chapter, until today no investor of an investment company was successful in claiming the breach of the fiduciary duties, neither under section 36(a) nor 36(b) ICA 1940. Given the fact that I have not discovered a secondary source that would investigate on this matter, I decided to conduct a similar database research on this matter as I did in the previous section analyzing the administrative and court proceedings in the last five years on the matter.

[1190] *See* List of current and archived fair funds, *available online at:* < http://www.sec.gov/litigation/fairfundlist.htm#adams>.

[1191] *See* Donald C. Langevoort, *Structuring Securities Regulation in the European Union: Lessons from the U.S. Experience in* INVESTOR PROTECTION IN EUROPE: CORPORATE LAW MAKING, THE MIFID & BEYOND, *supra* note 455, at 488; (Professor Langevoort describes that the SEC chooses cases carefully for their publicity value, "because a front page story creates more salience for the enforcement program than a score of cases that get minor coverage or none at all, even though severity of the harms may well be the same"). *See also* SEC former Chairman Christopher Cox stated: "[i]n 2006, we continued to order record monies to be returned to harmed investors… $50 million in McAfee; $50 million in Tyco; $55 million in Hartford; $153 million in Security Brokerage, $250 million in Bear Stearnds…[D]uring my 80-week tenure with the Commission, we have distributed over a billion dollars to injured investors." Christopher Cox, Chairman, U.S. SEC. & EXCH. COMM'N, Opening Remarks to the Practicing Law Institute's SEC Speaks Series (Feb. 9, 2007).

[1192] *See* Black, *SEC a Collection Agency*, *supra* note 1123, at 319.

[1193] On the contrary, *see* John C. Coffee, Jr. *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534 (2006) [hereinafter "Coffee, *Reforming the Securities Class Action"*] (Professor Coffee argued that private securities fraud class actions are not efficient *per se* and their principal roles should be deterrence, not a compensation). Interestingly, Professor Black fears that there is a danger that the formation of fair funds could lead to a weakening the SEC's effectiveness as wells as to further rejection for private securities fraud class actions. *See* Black, *SEC a Collection Agency*, *supra* note 1123, at 320.

Using the Westlaw Next research database,[1194] my initial search yielded a dataset of 191 administrative decisions and guidance material, which in comparison to the outcome of the search in case of disclosure is substantially smaller (1,128). Within this search, no court cases were found. I only focused on the administrative proceedings, setting aside also no-action letters and guidelines. The total number of cases was **fifty-four**. After reviewing all fifty-four cases, the reference to fiduciary duties was only present in connection between an adviser and an investment company, and did not extend to the relationship between an investment company (or investment adviser) and its investors, which shows that in practice establishing of fiduciary duties is futile.

The result of this search again substantiates the need of expanding the fiduciary duties of investment advisers not only towards the investment companies, but also towards the investors. Moreover, the limited amount of cases reveals the lack of interest or personnel of the SEC for overseeing the investment management of investment companies and its advisers. Alternatively, the case law restraining the fiduciary duties of investment companies and their advisers might negatively affect the SEC enforcement activity as well. The SEC is authorized to bring an action under section 36(a) ICA 1940 for a breach of fiduciary duties of an officer, director, and member of advisory board, investment adviser and others.[1195] Yet according to the case law, this activity of the SEC has been carried out only to a very limited extent. Thus, leaving section 36(a) ICA 1940 as a supplementary section in case of greater breach of the securities acts. The query whether the inactivity of the SEC is due to its disinterest or limited capacity is hard to answer, however I believe it is simply a result

[1194] In case of administrative proceedings, the combinations of two search phrases "investment company" & "fiduciary duty" were run. I further specified the SEC as conducting the proceeding.
[1195] 15 U.S.C. 80a-35(a) (2012).

of its inability to be omnipresent in each investment decision taken place on the market,[1196] which calls for the empowerment of those who are the direct targets of it – individual investors.

5.2. The European Securities and Market Authority: Guidance instead of Enforcement

In 1999 when the European Commission introduced its Financial Services Action Plan, it did not consider a formation of a financial enforcement authority on the EU-level.[1197] The former plan aimed to encourage closer co-ordination and supervisory convergence, not a pan-European enforcement body.[1198] The Committee of European Securities Regulation [hereinafter "CESR"], a technical advisor on securities matters was formed.[1199] CESR as such did not perform any enforcement powers; it mainly focused on consultation of national enforcement agencies and their technical instructing.

[1196] According to the SEC 2013 Fiscal Report, the SEC reviews around one third of the portfolios of investment companies each year. Although the SEC indicates it in its report the audit of 34% investment companies' portfolios, it is also necessary to note that under the SOX it is an obligation for the SEC to review the disclosures of all companies and investment company portfolios at least once every three years in order to uncover possible violations of the securities acts. Thus, the genuineness of this data is slightly questionable.

[1197] Yet there were few who suggested a formation of the European SEC, *see e.g.* Pan, *Harmonisation, supra* note 1109, Roberta S. Karmel, *The Case for a European Securities Commission,* 38 COLUM. J. TRANSNAT'L L. 9 (1999) [hereinafter "Karmel, *The Case for a ESC"*]; Gerard Hertig & Ruben Lee, *Four Predictions about the Future of EU Securities Regulation,* January 2003, *available online at:* < http://www.oecd.org/finance/financial-markets/18469147.pdf>.

[1198] *See* European Commission, Financial Services: Implementing the Framework For Financial Markets: Action Plan, (COM(99) 232) at 3; *See also* European Commission, Financial Services: Building a Framework for Action 5 (1999).

[1199] CESR was established in 2001 as a coordinating body among the national securities regulators, advising on the interpretation of the directives and regulations to the Member States. CESR also worked as an advisory group to the EU Commission, preparing the EU framework directives and ensure a consistent implementation by the Member States. The Committee of Wise Men in the Lamfalussy Report of 15 February 2001 also suggested CESR. In addition to the adoption of non-binding guidelines or standards, the CESR was developing also original means of action, relying on "soft law" techniques, including "peer review" process, a mediation proceeding when two competent authorities disagreed or failed to cooperate with CESR or one another. *See* Pierre-Marie Boury, *Does the European Union Need a Securities and Exchange Commission?,* 1 CAP. MARKETS L. J. 184, 188 (2006).

However, after the financial crisis in 2008, the approach has changed.[1200] The crisis has exposed many weaknesses of the Member State as well as the EU-level financial supervision and showed their deficiencies.[1201] The Larosière Report suggested a radical reformation of the supervisory regime through a European System of Financial Supervisions – a new EU supervisory framework.[1202] Part of this reform was the formation of the **European Securities and Market Authority** as of January 1, 2011 [hereinafter "ESMA"]. Thus, a new European body - ESMA was created taking over from CESR, which though only advisory, was yet an important temporary agent in the reform stage of the EU securities laws.[1203]

Contrary to the legal status of CESR, ESMA has obtained a legal personality, and thus could act independently.[1204] Although it is substantially financially subsidized by the Member States, the EU and through the fees,[1205] ESMA is proclaimed an **independent authority**[1206] seated in Paris. ESMA, similarly to the SEC, is comprised of more bodies, namely Board of Supervisors (in SEC:

[1200] In the wake of the financial crisis, the EU adopted legislative measures on substantive law; first was the Regulation (EC) No 1060/2009 on Credit Rating Agencies O.J. L 302/1, which was later replaced by Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on Credit Rating Agencies O.J. L146/1. After its proposal in 2009, in November 2010 the European Parliament and the Council of Ministers agreed on adopting a directive on the alternative investment fund managers, including private equity funds or hedge funds, *see* Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 O.J. L174/1.

[1201] *See* Article 1 ESMA Regulation.

[1202] *See* LAROSIÉRE REPORT, *supra* note 405; The European System of Financial Supervision (ESFS) included the supervisory authority for banking (European Banking Authority) and insurance and occupational pensions (European Insurance and Occupational Pensions Authority) and the European Securities and Market Authority (ESMA).

[1203] Commissioner Barnier called the formation of ESMA "a fundamental moment for the evolution of financial regulation in Europe." *See* Niamh Moloney, *I. Reform or Revolution? The Financial Crisis, EU Financial Markets Law, and the European Securities and Markets Authority,* 60 INT'L & COMP. L. Q. 521, 523 (2011) [hereinafter "Moloney, *Reform or Revolution?*"].

[1204] Article 5 ESMA Regulation.

[1205] Article 62 ESMA Regulation. The ESMA Budget for 2014 was of 33,203,823 €.

[1206] *See* Article 45 of the Preamble to ESMA Regulation states that "The Authority should serve as an independent advisory body to the European Parliament, the Council and the Commission in the area of its competence." Further, ESMA Regulation emphasizes in number of articles the independence of ESMA ant its bodies, *e.g.* Article 42, 46, 49 or 52 ESMA Regulation.

Commissioners), Chairperson, Management Board, Executive Director and Board of Appeal.[1207] Opposed to CESR, ESMA was provided with rule-making authority.[1208] Although ESMA may not adopt horizontal rules of general application, it may issue *sua sponte* opinions to EU institutions,[1209] propose "binding technical standards",[1210] and adopt guidances as well as recommendations.[1211] However, neither this rule-making power is absolute, as it is subject to Commission's oversight and European Parliament and Council's veto powers,[1212] which renders ESMA not an independent but dependent and scrutinized agency also on the rule making level.

5.2.1. Limited Enforcement Tools

Moving from the rule making power to enforcement power, many believed that the EU made a considerable step from CESR to ESMA by providing ESMA with powers that reach significantly farther than preparing guidelines or issuing individual decisions with binding effect.[1213] The European Parliament stated that ESMA would introduce a **fundamental shift** in how banks, stock markets (including investment

[1207] Article 6 ESMA Regulation, for more details of the composition, tasks or decision-making process, *see* Chapter III ESMA Regulation. *See* Niamh Moloney, *The European Securities and Markets Authority and Institutional Design for the EU Financial Market - A Tale of Two Competences: Part (1) Rule-Making,* 12 EUR. BUS. ORG. L. REV. 41, 61-62 (2011) [hereinafter "Moloney, *ESMA and Institutional Design (I),* Part I.*"*].

[1208] Article 1(2) ESMA Regulation enumerates those directives and regulations within which ESMA may act, plus those acts of the future which confer tasks on ESMA.

[1209] Article 34 ESMA Regulation.

[1210] Articles 10-15 ESMA Regulation. Under Article 290 TFEU, "regulatory technical standards" represent a delegation of quasi-rule making power. Further, under Article 291 TFEU, "implementing technical standards" will apply directly in the Member States as Regulations or Decisions. These articles in the TFEU reflect the necessity to enhance the harmonization of supervisory decision-making. *See also* Moloney, *ESMA and Institutional Design (I), supra* note 1207, at 66.

[1211] *E.g.* Article 16 ESMA Regulation.

[1212] On the limited rule-making powers of ESMA *see* Eddy Wymeersch, *Europe's New Financial Supervisory Bodies* 2-3 (Financial Law Institute, Working Paper Series, WP 2011-11).

[1213] *See* Dorothee Fischer-Appelt, *The European Securities and Markets Authority: The Beginnings of a Powerful European Securities Authority?*, 2001 L. & FIN. MARKET REV. 21, 22 (2001) or Pierre Schammo, *The European Securities and Markets Authority: Lifting the Veil on the Allocation of Powers*, 48, COMMON MARKET L. REV. 1879, 1879 (2011) (Professor Schammo claiming that the new supervisory authorities in the ESFS group were "allocated real powers to exercise their tasks") or Moloney, *Reform or Revolution, supra* note 1203, at 530.

companies and advisers) and insurance companies are policed.[1214] Yet ESMA has actually very limited enforcement tools against market participants and against the Member States.

Starting with the latter, according to the ESMA Regulation, competent authorities of Member States *"shall make every effort to comply with"* the guidelines and recommendations issued by ESMA.[1215] If a Member State does not obey the rules, ESMA may proceed with investigation of this breach and with the European Commission start a formal proceeding for breach of the EU law.[1216] In case the Member State's competent authority continues to disobey the EU law, ESMA may adopt individual decisions requiring market participants to act or cease to act.[1217] Further, ESMA can impose a decision on competent authorities and market participants in case of emergency situation.[1218] However, the determination whether there is an emergency situation is in the hands of the EU Council, in consultation with the Commission and ESRB, and where appropriate, the ESA.[1219] Lastly, ESMA may act as a mediator in case of disagreements between different competent authorities in relation to acts overseen by ESMA. In case the competent authorities fail to reach an agreement within specified time limit, ESMA may take a decision requiring them to take specific action or to refrain from action in order to settle the matter. This decision is binding upon the parties in order to ensure compliance with the EU law.[1220] Besides these powers, ESMA has additional anti-systemic risk tools, as prohibition of certain

[1214] *See* European Parliament, Press Release 20100921PR83190.
[1215] Article 16(3) ESMA Regulation.
[1216] Article 17(2) ESMA Regulation. The ESMA Regulation does not specify the term "Union law," whether under the Union law it also includes the ESMA's guidelines and recommendations. However, under the section 1 of the Article 17, the Union law does include the regulatory technical standards and implementing technical standards established in accordance with Article 10 to 15 of the ESMA Regulation.
[1217] Article 17(6) ESMA Regulation.
[1218] Article 18 ESMA Regulation.
[1219] Article 18(2) ESMA Regulation.
[1220] Article 19(3) ESMA Regulation.

products or services in case of emergency situation,[1221] identification and management of systemic risk and the development of resolution structures, promotion of a common supervisory curter or market assessment.[1222]

Concerning the market participants, including investment companies, in case of non-compliance of a national competent authority, ESMA may adopt an individual decision addressed to the market participant requiring the necessary action to comply with its obligation under the Union law, including the cessation of any practice.[1223] ESMA's tasks towards the investors are laid down in the Article 9 ESMA Regulation. However, under this article, ESMA has only analytical and advisory duties and **one right**, pursuant to which ESMA may temporarily prohibit or restrict certain financial activities that threaten the market, and thus the investors.[1224]

Leaving the general scope of enforcement tools of ESMA aside, the current standing of ESMA as an enforcement agency is questionable irrespective of the EU's intentions and proclamations.[1225] Even calling ESMA a supervisory authority is a disillusion. ESMA is currently in a similar standing, as was the SEC eighty years ago when created – a guiding authority explaining the securities laws for the others. However, EU should observe and learn from the change that the SEC had to undergo between 1934 and 1972 in order to become an effective enforcement agency for the EU common market. But unfortunately, due to political and policy differences among

[1221] Article 9(5) ESMA Regulation.
[1222] On further analysis of the powers of ESMA *see* Moloney, *Reform or Revolution, supra* note 1203, at 530-531; Dorothee Fischer-Appelt, *The European Securities and Markets Authority: The Beginnings of a Powerful European Securities Authority?*, L & FIN. MARKETS REV. 28-29 (2011); Niamh Moloney, *The European Securities and Markets Authority and Institutional Design for the EU Financial Market – A Tale of Two Competences: Part (2) Rules in Action,* 12 EUR. BUS. ORG. L. REV. 177, 198-200 (2011).
[1223] Article 17(6) and 19(4) ESMA Regulation.
[1224] Article 9(5) ESMA Regulation.
[1225] Article 2 of the Preamble of ESMA Regulation states, "before and during the financial crisis, the European Parliament has called for a move towards more integrated European supervision on order to ensure a true level playing field for all actors at the level of the Union to reflect the increasing integration of financial markets in the Union."

the Member States on the issue of sovereignty, the EU does not necessarily know where it is heading. On one hand, it calls for "more integrated European supervision," while the actions in form of directives leave the actual enforcement to Member States. On the other hand, when the EU deems necessary it is prepared to take over the entire supervision including investigation and sanctioning, as in the case of credit rating agencies,[1226] trade repositories[1227] or short selling.[1228]

More importantly, the EU has failed to justify its discrepancy in its approach: being able to take up the investigation and sanctioning of credit rating agencies or trade repositories while leaving for Member States' agencies fully supervise the investment companies and their advisers. This condition naturally causes Member States to raise doubts and questions, ultimately also affecting the markets and their participants' confidence. The standing of ESMA is categorically different from the SEC due to the principles of subsidiarity and proportionality embodied in TEU,[1229] which affect all of the EU bodies.[1230] When reviewing the legislative documents, there has been a proposal for an amendment of the European Parliament to provide

---

[1226] ESMA's powers over CRAs are found in the Regulation 1060/2009 on Credit Rating Agencies, O.J. L. 302/1 [hereinafter "CRA Regulation"]. This regulation was later amended by the Regulation No. 513/2011 (CRA-AR), O.J., L 145/30. ESMA is authorized to register EU-based and third-country CRAs. ESMA is further authorized to request information, investigate, and if necessary also to sanction. *See* Articles 23, 24, 36a and 36b of the CRA Regulation.

[1227] Trade repositories (TRs) centrally collect and maintain the records of derivatives. Under the Regulation (EU) 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs, and Trade Repositories O.J. L201/1 [hereinafter "EMIR"] ESMA was vested with powers to register, supervise, investigate and enforce through fines the TRs.

[1228] Under Article 28 Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on Short Selling and Certain Aspects of Credit Default Swaps O.J. L86/1 [Regulation on Short Selling], ESMA has direct powers of intervention with respect to short selling in exceptional circumstances, which will prevail over measures taken by national regulators.

[1229] *See* Article 5(3) TEU and Protocol No 2 on the Application of the Principles of Subsidiarity and Proportionality. The principle of subsidiarity is formulated in the following way: *"Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, by better achieved at the Union level."*

[1230] *See* Paul Craig, *Subsidiarity: A Political and Legal Analysis,* 50 J. COMMON MARKET STUD. 72 (2012), Professor Craig is analyzing the historical rationales and the contemporary difficulties with application of subsidiarity.

ESMA with authority to render an **injunction** in case of non-compliance by a financial market participant.[1231] However, according to the Opinion of the Committee on Legal Affairs, the possibility to adopt individual decisions relating to financial markets participants should be retained only to emergency situations, leaving this proposition neglected.[1232] Ultimately, the questions that the EU has to answer is whether it wants to operate a common market including the capital market and whether it intends to provide unified supervision and enforcement over this market.[1233] A powerful enforcement authority should foster an equity culture throughout the EU and develop and administer flexible regulation and not have diverse rules and applications in different Member States and ultimately different standards of the enforcement.[1234] Moreover, quicker and more flexible responses to activities and developments in the capital markets are required.[1235] The SEC has been successful throughout its existence not by virtue of its guiding powers but by its enforcement powers, which in historical perspective only grew and never declined. Therefore, the EU and its Member States have to decide whether the national interests are more essential than the functioning common market.[1236]

[1231] *See* Art 10, para. 3a of Report of the European Parliament, Committee on Economic and Monetary Affairs, On the Proposal for a Regulation of the European Parliament and of the Council Establishing a European Securities Markets Authority, 3 June 2010, Amendment 103, "Where the addressee of the decision refuses to comply with Union law or a specific decision taken by the Authority, the Authority may issue proceedings in the national courts, including application for interim relief."

[1232] *See* Position of the Rapporteur, Opinion of the Committee on Legal Affairs for the Committee on Economic and Monetary Affairs on the Proposal for a Regulation of the European Parliament and of the Council Establishing a European Securities and Markets Authority, 30 April, 2010.

[1233] If the EU is interested in economic integration, it becomes important to have a system that allocates resources efficiently, and does not favor one country's investment firms and investment industry over the others. *See* Donald C. Langevoort, *Structuring Securities Regulation in the European Union: Lessons from the U.S. Experience, in* INVESTOR PROTECTION IN EUROPE: CORPORATE LAW MAKING, THE MIFID & BEYOND, *supra* note 455, at 502.

[1234] *Id.*

[1235] *See* Karmel, *The Case for a ESC*, *supra* note 1197, at 12.

[1236] *See also* Avgouleas, *supra* note 486, at 84 (Professor Avgouleas also asserts the necessity to decide between the interests, given that the multi-jurisdictional marketplace need uniform rules and diligent monitoring in order to ensure efficient enforcement. Moreover, different national structures contribute to the erosion of supervisory standards and ultimately lead to loss of legitimacy in the eyes of the regulated). The issue arises, as the Member States themselves perceive ESMA as a new regulatory

5.2.2. Call for a Stronger ESMA & Its Limitations: Subsidiarity Principle & Meroni

Given the fact that the EU should consider broadening the enforcement powers of ESMA in order to ensure adequate investor protection, including monitoring of investment companies' cross-border activities, I analyze in this section whether such course of action is actually possible under the current EU law. The jurisprudence of the CJEU has been a major factor in facilitating the integration in many areas, including the common market.[1237] Therefore, within a realm of possibility, the question is whether the CJEU may become an intermediary between the current directives and regulations and those of future[1238] and assist with the formation of the common EU capital market and expand on the powers of ESMA, as it did in the recent case brought by the UK.[1239]

Among many legal and economic reasons that were already stated, there are few additional rationales why the EU should have a strong enforcement agency in the field of financial services. If the EU aims to form and operate a globally competitive market with investment and capital market activity moved beyond the national level, logically also the enforcement must be moved beyond the national level. The main task, as it was in the US after the Wall Street Crash of 1929, is to encourage investors and strengthen their confidence in all Member States to invest both within and beyond the national borders. In some Member States this kind of activity is completely new

body, which they believe has enforcement powers, and therefore should be able to protect the market. However, given the fact that ESMA has only very limited powers, the efficient enforcement does not take place and in case of future crisis, the Member States will raise the question why was ESMA unsuccessful in spite of its powers. I perceive it as a vicious circle where at the beginning there has to be a powerful political will in order to have an enforcement agency with extensive enforcement powers. Otherwise, there is only a shadow of it.

[1237] *See e.g.* Case 120/78 Rewe-Zentral AG v Bundesmonopolverwaktung für Branntwein [1979] 1 ECR 649; Case 76/90 Sager v Dennmeyer [1991] I ECR 4221 or Case 8/74, Procureur du Roi v Dasonville [1974] ECR 837.

[1238] As has been shown by the CRA or TRs.

[1239] *See* Case C-270/12 United Kingdom v. European Parliament & Council of the EU.

whereas in others the investors are already accustomed to it.[1240] Investors invest in investment companies, which may be set up in any Member State, and although the EU adopted a number of related directives, the Member States' transposition, concerning its quality and timing, continues to play a key role.[1241] This leads towards different laws in different Member States, which are additionally enforced through diverse mechanisms,[1242] leaving investors uncertain. In other words, if an investment company issues a prospectus with certain misstatement or omission, it can trigger different local liability regimes, principles and doctrines, depending not only on the Member State laws of investment companies, but possibly also on their conflict of laws provisions, given the cross-border character of the industry.[1243]

Furthermore, in face of home biases, without a common pan-European enforcement authority, the EU will never succeed with creating a common capital market.[1244] Investors' confidence and reliability on investment companies set up in

---

[1240] *See* EUROPEAN RETAIL INVESTMENT MARKET VALUE, 2014 REPORT, *available online at:* < http://www.jll.eu/emea/en-gb/Documents/Capital-markets/Retail-Report-2014.pdf>.

[1241] *See* Cherednychenko, *supra* note 486, at 409.

[1242] Professor Tajti described an interesting example of how inefficient national enforcement authorities can be, given their lack of experience with novel types of financial intermediaries. In his article, he analyzed the real estate investment cooperatives scandal of the early 2000' in Hungary. Even though the Hungarian Financial Supervisory Authority was entrusted with monitoring "financial organizations", it completely failed even to recognize that the cooperatives *de facto* represented financial institutions, which were selling securities and left them for a long time unsupervised. Ultimately, the cooperatives were organized as ponzi schemes and many people have lost their investments and life long savings. The unexperienced enforcement authority was unable to functionally approach what constituted a financial organization and a security. *See* Tajti, Tibor, *Central European Contribution to the American Debate on the Definition of "Securities" or Why Does the Definition of "Security" Matter?: the Fiasco of the Hungarian Real Estate Investment Cooperatives, Pyramiding, and Why Emerging Capital Markets Should Be Equipped to "Act" rather than "React,"* 15 TRANSNAT'L L. & CONTEP. PROBS. 109, 152-160 (2005).
For an overview of different supervisory and enforcement schemes *See* Eddy Wymeersch, *The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors*, 2 EUR. BUS. ORG. L. REV. 237, 290-294 (2007) [hereinafter "Wymeersch, *The Structure of Financial Supervision in Europe"*].

[1243] *See* Enriques & Gatti, *supra* note 369, at 76.

[1244] In the literature of home bias among investors, investors will consider those stocks, which are more present in the news, which is more likely to be closer to home. This could be also applied to the investment companies. *See e.g.* Joshua Coval & Tobias Moskowitz, *Home Bias at Home: Local Equity Preferences in Domestic Portfolios,* 54 J. FIN. 2045 (1999); Karen Lewis, *Trying to Explain Home Bias in Equities and Consumption,* 37 J. ECON. LIT. 571 (1999) or Gur Huberman, *Familiarity Breeds Investment*, 14 REV. FIN. STUD. 659 (2001).

different Member States will not be boosted unless they may anticipate a strong cross-border protection. Ultimately, insufficient enforcement in some Member States hinders efficient integration, notwithstanding the risk of enforcement protectionism.[1245] Moreover, ESMA by facilitating and pooling knowledge on the EU-level may also help reduce coordination problems among Member States.[1246] It is nowhere stated that ESMA has to be necessarily a centralized body.[1247] Hypothetically, it could have its seat in Paris with separate units in each and every Member State. EU does not have to necessarily copy the SEC concerning its structure, but rather its substantive enforcement powers.

Yet without sufficient political will, the legislative changes will not be adopted and enforcement will continue to be dispersed among the Member States. Thus, the possible option for greater ESMA enforcement may be through the CJEU as was the US Supreme Court for the SEC. However, there are several obstacles that the CJEU would have to pass. First obstacle is the **principle of subsidiarity**, which is perceived as a mechanism for alleviating disputes concerning the division of competences between the EU and the Member States.[1248] Given that formation of the internal market is a shared competence between the EU and Member States,[1249] the principle of subsidiarity applies. In simple terms, the question under the subsidiarity principle is

[1245] *See* Donald C. Langevoort, *Structuring Securities Regulation in the European Union: Lessons from the U.S. Experience* 502 *in* INVESTOR PROTECTION IN EUROPE: CORPORATE LAW MAKING, THE MIFID & BEYOND, *supra* note 455, at 502.
[1246] *See* Paul Magnette, *The Politics of Regulation in the European Union*, *in* REGULATION THROUGH AGENCIES IN THE EU. A NEW PARADIGM OF EUROPEAN GOVERNANCE 7 (Damien Garadin, *et al. eds.*, 2005).
[1247] As a note, the Larosière Report supported a decentralized model for EU enforcement mechanism.
[1248] Before the Lisbon Treaty, the TEC did not directly deal with the division of competences between the EC and Member States, which caused number of clashes between the two parties, where Member States feared of the federation and excessive centralization. *See* Craig, *supra* note 1230, at 73. Proportionality is also incorporated by implication in the principle of subsidiarity.
[1249] *See* Article 4 TFEU.

whether an action must take place on the EU-level or not.[1250] It is the CJEU that judges the subsidiarity in terms of comparative efficiency and proportionality.[1251] Although this principle belongs to the core ones of the entire EU law, the reality of different areas as the securities laws including the laws of investment companies, require more specificity than generality in its rules.[1252]

The second obstacle is the still "good" case law of the CJEU. The old *Meroni* case from 1956 has *inter alia* established that the European Commission may delegate powers to other EU bodies **only** if it does not entail any conferral of discretion amounting to actual policy.[1253] The CJEU stated that the delegation of powers "can only relate to clearly defined executive powers."[1254] Thus, if the delegated entity enjoys a wide margin of discretionary power entailing the "execution of actual economic policy," then the equilibrium of powers will be broken, as under the Treaties no legislative or executive powers is granted to bodies other than the EU institutions.[1255] However, if the entire ESFS is taken into account, where number of new institutions have been formed, and not only those enumerated in the Treaties,[1256]

[1250] *See* TAKIS TRIDIMAS, THE GENERAL PRINCIPLES OF EU LAW 176 (Oxford University Press, 2[d] ed. 2006).

[1251] *See* Derrick F. Wyatt, *Subsidiarity and Judicial Review in* JUDICIAL REVIEW IN EUROPEAN UNION LAW, LIBER AMICORUM IN HONOUR OF LORD SLYNN 518 (David O'Keefe & Antonio Bavasso, eds., 2000). *See also* Gráinne de Búrca, *The Principle of Subsidiarity and the Court of Justice as an Institutional Actor,* 36 J. COMMON MARKET STUD. 217, 222-224 (1998).

[1252] Under the principle of subsidiarity, certain aspects of the regulatory regime should be left for the Member States to decide upon. However, these general rules in areas as telecommunications, energy, agriculture or financial services regulation have led to regulatory failure, "with the consequence that the rules have had to be revised and the level of EU control ratcheted up." *See* Craig, *supra* note 1230, at 75.

[1253] *See* C-9/56 Meroni v. High Authority [1958] ECR 133 [hereinafter "Meroni"].

[1254] *Id.*

[1255] *See* Takis Tridimas, *Financial Supervision and Agency Power: Reflections on ESMA, in* FROM SINGLE MARKET TO ECONOMIC UNION, ESSAYS IN MEMORY OF JOHN A. USHER 61 (Niamh Nic Shuibne & Laurence W. Gormley, eds., 2012).

[1256] *See* Merijn Chamon, *EU Agencies: Does the Meroni Doctrine Make Sense?,* 17 MAASTRICHT J. OF EUR. & COMP. L. 281, 293 (2010); and Deirdre Curtin & Renaud Dehousse, *European Union Agencies: Tipping the Balance? in* THE AGENCY PHENOMENON IN THE EUROPEAN UNION 198 *et seq.* (Madalina Busuioc, *et al. eds.,* 2012).

the *Meroni* has been thus broken, and should not be considered a "good law" anymore.[1257]

Nevertheless, the *Meroni* case continues to be a part of the analysis of the granted powers to the EU bodies and authorities even today. In 2012 the UK challenged the adoption of Article 28 of the Regulation of Short Selling before the CJEU seeking its annulment.[1258] UK with London having the largest capital market in Europe does not believe in a formation of an additional supervisory body.[1259] Thus, UK contended that ESMA was granted a large margin of discretion against the EU principles relating to the delegation of powers as rendered in *Meroni.*[1260] Moreover, the UK contested Article 114 of TFEU as the legal basis for the adoption of the Regulation of Short Selling itself.[1261] Nevertheless, the CJEU dismissed the UK's challenge and upheld the authorization of ESMA to adopt individual decisions directed at natural or legal persons for harmonization purposes.[1262] Instead of overruling *Meroni* case, the CJEU considered the *Meroni* principle to be satisfied in case of ESMA's exercise of Article 28 as it was restrained by specific conditions and

[1257] For a detailed analysis *see* Carmine Di Noia & Matteo Gargantini, *Unleashing the European Securities and Markets Authority: Governance and Accountability after the ECJ Decision on the Short Selling Regulation (Case C-270/12),* 15 EUR. BUS. ORG. L. REV. 1, 31-35 (2014).

[1258] *See* Case C-270/12 United Kingdom v. European Parliament & Council of the EU.

[1259] *See* Andrew Whittaker, *A European Law for Regulated Markets? Some Personal Views, in* EUROPEAN SECURITIES MARKETS: THE INVESTMENT SERVICES DIRECTIVE AND BEYOND 270-271 (Guido Ferrarini ed., 1998).

[1260] *See* Meroni.

[1261] Article 114 TFEU is the key provision for adopting legislative measures that enable legislative harmonization for the establishment and functioning of the internal market. UK argued that under Article 114 TFEU only harmonizing measures may be adopted not individually measures directed to natural or legal persons. *See* paras, 88-91 of Case C-270/12 United Kingdom v. European Parliament & Council of the EU. Advocate General Jääskinen in his carefully drafted opinion supported the UK's application with respect to the Article 114 TFEU submission.

[1262] *See* Para. 97 of Case C-270/12 United Kingdom v. European Parliament & Council of the EU.

criteria.[1263] The CJEU stated that Articles 263 and 277 TFEU expressly permit EU bodies, offices and agencies to adopt acts of general application.[1264]

Setting aside the short-selling background of this decision, what are the possible effects of this CJEU ruling? Some believe that this decision was about the future of newly established ESFS bodies in order to potentially **stretch their powers** if necessary under the notion of "market integration".[1265] Although some scholars have not been convinced by this decision and fear further empowerment of the EU bodies,[1266] they continue to focus on the un-constitutionality of such development rather than on the economic necessity. In connection with investor protection, based on this decision and the general public outcry against it, I doubt that CJEU alone will be in a position to stretch the "market integration" argument to the extent that ESMA would gain SEC-like enforcement powers over individual market participants, even though it is ESMA's task to foster investor protection.[1267]

The CJEU has rejected the subsidiarity argument before against the exercise of the European Commission's powers to enforce competition law.[1268] Why should it thus accept the subsidiarity argument if the Commission through ESMA would enforce the capital market law? As long as the Commission and Parliament observe

[1263] The CJEU stated that ESMA's powers were circumscribed both by the requirement to consult with the ESRB as to the proposed measure and by the temporary nature of the adopted measure. *See* Paras 45 & 50 of Case C-270/12 United Kingdom v. European Parliament & Council of the EU.

[1264] *See* Para. 65 of Case C-270/12 United Kingdom v. European Parliament & Council of the EU. For in depth analysis of the case, *see* Elizabeth Howell, *The European Court of Justice: Selling Us Short?,* 11 EUR. COMP. & FIN. L. REV. 454 (2014) or Di Noia & Gargantini, *supra* note 1257.

[1265] *See* Eilís Ferran, *European Banking Union: Imperfect, but It can Work* (University of Cambridge Faculty of Law Research Paper No. 30/2014) or Elizabeth Howell, *supra* note 1264, at 474.

[1266] *See e.g.* Stephen Weatherill, *The Limits of Legislative Harmonization Ten Years after Tobacco Advertising: How the Court's Case Law Has Become a "Drafting Guide",* 12 GERMAN L.J. 827, 843 (2011).

[1267] See Preamble 66 and Article 8 of ESMA Regulation.

[1268] *See* T-65/98 Van den Bergh Foods v. Commission, judgment of 23 October 2003, paras 197-199, where the CJEU held that the existence of parallel proceedings before national courts did not prevent the EU Commission from initiating proceedings under the Article 81 and 82 given that fact that the common market was potentially affected.

the Protocol on the Application of the Principles of Subsidiarity and Proportionality and substantiate the qualitative and quantitative indicators for a Pan-European enforcement of capital market law, ESMA stands a chance in front of the CJEU.[1269] Yet this requires also the political will.

5.3. The Financial Conduct Authority: More Active Supervisory Engagement

Besides the ESMA that is perceived as more advisory than enforcement agency, each Member State has its own enforcement body. In the UK, with the adoption of the Financial Services and Market Act 2000 [hereinafter "FSMA 2000"], a complex system of financial regulation has been established. The FSMA 2000 introduced a replacing regulatory framework for the previous Insurance Companies Act 1982, Financial Services Act 1986 and Banking Act 1987, providing a **single unified regime** for investment, banking and insurance activities.[1270] Accordingly, under the FSMA 2000 a single enforcement agency was established - the **Financial Services Authority** [hereinafter "FSA"],[1271] which replaced all the former sectorial agencies. The FSA was an integrated enforcement authority on the financial market,[1272] praised

[1269] *See* para. 5 of the Protocol on the Application of the Principles of Subsidiarity and Proportionality, which states that "*Draft legislative acts shall be justified with regard to the principles of subsidiarity and proportionality. Any draft legislative act should contain a detailed statement making it possible to appraise compliance with the principles of subsidiarity and proportionality. This statement should contain some assessment of the proposal's financial impact and, in the case of a directive, of its implications for the rules to be put in place by Member States, including, where necessary, the regional legislation. The reasons for concluding that an objective of the Union can be better achieved at the level of the Union shall be substantiated by qualitative and, wherever possible, quantitative indicators. Draft legislative acts shall take account of the need for any burden, whether financial or administrative, falling upon the Union, national governments, regional or local authorities, economic operators and citizens, to be minimized and commensurate with the objective to be achieved.*"

[1270] *See* BANKING LITIGATION, *supra* note 62, at 409.

[1271] In 1997 the Chancellor of the Exchequer announced reforms to the UK financial services regulation. Afterwards the chairman of the Securities and Investments Board, Sir Andrew Large, took the reform work forward and produced a report that was presented to the Chancellor on July 27,1997. The draft regulation was produced in July 1998 and the Financial Services and Markets Bill were formally introduced to the House of Commons on June 17, 1998. Within the Committee stage, 2,750 amendments were considered with 1,500 being adopted over 200 hours of Parliamentary debate. The FSMA 2000 was given Royal Assents on June 14, 2000. *See* BLAIR & WALKER, *supra* note 88, at 5-6.

[1272] The oversight over the entire financial system in the UK was carried out by three agencies, namely HM Treasury, the Bank of England and the FSA.

also internationally.[1273] Following the UK, countries as Japan, South Korea or other EU Member States embraced this single supervisory model.[1274] According to some commentators at the time, the full integration has been associated with greater consistency and quality of supervision.[1275]

Yet in the wake of the financial crisis, after few days of the May 2010 election, the new Conservative-Liberal Democrat Coalition Government announced its plan to engage in a fundamental reform of the UK financial enforcement framework,[1276] starting with the FSA. The FSA was supposed to be abolished and new institutions under the auspices of the Bank of England were supposed to be put in charge of supervision. The FSA's regulatory functions were to be taken over by four institutions: (1) the Financial Conduct Authority (FSA), (2) the Prudential Regulatory Authority [hereinafter "PRA"], (3) the Bank of England and (4) the Financial Policy Committee [hereinafter "FPC"]. Although I am not elaborating here on the rationale behind the abandonment of the integrated supervisory authority system in the UK, it is important to mention that some commentators emphasized the political motivation

[1273] *See* Howell E. Jackson, *A Pragmatic Approach to the Phased Consolidation of Financial Regulation in the United States* (Harvard Public Law Working Paper No. 09/19, 2009).

[1274] Among the EU Member States it were countries as: Austria, Belgium, Germany, Czech Republic, Latvia and other, *see* Wymeersch, *The Structure of Financial Supervision in Europe*, *supra* note 1242, 297-300; *See also* Martin Schüler, *Integrated Financial Supervision in Germany (*ZEW – Centre for European Economic Research, Discussion Paper No. 04-035). On Japan and South Korea *see* Hong-Bum Kim & Chung H. Lee, *Financial Reform, Institutional Interdependency, and Supervisory Failure in Post Crisis Korea, available online at:* < http://www1.doshisha.ac.jp/~ccas/eng/Eseminars/e2005-07.pdf >/ *last visited* Jan. 25, 2015.

[1275] *See* Martin Čihák & Richard Podpiera, *Integrated Financial Supervision: Which Model?,* 19 N. AM. J. ECON. & FIN. 135 (2008); *see also* BLAIR & WALKER, *supra* note 88, at 53.

[1276] For a greater detail, *see* HM Treasury's consultation paper on the UK's proposed regulatory structure, HM TREASURY, A NEW APPROACH TO FINANCIAL REGULATION: BUILDING A STRONGER SYSTEM (2011) *available online at:* < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81411/consult_newfinancial_regulation170211.pdf >/ *last visited* Jan. 26, 2015, [hereinafter "HM TREASURY REPORT 2011"]. *See also* Brooke Masters, *Hoban Keen to Improve Competition,* FIN. TIMES, Feb. 16, 2011.

behind the re-appraisal of the institutional structure of the UK supervision instead of the economic or regulatory justifications.[1277]

Even though the origin of the 2008 financial crisis was in the US, the SEC despite a strong criticism was able to defend its position,[1278] while in the UK a restructuring took place although such steps were originally not advised.[1279] Having in mind my referral to additional political stakes in the second chapter of this thesis when a regulatory refurbishment takes place, the dissolution of FSA ultimately shows the importance of the governmental capital even in regulatory change of enforcement agency. The Shadow Chancellor George Osborne stated, *"We will abolish the Financial Services Authority, and will create instead a **strong new Consumer Protection Agency**. This will take responsibilities to protect the consumer that are currently and confusingly divided between the FSA and Office of Fair Trading, and place them in a single powerful body able to stand up for consumers and ensure they are treated fairly."*[1280] Support for retention of the FSA existed even among the members of the Bank of England. In February 2009, Sir John Gieve, the departing

---

[1277] *See* Eilís Ferran, *The Break-up of the Financial Services Authority*, 31 OXFORD J. LEGAL STUD. 455, 458 (2011) [hereinafter "Ferran, *The Break-up of the FSA*"] ("…the new Government to seek to gain political capital by taking bold action that responded to the public mood.") or Eric J. Pan, *Four Challenges to Financial Regulatory Reform*, 55 VILL. L. REV. 743, 754 (2009) (Professor Pan stated that in the UK, the FSA was closely associated with the Labour Government, having been one of the first legislative achievements of the Labour Government after its assumption of power in 1997).
[1278] *Id.* at 755.
[1279] Although the new Government at the time based its reformatting actions on the Lord Turner's Review, the Report itself did not recommend complete abandonment of the existing model, only its reformation; *see* FSA, THE TURNER REVIEW: A REGULATORY RESPONSE TO THE GLOBAL BANKING CRISIS 86-100 (2000), *available online at:* < http://www.fsa.gov.uk/pubs/other/turner_review.pdf>/ *last visited* Jan. 26, 2015.
[1280] WHITE PAPER, FROM CRISIS TO CONFIDENCE – A PLAN FOR SOUND BANKING. However, the FSA has also a conducted a number of high profile initiatives aimed at ensuring a better protection for investors, in particular the Treating Customers Fairly project. FSA secured significant amounts of redress for investors all in all of £1bn, including £102.7 million in case of the Standard Life. *See* FSA Final Notice, Jan. 20, 2010.

