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ISSUES ON FINANCIAL MARKET REGULATION, BUSINESS DEVELOPMENT AND GOVERNMENT'S POLICIES ON GLOBALIZATION

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Mission

The "Law and Economics Yearly Review" is an academic journal to promote a legal and economic debate. It is published twice annually (Part I and Part II), by the Fondazione Gerardo Capriglione Onlus (an organization aimed to promote and develop the research activity on financial regulation) in association with Queen Mary University of London. The journal faces questions about development issues and other several matters related to the international context, originated by globalization. Delays in political actions, limits of certain Government's policies, business development constraints and the "sovereign debt crisis" are some aims of our studies. The global financial and economic crisis is analysed in its controversial perspectives; the same approach qualifies the research of possible remedies to override this period of progressive capitalism's turbulences and to promote a sustainable retrieval.

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FOCUS ON GLOBAL PERSPECTIVES

BANK CORPORATE GOVERNANCE: A NEW PARADIGM

Francesco Capriglione* - Rainer Masera**

ABSTRACT: *Failures of the corporate governance of banking firms were one of the major causes of the 2007-09 Great Financial Crisis. Various reforms have been enacted to ameliorate Governance standards, notably risk management and incentive systems; but the key driver remains the improvement of shareholders rights, with a view to ensuring sustainable value creation. Instead, in this paper it is argued that, to strive for a structural advance in the risk appetite framework of the banking firm, the fundamental assumption behind corporate governance – i.e. that the ultimate authority lies in shareholders (the "owners") who detain exclusive voting rights – should be reconsidered. To start with, it is recalled that, according to the options enterprise model, the effective owners of a corporation can be identified with its debt holders. More specifically and more recently, in the case of banking firms, the bail-in/resolution mechanisms enacted create new obligations and responsibilities for holders of subordinated debt: accordingly, the traditional corporate governance framework should be modified to allow – in appropriate forms – for their voting rights and presence in the Board of Directors/Supervisory Board.*

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1. This work examines the issue related to the Corporate Governance (CG) of banks with specific reference to the implications of the new regulation system and the resolution mechanism introduced by the EU,and recent experiences in Italy. The considerations-both economic and legal-have general implications which could be extended on a global scale.

The financial crisis of 2007-2009 had its beginnings in the United States and culminated in the failure of Lehman and the rescue and bail-out of big banks and insurance companies, but then it spread with disruptive and long lasting effects also into Europe. Faced with the deep crisis, in November 2008,the European Commission entrusted a mandate to a High Level group, chaired by Jacques de Larosière, to advance a proposal for the revision of the European supervisory and regulatory financial system. The Report was presented on the 25th of February 2009 (de Larosiere *et al.*, 2009) with a series of significant reform proposals for a co-ordinated approach to regulation and financial oversight. These recommendations lie at the heart of the new system of European financial supervision. In particular, the Report has introduced new macro-prudential regulatory policies in order to prevent systemic crisis and has underlined the need to put macro-prudential objectives before the micro-prudential ones; moreover, it has suggested the creation of three separated authorities to micro-manage banks, insurance companies and markets[1].

Furthermore, the Report has highlighted the need to intervene in the banks' corporate governance. The Great Financial Crisis of 2007-2009 has a large number of causes, but at its roots lie the bad practices of many firms/financial institutions which sought short-termism, non-sustainable gains that could allow their managers to profit from them and, at the same time, to eventually distribute losses from high-risky investments among taxpayers. Also the techno-financing developments, especially in the derivatives market, were implemented with disre-

[1]The three authorities began their activities on the 1st January 2010. They are called EBA (European Banking Authority); ESMA (European Securities and Market Authority) and EIOPA (European Insurance and Occupational Pensions Authority).

gard for the rules[2], with the aim of creating short-term profits which caused severe economic and social problems in the medium term, instead of being able to reduce the costs of the intermediaries, and therefore improve the efficient levels of economic production. The need to avoid that the financial crisis would result in an implosion of economic activity induced many governments to burden the taxpayers with baling out "too big to fail companies", hence causing a social distribution of losses caused by the elusive/illegal behaviours[3].

The complexity of the micro and macro links are illustrated in Fig.1

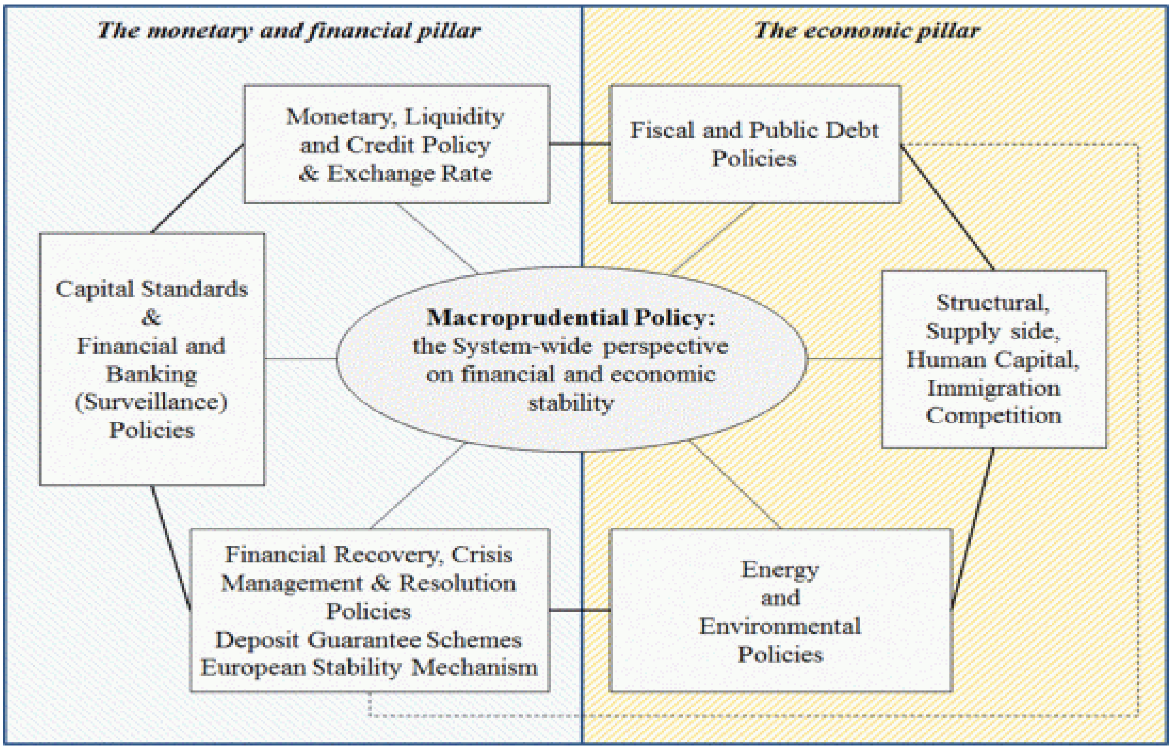

Fig. 1 – A complex system (network) representation of macro prudential

[2]It is worth noting that many big international banks – which are the main operators in the derivatives market and particularly in CDSs – have constantly operated to game the rules of the Basel Standards. The CDS market allows to short credit and to shift risk buckets in order to minimize the regulatory capital (see for instance Slovik, 2012).

[3] Hence the excesses of finance are at the roots of the great recession which began in 2008,with huge losses of growth and jobs, and with grave destruction of human capital, in particular the loss of opportunities for the youth, who risk being excluded for a long time from the world of employment. The inter-action between illicit activity and the financial crisis is illustrated in an exhaustive and coherent manner by the National Commission to examine the financial crisis in the United States (The Angelides Report). On the role of finance in determining the great crisis, see Masera (2009,2010). It is worth mentioning that the crisis of the 30's was also caused by illicit and illegal financial activities and the big American banks. In this respect, we must refer to the work of the Pecora Commission, instituted by the American Senate, and conducted by a great italo-american, forgotten by our country, Ferdinando Pecora. See United States Committee on Banking and Currency Stock Exchange Practices (1934).

and other economic policies.

Source: Masera (2015)

The priority of macro-prudential issues above the micro ones is analytically clear, even if the real centres of economic, monetary and political power are actually interested in implementing the specific policies under their control. This fragmentation is particularly significant in the Eurozone, due to the absence of a fiscal and political union.

Here it is not possible to deeper analyse the processes of re-regulation in Europe and USA. However, it should be noted the slowness and problematic aspects of European re-regulation when compared to the United States' rapid response introduced with the Dodd-Frank Act in 2010. In this respect, we are substantially making reference to the USA supports for national banks and economic markets, which – beyond bailouts – has been obtained through the introduction of Quantitative Easing (starting from 2008) on Federal securities and bonds, and the acquisition by the Fed – in accordance with the Treasury and public guarantees – of deteriorating bank credits, as well as the securitization of performing credits and the acquisitions implemented by national agencies[4].

The new supervisory system in the EU focuses on Banking Union (BU), which is broadly defined. As illustrated in Fig 2 with reference to the Eurozone, the BU hinges on the interaction between: the rules on capital (CRR/CRDIV-European Commission 2013a); the macro-prudential supervision entrusted to the European Systemic Risk Board; the micro-prudential oversight carried out by the ECB in the area of the Single Supervisory Mechanism (2014): the Single Resolution Mechanism, which became operative in 2016; the new accounting rules for banks IFRS 9-10-11-12-13 (2015-2017). The BU has also completed the so-called Single Rulebook, *i.e.* the unification and integration of legislative texts referred to each above-mentioned regulatory area. The EBA performs a key role in the co-ordination and updating of the Single Rulebook.

[4]On this point refer to Masera (2014,2013,2010) and Guida and Masera (2015).

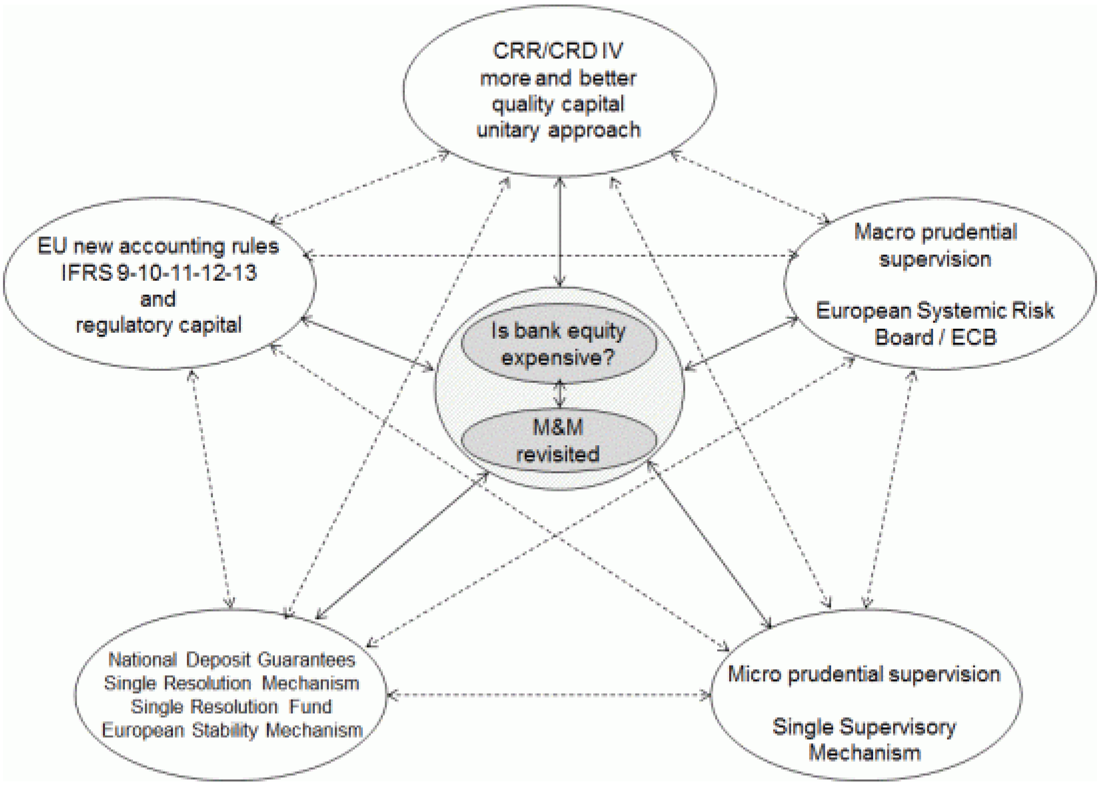

Fig. 2 – CRR/CRD IV, Macroprudential Supervision, Single Supervisory Mechanism, Resolution Framework, New Accounting Rules: A network representation of the EU Banking Union.

Source: Masera (2014b)

The BU can be specifically analysed in the Fig.3, which explains the relevance of the new banking resolution rules that have been introduced in EU in January 2016 (which Italy implemented with a prior experiment by the Decree of the Council of Ministers of November 25th, 2015 “for the resolution of four medium-small banks: Banca Marche, Banca dell’Etruria e del Lazio, Carichieti and Cassa di Ferrara).The analysis of the European resolution mechanism and its implications for Italian banks, especially for the smaller ones, appears complex. In particular, the rules for “bail-in” (internal rescue) are correctly aimed at protecting the tax-payers from the loss of the banks and its moral hazard implications, but they have been criticized for their very complex way of working (differently from what has taken place in the USA under the Dodd-Frank Act).

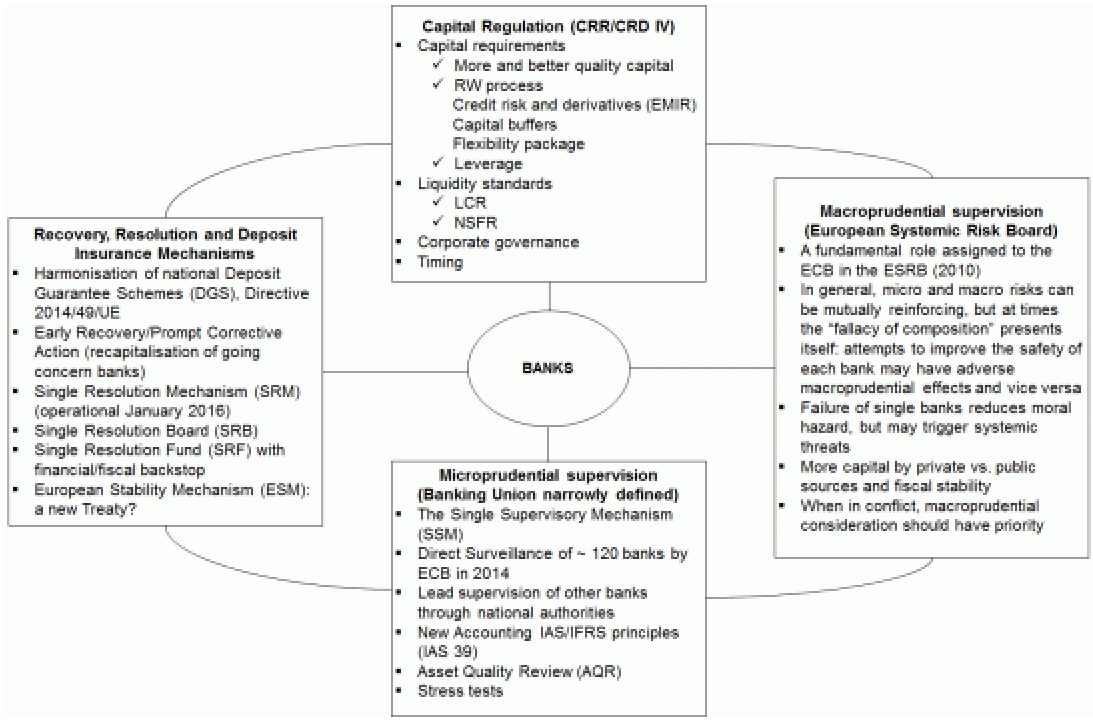

Fig. 3 – The new EU Bank Capital Regulatory Framework and the other three interactive building blocks of the “Banking Union Package”

Source: Masera 2014

The Governor of the Banca d’Italia (Visco, 2016a) indicated that the new rules may be “the source of serious risks of liquidity and financial instability”. If it were so, a cardinal rule of the macro-prudential regulation would be violated, *i.e.* the preservation of financial stability and preventing/ containing the systemic risks.

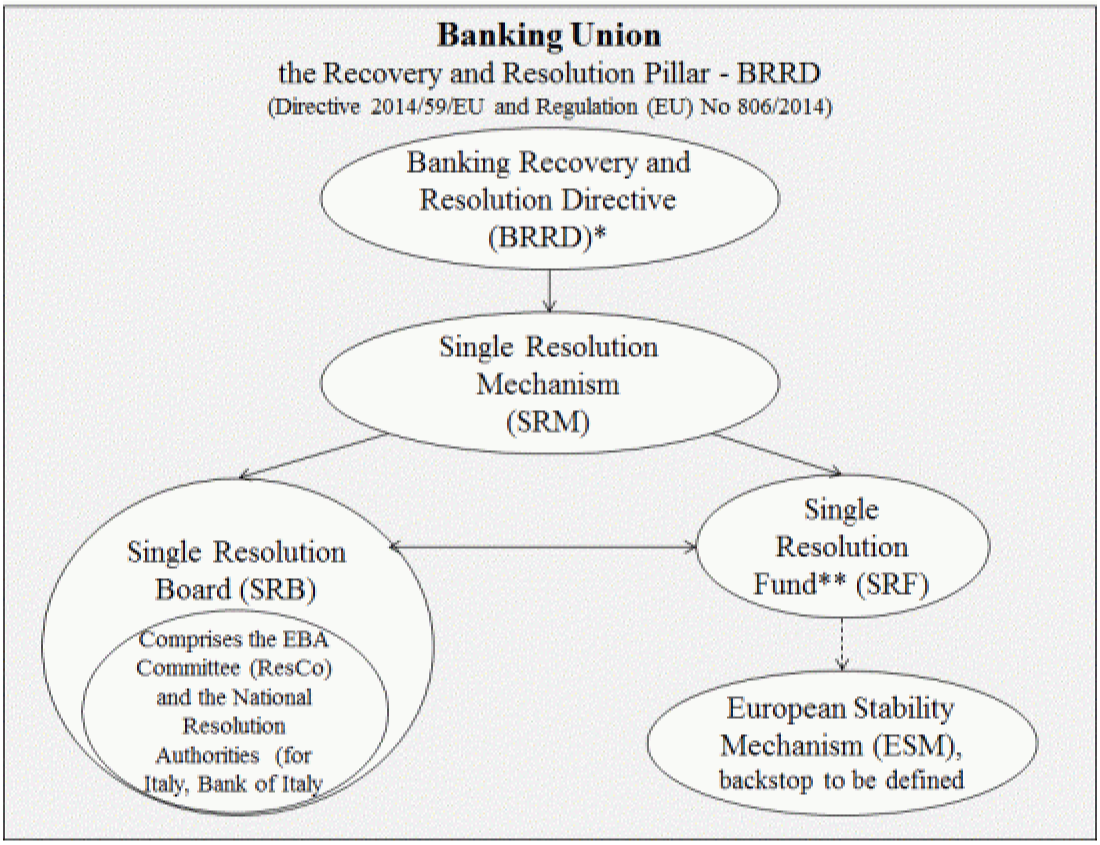

Fig. 4 – Banking Union: the BRRD and SRM pillar

Notes:

* Directive 2014/59/EU and Council Implementing Regulation (EU) 2015/81 of 19 December 2014 specifying uniform conditions of application of Regulation (EU) No 806/2014 of the European Parliament and of the Council with regard to ex ante contributions to the Single Resolution Fund.

** The SRF forms part of the “resolution” scheme of the Banking Union and is to gradually be strengthened. It will be replenished by the national contributions of the Member States collected from the banking industry and it will be progressively mutualised, with a capital supposed to reach some 55 billion euros between 2016 and 2023.

Source: Masera (2015)

Anyway, what matters is the systemic interaction with the new, complex rules about capital, liquidity and governance laid down in CRR/CRD IV (Figure 5); however, the latter faces changes towards what *de facto* appears as the fourth edition of Basel standards (Masera, 2015).

The capital strengthening of banks, under a unitary regulation for all Euro-zone countries, was a right target. Nevertheless, it is legitimate to ask ourselves whether the trade-off between regulation and growth has been properly treated with regard to its micro- and macro-prudential dimension. In particular, since rules have been tightened and multiplied in their number, the expansive action of monetary policy had to be increased: on the one hand, as far as the monetary base is concerned, the throttle was opened; on the other hand, with regard to the credit and money multiplier[5], the brakes have been applied. *Vice versa*, we should prevent the rules about capital, liquidity and banking resolution from neutralising the expansionary impulses of QE, whose distortive side effects might be exacerbated.

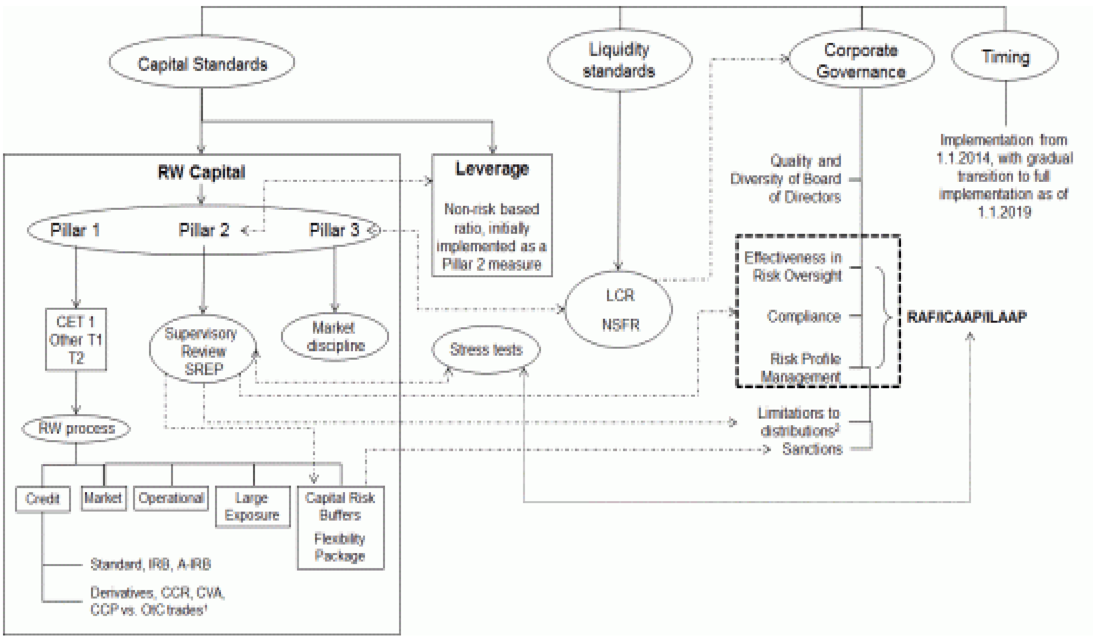

Figure 5 – CRR (Single Rule Book) / CRD IV framework

Notes:

(1) The framework is completed by the EBA technical standards.

(2) If a bank breaches the capital conservation buffer requirements, automatic limitations are made to buybacks, dividends and bonus payments.

Source: Masera (2014b)

These arguments have been supported and explained by several econo-

[5]See, for instance, Alessandri and Panetta (2015) and Masera (2016).

mists and professionals in the financial field[6], even inside monetary authorities; in spite of this, across Europe, they have been heard little so far. The International Monetary Fund itself has largely documented, in recent *Global Financial Stability Reviews*, that – beyond certain limits – the attempt to pursue the objective of a banking system apparently safer, through higher and higher capital ratios, might result in smaller growth and negatively feedback on the stability of intermediaries itself.

As shown in the charts above, the set of rules involving banks in Europe is impressive. To sum up, along with capital requirements stemming from Basel, the changes related to the creation of the Banking Union have been enacted, thus implying new constraints on banks in any case. Rules about capital have been tightened much more than in the United States, following the principle of a wrong, indiscriminate application, having regard neither to size nor to business models[7]. As indicated, no mechanisms of securitisation, provided with public guarantees, have been established, neither on problem loans nor on the ones *in bonis*; rules on banking resolution have added complexity and constraints to the system, to the point where, according to the Italian economic authorities, they should be revised.

Moreover, it is necessary to highlight that practically all banks have been directly or indirectly subject to a set of new provisions regarding the financial system as a whole, having an impact – in terms of compliance – on the activities of credit institutions, too, as shown in Figure 6. In particular, rules on market infrastructure (EMIR, CSDR, MiFID II, Derivatives and CC Houses) had been identified by then-Commissioner Hill (2016) as excessively burdensome.

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[6]For a large review of those arguments that have been proposed in the literature up to now, allow me to relate to Masera (2012), de Larosière (2013), Bassanini (2016).
[7]See, for instance, Yellen (2014, 2015), Masera and Guida (2015) and Masera (2016).

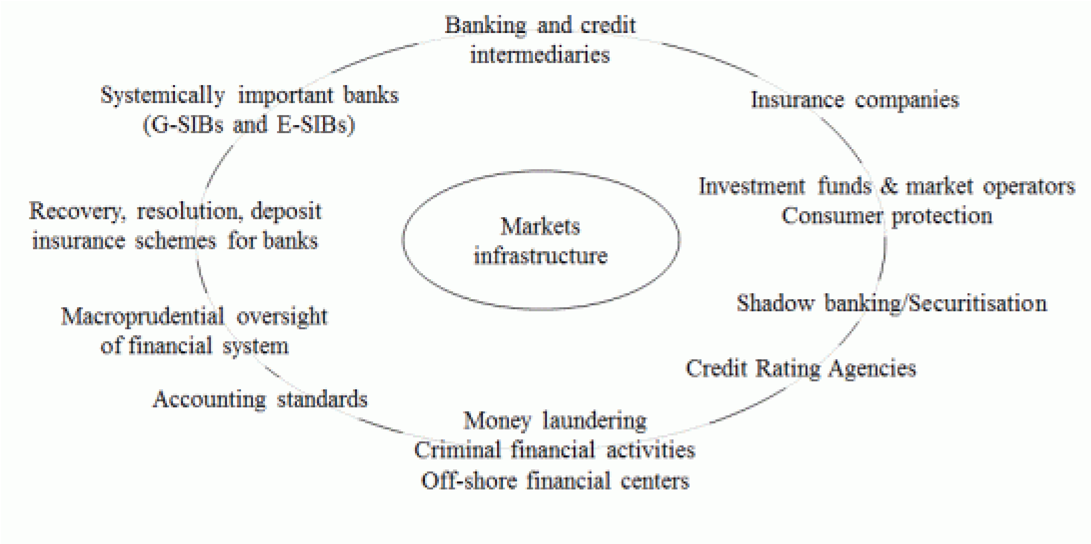


Figure 6 – The new regulations of the EU financial system

Source: Masera (2016)

Repeated amendments to primary and secondary rules, along with their tightening and increasing number, legitimise the basic issue of the need to estimate the costs and benefits of such rules, their interaction with economic policies and, ultimately, the connection between banking regulation, growth and financial stability itself. Changes in regulation have directly affected the issue of CG (Figure 5), trying to control the excessive risk appetite shown by the shareholders, the Board of Directors and the top management of banks. At the same time, new and tighter rules have been introduced about capital, liquidity and the maturity transformation aimed at internalising possible losses suffered by the credit institution, moving from a bail-out system to a bail-in one.

It was necessary to modify a supervisory framework that enabled the moral hazard of bank managers, ending up with all burdens being borne by the taxpayer ("head, I win; tail, you lose"). However, it has not been realized that such a problem would have required a different paradigm with regard to CG, that had played a pivotal role in the excessive risk shown by several credit institutions. In particular, as argued in this work, in order to tackle the root causes of the issue, one should consider an active voting role in general meetings and a position in the Board of Directors for subordinated bondholders. As we are trying to demonstrate, such a reform would be consistent with both the new charges on a relevant segment of bondholders and – above all – the need for changing from inside the risk profile and the strategy of the banking-firms, thus helping to pursue the creation of sustainable value in the medium term.

2. Since the Eighties, characterised by banking de-regulation, the axiom that the bank is a firm has gained ground. This approach had some good points; however, it ended up with neglecting that the banking company has nevertheless some features that are special with respect to other corporations. Credit institutions represent a key element of the implementation of monetary policy, basically – but not exclusively – because deposits are an essential component of money. Upon that assumption was dependent that approach mistakenly bringing to the uncritical application to banks of Modigliani-Miller "neutrality propositions", in a way that allowed to argue that raising capital ratios after 2008 will not have entailed "private" costs.

The relevance of financing decisions in order to determine the value of a bank arises from the specific characteristics of their assets, liabilities and associated risks. In fact, as highlighted by DeAngelo and Stulz (2013), credit institutions play a crucial role in the production of liquidity in the economic and financial system; moreover, as long as there is a risk premium (a reduction in the cost of funding) for liquid securities, then a high leverage is optimal for banks, becoming a source of value-creation itself. As highlighted by Adams and Rudolf (2010), credit institutions generate profits both on their assets (loans) and liabilities (deposits). In particular, their ability to receive deposits at lower rates than the market creates an extra-profit that grows with leverage. This means that Modigliani-Miller theorem, along with corporate finance models based upon it, should be properly modified in order to take this peculiarity into account. In the light of these specificities, too, the issue related to the need of revising the CG of enterprises – in particular, as far as the relationship between shareholders and bondholders is concerned – nowadays arises, as we shall see, especially for banking companies. However, we cannot neglect that traditional CG structures require, anyway, a general critical revisiting. The issue whether shareholders are actually the only "owners" of the firms, or not, has been faced – in an innovative and different manner – with reference to option pricing models elaborated by Black-Scholes and Merton (see Appendix). We should nevertheless underline that even such a model, assuming the validity of the abovementioned Modigliani-Miller theorem, should be properly amended or adjusted in order to consider the peculiarities of the banking company as indicated above.