Deputy Governor for Financial Stability, stated that he was not convinced that there was a clearly superior arrangement to the existing one.[1281]

Ultimately, all institutional models for financial market supervision have their pros and cons and it is up to the regulator to consider them when framing its own system.[1282] Nevertheless, since April 1, 2013 the UK began to apply a **"twin peaks"** model, [1283] where there are two agencies, one responsible for the **prudential** supervision of the sector – the PRA, an independent subsidiary of the Bank of England,[1284] and a separate one responsible for the **conduct of business** supervision - the Financial Conduct Authority [hereinafter "FCA"]. Given the focus of this thesis on investor protection in connection with the investment companies, in the subsequent parts I analyze the operational objectives, powers and enforcement practices of the FCA, which carries out prudential regulation and supervision over investment companies. The FCA is *de facto* a successor of the FSA and therefore in the following text I refer also to the materials of the FSA.[1285]

5.3.1. FSA v. FCA Supervisory Approaches: Actions instead of Words

[1281] *See* Sir John Gieve, *Seven Lessons from the Last Three Years* (London School of Economics, Feb. 19 2009), *available online at:* < http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2009/speech377.pdf >/ *last visited* Jan. 27, 2015.

[1282] *See e.g.* Marcus Killick, *"Twin Peaks" – A New Series or a New Chimera? An Analysis of the Proposed New Regulatory Structure in the UK,* 2012 COMPANY LAW 366 (2012); David T. Llewellyn, *Institutional Structure of Financial Regulation and Supervision: The Basic Issues,* paper presented to a World Bank seminar (June 2006), *available online at:* <http://siteresources.worldbank.org/INTTOPCONF6/Resources/2057292-1162909660809/F2FlemmingLlewellyn.pdf >/ *last visited* Jan. 27, 2015.

[1283] The first jurisdiction to adopt the twin peaks model was Australia in 1998.

[1284] The Bank of England is actually in the center of the regulatory system being responsible for both monetary policy and financial stability. *See* MACNEIL, *supra* note 527, at 74-75 and HM TREASURY REPORT 2011, *supra* note 1276, at 5.

[1285] *See also* Ferran, *The Break-up of the FSA*, *supra* note 1277, at 471.

Under the UK FSA 2012, the strategic objective of the FCA was to ensure that the relevant markets function well.[1286] Breaking the strategic objective down, the UK FSA 2012 defines the FCA's **operation objectives** as (1) consumer protection objective, (2) the integrity objective and (3) the competition objective.[1287] The UK FSA 2012 provides a specific interpretation as what one should understand under the notions of "consumer protection objective", "integrity objective" and "competition objective."[1288] When the twin peaks system was first presented, the HM Treasury Report 2011 set out in extensive detail how the FCA was expected to engage in regulation and supervision, calling mainly for more **interventionist approach**:

> *"The FCA will have a lower risk appetite for issues affecting whole sector, sub-sector or type of product – it will be less prepared to see detriment actually occur, instead seeking to act in a more preventative manner. This will entail for example, proactively intervening earlier in product's life cycle, with greater scrutiny of firms' product design and product governance complementing the traditional focus on sales and marketing, and the disclosure of information."*[1289]

However, in order to achieve the above stated regulatory goals, the FCA should be equipped with appropriate powers. Albeit those FCA's powers are to a great extent identical with the former FSA, the **FCA became more active** on the market than was the FSA.[1290] The FSA was often criticized for being less effective

[1286] UK FSA 2012, Part 1A, c. 1, §1B, sch. 2. Meaning of "relevant markets in strategic objective includes (1) the financial markets; (2) the markets for regulated financial services and (3) the markets for services that are provided by persons other than authorized persons in carrying on regulated activities but are provided without contravening the general prohibition; FSA 2012, Part 1A, c. 1, §1F.
[1287] UK FSA 2012, Part 1A, c. 1, §1B, sch. 3.
[1288] UK FSA 2012, Part 1A, c. 1, §§ 1C-E.
[1289] *See* HM TREASURY REPORT 2011, *supra* note 1276, at 69.
[1290] Since its establishment, the FCA authorized 1,046 firms, cancelled the permission of 28 firms and a further 237 firms took remedial steps to address breaches. The FCA all in all supervises almost

than the SEC in taking enforcement actions, including the number of initiated cases and the financial penalties that it imposed.[1291] In case of the FCA, those numbers for the time being differ. Since its formation, in the light of the information brought by the FCA itself or Financial Times, the FCA has been much more active than its predecessor. Within one year of FCA's establishment, the number of enforcement cases tripled and the amount of levied penalties rose more than six times.[1292]

On the other hand, some have already raised their suspicion as to the "accomplished" performance of the FCA, as challenging its decisions became pointless. Namely, a party that is aggrieved by the determination of the FCA may refer the matter to the Financial Services and Market Tribunal, which acts as an appellate body of the FCA's decisions.[1293] Although the Financial Services and Market Tribunal was never too favorable towards appellants as since 2003 it upheld only 13 out of 81 initiated appeals, after the establishment of FCA, the tribunal did not uphold any challenges by individuals against the FCA.[1294] It is true that an enforcement authority has to diligently supervise the market, but if none of its decision is overruled, one may question the balance of fairness of the entire process, which might also have a major negative effect on the market.

50,000 legal entities in the UK. The FCA imposed in financial penalties over £425m *See* FINANCIAL CONDUCT AUTHORITY, ANNUAL REPORT 2013/14 8 - 15 (10 July 2014) [hereinafter "FCA ANNUAL REPORT 13/14"]. *See also* David Kenmir & David Hislop, *FCA Conduct Regulation,* 2013 COMPLIANCE OFFICER BULL. 1, 2 (2013).

[1291] For the relevant statistics within the years 2002-2007, *see* John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PENN L. REV. 229, 262-283 (2007).

[1292] In 2011/2012 the FSA closed and investigated around 160 cases while in 2013/2014, the FCA closed and investigated more than 500 cases. Concerning the penalties, in 2011/2012 the FSA levied around £76.4 million, while in 2013/2014 the FCA collected £425 million; *see* FCA ANNUAL REPORT 13/14, *supra* note 1290, at 21.

[1293] The right to appeal against a decision of a supervisory authority stems from number of provisions under FSMA 2000; *see e.g.* FSMA 2000, Part IV c. 55; Part VI, c. 87O, 89N or Part VIII, c. 131H.

[1294] *See* Sam Fleming, *Challenging UK Watchdog's Decisions 'Fruitless', Lawyers Warn,* FIN. TIMES, May 13, 2014.

Nevertheless, given the short existence of the FCA, it is hard to genuinely evaluate its enforcement efficiency.

Concerning the approach to supervision and enforcement, the FCA has been applying a **three pillar approach**, comprising of: (1) Firm Systematic Framework of regular supervisory visits to those firms deemed to present a higher risk to the FCA's operational objectives; (2) event-driven work focused on specific emerging problems with products, rapidly addressing customer redress or remedial work; and (3) cross firm work, or thematic reviews that access issues which cut across number of sectors, where the FCA has identified significant risks before those risks become apparent.[1295] The main difference in the supervisory approaches between the FSA and FCA is that the FCA emphasizes the necessity to identify the future risk. The FSA was perceived to be more reactive than proactive, whereas the FCA tries to anticipate problems in advance and take necessary steps to prevent the predictable risks.[1296] Ultimately it is only to be seen whether the FCA will be in a position to foresee the next financial crisis and act beforehand as it proclaims.

5.3.2. Rules and Principles: Statutory Powers & Handbook as a Tool

In order for the FCA to continue its active supervision and enforcement on the UK market, the FCA has to be provided with a wide range of enforcement powers. Similarly to the SEC, the FCA (as well as the FSA) is an administrative body, which can initiate either (1) administrative or (2) judicial proceedings. The regulator when drafting the enforcement proceedings for FSA explained that *"We have sought to*

[1295] FINANCIAL CONDUCT AUTHORITY, THE FCA'S APPROACH TO ADVANCING ITS OBJECTIVES 18 (July 2013).
[1296] *See* David Kenmir & David Hislop, *supra* note 1290, at 2; *see also* HM TREASURY REPORT 2011, *supra* note 1276, at 30.

develop a decision-making procedure that is effective, fair and does not duplicate the function of the Financial Services and Markets Tribunal. Therefore, this procedure is not intended to provide judicial hearing of the case, but rather to enable the principal issues to be identified, and, if possible, resolved, before a Tribunal hearing."[1297]

The FCA has first of all a range of **disciplinary measures** at its disposal, namely (1) public censure,[1298] (2) financial penalty,[1299] (3) variation or cancellation of permission,[1300] (4) prohibition order[1301] or (5) disciplinary actions against approved persons.[1302] Secondly, the FCA can initiate a **criminal proceeding** as the FSMA 2000 lays down more than thirty criminal offences ranging from misleading the market to failing submitting certain notices to the FCA.[1303] In England and Wales, the prosecution for criminal offences under FSMA 2000 may be initiated by the FCA, by the Secretary of State (Department of Business, Innovation and Skills) or by or with the consent of the Director of Public Prosecutions. In Scotland, only the Crown Office brings the offences under FSMA 2000.[1304] In addition, the FCA is also empowered to bring claims under other statutes.[1305] Pursuant to *R v. Rollins*, the FCA (formerly FSA) has the power of a private individual to bring any prosecution, which fell within its memorandum and articles of association and was not precluded by the terms of its

[1297] *See* FINANCIAL SERVICES AUTHORITY, CONSULTATION PAPER 65: ENFORCEMENT MANUAL (2000) *in* Tony Woodcock, *How the FCA Makes Enforcement Decision*, 2014 COMPLIANCE OFFICER BULL. 1, 2 (2014).
[1298] FSMA 2000, Part XIV, c. 205.
[1299] FSMA 2000, Part XIV, c. 206.
[1300] *Id.*
[1301] FSMA 2000, Part V, c. 56.
[1302] FSMA 2000, Part V, c. 66.
[1303] They include among many criminal offences as: (a) breach of the general prohibition against carrying on regulated activity without authorization, *see* FSMA 2000, Part II, c. 23; (b) use misleading statements and practices to include another person to enter into an investment agreement, *see* FSMA 2000, Part XXVII, c. 397 or (3) misleading the Authority, *see* FSMA 2000, Part XXVII, c. 398.
[1304] *See* MACNEIL, *supra* note 527, at 118.
[1305] There are various offences under the Industrial and Provident Societies Act 1965, the Industrial and Provident Societies Act 1965, the Friendly and Industrial and Provident Act 1968, the Credit Unions Act 1971, the Building Societies Act 1986 and the Friendly Societies Act 1974 and 1992.

institutionalizing statute.[1306] The FSMA 2000 established personal criminal liability when the offence is committed by an organization with the consent or connivance of, or as a result of the negligence of, that individual.[1307] An individual prosecuted for criminal offence can be either an officer of a company, partner in partnership or an officer or member of the governing body of an unincorporated association.[1308] Thirdly, FSMA 2000 opens up the possibility of an action in damages at the suit of a private person.[1309] Yet this avenue has not been used very often as the investors rather turn to the **Financial Service Ombudsman**.[1310]

Interestingly, considering the internal FCA enforcement structure, the enforcement decisions have to be made separately from the FCA's investigators by the Regulatory Decisions Committee [hereinafter "RDC"]. The FSMA 2000 requires the investigation and recommendation functions to be carried out separately from decisions taking process.[1311] The members of the RDC represent the public interest and are appointed to apply their expertise and experience to decide whether the FCA should use particular supervisory and enforcement power or not.[1312] The RDC becomes involved once the FCA has concluded that it is appropriate to use particular powers against a legal or natural person.[1313]

[1306] *See* R v Rollins [2010] UKSC 39.
[1307] *See* MACNEIL, *supra* note 527, at 119.
[1308] FSMA 2000, Part XXVI c. 400.
[1309] FSMA 2000, Part X, c. 150.
[1310] *See* section 5.3.3.
[1311] FSMA 2000, Part XXVI c. 395.
[1312] For more on RDC and how it works, *see* Woodcock, *supra* note 1297, at 5-10.
[1313] *Available online at:* < http://www.fca.org.uk/about/structure/committees#RegulatoryDecisionsCommittee >/ *last visited* Feb. 7, 2015.

The main distinction of the UK system vis-à-vis the US is the UK's **principle-based approach** towards the financial services regulation.[1314] Although FSMA 2000 is a broad and lengthy statute, it is incomparable to the length and detail of all securities acts in the US. However, the story of the regulation is not concluded with the FSMA 2000; where the FSMA 2000 ends, the **FCA Handbook** begins.[1315] The FSMA applies extensive number of enabling provisions on the basis of which the FCA (formerly FSA) lays down secondary legislation.[1316] Next to each provision in the Handbook there is a letter indicating the character of that specific provision. It can either be binding or non-binding or even if some are binding, the letter displays whether the breach can be sanctioned only disciplinary or also criminally.[1317]

Since 2000, when the new regulatory framework was introduced, the UK started to apply a principle-based financial services regulation.[1318] Yet what does it mean if the regulator applies the principle-based approach? As Kaplow explained, where a rule would say, "Do not drive faster than 55 mph," a principle would say, "Do not

---

[1314] Before the financial crisis in 2008, the predecessor of the FCA-FSA tried to impose the lowest burden and cost on the financial industry and was commonly referred to as the "light touch" approach. However, since then both the Bank of England and the FCA have increased the burden and oversight.

[1315] All *available online at*: < http://fshandbook.info/FS/html/FCA>/ *last visited* Feb. 7, 2015. The FSA used to divide the Handbook into seven blocks, however nowadays the FCA divides the Handbook into ten blocks: (1) Glossary (defining the main terms used in the Handbook); (2) High Level Standards (containing the fundamental obligations of all firms under the regulatory system); (3) Prudential Standards (containing standards for regulatory capital and liquidity for banks, insurers and investment firms); (4) Business Standards (laying down the detailed requirements relating to firms' day-to-day business); (5) Regulatory Processes (consists of the manuals describing the operation of the FCA's and PRA's authorization, supervisory and disciplinary functions); (6) Redress (containing the process for handling complaints and compensation); (7) Specialist Sourcebook (laying down the requirements applying to individual business sector; (8) Listing, Prospectus and Disclosure (contains the UKLA Listing Rules, the rules for public offers and prospectuses, and the disclosure obligations for issuers whose securities are listed); (9) Handbook Guides (industry specified handbooks, providing guidelines for energy market participants or oil market participants); and (10) Regulatory Guides (providing guides to regulatory topics, *e.g.* enforcement guide, financial crime or unfair contract terms regulatory guide).

[1316] On the development of the Handbook *see* Andromachi Georgosouli, *The FSA Regulatory Policy of Rule-Use: A Move towards More Effective Regulation?* 12-23 (University of London – Centre for Commercial Law Studies, Working Paper 2006).

[1317] "R" indicates general rules made by FCA under sections 137A to 137F, 137H, 137O to 137R an 137T of the FSMA 2000. Other letters are E, G, D, P, C. For more detail, *see* FCA, READER'S GUIDE: AN INTRODUCTION TO THE HANDBOOK 23-25 (2013).

[1318] *See* Jonathan Edwards & Simone Wolfe, *Compliance: A Review*, 131 FIN. REG. & COMPLIANCE 48, 49-50 (2005).

drive faster than is reasonable and prudent in all circumstances."[1319] Naturally, in connection with the principle-based approach, there is a question of uncertainty and its respective costs for the market and its participants. Nevertheless, there is probably a great deal of overlap between the rules and principles in legal systems and although it is often claimed that regulatory systems are either principle-based or rule-based, it is more accurate to say that all systems use both, but to a different extent.[1320] Depending on how well the FCA will continue in its protection of the UK market in the future, it might be advisable to consider the adoption of a general regulation, which is subsequently narrowed down by rules, guidance and prohibitions adopted by the enforcement agency.

Even before the 2008 financial crisis, the UK's principle-based securities regulation was praised[1321] as many saw a great competitive edge in its flexibility.[1322] However, the flexible system was not in a position to speedily react and protect itself when the crisis came. Even the former FSA Chief Executive called for some re-evaluation of the principle-based approached, when he remarked that, *"[a] principles-based approach does not work with individuals who have no principles."*[1323] But the same logic could be applied also for the individuals who have no respect for law or rules. Therefore, the question is not whether the regulator proclaims its regulatory framework to be principle-based or rule-based, but to what extent does it enforce

[1319] *See* Louis Kaplow, *Rules versus Standards: An Economic Analysis,* 42 DUKE L.J. 557, 559 – 560 (1992).
[1320] *See* Cristie L. Ford, *New Governance, Compliance, and Principles-Based Securities Regulation,* 45 AM. BUS. L.J. 1, 9 (2008) or P.S. Atiyah, *From Principles to Pragmatism in the Function of the Judicial Process and the Law,* 65 IOWA L. REV. 1249, 1272 (1980).
[1321] Hank Paulson, US Treasury Secretary suggested that US should move towards a more flexible UK-style approach regulating capital markets; *see* Jeremy Grant & Krishna Guha, *Paulson Seeks British-Style Flexibility in Capital Markets,* FIN. TIMES, Nov. 21, 2006 at 1.
[1322] *See e.g.* Jenny Anderson, *U.S. Financial Sector Is Losing Its Edge, Report Says,* N. Y. TIMES, Jan. 22, 2007, at 3.
[1323] Hector Sants, *Delivering Intensive Supervision and Credible Deterrence,* speech delivered at the Reuters Newsmaker Event, March 12, 2009.

those principles and rules. According to the reports of the FCA, one could come to a conclusion that the FCA has started to enforce its principles, codes and guidelines more zealously. Moreover, even after the statement of the FSA Chief Executive, there is only a little evidence to date of any substantial change in formal position of principles within the FCA Handbook. The FCA has only expanded on the scope of the Handbook in order to provide the parties with advice through all the processes. Also the SEC has realized the added value of the guidelines, but not for the investment companies or the advisers, but only for the investors.[1324] Undoubtedly, guidelines similar to those of FCA Handbook would be greatly appreciated among all market participants, including the investment companies and advisers.

5.3.3. Financial Services Ombudsman: Looking Out for Retail Investors

Another institution that was introduced in the UK with the FSMA 2000 was the **Financial Services Ombudsman** [hereinafter "FSO"] that integrated eight different Ombudsmen schemes that were in place before and thus simplified the ombudsmen scheme for the consumers.[1325] The FCA established an independent company that operates the FSO –the Financial Ombudsman Service Ltd - in order to safeguard its independence from the FCA.[1326] Nevertheless, the FCA carries out certain control over the FSO through number of measures, including the appointment of chairman and members of the board,[1327] approval of its annual budget[1328] or through setting the monetary limits on awards,[1329] which makes it questionable whether the FOS can

[1324] The SEC since the formation of the Office of Investor Education and Advocacy, the office published number of publications for (1) seniors; (2) investors to mutual funds on various issues. *Available online at:* < http://www.sec.gov/investor#.VNzbRPnF-nE>/ *last visited* Feb. 12, 2015.
[1325] *See* Financial Services Authority, Customer Complaints 8 (Consultation Paper 4, December 1997) [hereinafter "Consumer Complaints"].
[1326] FSMA 2000, part XVI, c. 225(4) and sch. 17, para 3(4).
[1327] FSMA 2000, sch. 17, para 3 and 4.
[1328] FSMA 2000, sch. 17, para 9.
[1329] FSMA 2000, part XVI, c. 229(4).

actually achieve an operational independence.[1330] On the other hand the debate should start with the **relevance** of the FOS independence vis-à-vis the collaboration between the two agencies, as they share their objectives of protecting the investors.[1331]

The FOS was established as *"a scheme under which certain disputes may be resolved quickly and with minimum formality by an independent person"*.[1332] The FSMA 2000 lays down all the foundational provisions for the operation of the FOS, including: compulsory jurisdiction,[1333] voluntary jurisdiction,[1334] costs[1335] and funding.[1336] The most important part for the protection of individual interests of investors vis-à-vis investment companies and their advisers is the actions under the FOS's compulsory jurisdiction, which applies to any authorized firm (including investment companies and their advisers), against which a complaint has been made.[1337] According to the FSMA 2000, the investor (referred to as "consumer"), who is a private individual or small business or organization,[1338] has to first communicate the "substance" of his/her complaint to an investment company, providing it with a "reasonable opportunity to deal with it."[1339] Once such opportunity has been provided but disregarded, the investor may turn to the FOS, which should subsequently determine the complaint *"by reference to what is, in the opinion of the Ombudsman,*

[1330] *See* Eilís Ferran, *Dispute Resolution Mechanisms, in the UK Financial Sector* 15, *available online at:* < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=298176 >/ *last visited* Feb. 12, 2015.
[1331] *See* OMBUDSMAN NEWS, Issue 109, April/May 2013 (*"FOS describes itself 'as part of the statutory arrangements designed to help underpin consumer confidence in financial services. But unlike a regulator, we don't fine or dispute financial businesses. And unlike a regulator our role is to resolve **individual** disputes – a quicker and more informed alternative to the courts." See also* Consumer Complaints, *supra* note 1325, at paras 24 and 98.
[1332] FSMA 2000, part XVI, c. 226.
[1333] FSMA 2000, part XVI, c. 226A.
[1334] FSMA 2000, part XVI, c. 227.
[1335] FSMA 2000, part XVI, c. 230.
[1336] FSMA 2000, part XVI, c. 234 & 234A.
[1337] FSMA 2000, part XVI, c. 226(2) & (4).
[1338] DISP. 2.7.1R. As for businesses and organizations, only those may submit their complaint to FOS that subject to group annual turnover, annual income, or net asset value respectively is less than £1 million.
[1339] FSMA 2000, sch. 17, para 13.

fair and reasonable in all the circumstances of the case."[1340] The FOS has to provide each and every investor with a written statement of its decision, including the reasons for accepting or rejecting his/her complaint.[1341]

Once a complaint is accepted, the FOS's decision is binding and final on the investor and the investment company or its adviser.[1342] Unless new material evidence is produced, the FOS will not review its decision.[1343] The maximum monetary award in case of FOS's decision may not exceed the amount of £150,000 (from Jan. 1, 2012).[1344] However, the High Court in *Clark* case decided that even if the parties accept the FOS's award, the complainant – an investor – might claim additional damages.[1345] In this case, the investor accepted the award in the amount of £100,000, but subsequently brought a suit for additional losses incurred for £500,000. The decision in *Clark* contradicted the previous decision of the High Court rendered in 2010, where it found that the FOS was "tribunal" for the purpose of the "merger doctrine"[1346] and therefore the claimant could not bring two claims based on the same facts.[1347] In *Clark*, the court held that the merger doctrine did not apply due to a distinction between the right of action being considered by the FOS and by the court. Thus, not only are the investors protected through prompt decision procedure of the FOS, but they still may enjoy their private right of action if their claim against an

[1340] FSMA 2000, part XVI, c. 228(2).
[1341] FSA 2012, Sch. 11, para 14.
[1342] FSMA 2000, part XVI, c. 228(5).
[1343] *See* R (Cook) v FOS [2009] EWHC 426 (Admin).
[1344] Previously it has been £100,000. The money award can be enforced by the County Court in England and Wales, as well as in Scotland and Northern Ireland. For more *see* WALKER & PURVES, *supra* note 850, at 305-306.
[1345] Clark and Clark v In Focus Asset Management & Tax Solutions [2012] EWHC 3669 QB.
[1346] Under merger doctrine in UK civil procedure, *"a person in whose favour a tribunal of competent jurisdiction has provided a final judgment is precluded from afterwards recovering from any other English tribunal a second judgment for the same relief in respect of the same subject matter." See* Redcar & Cleveland Borough Council v. Bainbridge [2008] EWCA Civ 885. This doctrine is similar to civil law *res judicata* principle.
[1347] Andrews v SBJ Benefit Consultants [2010] EWHC 2875 (Ch).

investment company or adviser is greater than the maximum monetary award of the FOS.

5.4. Conclusion: Call for Investor Participation and Empowerment

The above analysis of the enforcement tools of the SEC, ESMA and the FCA shows that there are **great differences** in the enforcement powers of different agencies and for the time being ESMA is more of a guiding agency than an enforcement one. However, in the hindsight, this was also the case with the SEC, which similarly to ESMA was originally established only as an advisory agency. Nevertheless, with gradual development of the markets and more active investor participation the US regulators understood that without efficient enforcement tools, the agency would never properly oversee the market and protect the investors. In the EU, not even the 2008 financial crisis made the Member States realize that a common powerful enforcement agency is paramount. From today's perspective, unfortunately it seems that such political consensus may not be reached in the near future (if ever).

On the other hand, the case of the UK shows that the **quality** of enforcement is not necessarily contingent only on the powers of an enforcement agency, but also on its **endeavor**. When the FSA was established back in 2001, it stated that enforcement is only **one** of a range of its "regulatory tools" to ensure the compliance with regulatory requirements and to support pursuit of its statutory objectives – referring to the FOS.[1348] The FOS has been a completely novel regulatory tool, which seems to have brought a substantial difference for individual investors and their claims, and yet the investors continue to enjoy their private right of action under the FSMA 2000.

[1348] *See* Karen Anderson, Chris Bates & George Staple, *A New Millennium, A New Regulator? The Financial Services Authority's Approach,* 1 J. INVESTMENT COMPLIANCE 7, 8 (2001).

This shows that even if a regulator introduces a specific organization for enforcing investors' complaints, the private right of action does not become immaterial.

Unless the SEC becomes more investor-oriented and ESMA will be provided with substantial enforcement tools, the only way to protect investors is through their direct empowerment in form of an introduction of a harmonized private right of action for individuals and for classes. Private enforcement further enhances the individual participation, which has been emphasized by several new governance theory models[1349] while both parties gain with the shared enforcement. Public enforcement shares the burden of oversight, both in monetary and in non-monetary way[1350] and private enforcement might recover larger resources.[1351] In simple terms, it is a win-win situation for both governmental agencies and investors.

[1349] *See* Cristie L. Ford, *supra* note 1320, at 3-6.

[1350] Furthermore, public enforcement supplemented by private rights of action may reduce the need for additional regulation; *see* Howell E. Jackson, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications,* 24 YALE J. ON REG. 253, 264-265 (2007). *See also* Coffee, *Law and the Market*, *supra* note 645, at 245-246.

[1351] An empirical study has shown that private plaintiffs recovered statistically greater financial amounts where the SEC and private plaintiffs filed cases concerning the same alleged misconduct. *See* James D. Cox *et al.*, *Public and Private Enforcement of the Securities Laws: Have Things Changed Since Enron?*, 80 NOTRE DAME L. REV. 893, 897 (2005).

CHAPTER VI EMPOWERING INVESTORS THROUGH PRIVATE RIGHT OF ACTION: ENFORCEMENT AGENCIES CANNOT (COMPLETELY) CUT THE MUSTARD

The ambition of this thesis is to argue for better investor protection tools for retail investors investing with investment companies in the EU, the UK and the US through the notion of investor empowerment. With this philosophy in mind I have assessed the existing regulation on disclosure as well as fiduciary duties of investment companies and their advisers. Additionally, in the previous chapter, I have analyzed to what extent are the enforcement agencies in three jurisdictions in a position to efficiently protect the rights of investors. Although strengthening of agencies includes also measures that aim at facilitating investor's individual claims – as it is in the case of the UK – that is not necessarily the case everywhere. The UK established a special entity – the FSO – that facilitates investors' individual complaints. This model in comparison to the others seems to be the most pro-investor oriented. All the investors in the UK have to do is to file a complaint with an official authority, which will further investigate and where appropriate award damages. Yet it is the investor who has to be the initiator in the first place. Moreover, as discussed in the previous chapter, the UK FSMA 2000 additionally provides for private right of action in the case an investor suffered greater harm than the maximum amount he/she can claim before the FSO. Focusing on the private right of action, both the US and the EU provide investors with certain types thereof. In the US, however, investors vis-à-vis investment companies and their advisers have not been very successful in employing them while in the EU the nature and requirements of the private right of action continue to depend on individual Member States as they have not been yet harmonized.

In the lights of the above stated, it is the claim of this chapter that beside more efficient powers of enforcement agencies, investors should be provided with **express rights of action** vis-à-vis investment companies and their advisers, both in the US and in the EU. Moreover, keeping in mind the EU's aspiration to form a common market in financial services, I predominantly focus on introducing cross-border investor class actions that would not only secure investor protection irrespective of the place of their investment but would ultimately enhance also the harmonization of the laws on individual private right of action in the Member States (if any).

In this chapter, considering the investor empowerment agenda, I analyze the current state of art in the regulation of investment companies and its advisers concerning the **private right of action**: express, implied or non-existent. Focusing purely on whether investors enjoy this procedural right or not, I will show that investors even in the US enjoy only limited rights to redress against investment companies and their advisers. Though in this respect the investors' position is conspicuously the weakest on the level of the EU from all the three jurisdictions covered herein as so far no EU law explicitly foresees such tools for **intra-state** or **cross-border cases.** Moreover, only few Member States have recognized some specific form of private right of action for investors of investment companies or **class (or collective) action** as a procedural tool. In connection with the private right of action, I assess the existent regulation in the UK whereas when analyzing it I consider different mechanisms in the Member States that have embraced this procedural tool. I consider not only the existing means of enforcement in several jurisdictions, but also the pending proposals and ultimately suggest introduction of the EU private right of action for investors – both individual and collective – irrespective of the regulation in their home Member States, which could be applied not only in case of intra-state cases but also for cross-border investments.

6.1. Empowerment Approach: Private Right of Action

Before analyzing the investors' ability to enforce their rights privately, I address the policy rationales behind introducing the private right of action. Looking at the example of the US, private right of action represents an indispensable component of the overall regulatory design of the securities laws. When the SA 1933 and SEA 1934 were adopted, the US Congress recognized that private actions for damages could play an important role in **assuring compliance** with the securities acts.[1352] The US Congress created two methods by which certain obligations could have been enforced. One was through the SEC[1353] and the second through the private actions.[1354] The private actions were perceived as **supplementing** the SEC's enforcement efforts and thus encouraging greater compliance with the securities laws.[1355] Since then, the private actions became a part of the daily routine of securities industry in the US.

The reasons for introducing private actions reflect the market realities – investor protection is not necessarily and always the first priority of the SEC. Sometimes the goal to protect investors is only secondary and subordinated to the goals of promoting efficiency or capital formation.[1356] Considering the size of the market in the US, the

---

[1352] *See* HAROLD S. BLOOMENTHAL, SECURITIES LAW IN PERSPECTIVE 64 (C. Boardman, 1977). Although some opposition to the civil liability sections in both acts was present, during the floor debate in Congress, these sections were nevertheless passed. *See* Bernard W. Nussbaum, *Wall Street: From the Robber Baron to Regulation by the SEC in 95 Years*, 191 N. U. L. J. 48, 48 (1984).

[1353] Concerning the enforcement of general disclosure obligation, *see e.g.* SA 1933 (2012), §3(b), SEA 1934 (2012), §10(b), 15 U.S.C. §§77c(b), 78j(b) (2012).

[1354] *See e.g.* SA 1933 (2012), §§11, 12, SEA 1934 (2012), §8, 10, 18, 15 U.S.C. §§77k, 78h, 78j, 78r.3

[1355] *See* COX, HILLMAN & LANGEVOORT, *supra* note 620, at 799.

[1356] In 1996 the US Congress revised the SEC's statutory mandate and expressly required the SEC "to consider or determine whether an action is necessary or appropriate in the public interest" and to "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." Section 3(f) SEA 1934, 15 U.S.C. §78c(f) (2012). *See also* Paul S. Atkins & Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program*, 13 FORDHAM J. CORP. & FIN. L. 367, 369 (2008).

SEC is in no position to **oversee each and every investment**. The same policy objectives are also the aim of ESMA's operations.[1357] Both institutions are administrative agencies balancing their internal vision of investor protection against a host of competing pressures from the industry and government.[1358] Even though the FCA has in the UK established a separate entity – the FSO – the main task of which is to assist investors with enforcing their rights, the FSMA 2000 continues to provide for direct right of actions. This also shows that although the protection of investors is politically rewarding, governmental institutions are the investors' guardians only to a limited extent. As a consequence, investors should also themselves be vested with powers to enforce their rights vis-à-vis investment companies and their advisers.[1359]

In this section, the analysis of the private actions will be carried out with focus on investment companies. Bearing in mind the scope of this thesis, under the US regulation I assess only the private right of action for breach of fiduciary duties by investment companies and their advisers.[1360] Subsequently, from the US, I move to the EU where private right of action has not been yet adopted on the EU-level. This notwithstanding that the Member States hosting the financial center of Europe – the UK – has recognized the investors' private right of action for any loss already in 1986.[1361] Although the novelty was at the time considered to be the most controversial

[1357] In case of single market formation, the EU objective was to "act as a catalyst for economic growth across all sectors of the economy, boost productivity, and provide lower cost and better quality financial products for consumers and enterprises. *See* REPORT ON FINANCIAL INTEGRATION (Working Group of the Economic and Financial Committee, April 2002).

[1358] *See also* Langevoort, *Institutionalization of the Securities Markets*, *supra* note 11, at 1028 or Brian G. Cartwright, *Whither the SEC Now?*, 95 VA. L. REV. 1085, 1090 (2009) ("SEC is a part of government: it is inherently a political instrumentality").

[1359] *See e.g.* Michael Lewis & David Einhorn, *The End of the Financial World as We know It*, N.Y. TIMES, Jan. 4, 2009, at WK9 (condemning the SEC for its unwillingness to challenge Wall Street's status quo for political purposes).

[1360] Under sections 36(a) and 36(b) ICA 1940.

[1361] Financial Services Act 1986, c. 62, which stated the following: *"(1) Without prejudice to section 61 above, 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*** provision in the statute, it has not been discarded.[1362] In the second part of this chapter, I assess the possibility of the introduction of a class action for investors in the EU taking into account its formation in the US and the existent regulation in different EU Member States.

6.1.1. US: Critique of the Limited Investors' Margin

As far as investment companies are concerned, the original ICA 1940 contained **only one** section explicitly allowing for a **private right of action** – section 30(f).[1363] The former section 36 of the ICA 1940 provided the SEC with the right to bring action against a director, officer, investment adviser, depositor or advisory member for "*gross misconduct or gross abuse of trust*".[1364] However, it did not provide a private right of action. Only in 1970 the US Congress created an additional private right of action by amending the section 36.[1365]

In the US, the first published decision addressing the issue of private remedies under the ICA 1940 is from 1958. In *Cogan v. Johnston*,[1366] the court decided that individuals could bring private actions in federal courts to enforce liabilities and enjoy violations under the ICA 1940.[1367] In 1960, a Delaware court likewise approved the idea of private right of action.[1368] One year later, the Second and Eight Circuit courts addressed the same issue. In the first decision *Brouk v. Managed Funds, Inc.*,[1369] the Eight Circuit Court of Appeals dismissed the private action of an investor to hold a

***loss** as a result of the contravention subject to the defenses and other incidents applying to actions for breach of statutory duty…"*

1362 *See* James J. Fishman, *A Comparison of Enforcement of Securities Law Violations in the UK and US*, 14 COMPANY LAW. 163, 168 (1993).

1363 ICA 1940, ch. 686, §30(f), 54 Stat. 789, 836 (1940)

1364 ICA 1940, ch. 686, §36, 54 Stat. at 841 (1940).

1365 *See* section 4.2.1.3.

1366 Cogan v. Johnston, 162 F. Supp. 907 (S.D.N.Y. 1958).

1367 *Id.* at 909.

1368 Taussig v. Wellington Fund, Inc., 187 F. Supp. 179, 2020 (D. Del. 1960).

1369 Brouk v. Managed Funds, Inc. 286 F.2d 901 (8th Cir. 1961).

director of a mutual fund liable for violation of ICA 1940 without a "*manifest legislative intent*."[1370] The court stated that the failure to provide explicit private rights of action in the ICA 1940, as those in SA 1933 and SEA 1934, **indicated that the legislative omission was deliberate**.[1371]

However, two months later, the US District Court in New York in *Brown v. Bullock* rejected the reasoning of the Eight Circuit.[1372] The district court held that private actions could be maintained under several sections of the ICA 1940, as *"implied rights of action are not contingent upon statutory language which affirmatively indicates that they are intended. On the contrary, they are implied unless the legislation evidences a contrary intention."*[1373] Later that year the Second Circuit concurred with the holding of the Eight Circuit court.[1374]

The difference in the position of the two Circuit Courts can be explained in part by the **doctrine of implied liability**.[1375] The doctrine of implied liability was initially adopted in the context of securities laws in 1946 when in *Kardon v. National Gympsum Co.,*[1376] the US District Court for Middle District of Pennsylvania upheld the right of a plaintiff to sue for injuries suffered from a violation of section 10(b) and Rule 10b-5 under the SEA 1934.[1377] Despite the absence of an explicit private remedy, the court defined that the appropriate test for deciding on an implied right of action was, *"whether an intention can be implied to deny a remedy and to wipe out a liability which, normally by virtue of basic principles of tort law, accompanies… the*

[1370] *Id.* at 918.
[1371] *Id.*
[1372] Brown v. Bullock, 194 F. Supp. 207 (S.D.N.Y. 1961).
[1373] *Id.* at 224.
[1374] Brown v. Bullock, 294 F.2d 415 (2nd Cir. 1961).
[1375] *See* Meyer Eisenberg & Rihard M. Phillips, *Mutual Fund Litigation – New Frontiers for the Investment Company Act,* 62 COLUM. L. REV. 73, 85-90 (1962).
[1376] Kardon v. National Gympsum Co., 69 F. Supp. 512 (E.D. Pa. 1946).
[1377] *Id.* at 514.

whole statute…" In other words, the court emphasized the general purpose of the act together with the fact that *"the mere omission of an express provision for civil liability is not sufficient to negate what the general law implies."*[1378] Later, the US Supreme Court upheld the doctrine of implied liability.[1379] The doctrine allowed courts to imply a private action **unless** a specific contrary intention of Congress was present through explicit statutory language.[1380]

In late 1960's, it became apparent that the ICA 1940 was unable to adequately address the growing problem of excessive fees charged by investment advisers.[1381] However, some claimed that charging excessive fees only indicated a larger problem – investment company directors and investment advisers were actually breaching their fiduciary duties to their investors and neglecting their obligations under the ICA 1940.[1382] Yet as already analyzed in the IV chapter, the US Congress solved the problem of increasing fees by adopting section 36(b) ICA 1940 - focusing only on the excessive fees and completely disregarding the question of control of investment and the nature of the fiduciary duties owed to investors.[1383]

Since the regulatory change of section 36 ICA 1940 investors have quite often successfully enforced their implied right of action under the new 36(a) ICA 1940, but only before US district courts. In 1990's there were three cases, in all of which the US district courts authorized implied private actions under sections 36(a) ICA 1940.[1384]

1378 *Id.*
1379 SEC v. Joiner Corp., 320 U.S. 344 (1953). The US Supreme Court stated that *"courts will construe the details of an act in conformity with its dominating general purpose, will read text in light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy."*
1380 *See* Eisenberg & Phillips, *supra* note 1375, at 85-90.
1381 *See* William P. Rogers & James N. Benedict, *Money Market Fund Management Fees: How Much Is Too Much?*, 57 N.Y.U.L. REV. 1059, 1077-1080 (1982).
1382 *See* Eisenberg & Phillips, *supra* note1375, at 81-83.
1383 *See* section 4.2.1.
1384 *See* In re Nuveen Fund Litigation 1996 WL 328006 (N.D. III June 11, 1996) the plaintiffs claimed that a closed-end fund's proposal to issue new shares through its directors and adviser was a violation

Yet the US Supreme Court **never expressly recognized an implied right of action** under the section 36(a) ICA 1940. Actually, the US Supreme Court acted instead the other way. In one of the earlier decisions in 1991 *Kamen v. Kemper Financial Services, Inc.*,[1385] the US Supreme Court expressly declined the opportunity to support the implied right of action under 36(a) ICA 1940 and it only recognized the derivative action under the state corporate law.[1386]

Since then the US Supreme Court has signaled a strong presumption **against** implying private rights of action under the federal securities laws.[1387] The first case showing this direction of the US Supreme Court was the *Central Bank*,[1388] where the US Supreme Court held that there was no implied private right of action for aiding and abetting a violation under section 10(b) of SEA 1934.[1389] Later in 2001 in *Alexander v. Sandoval* decision,[1390] the US Supreme Court clearly stated that *"[l]ike substantive federal law itself, private rights of action to enforce federal law must be* ***created by Congress****,"* and *"[t]he judicial task is to interpret the statute Congress has passed to determine whether it displays an intent to create not just a private right but also a private remedy."*[1391] Further, the US Supreme Court stated that *"[s]tatutory intent on this latter point is determinative,"* as *"[w]ithout it, a cause of action does not exist and courts may not create one, no matter how desirable that might be as a*

of fiduciary duties under section 36(a); McLahlan v. Simon 31 F. Supp. 2d 731 (N.D. Cal. 1998) where class of investors of a mutual fund claimed a breach of fiduciary duty for termination of an investment adviser contract; and Dowling v. Naragansett Capital Corp 735 F. Supp. 1105 (D.R.O. 1990), where plaintiffs claimed that investment advisers with directors "orchestrated" a scheme to eliminate the shareholders through redemption and subsequently sell the fund at profit. For more background on the decisions *see* Knickle, *supra* note 886, at 823-826.

[1385] Kamen v. Kemper Financial Services, Inc., 500 U.S. 90 (1991).

[1386] *Id.* at 97.

[1387] *See* HAZEN, TREATIES ON THE LAW OF SECURITIES REGULATION, *supra* note 438, at §12.2.

[1388] Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994).

[1389] *Id.* at 176.

[1390] Alexander v. Sandoval, 532 U.S. 275 (2001).

[1391] *Id.* at 286.

policy matter, or how compatible with the statute.[1392] This "narrowing trend" has resulted in limiting the private remedies and it is questionable whether the US Supreme Court will any time soon change its interpretation and recognize the implied right of action.[1393] Moreover, this restrictive trend of the US Supreme Court undeniably cut back on the lower courts' willingness to create additional remedies, and thus the majority of recent cases **have denied** the existence of any other than the recognized implied remedies.[1394]

As a consequence, under the "current" US Supreme Court jurisprudence, the investors of investment companies have no right of action to enforce the fiduciary duties owed by the investment companies and their advisers. Moreover, as stated in the fourth chapter, since the adoption of the rule 36(b) ICA 1940, the investors have **never been successful** in applying this provision against the investment companies and their advisers, notwithstanding the fact that this provision represents only the tip of the iceberg of the control division in the investment company. As described, it is the investment adviser who *de facto* fully controls the investment of investors The movement towards literalism of securities laws and refusal of the courts to recognize and proceed with the investors claims cannot be the reasons for hampering investor protection. It would be more desirable if the US would re-evaluate not only the nature of the fiduciary duties of investment companies and their advisers towards the investors, but also reconsider the ability of investors to actually protect their rights as they are currently unfortunately extremely limited.