According to 'conventional wisdom', the shareholders of a company are identified as its proprietors. They hold equity capital and receive rights, on the income and the assets of the firm, that are subordinated with respect to creditors (the latter holding claims on debt capital). Shareholders are in a riskier position and are compensated through dividends (if the company can afford them) and capital gains, that do not have any predetermined bounds. Debtholders of a firm, as a priority with respect to any payment to shareholders, receive the interest due; in the event of the liquidation of the company, all debts must be satisfied before any distribution to shareholders. As long as the firm does not go bankrupt, stocks are 'perpetual', whereas debt has generally an expiry date. It is important to notice that, under a fiscal standpoint, both dividends and interest are subject to levies on the income of recipients; however, for a corporation, interest is fiscally deductible, whereas dividends contribute to taxable income. Hence, for the company, this gives rise to an evident advantage to finance itself through debt rather than equity. *Ceteris paribus*, this is increasing the potential instability of the economic and financial system. In particular, as far as banks are concerned, a paradoxical condition arises: debt (including deposits) has a fiscal advantage *vis-à-vis* equity, whereas regulatory constraints – based upon Basel standards – push for risk capital. Furthermore, shareholders have an additional incentive to increase the leverage and the risks faced by the banking firm, to the extent that – as argued before – a higher leverage brings to the creation of value that ends up with them being the main beneficiaries.

Both shareholders and bondholders have a common interest in preserving and increasing the value of the company they invested in. However, the different types of claims they have upon the firm's cash flows and capital gains may lead to potential but relevant conflicts. Shareholders are remunerated only after bondholders are paid off. It is then reasonable to assume that bondholders want to avoid excessively risky projects, while stockholders prefer a higher risk/reward ratio considering the fact that there is no cap to their potential return.

Bondholders are the firm's creditors, while shareholders are those who legally own shares of stock in the corporation. As a consequence, only shareholders have voting rights at general meetings as well as the chance to directly or indirectly appoint the top management of the firm[8]. The principles of corporate governance, recently developed for both industrial (OECD) and financial companies (BCBS), are mainly designed to protect and facilitate the exercise of the shareholders' rights.

Shareholders and bondholders are characterized by partially different objective functions. Shareholders, given their power to appoint board members and managers, have different control tools which make their objective functions even more complex and exacerbate agency problems.

In sum, according to the traditional approach above mentioned, the enterprise value (V) can be calculated as the sum of claims from both equity-holders (E) and debt-holders (B):

$$V = E + B \qquad [1]$$

Figure A.1. in the Appendix synthetises the implications stemming from equation [1] (which adopts value-based measures instead of accounting ones, with the assumption of a tax rate equal to zero). A crucial difference between shareholders and bondholders, from the risk/profit point of view, is that the for-

[8]In US, firms were allowed to recognize voting rights to debt-holders too, subject to the agreement of the State the firm was incorporated in.

mer can loose their entire investment before the interests of debenture-holders' are damaged. Conversely, shareholders can collect potentially unlimited returns while creditors have just the chance to get their investment back. Moreover, the overall scenario is even more complex for banks given the fact that their enterprise value increases with leverage. Formally:

$$\frac{\partial E}{\partial leverage} > 0 \qquad [2]$$

The economic and legal innovation at the basis of the capitalist economies, according to which companies are mainly limited liability, that entails shareholders are responsible only for the invested capital, is an ideal scenario for an analysis of the company through the options theory, assuming therefore that in the event of default the shareholders "pass" the company (assets and liabilities) to the creditors. From an analytic point of view, shareholders therefore have a "call option" on company assets. Vice versa, creditors sold to the shareholders a "put option" on the invested capital: from this point of view, they are the real owners of the company.

This approach in itself suggests to reconsider the traditional point of view, according to which, maximising the value of the shareholders is considered to be the concrete solution to CG problems; according to this scheme, the administrators and top management, chosen by the BoD/assembly, have the prime responsibility to maximize the value for the shareholders. This, even though we must recognize that the interests of the shareholders can impose costs on other stakeholders and, in particular, on creditors and ultimately on the company itself because of the existence of conflicts of interests. Literature has highlighted the specifically relevant debt-equity conflicts, in particular those of the debt overhang (Myers,1977) and those of risk shifting (Jensen and Meckling, 1976). The assumption of relevant risks can represent a benefit in the short term for the share value, at the expense of the sustainable value of the debt of the same company. These conflicts are, as matter of principle, exalted by the deposits insurance mechanisms and by the "too- big-to-fall" model (Miller,1991 and Masera and Mazzoni,2016).

All this has important implications for the CG: mechanisms and incentives must be created aiming at making sure that BoD and the company's management pursue risk/return objectives for the creation of sustainable value (Masera and Mazzoni,2006). Compliance and risk management represent essential components to foster a good CG and, namely they have to concur in controlling and avoiding conflicts of interest, particularly between shareholders and creditors.

In conclusion, the conventional wisdom, according to which bondholders are only creditors instead shareholders are the sole owners of the company, must be re-discussed. The company's cash flows are a primary interest for both: the CG should facilitate the creation of sustainable value and the reconciliation of the potential conflicts of interest between creditors and shareholders within the company itself. These considerations become particularly relevant and mandatory in the current context of bank resolution mechanisms (Figure 4), aiming at favouring the bail-in to overcome the schemes that resorted to the taxpayer in case of default of a large bank.

3. The aforementioned considerations are significant in order to understand the essential purposes and the security system behind the interplay operating between risk and debt capital. An analysis of the regulatory framework – with particular reference to the developments occurring after the 2007/2009 crisis and their inner *rationale* – provides a clear indication on the reasons why nowadays the traditional legal conception of banking *governance* standards has been profoundly reshaped.

Before going into the details of the convoluted structure that the EU legislator adopted in recent years, it is though necessary to briefly explore one of the main *rationale* behind the peculiar essence of the *banking governance* phenomenon, which is the regulation of financial intermediaries. Financial intermediaries accomplish a peculiar task within the market, and they deeply influence its development through their actions (Visco, 2016c): such a circumstance lays the ground for the *banking governance* regulation. As a consequence, it is pivotal to investigate the different technical organizations of these entities: law must, in fact, establish a dedicated regulatory framework able to conjugate the “management” and “control” aspects of the financial risk, in order to guarantee a proper organizational framing and to accomplish the stability of financial intermediaries.

Economic literature has widely shown how the interplay between savings and investments, and incomes, rests on the brokerage activity in order to reallocate resources from those entities focused on the accumulation of savings; this activity affects the efficiency of the market, and has been the basis of the constant relationship between productivity and economic growth experienced since the English industrial revolution (Abel and Bernanke, 2005; Sylos Labini, 2005; Ehnts, 2012). Banks are able to influence the market even beyond their entrepreneurial interests – and even beyond the interests of depositors and shareholders – through credit assessment activities and by monitoring firms (Lemma 2013): hence comes the awareness that banks’ activity can impact on the prospects for economic growth of a Country, and the negative interactions stemming from an inadequate activity (Visco, 2016b).

The impact of banks – in accordance with instructions coming from European Union institutions – on markets is the ultimate reason for which public supervisory authorities are appointed to monitor their risk activity in order to guarantee their solvency. The most relevant regulatory acts in this field are the Directive 89/299/EEC, the Directive 89/647/EEC (which has absorbed the contents of 1988 Basel Accord I) and the Directive 89/646/EEC – so called “Second Banking Directive” (that marks the abandonment of the substantive intervention policy of EU institutions on structural bases). Following these regulations, the supervision of the credit system refers to an entrepreneurial benchmark characterized by a prudential corporate governance (Minto, 2012; Ferro-Luzzi, 2004).

Regulating the banking *governance* shall – in order to properly accomplish an unavoidable supervision activity – shape the banking activity to sound and prudential rules, so as to guarantee the general stability, the efficiency and the competitiveness of the financial system (Mottura, 2009). Financial intermediaries are therefore compelled to comply with those standards that supervisory authorities appoint through their analysis (Goodhart, 2000). Such standards steadily tended to be evaluated through cost-benefit analysis and quantitative impact assessments: these tools are essential to fully evaluate intermediaries' actual situations and conducts (OECD 2005). These monitoring techniques have been supported – following the recent financial crisis – by macroprudential regulation interventions, regarded «*as a new approach… for adopting the more transformative remains open*» (Andenas and H-Y Chiu, 2014).

The necessity to implement "optimizing spaces" for the credit system – after being long suggested by economists (Ciocca, 1982, p. 21) – was addressed by the Italian 1995 *Consolidate Banking Regulation* (*Testo Unico Bancario,* legislative decree No. 385/1995 as subsequently amended). Art. 5 of the *Consolidate Banking Regulation* poses the principle of the "sound and prudent management" of financial entities: this principle marks the strict correlation between the patrimonial consistency of banks' operations and the arrangement of internal governance procedures adequate in order to carry out new financial activities significantly more complex than in the past. The principle of sound and prudent managements preserves a general (we might say, *macroeconomic*) objective of banking regulation, which is nonetheless addressed by regulating individual entities through an individual (we might say, *microeconomic*) approach towards a specific market condition. It must be further considered that a strict connection exists between substantive goals and regulatory powers that must be assigned to supervisory authorities: in order to properly accomplish their tasks, authorities must consider the specific characteristics of each entity operating in the banking sector, and evaluate their capacity of implementing sound and prudent management on the basis of the concrete situation addressed.

Therefore, banking activity encompasses both an entrepreneurial attitude – and its inner neutrality towards the market – and the pursuit of public interests; as a consequence, the *governance* approach to credit institutions should be considered a specific "subsection" within the general enterprise regulation. The overlaps between banking regulation and general enterprise *governance* are mostly related to their conducts, rather than to their substance (Masera, 2006). This major difference explains the disparity between credit institutions and "traditional" enterprises in terms of applicability of general rules and statutory autonomy, even if both these entities find a common ground in the relationship between the two elements of autonomy and business organization: this two aspects, though, significantly differ in their concrete development in the market, both in terms of organizational decisions and supervisory requirements that must be fulfilled in order to safeguard the public interests behind the financial sector.

On the basis of this consideration, it is clear how the *corporate governance* of banks is a pivotal requirement to ensure the stability of financial entities, since the criteria that regulate the management and control of credit institutions are strictly connected with the functioning of the credit organizational system, and with the equilibrium of the financial sector as a whole. Such an aim is pursued through the provision of corporate rules aiming at implementing risk-control systems against those conducts that might compromise the objectivity and the impartiality of strategic decisions operated by banks (*i.e.* which transactions should be operated, how resources should be allocated, which funding should be granted, etc.)[9] as well as endanger the fair evolution of the financial system.

All these aspects lead to one, first, conclusion: the architecture of corporate governance in the credit sector is instrumental to the proper development of banking activity. Such architecture has a deep impact on bank's business plans and goals (shaping the choices regarding their internal organization) and on the management of current account transactions. The capacity of bank's administrative

[9]Cfr. the second consultation of the Italian *Banca d'Italia* (2010) on "Banking risk administration and management of conflicts of interests towards related parties", p. 6.

and supervision organisms to execute properly the various assignments that the sector regulation identifies as mandatory is essential to create profits and realize the *core business* of banking firms. As a consequence, the proper management of a bank is the core factor to assess its compliance with the "sound and prudent management" principle, and the benchmark to be verified in order to evaluate its very own reliability and its inclination to continue in the business.

The responsibility of corporate bodies should assure a well-balanced exercise of their duties and powers: their choices must reconcile the profit-seeking purposes with a responsible assumption of the risks implied, and this equilibrium is programmed by way of given management choices (*rectius*, operational structures). If corporate bodies can accomplish these tasks with success, the banking company will satisfy both private and public interests that constitutes the basis of its real essence.

It is clear that regulating the knowledge of those who are part of banks' bodies, controlling the information flows and imposing transparency towards stakeholders represent fundamental aspects of the banking sector regulation: the independency of representatives as individuals, and of the bank as institution, is necessary to avoid (sometimes even unaware) conditioning in its operations. Rules must promote a management structure able to guarantee the adequacy of decision-making processes and to avoid a *laissez fair* approaches. Such a mechanism is necessary considering that the market is not always able to properly use the freedom granted by laws and regulators.

The "sound and prudent management" that characterized the banking sector supervision has been roughly tested by the arising of the 2007 financial crisis: by undermining the general stability of the financial system, the crisis forced the introduction of a regulation able overcome its effects and avoid them to become irreversible (*ex multis* Venuti, 2009; Montedoro, 2009, and Masera, 2009). As a consequence, European Union institutions promoted the adoption of "high quality" management architectures in order to grant the corporate governance system with a central role, to properly enact the instruments, methods and organizational assets that financial intermediaries must adopt in order to reach an adequate entrepreneurial *performance.*

4. The normative framework arranged at EU level moves from the above-mentioned bedrock in order deal with the criticalities in the banking European system caused by the 2007 crisis and by its development. The provisions gathered in the *CRR/CRD IV corpus* (Directive 36/2013/UE and Regulation 575/2013/UE) provide – in a strict connection with the creation of the *Banking Union* that we already investigated in the previous paragraphs – an important insight on the peculiarity of the credit system, while simultaneously strengthening the public control over intermediaries. The *CRD/CRD IV* highlights how the aim of the European legislator is improving the management of information within corporate bodies in order to determine policies that, on one side, combine profitability and "sound and prudent management" (Capriglione, 2015a) whereas, on the other side, can shape remuneration policies in accordance with risk management strategy and the bank's long-term development (Venturi, 2010). Also, this intervention should be read in accordance with the law regulating the sanctions system and the administrative procedure regarding their application, which is pivotal in order to overcome the uncertainties related to the efficacy and the dissuasive attitude of the intervention (Council of the European Union, 2010).

Despite fostering the transition towards new "high quality" organizational forms, the overall structure of the new legislation seems to be still tied to the traditional view of *corporate governance* as a mechanism to primary safeguard the position (*rectius*: the interest) of *shareholders*. The main consequence of this approach is that EU interventions do not take into account their impact on the shareholding structures as they currently are in the financial structure of banks.

A significant aspect is also the fact that the introduction of crisis management mechanisms for banks involves – in terms of corporate liability – subjects other than the shareholders, traditional owners of the capital risk.

In particular, this happens in those crisis management procedures where the aim of preventing hazardous conducts by banking authorities (as well as the concern to protect taxpayers from the economic burdens arising from these operations) led the legislator to increase capital ratios and implement *bail-in* rules in order to include bonds and other credits – except for deposits within a determined amount, that are granted with specific guarantees – in the resolution procedure.

In this context, the State aid regulation also plays a significant role: since economic aids coming from Member States are held adequate to distort competition in the unique-market (Gebsky, 2009; Tesauro, 2012; Argentati, 2015), in the past the European Commission forbid any kind of aids for banking institutions «*even without excluding, as a matter of principle, a specific derogation…in the case of a systemic crisis*» of the credit sector (Liberati, 2014).

More in particular it has to be underlined that such a choice was consistent with the idea that every reallocation of resources amongst sectors and enterprises should be considered as a potential alteration of market equilibrium, therefore conflicting with the rules stated by Treaties of the European Union.