[1392] *Id.* at 287.
[1393] *See* HAZEN, TREATIES ON THE LAW OF SECURITIES REGULATION, *supra* note 438, at §12.2.
[1394] *Id.*

6.1.2. EU: How Investors May *Never* Become Their Own Masters

The EU investor protection regime is designed in a different manner and the private EU –level enforcement-pillar is essentially lacking. It is a model exclusively based on **public supervision and enforcement** through the ESMA and the Member States' enforcement agencies. As analysis of the ESMA showed, the scope of ESMA's supervision and enforcement is however extremely limited. Irrespective that most[1395] of the EU directives do contain a catalogue of national agency powers,[1396] unless these become adopted uniformly, the styles and practices of national enforcement agencies will continue to differ.[1397] The national agencies' enforcement powers and styles considerably vary across the Member States,[1398] which is partially due to the – meaningfully differing – size of national funds available for supervision and enforcement.[1399] Moreover, given that ESMA has not yet even been provided with any substantial powers over the national enforcement agencies,[1400] the desirable uniformization of national enforcement agencies remains remote. One may thus legitimately speculate that until that occurs, introduction of investor private right of action could provide the necessary protection. At the time being, the EU is unable to assure such heightened level of protection on the EU-level.

[1395] UCITS V only emphasizes the necessity of cooperation between the national "competent authorities", but besides the authorization procedure and connected supervisory powers does not specify any other enforcement or supervisory powers for national enforcement agencies.

[1396] *E.g.* Chapter I, Title VI MiFID II lays down the powers and redress procedures of competent authorities.

[1397] *See* Wymeersch, *The Structure of Financial Supervision in Europe*, *supra* note 1242, at 286-302, (Professor Wymeersch compares different enforcement schemes in all of the EU Member States).

[1398] The CESR repeatedly highlighted this differentiation on the market; *see e.g.* REPORT ON THE SUPERVISORY FUNCTIONING OF THE PROSPECTUS DIRECTIVE AND REGULATION (CESR, CESR/07/225, 2007).

[1399] *See* Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-based evidence,* 93 J. FIN. ECON. 207, 235 (2009). Authors observe that EU Member States allocate sharply different levels of resources to financial supervision. United Kingdom and Luxembourg, considering their markets' importance, have the largest staffing and budgets devoted to the market supervision.

[1400] Article 5(8) UCITS V. According to this provision, ESMA "may" develop "draft" regulatory technical standards to specify the information to be provided to the competent authorities in the application for authorization of a UCITS.

As seen by the example of the US, despite its limitations in connection with investment companies, private right of action as a **mechanism** for enforcing investor protection is an important component of the securities regulatory system. It is difficult to achieve an equity culture without effective investor protection, including the opportunity for private redress.[1401] However, this opportunity has not yet been laid down by the EU and still continues to depend on the Member States' legal system.[1402] Absence of harmonized private right of action complicates cross-border redress and substantially impedes the formation of common market in financial services. If an investor is unable to protect his/her cross-border investments, the efficiency of such legal system is questionable. Moreover, keeping in mind Article 47 of the Charter of Fundamental Rights of the EU: "*Right to an effective remedy and to a fair trial*,"[1403] it should be one of the main interests of the EU to provide investors with effective remedy to protect their investments. The problem of enforcement of rules and the need for a further development of effective remedies has been highlighted number of times.[1404] Likewise, Article 166 of the Preamble of MiFID II emphasizes the right to an effective remedy. Yet what is the "**effective remedy**" for investors in their cross-border investments?

At an early stage of the MiFID I review, the European Commission proposed that a harmonized regime governing liability claims in relation to breaches of the disclosure, advisory service, and best execution or reporting rules should be

[1401] *See* Karmel, *The Case for an ESC*, *supra* note 1197, at 38.
[1402] *See* VEIL, *supra* note 628, at 126.
[1403] The section 1 of this Article reads: "Everyone whose rights and freedoms guaranteed by the law of the Union are violated has the right to an effective remedy before a tribunal in compliance with the conditions laid down in this Article."
[1404] *See e.g.* Chantal Mak, *Rights and Remedies Article 47 EUCFR and Effective Judicial Protection in European Private Law Matters* 5-6 (Centre for the Study of European Contract Law, Working Papers Series No. 2012-11).

designed.[1405] Similarly, the European Parliament suggested that in case of breach of MiFID II/MiFIR, the Member States should provide for criminal or civil actions.[1406] However, once all the representatives sat down to the table during the negotiations of MiFID II, a reoccurring concern from Member States in respect to introducing the private enforcement mechanism was raised in connection with how a new harmonized regime would fit with "well-established" domestic liability regimes.[1407] Even though no evidence was provided as to how the system was functioning – well or poor – the EU representatives failed to challenge this Member States' claim. Thus, ultimately **MiFID II only provides a reference** to the enforcement mechanisms available under the laws of the Member States, as it stipulates that *"Member States must ensure that mechanisms are in place to* ensure *that compensation may be paid or other remedial action be taken in accordance with national law for any financial loss or damage suffered as a result of an infringement"* under MiFID II/MiFIR.[1408]

While the EU was unable of achieving an agreement on securing the investors' private right of action on the EU-level in order to show its aspiration towards greater retail-investor protection, MiFID II promotes an extra-judicial mechanism, a *sui generis* form of alternative dispute resolution.[1409] MiFID introduced an extra-judicial mechanism for **consumer complaints** (similarly to the UK system).[1410] According to

[1405] *See* Public Consultation, *Review of the Markets in Financial Instruments Directive (MiFID)* 63, (European Commission, 8 Dec. 2010) [hereinafter MiFID Public Consultation 2010]; *available online at:* < http://ec.europa.eu/internal_market/consultations/docs/2010/mifid/consultation_paper_en.pdf>/ *last visited* Nov. 12, 2014.
[1406] *See* The Parliament's Resolution on the MiFIR Proposal, Article 9 (8a) (European Parliament, Oct. 26, 2012).
[1407] *See* Niamh Moloney, *Liability of Asset Managers: A Comment,* 7 CAP. MARKET. L.J. 414, 421 (2012) [hereinafter "Moloney, *Liability of Asset Managers*"].
[1408] Article 69 MiFID II.
[1409] *See* MOLONEY, EU SEC. REG. 3RD ED, *supra* note 670, at 414, where Professor Moloney stated that such proposition did not take into consideration also the industry hostility and wider complexities associated with pan-EU civil liability regimes. *See also* Moloney, *Liability of Asset Managers, supra* note 1407, at 419 and Danny Busch, *Why MiFID Matters to Private Law – The Example of MiFID's Impact on an Asset Manager's Civil Liability,* 7 CAP. MARKET. L.J. 386, 387 (2012).
[1410] Article 75 MiFID II.

Article 75 MiFID II *"[M]ember States must ensure the setting up of efficient and effective complaints and redress procedures for the out-of-court settlement of consumer disputes."* [1411] Furthermore, the Member States must also ensure that all investment companies adhere to one or more such bodies.[1412] These bodies must actively co-operate among themselves in cross-border disputes.[1413] As MiFID II will become effective only from January 3, 2017, it is only to be seen how the Member States will form and enforce the **alternative dispute resolution mechanism**.[1414] Nevertheless, the establishment of a complaint body does not fully solve the issue of investor redress and direct involvement in his/her protection of investment. One may fear that this extra-judicial mechanism is no more than another illusory EU investor protection method hardly providing real tools for investors.

In case of UCITS, the new UCITS V **does not call** for establishment of an alternative dispute resolution mechanism. UCITS V does not impose any minimum requirements concerning sanctions or remedies in respect of fault or misleading disclosure.[1415] UCITS V directly excludes civil liability *"[s]olely on the basis of the key investor information, including any translation thereof, **unless** it is misleading, inaccurate or inconsistent with the relevant part of the prospectus. Key investor information shall contain a clear warning in this respect."*[1416] In other words, UCITS investors are completely dependent on their national legal systems.

[1411] Article 75(1) MiFID II, *"Member States shall ensure the setting-up of efficient and effective complaints and redress procedures for the out-of-court settlement of consumer disputes concerning the provision of investment and ancillary services provided by investment firms, using existing bodies where appropriate. Member States shall further ensure that all investment firms adhere to one or more such bodies implementing such complaint and redress procedures."* In addition *"ESMA shall publish and keep up-to-date a list of all extra-judicial mechanisms on its website."*
[1412] Article 75 MiFID II.
[1413] *See* MOLONEY, EU SEC. REG. 3RD ED, *supra* note 670, at 415.
[1414] Up until the 20th November, ESMA has not yet published any guidelines concerning the extra-judicial mechanism.
[1415] *See* MOLONEY, EU SEC. REG. 3RD ED, *supra* note 670, at 259.
[1416] Article 79(2) UCITS V.

Without the EU interference, investors in the EU will most presumably never be empowered by private right of action as the majority of the Member States still does not necessarily comprehend the importance of this regulatory tool.[1417] As in the context of financial markets, the EU tends to be inspired by the UK as the most developed regulatory system of Europe, it would be desirable if the EU would follow the suit also as to individual redress. At the moment, however, nothing suggests such a perspective. Additional option for securing the private right of action could be the introduction of the EU variation of the US-style securities class action mechanism. A discussion in a similar vein has already commenced in the UK.[1418]

6.1.3. UK: Detailed Sourcebook Helps Investors with Their Claims

Historically, the UK embraced the idea of private right of action only in its Financial Services Act 1986 that implemented the long-called reform of Professor Gover.[1419] However, at that time only very few investors relied on this private right of action.[1420] Today, investment companies owe legal duties to their investors arising under contract and tort law and in particular based on financial regulation – the FSMA 2000. Besides the FSO that assists (until now very efficiently) with investors' individual claims, the FSMA 2000 provides investors with **additional mechanisms** to facilitate

---

[1417] Taking Germany, which has one of the most developed legal systems as an example, Germany only in 2011 adopted the Act to Strengthen Investor Protection and Improve the Functioning of Capital Markets, which referred to the necessity to register all investment advisers in Germany to BaFin as a new "revolutionary" tool to better protect retail investors in Germany. (Anlegerschutz- und Funktionverbesserungsgesetz, Gesetz zur Stärkung des Anlegerschutzes und Verbesserung der Funktionsfähigkeit des Kapitalmarkts, *available online at* :< http://gesetzgebung.beck.de/news/anlegerschutz-und-funktionsverbesserungsgesetz>/ *last visited* 19th November 2014) *See* Roman Jordans, *The German Law to Strengthen Investor Protection and Improve the Functioning of Capital Markets*, 26 J. INT'L BANK. L & REG. 259, 260 (2011).

[1418] *See e.g.* Brandan Malkin, *UK Firms Gear Up as Class Action Culture Hits Europe,* THE LAWYER, Feb. 7, 2005.

[1419] *"Only drastic changes in the basic organization of legal services could make civil litigation by individuals attractive and effective remedy in most cases. Nevertheless it is an enforcement mechanism which should be more readily available for us in the few cases where it might be sought." See* LAURENCE GOWER, REVIEW OF INVESTOR PROTECTION (January 1984) Cmnd 9125 in WALKER & PURVES, *supra* note 850, at 567.

[1420] *Id.* at 568.

their direct redress. In the context of investment companies and their advisers, the private rights of action could be categorized into three groups, namely (1) a statutory claim in tort for breach of some of the rules made by the regulatory authority,[1421] (2) a statutory claim for acting beyond the scope of authorization under the FSMA 2000[1422] and (3) a statutory claim for breach of the general prohibition, by means of which an investor can seek to recover sums invested as well as compensation for losses.[1423] Each of these provisions explicitly indicates that affected investors are in a position to bring an action.

The investor, while bringing an action against an investment company, can also reach its adviser by virtue of English common law principles applicable to the authority of agents. In case an investment company contracts directly with an adviser (which it usually does), there is a statutory requirement that the principal **must accept responsibility** for the representative.[1424] Therefore when an investor initiates a suit against an investment company, this suit absorbs also the actions and inactions of investment advisers. This absorption makes it ultimately easier to enforce their rights, but obviously it would be more efficient to give the right to investors to sue the adviser directly rather than only the investment company.

For these reasons, in the regulatory system under the FSMA 2000, a great help for investors represents the FCA Handbook - COBS,[1425] which is very detailed as to the duties of the investment companies. In case a contract between an investor and an investment company is vague, the investor can always plead contractual breaches of duty in parallel with claims for breach of statutory duty. However, in such case a

[1421] FSMA 2000, Part X, c. 138D.
[1422] FSMA 2000, Part II, c. 20.
[1423] FSMA 2000, Part II, c. 26.
[1424] FSMA 2000, Part III, c. 39 & 39A.
[1425] Conduct of Business Sourcebook, *available online at:* < http://fshandbook.info/FS/html/FCA/COBS>/ *last visited* Mar. 2, 2015.

court is likely to subsequently disregard the pleaded tortious or contractual liability. In this regard, Cooke J in *Basma Al Sulaiman* noted the following:[1426]

> *"Although a duty of care was pleaded in contract and tort, it is common ground that it adds little or nothing to the claim for breach of statutory duty, since it was alleged that there was a duty of care in advising BAS with regard to the purchase of Notes, to explain the risks associated with such purchases including the risk of leverage and to ensure that BAS understood those risks, and to ensure that the investment were suitable for her. The reasonable steps required under COB* [today COBS] *correlate with the exercise of reasonable care required in contract and tort to achieve the same ends."*[1427]

Thus, in the UK not only a regulator has provided investors with diverse causes of action vis-à-vis investment companies, but it also guides the market participants with specific rights and duties. The COBS are a guideline that, on one hand, in very clear and direct manner lay down what behavior is expected from investment firms, while on the other hand, navigate investors as to their rights when seeking protection of their investment. Even though a solution resting on a specific set of duties and rights is not as flexible as a system based on general fiduciary duties, it seems – based on the brief UK experiences – that it represents a great teaching tool not only for investors, but also for the investment companies as it is supplies a level of predictability very much needed on largely uncertain markets.

[1426] Basma Al Sulaiman v Credit Suisse Securities (Europe) Limited and Another [2013] EWHC 584 (Comm).
[1427] *Id.* at para 18.

6.2. Introducing Class Action in the EU

Collective redress represents part and parcel of a strategy towards effective enforcement of the set regulatory goals, supplementing public enforcement.[1428] Collective lawsuits were originally designed to benefit individuals by allowing them to more easily join and seek efficient legal relief.[1429] Even though this concept might be still foreign to many civil legal systems, this should not impair the enforceability of investor rights, even so in case of cross-border investments, which the EU openly craves for.

The jurisdiction which has the richest history with class actions is the US. Since the inception of the federal securities laws, the SEC enforcement authority has been **complemented** by private right of action.[1430] From the policy perspective, securities class action fulfills various regulatory rationales benefitting others,[1431] such as fostering corporate accountability, enforcing public norms, promoting deterrence or supplementing possible enforcer's inaction,[1432] including innovation or information sharing. However, there is also some criticism present towards the securities class actions among legal scholars. Professor Coffee and some other believe that there are

---

[1428] *See* Burkhard Hess, *Private Law Enforcement und Kollektivklagen*, JURISTENZEITUNG 66, 70 (2011).

[1429] For a description of the goals of the class actions rules *see* Benjamin Kaplan, *A Preparatory Note*, 19 B.C. L. REV. 497 (1969).

[1430] *See e.g.* section 11 of SA 1933, 15 U.S.C. §77k (2012) highlights the importance of full disclosure of the public offering of securities by conferring an investor-friendly right of action on those who purchase securities based on materially misleading registration statements. Further, the express private right of action for misleading reports filed with the SEC provide for private recoveries for market manipulation, *see* section 18(a) of SEA 1934, 15 U.S.C. §78(a) (2012).

[1431] "The class action mechanism is important not just because it enables a group of litigants to conquer a collective action problem and secure relief, but also – perhaps more so – because the litigation it engenders produces external benefits to society." *See* William B. Rubenstein, *Why Enable Litigation?: A Positive Externalities Theory of the Small Claims Class Action*, 74 UMKC L. REV. 709, 710 (2006). *See also* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS 14-16 (Harvard University Press, 2d ed. 1971).

[1432] *See* Owen M. Fiss, *The Political Theory of the Class Action*, 53 WASH. & LEE L. REV. 21, 22 (1996) ("In many instances, there is no need to disentangle the private and public purposes of a citizen-initiated lawsuit."); *see also* Elizabeth C. Burch, *Securities Class Actions as Pragmatic Ex Post Regulation*, 43 GA. L. REV. 63, 89-90 (2008). *See also* Rubenstein, *Why Enable Litigation*, *supra* note 1431, at 723-725.

two key policy goals of securities class actions; **compensation** and **deterrence**.[1433] Investors are compensated for losses suffered when misled in connection with purchasing or selling securities, while by securing the wrongdoers to pay for the costs of the harm caused by their action, a damage award additionally deters future wrongdoing. Professor Coffee believes that in reality these goals of the securities class actions are not materialized. He states that in face of the existing data, securities class actions perform poorly concerning the investors' financial recovery and therefore the compensation rationale behind them is unsubstantiated.[1434] On the other hand, in the light of the acquired data Professor Coffee confirms that securities class actions seem sufficiently pervasive to constitute a deterrent for most public corporations, [1435] which is definitely a substantial benefit. And although he contemplates that the amount of initiated securities class action is meaningful,[1436] it cannot be empirically quantified "how much" fraudulent conduct has been deterred by class action.[1437] Primarily because one cannot count the activity that did not take place.

All in all, class actions go hand in hand with the "**major objective**" of the securities law – protection of investors and the market.[1438] Naturally, after realizing

[1433] *See* Coffee, *Reforming the Securities Class Action*, *supra* note 1193, at 1538; Meritt B. Fox, *Why Civil Liability for Disclosure Violations When Issuers Do Not Trade?,* 2009 WISC. L. REV. 298, 302 (2009) and Lawrence E. Mitchell, *The "Innocent Shareholder": An Essay on Compensation and Deterrence in Securities Class-Action Lawsuits*, 2009 WISC. L. REV. 243, 246 (2009).

[1434] *See* Coffee, *Reforming the Securities Class Action*, *supra* note 1193, at 1545-1549.

[1435] *Id.* at 1548.

[1436] The SEC has also realized that in the context of financial penalties, shareholders are bearing the financial consequences of substantial financial penalties to a company.

[1437] *See* Ilya R. Segal & Michael D. Whinston, *Public vs. Private Enforcement of Antitrust Law: A Survey,* 14 (John M. Olin Program in Law & Econ., Stanford Law Sch., Working Paper No. 335, 2006).

[1438] *See e.g.* Berner v. Lazzaro, 930 F. 2d 1319, 1322 (9th Cir. 1984) ("The major objective of the federal securities laws in undoubtedly to provide protection to the investing public.") or Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 315 (1985) (Securities law aims for "protection of the investing public and the national economy through the promotion of 'a high standard of business ethics… in every facet of the securities industry'").

this, the question is how to efficiently regulate them?[1439] For the purposes of this thesis the main inquiry is the possible introduction of securities class action in the EU, as its introduction is perceived to be fundamental for protection of investors in their cross-border investment in the EU. Given the fact that the US among the first introduced class actions and continues to maintain the most efficient securities class action system, the analysis begins there.

6.2.1. Securities Class Action in the US

Going back to the history, the class action, group litigation or collective redress[1440] was permitted already under common law.[1441] In 1849 the codification of class action took place in the Field Codes of New York and California.[1442] Although the class action was allowed in cases where there was a **common interest in law or fact**,[1443] it had not been used much until 1938.[1444] Only in 1938 did the class action under Rule

[1439] Given the fact that the securities class actions are most of the time initiated against the publicly traded companies instead of the financial intermediaries, most of the academic debate revolves around the costs of the securities class actions and the argument that shareholders indirectly carry the costs of the class action instead of the wrongdoers. Also for this purpose the class action has numerous critics among the legal scholars.

[1440] *See* Stephen C. Yeazell, *Group Litigation and Social Context: Toward a History of the Class Action,* 77 COLUM. L. REV. 866, 866 (1977). (Professor Yeazell elaborates on how the group litigation in its infancy performed different tasks as in the present. In his article he divides the development of group litigation into three periods. In the first period, group litigation functioned as "[a] means of modernizing and adjusting the customary law governing manorial and parochial relationships on the eve of the agricultural revolutions." In the second period, in late eighteenth and early nineteenth century, he courts reread the old cases and applied them on the emerging new groups. In the third period, the group litigation was perceived as a "[s]olution to the discrepancies that result from the imposition of a mass-production economy on an individualized system of litigation."). On the history of class actions *see also* STEPHEN C. YEAZELL, FROM MEDIEVAL GROUP LITIGATION TO THE MODERN CLASS ACTION (Yale University Press, 1987) or Geoffrey C. Hazard, Jr., *Indispensable Party: Historical Origin of a Procedural Phantom,* 61 COLUM. L. REV. 1254 (1961).

[1441] *See* Guido Calabresi & Kevin S. Schwartz, *The Costs of Class Actions: Allocation and Collective Redress in the US Experience,* 32 EUR. J. L. ECON. 169, 171 (2011). David Dudley Field was the initiator of the reform of the civil procedure, which culminated in the enactment of the Field Code in 1850 by the state of New York. For a historical analysis *see* Stephen N. Subrin, *David Dudley and the Field Code: A Historical Analysis of an Earlier Procedural Vision,* 6 LAW & HIS. REV. 311 (1988).

[1442] *See* Calabresi & Schwartz, *supra* note 1441, at 171.

[1443] The New York Field Code of 1848, as amended in 1849, stated, "When the question is one of a common or general interest of many persons, or when the parties are very numerous and it may be impracticable to bring them all before the court, one or more may sue or defend for the benefit of the whole." *See* ALBA CONTE & HERBERT B. NEWBERG, NEWBERG ON CLASS ACTION 399-400 (Thomson West, 4th ed. 2002).

[1444] *See* Calabresi & Schwartz, *supra* note 1441, at 172.

23 become part of a completely new system of Federal Rules of Civil Procedure.[1445] Yet between 1938 and 1966 class actions were still not often employed. Only with the **rise of civil rights and antipoverty movements**, rose the importance of this procedural device.[1446]

The original Rule 23 in 1938 attempted to categorize class suits and their effects in terms of the "jural relations" of the parties.[1447] In 1966, a new Rule 23 was adopted, which aimed to *"achieve economies of time, effort, and expense, and promote uniformity of decision as to persons similarly situated without sacrificing procedural fairness or bringing about other undesirable results."*[1448] The new rule set aside the concept of the old rule that a jural relationship had to exist among the members of a class before a class could be authorized. However, it took additional years to develop the practice surrounding the class action.[1449] By the 1980's the class actions started to grow[1450] and by 1990's many already thought that the pendulum had swung too far.[1451] Most commentators have perceived class actions with suspicion as

[1445] As Rule 1 provides, the Federal Rules of Civil Procedure governs the procedure in all civil actions and proceedings in the United States district courts, except as states in Rule 81. Rule 81(a) contains a series of topic-specific provisions making the Federal Rules either applicable or not. The Federal Rules of Civil Procedure are not applicable to prize proceedings, but are applicable to bankruptcy proceedings to the extent provided by the Federal Rules of Bankruptcy Procedure, Citizenship cases or Special Writs. *See* STEVEN S. GENSLER, FEDERAL RULES OF CIVIL PROCEDURE, RULES AND COMMENTARY Rule 1(2014), *available at* WestlawNext.
[1446] The poverty lawyers and lawyers fighting for equality saw class actions as a major vehicle for reforming the laws and practices. *See* Mark C. Weber, *Preclusion and Procedural Due Process in Rule 23(B)(2) Class Actions*, 21 U. MICH. J.L. REF. 347, 350-351 (1988).
[1447] *See* WILLIAM B. RUBENSTEIN, NEWBERG ON CLASS ACTIONS: A BRIEF HISTORY OF CLASS ACTIONS §1:14 (2014), *available at* WestlawNext.
[1448] *See* Rules Advisory Committee's Note to Amended Rule 23, 39 F.R.D. 69, 102-103 (1966).
[1449] Several practical and doctrinal questions had to be answered, *e.g.* who pays for notice; who had standing to bring the suit or what would make that standing debatable. *See* RUBENSTEIN, *supra* note 1447, at §1:16.
[1450] Although there is no specific data collected, several commentators observed the increased number of various types of class suits during this period, *See e.g.* DEBORAH R. HENSLER, CLASS ACTION DILEMMAS 23-25 (Rand, 2000).
[1451] *See* PRIVATE LITIGATION UNDER THE FEDERAL SECURITIES LAWS HEARINGS BEFORE SUBCOMM. ON SEC., SENATE COMM. ON BANKING, HOUS. & URBAN AFFAIRS, 103d Cong., 1st Sess. 2 (1993) ("[s]ecurities litigation has gotten out of hand and is destroying the very capital formation policy it seeks to promote.").

nonmeritorious byproducts of self-interested and the attorneys.[1452] Also the US Supreme Court itself revealed a skeptical view of the class action plaintiff's attorneys.[1453] Ultimately, the private securities litigation in the US became a system *"undermined by those who seek to line their own pockets by bringing abusive and meritless suits,"*[1454] and therefore a reform was necessary to protect investors, issuers and all market participants from abusive securities litigation.

Between 1995 and 1998 the US Congress enacted a series of measures to control the securities class actions – in 1995 the Private Securities Litigation Reform Act of 1995[1455] [hereinafter "PSLRA"] and in 1998 the Securities Litigation Uniform Standards Act of 1998[1456] [hereinafter "SLUSA"]. The PSLRA added many new provisions, including a new procedure for appointment of lead plaintiffs, a discovery stay, new pleading standards or a new safe harbor for forward looking statements.[1457] The US Supreme Court remained active in this regard and rendered several decisions that abridged the mass tort class actions.[1458]

[1452] *See e.g.* Martin H. Redish, *Class Actions and the Democratic Difficulty: Rethinking he Intersection of Private Litigation and Public Goals* 2003 U. CHI. LEGAL F. 71, 77 (2003). Author argues that the class litigation *"amounts to little more than private attorneys acting as bounty hunters." Generally see* William M. Landes & Richard A. Posner, *The Private Enforcement of Law*, 4 J. LEGAL STUD. 1, 15 (1975). (Here authors are arguing that because the price to the attorneys in case of class suits does not decline one an optimum level of enforcement is reached, there will be an excessive level of enforcement activity).

[1453] In Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 739-740 (1975), the US Supreme Court stated, "There has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general… The very pendency of the lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit."

[1454] *Id.*

[1455] Private Securities Litigation Reform Act of 1995, Pub. L. 104-67, 109 Stat. 737 (Dec. 22, 1995); The US Congress found that the existence of professional securities class action plaintiffs encouraged the filling of abusive cases, through which the lawyers would cause a substantial drop in a company's market capitalization, which served them as an excellent bargaining (blackmailing) tool. *See* S. REP. 104-98, at 8-9.

[1456] Securities Litigation Uniform Standards Act of 1998, Pub. L. 105-353, 112 Stat. 3227 (Nov. 3, 1998).

[1457] For an analysis of the PSLRA's new provisions *see* LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 4636 - 4669 (Little Brown & Co., 3d ed. 1996).

[1458] *See e.g.* Amchem Products Inc. v. Windsor, 521 U.S. 591 (1997) (reversing the 23(b)(3) class certification in asbestos litigation as the requirements of commonality of issues of fact and law and

6.2.1.1. Securities Class Action: How Does It Work?

Since 1995 a new chapter on securities class action is being written.[1459] And although the PSLRA heightened the pleading standards for securities class actions in the US, a significant portion of private litigation under the securities regulation continues to occur through the class action procedures of Federal Rule of Civil Procedure 23 even today.[1460] It has to be emphasized that the PSLRA is a contradictory piece of regulation, where the regulator's intent is not fully consistent with the final version of the regulation. Namely, when the US Congress adopted the PSLRA, it underlined that the **regulatory purpose** of the PSLRA is protection of investors and of confidence maintenance in the securities markets.[1461] Yet ultimately the PSLRA increased the litigation burdens of investors when bringing the class action suit.

The prerequisites for initiating a federal class action include **numerosity**, **commonality**, **typicality** and **adequacy**.[1462] The Rule 23(b) additionally lays down three categories of class actions that are functionally different, yet not mutually exclusive in relation to one another. However, majority of the securities class actions fall under the third category, the "common question" class action, which became the most used tool in case of damage class actions. A "common question" class action is

---

adequacy of representation were not met); Ortiz v. Fibreboard Corp., 527 U.S. 815 (1999) (overturning the 23(b)(1)(B) mandatory class certification in asbestos litigation as the prerequisites of fund limitation independent of party agreement, inclusiveness of proposed class and equitable treatment of all class members were not met).

[1459] The PSLRA its aims and effects have been discussed into great detail by plentiful scholars. *See e.g.* Joel Seligman, *Rethinking Private Securities Litigation,* 73 U.CIN.L. REV. 95 (2004); Stephen J. Choi & Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA,* 106 COLUM. L. REV. 1489 (2006); A.C. Pritchard & Hillary A. Sale, *What Counts as Fraud? An Empirical Study of Motions to Dismiss Under the Private Securities Litigation Reform Act,* 2 J. EMPIRICAL LEGAL STUD. 125 (2005); Stephen J. Choi, Jill E. Fisch & A.C. Pritchard, *Do Institutions Matter? The Impact of the Lead Plaintiff Provision of the Private Securities Litigation Reform Act,* 83 WASH. U.L.Q. (2005) or Marilyn F. Johnson, Karen K. Nelson & A.C. Pritchard, *Do the Merits Matter More? The Impact of the Private Securities Litigation Reform Act,* 23 J. L. ECON & ORGANIZATION 627 (2007).

[1461] *See* H.R. REP. NO. 104-369, at 31 (1995).

[1462] Fed. R. Civ. P. 23(a).

established if *"the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy."*[1463] A court determines whether to certify a class or not, depending on the fulfillment of the requirements. Once it does, *"the court must direct to class members the best notice practicable"* concerning the proposed class action and give class members an option to exclude themselves from the class by "opting out".[1464] Otherwise a court decision will be binding on all class members, whether or not it is favorable to the class.[1465]

According to the data set from the Administrative Office of the US Courts, the securities class actions represent almost a **half** of all class actions pending in federal courts.[1466] Many criticize them as they generally take longer to resolve and consume more judicial time and attention than other types of class actions. A court in securities class actions has to play a greater monitoring role, as it has to select the "lead plaintiff" who represents the entire class. This requires a court to determine which potential plaintiff suffered the largest loss and therefore has the greatest interest in the suit.[1467] Furthermore, in order to substantiate the interest of the class before being even allowed a discovery (a discovery stay), the plaintiff has to satisfy an increased pleading test under the Rule 9(b) of the Federal Rule of Civil Procedure. According to this test, parties have to *"state with **particularity** the circumstances constituting fraud*

[1463] Fed. R. Civ. P. 23(b)(3).
[1464] Fed. R. Civ. P. 23(c)(2).
[1465] Fed. R. Civ. P. 23(c)(3).
[1466] In 2002, the total percentage of securities class actions was of 47.5 %; in 2003: 47% and in 2004: 47.9%. However, it is impossible to assess additional data since 2004 as the Administrative Office of the US Courts has not been collecting any data concerning federal class actions. However, it is claimed that in 2005 and 2006 there has been a 45% decline in securities class action fillings. *See* Paul Davies, *Class Inaction: Plaintiffs' Lawsuits Against Companies Sharply Decline,* WALL ST. J., Aug. 26, 2006, at A1.
[1467] *See* Coffee, *Reforming the Securities Class Action, supra* note 1193, at 1540-1543.

or mistake."[1468] Although the interpretation of this test continues to remain obscure,[1469] more worrisome is the application of the class action by investors of investment companies.

6.2.1.2. Relevance of Class Actions in Case of Investment Companies: Limited Application

Even though the mutual funds continue to experience growth and represent one of the most popular investment vehicles for retail investors, investors are protected only virtually. As shown in previous sections,[1470] the SEC has a limited reach when enforcing rights of investors. Thus, one would have thought that the US, a legal system known exactly for empowering investors with the private right of action, would provide sufficient legal tools for individuals to protect their investments. Yet individuals under the current regulation and "unfriendly courts" seeking to recover financial losses through private right of action face increased judicial scrutiny and great challenges while enforcing their rights. Although the securities class action represents a good negotiating tool for investors,[1471] one has to realize that since day

---

[1468] Fed. R. Civ. P. 9(b). This rule is beyond what is generally required from plaintiff under the rule 8(a), which only requires a pleading to enclose *"a short and plain statement of the claim showing that the pleader is entitled to relief."*

[1469] *See* MICHAEL J. KAUFMAN, SECURITIES LITIGATION: DAMAGES §3:10 (2014), *available at* WestlawNext. The Ninth Circuit established that *"particular facts giving rise to a strong inference of deliberate recklessness, at a minimum,"* have to be proved by the plaintiff. While, the Second, Third and Sixth Circuits agree, *"[p]laintiff may survive a motion to dismiss by pleading facts that give rise to a "strong interference" of recklessness."* Looking at the decisions of the district courts, one however finds that roughly sixty percent of the cases follow the lower standard laid down by the Second Circuit, while the others follow some higher standard. *See* In re Comshare Inc. Securities Litigation, 183 F.3d 542 (6th Cir. 1999); In In re Advanta Corp. Securities Litigation, 180 F.3d 525 (3d Circ. 1999) the court stated that "it remains sufficient for plaintiffs plead scienter by alleging facts 'establishing a motive and an opportunity to commit fraud, or by setting forth facts that constitute circumstantial evidence of either reckless or conscious behavior."

[1470] *See* sections 5.1.1. & 5.1.2.

[1471] *See* SECURITIES CLASS ACTION SETTLEMENTS: 2013 REVIEW AND ANALYSIS (Cornerstone Research: Economic and Financial Consulting and Expert Testimony, 2014), *available online at:* < http://securities.stanford.edu/research-reports/1996-2013/Settlements-Through-12-2013.pdf>/ *last visited* Jan. 3, 2015.

one investors have never won against investment companies or their advisers under the federal securities laws.[1472]

The historical adverse standing of investors and the limited private right of action opportunities under ICA 1940 do not allow investors in the US to defend their rights and become active investors as policy statements call for.[1473] The only option for investors to bring a class action against a mutual fund is to resort to other provisions of the US securities regulation – to the principal statutory weapons against fraud: Section **10(b)** and Rule **10b-5 SEA 1934** and blend these with the Federal Rules of Civil Procedure, Rule 23.[1474] However, even this became problematic since the Supreme Court decision in *Dura Pharmaceuticals, Inc. v. Broudo* in 2005.[1475]

After this decision and the decision in *Van Wagoner*[1476] it has been argued that investors (plaintiffs) can literally **never establish loss causation** and therefore never sustain a right of action under the current federal securities regulation when suing an investment company for a material misstatement or fraud.[1477] This stems from the

---

[1472] *See* Mercer E. Bullard, *Dura, Loss Causation, and Mutual Funds: A Requiem for Private Claims?*, 76 U. CIN. L. REV. 559, 559-560 (2008).

[1473] The US courts have rejected private right of actions based under the ICA 1940, *See* In re Eaton Vance Mut. Funds Fee Litig., 380 F.Supp. 2d 222,233 (S.D.N. Y. 2005) (finding no private right of action under sections 34(b), 36(a) and 48(a) ICA 1940); White v. Heartland High-Yield Mun. Bond Fund, 237 F. Supp. 2d 982, 986 (E.D. Wis. 2002) (finding no private right of action under sections 22 and 34(b) of ICA 1940); Olmsted v. Pruco Life Ins. Co., 283 F.3d 429, 432-33 (2d Cir. 2002) finding no private right of action under sections 26(f) and 27(i) ICA 1940).

[1474] Under section 10(b) and rule 10b-5, the plaintiff must prove that "the act or omissions of the defendant alleged to violate [the SEA 1934] cause the loss for which the plaintiff seeks to recover damages." *See* 16 U.S.C. §78u-4(b)(4) (2012).

[1475] Dura Pharmaceuticals, Inc. v. Broudo 544 U.S. 336 (2005).

[1476] In re Van Wagoner Funds, Inc. Securities Litigation, 382 F. Supp. 2d 1173 (N.D. Cal. 2004). Here the court required a strict loss causation in connection to the mutual funds. The plaintiffs in this case alleged that the fund's auditor misrepresented that some of the securities held by the fund had been carried at their fair value when they had actually been valued at cost, which was substantially higher than their fair value. This forced the fund to carry out buys and redemptions of its shares at an inflated price. Yet given the fact that the fund's share prices increased on the first "trading" day after the disclosure of auditor's misrepresentation, the court did not perceive the loss causation to be shown by the plaintiffs; *see* 1179-1183.

[1477] *See e.g.* Christopher J. Dutton, Note, *Dura Pharmaceuticals, Inc. v. Broudo: Extracting Teeth from Securities Regulation*, 33 N. KY. L. REV. 153, 179-82 (2006) or Jerod Neas, *Dura Duress: The Supreme Court Mandates a More Rigorous Pleading and Proof Requirement for Loss Causation under Rule 10b-5 Class Actions*, 78 U. COLO. L. REV. 347 (2007).

following facts. Investors (plaintiffs) bringing suits under sections 11 and 12(a)(2) of the SA 1933 and section 10(b) of SEA 1934 and rule 10b-5 thereunder must assert that the misconduct generated loss.[1478] Not only assert, but according to the PLSRA 1995 the investors have to plead and prove loss causation to recover their financial losses.[1479] In a classic issuer case, investors would have to show that the company inflated the price of security and then the price fell as the direct result of the public correction of false information. However, in case of mutual funds proving that is problematic as price of mutual fund shares is not affected by the public correction of a misrepresentation, as their shares are not priced in a market.[1480] The price of shares of mutual funds is determined as *per share* net asset value of the fund, which is assessed based on the fair market value of fund's portfolio.[1481] Secondary market plays no role in evaluating the mutual fund shares. Because of the way the funds are priced, no public disclosure of information will affect fund's net asset value.[1482]

In addition, under the restrictive reading of *Dura Pharmaceuticals, Inc. v. Broudo*, some courts have interpreted loss causation **strictly** and require a post-transaction decline in stock price that results from a corrective disclosure.[1483] However, such requirement renders a claim against mutual funds completely ineffective. The only types of investment company, where the secondary market plays a role in the case of evaluating price of its shares is the closed-end fund or UITs, if

[1478] Sections 11 and 12 of SA 1933 provide investment company (defendants) with an affirmative loss causation defense, reducing recoverable losses *"by the amount that represents other than the depreciation in value of such a security resulting from such part of the registration statement, with respect to which his liability is asserted." See* 15 U.S.C. §77k(e), 771(b) (2012).
[1479] 15 U.S.C. §78u-4(b)(2), (b)(4) SA 1939 (2012). The PSLRA allows a defendant to avoid liability in Section 12(a)(2) for "any portion or all of the amount" of depreciation in value of the subject security that resulted from factors other than the misstatement or omission. *See* also MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW 236 (LexisNexis, 5th ed. 2009).
[1480] *See* Bullard, *supra* note 1472, at 563-564.
[1481] 15 U.S.C. §80a-2(a)(41) ICA 1940 (2012).
[1482] *See* Bullard, *supra* note 1472, at 560-561.
[1483] *See e.g.* Jill E. Fisch, *Cause for Concern: Causation and Federal Securities Fraud*, 94 Iowa L. Rev. 811, 825 (2009).

resold in the secondary market. However, these two types of investment companies hold only a fraction of the investors' investment in comparison to mutual funds.[1484] Thus, the strict loss standard essentially strictly restrains investors from claiming their rights.

Realizing the unperceivable standard of the "strict" loss causation, alternative - "strong" loss causation standard has been introduced by some courts. Some courts have interpreted the *Dura Pharmaceuticals, Inc. v. Broudo* as requiring only a **direct connection** between the misrepresentation and the share price instead of the explicit share price decline.[1485] Still this is also a bar almost impossible to reach, as the price decline has to relate to the actual pricing of the fund; rendering thus the claims based on change of investment strategy, the amount of charged fees or other misrepresentations with respect to similar claims out of investors' control.[1486] Although courts continue to interpret the loss causation differently,[1487] ultimately, the current state of regulation of investment companies in the US, irrespective of powerful procedural tool as class action indisputable is, leaves investors without any practical remedy for breach of ICA 1940 or any manifest fraud. Considering that it is unlikely that the US Congress intended to create a loophole for mutual funds for

[1484] In 2013 the mutual funds held $15.00 trillion in assets, while the closed-end funds held $279 billion and UITs $87 billion; *See* 2014 INVESTMENT COMPANY FACT BOOK, *supra* note 17, at 2.

[1485] The court stated that loss causation requires "that the misstatement or omission conceal[s] something from the market that, when disclosed, negatively affects the value of the security." *See* Letell v. Merill Lynch & Co., 396 F.3d 161, 173 (2d Cir. 2005).

[1486] *See* Bullard, *supra* note 1472, at 569-570.

[1487] The US District Court of the Northern District of California in 2009 stated that a plaintiff needs only to show "that the subject of the fraudulent statement or omission" caused the loss suffered. Thus interpreting the loss causation broadly. *See* In re Charles Schwab Corp. Securities Litigation 257 F.R.D. 534, 547-548 (N.D. Cal. 2009). In contrast, In re State Street Bank & Trust Co. Fixed Income Funds Investment Litigation, the court dismissed the investors' claim for insufficiently pleading loss causation as they alleged that their fund managers misrepresented the nature, extent, and potential consequences of the investments in mortgage-backed securities. Although the court recognized similarities with the Charles Schwab case, it rejected those conclusions. *See* 774 F. Supp. 2d 584, 591-596 (S.D.N.Y. 2011).

making false or misleading statements on their prospectus or registration statement, the Congress should remedy this situation.[1488]

6.2.2. Possible Application in the EU

Setting aside the existing inefficiencies of the securities class actions in case of mutual funds in the US given the fact that the issues are of substantive origin rather than procedural, the important lesson shown by the US is how imperative is to clearly define the private right of action and the circumstances under which it is granted. In the EU, if correctly implemented, a class action as a procedural tool could represent a possible additional safeguard for investors' rights and even the cure for their passivism. Imagining common market for all financial services, including investment companies, where investors from different Member States would invest in diverse investment companies, irrespective of their seat or origin, a mechanism of class action would allow consolidation of small and dispersed claims. It would cover the costs of litigation while dividing substantial benefits if successful. Moreover, in connection with highly dispersed investors in case of investment companies, a class action is a logical procedural tool as if one investor's rights have been impaired, there is a great chance that there are also other investors, who have suffered the same damage.[1489] Joining forces with other participants on the same predicament can lead to much more effective use of resources and economies of scale as well as allowing those individuals to enforce their right, which otherwise would be not affordable or viable. The publicity that the class actions often bring with them might be beneficial for a

[1488] For an alternative wording of the section 12(b) of SA 1933, *see* Samuel L. Moultrie, Note: *Loss Causation, Mutual Funds, and Securities Act Claims: An Uncertain Future for Shareholders*, 25 REGENT U. L. REV. 443, 465- 469 (2013).

[1489] In 2006, the Euro Barometer showed that seventy-four percent of respondents in twenty-five Member States would be more willing to defend their rights in court if they could join with other consumers. *See* EUROBAROMETER: CONSUMER PROTECTION IN THE INTERNAL MARKET (European Commission, 2006).

great number of investors, who would otherwise be kept in dark. What better protection can a legal system provide than the ability to protect oneself?

Unfortunately, for the time being, the concept of a class action – especially in the version that would **closely resemble the US one** – is known, neither to the EU, nor many of its Member States. On the EU-level the class action is linked to **consumer protection** and the **competition** agenda.[1490] In 2007, Meglena Kuneva, the EU consumer affairs commissioner announced that she was looking at a new system of "collective redress" allowing European consumers to bring claims against providers of faulty goods or services, which would provide people with more confidence in cross-border acquisitions and service.[1491] Although the EU business leaders were naturally far from thrilled about the new direction of empowering the "consumers",[1492] the EU in its Consumer Policy Strategy 2007-2013 stated that "[*t]he Commission… **will consider** action on collective redress mechanisms for consumers both for infringements of consumer protection rules and for breaches of EU antitrust rules.*"[1493]

Later, on October 5, 2010 Vice-President Reding,[1494] Vice-President Almunia[1495] and Commissioner Dalli[1496] underlined in their Joint Information Note the need for a coherent European approach to collective redress. Following the Information Note, the European Commission held a public consultation and a public

---

[1490] Pressure for consumer collective actions can be traced to the 1980's, *see* Chrisopher Hodges, *Collective Redress: A Breakthrough or a Damp Squibb?,* 37 J. CONSUMER POL'Y 67, 68 (2014) [hereinafter "Hodges, *Collective Redress*"].
[1491] *See* George Parker, *EU Considers Consumer Class Action*, FIN. TIMES, March 4, 2007 (*"Only six percent of European consumers made at least one cross-border e-commerce purchase in 2006; only* ***one*** *percent used cross-border financial services."*).
[1492] *See* George Parker & Tobias Buck, *Business Warns EU Against Class Action Suits,* FIN. TIMES, March 14, 2007.
[1493] EU Consumer Policy Strategy 2007-2013 (COM (2007) 99 final).
[1494] Responsible for Justice, Fundamental Rights and Citizenship agenda in the EU.
[1495] Responsible for Competition agenda in the EU.
[1496] Responsible for Health and Consumer Policy agenda in the EU.

hearing on collective redress in early 2011.[1497] The purpose of this consultation was to identify common legal principles on collective redress in the EU. The consultation explored the fields in which the different forms of collective redress could have an added value for better protection of the rights of EU citizens and businesses, and for improving the enforcement of EU legislation. Based on the public consultation, the European Commission issued a Recommendation on common principles for injunctive and compensatory collective redress mechanisms in the Member States concerning violations of rights granted under EU law.[1498] The initiative **recommends that all Member States introduce collective redress mechanisms** to facilitate the enforcement of the rights that all EU citizens have under EU law (including but not limiting to competition law) that follows a set of common principles.

Thus, there are several questions that the EU is facing. First, whether an already existing concept in one of the Member States could be suitable for the EU. Second, in what form would be a class action concept introduced? Would it be a regulation or a directive? Would it be a general procedural concept applicable in all fields of law or would it be applicable only under specific circumstances? Furthermore, how would it respond to the existing cross-border jurisdictional regime under Brussels I?[1499] In the subsequent parts an analysis of these is provided.

[1497] *See* Public consultation materials, *available online at*: < http://ec.europa.eu/competition/consultations/2011_collective_redress/index_en.html >.

[1498] *Available online at*: <http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1398263020823&uri=OJ:JOL_2013_201_R_NS0013 >.

[1499] Council Regulation (EC) No 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, O.J. L12/01 [hereinafter "Brussel I"].

6.2.2.1. On Member State - Level

Reflecting on the EU Member States regulation of class action, a number of them has considered or already adopted recently a new set of class action laws.[1500] However, their approach towards the class action is not uniform and is different from what US offers.[1501] In several EU Member States class actions are allowed only in specific fields of law, such as consumer protection, unfair competition or labor law,[1502] while other countries decided to introduce class action as a general procedural device, irrespective of the field of law.[1503] In other countries, group litigation is achievable

[1500] Including countries as Bulgaria, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway or Sweden. *See e.g.* Yu-Hsin Lin, *Modeling Securities Class Actions Outside the United States: The Role of Nonprofits in the Case of Taiwan,* 4 N.Y.U. J. L. & BUS. 143, 145 (2007) and Stefano M. Grace, *Strengthening Investor Confidence in Europe: U.S.-Style Securities Class Actions and the Acquis Communautaire,* 15 J. TRANSNAT'L L. & POL'Y 281, 292-300 (2006).

[1501] By 2008, thirteen of the twenty-seven Member States had judicial collective redress mechanism. The European Commission study showed that "the vast majority of the existing collective redress mechanisms tend to have some elements that work, and some that do not. Almost all existing collective redress mechanisms have some added value compared to individual judicial redress and alternative dispute resolution schemes. But their efficiency and effectiveness could be improved. The mechanisms have been applied in relatively few cases." *See* Green Paper on Consumer Collective Redress, COM (2008), *available online at*: < http://ec.europa.eu/consumers/archive/redress_cons/docs/consultation_paper2009.pdf>/ *last visited* Mar. 10, 2015.

[1502] In **Belgium**, the Act on Claims for Collective Redress was adopted on March 28, 2014. This act is limited in scope and does not introduce general class action. A class action can be only initiated by a consumer and directed against a business entity. Class actions against other individuals or public authorities are not possible, *see* Loi portant insertion d'un titre 2 "De l'action en reparation collective" au livre XVII" Procédures juridictionnelles particulières" du Code de droit économique et portant insertion des definitions propres au livre XVII dans le livre 1er du Code de droit économique [Act on Claims for Collective Redress] of Mar. 28, 2014, MONITEUR BELGE [M.B.] [Official Gazette of Belgium] Mar. 29, 2014. For more details, *see* INTERNATIONAL COMPARATIVE LEGAL GUIDES, CLASS AND GROUP ACTIONS, BELGIUM 2015; In **Finland**, the Act on Class Action took effect on 1st October 2007, where the right of initiating actions and representing the class of consumers is assigned to the Consumer Ombudsman, *available online at:* < http://www.finlex.fi/en/laki/kaannokset/2007/en20070444.pdf>/ *last visited* Dec. 1, 2014; In **France**, consumer associations after being granted a legal approval at the national level by the Ministry of Economy and Finance may initiate such actions to obtain reparation before ant court on behalf of several consumers, *see* Article L.422-1 of the Consumer Code), *see also* INTERNATIONAL COMPARATIVE LEGAL GUIDES, CLASS AND GROUP ACTIONS, FRANCE 2015; Similar situation is in **Italy,** where according to Article 140-bis of Legislative Decree no 205/2005 consumers associations are entitled to bring court actions seeking monetary compensation for damages caused to consumers' collective interests. Similar situation is present also in **Romania**, where collective actions can be initiated in areas as consumer protection, human rights protection in fight against discrimination or labor law; *see* INTERNATIONAL COMPARATIVE LEGAL GUIDES, CLASS AND GROUP ACTIONS, ROMANIA 2015;

[1503] Since 2007, a new Civil Procedure Code, March, 1, 2008 adopted in **Bulgaria** recognized class action procedure for (1) a non-monetary relief and (2) class action for mass tort. In **Cyprus**, a class action is governed by order 9 of the Cyprus Civil Procedure Rules, *available online* at: <

through the **joinder of actions procedure**,[1504] which however has very little in common with the US type class actions.

There are only few jurisdictions, where the class action has been introduced as a form of a general legal redress, namely in Netherland, Sweden, Spain, Denmark and the UK. In Netherlands there are two types of class actions, both peculiar. First is a class action introduced in 2005 by the Collective Action Act and subsequently codified in the Civil Code – *"Collectieve Afwikkeling Massaschade"*.[1505] Pursuant to the Dutch Civil Code, consumer organizations and other interest groups, representing the harmed individuals, can seek declaratory and injunctive relief, but no damages. Concerning the second type of class action, Dutch law provides for out-of-court collective settlements between parties – as a very unconventional type of class action. Before a competent authority (Amsterdam Court of Appeal) can rule, an association representing plaintiffs has to conclude a settlement with a defendant. If a settlement is reached, the Amsterdam Court of Appeal can declare the settlement binding in relation to the entire class under the Act on Collective Settlement of Mass Damage Claims.[1506] However, on July 7, 2014 a new proposal on redress of mass damages under the Collective Action Act was initiated, under which class plaintiffs would be

---

http://www.cylaw.org/cpr.html>/ *last visited* Feb. 13, 2015. General class and joined actions are allowed also under **Irish** Civil Procedure Rules. In **Portugal**, the law established a specific procedure for class actions called *"Acção Popular"*.

[1504] It is the case of **Austria**, the class action ("*Sammelklage*") is not recognized by the Austrian Civil Procedure Code, *see* ZIVILPROCESSORDNUNG [ZPO] (CIVIL PROCEDURE CODE) [BUNDESGESETZBLATT [BGBL] vom 12.09.1950 (Austria). However, the Austrian Supreme Court held that a "class action with a specific Austrian character" (*mit österreichischer* Prägung) is legally permissible based on the §227 of the Austrian Civil Procedure Code concerning joinder of actions; *available online at:*< http://www.lawfirm.at/wp-content/uploads/pdfs/PHi.pdf>/ *last visited* Dec. 1, 2014; Similar is applicable for other Member States, including **Czech Republic, Denmark**, **Estonia, Hungary or Slovak Republic.**

[1505] Under article 3:305a/b of Civil Code (*Burgelijk Wetboek).* The law came into force following the Royal Decree of July 16, 2005.

[1506] *See* Allen & Overy, European Finance Litigation Review, *available online at:*< http://www.allenovery.com/publications/en-gb/european-finance-litigation-review/northern-europe/Pages/Radical-cahnges-proposed-to-Dutch-class-action-system.aspx>/ *last visited* Dec. 1, 2014.

allowed to claim also damages.[1507] Considering a substantial criticism against the proposed changes, it is questionable whether the act will be approved by the Parliament.

Since January 2003, Sweden has recognized class actions for all civil claims.[1508] The Group Proceeding Act is a purely procedural act, under which any single plaintiff, as a representative of a group of individuals and/or legal persons can bring a civil claim as long as the claims are *"founded on circumstances that are common or of a similar nature."*[1509] Plaintiffs in class action are entitled to same remedies as under the Swedish Code of Judicial Procedure and therefore monetary compensation, specific performance and declaratory judgments as well as injunctive relief are all available as remedies. Even though the Group Proceeding Act has been in place for eleven years, it has not been applied to full extent. In 2008, according to a complete review of number of cases, only twelve class actions had been brought under this act. Out of these, individuals brought eleven and the Consumer Ombudsman brought one action.[1510]

The Danish law on class action took effect on January 1, 2008.[1511] Danish class action (*Gruppesøgsmål*) is actionable under two mechanisms: (1) private opt-in class action and (2) representative action. In both cases, the court must determine that a class action is the best procedural format for litigating the issue. This court discretion was perceived as a tool against an abusive litigation. According to Professor

[1507] *Id.*
[1508] *See* Group Proceeding Act, SFS 2002:599, *available in English online at:*< http://www.government.se/content/1/c6/02/77/67/bcbe1f4f.pdf >/ *last visited* Dec. 1, 2014.
[1509] *See* section 8 of LAG OM OFFENTLIG UPPHANDLING (Svensk författnigssamling [SFS] 2007:1091) (Swed.) (Group Proceeding Act).
[1510] *See* INTERNATIONAL COMPARATIVE LEGAL GUIDES, CLASS AND GROUP ACTIONS, SWEDEN 2015.
[1511] *Available online in Danish:* < http://jm.schultzboghandel.dk/upload/microsites/jm/ebooks/bet1468/bet/hele.html> / *last visited* Jan. 6, 2015.

Werlauff, the Danish class action law only provides for procedural access to the courts, but it does not anyhow change the provisions concerning evidence, discovery, expert witnesses, expenses, etc.[1512] Thus, it is of the opinion of some lawyers in Denmark that the class action in the current form is not likely to become massively used due to the financial burden it represents for the plaintiffs and deficient incentives for Danish lawyers to even bring a claim.[1513]

In the UK, the collective class action procedure is known as "Group Litigation Order," which is in effect since May 2, 2000 [hereinafter "GLO"].[1514] GLO forms a part 19 (section III) of the Civil Procedure Rules.[1515] GLO "*[m]eans an order made under rule 19.11 to provide for the case management of claims which give rise to common or related issues of fact or law (the 'GLO issues').*"[1516] Until 2008, there have been only four cases in regard to financial misstatement or financial negligence with approximately of 750 class members.[1517] Unfortunately, out of the few cases that are available online on the UK Department of Justice website,[1518] none directly involves investment company.

Furthermore, the UK also begun to reevaluate their existing laws on class action[1519] and in connection with competition cases.[1520] The government at the time

[1512] *See* Erik Werlaugg, *Class Actions in Denmark*, article prepared for Oxford Conference on Globalization of Class Actions, Dec. 12-14, 2007, *available online at:* < http://globalclassactions.stanford.edu/sites/default/files/documents/Demark_National_Report.pdf>/ *last visited* Jan. 5, 2015. [hereinafter "Denmark National Report"].
[1513] *See* Robert Gaudet Jr., Earth to Brussels: Lessons Learned From Swedish, Norwegian, Danish, and Dutch Class Actions for the European Union Debate on Collective Redress 51 (unpublished MA thesis, Stockholm University).
[1514] It was implemented via Pt 19. III of the Civil Procedure Rules.
[1515] Part 19 – Parties and Group Litigation, *available online at:* < http://www.justice.gov.uk/courts/procedure-rules/civil/rules/part19#19.11>/ *last visited* Jan. 5, 2015.
[1516] Civil Procedure Rules 19.10.
[1517] *See* Civil Justice Council of England and Wales, Reform of Collective Redress in England and Wales: A Perspective of Need 13 & 17 (Rachael Mulheron ed., 2008).
[1518] Group Litigation Orders, *available online at:* < http://www.justice.gov.uk/courts/rcj-rolls-building/queens-bench/group-litigation-orders>/ *last visited* Jan. 5, 2015.
[1519] *See* Improving Access to Justice Through Collective Action 17 (Civil Justice Council, Final Report 2008).

rejected the recommendation to provide efficient justice to all parties and decided to only continue its study in two fields. First was the competition law and second was the financial law. Although the bill that incorporated an opt out procedure for financial services claims reached the Third Reading in the House of Lords, it was dropped shortly before the 2010 general election.[1521] It is claimed that the government sought to pass as much of its legislation as possible prior to the dissolution of Parliament.[1522] Yet given the fact that the bill was already in third reading, which means it had passed in January 2013 an opt-out collective action scheme before the Competition Appeal Tribunal was introduced,[1523] but no revision of the general GLO was yet proposed.

Nevertheless, an interesting case as to the circumstances and size of a claim has recently arisen in the UK against Lloyds Banking Group. Investors - the "Lloyds Actions Now" – claim misrepresentation and breach of fiduciary duties.[1524] They were misled into supporting a 2008 takeover of the HBOS Pls that prompted a £20 billion bailout by the UK government. The UK High Court approved the GLO and currently new and new investors are joining this class action.[1525] Even though the

---

[1520] *See* PRIVATE ACTIONS IN COMPETITION LAW: A CONSULTATION ON OPTIONS FOR REFORM – GOVERNMENT RESPONSE (Department for Business Innovation & Skills, January 2013), *available online at:* < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/70185/13-501-private-actions-in-competition-law-a-consultation-on-options-for-reform-government-response1.pdf>/ *last visited* Jan. 6, 2015.

[1521] Financial Services Act 2010; Draft of the proposal is *available online at:* < http://www.legislation.gov.uk/ukpga/2010/28/pdfs/ukpga_20100028_en.pdf>/ *last visited* Jan. 6, 2015.

[1522] *See* Andrew Higgins & Adrian Zuckerman, *Class Action in England? Efficacy, Autonomy and Proportionality in Collective Redress* 5 (University of Oxford, Legal Research Paper Series No 93/2013).

[1523] *Id.*

[1524] Plaintiffs claim that the directors of Lloyds TBS breached fiduciary duty and other duties owed to shareholders when advising them that the acquisition of HBOS and the connected bailout of Lloyds Banking Group were in their best interest, and in procuring shareholders' approval of the transactions on the basis of misleading information.

[1525] Since August until November, more than 5,000 investors have joined the action, claiming a loss of £400 million in the government-arranged takeover of HBOS; *see* Martin Arnold, *More Than 5,000 Join Lawsuit against Lloyds over HBOS Deal,* FIN. TIMES, Nov. 9, 2014. There is even a web site devoted to the shareholder action, *available online at:* < http://www.lloydscase.com>/ *last visited* Jan. 8, 2015.

outcome of this case is only to be seen, it is highly probable that this will be one of the highest-value claims heard in an English court.[1526]

Considering the civil law jurisdiction, as Germany or Austria, recently there has been a movement in connection with the relevance of class actions. Although they do not regulate class action in a form of a general legal redress, they recently became to recognize its importance as a type of a procedural tool, mainly in connection with securities law. In Germany under the German Capital Investors Model Proceedings Act (*Kapitalanleger-Musterverfahrengesetz*) [hereinafter "KapMuG"] investors are able to have certain sections of pending securities actions adjudicated collectively.[1527] Although at the beginning the KapMuG only applied to damages based on public information concerning securities under German Securities Acquisition and Takeover Act (*Werpapiererwerbs- und Übernahmegesetz*) issued by a securities issuer, after the amendments in 2012, investors may bring claims against a broker or dealer of financial products.[1528] Yet investors may not bring class actions against UCITS MC or other types of investment companies as they are governed by the Securities Trading Act (*Wertpapierhandelsgesetz*) [hereinafter "WpHG"].[1529] The WpHG does not assign any remedial rights to investors, it is purely the Supervisory Authority, which may commence a proceeding against an investment company. Thus ultimately a class action is not available to investors of investment companies in Germany.

[1526] *See* Caroline Binham & Martin Arnold, *Lloyds Faces Lawsuit over HBOS Takeover*, FIN. TIMES, Aug. 6, 2014.
[1527] This act came into force in 2005, when the German courts faced difficulties with administering large number of similar securities actions, around 13,000, brought against Deutsche Telekom.
[1528] For a more detailed review on German class action under German Securities Acquisition and Takeover Act, *see* INTERNATIONAL COMPARATIVE LEGAL GUIDES, CLASS AND GROUP ACTIONS, GERMANY 2015.
[1529] *See* Gesetz über den Wertpapierhandel [WpHG] [Securities Act], July, 26, 1994, BGBl I S. 2708, art. 2(1) (Ger.).

As observed several times, it is usually a crisis or a scandal that brings attention of regulators closer to solving issues. Although the Austrian Civil Procedure Code recognizes only a joinder of action, after 20,000 Austrians have lost their investments in closed-end real estate and shipping funds in May 2014, the Association for Consumer Information (*Der Verein für Konsumenteninformation*) has been arguing for introducing class actions against closed-end funds.[1530] Nevertheless, until today investors' options for class action against investment companies in Austria remain limited.

Considering the diverse approaches towards the collective redress in the EU, it is hardly imaginable that investors from different Member States would be able to join forces and unitedly sue *e.g.* an investment company in case of a fraud, misrepresentation or excessive fees. In addition, as Professor Warren underlines, the EU Member States themselves lack the *"facilitating features credited for the nurture and development of the US securities class actions"*[1531] Among these are contingency fee,[1532] discovery mechanism,[1533] jury trial or punitive damages.[1534] Conclusively, the only viable option for facilitating private enforcement rights of investors and thus providing them with sufficient protection in the desired common market is by **introducing an EU regulation on class action**.

[1530] *Available online at:* <http://kurier.at/wirtschaft/finanzen/verlustreiche-fonds-vki-wird-info-plattform-starten/66.710.470> or < http://www.ots.at/presseaussendung/OTS_20140220_OTS0016/vki-startet-sammelklagen-aktion-in-sachen-geschlossene-fonds>/ *last visited* Dec. 2, 2014.

[1531] *See* Manning Gilbert Warren III, *The U.S. Securities Fraud Class Action: An Unlikely Export to the European Union,* 35 BROOK. J. INT'L L. 1075, 1084 (2012) [hereinafter "Manning, *The U.S. Securities Fraud Class Action*"].

[1532] EU Member States generally proscribe plaintiffs' lawyers from collecting contingent fees. *See* Deborah R. Hensler, *The Globalization of Class Action: An Overview,* 622 ANNALS AM. ACAD. POL. & SOC. SCI. 7, 22 (2009).

[1533] In the US the parties in litigation have open access to each other's relevant documents and testimony, *see* Warren III, *The U.S. Securities Fraud Class Action*, *supra* note 1531, at 1084-1086.

[1534] In the EU jurisdictions, the jury trials in civil cases are nonexistent and punitive damages are not available. *See* Mark A. Behrens, Gregory L. Fowler & Silvia Kim, *Global Litigation Trends – Class Actions, Contingency Fees, and Punitive Damages: Moving Toward the American Civil Law Model?,* 17 MICH. ST. J. INT'L L. 165, 187 (2009).

6.2.2.2. On EU - Level: A New Regulation Is Needed Yet Only Recommendation Is Given

The EU has been engaged in establishing a EU common market in financial services since 1992. Series of directives and regulations have been adopted in order to enable all participants "free movement" and allow everyone to choose any goods or services border-less. Yet according to the Report on Retail Financial Services from 2012 only **nine percent** of 26,856 respondents purchased goods or services outside their country in any other EU Member State, including financial products.[1535] It is naturally a question of interpretation whether one perceives nine percent to be sufficient or not. Yet the fact that the question was posted in a way to include all kinds of goods and services while conducting a special report on financial products is also telling. Most presumably the number would be much lower had the inquirer targeted only financial services, not to mention cross-border investment in investment companies. Now comes the question - how could the EU increase the number of investors in the EU? Naturally one of the suggestions is to provide them with adequate protection in a form of a cross-border redress. This has been tardily recognized also by the EU, but only partially.

In February 2011, the European Commission launched a *Public Consultation*: *Towards a Coherent European Approach to Collective Redress,*[1536] with purpose to identify **common legal principles on collective redress**, which would fit into the EU

[1535] SPECIAL EUROBAROMETER 373: RETAIL FINANCIAL SERVICES 114 (European Commission, 2012).

[1536] Institution-wise, the preparation for collective redress introduction, has been carried out in a fairly uncoordinated way by two Directorates General of the European Commission, namely DG SANCO (Health and Consumer Protection)and DG COMP (Competition). Moreover, in 2010 they were joined by the DG JUSTICE (Justice, Fundamental Rights and Citizenship) in order to develop a "horizontal approach to collective redress in the EU. Unfortunately, there has been only limited cooperation between the two DGs, *see* Lukasz Gorywoda, *The Emerging EU Legal Regime for Collective Redress: Institutional Dimension and Its Main Features in* CROSS-BORDER CLASS ACTIONS: THE EUROPEAN WAY 175-178 (Arnaud Nuyts & Nikitas E. Hatzimihail, 2014); *see also* Hodges, *Collective Redress*, *supra* note 1490, at 68-70 & 75-76.

legal system and into the redress framework of the Member States.[1537] Subsequently, the European Parliament adopted a resolution, pursuant to which *"access to justice by means of collective redress comes within the sphere of* ***procedural law*** *and is concerned that uncoordinated EU initiatives in the field of collective redress will result in a fragmentation of national procedural and damages laws, which will weaken and not strengthen access to justice within the EU; calls, in the event that it is decided after detailed consideration that a* ***Union scheme of collective redress*** *is needed and desirable."*[1538]

Now, the question is in which form should a class action be adopted and whether an adjustment to existing regulation would be sufficient or a completely new legislative act is important. Although the EU had traditionally a narrowly circumscribed sphere for legislative initiative regarding civil procedure, after the adoption of the Lisbon Treaty, additional sphere for maneuvering has surfaced. First, under Article 19(1) TEU the *"Member States shall provide remedies sufficient to ensure effective legal protection in the fields covered by Union law."*[1539] Second, Article 81 (2) TFEU provides the possibility for the EU to adopt civil justice measures without requiring an internal market – ensuring,[1540] aimed in ensuring in *"(...) (d) cooperation in the taking of evidence; (e) effective access to justice; (f) the*

[1537] *Towards a Coherent European Approach on Collective Redress* (European Commission, Public Consultation) *available online at:* <http://ec.europa.eu/competition/consultations/2011_collective_redress/index_en.html> *last visited* Jan. 5, 2015.

[1538] European Parliament Resolution of 2 February 2012 on *Towards a Coherent Approach to Collective Redress,* sec. 15 (2011/2089(INI)); *available online at:* < http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2012-0021+0+DOC+XML+V0//EN >/ *last visited* Jan. 5, 2015.

[1539] *See* Article 19(1) TEU, second sentence.

[1540] The former Article 65 EC stated that civil procedure measures with cross-border implications could be taken "in so far as necessary for the proper functioning of the internal market." The full text of Article 81(1) TFEU is the following: "The Union shall develop judicial cooperation in civil matters having cross-border implications, based on the principle of mutual recognition of judgments and of decisions in extrajudicial cases. Such cooperation may include the adoption of measures for the approximation of the laws and regulations of the Member States." See Article 81(1) TFEU.

elimination of obstacles to the proper functioning of civil proceedings, if necessary by promoting the compatibility of the rules on civil procedure applicable in the Member States; (...).” These two articles in conjunction could be considered as a potential basis for an EU collective class action measure. Moreover, in *vom Colson*, the CJEU ruled that Member States have to **guarantee real and effective judicial protection** of individual’s remedies, emphasizing the principles of effectiveness.[1541] As currently shown by the EU studies,[1542] the Member States fail to provide effective judicial protection in collective cross-border cases and thus EU intervention is unavoidable.

Given that this issue is of procedural character, the focus for the analysis should be **Brussel I**, whether it entails the existing regulatory tool for collective redress or not. The purpose of Brussel I is to facilitate inter-European litigation by (1) providing clear and predictable rules concerning national jurisdiction and (2) providing an easy and predictable means for recognizing and enforcing judgments from other Member States.[1543] Although Brussels I contemplates the possibility of some types of multiparty suits, it is substantially guided by the “leitmotiv” of two-party proceeding.[1544] Especially articles 27, 32 and 34 reflect the one-to-one model.[1545] In addition, the jurisdictional regime under Brussel I is defendant-oriented.[1546] Even though specific provisions allow diversion from the general rule, they are no easy to

[1541] *See* Case 14/83, von Colson and Kamann v. Land Nordrhein-Westfalen, para. 23 [1984] ECR 1891.
[1542] Consultations, Hearings and Studies of European Commission on the matter *available online:* < http://ec.europa.eu/consumers/archive/redress_cons/collective_redress_en.htm#Studies>/ *last visited* Jan. 6, 2015.
[1543] *See* Richard Fentiman, *Brussels I and Third States: Future Imperfect?*, 13 CAMBRIDGE Y.B. EUR. LEGAL STUD. 65 (2012).
[1544] *See* Burkhard Hess, *Collective Redress and the Jurisdictional Model of the Brussel I Regulation in* CROSS-BORDER CLASS ACTIONS: THE EUROPEAN WAY 60 (Arnaud Nuyts & Nikitas E. Hatzimihail, eds. 2014); *see also* Zheng S. Tang, *Multiple Defendants in the European Jurisdiction Regulation,* 34 EUR. L. REV. 80, 82-83 (2009).
[1545] Article 27 of Brussel I regulates pendency and articles 32 and 34 address res judicata and recognition conflicting judgments.
[1546] General jurisdiction is available at the defendant seat; *see* Articles 2 & 60 Brussel I.

argue in connection with a collective litigation.[1547] Several scholars thus have concluded that instead of Brussel I revision a completely new piece of legislation should be adopted.[1548]

The type of EU legislation is naturally up to the EU to decide within the means provided to it under the TEU and the TFEU. And although Regulations or Directives, including substantive and procedural issues, govern majority of the key issues that fall under the EU competence, in this case the Commission decided that a **Recommendation** was sufficient.[1549] The EU Council should adopt a Recommendation on the basis of Article 292 TFEU[1550] and Member States would be provided two years to implement the principles recommended in their national collective redress systems.[1551] Irrespective of policy parameters of the Recommendation, which are by themselves porous,[1552] it is highly probable that the Recommendation will ultimately miss its targets and will not provide plaintiffs in cross-border cases with any additional help. Considering the current heterogeneous style of regulating collective redress in Member States, while some of them have not even introduced this procedural tool, a Recommendation as a **soft law instrument** will have only limited influence. Moreover, according to some, there is one concern connected to the policy parameters of the Recommendation. It desires to avoid an

---

[1547] For the challenges on claims joinder under Brussel I *see* Hess, *Collective Redress, supra* note 1544, at 61-63 or S.I. Strong, *Cross-Border Collective Redress in the European Union: Constitutional Rights in the Fact of the Brussel I Regulation,* 45 ARIZ. ST. L.J. 233, 251-262 (2013).

[1548] *See e.g.* Hess, *Collective Redress*, *supra* note 1544, at 67; Strong, *supra* note 1549, at 270

[1549] *See* Communication from the Commission, *Towards a European Horizontal Framework for Collective Redress* 48 COM (2013) 401/2, 2013 [hereinafter "Communication on Collective Redress"].

[1550] Article 292 TFEU states: "The Council shall adopt recommendations. It shall act on a proposal from the Commission in all cases where the Treaties provide that it shall adopt acts on a proposal from the Commission. It shall act unanimously in those areas in which unanimity is required for the adoption of a Union act. The Commission, and the European Central Bank in the specific cases provided for the Treaties, shall adopt recommendation."

[1551] *See* Communication on Collective Redress, *supra* note 1549, at 48.

[1552] As assessed by Professor Hodges, who has been writing extensively on the issues of collective redress; *see* Hodges, *Collective Redress, supra* note 1492, at 78-85.

abusive litigation culture,[1553] which could lead to a design of a collective redress that is so restrictive that it curtails its effectiveness.[1554]

On the other hand, some scholars claim that the EU does not necessarily need a general class action mechanism, as the European architecture has an opposite balance between public and private enforcement as the US.[1555] Without challenging that the individual European jurisdictions generally favor the public enforcement,[1556] one has to realize that the securities regulation is specific and enforcement in the US has been borne both by public agency and private investors. Also in the UK, there is a powerful FCA joined by private right of action and the GLO. Even though the FCA in 2014 collected the total amount of £1,471,431,800 in fines,[1557] a significant class action against Lloyds has been recently initiated. The logic requires asking whether the illegal actions, misrepresentations and frauds of the various financial institutions, including investment companies are present only in highly developed financial

[1553] As the European Commission stated its overall goal in a following manner: "For the Commission, any measures for judicial redress need to be appropriate and effective and bring balanced solutions supporting European growth, while ensuring effective access to justice. Therefore, **they must not attract abusive litigation** or have effects detrimental to respondents regardless of the results of the proceedings. Examples of such adverse effects can be seen in particular in 'class actions' as known in the United States. The European approach to collective redress must thus give proper thought to preventing these negative effects and devising adequate safeguards against them." *Id.* at 1.1.
[1554] *See e.g.* Rachael Mulheron, *The Case for an Opt-Out Class Action for European Member States: A Legal and Empirical Analysis*, 15 COLUM. J. EUR. L. 409, 452-453 (2009); DEBORAH HENSLER ET ALS., THE ANNALS OF THE AMERICAN ACADEMY OF POLITICAL AND SOCIAL SCIENCE 22-23 (SAGE Publication, 2009) or S.I. Strong, *Regulatory Litigation in the European Union: Does the U.S. Class Action Have a New Analogue?* 65-66 (School of Law, University of Missouri, Research Paper No. 2012-25, 2012).
[1555] *See* Christopher Hodges, *Objectives, Mechanisms and Policy Choices in Collective Enforcement and Redress in* MASS JUSTICE (Jenny Steele & Willem H. van Boom eds. 2011).
[1556] Public enforcement predominates in enforcement of competition, environmental and data protection, *see* Francesca Bignani, *Cooperative Legalism and the Non-Americanization of European Regulatory Styles: The Case of Data Privacy* 59 AM. J. COMP. L. 411 (2011). In case of consumer law the public enforcement also plays the major role, *see* Fabrizio Cafaggi & Hans W. Micklitz, *Administrative and Judicial Collective Enforcement of Consumer Law in the US and the European Community* 38-42 (European University Institute, EUI Working Papers, 2007/22); *see also* Michael Faure, *et al.*, *Enforcement Practices for Breaches of Consumer Protection Legislation*, 20 LOY. CONSUMER L. REV. 361 (2008).
[1557] *Available online at:* < http://www.fca.org.uk/firms/being-regulated/enforcement/fines/2014>/ *last visited* Jan. 7, 2015. Although in most cases FCA fined banks, it also fined a retail investment management firm with £18,643,000 fine for failings relating to fund management and for exposing investors to greater levels of risk than they had been led to expect.

centers – US & UK – or the others only fail to detect them and subsequently remedy them?

6.3. Conclusion: Law without Enforcement Is Only Good Advice[1558]

In case of securities regulation – including the regulation of investment companies - it is ultimately the **combination** of public and private enforcement that is necessary to ensure the effectiveness of the legal standards and practice. Currently, both the EU and US suffer from several deficiencies. Since its establishment the SEC has become a powerful agency. Its competences gradually developed and today by employing a great number of counsels it forms a skilled army against financial abuse and fraud. Yet neither the SEC can protect all and as shown its activity is also politically influenceable. In addition it has neither foreseen the 2008 financial crisis coming, when the *"[m]ismanagement and greed became the operating standard while regulators were asleep at the switch*."[1559] Although it is claimed that strong enforcement agency might deter and punish fraud better than individual investors, who are largely at the mercy of fraudsters,[1560] the enforcement mechanism in the US was set up in a form of joined forces of an agency and investors. For many years, the investors could actively defend their rights by virtue of direct and implied rights of action – at least it has been so proclaimed. Yet when looking closely to the investor protection in case of mutual funds, the reality is different. Until today investors of mutual funds were never successful in a court proceeding, neither as individuals nor as a class. This simply shows that investors are not able to protect their investments. As long as investors have an obligation to fulfill their duties as responsible owners under the notion of empowered investor, such as an active oversight of their

[1558] Quote of Abraham Lincoln.
[1559] In 2008 the presidential candidate John McCain called for the firing of SEC Chair Christopher Cox, *see McCain's Scapegoat,* WALL. ST. J., Sep. 19, 2008, at A22.
[1560] *See* Prentice, *The Inevitability of a Strong SEC*, *supra* note 1109, at 828.

investment, they should have legal tools do so, which are surprisingly missing in the US.

On the other side of Atlantic, the enforcement of investment company regulation continues to vary. The UK has since 2000, with several changes in 2010 and 2012, completely remodeled its regulatory framework of financial services by introducing a single regulatory framework and then in 2012 establishing a new macro-prudential and a split prudential and conduct institutional model.[1561] Even though only couple of years has past, the UK has clearly decided to protect their investors by providing **clear standards of behavior** for investment companies, additional enforcement agency (FOS) and direct rights of action. Although the EU tends to take inspiration from the UK, its enforcement agency has literally no powers and it only "guides" the market participants. Each Member State has its own enforcement body and the nature in which the harmonized regulation of UCITS is enforced greatly differs from one Member State to another. The current state of art thus only contributes to legal uncertainty of all participants and inability of the EU to form a functioning common market for financial services. This should be swiftly remedied. Besides developing stronger powers for ESMA, which can oversee and participate in the enforcement of investor financial harms, it is also necessary to facilitate individual cross-border enforcement mechanism to promote the investor confidence necessary for cross-border investments. Introduction of private securities remedies in the EU and its Member States would also have a beneficial effect on their

[1561] *See* WALKER & PURVES, *supra* note 850, at 3.

ability to address better the financial needs and reflect more rapidly to the development of the regulation of investment companies.[1562]

If the EU aims to form and operate a globally competitive market with investment and capital market activity crossing national borders, protection of cross-border investment must be also ensured. As long as investors will not gain confidence that they can trust an efficient pan-European agency and that they individually or as a class have rights that they could freely and surely enforce, the cross-border common market will never take place.

[1562] Legal systems that embrace case law and judicial discretion are generally more responsive to the changing economic conditions than legal systems that rely more rigorously on the statutory law. *See* Thorston Beck *et a*l., *Law and Finance: Why Does Legal Origin Matter?* 31 J. COMP. ECON. 653, 660 (2003); *see generally* RICHARD A. POSNER, ECONOMIC ANALYSIS OF THE LAW (Little Brown, 1973).

CONCLUSION AND FINAL REMARKS

In this thesis I have argued for investor protection through retail investor empowerment. My postulate has been that retail investors should be perceived as active market participants, who are able to recognize and realize their rights and duties rather than as passive consumers. Consumer policy is more paternalistic and calls for more precautionary, *ex ante* approach. Although, some of the regulatory proposals applied in consumer law could be applied in connection with the investor protection *vis-à-vis* the investment companies, treating investors as unsophisticated and incapable of enforcing their own rights will support neither the progress of the markets nor the development of retail investor culture in the EU – where investing with investment companies begins to reach the masses.

The fact that the US has not inclined towards the consumerist policy in connection with retail investment market – the biggest in the world – suggests that their policy-makers have believed that the **uninformed** and **credulous** investors, as they once called them, are able to learn. And the history shows that they are correct. No regulation or regulator can protect everyone and definitely it cannot protect those investors who take excessive risks and by their own decision walk on thin ice. According to Milton Friedman, a lack of financial knowledge is not necessarily problematic, given that investors (in my opinion majority of them) learn to behave optimally through trial and error. Friedman compares an investor to a pool player, who does not have to have an extensive knowledge of physics in order to play pool.[1563] One should also remember that the investment companies that are of a

[1563] This comparison was used in one of the essays of Milton Friedman in 1953 when the US retail investment market was developing. Possibly if we compared the retail investment market of EU today to the one in the US in 1953, the percentage of active investors would be similar. *See* MILTON FRIEDMAN, ESSAYS IN POSITIVE ECONOMICS 20 (University Chicago Press, 1953).

general interest for retail investors are perceived as low risk investments. Ultimately, as Richard Thaler and Cass Sustein in their research demonstrate, the policy-makers can and should "**nudge**" individuals towards desirable decisions by shaping the regulatory architecture in which their choices are made.[1564] Regulators should form a framework in a way that "nudges" the investors to be cautious, gain experience and to learn, rather than to allow them to continuously claim a weaker party card and rely on regulators for a bulletproof protection, which anyhow – as shown also recently – cannot be ensured.

Despite retail investors suffering from behavioral biases, regulators instead of perceiving them as incapable of their own individual protection should design regulatory framework in a way that the retail investors become **active part** of the entire architecture. Retail investors should be not active only in connection with initial investing with investment companies, but also in identifying, demanding and overseeing the financial services as well as in supervising and enforcing their rights. Moreover, the EU together with the UK should be extra-cautious not to mix different notions, policies and narratives and apply the consumer law where it is not necessary, as it ultimately may have negative effect on formation of retail investor culture. Even though the consumerist approach towards the regulation of investment companies might be perceived as advisable in the post-crisis period, a conceptual change from investor to consumer raises number of problems, which include legal uncertainty, policy and regulatory incoherence as well as problems of interpretation, which all serve precisely the contrary purpose than the investor (consumer) protection should.

[1564] Even though that Thaler and Sustain based their claim on the research and analysis of the health care law, human biases are present irrespective of the field of law. *See generally* RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS (Yale University Press, 2008).

Instead, regulators should "**nudge**" investors to be active in their decision-making as well as responsibility-taking actions. The ultimate question however is "**how**"? In this regard, based on my analysis of the four building blocks of the investment company regulation in three legal systems, I claim the following. First of all, the importance of disclosure is undisputed as through prospectus investors learn of investment company's investment strategy, fees, risks encompassed in the investment and conditions of their redemption right. However, due to investors' **limited control** over their investment from the moment of investing, the standard of fiduciary duties imposed on those in control should be strengthened. The moment investors entrust their investment with an investment company, they completely surrender their control and are left at the full mercy of the investment companies and their advisers. As a consequence, the investment companies together with their investment advisers should owe **meticulous fiduciary duties** to their investors. First of all, why also the advisers should owe the fiduciary duty when the investors invest directly with investment companies? By unveiling how investment companies operate – being **functionally** only *"a shell, a pool of assets consisting of securities, belonging to the investors of the fund"*[1565] – one realizes that investment companies, despite being separate legal entities, are in fact only "tools" held tightly in the hands of their investment advisers and this has to be reflected upon by the regulation. It is the adviser that fully controls the investments of the investors and therefore should owe fiduciary duties to them. Yet what is the "**nature**" of these fiduciary duties? Recognizing distinctions in this notion in diverse areas of law, its character and scope should be clearly stipulated by regulators in order to provide greater – foreseeable protection for investors. Given that the most scrupulous fiduciary duties can be found

[1565] *See* Zell v. InterCapital Income Securities, Ind., 675 F.2d 1041, 1046 (9th Cir. 1982). *See also* Leland E. Modesitt, *Mutual Fund A Corporate Anomaly,* 14 U.C.L.A.L.REV. 1252 (1967).

in the trust law, which imposes higher fiduciary responsibilities than corporate law, it is my suggestion to apply on investment companies and their advisers (or anyone who *de facto* controls the investment) the **fiduciary duties known in trust law**. In this way the opportunistic behavior of directors and advisers of investment companies would be easier constrained and subsequently enforced. Therefore, a greater protection of retail investors could be secured.