It must be observed, in particular, that the introduction of a general *bail in* principle for bonds – without distinguishing on the base of the size of the issuing bank, or by the characteristics of the financing scheme – has a significant impact on the general criteria of Italian corporate law, that recognises a significant role of the shareholders in the definition of banking's strategies as well as in the identification of those who must be held responsible for the corporate management.

The relation between shareholders' equity and their role in the banking governance seems to be ultimately overturned: the new EU regulation for the banks' crisis resolution affects credit institutions in which a part of the members is responsible for the management of the entity besides the board of directors. These members have a significant interest in assessing the profits arising from a proper balance between risks and returns: therefore, assigning them the accomplishment of this activity – that was traditionally conducted by shareholders – seems to guarantee a consistent awareness to company risk.

The roots on which *bank governance* is built up need to be re-shaped in order to enhance the aspect of the congruence between risk and liability, which characterizes the essence of such roots. The recent Italian experience recognizes to this law & economics background by means of the introduction of the *bail in* mechanism, that modified the way to cope with banks' crisis and enlarged the number of subjects that should take responsibility in the occurrence of such events. Going more in details, the implementation of the so-called MREL (*Minimum Requirement for Own Funds and Eligible Liabilities*) provided by Art. 45 of the Directive 59/2014/EU and Art. 12 of Regulation 806/2014/EU – which was adopted in Italy through Art. 50, par. 1, of legislative decree No. 180/2015 – by imposing to the banks to maintain «*on individual and consolidated base, a minimum amount of liabilities that can be susceptible to bail in*», subsequently reduces the application of the *bail-in* mechanism to credit (included within the 8% general range of liabilities) whose characteristics are specified by the Bank of Italy, as provided by the Art. 50, par. 6 of the legislative decree No. 180. Such a choice allows the Bank of Italy to delineate an *ex ante* "bail-in zone" from which bank deposits will be excluded, while non-guaranteed bonds will certainly not.

This stems from the obligation to respect – in the application of the *bail-in* – the principle of proportionality as a fundamental parameter in the regulation of the European financial sector. The principle of proportionality, in fact, operates not only as a guide-rule for the general process of normative harmonization, but also as a mandatory rule imposing that any law should be applied «*following process that, one hand, minimize the costs related to the compliance to EU law and, on the other hand, can orientate the financial intermediaries' activity towards the aims of the related normative*» (Troiano, 2015). As a consequence, this principle must be further specified into the constant pursuit of a behavioural conformity amongst market operators, that stands as the basis for a fair competition amongst peers in a market free from disparities (Montedoro, 2015). Therefore, the *bail-in's* effect (to convert credits in liabilities) could be rationalized only moving from the fact that any intervention from the public administration using its discretional powers should be limited to cases of strict necessity (as it is clearly stated at point 102 of the European Court judgment of July 19th, 2016, that we will examine hereafter), that is in proportion to the banks' losses. In other words, it must be ascertained that – in any hypothesis of *bail-in* – the result achieved would be the same that would have been reached through liquidation procedures: the *bail-in* must be, though, a *neutral* intervention.

The very same logic behind the *bail-in* procedures can be found in the EU law on State aids: within this regulatory framework, of particular interest is the analysis of the provisions on the so-called *burden sharing*, which is a rule of solidarity between shareholders and other subordinated creditors. In fact, these rules impose that shareholders, "hybrid capital security" holders and bondholders to «*contribute in reducing the lack of capital al much as possible*» (European Commission, 2013 b) in order to justify interventions in support of subjects (*i.e.* banks) in need for capital. Even if this "sharing obligations" criterion is definitely compliant to EU law – also considering the fact that it aims at hindering conducts based on *moral hazard* that could have a significant impact on the community – it is clear that such a provision has the concrete effect of assimilating bank's creditors with risk capital owners.

The European Commission, in the above mentioned Communication dated August 1st, 2013, identified the equalization as one of the different financial instruments that concur to the formation of banks' capital; this consideration supported the choice of associating – in terms of effect of the "sharing" – shareholders and others subordinated creditors in case of interventions based on banks' financial difficulties. On this aspect it must be observed that shares should definitely be considered primary in terms of exigency of capital replenishment, whereas the same conclusion cannot be applied to "subordinated loan", even if the regulation of the banking sector classifies them as those patrimonial elements that should be required to assess the capital adequacy in compliance with the provisions of Basel III (and, then, to the technical standards it fosters).

On the other hand, subordinated loans – despite being part of an innovative view of financial techniques, that refuse their traditional interpretation as values tied to business risk – must be kept separated from those assets that are qualified as "share capital". Those who own subordinated loans are not able, in fact, to exert an influence on the banks' choices and operations: as a consequence, their participation *should be* considered in the calculation of the credit entity's asset only partially, as it similarly happens to hybrid financial instruments (which cannot be qualified as share capital) on the basis of different reimbursement order of funding sources (Capriglione 2007).

Finally, in the above mentioned context, furthers element to be kept into consideration throughout this analysis come from the innovations brought into the Italian system by the creation of the *Banking Union* and, in particular, by the "*Single Supervisory Mechanism"* implemented at the end of 2013. This new regulatory framework seems to be less appropriate to the utilization of informal *moral suasion* techniques, since its major "distance" from the supervised entities makes the resort to these instruments more difficult than before (Capriglione, 2015b). *Moral suasion* approaches are inefficient because, in the context of the new multilevel architecture of the banking sector, the participation of many different actors in the regulation – apart from requiring a significant effort in the development of instrument to coordinate these entities – is a considerable hinder to their provisions' authority and persuasiveness.

5. The possibility, contemplated by the European legal framework, to include the bond-holders among those who are required to make up for the losses of the businesses, through a so called mechanism of "internal" share of the losses,

sparks off an innovation within the systemic set-up of the banking undertaking. This novelty, as far as the Italian scenario is concerned, encourages to mull over some aspects of a regulatory nature concerned with that legal system that may ultimately affect the consistency of the legislative amendments more recently introduced by the EU legislation. Yet, also the CG principles enunciated by the Basel Committee on Banking Supervision in as early as July 2015, highlight the priority of the protection of the debt-holders' interests, as opposite to that of the equity-holders,[10] particularly in respect of the retail banks, as such introducing the principle of proportionality in several occasions neglected (EBA Banking Stakeholder Group, 2014; Alessandrini *et al*., 2016; Montedoro, 2016; Masera, 2016). Ultimately, these principles mark a significant progress in the logic of the "inter-company relationships".

It is clear that, while the above-mentioned legislative trend, by interacting with the traditional role played by the shareholders, gives rise to a sort of «structural *misalignment…between the interest…of the shareholders…and the interest…of the depositors and of the creditors in general*» (Lamandini, 2015). Thus, there is a decrease in the hiatus existing between the rights pertaining to the holders of the risk-capital (equity) and the those vested with mere claims vis-a-vis the bank (*i.e.* creditors); accordingly, there is a change in the traditional relationship between ownership, management and control which, as per the demarcation line originally drawn by Berle and Means (1932), has traditionally characterised the topic of the corporate control. In light of this, a revision of such principles on which the theory of the banking entity business has lain for a long time is required. This theory has been analysed as regards the aspects of the «*ownership rights*» on the capital, as a pre-requisite to have access to the *governance*; theory in which the market dynamic, the business organization and the principle of authority end up being mingled with each other according to multifarious modalities in search for an optimal structure, characterized by financial balance (Jensen and

[10]Cfr. Basel Committe on Banking Supervision (2015), Introduction, §2.

Meckling, 1976; Stiglitz, 1992) and fair connection between power and responsibility (Williamson, 2000).

Having said that, while in the past the highlight of the importance of the human capital and its access to the business reality as origin of a power and, therefore, the start of its exercise in an authoritative way had marked a notable opportunity to critically reassess the matter under discussion (Rajan e Zingales, 1998), what nowadays is at stake is the need for redefining the internal balance within the corporate governance of banks, in light of the legal changed made to the relevant regulation. In other words, it is essential to reassess the impact of the previous legislation which at the present has become inadequate if the current mechanisms of organisation and functioning of the banking business were kept unchanged. Upon a further analysis, these mechanisms have become all in a sudden *obsolete*, for the reason that, as a result of the new *resolution* plan, it is, to say the least, anachronistic the legal framework which vests exclusively the shareholders of banking institutions the exercise of the authoritative power that identifies the essence of the corporate governance. And yet, as previously underlined, nowadays among those who are deemed responsible for the negative consequences of possible crises and/or mismanagement, there are also individuals and/or bodies which are different from those who have appointed the management and the supervisory bodies of banks which have become insolvent. Therefore it can be said that there is a substantial identification between the two categories of both shareholders and debtholders. On their turn, these categories result in partaking in business activities with modalities which are not different, as promptly emphasised by the financial media who highlight: «*many bank bondholders will find their investment is at substantial risk – of conversion to equity, or of a "haircut" to its value, or of having its interest coupons eliminated*» (Jenkins, 2016).

Therefore, a scenario is emerging where the start of the new kind of banking institution is kicking off. Within this, the coherent application of criteria of rationality – both economic and legal – prompts the introduction of opportune changes to the traditional model of “corporate governance” hinged exclusively upon its linkage with the “capital” (that marks the lines – both legal and economic – of the business entities under discussion and, therefore, the interrelated system of rights). Hence, the need, duly put forward by scholars, of a specific legislative intervention aimed at rebalance the risk-responsibility relationship within the regulation of the banking corporate governance; unequivocal signs of this phenomenon are, on the one hand, the expected introduction *in subiecta materia* of the «*special prerogatives… provided by Art. 2351, last paragraph of the Italian Civil Code (appointment of a member of the board of directors and a statutory auditor) in favour of creditors*» and, on the other hand, the clear recognition of the role of the guarantee funds (*fondi di garanzia*) in view of granting the latter the right to «*appoint a member of the management body and/or the supervisory one*» (Lamandini, 2015).

In such a logic order that, similarly to what just highlighted, is aimed at taking into account the main role played by the bond-holders within the business organization, emphasis can be placed on recent studies, carried out in the USA, where a revision of the corporate governance model is put forward in order to recognize to this category of *stakeholders* an adequate and relevant position, consistent with their specific function (Schwarcz, 2016). More in detail, the analysis under discussion is based on a linkage between bond-holders and corporate governance, as regards the risk-aversion which informs their operational choices; hence, the originality of the action of such category which translated itself not only in the cost-reduction but also in the effective reduction of the systemic risk.

It is clear how such a re-cogitation of the corporate governance model is not ascribable to the motivations that have been represented above, with specific regards to the possible impact of the crisis on different categories from the shareholders; however, it cannot be denied that, as a result of such an investigation, the traditional link between ownership and power in the management of the business is certainly overcome. It is worth briefly recollecting that, as from 2014, the Bank of Italy has taken on board the market operators' requests which claimed a stronger autonomy and independence of the management body by given the possibility to such body «*for purposes of both the appointment and co-optation of directors…to previously identify its own optimal composition in connection with the identified objectives*» by proposing the candidates' professional profile; proposal that shareholders can decline only with justified reasons (Banca d'Italia, 2014). This has justified the view that there is a new set-up of the interests which lead the corporate governance of banks (Sacco Ginevri, 2016), since the breakup in the traditional vision, indeed static, of the relationship between rights and obligations, which so far has inspired the *Preferred Shareholder Model*.

Therefore, it can be affirmed that, for multifarious reasons – ascribable either to a more balanced interaction between risk and responsibility (as can be inferred by the EU legislation) and to the promotion of the medium-term business *performance* by reducing the volatility through new balances of operational forms (as the transalpine studies seems to outline) – times are ripe for the implementation of a legislative and regulatory change in the matter under discussion, in order to align the legislative framework to the facts, the law to the evolution of the history.

6. An indirect confirm of the conclusions previously reached is offered by the precise orientations rendered by the domestic and European Court of Justice's case law, which includes evaluations that – joined with the recent special regulations – univocally converge on the idea of a substantial equivalence between the position of shareholders and subordinated bondholders.

Regarding the orientation of the domestic case law, the reflections expressed by the Court (*Tribunale*) of Arezzo in the decision dated February 11th, 2016 – related to a trial that followed the activation of the resolution procedure towards the «*four banks*» (CariFerrara, Banca Parma, Popolare dell'Etruria and

CariChieti), submitted to the measures adopted by the Bank of Italy for the distressed financial situation they were facing – through which BPEL has been declared insolvent (Rossano, 2016, p. 73 et seq.).

The Court, in analyzing the application of the resolution program – that, amongst other measures, envisaged the integral reduction of the reserves, the share capital and the subordinated bonds contained in the own funds of the relevant institutes – after having stressed the «*complete harmony*» between the Italian legislation (legislative decree No. 180 and No. 181 of 2015) and the European directive regarding the banking crisis (Directive 2014/59/UE), examined the positions of the different category of creditors (shareholders and subordinated bondholders), coming to conclusions extremely relevant for a precise clarification of the subject matter we are examining. Specific reference is made to the statement according to which «*the position of the shareholders and the subordinated bondholders (…) appears substantially uniform, as they both participate, even if in different ways, to the risk capital*»; this specification does not raise any doubt on how the legislative and regulatory innovations must be read, innovations that, in practical terms, allow to consider overcome the distinction of roles (and, thus, the differences in terms of risks' consequences) of the participants to the (debt and equity) capital (that address towards unitary configuration).

We will not analyze herein the effectiveness of the reasons upon which the competent authority, according to its discretionary power, adopted specific measures in an economic situation clearly not appropriate to guarantee the respect of the prudential requirements mandatory for the continuity of the business activity. What has to be underlined is, instead, the recognition, by the Court, of a necessary assimilation between shareholders and debtholders in the assumption of the management risks and, therefore, in the loss sharing arising from *mala gestio*.

As anticipated, also the European case law takes into account the systemic change deriving from the new banking crisis regulation. Reference is made, in particular, to the decision of the European Court of Justice dated July 19th, 2016 regarding the lawfulness of the burden sharing measures[11]. In this decision the Court, dealing with the issue of the burden sharing, accedes to an interpretation of the bail-in procedure in which, while recognizing the complete legitimacy of such procedure, regarding the issue of the State aid specifies that it is still possible to allow (even if only in specific cases) deviations from the ban imposed by the European legislation.

More in particular, is cleared that the «*specific exceptional circumstances*», provided for by the current legislation, have to be read in light of the well-known criteria of «*equal treatment*» and «*protection of legitimate expectations*». In this regard, points 41, 43 and 44 of the mentioned EU Commission Communication dated August 1st, 2013 are recalled, specifying that «*the granting of a State aid implies, primarily, that the losses are absorbed through the share capital and then, in principle, a contribution from the subordinated creditors*»; this criteria can be waived, in accordance with «point 45», if the aforementioned contribution could «*damage the financial stability*» of the bank or could lead to «*disproportionate results*». It is clear that putting into correlation the system of the aids with the aim of «*fixing the financial turmoil that affects the economy of a Member State*», leads to recognize to the Commission the discretional power to define the criteria according to which evaluate the compatibility, with the internal market, of the measures adopted by the Member States, limiting – with the communication of its decisions – the perimeter of the intervention faculty.