In addition, apart from the imposed fiduciary duties and rights, a **powerful supervisory agency**, comparable to the SEC or FCA, should be in place in the EU. As long as the EU (or any other legal system) desires to promote an efficient common market in financial services and nourish retail investor culture, a powerful independent enforcement agency has to be established. If the EU intends to operate a common market of financial services, a unified supervision and enforcement represent its essential part.[1566] A powerful enforcement authority should foster retail investor culture throughout the EU and develop and administer flexible regulation. Diverse rules and applications in different Member States and ultimately different standards of the enforcement do not benefit the operation of a common market.[1567] Moreover, as the history shows, it is insufficient for an enforcement agency to merely advise and guide the market participants, as it is the case of the ESMA; an agency has to be in a position to efficiently oversee and enforce the rules. Otherwise, the protection of retail investors is greatly endangered, and so is the efficient functioning of the market.

Yet no agency can be omnipresent. In line with the investor empowerment approach, all investors who entrust their finances in hands of investment companies

---

[1566] If the EU is interested in economic integration, it becomes important to have a system that allocates resources efficiently, and does not favor one country's investment firms and investment industry over the others. *See* Donald C. Langevoort, *Structuring Securities Regulation in the European Union: Lessons from the U.S. Experience, in* INVESTOR PROTECTION IN EUROPE: CORPORATE LAW MAKING, THE MIFID & BEYOND, *supra* note 455, at 502.
[1567] *Id.*

and their advisers should be provided with tools that would enable them to **sufficiently protect themselves** – in form of **private right of action**. Only then a balance between the parties can be achieved. Retail investors by embracing their empowerment would become more conscious of and more active with their investments as well as their concomitant rights. In case of the EU, it is of utmost importance to facilitate individual cross-border enforcement mechanism that would promote investor confidence necessary for cross-border investments. The EU should adopt a regulation providing investors with private right of action. The introduction of private securities right of action in the EU and its Member States would have a beneficial effect both on the level of retail investor protection as well as on the formation of retail investor culture.

Ultimately, any legal system desiring a functioning and efficient market of financial services should create a necessary regulatory framework that would **functionally approach** the division of control and information among different market participants. Those, who are *de facto* in control of investors' investments, should not be in a position to hide behind legal structures. However, neither should retail investors be allowed to eternally claim weaker position since their desire is identical with the one of those with whom they entrust their money – profit. As a result of numerous financial crises, regulators should be now in a better position to realize the market realities and efficiently reflect upon them. They should divide duties and rights – empower those who have been powerless – in a way to balance the them and to "nudge" all the market participants to become active, not only with investing, but also in supervising and enforcing their rights. Moreover, regulators should seek to reinforce **trust** within their regulatory design. Since trust represents *"a* *willingness to make oneself vulnerable to another…,'*[1568] regulators should minimize the "vulnerability" of investors and empower them, as it is only through our own abilities to enforce our rights that we begin to trust the others that they will perform their duties.

[1568] Blair & Stout, *supra* note 475.

BIBLIOGRAPHY

Books

1. Amato, Cristina & Perfumi, Chiara, *Financial Investors as Consumers: Italian Legislation from a European Perspective in* CONSUMER CREDIT, DEBT AND INVESTMENT IN EUROPE (James Devenney & Mel Kenny eds., 2009).
2. Anderson, C. Seth, INVESTMENT MANAGEMENT AND MISMANAGEMENT: HISTORY, FINDINGS, AND ANALYSIS (Springer, 2006).
3. Anderson, C. Seth, Born, A. Jeffery & Schnusenberg Oliver, CLOSED-END FUNDS, EXCHANGE-TRADED FUNDS AND HEDGE FUNDS: ORIGINS, FUNCTIONS, AND LITERATURE (Springer, 2010).
4. Atack, Jeremy & Neal Larry, THE ORIGIN AND DEVELOPMENT OF FINANCIAL MARKETS AND INSTITUTIONS: FROM THE SEVENTEENTH CENTURY TO THE PRESENT (Cambridge University Press, 2009).
5. AUTHORISED FUNDS: A REGULATORY GUIDE (Investment Management Association, 2012).
6. Baldwin, Robert, Cave, Martin & Lodge, Martin, *Introduction: Regulation – The Field and the Developing Agenda, in* THE OXFORD HANDBOOK OF REGULATION (Robert Baldwin *et. al.* ed., 2010).
7. BANKING LITIGATION (David Warnt & Nicholas Elliott QC, 2005).
8. Banner, Stuart, ANGLO-AMERICAN SECURITIES REGULATION, CULTURAL AND POLITICAL ROOTS, 1690-1860 (Cambridge University Press, 2002).
9. Barber, Bernard, THE LOGIC AND LIMITS OF TRUST (Rutgers University Press, 1983).
10. Bardach, Eugene & Kagan, A. Robert, GOING BY THE BOOK: THE PROBLEM OF REGULATORY UNREASONABLENESS (Transaction Publishers 2^{d} ed. 2003).
11. Benjamin, Joanna, FINANCIAL LAW (Oxford University Press, 2007).
12. Benson, John, THE RISE OF CONSUMER SOCIETY IN BRITAIN 1880-1970 (Longman, 1994).
13. Benston, J. George, THE SEPARATION OF COMMERCIAL AND INVESTMENT BANKING: THE GLASS-STEAGALL ACT REVISITED AND RECONSIDERED (1990).
14. Benston, J. George, *The Costs ad Benefits of Government-Required Disclosure: SEC and FTC Requirements in* CORPORATIONS AT THE CROSSROADS: GOVERNANCE AND REFORM (D. DeMott ed. 1980).
15. Berger, N. Allen *et al.*, *The Transformation of the US Banking Industry: What a Long, Strange Trip It's Been, in* 1995 BROOKINGS PAPERS ON ECONOMIC ACTIVITY 55 (1995).
16. Berle, A. Adolf & Means, C. Gardinger, THE MODERN CORPORATION AND PRIVATE PROPERTY (Transaction Publisher, 1932).
17. Berman, A. George et al., CASES AND MATERIALS ON EUROPEAN UNION LAW (West Academic Publishing, 2nd ed. 2007).
18. Beshears, John, et al., *How Does Simplified Disclosure Affect Individuals' Mutual Fund Choices? in* EXPLORATIONS IN THE ECONOMICS OF AGING (University of Chicago Press, 2011).
19. Bielecky, Tomasz & Brigo, Damiano & Paras, Frederic, CREDIT RISK FRONTIERS: SUBPRIME CRISIS, PRICING AND HEDGING, CVA, MBS, RATINGS AND LIQUIDITY (Bloomberg Press, 2011).
20. Bierman, Jr. Harold, THE GREAT MYTHS OF 1929 AND THE LESSONS TO BE LEARNED (Praeger, 1991).
21. Bines, E. Harvey & Thel, Steve, INVESTMENT MANAGEMENT LAW AND REGULATION (Aspen Publishers, 2nd ed. 2004).
22. Bittker, I. Boris & Eustice, S. James, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS (Warren Gorham & Lamont, 7th ed. 2000).
23. BLACK'S LAW DICTIONARY (9th ed.).
24. Blackstone, William, COMMENTARIES ON THE LAWS OF ENGLAND I (2002).

25. Blair, Michael & Walker, George, FINANCIAL SERVICES LAW (Oxford University Press 2d ed. 2006).
26. Blair, Michael & Walker, George, FINANCIAL SERVICES LAW (Oxford University Press 3d ed. 2014).
27. Blinder, S. Alan, AFTER THE MUSIC STOPPED: THE FINANCIAL CRISIS, THE RESPONSE AND THE WORK AHEAD (Penguin Books, 2013).
28. Bloomenthal, S. Harold, SECURITIES LAW IN PERSPECTIVE (C. Boardman, 1977).
29. Bloomenthal, S. Harold & Wolff, Samuel, SECURITIES LAW HANDBOOK (WestlawNext Online Database, updated May 2014).
30. Bogdan, Michael, COMPARATIVE LAW (Kluwer, 1994).
31. Bogert, G. George, et. al., CASE AND TEXT ON THE LAW OF TRUSTS (University Casebook, 9th ed. 2012).
32. BOWSTEAD & REYNOLDS ON AGENCY (Peter G. Watts ed. 19th ed. 2010).
33. Brandeis, Louis, OTHER PEOPLE'S MONEY AND HOW BANKERS USE IT (1914).
34. Bratton, William, et al., INTERNATIONAL REGULATORY COMPETITION AND COORDINATION: PERSPECTIVES ON ECONOMIC REGULATION IN EUROPE AND THE UNITED STATES (Oxford University Press, 1997).
35. Braun, Alexandra, *The Framing of a European Law of Trusts* in THE WORLDS OF THE TRUST (L Smith ed., 2013).
36. Bromberg, R. Alan, Lowenfels, D. Lewis & Sullivan J. Michael, BROMBERG & LOWENFELS ON SECURITIES FRAUD (WestlawNext, 2014).
37. Brownell, Charles, SUBPRIME MELTDOWN: FROM US LIQUIDITY CRISIS TO GLOBAL RECESSION (CreateSpace Independent Publishing Platform, 2008).
38. Burch Jr., C. John & Foester, S. Bruce, CAPITAL MARKETS HANDBOOK (WestlawNext, 2014).
39. Bullock, Hugh, THE STORY OF INVESTMENT COMPANIES (Columbia University Press, 1959).
40. Burg, F. David, THE GREAT DEPRESSION (Facts on File, 2d ed. 2005).
41. Cartwright, Peter, CONSUMER PROTECTION IN FINANCIAL SERVICES (Kluwer Law International, 1999).
42. CASEBOOK ON EUROPEAN CONSUMER LAW (Reiner Schulze *et al.* eds., Hart Publishing, 2002).
43. Casey, Jean-Pierre & Lannoo, Karel, THE MIFID REVOLUTION (Cambridge University Press, 2009).
44. Chalmers, Damian, Davies, Gareth and Monti, Giorgio, EUROPEAN UNION LAW: TEXT AND MATERIALS (Cambridge University Press, 2006).
45. Clark C. Robert, *Agency Costs Versus Fiduciary Duties*, in PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS (John W. Pratt & Richard J. Zeckhauser eds. 1985).
46. Coffee, C. John, Jr. & Sale, A. Hillary, SECURITIES REGULATION: CASES AND MATERIALS (Foundation Press, 11th ed. 2009).
47. Cooper, Kerry & Fraser, R. Donald, BANKING DEREGULATION AND THE NEW COMPETITION IN FINANCIAL SERVICES (1984).
48. Conkin, K. Paul, THE NEW DEAL (Harlan Davidson, 2nd ed., 1975).
49. Conte, Alba & Newberg, B. Herbert NEWBERG ON CLASS ACTION (Thomson West, 4th ed. 2002).
50. Cox, D. James, Hillman W. Robert, & Langevoort, C. Donald, SECURITIES REGULATION: CASES AND MATERIALS (Aspen Publishers, 3rd ed. 2001).
51. Cox, D. James, Hillman W. Robert, & Langevoort, C. Donald, SECURITIES REGULATION: CASES AND MATERIALS (Aspen Publishers, 6th ed. 2009).
52. CCH MUTUAL FUNDS GUIDE (Wolters Kluwer, 1999).
53. Craig, Paul & De Búrca, Grain, EU LAW, TEXT, CASES AND MATERIALS (Oxford University Press, 4th ed. 2007).
54. Craig, Paul & De Búrca, Grain, EU LAW, TEXT, CASES AND MATERIALS (Oxford University Press, 5th ed. 2011).

55. CROSS-BORDER CLASS ACTIONS: THE EUROPEAN WAY (Arnaud Nuyts & Nikitas E. Hatzimihail, 2014);
56. CURRENT LEGAL PROBLEMS 2010-2011 (George Letsas & Colm O'Cinneide eds., 2011).
57. Cushman Barry, THE GREAT DEPRESSION AND THE NEW DEAL (Michael Grossberg & Christopher Tomlins eds., in The Cambridge History of Law in America, Vol. 3, 2008).
58. Dagan, Hanoch, THE LAW AND ETHICS OF RESTITUTION (Oxford University Press, 2004).
59. Davies, Howard & Green, David, GLOBAL FINANCIAL REGULATION: THE ESSENTIAL GUIDE (Polity Press, 2008).
60. Davis, P. John, CORPORATIONS, A STUDY OF THE ORIGIN AND DEVELOPMENT OF GREAT BUSINESS COMBINATIONS AND OF THEIR RELATIONS TO THE AUTHORITY OF THE STATE 224-226 (BeardBooks, Reprinted 2000).
61. De Sevres, K. Nicolette & Sasso, Lorenzo, *The New European Financial Markets Legal Framework: a Real Improvement? An Analysis of Financial Law and Governance in European Capital Markets From a Micro- and Macro-economic Perspective,* 7 CAP .MARKETS L. J. 30, (2012).
62. De Tocqueville, Alexis, DEMOCRACY IN AMERICA (Library of America, 1835).
63. Degen, A. Robert, THE AMERICAN MONETARY SYSTEM (Lexington Books, 1987).
64. DISCRIMINATION IN LABOR MARKETS (Orley Aschnfelter & Alber Reed eds., 1973).
65. Du Bois, Budington Armand, THE ENGLISH BUSINESS COMPANY AFTER THE BUBBLE ACT 1720-1800, (Commonwealth Fund, 1938).
66. Esser, Josef, GRÜNDSATZ UND NORM IN DER RICHTERLICHEN FORTBILDUNG DES PRIVATRECHTS (Mohr, 1956).
67. Frank H. Easterbrook & Daniel R. Fischel, THE ECONOMIC STRUCTURE OF CORPORATE LAW (Harvard University Press, 1991).
68. Edwards, W. George, THE EVOLUTION OF FINANCE CAPITALISM (Longmans, Green & Co., 1938).
69. Etkins, Stanley & McKitrick Eric, THE AGE OF FEDERALISM: THE EARLY AMERICAN REPUBLIC, 1788 – 1800 (Oxford University Press, 1993).
70. EUROPEAN CAPITAL MARKET INSTITUTE, FINAL REPORT OF THE EUROPEAN INVESTORS' WORKING GROUP: RESTORING INVESTOR CONFIDENCE IN EUROPEAN CAPITAL MARKETS (March 2010).
71. EUROPEAN SECURITIES MARKETS: THE INVESTMENT SERVICES DIRECTIVE AND BEYOND (Guido Ferrarini ed., 1998).
72. Felsenfeld, Carl, BANKING REGULATION IN THE UNITED STATES (Juris Pub., 4thed. 2001).
73. Ferran, Eilís, BUILDING AN EU SECURITIES MARKET (Cambridge University Press, 2004).
74. Ferran, Eilís, *et al.,* THE REGULATORY AFTERMATH OF THE GLOBAL FINANCIAL CRISIS (Cambridge University Press, 2012).
75. FINAL REPORT OF THE EUROPEAN INVESTORS' WORKING GROUP, RESTORING INVESTOR CONFIDENCE IN EUROPEAN CAPITAL MARKETS 3-4 (European Capital Markets Institute in partnership with CFA Institute Centre for Financial Market Integrity, March 2010, 2d ed.).
76. Fink, P. Matthew, THE RISE OF MUTUAL FUNDS: AN INSIDER'S VIEW (Oxford University Press, 2008).
77. Fisher, Irving, THE STOCK MARKET CRASH – AND AFTER (New York 1930).
78. Frankel, Tamar, THE REGULATION OF MONEY MANAGERS: THE INVESTMENT COMPANY ACT AND THE INVESTMENT ADVISERS ACT (Volume 2, Aspen Publishing, 1998).
79. Frankel, Tamar, TRUST AND HONESTY: AMERICA'S BUSINESS CULTURE AT A CROSSROAD (Oxford University Press, 2008).
80. Friedman, M. Lawrence, A HISTORY OF AMERICAN LAW (Simon & Schulter, 1973).
81. Friedman, Milton, ESSAYS IN POSITIVE ECONOMICS (University Chicago Press, 1953).

82. Friedman, Milton & Schwartz, Jacobson Anna, A MONETARY HISTORY OF THE UNITED STATES 1867 – 1960 (Princeton University Press, 1963).
83. FROM SINGLE MARKET TO ECONOMIC UNION, ESSAYS IN MEMORY OF JOHN A. USHER (Niamh Nic Shuibne & Laurence W. Gormley, eds., 2012).
84. Galbraith, K. John, THE GREAT CRASH 1929 (Houghton Mifflin Company, 1954).
85. GENSLER, S. STEVEN, FEDERAL RULES OF CIVIL PROCEDURE, RULES AND COMMENTARY (WestlawNext, 2014).
86. Getzler, Joshua, *Duty of Care*, in BREACH OF TRUST 41 (Peter B. H. Birks & Arianna Pretto eds., 2002).
87. Gevurtz, A. Franklin, CORPORATION LAW (WestGroup, 2000).
88. GLOBAL ASSET MANAGEMENT: STRATEGIES, RISKS, PROCESSES AND TECHNOLOGIES (Michael Pinedo & Ingo Walter eds., 2013).
89. Goetzmann, N. William & Rouwenhorst, K. Geert, THE ORIGINS OF VALUE (Oxford University Press, 2005).
90. GOLDSMITH, W. RAYMOND, FINANCIAL STRUCTURE AND DEVELOPMENT (Yale University Press, 1969),
91. Gower, Laurence, MODERN COMPANY LAW (Stevens, 1954).
92. Gray, Joanna & Hamilton, Jenny, IMPLEMENTING FINANCIAL REGULATION: THEORY AND PRACTICE (John Wiley & Sons, 2006).
93. Grote, Rainer & Marauhn, Thilo, THE REGULATION OF INTERNATIONAL FINANCIAL MARKETS: PERSPECTIVES FOR REFORM (Cambridge University Press, 2006).
94. Haft, J. Robert & Fass, M. Peter, FEDERAL SECURITIES LAWS AND TAX-ADVANTAGED SECURITIES (WestlawNext, 2014).
95. Hart, Henry & Sacks, Albert, THE LEGAL PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATION OF LAW (Foundation Press, 2006).
96. Harris, Ron, INDUSTRIALIZING ENGLISH LAW: ENTREPRENEURSHIP AND BUSINESS ORGANIZATION, 1720-1844 (Cambridge University Press, 2000).
97. Harwood, E.C., & Blair L. Robert, INVESTMENT TRUSTS AND FUNDS FROM THE INVESTOR'S POINT OF VIEW (Great Barrington, 1937).
98. Hayden, S. Warrn, *Blue Sky Laws and Their Relations to the Investment Banker*, in PROC. OF THE ORGANIZATION MEETING AND THE FIRST ANN. CONVENTION OF THE INVESTMENT BANKERS' ASS'N AM. (1912).
99. Hayek, Friedrich, THE CONSTITUTION OF LIBERTY (University of Chicago Press, 1960).
100. Hazen, Lee Thomas, TREATISE ON THE LAW OF SECURITIES REGULATION (WestlawNext, 2014).
101. Henriques , B. Diana, FIDELITY'S WORLD (Scribner, 1995).
102. Hensler, R. Deborah, CLASS ACTION DILEMMAS (Rand, 2000).
103. HENSLER, R. DEBORAH ET ALS., THE ANNALS OF THE AMERICAN ACADEMY OF POLITICAL AND SOCIAL SCIENCE (SAGE Publication, 2009).
104. Hix, Simon, THE POLITICAL SYSTEM OF THE EUROPEAN UNION (Palgrave Macmillan, 2d ed. 2005).
105. HM Treasury, Transposition of UCITS IV: Consultation Document (December 2010).
106. Holdsworth VIII, Searle William, A HISTORY OF ENGLISH LAW (Sweet & Maxwell, 5th ed. 1942).
107. Hoover, Herbert, THE CHALLENGE TO LIBERTY (C. Scribner's sons, 1934).
108. HUDSON, ALASTAIR, THE LAW OF FINANCE (Sweet & Maxwell, 2009).
109. Hughes, L. Paul, & Larkin, F. JAMES, TUDOR ROYAL PROCLAMATIONS (Yale University Press, 1964).
110. Hung, Angela, et al., INVESTOR AND INDUSTRY PERSPECTIVES ON INVESTMENT ADVISERS AND BROKER-DEALERS (Rand Institute, 2008).
111. IDS FINANCIAL SERVICES, INVESTING IN THE FUTURE: A CENTURY OF IDS (1994).
112. INTERNATIONAL COMPARATIVE LEGAL GUIDES, CLASS AND GROUP ACTIONS, BELGIUM 2015.
113. INTERNATIONAL COMPARATIVE LEGAL GUIDES, CLASS AND GROUP ACTIONS, FRANCE 2015.

114. INTERNATIONAL COMPARATIVE LEGAL GUIDES, CLASS AND GROUP ACTIONS, GERMANY 2015.
115. INTERNATIONAL COMPARATIVE LEGAL GUIDES, CLASS AND GROUP ACTIONS, ROMANIA 2015.
116. INTERNATIONAL COMPARATIVE LEGAL GUIDES, CLASS AND GROUP ACTIONS, SWEDEN 2015.
117. INVESTOR PROTECTION IN EUROPE: CORPORATE LAW MAKING, THE MIFID & BEYOND 488 (Guido Ferrarini & Eddy Wymeersch eds., 2006).
118. Johnson, Joan, PRINCELY CHANDOS: JAMES BRYDGES 1674-1744 (A. Sutton, 1984).
119. Jones, F. Robert, THE KING OF THE ALLEY: WILLIAM DUER, POLITICIAN ENTREPRENEUR, AND SPECULATOR, 1768 – 1799 (American Philosophical Society, 1992).
120. JUDICIAL REVIEW IN EUROPEAN UNION LAW, LIBER AMICORUM IN HONOUR OF LORD SLYNN (David O'Keefe & Antonio Bavasso, eds., 2000).
121. LABOUR PARTY, NEW LABOUR, NEW LIFE FOR BRITAIN (1996).
122. Kahn-Freud, Otto, On Uses and Misuses of Comparative *Law in* SELECTED WRITINGS (Otto Kahn-Freud, 1978).
123. Kalss, Susanne, DIE RECHTLICHE GRUNDLAGE KAPITALMARKTBEZOGENER HAFTUNGSANSPÜCHE (8 ÖBA 2000).
124. Karmel, S. Roberta, REGULATION BY PROSECUTION (Simon & Shuster, 1982).
125. Kaufman, J. Michael, SECURITIES LITIGATION: DAMAGES (WestlawNext, 2014).
126. Kindelberger, P. Charles, MANIAS, PANICS AND CRASHES (John Wiley and Sons, 3rd ed. 1996).
127. Kirsch, E. Clifford, THE FINANCIAL SERVICES REVOLUTION (McGraw-Hill, 1997).
128. Klöhn, Lars, KAPITALMARKT, SPEKULATION UND BEHAVIORAL FINANCE (Duncker und Humblot Verlag, 2006).
129. Konig, D. Thomas, LAW AND SOCIETY IN PURITAN MASSACHUSETTS (University of North Carolina Press, 1979).
130. Kraakmann, H. Reinier, *Disclosure and Corporate Governance: An Overview Essay in* REFORMING COMPANY AND TAKEOVER LAW IN EUROPE (Guido Ferrarini & et. al., eds., 2004).
131. Kreps, M. David, A COURSE IN MICROECONOMIC THEORY (Princeton University Press, 1990).
132. Kroos, E. Herman & Blyn, R. Martin, A HISTORY OF FINANCIAL INTERMEDIARIES (Random House, 1971).
133. Langford, Paul, A POLITE AND COMMERCIAL PEOPLE: ENGLAND 1727-1783 (Oxford University Press, 1989).
134. Lemke, P. Thomas & Lins, R. Gerald, REGULATION AND COMPLIANCE FOR INVESTMENT ADVISERS (WestlawNext, 2014).
135. LEWIN ON TRUSTS (John Mowbray *et. als.* eds.,18th ed. 2008).
136. LIABILITY OF ASSET MANAGERS (Danny Busch & Deborah DeMott eds. 2012).
137. Loistl, Otto & Petrag, Robert, ASSET MANAGEMENT STANDARDS: CORPORATE GOVERNANCE FOR ASSET MANAGEMENT (Palgrave Macmillan, 2003).
138. Lorie H. James & Hamilton, T. Mary, THE STOCK MARKET: THEORIES AND EVIDENCE (R.D. Irwin, 1973).
139. Loss, Louis & Seligman, Joel, SECURITIES REGULATION (Little Brown & Co., 3d ed. 1996).
140. MacNeil, G. Iain, AN INTRODUCTION TO THE LAW ON FINANCIAL INVESTMENT (Hart Publishing, 2d ed. 2012).
141. Maitland, W. Frederic, EQUITY: A COURSE OF LECTURES (John Brunyate rev ed., 2nd ed. 1936).
142. Malkiel, G. Burton, A RANDOM WALK DOWN WALL STREET: THE TIME TESTED STRATEGY FOR SUCCESSFUL INVESTING (W.W. Norton & Company, 8th ed. 2003).

143. Markham, W. Jerry, FINANCIAL HISTORY OF THE UNITED STATES, VOLUME I and II (M.E. Sharpe, 2002).
144. Markham, W. Jerry & Gjyshi, Rigers, RESEARCH HANDBOOK ON SECURITIES REGULATION IN THE UNITED STATES (Edward Edgar Publishing Limited, 2014).
145. MASS JUSTICE (Jenny Steele & Willem H. van Boom eds. 2011).
146. McCormick, Roger, LEGAL RISK IN THE FINANCIAL MARKETS (Oxford University Press, 2006).
147. McKinnon, I. Ronald, MONEY AND CAPITAL IN ECONOMIC DEVELOPMENT (Brookings Institution, 1973).
148. McNeese, Tim, THE GREAT DEPRESSION 1929 – 1938 (Chelsea House Publishers, 2010).
149. McMeel, Gerard, THE CONSTRUCTION OF CONTRACTS (Oxford University Press, 2007).
150. McVea, Harry, *The EU Financial Services Action Plan and Its Impact on Corporate Finance in* CORPORATE FINANCE LAW IN THE UK AND EU (Dan Prentice & Arad Reisberg eds., 2011).
151. Merryman, H. John, THE CIVIL LAW TRADITION: AN INTRODUCTION TO THE LEGAL SYSTEMS OF WESTERN EUROPE AND LATIN AMERICA (Stanford University Press, 1985).
152. Micklitz, W. Hans, *et al.* (eds.), CASES, MATERIALS AND TEXT ON CONSUMER LAW (Hart Publishing, 2010).
153. Moffat, Graham, *et al*., TRUSTS LAW: TEXT AND MATERIALS (Cambridge University Press, 5th ed. 2009)
154. Moloney, Niamh, HOW TO PROTECT INVESTORS: LESSONS FROM THE EC AND THE UK (Cambridge University Press, 2010).
155. Moloney, Niamh, EC SECURITIES REGULATION (Oxford University Press, 2d ed. 2008).
156. Moloney, Niamh, EU SECURITIES REGULATION (Oxford University Press, 3rd ed. 2014).
157. Moloney, Niamh, HOW TO PROTECT INVESTORS: LESSONS FROM THE EC AND THE UK (Cambridge University Press, 2010).
158. Moloney, Niamh, *Financial Services and Markets in* THE OXFORD HANDBOOK OF REGULATION 437-455 (Robert Baldwin et al. eds., 2010).
159. Morgan, Victor Edward & Thomas, Arthur William, THE STOCK EXCHANGE: ITS HISTORY AND FUNCTIONS (Elek Books, 1962).
160. Morgan, Edward Victor & Thomas, William Arthur, THE STOCK EXCHANGE: ITS HISTORY AND FUNCTIONS (HarperCollins Distribution Services, 2d ed. 1969).
161. Morris, Carolin & Murphy, Cian, GETTING A PHD IN LAW (Hart Publishing, 2011).
162. Muller, Charles & Ruttiens, Alain, A PRACTICAL GUIDE TO UCITS FUNDS AND THEIR RISK MANAGEMENT (EdiPro, 2013).
163. Neal, Larry, THE RISE OF FINANCIAL CAPITALISM: INTERNATIONAL CAPITAL MARKETS IN THE AGE OF REASON (Cambridge University Press, 1990).
164. Neate, W. Francis, THE DEVELOPING GLOBAL SECURITIES MARKET (Wolters Kluwer Law & Business, 1987).
165. Niemann, Arne, EXPLAINING DECISIONS IN THE EUROPEAN UNION (Cambridge University Press, 2006).
166. Nichols, W. Bruce, *Legislative History of the Glass-Steagall Act*, in THE GLASS-STEAGALL ACT: BANKS AND THE SECURITIES BUSINESS (Martin E. Lowy & Cantwell F. Muckenfuss eds. 1984).
167. Nocera, Joe & McLean, Bethany, ALL THE DEVILS ARE HERE: UNMASKING THE MEN WHO BANKRUPTED THE WORLD (Penguin, 2010).
168. Noonan, T. John Jr., THE SCHOLASTIC ANALYSIS OF USURY (Harvard University Press, 1957).
169. Olson, Mancur, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (Harvard University Press, 2d ed. 1971).
170. OXFORD DICTIONARY OF ECONOMICS (3d ed. 2003).
171. Parrish, E. Michael, SECURITIES REGULATION AND THE NEW DEAL (Yale University Press. 1970).
172. Pecora, Ferdinand, WALL STREET UNDER OATH – THE STORY OF OUR MODERN MONEY CHANGERS (1939).

173. Peterson, John & Bomberg, Elizabeth, DECISION-MAKING IN THE EUROPEAN UNION (Palgrave Macmillan, 1999).
174. Perkins, J. Edwin, AMERICAN PUBLIC FINANCE AND FINANCIAL SERVICES 1700 – 1815 (Ohio State University Press, 1997).
175. Posner, A. Richard, ECONOMIC ANALYSIS OF THE LAW (Little Brown, 1973).
176. Prentice, Dan & Reisbeg, Arad, CORPORATE FINANCE LAW IN THE UK AND EU (Oxford University Press, 2011).
177. PRINCIPLES, DEFINITIONS AND MODEL RULES OF EUROPEAN PRIVATE LAW: DRAFT COMMON FRAME OF REFERENCE (Christian von Bar, Eric Clive & Hans Shulte Nölke eds., 2009).
178. Ramsay, Iain, CONSUMER LAW AND POLICY: TEXT AND MATERIALS ON REGULATING CONSUMER MARKETS (Hart Publishing, 3rd ed. 2012).
179. Reagan, Ronald, A TIME FOR CHOOSING: THE SPEECHES OF RONALD REAGAN, 1961-1982 (Regnery Gateway, 1983).
180. REGULATION THROUGH AGENCIES IN THE EU. A NEW PARADIGM OF EUROPEAN GOVERNANCE 7 (Damien Garadin, *et al. eds.*, 2005).
181. RESEARCH METHODS OF LAW (Mike McConville & Wing Hong Chui eds., 2007).
182. Riley, C. James INTERNATIONAL GOVERNMENT FINANCE AND THE AMSTERDAM CAPITAL MARKET 1740 – 1815 (Cambridge University Press, 1980).
183. Rubenstein, B. William, NEWBERG ON CLASS ACTIONS: A BRIEF HISTORY OF CLASS ACTIONS (WestlawNext, 2014).
184. Russell, Ray, AN INTRODUCTION TO MUTUAL FUNDS WORLDWIDE (Wiley, 2007).
185. Rutterford, Janette, INTRODUCTION TO STOCK EXCHANGE INVESTMENT (Palgrave Macmillan, 3d ed. 2007).
186. Salomon, Max, GRUNDLEGUNG ZÜR RECHTSPHILOSOPHIE (Berlin-Grünewald, 1925).
187. Scalia, Antonin, A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW (Amy Gutmann ed., 1997).
188. Schammo, Pierre, EU PROSPECTUS LAW: NEW PERSPECTIVES ON REGULATORY COMPETITION IN SECURITIES MARKETS (Cambridge University Press, 2011).
189. Scheiber, N. Harry, THE NEW DEAL LEGACY AND THE CONSTITUTION: A HALF-CENTURY RETROSPECT, 1933 – 1983 (University of California Press, 1984).
190. Scott, S. Hal, THE GLOBAL FINANCIAL CRISIS (Foundation Press, 2009).
191. Scott, W. Austin & Fratcher, F. William, THE LAW OF TRUSTS (4th ed. 1987).
192. Scratchley, Arthur, ON AVERAGE INVESTMENT TRUSTS (Shaw and Sons, 1875).
193. SECOND INTERIM REPORT MONITORING THE LAMFALUSSY PROCESS 1 (Inter-Institutional Monitoring Group, Dec. 2003).
194. Seligman , Joel, THE TRANSFORMATION OF WALL STREET (rev. ed. 1995).
195. Seligman, Joel, THE TRANSFORMATION OF WALL STREET A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE (Aspen Publisher, 3d ed. 2003).
196. Sheehan, Duncan THE PRINCIPLES OF PERSONAL PROPERTY LAW (Hart Publishing, 2011).
197. Shiller, J. Robert, THE SUBPRIME SOLUTION: HOW TODAY'S GLOBAL FINANCIAL CRISIS HAPPENED, AND WHAT TO DO ABOUT IT (Princeton University Press, 2008).
198. Schubert, A. Frank, INTRODUCTION TO LAW AND THE LEGAL SYSTEM (Houghton Mifflin Company, 9th ed. 2008).
199. Simpson, W.B. A., A HISTORY OF THE COMMON LAW OF CONTRACT (Clarendon Press, 1975).
200. Soros, George, FINANCIAL TURMOIL IN EUROPE AND THE UNITED STATES: ESSAYS (PublicAffairs, 2012).
201. Steinberg, I. Marc, UNDERSTANDING SECURITIES LAW (LexisNexis, 5th ed. 2009).
202. Steinberg, I. Marc & Ferrara, C. Ralph, SECURITIES PRACTICE: FEDERAL AND STATE ENFORCEMENT §2:2 (WestlawNext, 2014).
203. Steiner, Howard Wiliam, INVESTMENT TRUSTS, AMERICAN EXPERIENCE (Adelphi, 1929).

204. Stutchbury, Piers Oliver, THE MANAGEMENT OF UNIT TRUSTS (Shaw and Sons,1964).
205. Sunstein, R. Cass, FREE MARKETS AND SOCIAL JUSTICE (Oxford University Press, 1997).
206. Swann, Dennis, THE ECONOMICS OF COMMON MARKET: INTEGRATION IN THE EUROPEAN UNION (Edward Elgar Pub., 7th ed. 1992).
207. Thaler, H. Richard & Sunstein, R. Cass, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS (Yale University Press, 2008).
208. THE AGENCY PHENOMENON IN THE EUROPEAN UNION. (Madalina Busuioc, *et al. eds.*, 2012).
209. THE EVOLVING PENSION SYSTEM: TRENDS, EFFECTS AND PROPOSALS FOR REFORM (William G. Gale *et. al.* eds., 2006).
210. THE MAKING OF THE CONSUMER: KNOWLEDGE, POWER AND IDENTITY IN THE MODERN WORLD (Frank Trentman ed., 2006).
211. THE OXFORD HANDBOOK OF COMPARATIVE LAW (Matthias Reimann & Reinhard Zimmermann eds., 2006).
212. Thomas, Gerain & Hudson, Alastair, THE LAW OF TRUSTS (Oxford University Press, 2004).
213. TREATISE ON THE LAW OF CORPORATIONS (WestlawNext, 2014).
214. Tridimas, Takis, THE GENERAL PRINCIPLES OF EU LAW (Oxford University Press, 2d ed. 2006).
215. Valiante, Diego & Lannoo, Karel, MIFID 2.0: CASTING NEW LIGHT ON EUROPE'S CAPITAL MARKETS (Report of the ECMI-CEPS Task Force on the MiFID Review).
216. Veil, Rüdiger, EUROPEAN CAPITAL MARKETS LAW (Hart Publishing, 2013).
217. Viscusi, W. Kip & Magat A. Wesley, LEARNING ABOUT RISK: CONSUMER AND WORKER RESPONSES TO HAZARD INFORMATION (Harvard University Press, 1987).
218. de Waal, J. Marius, A European Law of Trusts? in EUROPEAN PRIVATE LAW BEYOND THE COMMON FRAME OF REFERENCE (Antoni Vaquer ed., 2008).
219. Warren, G. Manning, EUROPEAN SECURITIES REGULATION (Kluwer Law International, 2003).
220. Watson, Alan, LEGAL TRANSPLANTS: AN APPROACH IN COMPARATIVE LAW (2nd ed. 1993).
221. Weatherill, Stephen, EU CONSUMER LAW AND POLICY (Elgar European Law, 2005).
222. Weisenberger, Arthur, INVESTMENT COMPANIES (1961).
223. Wigmore, A. Barrie, THE CRASH AND ITS AFTERMATH: A HISTORY OF SECURITIES MARKETS IN THE UNITED STATES, 1929 -1933 (Greenwood Press, 1985).
224. Williams, Tony, *Empowerment of Whom and for What? Financial Literacy Education and the New Regulation of Consumer Financial Services*, 29 LAW & POL'Y 226 (2007).
225. Williamson, E. Oliver E., THE ECONOMIC INSTITUTIONS OF CAPITALISM (The Free Press, 1985).
226. Witte, F. John, THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX (University of Wisconsin Press, 1985).
227. Woolcock, Stephen, *Competition among rules in the single European market in* REGULATION: LEGAL FORM AND ECONOMIC THEORY (Anthony I. Ogus ed., 2004).
228. Yeazell, C. Stephen, FROM MEDIEVAL GROUP LITIGATION TO THE MODERN CLASS ACTION (Yale University Press, 1987).
229. Yurow, Louis, et al., MUTUAL FUNDS REGULATION AND COMPLIANCE HANDBOOK (WestlawNext Database, 2014).
230. Zweigert, Konrad & Kötz, Hein, AN INTRODUCTION TO COMPARATIVE LAW (Oxford University Press, 1992).

Articles

1. Aboulian, Baptiste, *Europe to Get Cross-Border Supervisor*, FIN. TIMES, June 14, 2009.

2. Acharya, Viral et al., *A critical assessment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010*, VoxEU.org (Nov. 24, 2010).
3. Ackermann, Josef, comments at *The Structure of Regulation; Lessons from the Crisis of 2007,* LSE Financial Markets Group and Deutsche Bank Conference (London, 3rd March 2008).
4. Adler, S. Paul, *Market, Hierarchy, and Trust: The Knowledge Economy and the Future of Capitalism*, 12 ORG. SCIENCE 215 (2001).
5. Ajay, Khorana, *et.al., An Examination of Herd Behavior in Equity Markets: An International Perspective* (1999), *available online at:* < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=181872>.
6. Akerlof, A. George, *The Market for "Lemons" Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON 488 (1970).
7. Almazan, Andres, *et. al., Why Constrain Your Mutual Fund Managers?* 73 J. FIN. ECON. 289 (2004).
8. Alchian, A. Armen & Demsetz, Harold, *Production, Information Costs and Economic Organization,* 62 AM. ECON. REV. 777 (1972).
9. Anderson, Jenny, *U.S. Financial Sector Is Losing Its Edge, Report Says,* N. Y. TIMES, Jan. 22, 2007.
10. Anderson, Karen, Bates, Chris & Staple, George, *A New Millennium, A New Regulator? The Financial Services Authority's Approach,* 1 J. INVESTMENT COMPLIANCE 7 (2001).
11. *A Ragbag of Reform*, ECONOMIST 93, March 3, 2001.
12. Armour, John, *Who Should Make Corporate Law? EU Legislation versus Regulatory Competition,* 58 CURRENT LEGAL PROBS. 369 (2005).
13. Armour, John, *Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origins Hypothesis* (ECGI Working Paper Series in Law, Working Paper 108/2008, May 2008).
14. Arnold, Martin, *More Than 5,000 Join Lawsuit Against Lloyds over HBOS Deal,* FIN. TIMES, Nov. 9, 2014.
15. Arruñada Benito et al., *Contractual Allocation of Decision Rights and Incentives: The Case of Automobile Distribution,* 17 J. L. ECON. ORG. 257 (2001).
16. Atiyah, P.S., *From Principles to Pragmatism in the Function of the Judicial Process and the Law,* 65 IOWA L. REV. 1249 (1980).
17. Atkins, S. Paul & Bondi, J. Bradley, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program,* 13 FORDHAM J. CORP. & FIN. L. 367 (2008).
18. Avgouleas, Emilios *The Harmonisation of Rules of Conduct in EU Financial Markets: Economic Analysis, Subsidiarity and Investor Protection,* 6 EUR. L.J. 72 (2000).
19. Bainbridge, M. Stephen, *Mandatory Disclosure: A Behavioral Analysis,* 68 U. CIN. L. REV. 1023 (2000).
20. Bainbridge, M. Stephen & Gulati, G. Miu, *How do Judges Maximize? (The Same Way Everybody Else Does – Boundedly): Rules of Thumb in Securities Fraud Opinions*, 51 EMORY L.J. 83 (2002).
21. Banner Stuart, *The Origin of the New York Stock Exchange, 1791-1860,* 27 J. LEGAL STUD. 113 (1998).
22. Barbash, P. Barry & Massari, Jai, *The Investment Advisers Act of 1940: Regulation by Accretion* 38 RUTGERS L.J. 627 (2007-2008).
23. Barber, M. Brad & Odean, Terrance, *Boys Will Be Boys: Gender, Overconfidence, and Common Stock Investment* 116 Q.J.E. 261 (2001).
24. Barlett III, P. Rovert, *Inefficiencies in the Information Thicket: A Case Study of Derivative Disclosures During the Financial Crisis,* 36 J. CORP. L. 1 (2010).
25. Barnett, D. Larry, *The Regulation of Mutual Fund Boards of Directors: Financial Protection or Social Productivity,* 16 J.L. & POL'Y 489 (2008).
26. Barrison J. Daniel, *State Blue Sky Laws: An Alternative to the Federal Securities Laws and State Common Law in Third-Party Accountant Malpractice Cases,* 57 TEMP. L.Q. 601 (1984).

27. Bates, E. George & Douglas, O. William, *The Federal Securities Act of 1933,* 43 YALE L.J. 171 (1933).
28. Beck, Thorston, *et a*l., *Law and Finance: Why Does Legal Origin Matter?* 31 J. COMP. ECON. 653 (2003).
29. Behrens, A. Mark, Fowler, L. Gregory & Kim, Silvia, *Global Litigation Trends – Class Actions, Contingency Fees, and Punitive Damages: Moving Toward the American Civil Law Model?,* 17 MICH. ST. J. INT'L L. 165 (2009).
30. Ben-Shahar, Omri & Schneider, E. Carl, *The Failure of Mandated Disclosure,* 158 U. PA. L. REV. 647 (2010).
31. Benjamin, Joanna, *The Narratives of Financial Law,* 30 OXFORD J. LEG. STUD. 787 (2010).
32. Benston, J. George, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934,* 63 AM. ECON. REV. 132 (1973).
33. Berkowitz, Daniel et al., *The Transplant Effect,* 51 AM. J. COMP. L. 163 (2003).
34. Bernanke, S. Ben, *Non-Monetary Effects of the Financial Crisis in the Propagation of the Great Depression* 73 AM. ECON. REV. 257 (June 1983).
35. Bernstein, A. Michael, *The Great Depression as Historical Problem,* 16 OAH MAGAZINE OF HISTORY (Fall, 2001).
36. Berger, N. Allen, Kashyap, K. Anil & Scalise M. Joseph, *The Transformation of the US Banking Industry: What a Long, Strange Trip It's Been*, 1995 BROOKINGS PAPERS ON ECON. ACTIVITY 55 (1995).
37. Beshears, John *et al*., *How Does Simplified Disclosure Affect Individuals' Mutual Fund Choices?* (NBER WORKING PAPER 14589, April 2009).
38. Bignani, Francesca, *Cooperative Legalism and the Non-Americanization of European Regulatory Styles: The Case of Data Privacy* 59 AM. J. COMP. L. 411 (2011).
39. Bines, E. Harvey, *Modern Portfolio Theory and Investment Management Law: Refinement of Legal Doctrine,* 76 COLUM. L. REV. 721 (1976).
40. Binham, Caroline & Arnold, Martin, *Lloyds Faces Lawsuit over HBOS Takeover,* FIN. TIMES, Aug. 6, 2014.
41. Birdthistle, A. William, *Investment Indiscipline: A Behavioral Approach to Mutual Fund Jurisprudence,* 2010 U. ILL. L. REV. 61 (2010).
42. Birks, Peter, *Rights, Wrongs, and Remedies,* 20 OXFORD J. LEGAL STUD. 1 (2000).
43. Black, Barbara, *Protecting the Retail Investor in an Age of Financial Uncertainty,* 35 U. DAYTON L. REV. 61 (2009).
44. Black, Barbara, *Should the SEC Be a Collection Agency for Defrauded Investors?,* 63 BUS. LAW. 317 (2008).
45. Black, Julia, *Involving Consumers in Securities Regulation* (Prepared for the Taskforce to Modernize Securities Regulation in Canada, June 23, 2006).
46. Black, S. Bernard, *Information Asymmetry, the Internet, and Securities Offerings,* 2 J. SMALL & EMERGING BUS. L. 91 (1998).
47. Black, S. Bernard, *The Legal and Institutional Preconditions for Strong Securities Markets,* 48 UCLA L. REV. 781 (2001).
48. Blair, M. Margaret & Stout, Lynn, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law,* 149 U. PA. L. REV. 1735 (2001).
49. *Blue Sky Laws*, 79 COLUM. L. REV. 84-85 (1924).
50. BME Consulting, *The EU Market for Consumer Long-Term Retail Savings Vehicles. Comparative Analysis of Products, Market Structure, Cost, Distribution Systems, and Consumer Savings Patterns* 15 (2007).
51. Bosland, C. Checie, *The Investment Company Act of 1940 and Its Background*, 49 J. POL. ECON. 477 (1941).
52. Bottazi, Laura *The Importance of Trust for Investment: Evidence from Venture Capital* (National Bureau of Economic Research Paper Series, 2011).
53. Boury, Pierre-Marie, *Does the European Union Need a Securities and Exchange Commission?,* 1 CAP. MARKETS L. J. 184 (2006).

54. Bradford, Steven, *Expanding the Investment Company Act: The SEC's Manipulation of the Definition of Security*, 60 OHIO ST. L.J. 995 (1999).
55. Bradley, Bill, *Five Ways to Restore Financial Trust*, WALL ST. J., Feb. 19, 2009.
56. Bradley, Caroline, *Deregulation of Financial Services Activity in Europe after 1992*, 11 OXFORD J. LEGAL STUD. 545 (1991).
57. Braithwaite, Tom, *Dodd Proposes Consumer Role for the Fed*, FIN. TIMES, March 2, 2010.
58. Braithwaite, Tom, *Dodd Determined to Create Consumer Bureau*, FIN. TIMES, April 21, 2010.
59. Braithwaite, Tom & Sieff, Kevin, *US Consumer Protection Deal Near*, FIN. TIMES, March 11, 2010.
60. Braun, Alexandra, *Trusts in the Draft Common Frame of Reference: The "Best Solution" for Europe?* 70 CAMBRIDGE L. J. 327 (2011).
61. Browning, E. S., *School of Scandal*, WALL ST. J., December 13, 1999.
62. Brudney, Victor, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595 (1997).
63. Bucciol, Alessandro & Miniaci, Raffaele, *Household Portfolio Risk*, REV. FIN. (2014).
64. Buell, W. Samuel, *Novel Criminal Fraud*, 81 N.Y.U. L. REV. 1971 (2006).
65. Bullard, E. Mercer, *Dura, Loss Causation, and Mutual Funds: A Requiem for Private Claims?*, 76 U. CIN. L. REV. 559 (2008).
66. Burn, Lachlan, *KISS, but tell all: short-form disclosure for retail investors*, 5 CAP. MARKET L. J. 141 (2010).
67. de Búrca, Gráinne *The Principle of Subsidiarity and the Court of Justice as an Institutional Actor*, 36 J. COMMON MARKET STUD. 217 (1998).
68. Burch, C. Elizabeth, *Securities Class Actions as Pragmatic Ex Post Regulation*, 43 GA. L. REV. 63 (2008).
69. Busch, Danny, *Why MiFID Matters to Private Law – The Example of MiFID's Impact on an Asset Manager's Civil Liability*, 7 CAP. MARKET. L.J. 386 (2012).
70. Bussani, Mauro & Mattei, Ugo, *The Common Core Approach to European Private Law*, 3 COLUM. J. EUR L. 434 (1998).
71. Butler, N. Henry & Ribstein, E. Larry, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990).
72. Cafaggi, Fabrizio & Micklitz, W. Hans, *Administrative and Judicial Collective Enforcement of Consumer Law in the US and the European Community* (European University Institute, EUI Working Papers, 2007/22).
73. Calabresi, Guido & Schwartz, S. Kevin, *The Costs of Class Actions: Allocation and Collective Redress in the US Experience*, 32 EUR. J. L. ECON. 169 (2011).
74. Campbell, David, *Welfare Economics for Capitalists: The Economic Consequences of Judge Posner*, 33 CARDOZO L. REV. 2233 (2012).
75. Campbell, Y. John, *Household Finance*, 4 J. FIN. 1553 (2006).
76. Campbell, Y. John, *et al.*, *Consumer Financial Protection*, 25 J. ECON. PERSPECTIVES 91 (2011).
77. Campello, Murillo *et al.*, *The Real Effects of Financial Constraints: Evidence from a Financial Crisis*, 97 J. FIN. ECON. 470 (2010).
78. Carlson, S. Robert , *Aggregate Performance of Mutual Funds*, 1948 – 1967, 5 J. FIN. QUANTITATIVE ANALYSIS 1 (1970).
79. Carter, C. John, *The Fiduciary Rights of Shareholders*, 29 WM. & MARY L. REV. 823, (1988).
80. Cartwright, G. Brian, *Whither the SEC Now?*, 95 VA. L. REV. 1085 (2009).
81. Casey, Jean-Pierre, *Shedding Light on the UCITS-MiFID Nexus and Potential Impact of MiFID on the Asset Management Sector* (ECMI, 2008).
82. Cassidy, John, *What Good is Wall Street?* NEW YORKER, Nov. 29, 2010.
83. CESR, *Best Execution under MiFID: Questions and Answers* (CESR/07-320, May 2007).

84. Chambers, David & Esteves, Rui, *The First Global Emerging Markets Investor: Foreign & Colonial Investment Trust 1880-1913,* 52 EXPLORATION IN ECON. HIST. 1, (2014).
85. Chamon, Merijn, *EU Agencies: Does the Meroni Doctrine Make Sense?,* 17 MAASTRICHT J. OF EUR. & COMP. L. 281 (2010).
86. Cherednychenko, O. Olha, *The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights,* 33 J. CONSUM. POLICY 403 (2010).
87. Chertok, Seth, *A Comprehensive Guide to Title IV of the Dodd-Frank Act 2010 and the Rules Promulgated Thereunder,* 12 U.C. DAVIS BUS. L.J. 125 (2012).
88. Chiu, H-Y Iris, *Securities Intermediaries in the Internet Age and the Traditional Principal-Agent Model of Regulation: Some Observations from European Union Securities Regulation*, 2 VA. L. & BUS. REV. 307 (2007),
89. Choi, J. Stephen, *Regulating Investor Not Issuers: A Market-Based Proposal,* 88 CAL. L. REV. 279 (2000).
90. Choi, J. Stephen, *Market Lessons for Gatekeepers,* 92 NW. U. L. REV. 916 (1998).
91. Choi, J. Stephen & Fisch, E. Jill, *How to Fix Wall Street: A Voucher Financing Proposal for Securities Intermediaries,* 113 YALE L.J. 269 (2003).
92. Choi, J. Stephen, Fisch, E. Jill & Pritchard, A.C., *Do Institutions Matter? The Impact of the Lead Plaintiff Provision of the Private Securities Litigation Reform Act,* 83 WASH. U.L.Q. (2005).
93. Choi, J. Stephen & Pritchard, A.C., *Behavioral Economics and the SEC,* 56 STAN. L. REV. 1 (2003).
94. Choi, J. Stephen, & Thompson, B. Robert, *Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA,* 106 COLUM. L. REV. 1489 (2006).
95. Claessens, Stijn, *Current Challenges in Financial Regulation* (World Bank, Working Papers, 2007).
96. Clark, C. Robert, *The Soundness of Financial Markets,* 1976 YALE L. J. 1 (1976).
97. *Clinton Signs Legislation Overhauling Banking Laws,* N. Y. TIMES, Nov. 13, 1999.
98. Coates IV, C. John, *Private vs. Political Choice of Securities Regulation: A Political Cost/Benefit Analysis,* 41 VA. J. INT'L L. 531 (2001).
99. Coates IV, C. John & Hubbard, Glenn, *Competition in the Mutual Fund Industry: Evidence and Implications for Policy,* 33 J. CORP. L. 151 (2007).
100. Coffee Jr., C. John, *Brave New World?: The Impact(s) of the Internet on Modern Securities Regulation,* 52 BUS. LAW. 1195 (1997).
101. Coffee, Jr., C. John, *Law and the Market: The Impact of Enforcement,* 156 U. PENN L. REV. 229 (2007).
102. Coffee Jr., C. John, *Market Failure and the Economic Case for a Mandatory Disclosure System,* 70 VA. L. REV. 717 (1984).
103. Coffee Jr., C. John, *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role,* 89 COLUM. L. REV. 1618 (1989).
104. Coffee Jr., C. John, *The Political Economy of Dodd-Frank: Why financial Reform Tends to Be Frustrated and Systemic Risk Perpetuated,* 97 CORNELL L. REV. 1019 (2012).
105. Coffee Jr., C. John, *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation,* 106 COLUM. L. REV. 1534 (2006).
106. Cohen, H. Milton, *"Truth in Securities" Revisited,* 79 HARV. L. REV. 1340 (1966).
107. Cohen, Ronnie & O'Bryne, Shannon, *Burning Down the House: Law, Emotion and the Subprime Mortgage Crisis,* 45 REAL PROP. TR. & EST. L. J. 677 (2011).
108. Cohen, Z. Jonathan, *The Mellon Bank Order: An Unjustifiable Expansion of Banking Powers,* 8 ADMIN. L.J. AM. U. 335 (1994).
109. Coffee Jr., C. John, *Law and the Market: The Impact of Enforcement,* 156 U. PENN. L. REV. 229 (2007).
110. Coffee Jr., C. John & Sale, A. Hillary, *Redesigning the SEC: Does the Treasury Have a Better Idea?,* 95 VA. L. REV. 707 (2009).
111. Cole, Lance, *The SEC's Cooperation Policy: A Duty to Correct or Update?,* 41 SEC. REG. L.J. 127 (2013).

112. Colombo, J. Ronald, *Merit Regulation Via the Suitability Rules*, 12 J. INT'L BUS. & L. 1 (2013).
113. Colombo, J. Ronald, *The Role of Trust in Financial Regulation*, 35 VILLANOVA L. REV. 577 (2010).
114. Colombo, J. Ronald, *Trust and the Reform of Securities Regulation*, 35 DEL. J. CORP. L. 829 (2010).
115. Comment, *Duties of the Independent Director in Open-End Mutual Funds*, 70 MICH. L. REV. 696 (1972).
116. Comment, *Mutual Funds and Independent Directors: Can Moses Lead to Better Business Judgment?*, 1972 DUKE L. J. 429 (1972).
117. Corbett, J. Charles & Tang, S. Christopher, *Designing Supply Contracts: Contract Type and Information Asymmetry*, 17 INT'L SERIES OPERATIONS RESEARCH & MGMT. SCI. 269 (1999).
118. Coval, Joshua & Moskowitz, Tobias, *Home Bias at Home: Local Equity Preferences in Domestic Portfolios*, 54 J. FIN. 2045 (1999).
119. Cover, M. Robert *Nomos and Narrative*, 97 HARV. L. REV. 4 (1983-1984).
120. Cowen J. David, *The First Bank of the United States and the Securities Market Crash of 1792*, 60 J. ECON. HIST. 1041 (2000).
121. Cox, D. James, *Reinventing the SEC by Staring into its Past*, 78 U. CIN. L. REV. 459 (2009).
122. Cox, D. James *et al.*, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737 (2003).
123. Cox D. James & Payne, W. John, *Mutual Fund Expense Disclosures: A Behavioral Perspective*, 83 WASH. U. L. Q. 905 (2005).
124. Cox, D. James *et al.*, *Public and Private Enforcement of the Securities Laws: Have Things Changed Since Enron?*, 80 NOTRE DAME L. REV. 893 (2005).
125. Cox, J. Laura, *The Impact of the Citicorp-Travelers Group Merger on Financial Modernization and the Repeal of Glass-Steagall*, 23 NOVA L. REV 899, (1999).
126. Craig, Paul, *Subsidiarity: A Political and Legal Analysis*, 50 J. COMMON MARKET STUD. 72 (2012),
127. Crook, Clive, *US Financial Reform Ignores Wider Terrain*, FIN. TIMES, March 21, 2010.
128. Cross, B. Frank & Prentice, A. Robert, *The Economic Value of Securities Regulation*, 28 CARDOZO L. REV. 333 (2006).
129. Cuaresma, C. Jolina, *The Gramm-Leach-Bliley Act* 17 BERKELEY TECH. L.J. 497 (2002).
130. Cunningham, A. Lawrence, *Behavioral Finance and Investor Governance* 59 WASH. & LEE L. REV. 767 (2002).
131. Cunningham, A. Lawrence, *Capital Market Theory, Mandatory Disclosure, and Price Discovery*, 51 WASH. & LEE L. REV. 843 (1994).
132. Čihák, Martin & Podpiera, Richard, *Integrated Financial Supervision: Which Model?*, 19 N. AM. J. ECON. & FIN. 135 (2008).
133. Dalley, J. Paula, *The Use and Misuse of Disclosure as a Regulatory System*, 34 FLA. ST. U. L. REV. 1089 (2007).
134. Damato, Karen, *"Timing" at Mutual Funds Can Cost 2% a Year*, WALL ST. J., Sept. 19, 2003.
135. Dass, Nishant *et al.*, *Allocation of decision rights and the investment strategy of mutual funds*,110 J. FIN ECON. 254 (2013).
136. Davis, K. Archie, *Banking Regulation Today: A Banker's View*, 31 L. & CONTEMP. PROBS. 639 (1966).
137. Davies, Paul, *Class Inaction: Plaintiffs' Lawsuits Against Companies Sharply Decline*, WALL ST. J., Aug. 26, 2006.
138. Davis, Phil, *Protecting Investors Proves Tricky*, FIN. TIMES, March 20, 2001.
139. Dean H. Arthur, *Twenty-five Years of Federal Securities Regulation by the Securities and Exchange Commission*, 59 COLUM. L. REV. 697 (1959).
140. DeMott, A. Deborah, *Beyond Metaphor: An Analysis of Fiduciary Obligations*, 1988 DUKE L.J. 879, 879 (1988)

141. DeMott, A. Deborah, *Causation in the Fiduciary Realm*, 91 BUL. REV. 851 (2011).
142. Dent Jr., W. George, *Ancillary Relief in Federal Securities Law: A Study in Federal Remedies*, 67 MINN. L. REV. 865 (1983).
143. Dickson, Tim *UCITS Will Help Remove Barriers*, FIN. TIMES, Oct. 31, 1987.
144. Di Noia, Carmine & Gargantini, Matteo, *Unleashing the European Securities and Markets Authority: Governance and Accountability after the ECJ Decision on the Short Selling Regulation (Case C-270/12)*, 15 EUR. BUS. ORG. L. REV. 1 (2014).
145. Dixon, W. Robert, *Note: the Gramm-Leach-Bliley Financial Modernization Act: Why Reform in the Financial Services Industry Was Necessary and the Act's Projected Effects on Community Banking*, 49 DRAKE LAW REV. 621 (2001).
146. Dolley, N. Joseph, *Blue Sky Law*, 77 AM. BANKER 1705 (1912).
147. Donald, C. David, *Approaching Comparative Company Law*, 14 FORDHAM J. CORP. & FIN. L. 83 (2008).
148. Douglas, O. William, *Protecting the Investor*, 23 YALE REV. 521(1934).
149. Dudley, C. William & Hubbard, R. Glenn, *How Capital Markets Enhance Economic Performance and Facilitate Job Creation* (Global Market Institute, Goldman Sachs, November 2004).
150. Dutton, J. Christopher, Note, *Dura Pharmaceuticals, Inc. v. Broudo: Extracting Teeth from Securities Regulation*, 33 N. KY. L. REV. 153 (2006).
151. Dye, A. Ronald, *Mandatory Versus Voluntary Disclosures: The Cases of Financial and Real Externalities*, 65 ACCOUNTING REV. 1 (1990).
152. Dykstra, C.A., *Blue Sky Legislation*, 7 AM. POL. SCI. REV. 230 (1913).
153. Eaton, M. David, *The Commercial Banking-Related Activities of Investment Banks and Other Nonbanks*, 44 EMORY L. J. 1187 (1995).
154. Easterbrook, H. Frank & Fischel, R. Daniel, *Mandatory Disclosure and Protection of Investors*, 70 VA. L. REV. 669 (1984).
155. Edwards, Jonathan & Wolfe, Simone, *Compliance: A Review*, 131 FIN. REG. & COMPLIANCE 48 (2005).
156. Eisenberg, A. Melvin, *Text Anxiety*, 59 CAL. L. REV. 305 (1986).
157. Eisenberg, Meyer & Phillips, M, Rihard *Mutual Fund Litigation – New Frontiers for the Investment Company Act*, 62 COLUM. L. REV. 73 (1962).
158. Enriques, Luca & Gatti, Matteo, *Is There a Uniform EU Securities Law After the Financial Services Action Plan*, 14 STAN. J.L. BUS & FIN 43 (2008).
159. *EU Eyes More Regulation in Answer to Crisis*, AGENCE FRANCE PRESSE, Nov. 4, 2008.
160. *EU Must Unite to Tackle Roots of Financial Crisis: Brown*, AGENCE FRANCE PRESSE, Oct. 15, 2008.
161. *EU Pushes for Reforms to Global Financial System*, DEUTSCHE WELLE, Oct. 16, 2008.
162. Farrow, Paul, *Will the New Financial Conduct Authority Protect Consumers?* THE TELEGRAPH, January 13th, 2012.
163. Fama, F. Eugene, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980).
164. Fama, F. Eugene, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970).
165. Faure, Michael, *et al.*, *Enforcement Practices for Breaches of Consumer Protection Legislation*, 20 LOY. CONSUMER L. REV. 361 (2008).
166. Fentiman, Richard, *Brussels I and Third States: Future Imperfect?*, 13 CAMBRIDGE Y.B. EUR. LEGAL STUD. 65 (2012).
167. Ferran, Eilís, *After the Crisis: The Regulation of Hedge Funds and Private Equity in the EU*, 12 EUR. BUS. ORG. L. REV. 379 (2011).
168. Ferran, Eilís *Dispute Resolution Mechanisms, in the UK Financial Sector* 15, *available online at:* < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=298176 >.
169. Ferran, Eilís, *European Banking Union: Imperfect, but It can Work* (University of Cambridge Faculty of Law Research Paper No. 30/2014).
170. Ferran, Eilís *The Break-up of the Financial Services Authority*, 31 OXFORD J. LEGAL STUD. 455 (2011).

171. Ferrara, C. Ralph, *et al., Hardball! The SEC's New Arsenal of Enforcement Weapons,* 47 BUS. LAW. 33 (1991).
172. Ferson, Wayne & Schadt, Rudi, *Measuring Fund Strategy and Performance in Changing Economic Conditions,* 51 J. FIN. 425 (1996).
173. Finger, K. Wallis, *Unsophisticated Wealth: Reconsidering the SEC's "Accredited Investor" Definition Under the 1933 Act,* 86 WASH. U. L. REV. 733 (2009).
174. Fisch, E. Jill, *Cause for Concern: Causation and Federal Securities Fraud,* 94 Iowa L. Rev. 811 (2009).
175. Fisch, E. Jill, *Rethinking the Regulation of Securities Intermediaries*, 158 U. PA. L. REV. 1961 (2010).
176. Fischhoff, Baruch, *Hindsight Is Not Equal to Foresight: The Effect of Outcome Knowledge on Judgment Under Uncertainty,* 1 J. EXPERIMENTAL PSYCHOL: HUM. PERCEPTION & PERFORMANCE 288 (1975).
177. Fishman, J. James, *A Comparison of Enforcement of Securities Law Violations in the UK nd US*, 14 COMPANY LAW. 163 (1993).
178. Fishman, J. Michael & Hagerty, M. Kathleen, *Mandatory Versus Voluntary Disclosure in Markets with Informed and Uninformed Customers*, 19 J. L. ECON. & ORG. 45 (2003).
179. Fiss, M. Owen, *The Political Theory of the Class Action*, 53 WASH. & LEE L. REV. 21 (1996).
180. Fleming, A. Rick, *100 Years of Securities Law: Examining a Foundation Laid in the Kansas Blue Sky*, 50 WASHBURN L.J. 583 (2011).
181. Fleming, Sam, *Challenging UK Watchdog's Decisions 'Fruitless', Lawyers Warn,* FIN. TIMES, May 13, 2014.
182. Fletcher III, C. Edward, *Sophisticated Investors Under the Federal Securities Laws,* 1988 DUKE L. J. 1081 (1988).
183. Ford, L. Cristie, *New Governance, Compliance, and Principles-Based Securities Regulation*, 45 AM. BUS. L.J. 1, (2008).
184. Forsythe, Robert, *et. al.*, *Anatomy of an Experimental Political Stock Market,* 82 AM. ECON. REV. 1142 (1992).
185. Fox, B. Meritt, *Why Civil Liability for Disclosure Violations When Issuers Do Not Trade?,* 2009 WISC. L. REV. 298 (2009).
186. Franco, A. Joseph, *A Consumer Protection Approach to Mutual Fund Disclosure and the Limits of Simplification,* 15 STAN. J. L. BUS. & FIN. 1 (2009).
187. Frankel, Tamar, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209 (1995).
188. Frankel, Tamarm *Fiduciary Duties of Brokers-Advisers-Financial Planners and Money Managers* (Boston University School of Law, Working Paper No. 09-36, 2009, revised 2010).
189. Frankel, Tamar, *Fiduciary Law*, 71 CAL. L. REV. 795 (1983).
190. Frankel, Tamar, *Regulation and Investors' Trust in the Securities Markets,* 68 BROOK. L. REV. 438, (2002).
191. Frankel, Tamar, *The Legal Infrastructure of Markets: The Role of Contract and Property Law*, 73 B.U. L.REV. 389 (1993).
192. Frankel, Tamar, *Towards Universal Fiduciary Principles* 39 QUEEN'S L.J. 391 (2014).
193. Freeman, P. John, et al., *Mutual Fund Advisory Fees: New Evidence and a Fair Fiduciary Duty Test*, 61 OKLA. L. REV. 83 (2008).
194. Gatto, Alexandra, *Governance in the European Union: A Legal Perspective*, 12 COLUM. J. EUR. L. 487, (2006).
195. Garcimariín, Francisco *The Law Applicable to Prospectus Liability in the European Union*, 10 L. & FIN. MARKETS REV. 449 (2011).
196. Garrett, W. Paul, *The Jazz Age*, FIN. N. AM. REV. (Feb. 1930).
197. Georgosouli, Andromachi, *The FSA Regulatory Policy of Rule-Use: A Move towards More Effective Regulation?* (University of London – Centre for Commercial Law Studies, Working Paper 2006).

198. Gerner-Beuerle, Carsten, *United in Diversity: Maximum Versus Minimum Harmonization in EU Securities Regulation*, 7 CAP. MARKETS L. 317 (2012).
199. Gill, B. Oren & Warren, Elizabeth, *Making Credit Safer*, 157 U. PA. L. REV. 1, 6 (2008).
200. Gilson, J Ronald & Kraakman, H. Reinier *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984).
201. Gigerenzer, Gerd, *Why Heuristics Work*, 3 PERSPECTIVES ON PSYCHOLOGICAL SCIENCE 20 (2008).
202. Goldfarb, A. Zachary, et al., *U.S. May Add New Financial Watchdog*, WASH. POST, May 20, 2009.
203. Goldring, F. Gary, *Mandatory Disclosure of Corporate Projections and the Goals of Securities Regulation*, 81 COLUM. L. REV. 1525 (1981).
204. Goodhard, A.E. Charles, *The Background to the 2007 Financial Crisis*, 4 J. INT'L ECON. & ECON. POL. 331 (2008).
205. Goshen, Zohar & Parchomovsky, Gideon, *The Essential Role of Securities Regulation*, 55 DUKE L. J. 711 (2006).
206. Grace, M. Stefano, *Strengthening Investor Confidence in Europe: U.S.-Style Securities Class Actions and the Acquis Communautaire*, 15 J. TRANSNAT'L L. & POL'Y 281 (2006).
207. Graham, Benjamin, *The Undistributed Profits Tax and the Investor*, 46 YALE L. J. 1 (1936).
208. Grant, Jeremy & Guha, Krishna, *Paulson Seeks British-Style Flexibility in Capital Markets*, FIN. TIMES, Nov. 21, 2006.
209. Grant, K. Joseph, *What the Financial Services Industry Puts Together Let no Person Put Asunder: How the Gramm-Leach-Bliley Act Contributed to the 2008-2009 American Capital Market Crisis*, 73 ALB. L. REV 371 (2010).
210. Greene, F. Edward, *Dodd-Frank: a lesson in decision avoidance*, 6 CAP. MARKETS L. J..29 (2011).
211. Greene, M. Lawrence, *Fiduciary Standards of Conduct under the Investment Company Act of 1940*, 28 GEO. WASH. L. REV. 266 (1959-1960).
212. Greenfield, Kent, *Using Behavioral Economics to Show the Power and Efficiency of Corporate Law as Regulatory Tool*, 35 U. C. DAVIS L. REV. 581 (2002).
213. Gregory, A. William, *The Fiduciary Duty of Care: A Perversion of Words*, 38 AKRON L. REV. 181 (2005).
214. Grinblatt, Mark, Titman, Sheridan & Wermers, Russ, *Momentum Strategies, Portfolio Performance and Herding: A Study of Mutual Fund Behavior*, 85 AM. ECON. REV. 1088 (1993).
215. Guha, Krishna & Grant, Jeremy, *Paulson to Call for Rethink on US Rules*, FIN. TIMES, Nov. 19, 2006.
216. Guiso, Luigi, *A Trust-Driven Financial Crisis: Implications for the Future of Financial Markets* (EUI Working Papers ECO 2010/07).
217. Guttentag, D. Michaler, *Protection form What? Investor Protection and the JOBS Act*, 13 U.C. DAVIS BUS. L.J. 207 (2013).
218. Hamilton, Jim, *White Details Scope of Staff Study of Accredited Investors Definition*, SEC TODAY, Nov. 29, 2013.
219. Hanna, John, *The Securities Exchange Act of 1934*, 23 CAL. L. REV. 1 (1934).
220. Hansen, G. Robert, *A Theory for the Choice of Exchange Medium in Mergers and Acquisitions*, 60 J. OF BUS. 75 (1987).
221. Hansmann, B. Henry, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497 (1981).
222. Hansmann, B. Henry & Mattei, Ugo, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. REV. 434 (1998).
223. Hansmann, B. Henry, *et al., Law and the Rise of the Firm*, 119 HARV. L. REV. 1333 (2006).

224. Hanson, D. John & Kysar, A. Douglas, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74 N.Y.U. L. Rev. 630 (1999).
225. Harding, Matthew, *Manifesting Trusts*, 29 OXFORD J. L. STUD. 245 (2009).
226. Harding, Matthew, *Trust and Fiduciary Law*, 33 OXFORD J. LEGAL STUD. 81 (2013).
227. Hasen, L. Richard, *Efficiency Under Informational Asymmetry: the Effect of Framing on Legal Rules*, 38 UCLA L. REV. 391 (1990).
228. Hayden, M. Grant & Stephen, E. Ellis, *Law and Economics after Behavioral Economics*, 55 U. KAN. L. REV. 629 (2006).
229. Hayes, A. John, *After Murphy: Building on the Consumer Protection Principle*, 12 OXFORD J. LEGAL STUD. 112 (1992).
230. Hazard Jr., C. Geoffrey, *Indispensable Party: Historical Origin of a Procedural Phantom*, 61 COLUM. L. REV. 1254 (1961).
231. Hazen, L. Thomas, *Administrative Enforcement: An Evaluation of the Securities and Exchange Commission's Use of Injunctions and Other Enforcement Techniques*, 31 HASTINGS L.J. 427 (1979).
232. Hazen, L. Thomas, *Symposium Introduction: The Supreme Court and the Securities Laws: Has the Pendulum Slowed?*, 30 EMORY L.J. 5 (1981).
233. Healy, M. Paul & Palepu, G. Krishna, *Information Asymmetry, corporate disclosure and the capital markets: A review of the empirical disclosure literature*, 31 J. ACCOUNTING & ECON. 405 (2001).
234. Helfman, Tara, *Land Ownership and the Origin of Fiducairy Duty*, 41 REAL PROP. PROB. & TR. J. 651 (2006).
235. Henninger, Daniel, *In Government We Trust?* WALL ST. J., Aug. 20, 2009.
236. Hensler, R. Deborah, *The Globalization of Class Action: An Overview*, 622 ANNALS AM. ACAD. POL. & SOC. SCI. 7 (2009).
237. Hertig, Gerard & Lee, Ruben *Four Predictions about the Future of EU Securities Regulation*, January 2003, *available online at:* < http://www.oecd.org/finance/financial-markets/18469147.pdf>.
238. Hess, Burkhard, *Private Law Enforcement und Kollektivklagen*, JURISTENZEITUNG 66 (2011).
239. Higgins, Andrew & Zuckerman, Adrian, *Class Action in England? Efficacy, Autonomy and Proportionality in Collective Redress* (University of Oxford, Legal Research Paper Series No 93/2013).
240. Hill, A. Claire & O'Hara, Erin Ann, *A Cognitive Theory of Trust*, 84 WASH. U. L. R. 1717, (2006).
241. Hodges, Chrisopher, *Collective Redress: A Breakthrough or a Damp Squibb?*, 37 J. CONSUMER POL'Y 67 (2014).
242. Holmstrom Bengt & Tirole, Jean, *Market Liquidity and Performance Monitoring*, 101 J. POL. ECON. 678 (1993).
243. Hosking, Geoffrey, *Trust and Financial Markets*, THE EUR. FIN. REV., Oct. 21, 2014.
244. Howell, Elizabeth, *The European Court of Justice: Selling Us Short?*, 11 EUR. COMP. & FIN. L. REV. 454 (2014).
245. Huberman, Gur, *Familiarity Breeds Investment*, 14 REV. FIN. STUD. 659 (2001).
246. Hudson, Alastair, *The Future of Company Law: New Fiduciaries, New Britain*, 21 COMPANY LAW. 95 (2000).
247. Hutson, Elaine, *The Early Managed Fund Industry: Investment Trusts in 19th century Britain*, 14 INT'L REV. FIN. ANALYSIS, 439 (2004).
248. Isaac, M. William & Fein, L. Melanie, *Facing the Future – Life Without Glass-Steagall*, 37 CATH. U. L. REV 281 (1988).
249. Issacharoff, Samuel, *Contracting for Employment: the Limited Return of the Common Law*, 74 TEX. L. REV. 1783 (1996).
250. Jackson, E. Howell, *A Pragmatic Approach to the Phased Consolidation of Financial Regulation in the United States* (Harvard Public Law Working Paper No. 09/19, 2009).
251. Jackson, E. Howell, *Regulation in a Multisectored Financial Services Industry: An Exploration Essay'*, 77 WASH. U. L. Q, 319 (1999).

252. Jackson, E. Howell, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications*, 24 YALE J. ON REG. 253 (2007).
253. Jackson, E. Howell & Roe, J. Mark, *Public and Private Enforcement of Securities Laws: Resource-based evidence,* 93 J. FIN. ECON. 207 (2009).
254. James, K. Laylin, *The Securities Act of 1933*, 32 MICH. L. REV. 624 (1933-1934).
255. Jaretzki, Alfred Jr., *The Investment Company Act of 1940*, 26 WASH U.L.Q. 303 (1940-1941).
256. Jensen, C. Michael, *Problems in Selection of Security Portfolios: the Performance of Mutual Funds in the Period 1945 – 1964*, 23 J. FIN. 389 (1968).
257. Jensen, C. Michael, *Some Anomalous Evidence Regarding Market Efficiency*, 6 J. FIN. ECON. 95 (1978).
258. Jensen, C. Michael & Meckling, H. William, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,* 3 J. FIN. ECON. 305 (1976).
259. Johnson, D. Emily, *The Fiduciary Duty in Mutual Fund Excessive Fee Cases: Ripe for Reexamination,* 59 DUKE L.J. 145 (2009).
260. Johnson, F. Marilyn, Nelson, K. Karen & Pritchard, A.C., *Do the Merits Matter More? The Impact of the Private Securities Litigation Reform Act*, 23 J. L. ECON & ORGANIZATION 627 (2007).
261. Johnson, Lyman, *A Fresh Look at Director "Independence": Mutual Fund Fee Litigation and Gartenberg at Twenty-Five*, 61 VAND. L. REV. 497 (2008).
262. Jordans, Roman, *The German Law to Strengthen Investor Protection and Improve the Functioning of Capital Markets*, 26 J. INT'L BANK. L & REG. 259 (2011).
263. Jolls, Cristine et al., *A Behavioral Approach to Law and Economics,* 50 STAN. L. REV. 1471 (1998).
264. Jones, A. Kevin, *The National Securities Markets Improvement Act of 1996: A New Model for Efficient Capital Formation,* 53 ARK. L. REV. 153 (2000).
265. Kahan Marcel & Klausner, Michael, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U.L.Q. 347 (1996).
266. Kahan, Marcel & Klausner, Michael, *Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate")*, 83 Va. L. Rev. 713 (1997).
267. Kahneman, Daniel, *Maps of Bounded Rationality: Psychology for Behavioral Economics,* 93 AM. ECON. REV. 1449 (2003).
268. Kahneman, Daniel, Knetsch, L. Jack & Thaler, H. Richard, *Experimental tests of the endowment effect and the Coase Theorem,* 98 J. Pol. Economy 1325 (1990).
269. Kaplow, Louis, *Rules versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992).
270. Karmel, S. Roberta, *Blue-sky Merit Regulation: Benefit to Investors or Burden on Commerce?* 53 BROOK. L. REV. 105 (1987-1988).
271. Karmel, S. Roberta, *Creating Law at the Securities and Exchange Commission: The Lawyer as Prosecutor,* 61 LAW & CONTEP. PROBS. 33 (1998).
272. Karmel, S. Roberta, *Reconciling Federal and State Interests in Securities Regulation in the United States and Europe,* 28 BROOK. J. INT'L L. 495 (2003).
273. Karmel, S. Roberta, *The Case for a European Securities Commission,* 38 COLUM. J. TRANSNAT'L L. 9 (1999).
274. Karmel, S. Roberta & Ketels, P. John, *Securities Commentary* 44 BROOK. L. REV. 1189 (1978).
275. Kaplan, Benjamin, *A Preparatory Note,* 19 B.C. L. REV. 497 (1969).
276. Kass, L. Benny, *We Can, Indeed, Fight City Hall: The Office and Concept of Ombudsman*, 53 A.B.A. J. 231 (1967).
277. Keleher, Ellen, *Almost 20 Money Market Funds Bailed Out*, FIN. TIMES, Oct. 20, 2013.
278. Keller, Elisabeth & Gehlmann, A. Gregory, *Introductory Comment: A Historical Introduction to the Securities Ac of 1933 and the Securities Exchange Act of 1934*, 49 OHIO ST. L.J. 330 (July 1988).
279. Kenmir, David & Hislop, David, *FCA Conduct Regulation*, 2013 COMPLIANCE OFFICER BULL. 1 (2013).

280. Kilbride, J. Bernard, *The British Heritage of Securities Legislation in the United States*, 17 SW. L.J. 258 (1963).
281. Killick, Marcus, *"Twin Peaks" – A New Series or a New Chimera? An Analysis of the Proposed New Regulatory Structure in the UK*, 2012 COMPANY LAW 366 (2012).
282. Kim, Hong-Bum & Lee, H. Chun, *Financial Reform, Institutional Interdependency, and Supervisory Failure in Post Crisis Korea, available online at:* < http://www1.doshisha.ac.jp/~ccas/eng/Eseminars/e2005-07.pdf >.
283. Klein, Benjamin & Leffler, B. Keith, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981).
284. Klein, Maury, *The Stock Market Crash of 1929: A Review Article*, 75 BUS. HIST. REV. 325 (2001).
285. Knickle, H. Norman, *The Investment Company Act of 1940: SEC Enforcement and Private Actions*, 23 ANN. REV. BANKING & FIN. L. 777 (2004).
286. Korobkin, Russell, *What Comes after Victory for Behavioral Law and Economics,* 2011 U. ILL. L. REV. 1653 (2011).
287. Korobkin, B. Russel, & Ulen, S. Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics,* 88 CAL. L. REV 1051 (2000).
288. König, Thomas, *Analysing the Process of EU Legislative Decision-Making: To make a Long Story Short…,* 9 EUR. UNION POL. 145 (2008).
289. Knauss, L. Robert, *A Reappraisal of the Role of Disclosure,* 62 MICH. L. REV. 607 (1964).
290. Knickle, H. Norman, *The Investment Company Act of 1940: SEC Enforcement and Private Actions*, 23 ANN. REV. BANKING & FIN. L. 777 (2004).
291. Kruithof, Marc & Van Gerven, Walter, *A Differentiated Approach to Client Protection: The Example of MiFID* (Financial Law Institute, Univeristeit Gent, Working Paper 2010-07, June 2010).
292. Krupsky, F. Joseph, *Role of Investment Company Directors*, 32 BUS. L. 1748 (1977).
293. Kubarych, M. Roger, *International Regulatory Harmonization: The Economic and Financial Environment*, 14 BROOK. J. INT'L L. 839 (1988).
294. *Labouring with Lamfalussy,* ECONOMIST 97, June 16, 2001.
295. Laby, B. Arthur, *Fiduciary Obligations of Broker-Dealers and Investment Advisers,* 55 VILL. L. REV. 701 (2010).
296. Laby, B. Arthur, *SEC v. Capital Gains Research Bureau and the Investment Advisers Act of 1940*, 91 B.U. L. REV. 1051 (2011).
297. Lampe, E. Carolyn, *The Penny Stock Reform Act of 1990: A Costly Solution to a Serious Problem*, 13 GEO. MASON U. K. REV. 779 (1991).
298. Landes, M. William & Posner, A. Richard, *The Private Enforcement of Law*, 4 J. LEGAL STUD. 1 (1975).
299. Landis, M. James, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29 (1959).
300. Landon Jr., Tomas, *S.E.C. Putting Mutual Funds Under Scrutiny on Late Trading,* N.Y. TIMES, Sep. 5, 2003.
301. Langbein, H. John, *The Contractarian Basis of the Law of Trusts,* 105 YALE L. J. 625 (1995).
302. Langbein, H. John, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 YALE L.J. 165 (1997).
303. Langbein, H. John, *The Uniform Prudent Investor Act and the Future of Trust Investing,* 81 IOWA L. REV. 641 (1996).
304. Langevoort, C. Donald, *Are Judges Motivated to Create "Good" Securities Fraud Doctrine?,* 51 EMORY L.J. 209 (2002).
305. Langevoort, C. Donald, *Disclosures that "Bespeak Caution",*49 BUS. LAW. 481 (1994).
306. Langevoort, C. Donald, *Global Securities Regulation After the Financial Crisi*, 13 J. INT'L ECON. L. 799 (2010).