The attention dedicated by the Court to the «*burden sharing measures*» – from which it is possible to deduce some space for a flexible interpretation of the exceptional circumstances provided for by the relevant legal framework – takes certainly into account the substantially *equal* position that the new banking regulation recognizes to shareholders and to subordinated creditors of the those banking institutions interested in a waiver. In this regard, it is crucial the excerpt of

[11]See ruling 19th July 2016, regarding the case C-526/14 Kotnik and others, viewable on http:// curia.europa.eu/juris/document.

the decision where it is specified that, according to the above mentioned Communication of 2013, «*the principle according to which no creditor can be left disadvantaged should be respected*»; thus «*subordinated creditors should therefore not receive less, in economic terms, than what their instrument would have been worth if no State aid were to be granted*» (point 77). This is an unequivocal reference to the well-known «*no creditors worse off*» principle (aimed at containing the losses of any creditor within the limits provided for by the cases of the "administrative compulsory liquidation") from which derives the conclusion adopted by the Court, according to which «*the burden-sharing measures on which the grant of State aid in favor of a bank showing a shortfall is dependent cannot cause any detriment to the right to property of subordinated creditors that those creditors would not have suffered within insolvency proceedings that followed such aid not being granted*» (point 78).

There is no doubt that this conclusion, reaffirming the limits of the «*burden sharing*» in order not to cause any detriment to the rights of the subordinated creditors, shows an implicit acknowledgment of the modification of the legal position of such creditors. The preliminary elements of a legal framework not compliant with the "risk /responsibility" criteria can be identified, criteria that must distinguish the participation to the corporate structure. Hence, an indirect confirmation of the necessity, arisen in this work, to reconsider the special legal framework applicable to the examined matter.

Lastly, also the recent decision of the European Court of Justice dated November 8th, 2016[12], in which the application for annulment of an injunction of capital increase requested by the Irish Ministry of Finance has been rejected, seems to be oriented in identifying a substantial change in the traditional position of the banks' shareholders. This decision was taken because the Court, in light of the systemic stability, choose the option of a capital increase, thus reducing the

[12]See case C-41/15, regarding the request to the Court from the High Court (Supreme Court, Ireland), with decision of the December 2nd, 2014, of a preliminary ruling, in accordance with art. 267 TFEU.

right of the shareholders to autonomously adopt management decisions. It is clear, therefore, that, at a time of emergency, an authoritative intervention reversing the traditional powers of the banks' ownership structure can be justified. This decision is in line with the scholars' orientation that, in the aftermath of the 2007/2009 crisis, represented the complexity – in the "banking resolution regime" – of a balance between prudential regulation and shareholders' rights (Alexander, 2009).

7. Both creditors and shareholders benefit from the distribution of the company cash flows and from the company's well-being. Nevertheless, as consequence of the different results' partition, risk appetite and risk tolerance of the two groups of investors are completely different. The contrasts and the conflicts of interests are intensified during periods of financial stress. The shareholder and the manager appointed by the latter are insiders that might try to coerce the risks profile, privileging short-term returns, even if this could threaten the business continuity. On the other hand, the debtholder's principal aim is not to undermine the company's equity structure and not to coerce the expected returns.

The company's optional model offers an interpretation of the shareholders and debtholders completely different from the traditional one. More in particular, it reverses the conventional wisdom that assigns to the first the role of owners and to the second the one of creditors stakeholders. In case of debt financing, the shareholders "offer the company" to the debtholders. The shares can be considered as a call option with an exercise price equal to the debt nominal value, written on the value of the company's assets. According to this interpretation, it can be affirmed, if anything, that the debtholders are the "owners" of the company that have moreover offered to the shareholders a buy-back option. In light of these reflections, it is still appropriate to reconsider the traditional corporate governance models which assign a main role to the shareholder. OECD principles states that «*the corporate governance framework should protect and facilitate the* *exercise of shareholders' rights»* (OECD, 1999 and 2015).

The above mentioned reflections become even more pertinent for a bank, as a consequence of its special characteristics and particularly as a result of the legislative changes – extensively analyzed in this work – designed to regulate banks' resolutions that assign peculiar obligations and duties to the subordinated bondholders. The new recommendations on the banks' corporate governance concerning the role of the shareholders and the creditors recently elaborated by the BCBS are more articulate and well-balanced (2015).

It is not easy to draw conclusions on the on-going legal and economical processes previously analyzed. It is still possible, though, to take the cue from the hypothesis here described, in light of the special legislation's evolution and the case-law interpretation.

In the current context of structural and functional developments inspired by the recent crisis, the change deeply interested not only the organization of financial intermediaries, but also the logic behind the banking governance model. On the contrary, the new paradigm that distinguishes the latter – in conferring a peculiar importance to the identification of the criteria suitable to obtain optimal management's results – does not take into account the substantial equalization between shareholders and subordinated debtholders, now responsible for hypotheses of *mala gestio* of the former without a distinction of obligations. Reasons of fairness – in addition to a necessary consistency with a proper interpretation of the power/duty relationship, which is a characteristic of the corporate relationships – impose a regulatory reinterpretation of the here examined matter, in order to create an effective balance (currently not present) between the parties of the banking system.

If the evaluations developed in this work are correct, it is necessary to carefully examine how to actually intervene in order to support a different incentive and check and balance internal system. These developments require analysis and researches that have not been herein expanded upon, but that are consistent with the principle that it is clearly establishing, according to which banks' shareholders meeting and board of directors must promote a sustainable success that is beneficial to all the stakeholders.

Obviously, it will be necessary – also through eventual modifications of the bail-in regulation – to search for the possibility of giving room to the debtholder in managing the company; hence, the complex set of problems that will be dealt by the regulator in relation to the identification of the contents of the legislative intervention to adopt and to the choice of the technical forms suitable to accomplish the predetermined aim. This with the evident risk of creating some confusion in the roles and responsibilities (in case of a co-management between shareholders and debtholders). In this regard, it has to be considered that in Italy also the 1942 civil code envisaged an involvement of the debtholders, granting to the debtholders meeting the authority to resolve upon decisions that could affect their respective rights.

Appendix – The option theory approach for stocks' valuation

The origins of the financial models must be found in the article by Black and Scholes (1973) on the pricing of options, as well as in two papers by Merton (1973, 1974) on option pricing and on the risk structure of the interest rates (Duffie, 1997). The novelty of the approach was described as follows by Black and Scholes:

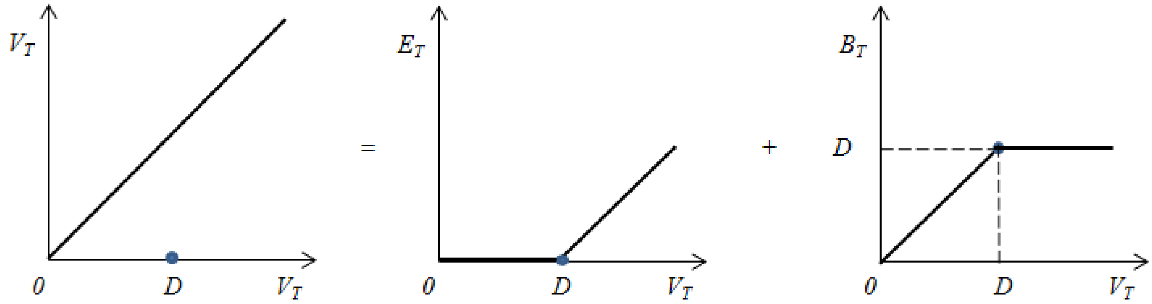
«It is not generally realized that corporate liabilities other than warrants may be viewed as options. Consider, for example, a company that has common stock and bonds outstanding and whose only asset is shares of common stock of a second company. Suppose that the bonds are "pure discount bonds" with no coupon , giving the holder the right to a fix sum of money, if the corporation can pay it, with a maturity of 10 years. Suppose that the bonds contain no restrictions on the company except a restriction that the company cannot pay any dividends until after the bonds are paid off. Finally, suppose that the company plans to sell all the stock it holds at the end of 10 years, pay off the bond holders if possible, and pay any remaining money to the stockholders as a liquidating dividend.

Under these conditions, it is clear that the stockholders have the equivalent of an option on their company's assets. In effect, the bond holders own the company's assets, but they have given an option to the stockholders to buy the assets back. The value of the common stock at the end of 10 years will be the value of the company's assets minus the face value of the bonds, or zero, whichever is greater».

In other words, the equity of a limited liability corporation is equivalent to an option on the total asset value of the firm. The enterprise value can be measured by the price at which total liabilities can be bought in the market. A simple graphic presentation is offered in Fig. a.1 below.

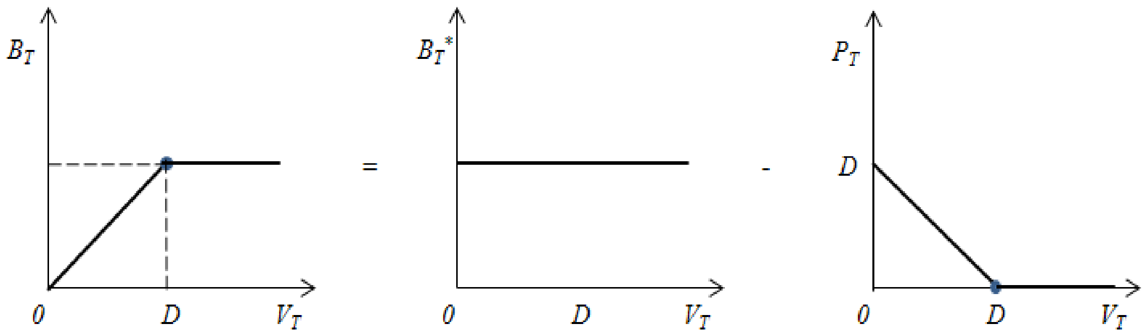
Fig. A.1 –Stocks and Bonds: graphic illustration

$$V_T = E_T + B_T \qquad [A.1]$$



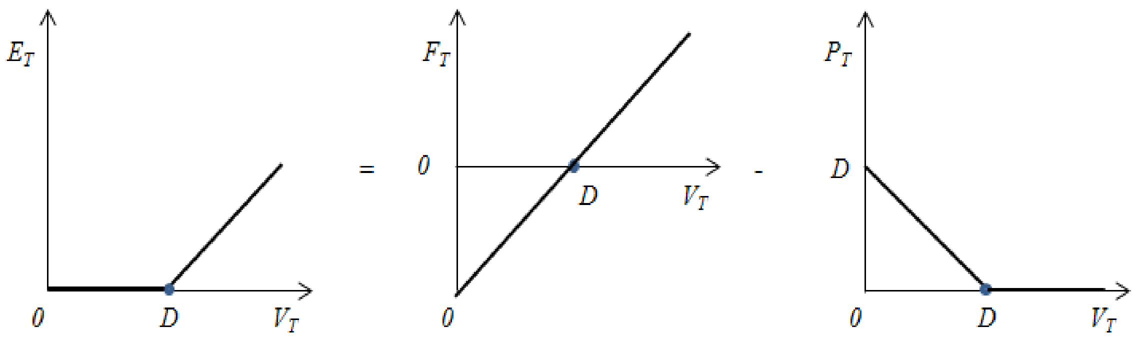
The enterprise value (V_T) is given by the sum of the values of stocks (E_T) and bonds (B_T).

$$B_T = B_T^* - P_T \qquad [A.2]$$



The value of a bond (B_T) is equal to the difference between the values of a risk-free bond (B_T^*) and a put (P_T).

$$E_T = F_T^* - P_T \qquad [A.3]$$



The value of a stock (E_T) is equal to the difference between the value of a forward (F_T^*) and a put (P_T).

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MINIMALIST DESIGN PRINCIPLES FOR PROSPECTUS, KEY INFORMATION DOCUMENT AND PRIIPs' REGULATION

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ABSTRACT: *This article explores the main issues concerning informational mechanism for investors in Europe, regarding in particular capital markets and financial regulation. The analysis first highlights certain criticalities connected to the prospectus regulation and the relevant consequences. This paper then analyses how KIDs (key information document) regulation seeks to find a balance between «the need for information and information over production», by examining the characteristics of such documents (short and standardized format, length cap, etc.), with specific regard to the description of risk return and costs. Finally, the deficiencies of such regulation lead to advocate the adoption of a neutral risk-based approach (the «probability scenarios of performance») that would make possible to provide investors with a set of information describing performances' probability net of costs.*

1. The obligation to draft, distribute and publish the prospectus is the polestar of capital markets disclosure regulation. The rationale underpinning this

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obligation is rooted in the well-known principle of mandatory disclosure.[1] The positive effects of the overall prospectus regime are undisputed, and there have been many adjustments to the original scheme over time to keep it up to date.[2] But some more contradictory aspects deserve closer attention. Notably, where contradictions in disclosure and the resulting uncertainty arise, issuers and investors inevitably face increased costs and higher risks when seeking or lending capital in the markets. Specifically, there are three main elements which appear to be addressed in an inefficient and unclear manner.

The first concerns the uncertainty of the prospectus purpose. The prospectus helps investors to know what they are buying and from whom and, more generally, if the securities (whether in the form of debt or equity) are a suitable investment choice. This rationale, of course, applies differently whether sophisticated or retail investors are at stake. The prospectus regime takes into account the differences between the two broad categories in that it provides for a summary prospectus to be distributed to retail investors. In addition, the whole regime seems to be particularly oriented towards retail investors, as shown by the mandate for easily and comprehensible language as a primary concern of the prospectus content.

Secondly, the prospectus content being exhaustively prescriptive, requires the issuer to include densely technical information to the most sophisticated investors. The latter generally possess superior wealth and financial skills which al-

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[1]See, EASTERBROOK and FISCHEL *The Economic Structure of Corporate*, Harvard University Press, 1991, pp 276. For an overview see: ROMANO, *The Genius of American Corporate Law*, American Enterprise Institute, 1993, p. 86; FRANCO, *Why Antifraud Prohibitions Are Not Enough: The significance of Opportunism, Candor and Signalling in the Economic Case for Mandatory Securities Disclosure, Columbia Business Law Review*, 2002, pp. 349-352. COFFEE, *Market failure and the Economic case for a Mandatory Disclosure System, 70, Virginia Law Review*, 1984, pp. 717-753.

[2]The most important areas covered include the update of the offer and admission definitions as well as the related admissions exemptions, substantive changes to the summary prospectus, a new reduced disclosure regime for right and certain other offering and changes to the withdrawal rights in connection with prospectus supplements. In more details see DE POLI, *L'Offerta al Pubblico di Sottoscrizione e di Vendita di Prodotti Finanziari*, in CAPRIGLIONE, *Manuale di Diritto Bancario e Finanziario, Bancario e Finanziario,* Cedam, 2015, pp. 605 – 612.

low them to fully process and gather the information contained into the prospectus.

However, these two different goals of the prospectus regime seem not to be fully harmonised one another. There are two main arguments pointing out the alleged high degree of inconsistency into the prospectus regime. The first is that the prospectus regime does not fully explain to whom each document is directed and how every document interacts one another. In fact, even if it is true that the information contained in the full prospectus is dense and technical, there is no specific requirement specifying that the prospectus is only directed to those who are able to fully understand it. The regime requires only that if retail investors are involved, a summary prospectus must be distributed.