307. Langevoort, C. Donald, *Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation*, 97 NW. U. L. REV. 135 (2003).
308. Langevoort, C. Donald, *Technological Evolution and the Devolution of Corporate Financing Reporting*, 46 WM. & MARY L. REV. 1 (2004).
309. Langevoort, C. Donald, *The SEC as a Lawmaker: Choices about Investor Protection in the Face of Uncertainty*, 84 WASH. U. L. REV. 1591 (2006).
310. Langevoort, C. Donald, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. 1025 (2009).
311. Langevoort, C. Donald, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. PENN. L. REV. 851 (1992).
312. Lannoo, Karel, *Unlocking Europe's Supervisory Borders,* W.S.J. Oct. 28, 2008.
313. Lannoo, Karel & Levin, Mattias, *Securities Market Regulation in the EU: Everything You Always Wanted to Know About the Lamfalussy Procedure* (CEPS Research Report in Finance and Banking, No. 33, May 2004).
314. Lauricella, Tom, *Two-Tier System: For Staid Mutual Fund Industry, Growing Probe Signals Shake-up*, WALL ST. J., Oct. 20, 2003.
315. La Porta, Rafael, *et al., Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3 (2000).
316. La Porta, Rafael *et al., What Works in Securities Laws?*, 61 J. FIN. 1 (2006).
317. Lee, Larissa, *The Ban Has Lifted: Now Is the Time to Change the Accredited-Investor Standard*, 214 UTAH L. REV. 369 (2012).
318. Legrand, Pierre *Against a European Civil Code*, 60 MODERN L. REV. 44 (1997).
319. Leslie, B. Melanie, *Trusting Trustees: Fiduciary Duties and the Limits of Default Rules,* 94 GEO. L. J. 67 (2005).
320. Levine, Ross, *Stock Markets, Growth, ad Tax Policy*, 46 J. FIN. 1445 (1991).
321. Levine, Ross & Zeros, Sara, *Stock Markets, Banks, and Economic Growth*, 88 AM. ECON. REV. 537 (1998).
322. Levitin, J. Adam, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. ON REG. 143 (2009).
323. Levitin, J. Adam & Watcher, M. Susan, *Explaining the Housing Buble*, 100 GEO. L. J. 1177 (2012).
324. Lewis, E. David, *The Politics of Agency Termination: Confronting the Myth of Agency Immortality*, 64 J. POL. 89 (2003).
325. Lewis, Karen, *Trying to Explain Home Bias in Equities and Consumption,* 37 J. ECON. LIT. 571 (1999).
326. Lewis, Michael & Einhorn, David, *The End of the Financial World as We know It,* N.Y. TIMES, Jan. 4, 2009.
327. Lin, Yu-Hsin, *Modeling Securities Class Actions Outside the United States: The Role of Nonprofits in the Case of Taiwan*, 4 N.Y.U. J. L. & BUS. 143 (2007).
328. Liptak, Adam,*Supreme Court Rules Against Zicam Maker,* N.Y. TIMES, Mar. 23, 2011.
329. Livermore, Shaw *Investment Trusts in 1930*, 3 J. BUS. U. CHI. 432 (1930).
330. Lobell, D. Nathan, *Rights and Responsibilities in the Mutual Fund*, 70 YALE L. J. 1258 (1961).
331. Lobell, D. Nathan, *The Mutual Fund: A Structural Analysis*, 47 VA. L. REV. 181 (1961).
332. Longstreth, Bevis, *The Profile: Designer Disclosure for Mutual Funds,* 64 BROOK. L. REV. 1019 (1998).
333. Loomis, A. Philip Jr., *The Securities Exchange Act of 1934 and the Investment Advisers Act of 1940*, 28 GEO. WASH. L. REV. 214 (1959-1960).
334. Lopez, A. Eduard, *Equitable Remedies for Breach of Fiduciary Duty under ERISA After Varity Corp. v. Howe*, 18 BERKELEY J. EMP. & LAB. L. 323 (1997).
335. Lovitch, B. Fred, *The Investment Advisers Act of 1940 – Who is an "investment adviser"?* 24 U. KAN. L. REV. 67 (1975-1976).
336. Lunt, Penny, *How Are Mutual Funds Changing Banks?* A.B.A. BANKING J., 31 (1993).
337. Lupoi, Maurizio, *The Civil Law Trust*, 32 VAND. J. TRANSNAT'L L. 967 (1999).

338. Macey, R. Jonathan, *The Business of Banking: Before and After Gramm-Leach-Bliley*, 25 J. CORP. L. 691 (2000).
339. Macey, R. Jonathan & Miller, P. Geoffrey, *Origin of the Blue Sky Laws,* 70 TEX. L. REV. 347 (Dec. 1991).
340. Macey, R. Jonathan, *Wall Street in Turmoil: State-Federal Relations Post-Eliot Spitzer* 70 BROOK. L. REV. 117 (2005).
341. Mackay, Diana, *Mainstream retail is damaged, but not dead*, FIN. TIMES, June 1, 2014.
342. Madrian, C. Brigitte & Shea, F. Dennis, *The Power of Suggestion: Inertia in 401(k) participation and savings behavior*, 6 Q.J.E. 1149 (2001).
343. Mahoney, G. Paul, *Manager-Investor Conflicts in Mutual Funds,* 18 J. ECON. PERSP. 161 (2004).
344. Mahoney, G. Paul, *Mandatory Disclosure as a Solution to Agency Problems,* 62 U. CHI. L. REV. 1047 (1995).
345. Mahoney, G. Paul, *Securities Regulation by Enforcement: An International Perspective,* 7 YALE J.REG. 305 (1990).
346. Maiello, Michael, *Mutual Funds: Economies of Scale,* FORBES, June 2, 2009.
347. Mak, Chantal, *Rights and Remedies Article 47 EUCFR and Effective Judicial Protection in European Private Law Matters* (Centre for the Study of European Contract Law, Working Papers Series No. 2012-11).
348. Malkin, Brandan, *UK Firms Gear Up as Class Action Culture Hits Europe,* THE LAWYER, Feb. 7, 2005.
349. Manning, F. John, *Textualism as Nondelegation Doctrine,* 97 COLUM. L. REV. 673 (1997).
350. Marcacci, Antonio, *IOSCO and the Spreading of a US – Like Regulatory Philosophy around the World*, 25 EUR. BUS. L.REV. 759 (2014).
351. Marcosson, F. Issac, *Barring Out the Stock Thieves: How Kansas Has Set an Example to the Other American States in Her System of Safeguarding the Money of Her People,* MUNSEY'S MAGAZINE, February 1912, at 674.
352. Markham, W. Jerry, *Mutual Fund Scandals – a Comparative Analysis of the Role of Corporate Governance in the Regulation of Collective Investments,* HASTINGS BUS. L. J. 67 (2006).
353. Masters, Brooke, *Hoban Keen to Imrpove Competition,* FIN. TIMES, Feb. 16, 2011.
354. Matthews, F. Arthur, *Recent Trends in SEC Requested Ancillary Relief in SEC Level Injunction Actions,* 31 BUS. LAW. 1323 (1976).
355. *McCain's Scapegoat,* WALL. ST. J., Sep. 19, 2008.
356. McCarthy, Arlene, *New Parliament Must 'Restore Confidence and Trust in Markets,* THE PARLIAMENT MAGAZINE, May 1, 2014.
357. McCrum, Dam, *Charles Schwab Agrees $119m settlement,* FINANCIAL TIMES, Jan. 12, 2011.
358. McFerrin, B. John, *Blue Sky Laws of the Southeastern States*, 17 SOUTHERN ECON. J. 302 (1951).
359. McGarity, O. Thomas, *Regulatory Reform in the Reagan Era,* 45 MD. L. REV. 253 (1986).
360. McGrattan, R. Ellen & Prescott, C. Edward, *The Stock Market Crash of 1929: Irving Fisher Was Right!* (National Bureau of Economic Research, Working Paper No. 8622, December 2001).
361. Melley, E. Anne, *Receipt of Compensation; Fiduciary Duty*, 45 AM. JUR. 2D INVESTMENT COMPANIES ETC. (WestlawNext, 2014).
362. McKibbin, J. Warwick & Stoeckel Andrew, *The Global Financial Crisis: Causes and Consequences* (Working Paper in International Economics No. 2.09, Lowy Institute, November 2009).
363. Michell, Gregory, *Why Law and Economics' Perfect Rationality Should Not Be Traded for Behavioral Law and Economics' Equal Incompetence,* 91 GEO. L. J. 67 (2002).

364. Mikhail, B. Michael, Beverly R Walther & Richard Willis, *The Development of Expertise: Do Securities Analysts Improve their Performance with Experience?*, 35 J. ACCT. RES. 131 (1997).
365. Miller, A. George, *The Magical Number Seven, Plus or Minus Two: Some Limits on Our Capacity for Processing Information*, 63 PSYCHOL. REV. 81 (1956).
366. Miller, K. Sandra, *The Best of both Worlds: Default Fiduciary Duties and Contractual Freedom in Alternative Business Entities*, 39 J. CORP. L. 295 (2014).
367. Mitchell, E. Lawrence *The Fairness Rights of Corporate Bondholders,* 65 N.Y.U. L. REV. 1165 (1990).
368. Mitchell, E. Lawrence, *The "Innocent Shareholder": An Essay on Compensation and Deterrence in Securities Class-Action Lawsuits*, 2009 WISC. L. REV. 243 (2009).
369. Mitchener, James Kris & Weidenmier D. Marc., *The Baring Crisis and the Great Latin American Meltdown of the 1890s* (Santa Clara University and NBER, 2006).
370. Mithios, D. Alan, *The Impact of Mandatory Disclosure Laws on Product Choices: An Analysis of the Salad Dressing Market,* 43 J. L. & ECON. 651 (2000).
371. Modesitt, E. Leland, *Mutual Fund A Corporate Anomaly,* 14 U.C.L.A.L.REV. 1252 (1967).
372. Molodovsky, Nicholas, *Building a Stock Market Measure: A Case Story*, 23 FIN. ANALYSTS J. 43 (1967).
373. Moloney, Niamh, *Confidence and Competence: The Conundrum of EC Capital Market Law,* 4 J. CORP. STUD. 1 (2004).
374. Moloney, Niamh, *Financial Market Regulation in the Post-Financial Services Action Plan Era,* 55 INT'L & COMP. L. Q. 982 (2006).
375. Moloney, Niamh, *Large-Scale Reform of Investor Protection Regulation: the European Union Experience,* 4 MACQUARIE J. BUS. L. 147 (2007).
376. Moloney, Niamh, *Liability of Asset Managers: A Comment*, 7 CAP. MARKET. L.J. 414 (2012).
377. Moloney, Niamh, *The European Securities and Markets Authority and Institutional Design for the EU Financial Market - A Tale of Two Competences: Part (1) Rule-Making*, 12 EUR. BUS. ORG. L. REV. 41 (2011).
378. Moloney, Niamh, *The European Securities and Markets Authority and Institutional Design for the EU Financial Market – A Tale of Two Competences: Part (2) Rules in Action,* 12 EUR. BUS. ORG. L. REV. 177 (2011).
379. Moloney, Niamh, *I. Reform or Revolution? The Financial Crisis, EU Financial Markets Law, and the European Securities and Markets Authority,* 60 INT'L & COMP. L. Q. 521 (2011).
380. Moloney, Niamh, *The Investor Model Underlying the EU's Investor Protection Regime: Consumers or Investors?* 13 EUROP. BUS. ORG. L. REV. 169 (2012).
381. Moloney, Niamh, *The Lamfalussy Legislative Model: A New Era for the EC Securities and Investment Services Regime,* 52 INT'L &COMP. L. Q. 509 (2003).
382. Moloney, Niamh, *Time to Take Stock on the Markets: Financial Services Action Plan Concludes as the Company Law Action Plan Rolls Out,* 53 INT'L &COMP. L. Q. 999 (2004).
383. *Money Go Round: What UCITS Are,* DAILY TELEGRAPH, Feb. 3, 1990.
384. Daniel J. Morrissey, *The Road Not Taken: Rethinking Securities Regulation and the Case for Federal Merit Review,* 44 U. RICH. L. REV. 647 (2010).
385. Motley, Warren, Jackson, Charles Jr. & Barnard, John Jr., *Federal Regulation of Investment Companies Since 1940*, 63 HARV. L. R. 1134 (1950).
386. Moultrie, L. Samuel, Note: *Loss Causation, Mutual Funds, and Securities Act Claims: An Uncertain Future for Shareholders,* 25 REGENT U. L. REV. 443 (2013).
387. Mulheron, Rachael, *The Case for an Opt-Out Class Action for European Member States: A Legal and Empirical Analysis,* 15 COLUM. J. EUR. L. 409 (2009).
388. Mulvey, Thomas, *Blue Sky Law,* 36 CAN. L. TIMES 37 (1916).
389. Murphy, M. Sean, *Recent Developments in Litigation Involving Mutual Funds and Investment Advisers,* SS016 ALI-ABA 943 (2010).

390. Murphy, Paul, *FCA 1.1. – Ian Charles Hannam 1,* FIN. TIMES, May 28, 2014.
391. Myers, Stewart & Majluf, Nicholas, *Corporate Financing and Investment Decisions When Firms Have Information that Investors Do Not Have,* 13 J. FIN. ECON. 187 (1984);
392. Nash, D. Gerald, *Government and Business: A Case Study of State Regulation of Corporate Securities: 1850 – 1933*, 38 BUS. HIST. REV 144 (1964).
393. Neas, Jerod, *Dura Duress: The Supreme Court Mandates a More Rigorous Pleading and Proof Requirement for Loss Causation under Rule 10b-5 Class Actions,* 78 U. COLO. L. REV. 347 (2007).
394. Nelson, Caleb, *What Is Textualism?*, 91 VA. L. REV. 347, (2005).
395. Note, *A Banker's Adventures in Brokerland: Looking through Glass-Steagall at Discount Brokerage Services,* 81 MICH L. REV. 1498 (1983).
396. Note, *The Bank Holding Company Act of 1956,* 9 STAN. L. REV. 333 (1957).
397. Note, *The Mutual Fund and its Management Company: An Analysis of Business Incest,* 71 YALE L. J. 135 (1961).
398. Note, *Recognition of Legislative Intent in Judicial Interpretation of Investment Company Act of 1940*, 40 GEO. WASH. L. REV. 890 (1972).
399. Norman, P., *Brussels Wise Men 'Satisfied' With Reform*, FIN. TIMES, June 2, 2003.
400. Norton, J. Joseph, *Up Against 'The Wall': Glass-Steagall and the Dilemma of a Deregulated ('Regulated') Banking Environment,* 42 BUS. LAW. 327 (1987).
401. Nourse, F. Victoria, *A Decision Theory of Statutory Interpretation: Legislative History by the Rules,* 122 YALE L. J. 70 (2012).
402. Nussbaum, W. Bernard, *Wall Street: From the Robber Baron to Regulation by the SEC in 95 Years,* 191 N. U. L. J. 48 (1984).
403. Nutt, J. William, *A Study of Mutual Fund Independent Directors,* 120 U. PA. L. REV. 179 (1971).
404. Oesterle, A. Dale, *The Overused and Under-Defined Notion of "Material" in Securities Law*, 14 U. PA. J. BUS. L. 167 (2011).
405. Oten, Rogér & Schweitzer, Mark, *A Comparison Between the European and the US Mutual Fund Industry,* 28 MANAGERIAL FIN. 12 (2002).
406. Ouandlous, Arav, *Capital Markets and Economic Development: A Framework for Newly Liberalized Economies*, 8 J. BUS. & ECON. RESEARCH 9 (2010).
407. Pagano, Marco, *Financial Markets and Growth: An Overview* 37 EUR. ECON. REV. 613 (1993).
408. Palin, Adam, *EU Law Set to Improve UK Consumer Protection,* FIN. TIMES, June 12, 2014.
409. Palin, Adam, *FCA Moves to Ban Premium Complaint Lines,* FIN. TIMES, Dec. 12, 2014.
410. Palmiter, Alan & Taha, E. Ahmed, *Mutual Fund Investors: Divergent Profiles,* 3 COLUM. BUS. L. REV. 934 (2008).
411. Pan, J. Eric, *Four Challenges to Financial Regulatory Reform,* 55 VILL. L. REV. 743 (2009).
412. Pan, J. Eric, *Harmonisation of U.S. – EU Securities Regulation: The Case of a Single European Securities Regulator,* 34 LAW & POL'Y INT'L BUS, 499 (2003).
413. Pan, J. Eric, *Understanding Financial Regulation,* 2012 UTAH L. REV. 1897 (2012).
414. Paredes, A. Troy, *Blinded by the Light: Information Overload and its Consequences for Securities Regulation*, 81 WASH U. L.Q. 417 (2003).
415. Paredes, A. Troy, *On the Decision to Regulate Hedge Funds: The SEC's Regulatory Philosophy, Style, and Mission,* 2006 U. ILL. L. REV. 975 (2006).
416. Park, J. James, *The Competing Paradigms of Securities Regulation,* 57 DUKE L. J. 625 (2007).
417. Parker, George, *EU Considers Consumer Class Action,* FIN. TIMES, March 4, 2007.
418. Parker, George & Buck, Tobias, *Business Warns EU Against Class Action Suits,* FIN. TIMES, March 14, 2007.

419. Parnall, Theodore, Kohl, R. Bruce & Huff, W. Curtis, *Private and Limited Offerings After a Decade of Experimentation: The Evolution of Regulation D,* 12 N. M. L. REV. 633 (1982).
420. Parrish, E. Michael, *The Great Depression, the New Deal, and the American Legal Order,* 59 WASH. L. REV. 723 (September 1984).
421. Paul, J. Patrick, *The European Community's UCITS Directive: One Model for United States Regulatory Change in a Globalized Securities Market,* 25 VAND. J. TRANSNAT'L L. 61 (1992).
422. *Penny Stock Fraud Costing Consumers Billions,* REUTERS BUS. REP., May 9, 1989.
423. Pimlott, F. Graham, *The Reform of Investor Protection in the U.K. – An Examination of the Proposals of the Gower Report and the U.K. Government's White Paper of January, 1985,* 7 J. COMP. BUS. & CAP. MARKET L. 141 (1985).
424. Pitt, L. Harvey & Shapiro, L. Karen, *Securities Regulation by Enforcement: A Look Ahead at the Next Decade,* 7 YALE J. ON REG. 149 (1990).
425. Polking, J. Paul & Cammarn, A. Scott, *Overview of the Gramm-Leach-Bliley Act,* 4 N.C. BANKING INST. 1 (2000).
426. Pollack, Lisa, *The Formula that Wall Street Never Believed In,* FINANCIAL TIMES, June 15, 2012.
427. Pollman, Elizabeth, *Information Issues on Wall Street 2.0,* 161 U. PA. L. REV. 179 (2012).
428. Posner, A. Richard, *Behavioral Finance Before Kahneman,* 44 LOY. U. CHI. L.J. 1341 (2013).
429. Pound, John, *Proxy Voting and the SEC: Investor Protection Versus Market Efficiency,* 29 J. FIN. ECON. 241 (1995).
430. Pownall, Grace & Waymire, Gregory, *Voluntary Disclosure Credibility and Securities Prices: Evidence From Management Earnings Forecasts,* 27 J. ACCOUNTING RESEARCH 227 (1989).
431. Prentice, A. Robert, *The Inevitability of a Strong SEC,* 91 CORNELL L. REV. 775 (2006).
432. Prentice, Robert, *Whither Securities Regulation? Some Behavioral Observations Regarding Proposals for Its Future,* 51 DUKE L.J. 1397 (2002).
433. Pritchard, A.C. & Sale, A. Hillary, *What Counts as Fraud? An Empirical Study of Motions to Dismiss Under the Private Securities Litigation Reform Act,* 2 J. EMPIRICAL LEGAL STUD. 125 (2005).
434. Pritchard, A. C. & Thompson, B. Robert, *Securities Law and the New Deal Justices, 95* VA. L. REV. 841 (2009).
435. Radin, Max, *Statutory Interpretation,* 43 HARV. L. REV. 863 (1930).
436. Radmer, J. Michael, *Duties of Directors of Investment Companies,* 3 J. CORP. L. 61 (1977).
437. Randall, Clarke, *Fiduciary Duties of Investment Company Directors and Management Companies under the Investment Company Act of 1940,* 31 OKLA. L. REV. 635 (1978).
438. *Restoring Investor Confidence in European Capital Markets* 4 (European Investors' Working Group, March 2010).
439. *Reagan: Putting His Philosophy to Work Fast,* BUS. WK., Nov. 17, 1980.
440. Redish, H, Martin, *Class Actions and the Democratic Difficulty: Rethinking he Intersection of Private Litigation and Public Goals* 2003 U. CHI. LEGAL F. 71 (2003).
441. Ribstein,E. Larry, *Are Partners Fiduciaries?* 1 U. ILL. L. REV. 209 (2005).
442. Ribstein, E. Larry, *Fencing Fiduciary Duties,* 91 B. U. L. REV. 899 (2011).
443. Richards, Paul, *The EU Financial Services Action Plan: A Guide,* BANK OF ENGLAND Q. BULL. (2003).
444. R.G.C., *Mutual Funds and the Investment Advisory Contract,* 50 VA. L. REV. 141 (1964).
445. Robinson, R. Leland, *Investment Trusts,* 3 J. BUS. U. CHI.279 (1930).
446. Roe, J. Mark, *Deleware Competition,* 117 HARV. L. REV. 588 (2003).

447. Roe, J. Mark, *Political Elements in the Creation of a Mutual Fund Industry*, 139 U. PA. L. REV. 1469 (1991).
448. Rogers, B., *Blue Sky Laws* 87 A.L.R. 42 (1933).
449. Rogers, P. William & Benedict, N, James, *Money Market Fund Management Fees: How Much Is Too Much?*, 57 N.Y.U.L. REV. 1059 (1982).
450. Romano, Roberta, *Empowering Investors: A Market Approach to Securities Regulation,* 107 YALE L.J. 2359 (1998).
451. Romano, Roberta, *Is Regulatory Competition a Problem or Irrelevant for Corporate Governance?* (European Corporate Governance Inst. – Law, Working Paper No. 26/2005, 2005).
452. Rose, K. Andrew & Spiegel, M. Mark, *Cross-Country Causes and Consequences of the 2008 Crisis: Early Warning* (Federal Reserve Bank of San Francisco, Working Paper, July 2009).
453. Roth, Wulf-Henning, *The European Economic Community's Law on Services: Harmonisation,* 25 COMMON MKT. L. REV. 35 (1988).
454. Rotschild, Michael & Stiglitz, Joseph, *Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information*, 90 Q. J. ECON. 629 (1976).
455. Rottenberg, W. Alan, *Developing Limits on Compensation of Mutual Fund Advisers,* 7 HARV. J. ON LEG. 309 (1970).
456. Rouwenhorst, K. Geert, *The Origins of Mutual Funds* (Yale ICF Working Paper No. 04-48, 2004).
457. Rubin, L. Edward, *Deregulation, Reregulation and the Myth of the Market,* 45 WASH. & LEE L. REV. 1249 (1988).
458. Rubenstein, B. William, *Why Enable Litigation?: A Positive Externalities Theory of the Small Claims Class Action,* 74 UMKC L. REV. 709 (2006).
459. Russo, J. Edward, et al., *Nutrition Information in the Supermarket,* 13 J. CONSUMER RES. 48 (1986).
460. Samuelson, A. Paul, *Proof That Properly Anticipated Prices Fluctuate Randomly,* 6 INDUS. MGMT. REV. 41 (1965).
461. Samuelson, Williams *Bargaining Under Asymmetric Information,* 52 ECONOMETRICA 995 (1984).
462. Samuelson, William & Zeckhauser, Richard, *Status Quo Bias in Decision Making,* 1 J. RISK & UNCERTAINTY 7 (1988).
463. Sargent, A. Mark, *State Disclosure Regulation and the Allocation of Regulatory Responsibilities,* 46 MD. L. REV. 1027 (1987).
464. Saxon, J. James & Miller, E. Dean, *Common Trust Funds,* 53 GEO. L.J. 994 (1965).
465. Schooner, M. Heidi & Taylor, Michael, *United Kingdom and United States Responses to the Regulatory Challenges of Modern Financial Markets,* 38 TEX. INT'L L.J. 317 (2003).
466. Section 19 FSMA 2000.
467. Schonfeld, E. Victoria & Kerwin, M.J. Thomas, *Organization of a Mutual Fund,* 49 BUS. LAW. 107 (1993).
468. Schüler, Martin, *Integrated Financial Supervision in Germany* (ZEW – Centre for European Economic Research, Discussion Paper No. 04-035).
469. Schwartz, Alan & Scott, E. Robert, *Contract Theory and the Limits of Contract Law,* 113 YALE L. J. 1 (2003).
470. Schwartz, Jeff, *Reconceptualizing Investment Management Regulation,* 16 GEO. MASON L. REV. 521, 522 (2009).
471. Scogland, L. Willam *Fiduciary Duty: What Does It Mean?* 24 TORT & INS. L. J. 803 (1989).
472. Scott, S. Hal, *A General Evaluation of the Dodd-Frank US Financial Reform Legislation,* 25 J. I. B. L. R. 477 (2010).
473. Scott, S. Hal, *The Reduction of Systemic Risk in the United States Financial System,* 33 HARV. J.L. & PUB. POL'Y 671 (2010).
474. Scott, W. Austin, *The Nature of the Rights of the Cestui Que Trust*, 17 COLUM. L. REV. 269 (1917).

475. Sealy, S. Leonard, *Fiduciary Relationships*, 1962 CAMBRIDGE L. J. 69 (1962).
476. Segal, R. Ilya & Whinston, D. Michael, *Public vs. Private Enforcement of Antitrust Law: A Survey* (John M. Olin Program in Law & Econ., Stanford Law Sch., Working Paper No. 335, 2006).
477. Seligman, Joel *Self-funding for the Securities and Exchange Commission,* 28 NOVA L. REV. 233 (2004).
478. Seligman, Joel, *The Historical Need for a Mandatory Disclosure System,* 9 J. CORP. L. 1 (1983).
479. Seligman, Joel, *Key Implications of the Dodd-Frank Act for Independent Regulatory Agencies,* 89 WASH. U. L. REV. 1 (2011).
480. Seligman, Joel, *Rethinking Private Securities Litigation,* 73 U.CIN.L. REV. 95 (2004).
481. Seligman, Joel, *The SEC in a Time of Discontinuity,* 95 VA. L. REV. 667 (2009).
482. Sethi, Jasmin, *Another Role for Securities Regulation: Expanding Investor Opportunity,* 16 FORDHAM J. CORP. & FIN. L. 783, (2011).
483. Shell, Richmond *Opportunism and Trust in the Negotiation of Commercial Contract: Towards a New Cause of Action,* 44 VAND. L. REV. 221 (1991).
484. Simon, A. Herbert, *The Logic of Heuristic Decision Making,* 54 BOSTON STUD. PHIL. SCI. 154 (1977).
485. Sittkof, H. Robert, *An Agency Costs Theory of Trust Law,* 89 CORNELL. L. REV. 621 (2004).
486. Sitkoff, H. Robert, *Trust Law, Corporate Law, and Capital Market Efficiency,* 28 J. CORP. L. 565 (2003).
487. Sjostrom Jr., K. William, *Tapping the Reservoir: Mutual Fund Litigation Under Section 36(a) of the Investment Company Act of 1940,* 54 U. KAN. L. REV. 251 (2005).
488. Smith, Alasdair & Wallace, Helen, *The European Union: Towards a Policy for* Europe, INT'L AFF. 430 (1994).
489. Smith, A. Russel, *State "Blue-Sky" Laws and the Federal Securities Acts,* 34 MICH L. REV. 1135 (1936).
490. Smith, D. Gordon, *The Critical Resource Theory of Fiduciary Duty,* 55 VAND. L. REV. 1939 (2002).
491. Smith, Randall & Lohse, Deborah, *Financial Firms Already Know How to Avoid Barrier Rules,* WALL ST. J., Oct. 22, 1999.
492. Snowdon, Peter & Lovegrove, Simon, *MiFID Review,* 94 COMPLIANCE OFFICER BULL. 1 (2012).
493. Spence, Michael, *Job Market Signaling,* 87 Q. J. ECON. 355 (1973).
494. Spindler, Gerald *Behavioural Finance and Investor Protection Regulation,* 34 J. CONSUM. POLICY 315 (2011).
495. Staub, Clere, *Fiduciary Liability Issues in ERISA Pension Plan Termination,* 11 HOUS BUS. & TAX L. J. 4217 (2011).
496. Stearns, N. Peter, *Stages of Consumerism: Recent Work on the Issues of Periodization,* 69 J. MODERN HIST. 102 (1997).
497. Sterk, E. Stewark, *Trust Protectors, Agency Costs, and Fiduciary Duty,* 27 CARDOZO L. REV. 2761 (2006).
498. Stigler, J. George, *Public Regulation of the Securities Markets,* 37 J. BUS. 117 (1964).
499. Stiglitz, E. Joseph, *Information and the Change in the Paradigm in Economics,* 92 AM. ECON. REV. 460 (2002).
500. Stout, A. Lynn, *The Investor Confidence Game*, 68 BROOK L. REV. 407 (2002).
501. Stout, A. Lynn, *Inefficient Markets and the New Finance,* (UCLA, Law & Economics Research Paper Series, Research Paper No. 05-11; *available online at:*< http://papers.ssrn.com/sol3/papers.cfm?abstract_id=729224>.
502. Stiglitz, E. Joseph, *The Fruit of Hypocrisy,* GUARDIAN, Sep. 16, 2008.
503. Strauss, L. Peter, *The Place of Agencies in Government: Separation of Powers and the Fourth Branch,* 84 COLUM. L. REV. 573 (1984).
504. Strong, S.I., *Cross-Border Collective Redress in the European Union: Constitutional Rights in the Fact of the Brussel I Regulation,* 45 ARIZ. ST. L.J. 233 (2013).

505. Strong, S.I., *Regulatory Litigation in the European Union: Does the U.S. Class Action Have a New Analogue?* (School of Law, University of Missouri, Research Paper No. 2012-25, 2012).
506. Stucke, E. Maurice, *Rise of Behavioral Law and Economics,* 13 TRANSACTIONS 309 (2012).
507. Student Symposium, *Blue Sky Laws,* 17 W. RES. L. REV. 1098 (1965-1966).
508. Subrin, N. Stephen, *David Dudley and the Field Code: A Historical Analysis of an Earlier Procedural Vision*, 6 LAW & HIS. REV. 311 (1988).
509. Tafara, Ethiopis & Peterson, J. Robert , *A Blueprint for Cross-border Access to US Investors: A New International Framework*, 48 HARV. INT'L L. J. 31, 67 (2007).
510. Tajti, Tibor, *Central European Contribution to the American Debate on the Definition of "Securities" or Why Does the Definition of "Security" Matter?: the Fiasco of the Hungarian Real Estate Investment Cooperatives, Pyramiding, and Why Emerging Capital Markets Should Be Equipped to "Act" rather than "React,"* 15 TRANSNAT'L L. & CONTEP. PROBS. 109 (2005).
511. Tang, S. Zheng, *Multiple Defendants in the European Jurisdiction Regulation,* 34 EUR. L. REV. 80 (2009).
512. Teubner, Gunther, *Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences,* 61 MODERN L. REV. 11 (1998).
513. TIME, *The Prudent Man,* June 1, 1959.
514. TIME, The Roosevelt Week, July 11, 1932.
515. Tolins, B. Richard, *The Investment Company Act of 1940,* 26 CORNELL L. Q. 77 (1940-1941).
516. Tracu, E. John & MacChesney, B. Alfred, *The Securities Exchange Act of 1934*, 32 MICH. L. REV. 1025 (June 1934).
517. Treadway Jr.,C. James, *SEC Enforcement Techniques: Expanding and Exotic Forms of Ancillary Relief,* 32 WASH. & LEE L. REV. 637 (1975).
518. Tversky, Amos & Kaheman, Daniel, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCI. 1124 (1974).
519. Tugwell, G. Rexford, The New Deal in *Retrospect*, 4 W. POL. Q. 363 (1948).
520. The Investment Company Institute, THE EVENING BULLETIN (May 19, 1971).
521. Zieger, H. Rober, *Herbert Hoover, the Wage-Earner, and the "New Economic System" 1919 – 1929,* 51 BUS. HIST. REV. 161 (Summer, 1977).
522. Vandall, J. Frank, *Judge Posner's Negligence-Efficiency Theory: A Critique,* 35 EMORY L.J. 383 (1986).
523. Vandenbroucke, Jürgen, *(Non-)complexity Through The Eyes of MiFID,* 37 EUR. J. LAW. ECON. 477 (2014).
524. Verdier, Pierre-Hugues, *Mutual Recognition in International Finance,* 52 HARV. INT'L L.J. 55, (2011).
525. Verrecchia, E. Robert, *Essays on Disclosure*, 32 J. ACCT. & ECON. 97 (2001).
526. Walker, C.H., *Unincorporated Investment Trusts in the Nineteenth Century,* 4 ECON. HIST. 341 (1940).
527. Warren, Elizabeth, *Wall Street; s Race to the Bottom*, WALL ST. J., Feb. 9, 2010.
528. Warren III, G. Manning, *Reflections on Dual Regulation of Securities: A Case Against Preemption,* 25 B.C.L. REV. 495 (1984).
529. Warren III, G. Manning, *A Review of Regulation D: Present Exemption Regimen for Limited Offerings Under the Securities Act of 1933*, 33 AM. U. L. REV. 355 (1984).
530. Warren III, G. Manning, *Global Harmonization of Securities Laws: The Achievements of the European Communities,* 31 HARV. INT'L L. J. 185 (1990).
531. Warren III, G. Manning, *The U.S. Securities Fraud Class Action: An Unlikely Export to the European Union,* 35 BROOK. J. INT'L L. 1075 (2012).
532. Watson, Alan, *Aspects of Reception of Law,* 44 AM. J. COMP. L. 335 (1996).
533. Weatherill, Stephen, *Compulsory Notification of Draft Technical Regulations: The Contribution of Directive 83/189 to the Management of the Internal Market,* 16 YEARBOOK EUR. L. 129 (1996).

534. Weatherill, Stephen, *The Limits of Legislative Harmonization Ten Years after Tobacco Advertising: How the Court's Case Law Has Become a "Drafting Guide"*, 12 GERMAN L.J. 827 (2011).
535. Weber, C. Mark, *Preclusion and Procedural Due Process in Rule 23(B)(2) Class Actions*, 21 U. MICH. J.L. REF. 347 (1988).
536. Welker, Michael, *Disclosure Policy, Information Asymmetry, and Liquidity in Equity Markets*, 11 CONTEMP. ACCT. RES. 801 (1995).
537. Welle, A. Elaine, *Freedom of Contract and the Securities Laws: Opting Out of Securities Regulation by Private Agreement*, 56 WASH. & LEE L. REV. 519 (1999).
538. Werlaugg, Erik, *Class Actions in Denmark, available online at:* < http://globalclassactions.stanford.edu/sites/default/files/documents/Demark_National_Report.pdf.
539. White, J. Lawrence, *The Gramm-Leach-Bliley Act of 1999: A Bridge Too Far? Or Not Far Enough?* 43 SUFFOLK U. L. REV. 937 (2010).
540. White, J. Lawrence, *The Gramm-Leach-Bliley Act of 1999: A Bridge Too Far? Or Not Far Enough?* 43 SUFFOLK. U. L. REV. 937 (2009-2010).
541. White, N. Eugene, *The Stock Market Boom and Crash of 1929 Revisited*, 4 J. ECON. PERSPECTIVES (1990).
542. Whitehead, K. Charles, *Reframing Financial Regulation*, 90 B.U. L. REV. 1 (2010).
543. Whitehead, K. Charles, *Regulating for the Next Financial Crisis*, 24 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 3 (2011).
544. Whitehead, K. Charles, *The Goldilocks Approach: Financial Risk and Staged Regulation*, 97 CORNELL L. REV. 101 (2012).
545. Wilmarth, E. Arthur Jr., *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 CONN. L. REV. 963 (2009).
546. Wilmarth, E. Arthur Jr., *The Financial Services Industry's Misguided Quest to Undermine the Consumer Financial Protection Bureau*, 31 REV. BANKING & FIN. L. 881 (2011).
547. Wohl, B. Laurence, *Fiduciary Duties Under ERISA: A Tale of Multiple Loyalties*, 20 U. DAYTON L. REV. 43 (1994).
548. Wolfson, Nicholas, *A Critique of the Securities and Exchange Commission*, 30 EMORY L. J. 119 (1981).
549. Woodcock, Tony, *How the FCA Makes Enforcement Decisison*, 2014 COMPLIANCE OFFICER BULL. 1 (2014).
550. Wright, Gavin, *The Political Economy of New Deal Spending: An Econometric Analysis*, 56 REV. OF ECON & STATISTICS 30, (1974).
551. Wymeersch, Eddy, *The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors*, 2 EUR. BUS. ORG. L. REV. 237 (2007).
552. Yeazell, C. Stephen, *Group Litigation and Social Context: Toward a History of the Class Action*, 77 COLUM. L. REV. 866 (1977).
553. Zak, Paul & Knack, Stephen, *Trust and Growth*, 111 ECON. J. 295 (2001).

Unpublished Materials

1. Groh, R. Natalie, The 'Boston-Type Open-End Fund' - Development of a National Financial Institution: 1924-1940 ([Harvard University, Ph.D. dissertation 1977).
2. Roye, F. Paul, Director, Division of Investment Management, US SEC, Remarks at the Securities Law Developments Conference: Mutual Funds – A Century of Success, Challenges and Opportunities for the Future (Dec. 9, 1999).
3. Seymour, Thaddeus, *Literature and the South Sea Bubble* (University of North Carolina, Ph.D. dissertation 1955).

Statutes and Regulations

European Union

1. Council Directive 83/189/EEC of 28 March 1983 Laying Down a Procedure for the Provision of Information in the Field of Technical Standards and Regulations [1983] O.J. L109/8.
2. Council Directive 89/298/EEC of Coordinating the Requirements for the Drawing-up, Scrutiny and Distribution of the Prospectus to be Published When Transferable Securities are Offered to the Public, 32 O.J. EUR COMM. L124/8.
3. Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulation and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) O.J. L375.
4. Council Directive 93/6 on the Capital Adequacy of Investment Firms and Credit Institutions, 1993 O.J. L 141/1.
5. Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts O.J. L95/29.
6. Council Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), O.J. L 302/32.
7. Council Regulation (EC) No 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, O.J. L12/01.
8. Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements O.J. L149/1.
9. Commission Regulation (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information of the prospectus in a durable medium other than paper or by means of a website, O.J. L176/1.
10. Council Regulation (EC) No 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, O.J. L12/01.
11. Directive 2001/107/EC of the European Parliament and of the Council of 21 January 2002 Amending Council Directive 85/611/EEC on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS) with a View to Regulating Management Companies and Simplified Prospectuses O.J. L41/20.
12. Directive 2001/108/EC of the European Parliament and of the Council of 21 January 2002 Amending Council Directive 85/611 EEC on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS), with regard to Investment of UCITS
13. Directive (EC) 2003/6 on Insider Dealing and Market Manipulation (Market Abuse) O.J. L 96/16.
14. Directive 2003/71 of the European Parliament and of the Council of 4 November 2003 on the Prospectus to Be Published When Securities are Offered to the Public or Admitted to Trading and Amending Directive 2001/34/EC, O.J. L 345/64.
15. Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC O.J. L390/38.
16. Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No1095/2010 O.J. L174/1.

17. Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/557/EEC and Directive 97/7/EC of the European Parliament and of the Council O.J. L304/64.
18. Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2016 on deposit guarantee schemes was adopted O.J. L173/149.
19. Directive 2014/64/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU OJ L173/349.
20. Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS) as Regard Depositary Functions, Remuneration Policies and Sanctions O.J. L.257/186.
21. Regulation (EC) No 1060/2009 on Credit Rating Agencies O.J. L 302/1.
22. Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing European Commission Decision 2009/77/EC O.J. L331/84.
23. Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on Short Selling and Certain Aspects of Credit Default Swaps O.J. L86/1.
24. Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Regulation (EU) No 648/2012, O.J. L173/84.
25. Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012, on OTC Derivatives, Central Counterparties and Trade Repositories O.J. L201/1.
26. Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds O.J. L115/1.
27. Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European Social Entrepreneurship Funds O.J. L115/18.
28. Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on Credit Rating Agencies O.J. L146/1.
29. Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC O.J. L173/1.
30. Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 O.J. L173/84.
31. Single European Act O.J. EC No. L. 169/1.
32. Treaty Establishing the European Economic Community.
33. The Treaty of the European Union.
34. The Treaty of Functioning of the European Union.

United Kingdom

1. An Act for Better Securing Certain Powers and Privileges Intended to Be Granted by His Majesty by Two Charters for Assurance of Ships and Merchandizes at Sea, and for Lending Money upon Bottomry; and for Restraining Several Extravagant and Unwarrantable Practices therein Mentioned, 1972 (The Bubble Act).
2. Banking Act 1987.
3. Banking Co-ordination (Second Council Directive) Regulation 1992 SI 1992/3218.
4. Building Societies Act 1986.
5. Civil Procedure Rules.
6. Credit Rating Agencies Regulation 2010 (SI 2010/906).

7. Credit Unions Act 1979.
8. Financial Services Act 1986.
9. Financial Services Act 2010.
10. Financial Services Act 2012.
11. Financial Services and Markets Act 2000.
12. Friendly Societies Acts 1974.
13. Friendly Societies Acts 1992.
14. FSMA 2000 (Collective Investment Schemes) Order 2001 (SI 2001/1062).
15. FSMA 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulation 2001 (SI 2001/995).
16. Insurance Companies Act 1982.
17. Investment Services Regulations 1995 SI 1995/3275.
18. Joint Stock Companies Registration Act of 1844.
19. Joint Stock Companies Registration Act of 1862.
20. Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).
21. Prevention of Fraud Investment Act, 1958 6 & 7 Eliz. 2 45.
22. Unfair Terms in Consumer Contract Regulation 1999.

Other EU Member States

1. Act on Class Action 444/2007 (*Ryhmäkannelaki*) (Finland).
2. Act No 203/2011 Coll. on Collective Investment as amended by Act No 547/2011 Coll. (Slovak Republic).
3. Act No 206/2013 Coll., Act No 352/2013 Coll., and Act No 213/2014 Coll. (Slovak Republic).
4. Burgerlijk Wetboek (Civil Code) (established in 1992) (Netherlands).
5. Code of Civil Procedure, March, 1, 2008 (Bulgaria).
6. CODE DE LE CONSOMMATION (France).
7. Civil Procedure Rules Established under Civil Procedure Law, Cap. 6 (Cyprus).
8. Gesetz über den Wertpapierhandel [WpHG] [Securities Act], July, 26, 1994, BGBl I S. 2708 (Ger.).
9. LAG OM OFFENTLIG UPPHANDLING (Svensk författnigssamling [SFS] 2007:1091) (Swed.).
10. Legislative Decree no 205/2005 (Italy).
11. Loi portant insertion d'un titre 2 "De l'action en reparation collective" au livre XVII" Procédures juridictionnelles particulières" du Code de droit économique et portant insertion des definitions propres au livre XVII dans le livre 1er du Code de droit économique [Act on Claims for Collective Redress] of Mar. 28, 2014, MONITEUR BELGE [M.B.] [Official Gazette of Belgium] Mar. 29, 2014.
12. ZIVILPROCESSORDNUNG [ZPO] (CIVIL PROCEDURE CODE) [BUNDESGESETZBLATT [BGBL] vom 12.09.1950 (Austria).