Thirdly, the regime encourages the inclusion of forward-looking statements in the prospectus (the so-called soft information). If on the one hand such statements are strategically important to ensure a fair representation of the issuer and thus a correct price formation mechanism, on the other they increase the risk of an excessively prudential approach to disclosure, therefore precluding investors from obtaining highly valuable information.[3]

The result, of such over comprehensive but uninformative disclosure, incentives average investors not to read the lengthy document either because they do not have the will to do so or they do not fully understand the content. Equally, sophisticated investors often do not need the amount of information provided by the prospectus because they possess the resources and knowledge to efficiently

[3]See, BRUDNEY, *A Note on Materiality and Soft Information Under Federal Securities Laws*, 75, *Virginia Law Review*, 1989, p.723; POOLE, *Improving the Reliability of Management Forecast*, 14, *Journal of Corporate Law*, 1989, 547. Many have argued that forward-looking statements may constitute a safe-harbor for market manipulation practices. See, among the others, KUEHNLE, *On Scienter, Knowledge, and Recklessness Under the Federal Securities Law*, 34, *Houston Law Review*, 1997, where it is stated: "*If cautionary language is used, there is no liability even if the forward-looking statement appears to be the only provision of the federal securities laws that actually permits making false statements knowingly to the investors*" pp.127-137. See also, SELIGMAN, *The Private Securities Litigation Reform Act of 1995*, 38, *Arizona Law Review*, 1996, 717-732; COFEE, *The Future of PSLRA: Or, Why the Fat Lady Has Not Yet Sung*, 51, *Business Law*, 1996, p. 975; LAGENVOORT, *Disclosures that Bespeak Caution*, 49, *Business Law*, 1994, p. 489.

evaluate the issuer's condition without it.

2. Disclosure overload and the lack of a general applicable principle while drafting prospectus can cause the issuer and its advisers to play a sort of guessing game when selecting the relevant information. What might an investor care about? The answer deeply relates to the nature of the securities issued. If equity, information will be complex and related to many aspects of the issuer business. By contrast, if a debt security is issued, the information required for the investors is narrower. Being a pure credit decision the investor will be seeking only information concerning the issuer's capability of repaying the credit extended. In case of a secured debt issuance, investor will be concerned with the nature of the secured or underlying asset.[4] *Inter alia*, there are two main consequences associated with information overload. First, from the issuer perspective, information is not free, so producing it should be justified only when necessary and it should not be driven by liability risks consideration. Second, from the investor perspective, fathomable information triggered by regulation may result in material information becoming harder to find and to process.[5] The literature analysing difficulties encountered by individuals in understanding financial information is massive as well as literature discussing the role of cognitive factors in information processing.[6]

[4]The PD on this regards, sets down specific information in the annexes (contained in the prospectus regulation) which must be included in accordance to the nature of the securities, but it does not address and qualify the meaning of general disclosure requirements. Some prospectus practitioners have described the annexes as tools 'to give a prospectus writer a nudge as to what headings to put down on the blank sheet of paper'. See BURN, *Capital Markets Union and Regulation of the EU's Capital Markets*, 11, *Capital Markets Law Journal*, 2016, p.356.

[5]For a critical disentangling of the issues arising from information overload in the securities regulation field see PAREDES, *Blinded by the Light: Information Overload and its Consequences for Securities Regulation*, 81, *Washington University Law Review*, 2003, pp. 417-485.

[6]Just to mention a recent global survey on investors' financial education, The Standard and Poor's Ratings Services Global Financial Literacy Survey. For a theoretical perspective, see, RUBALTELLI, *Numerical Information Format and Investment Decisions: Implications for the Disposition Effect and the Status Quo Bias*, 6, *The Journal of Behavioral Finance*, 2005, p. 19. See also, WILLIS, *Decision-making and the Limits of Disclosure: The Problem of Predatory Lending: Pricing*, 65, *Maryland Law Review*, 2006, p. 707. For an exhaustive and updated overview of the interactions between law and behavioral economics see ZAMIL and TEICHMAN, *Oxford Handbook of Behavioral economics and the Law*, Oxford University Press, 2014; with particular reference to herding behavior see generally, PRECHTER, *The Wave Principles of Human Social Be-*

Regulators have tried to shape the prospectus regime accordingly. At the centre of regulators attempts, there is the summary prospectus. The idea behind a differential disclosure approach is not new. William H. Beaver, for instance, more than forty years ago suggested to differentiate between professional and retail investors for the purpose of disclosure.[7] From his perspective, differentiation would not impair the Efficient Capital Markets Hypothesis (ECMH) since market prices would anyways reflect all available information.[8]

3. Many market participants have described the summary prospectus as inadequate in providing a valuable source of information to retail investors. Lack of satisfaction was confirmed by the Commission Prospectus Directive review proposal.[9]

It is not fairly clear in fact, what is the role of the summary in connection with the full prospectus. *Prima facie*, the summary prospectus is designed to "aid investors when considering whether to invest in such securities".[10] The Directive's language suggests the summary should be viewed as a tool of assistance for the

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haviour and the New Science of Socionomics, 1999, pp. 152-153. See also the keystone analysis of Abhijit V. Banerjee in BANERJEE, *A simple Model of Herd Behaviour*,107, *Quarterly Journal of Economics*,1992, pp. 797-798; and ROCK, *An Economic Psychological Approach to Herd Behaviour*,40, *Journal of Economic Issues*, 2006, p.75.

[7]See, BEAVER, *Market Efficiency*, 56, *Accounting Review*, 1981.

[8]The basic assumption of the theory is that markets can be defined as informational efficient when securities' prices impounds all relevant information with sufficient speed that even sophisticated investors are unable to profit by trading on newly available information. The father of the theory distinguishes three different ways of interpreting the ECMH: securities markets can be said to be efficient in weak-form (when current prices reflect the information contained in past prices), semi-strong form (when prices reflect all the information, both present and past, that is publicly available) or strong-form (when they reflect at any time both publicly available and private information). In a market efficient in strong from, any market participant cannot take advantage of any other information than those fully reflected (and incorporated) into the securities' prices thus being unable to "beat the market". See FAMA, *Efficient Capital Markets: A review of Theory and Empirical Work*, 25, *Journal of Finance*, 1970, pp. 383. For a critical analysis of the ECMH see, GILSON and KRAAKMAN, *The Mechanisms of Market Efficiency*, 70, *Virginia Law Review*, 1984, p. 549; SHEIFLER and SUMMERS, *New Critiques of the Efficient Market hypothesis*, 4, *Journal of Economic Perspective*, 1990, p. 19; CUNNINGHAM, *From Random Walks to Chaotic Crashes: The Linear Genealogy of the Efficient Capital Market Hypothesis*, *Cardozo Law School, Public Law and Legal Theory*, Research Paper Series, 2000.

[9]European Commission, Directorate general financial stability, financial services and capital markets union, Consultation document, review of the prospectus directive, 2015.

[10]PD, Art 5 as Amended by the PD Amending Directive, art 1(5).

retail investors while the full prospectus remains the only source upon which relying when making a final investment decision. Such interpretation is supported by the liability provisions addressing the summary prospectus, where it is stated that liability may arise if the information contained in the summary are misleading, inaccurate or inconsistent when "*read together with the other parts of the prospectus*".[11]

However, it might be argued that such interpretation does not fit with the definition of key information. In fact, key information is thought to be a source by which investors should be able to understand the nature and the risks of the issuer. So if the summary is only a mere introduction to the information contained in the full prospectus and must be read with it, investors should not gain any understanding of the nature and the risks of the issuer from the summary. Accordingly, the summary prospectus would result in a tool to attract investors' attention rather than an informative tool.

It might be further argued that the civil liability provision contributes to summary prospectus ambiguity. Breaking up the provision in two key requirements, the first requires that the summary not be misleading, inaccurate or inconsistent when read with the full prospectus, and the second requires the summary to contain key information when read with the full prospectus.

The exact meaning of the first limb casts some doubts. It is not clear whether the provision ensures a safe harbour for the issuer if any misleading, incorrect or inconsistent information in the summary is corrected by a reading of the full prospectus, or alternatively, that if the summary is misleading, once read in the context of the full prospectus, then the civil liability exemption does not apply. As for the second part, it is not clear whether the provision excludes liability if the key information, omitted in the summary, is provided in the full prospectus, or

[11] The full text provides "*However, Member States shall ensure that no civil liability shall attach to any person solely on the basis of the summary, including any translation thereof, unless it is misleading, inaccurate or inconsistent when read together with the other parts of the prospectus*". See, PD, Art 6 as Amended by the PD Amending Directive, Art 1(6).

if liability attaches when some key information provided in the full prospectus is not contained in the summary.[12]

The above mentioned tensions need to be reconciled in order to reduce uncertainty for market participants.

4. With the intent of providing an affordable solution to deficiencies of the informational mechanism affecting retail investors, the EU legislator has adopted the so called PRIIPs regulation. The acronym stands for packaged retail investment and insurance products.[13]

The regulation explicitly recognizes the flaws associated with the information disclosure mechanism for retail investors. It explicitly states that retail investors need information to make an informed decision but at the same time it admits they may not read informative documents "unless information is short and concise".[14] On its surface, the regulation seems to follow the well-known regulatory path supporting a quantitative reduction of information.

However, the PRIIPs regulation represents, to some extent, a major departure from the regulatory strategy adopted for the summary prospectus. At the same time, this departure reflects a major paradigm shift on financial regulation which sought to overcome the traditional sectoral legislation in favour of cross-sectoral legislation. Put simply, traditional financial regulation was rigidly sectoral which means that banking, securities and insurance markets were regulated by three different bundles of regulation. Accordingly, formal qualification of a certain product or service was of crucial importance because depending on that qualification, significantly different rules applied to services and products.

The sectoral approach lacked dynamism and proved not to be suitable for

[12]See, BURN, *Capital Markets Union and Regulation of the EU's Capital Markets*, 11, Capital Markets Law Journal, 2016, p. 356.
[13]Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs), 2014, OJ L 352/1.
[14]Recital 15, PRIIPs Regulation, (2014).

intercepting financial products and services innovation, which started to create products labelled differently but substantially similar from an economic point of view. This process was neither efficient[15] nor fair for retail investors and financial institutions. Further, this mechanism incentivized regulatory arbitrage.[16] Retail investor products were particularly vulnerable to regulatory arbitrage and therefore they were exposed to risks of different degree of protection varying from the sector.[17]

The regulatory approach rests on two pillars. The first emphasizes the importance of information therefore ensuring that investors are well informed about the product they are buying before entering into any transaction. The second concerns the sale process and the role of advisors or sellers, which is outside the scope of this paper.[18]

5. The PRIIPs' regulation seeks to achieve two different but interconnected results: 1) improving comparability of financial products with similar economic features, even when they have a different legal qualification; and 2) improving investor information.[19]

In order to provide the desired horizontal approach, PRIIPs regulation's scope focuses on the features of the product issued or offered "*regardless of their form or construction*".[20] The main feature of these products is that they must be

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[15]Financial institutions which offer different kind of products or services were compelled to different processes depending on the label and thus on the formal sector in which the product or services was to be classified.

[16]See, KREMERS, SCHOENMAKERS and WIERTS, *Cross-sector Supervision: Which model?* in HERRING and LITAN (Eds.), *Brookings-Wharton Papers on Financial Services*, 2003, p. 241.

[17]European Commission, Open Hearing on Retail Investment Products, 15 *July* 2008. The documents highlight the spread of regulatory arbitrage practices particularly concentrated in France and Netherlands.

[18]The Regulation sets forth that a person advising or selling a PRIIP should provide retail investors with the KID in good time before those retail investors are bound by any contract or offer relating to that PRIIP so encompassing pre-contractual conducts among parties. The same provision additionally provides for post-contractual duties on the relevant category of sellers or advisors. Section III (Provision of the key information document).

[19]*Ibid.*

[20]Communication of the commission to the European Parliament and the Council, Packaged Retail Investment Products" (COM,2009) 204 final, *30 April* 2009. For further explanation, Explanatory

packaged or manufactured.[21]

The choice to limit the regulation's applicable scope in this way is based upon two different considerations. The first is that, arguably, packaged products are the most difficult products to understand for the retail investors. The second, is that, the dynamism behind the process of packaging can easily lead to fundamentally identical investment propositions taking different legal forms and being offered across different industry sectors.[22]

Such rationale, on its surface, seems to be justified in light of the past financial crisis and its triggering mechanism. Securitizations and structured products were, indeed, blamed as the major contributors of information asymmetries and the destructive domino effect leading to the 2008 global financial crisis.

Non-layered products are therefore excluded from the regulation's scope. Interestingly, the Commission proposed that the PRIIPS regulation should have replaced the summary prospectus requirements but eventually the proposal was abandoned. Among the reasons for the rejection of this proposal, the Commission highlighted the fact that Prospectus summary and more generally the Prospectus Directive (PD) serve a broader objective than the PRIIPs KID, such as market transparency and providing a full picture of all details in relation to a proposed contract. However, the ongoing Prospectus review proposal suggests there might be a turn around on the issue.

6. It might be said that, conceptually, PRIIPs regulation does not bring any major change to investor protection. As traditional law and economics theory sug-

memorandum to the proposal for a PRIIPS regulation (note 3) p. 2: "*Existing disclosures vary according to the legal form products takes, rather than its economic nature or the risks it raises for retail investors. The comparability, comprehensibility and presentation of information vary, so the average investor can struggle to make necessary comparisons between products*".

[21]The packaged or manufactured nature of the products refers to: "*packaging or structuring different elements together, for instance by wrapping a financial asset or assets within another structure, or by providing investment management through a collective investment scheme, or by devising a financial instrument that creates exposure to other financial instruments, indices or reference values*". European Commission, "*Consultation by Commission Services on legislative steps for the Packaged Retail Investment Products Initiative*", *November* 2010, p. 5.

[22]Explanatory Memorandum to the Proposal for a PRIPs Regulation, p. 7.

gests, information asymmetries arising from unbalanced parties' position can be taken away by providing investors with more information, so as to make information itself a gap filler between parties.[23]

The KID, following the UCITS's regulatory model[24], seeks to find a balance between the need for information and information over production. The tension between these two exigencies crystallises into the question "what to disclose". The answer to this question is of crucial importance in order to strike the right balance. The regulation in this regard mandates for the KID to be written in a short and standardized format. The KID follows the Key Investor Information Document (KIID) approach requiring a length cap to the document, and it is worth noting that the same rationale was followed for the prospectus summary.[25]

Beside the KID format, which should ensure consistency and comparability among different kinds of products in different sectors, the KID focuses on the quality of the information. Notably, the KID is conceived as a stand-alone document and shall not present any marketing material nor it should cross-reference to it.[26] In addition, a statement containing a "comprehension alert" should be inserted.[27]

The regulation leaves space for technical implementation by competent au-

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[23]See, *supra*, note 7.

[24]The KID's rationale and structure follows the one adopted and developed by the UCITS' IV Directive with the key investor information(KII). The KII roots on an evidence-based approach toward disclosure requirements in that its implementation was preceded by extensive surveys on retail market participants. See, *inter alia*, IFF Research and YouGov, "*UCITS Disclosure testing. Research Report*" (Study prepared for the European Commission), *June* 2009.

[25]PRIIPs Regulation introduces a formal maximum of 3 sides of A4-sizedpaper when printed. Article 6 (4).

[26]It is further requested an explanatory statement to be included on the title: "*this documents provides you with key information about this investment product. It is not marketing material. The information is required by law to help you understand the nature, risks costs, potential gains and losses of this product and to help you compare it with other products*". Article 8 (2) PRIIPs Regulation.

[27]In particular Recital 18 points out some cases in which such alert may be particularly useful and therefore more stringent the obligation to comply with it. The text generally refers to products whose underlying value may be derived or stemming from assets in which an investor does not commonly invest. Further, it is included the case in which the investment's pay-off takes advantage of retail investor's biases, such as a teaser rate followed by a much higher floating conditional rate. See PRIIPs Rec. (18).

thorities and it implies the adoption of an optimal common template through the use of market surveys. In June 2016, the Commission released supplemental regulations addressing PRIIPs by laying down regulatory technical standards specifically addressing the KID template's structure, information as well as the revision procedure of such documents.[28]

The KID is particularly innovative as to the description of risk return and costs. For both these elements the PRIIPs sets forth the use of visual indicators to facilitate comprehension of the information provided in those sections.[29]

7. On the one hand it is unquestionable that the regulation is capable of increasing transparency and comparability among products. On the other however, the choice to limit the scope of the regulation to packaged products raises some doubts.

By excluding non-packaged products (i.e. simple products) from the regime, the regulation significantly impairs retail investors' ability to compare costs risks and other features of a packaged product and its simple counterpart (while approaching two products of different flavours, retail investors would find themselves in a hard position since the simple product is not covered by the regulation and has lengthy and complex documents).

For instance, in comparing a convertible bond with a simple bond there will be no KID for the latter to facilitate comparison. Given the flaws associated with the summary prospectus, it is reasonable to infer the retail investor could not compare at all such products. It is important to highlight that often such products

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[28]European Commission, Supplementing Regulation n. 12/2014 of the European Parliament and of the Investment Products (PRIIPs), 2016. The articles of the regulation, as enriched by the regulatory technical standards, compose a regulatory puzzle in which the manufacturer or offeror is compelled to draft a document which is designed to guide the investor step by step toward the investment decision. In fact, the KID sections in article 8 are labelled with questions: "What is this products?"; "What are the risks and what could I get in return?"; "What happens if the PRIIPs manufacturer is unable to pay out?"; "What re the costs?"; "How long should I hold it and can I take money out early?"; "How can I complain?". See, Art. 8 (c-h), PRIIPS Regulation.

[29]For a comparative analysis concerning the short-form disclosure and its beneficial effects see GODWIN and RAMSAY, *Short-form Disclosure - an Empirical Analysis of Six Jurisdiction, Capital Markets Law Journal*, 2016, p. 296-316.

may have the same economic feature therefore being substitutes.

Another problem associated with the PRIIPs regulation is the risk of duplication. As for now, it is not clear how this regulation and the PD regime interact one another. Some scholars point out that, lacking specific guidelines, imposing a KID requirement on packaged products does not exclude the duty to comply with the PD regime.[30] As result, in addition to the KID, the issuer, would be compelled to provide a summary prospectus. It is argued that such an operating framework runs counter to the goal of ensuring an effective level playing field between different types of products.[31]

The PD regime is, however, under review in order to strengthen and make more effective the Capital Markets Union.[32] So it is reasonable to believe the PD regime will undergo surgery on this regards.

8. On the one hand, the European Legislator's choice to include, into the PRIIP's documentation, a simplified visual indicator of risks-returns and costs serves as a positive example for the Prospectus regime. PRIIP's KID reproduces the same synthetic risk and reward indicator adopted for the UCITS' KID.[33]

The Positive aspects of such indicators are clear. First, it is a simple measure

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[30]For a brief analysis addressing the need for disclosure requirements' semplification see, SICLARI, *European Capital Markets Union e Ordinamento Nazionale*, 4, *Banca Borsa e Titoli di Credito*, 2016, p. 481; SCHAEKEN WILLEMAERS, *Client Protection on European Financial Markets – From Inform Your Client to Know Your Product and Beyond: An Assessment of the PRIIPs Regulation, MiFID II/MiFIR and IMD 2,* Revue Trimestrielle de Droit Financier, 2014. Available at SSRN: https://ssrn.com/abstract=2494842.

[31]*Ibid;* Concerns raise among market participants also, see European Commission, Key Information Documents (KIDs) for packaged retail investment and insurance products- Frequently Asked Question, *April* 2015.

[32]European Commission, *Green Paper – Building a Capital Markets Union*, (COM, 2015), p. 63. See also European Commission, Consultation Document- *Review of the Prospectus Directive*, (February, 2015), p. 5 and 16-18.

[33]The synthetic risk indicator does not exactly quantify the risk but conversely it represents the product's risk through a numeric scale varying from 1 to 7 which indicate the possible combination of risk-rewards. The higher the numeric value showed in the synthetic risk indicator, the higher the risk-reward proportion (i.e. more risk more expected returns). It should be noted that such value and the corresponding proportion express the product's standard deviation from its past performances.

so that it can be easily understood and processed. Secondly, from a theoretical standpoint, it has a high potential of comparability and it can apply even to the most sophisticated and layered products. Third, the calculation method upon which the indicator is based does not imply highly complex operations (so it does not result high cost and efforts of oversight of market commissions).

However, on the other hand there are some criticalities affecting the indicator. First, every product requires additional information being the risk indicator insufficient to include any product peculiarity. For instance, a debt product will require further description concerning the credit risk, a low liquidity product requires explanation of their related liquidity risk, etc. Second, a synthetic risk indicator renders standard deviation of a given observation to be oversimplified. That means that one number presented as the synthetic risk indicator includes products with different degree of volatility (for instance, products with a volatility value between 0.5% and 2%). As result the indicator may be confusing for retail investors. Third, information as regards past performance may be misleading to investors that may assume past performances as reference value for future performance (notwithstanding any contrary statement contained in the document).

In light of the above, a paradigm's shift in the method adopted to represent products' information is desirable. On this regard, we advocate for a shift back toward a risk-based approach and in particular, toward the probability scenarios of performance.[34] Providing less educated investors with a set of information describing performances' probability, net of costs, may undoubtedly overcome the aforementioned flaws associated with the synthetic risk indicator. Put simply, probability scenarios are the results of analysis based on risk-neutral approach.[35]

Probable scenarios provide clear and easy to understand results ("price alter-ego"). In addition, the informational set envisaged by probability scenarios

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[34]The risk based approach, pioneered by CONSOB in 2009, was "unreasonably" discarded by ESMA as valuable method underpinning qualitative disclosure in favour of what-if scenarios.

[35]An explanatory description of the importance model risk pricing, as regards derivativs, is given in MASERA and MAZZONI, *Derivatives Pricing and Model Risk*, 2, *Law and Economics Yearly Review*, 2013, pp. 296-312.

satisfy pre-contractual exigencies of investors in that they provide an effective qualitative representation concerning the costs/prices, risks and time horizon of the investment.

"ACTING IN CONCERT"
IN THE BANKING AND FINANCIAL SECTORS *

Alexander N. Kostyuk** - Andrea Sacco Ginevri***

"If we be acting in concert (…)
there are surely a majority of chances
that we must be acting right"
(R.L.B.STEVENSON,
Lay Morals and Other Papers, 1911)

ABSTRACT: *This Article explores the main convergences and divergences among the different notions of "persons acting in concert" adopted by certain EU and US regulations concerning financial institutions and public companies, for the purpose of identifying a common set of principles governing the interpretation and application of such legal concept.*

In particular, the "acting in concert" relationship is scrutinized herein taking into account the EU directives on the acquisition of significant holding in banks and other financial institutions, the EU directive on takeover bids on listed corporations and both the EU and US transparency regulations on the ownership of public companies.

This analysis shows that while under the regulations on the ownership structure of banks and financial institutions the legal notion of "persons acting in concert" is widely applied and extensively interpreted – since the operation of such companies must be protected also from potential (and not only actual) risks – both

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*Although jointly elaborated, this article has been drafted as follows: paragraph 5 by Alexander N. Kostyuk; paragraphs 1, 2, 3, 4 and 6 by Andrea Sacco Ginevri.

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the takeover bids' and transparency rules mainly look at the actual exercise of governance rights over listed targets, for the purpose of expanding, respectively, the list of bidders and the information provided to the public on the ownership structure of such companies.

As a consequence of the above, we conclude that the notion of "persons acting in concert" should remain flexible and adaptable to the different goals pursued in the various sets of rules as the case may be. However, other forms of collaboration among investors – not aimed at threatening the interests protected by the relevant financial regulations – should not be considered as "acting in concert" conducts for such a purpose, since an overreaching of activities triggering an acting in concert presumption might discourage an effective exercise of monitoring rights attached to minority stakes, thus affecting the best governance of financial institutions and public companies.

SUMMARY: 1. Introduction. – 2. The EU regulation on the acquisitions and increases of qualifying holdings in banks and other EU supervised entities. – 3. Acting in concert and takeover bids' directive. – 4. Transparency rules in the European Union – 5. Block-holders disclosure under the U.S. securities laws. – 6. Conclusions.

1. In the recent years an increasing number of legal frameworks deal with the notion of "persons acting in concert" in the international financial systems. References to such concept are generally aimed at achieving different goals, ranging from the extension of the parties bounded by disclosure duties vis-à-vis either the public or the competent supervisory authorities – in case of acquisition of significant stakes in banks, insurance companies, investment firms and listed issuers – to the identification of the joint offerors under the applicable takeovers' rules.

Despite the assortment of regulatory notions of "acting in concert" worldwide, the "anti-avoidance" essence of such concept generally aims at expanding the list of entities bound by the same legal duty as a consequence of a strong connection among them. The proliferation of a variety of relationships among natural and legal persons operating in the financial markets increased the risk that the traditional categories of *interposition* were not adequate to attract the several structures which can be currently adopted by the same "center of powers".

In other words, rules addressed only to the persons belonging to the same *corporate group* or *family* cannot properly cover certain connections among sophisticated investors operating in the modern financial markets. This happens in a context in which acquisitions and material corporate transactions often require the involvement of several parties, with different skills and financial sources, unified by a common intent: the acquisition of a joint control over a target company.

Thus, domestic and transnational sets of rules now expressly include "persons acting in concert" among those jointly liable with either the bidder, or the target company, in the context of a public M&A deal, on the assumption that such persons potentially cooperate in order to achieve the same goals on the basis of pre-existing and relevant relationships (so that their activities are deemed products of a combined action).

However, if these rules are not properly addressed and well-balanced, they could interfere with the free exercise of shareholders' rights, leading to a sub-optimal level of management's monitoring in public companies.[1] In other words, as pointed out by the EU Commission, the lack of legal certainty provided by the current EU rules on this subject is perceived as an obstacle to effective shareholders' cooperation since equity-investors need to know when they can

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[1]See, among others, DIEUX and LEGEIN, *Questions relatives à la notion de concert en droit belge*, in *Forum Financier/Droit bancaire et financier*, 2012, p. 143 s.; BONNEAU and PIETRANCOSTA, *Acting in Concert in French Capital Markets and Takeover Law*, in *Revue Trimestrielle de Droit Financier*, 2013, p. 17 s.; BIARD, *Action de concert*, in *Revue de droit bancaire et financier*, 2007, p. 68 s.; SANTELLA, BAFFI, DRAGO and LATTUCA, *A Comparative Analysis of the Legal Obstacles to Institutional Investor Activism in the EU and in the US*, in *European Business Law Review*, 2012, p. 257 s. [observing that *"The possibility of acting in concert without restrictions would help to overcome the collective action problems"*].

share information and cooperate with one another without running the risk that their actions may trigger unexpected legal consequences.[2]

For such a purpose, certain financial laws and regulations make a distinction between a “white-list” of permitted acting in concert conducts – that typically include initiatives promoted by *minority* shareholders (concerning the harmonized exercise of their reciprocal corporate rights) – and a “black-list” of personal connections that generally trigger a presumption of joint-responsibility among the entities acting in concert.[3]

2. Due to the increasing integration of financial markets and the frequent use of group structures extended across multiple Member States, a single acquisition or increase of a qualifying holding in financial institutions may be subject to scrutiny in several countries. This has led to the adoption of EU law provisions based on the principle of maximum harmonization of the procedural rules and assessment criteria throughout the European Union.[4]

Consistently, the EU Directive 2007/44/EC (the “Acquisition Directive”)[5] established a legal framework for the prudential assessment of acquisitions by natural or legal persons of a qualifying holding in credit institutions, insurance and reinsurance companies and investment firms (hereinafter, collectively,

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[2]See the *Action Plan on Corporate Governance and Company Law* of December 12, 2012, available at *www.europa.eu*, p. 11 s.

[3]An overview of such conducts is provided by ESMA, *Information on shareholder cooperation and acting in concert under the Takeover Bids Directive – 1st update*, June 2014, available at *www.esma.europa.eu*, in which the authority recognizes that shareholders may wish to cooperate in a variety of ways and in relation to a variety of issues for the purpose of exercising good corporate governance but without seeking to acquire or exercise control over the companies in which they have invested.

[4]In other words the thresholds for notifying a proposed acquisition or a disposal of a qualifying holding, the assessment procedure, the list of assessment criteria and other provisions of the directive to be applied to the prudential assessment of proposed acquisitions should therefore be subject to maximum harmonization.

[5]See the EU Directive 2007/44/EC, published in *O.J.E.U.*, n. L 247/1 of 21 September 2007, p. 1 s. The Acquisition Directive amended the European directives applicable on this issue to credit institutions (Directive 2006/48/EC), investment firms (Directive 2004/39/EC), and insurance and reinsurance undertakings (Directive 2007/44/EC).