United States of America

1. Bank Holding Company Act of 1956, Pub. L. No. 84-511, 70 Stat. 133.
2. Bank Holding Company Act Amendments of 1970, Pub. L. No 91-607, 84 Stat. 1760.
3. Banking Act of 1933 (Glass-Steagall Act), Pub. L. No. 73-65, 48 Stat. 162.
4. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.
5. Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829.
6. Federal Trade Commission Act of 1914, 38 Stat. 717.
7. Federal Rules of Civil Procedure.
8. Financial Services Modernization Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338.
9. Investment Advisers Act of 1940, Pub. L. No. 76-768, Stat. 847.
10. Investment Company Act of 1940, Pub. L. No. 76-768, Stat. 847.
11. National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat 3416 (1996).

12. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (Dec. 22, 1995).
13. Restatement (Third) of Trust (2003).
14. Revenue Act of 1936, Pub L. No. 740, 49 Stat. 1648.
15. Revenue Act of 1942, Pub. L. No. 753, Ch. 619, 56 Stat. 798.
16. The Sarbanes-Oxley Act of 2002, Pub. L. No. 107-2014, 116 Stat. 745.
17. Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931.
18. Securities Investor Protection Act of 1970, Pub. L. No. 91-598,84 Stat. 1636.
19. Securities Litigation Uniform Standards Act of 1998, Pub. L. 105-353, 112 Stat. 3227.
20. Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2085.
21. Uniform Securities Act (1956).
22. Uniform Trust Code (2010).
23. State Laws
    - Investment Companies, Business of Regulated, Part I, Title 6, No. 592, Act and Resolutions of General Assembly of the State Georgia, 1904.
    - Act of March 10, 1911, ch. 133, 1911 Kan. Sess. Laws 210.
    - DEL. CODE ANN. TIT 8.
    - DEL. CODE ANN. TIT 12.

Hearings, Reports, Documents, Speeches and Committee Prints

US

1. Aguilar, A. Luis, Commissioner SEC, Revisiting the "Accredited Investor" Definition to Better Protect Investors, Dec. 17, 2014, *available online at:* < http://www.sec.gov/news/statement/spch121714laa.html#.VLF434dzZD8>.
2. Cox, Christopher, Chairman, U.S. SEC. & EXCH. COMM'N, Opening Remarks to the Practicing Law Institute's SEC Speaks Series (Feb. 9, 2007).
3. Department of the Treasury, Regulatory Reform: A New Foundation: Rebuilding Financial Supervision and Regulation 7 (June 17, 2009).
4. Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Investment Company Act Release No. 28,585, 74 Fed. Reg. 4570-73 (Jan. 26, 2009).
5. FEDERAL SECURITIES ACT: HEARINGS ON H.R. 4314 BEFORE THE HOUSE COMMITTEE ON
6. Fletcher, Stock Exchange Practices, S. Rep. No. 73-1455 (1934).
7. FINAL REPORT OF SEC TRANSITION TEAM, SEC. REG. & L. REP. (BNA) No. 587, at K-1 (Jan. 21, 1981).
8. Guides for Disclosure of Projections of Future Economic Performance, Securities Act. Rel. No. 5992 (Nov 7, 1978), Fed. Secur. L. Rptr (CCH) sec. 81,756 at 81036.
9. HEARINGS ON S. 3580 BEFORE SUBCOMMITTEE OF THE SENATE COMMITTEE ON BANKING AND CURRENCY, 76TH CONG., 2d Sess. 38-39 (1940).
10. HEARINGS ON H.R. 10065 BEFORE SUBCOMMITTEE OF THE HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE, 76th Cong., 3d Sess.
11. HEARINGS ON S. 3580 BEFORE SUBCOMMITTEE OF THE SENATE COMMITTEE ON BANKING AND CURRENCY, 76TH CONG., 2ND SESS. (1940).
12. HEARINGS BEFORE A SUBCOMMITTEE OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE OF THE HOUSE OF REPRESENTATIVES ON H.R. 10065, 76th Cong., 3d Sess. (1940)
13. HEARING BEFORE THE SUBCOMM. ON TELECOMMUNICATIONS AND FIN. OF THE HOUSE OF COMM ON ENERGY AND COMMERCE, 101st Cong., 2d Sess. (statement of Richard C. Breeden) (1990).
14. H.R. REP. NO. 73-85 (1933).

15. H.R. Rep. No. 85, 73d. Cong., 1st Sess. 10-11 (1933).
16. H.R. Rep. No. 104-369 (1995).
17. ICA 1940 Rel. IC-19382, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) 85, 123 (SEC April 6, 1993).
18. Interactive Data for Mutual Fund Risk/Return Summary, SA 1933 Rel. No. 33-9006, SEA 1934 Rel. No. 34-59391, Trust Indenture Act Rel. No. 39-2462, ICA 1940 Rel. No. IC-28617, 2009 WL 330271 (SEC Feb. 11, 2009).
19. Interpretive Matters Concerning Independent Directors of Investment Companies, Investment Company Act Release No. IC-24083, 64 Fed. Reg. 59,877 (Nov. 3, 1999).
20. Interstate and Foreign Commerce, 73d Cong., 1st Sess., 101 (1933).
21. Investment Company Act Amendment of 1967: Hearing on H.R. 9510 and H.R. 9511 Before the Subcomm. On Commerce & Fin. Of the H. Comm. On Interstate and Foreign Commerce, 90th Cong. 674 (1967).
22. Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, pursuant to § 30 of the Public Utility Holding Co. Act of 1935.
23. The NASAA Report on Fraud and Abuse in the Penny Stock Industry: Report to the Subcomm. on Telecommunications and Fin. of the House Comm. on Energy and Commerce (1989).
24. New Disclosure Option for Open-End Management Investment Companies, Securities Act Release No. 7513 (Mar. 13, 1998), 63 Fed. Reg. 13, 968 (Mar. 23, 1998).
25. OCC & SEC, Report on the OCC/SEC Survey of Mutual Fund Investors, Executive Summary (June 26, 1996).
26. Plain English Disclosures, Securities Act Release No. 7497, Exchange Act Release No. 39593, Investment Company Act Release No. 23011, [1998 Transfer Binder], Fed. Sec. L. Rep. (CCH) (January 28, 1998).
27. A Plain English Handbook: How to Create Clear SEC Disclosure Documents [SEC, 1998], *available online at:* < https://www.sec.gov/pdf/handbook.pdf>.
28. Private Litigation Under the Federal Securities Laws Hearings Before Subcomm. On Sec., Senate Comm. On Banking, Hous. & Urban Affairs, 103d Cong., 1st Sess. 2 (1993).
29. Recommendation of the Investor as Purchaser Subcommittee and the Investor Education Subcommitee: Accredited Investor Definition 3, *available online at:* < http://www.sec.gov/spotlight/investor-advisory-committee-2012/accredited-investor-definition-recommendation.pdf>.
30. Registration Form Used by Open-End Management Investment Companies, Investment Company Act Release No. 12,927, 48 Fed. Reg. 814 (Jan. 7, 1983).
31. Report on the Advisery Committee on Corporate Disclosure to the Securities on Exchange Commission, 95TH Cong., 1ST Sess., 327 of the House Committee on Interstate and Foreign Commerce.
32. Role of Independent Directors of Investment Companies, Sec. Exch. Act Rel. No. 34-43786, 2001 WL 6738 (SEC, Jan. 2, 2001)
33. SEC Release No. 33-8238; 34-47986; IC-26068; File Nos. S7-40-02; S7-06-03, on Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports (Jan. 23, 2003).
34. SEC, Report on Public Policy Implications of Investment Company Growth, H.R. S. Rep. No. 2337, 89th Cong., 2d Sess. 148 (1966).
35. S.Rep.No. 184, 91st Cong., 1st Sess. 32 (1969).
36. SEC, Report of the Advisery Committee on the Capital Formation and Regulatory Processes 33 (July 24, 1996).
37. SEC, Report of the Advisery Committee on the Capital Formation and Regulatory Processes 33 (July 24, 1996).
38. Securities Exchange Commission, Public Policy Implications on Investment Company Growth, H. R. Rep. No. 2337, 89th Cong., 2d Sess. (1966).

39. Senate Comm. On Banking & Currency, Investment Company Amendments Act of 1969, S. Rep. No. 184, 91st Cong., 1sr Sess. (1969).
40. Senate Commi. on Banking, Housing & Urban Affairs, 111TH Cong. Restoring American Financial Stability Act: Chairman's Mark Text (2009), *available at* <http://www.banking.senate.gov/public/_files/Comittee_Report_S_Rept_111_176.pdf>.
41. S. Rep. No. 47, 73RD Cong., 1ST Sess. 1 (1933).
42. S. Rep. 91-184, S. Rep. No. 184, 91st Cong., 2nd Sess. 1970.
43. S. Rep. No. 96-958 (1980).
44. S. Rep. No. 101-337 (1990).
45. S. Rep. No. 111-176 (2010).
46. Statement of Sen. Robert F. Wagner on S. 3480, 86 Cong. Rec. 2844-47 (Mar. 14, 1940).
47. Stock Exchange Practices: Report of the Comm. On Banking and Currency, S. Rep. No. 1455. 73d Cong., 2d Sess. 333 (1934).
48. Rules of Practice and Rules on Fair Fund and Disgorgement Plans, U.S. Securities and Exchange Commission, March 2006,
49. U.S. Sec. & Exch. Comm'n, Fiscal Year 2013 Agency Financial Report.
50. U.S. Sec. & Exch. Comm'n, 2006 Performance and Accountability Report.
51. U.S. Sec. & Exch. Comm'n, FY 2015 Congressional Budget Justification, FY 2015 Annual Performance Plan, FY 2013 Annual Performance Report 4 (2014), *available at:* <http://www.sec.gov/about/reports/secfy15congbudgjust.pdf.>.

EU

1. Commission, Communication on Packaged Retail Investment Products (2009) (Com(2009) 204) (PRIPS Communication) 1).
2. Commission White Paper: Completing the Internal Market, COM (1985) 310 final (June 28-29, 1985).
3. Common Position No 1/2001 OJ2001 C23/1.
4. Commission Staff Working Paper, Impact Assessment of MiFID II, Oct. 20, 2011.
5. Commission Staff Working Document: Economic Review of the Financial Regulation Agenda, at 138, COM (2014) 279 final.
6. Commission Statement, *More Transparent and Safer Financial Markets: European Commission Welcomes European Parliament Vote on Updated Rules for Markets in Financial Instruments (MiFID II)*, April, 15, 2014, stating the policy objectives of MiFID II; *available online at:* < http://europa.eu/rapid/press-release_STATEMENT-14-129_en.htm>.
7. Communication from the Commission, *Towards a European Horizontal Framework for Collective Redress* 48 COM (2013) 401/2, 2013.
8. *Comprehensive EU Responses to the Financial Crisis: Substantial Progress Towards a Strong Financial Framework for Europe and a Banking Union for the Eurozone* (European Commission, Memo, 17 Dec. 2013).
9. Communication from the Commission to the European Parliament and the Council on 30 April 2009, COM (2009) 204 final.
10. Consultations, Hearings and Studies of European Commission on the matter *available online:* < http://ec.europa.eu/consumers/archive/redress_cons/collective_redress_en.htm#Studies>/.
11. Decision 3052/95/EC of the European Parliament and of the Council, established a procedure for the exchange of information on national measures derogating from the principle of the free movement of goods within the Community [1995] OJ L321/1.
12. ECON Committee, Workship on Consumer Protection (February 2009, PE 416.213) Briefing Notes.
13. EU Consumer Policy Strategy 2007-2013 (COM (2007) 99 final).

14. EUROBAROMETER: CONSUMER PROTECTION IN THE INTERNAL MARKET (European Commission, 2006).
15. European Commission, *A Summary of the Written Contributions on the Green Paper on Retail Financial Services* 21 (2007).
16. European Commission, *Financial Services: Implementing the Framework for Financial Markets: Action Plan* (COM (1999) 232).
17. European Commission, Financial Services: Building a Framework for Action (1999).
18. European Commission, Financial Services: Implementing the Framework for Financial Markets: Action Plan, at 10 (COM (1999) 232).
19. European Commission Press Release, *Commission Proposes Legislation to Improve Consumer Protection in Financial Services*, July 3, 2012; *available online at:* <http://europa.eu/rapid/press-release_IP-12-736_en.htm?locale=en>.
20. European Parliament Resolution of Feb. 2, 2012 on *Towards a Coherent European Approach to Collective Redress* (2011/2089(INI)).
21. EUROPEAN RETAIL INVESTMENT MARKET VALUE, 2014 REPORT, *available online at:* < http://www.jll.eu/emea/en-gb/Documents/Capital-markets/Retail-Report-2014.pdf>.
22. FINAL REPORT OF THE COMMITTEE OF WISE MEN ON THE REGULATION OF EUROPEAN SECURITIES MARKET, *available online at*: <http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf >.
23. FSAP REPORT, *available online at:* < http://ec.europa.eu/internal_market/finances/docs/actionplan/index/090707_economic_impact_en.pdf >.
24. Green Paper on Consumer Collective Redress, COM (008).
25. Markets in Financial Instruments Directive: Feedback Statement on 1st Mandate Advice 37-39 (CESR, 2005).
26. Larosiére Report: European Commission, *Mandate for the high-level expert group on financial supervision in the EU' annexed to the Report of the high-level group on financial supervision in the EU*, Brussels 25th February 2009, 69, *available online at*: < http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf>.
27. Markets in Financial Instruments Directive (MiFID II): Frequently Asked Questions (15 April 2014), *available at*: <http://europa.eu/rapid/press-release_MEMO-14-305_en.htm?locale=en>/.
28. Position of the Rapporteur, Opinion of the Committee on Legal Affairs for the Committee on Economic and Monetary Affairs on the Proposal for a Regulation of the European Parliament and of the Council Establishing a European Securities and Markets Authority, 30 April, 2010.
29. Public Consultation, *Review of the Markets in Financial Instruments Directive (MiFID)* 63, (European Commission, 8 Dec. 2010).
30. Press Release CESR/07/241.
31. Press Release CESR/07-205.
32. Protocol on the Application of the Principles of Subsidiarity and Proportionality.
33. Report by Mario Monti to the President of the European Commission: A NEW STRATEGY FOR THE SINGLE MARKET (June 9, 2010), *available online at:* < http://ec.europa.eu/internal_market/strategy/docs/monti_report_final_10_05_2010_en.pdf>.
34. Report of the European Parliament, Committee on Economic and Monetary Affairs, On the Proposal for a Regulation of the European Parliament and of the Council Establishing a European Securities Markets Authority, 3 June 2010.
35. REPORT ON FINANCIAL INTEGRATION (Working Group of the Economic and Financial Committee, April 2002).
36. REPORT ON THE SUPERVISORY FUNCTIONING OF THE PROSPECTUS DIRECTIVE AND REGULATION (CESR, CESR/07/225, 2007).
37. Review of the Lamfalussy Process, Communication from the Commission of 20 November 2007, *available online at:* <

http://ec.europa.eu/internal_market/finances/docs/committees/071120_final_report_en.pdf >.
38. Special Eurobarometer 373: Retail Financial Services (European Commission, 2012).
39. The Parliament's Resolution on the MiFIR Proposal (European Parliament, Oct. 26, 2012).

UK

1. Civil Justice Council of England and Wales, Reform of Collective Redress in England and Wales: A Perspective of Need (Rachael Mulheron ed., 2008).
2. Collective Investment Scheme Sourcebook.
3. Conduct of Business Sourcebook.
4. FCA, Reader's Guide: An Introduction to the Handbook (2013).
5. Financial Conduct Authority, Annual Report 2013/14 (10 July 2014).
6. Financial Conduct Authority, The FCA's Approach to Advancing Its Objectives (July 2013).
7. FCA, Pre-sale Disclosure (May 1, 2013), *available online at:* < http://www.fca.org.uk/firms/being-regulated/meeting-your-obligations/cobs/disclosure>/.
8. HM Treasury, *The UK Investment Management Strategy*, *available online at:* < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/258952/uk_investment_management_strategy_amended.pdf>.
9. Financial Services Authority, Consultation Paper 65: Enforcement Manual (2000).
10. Financial Services Authority, Customer Complaints (Consultation Paper 4, December 1997).
11. FSA, The Turner Review: A Regulatory Response to the Global Banking Crisis (2000), *available online at:* < http://www.fsa.gov.uk/pubs/other/turner_review.pdf
12. HM Treasury, A New Approach to Financial Regulation: Building a Stronger System (2011), *available online at:* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81411/consult_newfinancial_regulation170211.pdf.
13. Improving Access to Justice Through Collective Action (Civil Justice Council, Final Report 2008).
14. Memorandum of Understanding between the Financial Services Authority and the Financial Ombudsman Services (2013) *available online at:* < http://www.financial-ombudsman.org.uk/about/MOU_with_FCA-APRIL2013.pdf >.
15. Private Actions in Competition Law: A Consultation on options for reform – government response (Department for Business Innovation & Skills, January 2013).
16. Sants, Hector, (former FSA Chief Executive) *Delivering Intensive Supervision and Credible Deterrence*, speech delivered at the Reuters Newsmaker Event, March 12, 2009.
17. Sir Gieve, John, *Seven Lessons from the Last Three Years* (London School of Economics, Feb. 19 2009), *available online at:* < http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2009/speech377.pdf.
18. Thematic Review: Best Execution and Payment for Order Flow (Financial Conduct Authority, July 2014), *available online at:* < http://www.fca.org.uk/static/documents/thematic-reviews/tr14-13.pdf>.
19. White Paper, From Crisis to Confidence – A Plan for Sound Banking.

Cases

European Union

1. Case 9/56 Meroni v. High Authority [1958] ECR 133.
2. Case 8/74, Procureur du Roi v Dasonville [1974] ECR 837.
3. Case 120/78 Rewe-Zentral Ag v Bundesmonopolverwaltung für Branntwein [1979] E.C.R. 1979-00649.
4. Case 98/80 Romano v. Institut national dássurance maladie-invalidité [1981] ECR 1241.
5. C-217/80 Amministrazione delle Finanze dello Stato v Salumi [1981] E.C.R. 2735.
6. C-21/81 Openbaar Ministerie v Bout [1982] E.C.R. 381.
7. Case 14/83, von Colson and Kamann v. Land Nordrhein-Westfalen [1984] ECR 1891.
8. Case 21/87 Borowitz v. Bundesversicherungsanstalt für Angestellte [1988] ECR 3715.
9. Case 76/90 Sager v Dennmeyer [1991] I ECR 4221.
10. Case C-102/91 Knoch v Bundesanstalt für Arbeit [1992] ECR I-04341.
11. Case C-34/92 Grusa Fleisch v Hauptzollamt Hamburg-Jonas [1993] ECR I-4147.
12. Case C-376/98 Germany v. Parliament and Council [2000] E-8500.
13. Case C-301/03 P Carmine Salvatore Tralli v. European Central Bank [2005] ECR I-4071.
14. Case C-45/08 Spector Photo Group NV and Chris Van Raemdonck v Commissie voor het Bank-, Financie- en Assurantiewezen (CBFA) [2009] ECR I-12073.
15. Case C-270/12 United Kingdom v. European Parliament & Council of the EU.
16. Case T-65/98 Van den Bergh Foods v. Commission [2003] ECR II-4662.

United Kingdom

1. Andrews v SBJ Benefit Consultants [2010] EWHC 2875 (Ch).
2. Bonner & Ors v. Cox & Ors [2005] EWCA Civ 1512.
3. Brachan v. Griffin, 3 Call. (3 Va.) 433 (1803).
4. Bristol and West Building Society v Mothew [1997] 2 WLR 436.
5. Bryen & Langley Ltd v Boston, [2005] EWCA (Civ) 973.
6. Clark and Clark v In Focus Asset Management & Tax Solutions [2012] EWHC 3669 QB.
7. Equitable Life Assurance Society v. Hyman [2002] 1 AC 408.
8. Fyffes Plc v. DCC Plc & Ors [2007] IESC 36.
9. Jones v. Brinley, 1 East 1, 102 Eng. Rep. 1 (K.B. 1800).
10. Maple Leaf Macro Volatility Master Fund v Rouvroy and Trylinski, [2009] EWHC 257.
11. Murphy v. Brentwood District Council, [1990] 2 All ER 908, HL.
12. Nightingal v. Devisme, 5 Burr. 2589, 98 Eng. Rep. 361 (K.B. 1770).
13. R v Rollins [2010] UKSC 39.
14. R (Cook) v FOS [2009] EWHC 426 (Admin).
15. Redcar & Cleveland Borough Council v. Bainbridge [2008] EWCA Civ 885.
16. Ridgely v. Riggs, 4 Har. & J. (8 Md.) 358 (1818).
17. Roberts v. Tremayne, Cro. Jac. (K.B. 1618).
18. Smith v. Anderson [1880] 15 Ch D 247.
19. Sykes v. Beadon [1879] 11 Ch D 170.
20. Smith v Eric S. Bush [1990] 1 AC 831, HL.
21. Spreadex Ltd v Sanji Sekhon [2008] EWHC 1136 (Ch).
22. Voisin and Abacus v Matheson Securities [2000] UR 144.
23. Wilson v MF Global UK Ltd [2011] EWHC.

United States of America

1. Alexander v. Sandoval, 532 U.S. 275 (2001).
2. Amchem Products Inc. v. Windsor, 521 U.S. 591 (1997).
3. Amron v. Morgan Stanley Ind. Advisors Inc., 464 F.3d 338 (2d Cir 2006).
4. Arnold v. Ruggles, 1 R.I. 165.
5. Basic Inc. v. Levinson, 485 U.S. 224 (1988).

6. Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299 (1985).
7. Belikoff v. Eaton Vance Corp., 481 F.3d 110 (2nd Cir. 2007).
8. Berner v. Lazzaro, 930 F. 2d 1319 (9th Cir. 1984).
9. Berson v. Applied Signal Technology, Inc., 527 F.3d 982 (9th Cir. 2008).
10. Brouk v. Managed Funds, Inc. 286 F.2d 901 (8th Cir. 1961).
11. Brown v. Bullock, 194 F. Supp. 207 (S.D.N.Y. 1961).
12. Brown v. Bullock, 294 F.2d 415 (2nd Cir. 1961).
13. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975).
14. Burks v. Lasker, 441 U.S. 471 (1979).
15. Caldwell v. Sioux Falls Stock Yards Co., 242 US 559 (South Dakota).
16. Cede & Co. v. Technicolor, Inc. 634 A.2d 345, 367 (Del. 1993).
17. Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994).
18. Cogan v. Johnston, 162 F. Supp. 907 (S.D.N.Y. 1958).
19. Crutcher et al. v. Jouce et al., 134 F.2d 809 (10th Cir. 1943).
20. Dodona I, LLC. v. Goldman Sachs & Co., 847 F. Supp. 2d 624 (2012).
21. Dowling v. Naragansett Capital Corp 735 F. Supp. 1105 (D.R.O. 1990).
22. Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336 (2005).
23. Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).
24. Esplin v. Hirschi, 402 F.2d 94 (10th Cir. 1968).
25. Farmers and Mechanics Bank of Frederick Cty. V. Wayman, 5 Gill 336 (Md. 1847).
26. First Nat. Bank v. State, 77 So. 2d 653 (1954).
27. Gabelli v. SEC, 133 S. Ct. 1216 (2013).
28. Ganino v. Citizens Utils. Co., 228 F.3d 154, 162 (2d Cir. 2000).
29. Gartenber v. Merrill Lynch Asset Mgmt., 694 F.2d 923 (2d Cir. 1989).
30. Gram v. Stebbins & Stebbins, 6 Paige Ch. 124 (N.Y. Ch. 1836).
31. Hall v. Geiger-Jones Co., 242 US 539 (Ohio).
32. Herpich v. Wallace, 430 F. 2d 792 (1970).
33. Hirsch v. du Pont, 553 F.2d 750 (2d Cir. 1977).
34. In re Advanta Corp. Securities Litigation, 180 F.3d 525 (3d Circ. 1999).
35. In re AOL, Inc. Repurchase Offer Litigation, Fed. Sec. L. Rep. (CCH) P 97609, 2013 WL 4441516 (S.D.N.Y. 2013).
36. In re Borden's Trust, 358 Pa. 138, 56 A.2d 108 (1948).
37. In re Charles Schwab Corp. Securities Litigation 257 F.R.D. 534, 547-548 (N.D. Cal. 2009).
38. In re Comshare Inc. Securities Litigation, 183 F.3d 542 (6th Cir. 1999).
39. In re Corning, Inc. Sec. Litig., 349 F. Supp. 2d 698 (S.D.N.Y. 2004).
40. In re Donald J. Trump Casino Sec. Litig., 793 F. Supp. 543 (D.N.J. 1992).
41. In re Eaton Vance Mut. Funds Fee Litig., 380 F.Supp. 2d 222 (S.D.N. Y. 2005).
42. In re Estate of Cook, 20 Del. Ch. 123 (1934).
43. In re Nuveen Fund Litigation 1996 WL 328006 (N.D. III June 11, 1996).
44. In re Rigel Pharmaceuticals, Inc. Securities Litigation, Fed. Sec. L. Rep. (CCH) P 97000 (9th Cir. 2012).
45. In re State Street Bank & Trust Co. Fixed Income Funds Investment 774 F. Supp. 2d 584 (S.D.N.Y. 2011).
46. In re Trust of Mintz, 444 Pa. 189, 282 A.2d (1971).
47. In re Van Wagoner Funds, Inc. Securities Litigation, 382 F. Supp. 2d 1173 (N.D. Cal. 2004).
48. Independent Investor Protective League v. SEC, 495 F.2d 311 (1974).
49. Indus. Ass'n v. Bd. of Gov. of the Fed. Reserve Sys., 807 F. 2d 1052 (D.C. Cir 1986).
50. International Brotherhood of Teamsters v. Daniel, 439 U.S. 551 (1979).
51. Inv. Co. Inst v. Camp, 401 US 617 (1971).
52. Jerry N. Jones, et al., Petitioners, v. Harris Associates L.P., 559 U.S. 335 (2010).
53. Kamen v. Kemper Financial Services, Inc., 500 U.S. 90 (1991).
54. Kapps v. Torch Offshore, Inc., 379 F.3d 207 (5th Cir 2004).

55. Kardon v. National Gympsum Co., 69 F. Supp. 512 (E.D. Pa. 1946).
56. Kardon v. National Gypsum Co., 377 U.S. 426 (1964).
57. Kimball v. Whitney, 233 Mass 321 (1919).
58. Kohn v. American Metal Climax, Inc. 487 F.2d 255 (3d Cir. 1972).
59. Kratz v. Prudential Investments Fund Management LLC, 305 F.3d 140 (3d Cir. 2002).
60. Laird v. Integrated Res., Inc., 897 F.2d 826 (5th Cir. 1990).
61. Letell v. Merill Lynch & Co., 396 F.3d 161 (2d Cir. 2005).
62. Levitin v. Paine Webber, Inc. 159 F.3d 698, 702 (2d Cir. 1998).
63. Linden Place v. Stanley Bank 167 P.3d 374 (2007).
64. Luce v. Edelstein, 802 F.2d 49 (2d Ci. 1986).
65. Majer v. Sonex Research, Inc., 541 F. Supp.2d 693 (E.D.Pa. 2008).
66. Matrixx Initiatives, Inc. v. Siracusano, 131 S.Ct. 1309 (2011).
67. McLahlan v. Simon 31 F. Supp. 2d 731 (N.D. Cal. 1998).
68. Mechanics Bank of Alexandria v. Seton, 1 Pet. (26 U.S.) 299 (1828).
69. Merrick v. N. W. Halsey & Co., 242 US 568 (Mich. 1917).
70. Migdal v. Rowe Price-Fleming Intern., Inc., 248 F.3d 321 (4th Cir. 2001).
71. Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970).
72. Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1280 (Del. 1989).
73. Moorhead v. Merrill Lynch, 949 F.2d 243 (8th Cir. 1991).
74. Morrissey v. Commissioner, 296 U.S. 344 (1935).
75. Moses v. Burgin, 445 F. 3d 369 (1st Cir. 1971).
76. Nachman Corp. v. Pension Ben. Guaranty Corp., 446 U.S. 359 (1980).
77. New Jersey Carpenters Health Fund v. Royal Bank of Scotland Groups, Plc., 709 F.3d 109 (2d Cir 2013).
78. Official Committee of Unsecured Creditors of WorldCom, Inc. v. SEC, 467 F.3d 73 (2d Cir. 2006).
79. Olmsted v. Pruco Life Ins. Co. of New Jersey, 283 F.3d 429 (2002).
80. Option Advisory Service Inc. v. SEC, 668 F. 2d 120 (1981).
81. Ortiz v. Fibreboard Corp., 527 U.S. 815 (1999).
82. Papilsky v. Berndt, No 71 Civ. 2534 (S.D.N.Y. June 24, 1976).
83. People v. Federated Radio Corp., 154 N.E. 655 (N. Y. 1926).
84. Pepper v. Litton, 308 U.S. 295 (1939).
85. Piambino v. Bailey, 610 F.2d 1306 (5th Cir. 1980).
86. Rogers v. Cisco Systems, Inc., 268 F.Supp. 2d 1305 (2003).
87. Salem United Methodist Church v. Bottorff, 138 S.W.3d 788 (Mo. Ct. App. S.D. 2004).
88. Saminsky v. Abbott, 40 Del. Ch. 528, 185 A.2d 765 (1961).
89. Saxe v. Brady, 40 Del. Ch. 474, 184 A.2d 602 (1962).
90. SEC v. Advance Growth Capital Corporation et al. 470 F. 2d 40 (1972).
91. SEC v. Capital Gains Research Bureau, Inc., 2nd Cir. (N.Y.) 746 (1961).
92. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963).
93. SEC v. Chenery Corp., 318 U.S.80 (1942).
94. SEC v. Fifth Avenue Coach Lines, Inc. 289 F. Supp. 3 (1967).
95. SEC v. W. J. Howey, Co., 328 U.S. 293 (1946).
96. SEC v. JB Oxford Holdings, Inc., Litigation Release No. 18850, 83 S.E.C. Docket 1988 (Aug. 25, 2004).
97. SEC v. Joiner Corp., 320 U.S. 344 (1953).
98. SEC v. Pardue, 367 F. Sup..2d 773 (E.D. Pa. 2005).
99. SEC v. Pentagon Capital Management Plc., 844 F. Supp. 2d 377 (2012).
100. SEC v. Pentagon Capital Management Plc, 725 F.3d 279 (2013).
101. SEC v. Ralston Purina Co., 346 U.S. 119 (1953).
102. Securities Industry Association v. Board of Governors of the Federal Reserve System 468 US 207, 221 (1984).
103. Securities Industry Association v. Federal Reserve System 839 F.2d 47 (2d Cir. 1988).
104. Sharehon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039 (2d Cir. 1982).

105. Sinay v. Lamson & Sessions Co., 948 F.2d 1037 (6th Cir. 1991).
106. Smith v. Oppenheimer Funds Distributor, Inc., 824 F. Supp. 2d 511 (S.D.N.Y. 2011).
107. Staples v. Gould, 9 N.Y. 520, 523 (1854).
108. State v. Agey 171 N.C. 831 99 S. E. 726. (North Carolina, 1916).
109. Strong v. Repide, 213 U.S. 419 (1909).
110. Stonemets v. Head, 154 S.W. 108, 114 (Mo. 1913).
111. Taussig v. Wellington Fund, Inc., 187 F. Supp. 179, 2020 (D. Del. 1960).
112. Taylor v. Davis, 110 U.S. 330, 334-35, 4 S.Ct. 147, 150, 28 L.Ed. 163 (1884).
113. Traveler's Health Ass'n v. Virginia, 339 U.S. 643 (1950).
114. TSC Industries, INC., v. Northway, Inc. 96 S.Ct. 2126 (1976).
115. United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975).
116. United States v. Gaudin, 515 U.S. 506 (1995).
117. Ward v. Van Duzer, 2 N.Y. Super, 162, 166 (1829).
118. Wielgos v. Commonwealth Edison Co., 892 F.2d 509 (7th Cir. 1989).
119. William R. Compton v. Allen, 216 F. 537 (S.D. Iowa,1914).
120. White v. Heartland High-Yield Mun. Bond Fund, 237 F. Supp. 2d 982 (E.D. Wis. 2002).
121. Zell v. InterCapital Income Securities, Ind., 675 F.2d 1041 (9th Cir. 1982).

Germany

1. Higher Regional Court Düsseldorf 16 December 2010, WM 2011, 399.

Administrative Proceedings before SEC

2. In the Matter of Daniel Bogar, Bernerd E. Young, and Jason T. Green, Admin. Proc. File No. 3-15003, August 2, 2013.
3. In the Matter of Thomas C. Bridge, James D. Edge and Jeffrey K. Robles, Admin. Proc. File No. 3-12626, September 29, 2009.
4. In the Matter of Miguel A. Ferrer and Carlos J. Ortiz, Admin. Proc. File No. 3-14862, October 29, 2013.
5. In the Matter of Fiduciary Asset Management, LLC, Admin. Proc. File No. 3-15140, December 19, 2012.
6. In the Matter of Chariot Advisors ,LLC and Elliott L. Shifman, Admin. Proc. File No. 3-15433, July 3, 2014.
7. In the Matter of Diane M. Keefe, Admin. Proc. File No. 3-13337, December 8, 2010.
8. In the Matter of Joseph John Vancook, Admin. Proc. File No. 3-12753, November 20, 2009.
9. In the Matter of Charles Schwa Investment Management, Charles Schwab & Co., Inc., and Schwab Investments, Admin. Proc. File No.3-14184, January 11, 2011.
10. In the Matter of Mohammed Riad and Kevin Timothy Swanson, Admin. Proc. File No. 3-15141, December 19, 2012.
11. In the Matter of Morgan Asset Management, Inc., Morgan Keegan & Company, Inc., James C. Kelsoe, Jr., and Joseph Thompson Weller, CPA, Admin. Proc. File No. 3-13847, June 22, 2011.
12. In the matter of J. Kenneth Alderman, CPA, Jack R. Blair, Albert C. Johnson, CPA, James Stillman R. McFadden, Allen B. Morgan Jr., W. Randall Pittman, CPA, Mary S. Stone, CPA, and Archie W. Willis III, Admin. Proc. File No. 3-15127, December 10, 2012.
13. In the Matter of Lisa B. Premo, Admin. Proc. File No. 3-14697, December 26, 2012.
14. Complaint, S.E.C. v. Security Trust Company, N.A., Grant D. Seeger, William A. Kenyon, nd Nicole McDermott, (D. Ariz., Nov. 24, 2003).

International Materials

1. Convention on the Law Applicable to Trusts and On Their Recognition, Proceedings of the Fifteenth Session (1985).

Selected Internet Sources

1. Aguilar, A. Luis, Comm'r, Sec. Exch. Comm'n, SEC's Oversight of the Adviser Industry Bolsters Investor Protection, Address at the Investment Advisers Association Annual Conference (May 7, 2009), *available online*: http://www.sec.gov/news/speech/2009/spch050709laa.htm>.
2. Alan Greenspan speech, March 2007, as reported by Bloomberg.com. For data on economic consequences of Credit Crunch, *see* Bulent Gokay, *The 2008 World Economic Crisis: Global Shifts and Faultlines, available online at:* <http://www.globalresearch.ca/the-2008-world-economic-crisis-global-shifts-and-faultlines/12283>.
3. Allen & Overy, European Finance Litigation Review, *available online at:*< http://www.allenovery.com/publications/en-gb/european-finance-litigation-review/northern-europe/Pages/Radical-cahnges-proposed-to-Dutch-class-action-system.aspx>.
4. A PLAIN ENGLISH HANDBOOK: HOW TO CREATE CLEAR SEC DISCLOSURE DOCUMENTS 5 [SEC, 1998], *available online at:* < https://www.sec.gov/pdf/handbook.pdf>.
5. Chen, Gong-Meng, *et al*., *Behavior and Performance of Emerging Market Investors: Evidence from China* (2004), *available online at:* <http://www.google.com/url?sa=t&rct=j&q=.%20nofsinger%20%26%20oliver%20m.%20rui%2C%20behavior%20and%20performance%20of%20emerging%20market%20investors%3A%20evidence%20from%20china&source=web&cd=1&ved=0CCsQFjAA&url=http%3A%2F%2Fciteseerx.ist.psu.edu%2Fviewdoc%2Fdownload%3Fdoi%3D10.1.1.202.7314%26rep%3Drep1%26type%3Dpdf&ei=d9LAUe__H8vn4QTM4YHoDQ&usg=AFQjCNGbhM3SzH9hYSES_UBMLXw_20HDew&sig2=yrJ5VPMfShJD1xbvV9g4ow&bvm=bv.47883778,d.bGE >/.
6. David Pendery, *Three Top Economists Agree 2009 Worst Financial Crisis Since Great Depression; Risks Increase if Right Steps are Not Taken*, Reuters, Feb. 27, 2009, *available online at:* <http://www.reuters.com/article/2009/02/27/idUS193520+27-Feb-2009+BW20090227>.
7. Don Phillips, SEC Interactive Data Roundtable 26 (June 12, 2006), available at: < http://www.sec.gov/spotlight/xbrl/xbrlofficialtranscript0606.pdf >.
8. ESMA register of UCITS Management Companies, *available online at:* < http://www.esma.europa.eu/page/UCITS-Management-Companies >.
9. EUROPE ECONOMICS, EU FINANCIAL REGULATION: REPORT FOR BUSINESS FOR BRITAIN (June 17, 2014), *available online* at: < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/388827/Business_for_Britain_Evidence.pdf>.
10. FCA Handbook, *available online at:* <http://www.fshandbook.info/FS/>/.
11. Interview with Warren Buffett: Wall Street Not "Evil But Needs "Carrots" and "Sticks", *available online at*: < http://www.cnbc.com/id/33412615>.
12. *Invest Wisely: Advice From Your Securities Industry Regulators*, SEC, *available online at:*< https://www.sec.gov/investor/pubs/inws.htm>/
13. IOSCO, Objectives and Principles of Securities Regulation, *available online at:* < https://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf >.
14. Julia Black, *Involving Consumers on Securities Regulation.* Report for the Taskforce to Modernize Securities Regulation in Canada (2006), *available online at:* < http://www.lse.ac.uk/collections/law/staff%20publications%20full%20text/black/Involving%20Consumers%20in%20Securities%20Regulation%20-%20Taskforce%20report.pdf >.
15. Llewellyn, T. Davis, *Institutional Structure of Financial Regulation and Supervision: The Basic Issues*, paper presented to a World Bank seminar (June 2006), *available online*

at: <http://siteresources.worldbank.org/INTTOPCONF6/Resources/2057292-1162909660809/F2FlemmingLlewellyn.pdf >.

16. Office of Investor Education and Advocacy, *available online at:* < http://www.sec.gov/oiea >.
17. PIMCO Funds Prospectus, *available online at:* < http://pe.newriver.com/summary.asp?cid=PIMCOLL&cusip=693390700&doctype=pros&oldurl=%2FRegulatory%2FExternal%20Documents%2FPIMCO_Bond_Funds_Statutory.pdf >.
18. Presentation by Gerard Caprio (Director, Financial Sector Policy and Strategy Department, in the World Bank's Financial Sector Vice Presidency) maintaining that there is a clear causal link between finance and development; *Finance For Growth: Policy Choices in Volatile World; available online at:* <http://www1.worldbank.org/finance/assets/images/financeforgrowth_english.pdf>.
19. President Barack H. Obama, Remarks on Signing the Dodd-Frank Wall Street Reform and Consumer Protection Act (July 21, 2010), *available online at:* < http://www.whitehouse.gov/the-press-office/remarks-president-signing-dodd-frank-wall-street-reform-and-consumer-protection-act>.
20. Price Water House Coopers, Distributing Our Knowledge: Fund Distribution: UCITS and Alternative Investment Funds, *available online at:* <http://download.pwc.com/ie/pubs/2014-pwc-ireland-distribution-knowledge-12-05-2014-1.pdf>.
21. Reed, Christopher *Damn'd South Sea: Britain's Greatest Financial Speculation and its Unhappy Ending,* Harv. Magazine, *available online at:* <https://harvardmagazine.com/1999/05/damnd.html>.
22. SEC Article: *The Investor's Advocate: How the SEC Protects Investors Maintains Market Integrity and Facilitates Capital Formation, available online at*: < http://www.sec.gov/about/whatwedo.shtml#.U5r8wtyAqKs>.
23. SEC's Office of Investor Education and Advocacy, *available online at:* <http://www.sec.gov/investor/pubs/aboutoiea.htm.>.
24. Securities Class Action Settlements: 2013 Review and Analysis (Cornerstone Research: Economic and Financial Consulting and Expert Testimony, 2014), *available online at:* < http://securities.stanford.edu/research-reports/1996-2013/Settlements-Through-12-2013.pdf>.
25. Sidley & Austin Law Firm, Memorandum on Regulation FD, *available online at:* < http://www.sidley.com/files/News/73834e5b-2894-4f77-ab21-46dad2c27adc/Presentation/NewsAttachment/082a6d25-fb44-4d07-95d7-487f1b7fc0b8/SEC%20September%202000.pdf>.
26. The history of the FDIC 1933-1983, *available online at*: < http://www.fdic.gov/bank/analytical/firstfifty/chapter1.pdf>.
27. The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation, *available online at:* <http://www.sec.gov/about/whatwedo.shtml#intro>.
28. "The TRust Index", *available online at:* < http://thomsonreuters.com/site/trust/>/.
29. US SEC, 80th Anniversary, *available online:* <http://www.sec.gov/spotlight/sec-80.shtml>.
30. Victor DeMiguel, Lorenzo Garlappi & Raman Uppal, *1/N*, EFA 2006 Zurich Meetings, *available online at:* <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=911512>.