"supervised entities").[6] The Acquisition Directive is intended to prevent the circumvention of initial conditions for authorization to carry out the relevant activity and, more generally, to set prudential requirements aimed at safeguarding the stability of the market.[7]

According to the Acquisition Directive, Member States' legislations shall require any natural or legal person, *including such persons acting in concert*, who have taken a decision either to acquire a qualifying holding in a supervised entity – or to further increase such a qualifying holding (over certain material thresholds of voting rights or share capital of the target company)[8] – to inform the competent supervisory authorities indicating the size of the intended holding and any relevant information. [9]

Since the definition of "*persons acting in concert"* is not provided in the Acquisition Directive – and considering the lack, in the sectoral law provisions, of harmonized notions of "persons acting in concert'" – different methods have been employed by the national competent authorities to establish the existence of such relationship.[10] Moreover, the need for further clarifications about the meaning of "acting in concert" is also explained by the differences between the definitions of such linkage used in other EU directives, such as the EU directive 2004/25/EC (the "Takeover Bids Directive")[11] and the EU directive 2004/109/EC (the "Transparency Directive")[12] (see, respectively, the following paragraphs 3 and

[6]More in particular, for the purpose of this article the term "supervised entity" replaces the following terms (which are used in the sectoral directives): "credit institution", "assurance undertaking", "insurance undertaking", "re-insurance undertaking" and "investment firm".
[7]See recitals 3 and 4 of the Acquisition Directive.
[8]As a result of which the proportion of the voting rights or of the capital held would reach or exceed 20 %, 30 % or 50% (or so that the supervised entity would become its subsidiary).
[9]As a consequence of the acting in concert, each of the persons concerned (or one person on behalf of the rest of the group of persons acting in concert) should notify the target supervisor of the relevant acquisition or increase of a qualifying holding.
[10]See the EC Commission report on the application of Directive 2007/44/EC of 11 February 2013, available at *www.eur-lex.europa.eu*.
[11]See Article 2(1) (d) of Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, published in O.J. L. 142 of 30.4.2004, p. 12.
[12]See Article 10(a) of 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, published in O.J. L. 390 of

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In such a context, the non-binding guidelines for the prudential assessment of acquisitions, originally drafted in 2008 by the former three Level-3 Committees (CEBS, CESR, and CEIOPS), broadly defined «*persons acting in concert when each of them decides to exercise his rights linked to the shares he acquires in accordance with an explicit or implicit agreement made among them*».[13]

Just recently, on December 2016, EBA, EIOPA and ESMA (collectively, the "ESAs")[14] amended and updated the "2008 joint guidelines" on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sectors (which are addressed to the competent national supervisory authorities) in order to clarify certain complex issues on this subject including, among others, the scope of the "acting in concert" notion and practice (the "updated joint guidelines").[15] According to the updated joint guidelines, the competent supervisory authorities should not be precluded from concluding that certain persons are acting in concert merely due to the fact that one or several such persons are *passive*, since inaction may contribute to creating the conditions for an acquisition or increase of a qualifying holding or for exercising influence over the target company.[16]

Furthermore, the updated guidelines provide two non-exhaustive lists of

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31.12.2004.

[13]See point 1 of Appendix I of the joint guidelines for the prudential assessment of acquisitions and increases in holdings in the financial sector as required by Directive 2007/44/EC, available at *www.eba.europa.eu*. When certain persons act in concert, domestic supervisory authorities should aggregate their holdings in order to determine whether such persons acquire a qualifying holding or cross any relevant threshold contemplated in the sectoral directives and regulations.

[14]See on the role of ESAs, among others, TROIANO, *Interactions between EU and national authorities in the new structure of EU financial system supervision*, in *Law and Economics Yearly Review*, 2012, vol. 1, p. 104 s.; ID, *The new institutional structure of EBA*, in *Law and Economics Yearly Review*, 2013, vol. 1, p. 163 s.

[15]The updated guidelines have been issued by the ESAs pursuant to Article 16 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010, and are available at *www.esas-joint-committee.europa.eu*. The updated guidelines will apply from October 1, 2017.

[16]See the joint guidelines, p. 12. In other words, the competent supervisory authorities should take into account all relevant elements in order to establish, on a case-by-case basis, whether certain parties act in concert.

activities, in which the ESAs respectively mention factors that generally trigger (the "black-list") or not (the "white-list") the notion of "acting in concert" for the limited purposes of the Acquisition Directive and connected regulations.

On the one hand, the black-list of relevant "concerting activities" developed by the ECAs includes certain matters that normally disclose a common intent of the parties to jointly exercise a significant influence over the governance of the target company. Such factors include the execution of shareholders' agreements or other similar agreements on matters of corporate governance concerning the target company (*i.e.* "contractual collaboration")[17], the existence of family memberships, occupational connections [18] or group relationships (*i.e.* "subjective collaboration")[19]; the draw-down of the same financial sources (*i.e.* "financial collaboration")[20], and/or the occurrence of consistent voting patterns by certain shareholders (*i.e.* "voting collaboration").

On the other hand, according to the ECAS' view, when shareholders cooperate only in order to exercise their *minority* corporate rights, their collaboration is generally considered exempted from the acting in concert presumption, unless their cooperation is not merely an expression of a common approach on a specific matter but one element of a broader agreement or understanding between the shareholders.[21] More in particular, in certain circumstances (*i.e.* the "white-list") persons are not typically deemed to be acting in concert, such as when they *(a)* enter into discussions with each other about possible matters to be raised with

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[17]Excluding, however, pure share purchase agreements, tag along and drag along agreements and pure statutory pre-emption rights, on the assumption that such agreements typically do not pursue governance objectives.

[18]Whether the proposed acquirer holds a senior management position or is a member of a management body or of a management body in its supervisory function of the target undertaking or is able to appoint such a person.

[19]Excluding, however, those situations which satisfy the independence criteria set out in paragraph 4 or, as the case may be, 5 of Article 12 of Directive 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, as subsequently amended.

[20]For the purpose of the acquisition or increase of holdings in the target company.

[21]According to the joint guidelines (par. 4.9), the "white-list" includes activities that generally do not trigger an acting in concert conduct among different persons.

the company's management body or when they make representations to the company's management body about company policies, practices or particular actions that the company might consider taking; *(b)* exercise certain statutory "minority" rights attached to their shares[22] and/or agree to vote in specific resolutions in the general meeting (aimed at protecting their minority corporate interest), in any case not affecting the appointment of members of the management body. Among the exempted resolutions the ECAs mentioned, for instance, the following: rejection of a related party transaction; approval (or rejection) of proposals concerning either directors' and auditors remunerations, or extraordinary transactions (including acquisition or disposal of assets, reduction of capital and/or share buy-back, capital increases, dividend distributions); other "monitoring" resolutions (such as the appointment and removal of auditors, appointment of special investigators, company's financial statements, company's policy in relation to the environment or any other matter relating to social responsibility or compliance with recognized standards or codes of conduct).

In the middle between the black-list and the white-list ECAs also identified a "grey-area" in which are placed cases of cooperation among shareholders in relation to the appointment of minority members of the management body of the target company. In such circumstances, certain further factors should be scrutinized in order to verify if the collaboration among shareholders pursue the intent of fostering an efficient minority action or the goal of a joint influence over the business and governance of the target company.[23]Only in the latter case the collaboration among shareholders does trigger the notion of the acting in concert

[22]Such as statutory rights to add items to the agenda of a general meeting; table draft resolutions for items included or to be included on the agenda of a general meeting; or call a general meeting, other than the annual general meeting.

[23]Such analysis looks at the following factors: (a) the nature of the relationship between the shareholders and the proposed member(s) of the management body; (b) the number of proposed members of the management body being voted for pursuant to a voting agreement; (c) whether the shareholders have cooperated in relation to the appointment of members of the management body on more than one occasion; (d) whether the shareholders are not simply voting together but are also jointly proposing a resolution for the appointment of certain members of the management body; and (e) whether the appointment of the proposed member(s) of the management body will lead to a shift in the balance of power in such management body.

activity.

The European framework confirm that policymakers could follow different approaches in order to identify a relevant "acting in concert" conduct, ranging from the establishment of exhaustive or non-exhaustive lists of circumstances in which persons are deemed or presumed to act in concert, to the establishment of a list of activities where cooperation among shareholders will not, by itself, lead to a conclusion that such persons are acting in concert. However, as the ECAs correctly observed, there are no grounds that would render one policy option preferable to another, on a standalone basis, considering that, on one side, identifying factors which might indicate that persons are acting in concert enhance supervisory convergence, but, on the other side, leaving the national supervisory authorities with the flexibility to deal with specific circumstances on a case-by-case basis would enable the supervisors to judge each case on its own merits.

However, the legal framework concerning the acquisition of material stakes in banks and other supervised entities shows relevant differences compared with other notions of acting in concert disseminated in the EU legislative framework. First, the notification requirements set forth by the Acquisition Directive are triggered even if the increase of the relevant shareholding would not cause a change of control over the supervised entity, considering that such authorizations aim at protecting the transparency and stability of companies running activities of public interest.[24] Thus, the scope of the "acting in concert" is broader than in other EU legal framework, so that it includes not only contractual cooperation among shareholders concerning shares actually owned by them, but also the converging "decision" to exercise their respective corporate rights (not limited to the voting

[24]As pointed out by PELLEGRINI, *Financial derivatives. regulation and disputes in the Italian legal order*, in *Law and Economics Yearly Review*, 2013, vol. II, p. 376, as a consequence of the financial crisis there is now a tendency to abandon traditional forms of self-regulation of intermediaries in favour of an increase in public control to guarantee the protection of the diverse public and private interests that underlie the functioning of the financial markets. In this respect see also CAPRIGLIONE and SEMERARO, *Financial Crisis and Sovereign Debt. The European Union between Risks and Opportunities*, in *Law and Economics Yearly Review*, 2012, vol. I, p. 4 s.; CAPRIGLIONE and SACCO GINEVRI, *Politics and Finance in the European Union. The Reasons for a Difficult Encounter*, Wolters Kluwer, 2016, p. 81 s.

rights)[25] independently from the fact that this decision is «*taken before or after the time the relevant persons decide to purchase shares in the firm*».[26]

3. The notion of "persons acting in concert" plays a relevant role also in the context of transactions in control over public companies, since in such environment its scope indirectly impacts on the tradability of listed shares and, therefore, on certain financial markets' dynamics.[27]

Article 2, par. 1, lett. d, of the Takeover Bids Directive expressly define "persons acting in concert" as any natural or legal persons who cooperate with the offeror or the offeree company on the basis of an agreement, either express or tacit, either oral or written, «*aimed either at acquiring control of the offeree company or at frustrating the successful outcome of a bid*».[28]

Such a notion has been set forth by the Takeover Bids Directive in order to expand the scope of the events triggering an obligation to launch a mandatory tender offer over the entire share capital of target listed companies. As well known, the mandatory bid rule mainly aims at spreading the "controlling premium" paid by the new controlling entity among all the existing shareholders of the target company who are not interested in maintaining their equity-

[25]This view has been shared by member states enacting these provisions. See for instance FSA, *Handbook, SUP 11, Annex 6G, Aggregation of holdings for the purpose of prudential assessment of controllers*, available at *www.fsa.gov.uk*, 2016 [where the authority observed that «*[w]hile the rights 'linked to' shares for these purposes are most likely to be voting rights, persons may be 'acting in concert' where they decide to exercise other rights related to shares, either in addition to or instead of rights attached to voting power, in accordance with an agreement made between them* »]. In this respect see GHETTI, *Acting in Concert in EU Company Law: How Safe Harbours can Reduce Interference with the Exercise of Shareholder Rights*, in *ECFR*, 2014, p. 604 ss.

[26]See FSA, *Handbook, SUP 11, Annex 6G, Aggregation of holdings for the purpose of prudential assessment of controllers*, available at *www.fsa.gov.uk*, 2016.

[27]See, among others, ENRIQUES, GILSON and PACCES, *The Case for an Unbiased Takeover Law (with an Application to the European Union)*, in *Harvard Business Law Review*, 2014, p. 86 s.

[28]Member States have adopted different definitions of "persons acting in concert". Some have replaced the notion set forth by Article 2.1, par. 1, let. D, of the Takeover Bids Directive, while others have also incorporated, in various ways, the broader concept of «*the concerted exercise of voting rights by shareholders*» with a view to pursuing a common policy or strategy in relation to the company or exercising a dominant influence over it, taking into account the dirrefenr notion of acting in concert provided by Article 10 of the Transparency Directive (on which see next par. 4) [more details in ESMA, *Information on shareholder cooperation and acting in concert under the Takeover Bids Directive – 1st update*, June 2014, available at *www.esma.europa.eu*, p. 15].

investment in such listed company.[29]

In particular, pursuant to Article 5, par. 1, of the Takeover Bids Directive, a mandatory tender offer must be launched when a natural or legal person, as a result of his/her own acquisition – or the acquisition by "persons acting in concert" with him/her – directly or indirectly exceeds certain thresholds of voting rights in a target listed company (added to any existing holdings of those securities of his/hers and the holdings of those securities of "persons acting in concert" with him/her) giving him/her control of that company.

Therefore, where the securities held by a group of shareholders carry voting rights, which in total are below the national threshold for "control", there are no immediate bid consequences for those shareholders, even if they are regarded as persons acting in concert.[30] On the other hand, a mandatory tender offer obligation is triggered if one or more of those shareholders *acquires* more voting securities so that *(a)* either in total the securities held by the group carry the specified percentage of voting rights that confers "control" under national takeover rules, *(b)* or the pre-existing controlling structure over target has been significantly modified.

While in certain EU countries the obligation to launch a mandatory tender offer merely arises from when shareholders act in concert in circumstances where, independently, they have already acquired securities in that company which, in to-

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[29]See WYMEERSCH, *A New look at the Debate about the Takeover Directive*, available at *www.ssrn.com*, p. 4 s.; CENZI VENEZZE, *The Costs of Control-enhancing Mechanisms: How Regulatory Dualism Can Create Value in the Privatisation of State-owned Firms in Europe*, in *EBOR*, 2014, p. 499 s.

[30]See EUROPEAN COMMISSION, *Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Application of Directive 2004/25/EC on takeover bids*, June 2012, available at: *www.europa.eu*, p. 9 [where the European Commission stated that "*the concept of "acting in concert" could be clarified on EU level, in order to provide more legal certainty to international investors as to the extent to which they can cooperate with each other without being regarded as "acting in concert" and running the risk of having to launch a mandatory bid*"]; EUROPEAN PARLIAMENT, *Resolution of 21 May 2013 on the application of Directive 2004/25/EC on takeovers bids*, available at *www.europarl.europa.eu* [where the European Parliament observed that: «*the concept of 'acting in concert' is essential when calculating the threshold that triggers the launch of a mandatory bid, and understands that Member States have transposed the definition provided for in the Directive differently*»].

tal, carry the specified percentage of voting rights that confers "control" under national takeover rules (*i.e.* even though no further securities have been acquired)[31], in other EU jurisdictions no mandatory bid obligation will arise initially when the shareholders come together to act in concert in such circumstances.[32] In the middle stays the Italian regime, pursuant to which a mandatory tender offer obligation will arise when shareholders acting in concert exceed the relevant threshold as a result of acquisitions of securities carrying voting rights made by any of them if they are made in the twelve months before they come together to act in concert (or at any time after they come together to act in concert).[33]

In a nutshell, for the purpose of the Takeover Bids Directive the acquisition of a block-holding which generally grants the "controlling powers" over a listed target triggers the obligation – for the new controlling entity – to launch a mandatory tender offer rule addressed to the remaining shareholders of target. Given the above, a change of control becomes relevant under such perspective even if the new controlling entity is composed by two or more persons acting in concert or, alternatively, if the support of such persons caused or fostered the acquisition if the controlling stake by one or more of them.

Therefore, since the essence of a control influence requires the disposal of voting rights attached to the securities issued by the relevant target company, for the purpose of the takeover bids' regulations an acting in concert relationship produces legal consequences when it affect the distribution of the voting rights in the shareholders' meeting of the target company.

However, EU and domestic authorities recognize that shareholders may wish to cooperate in several ways for the purpose of exercising good corporate

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[31]These Member States are Austria, Croatia, the Czech Republic, Finland, France, Germany, Greece, Lithuania, the Netherlands, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain and Sweden [see ESMA, *Information on shareholder cooperation and acting in concert under the Takeover Bids Directive – 1st update*, June 2014, available at *www.esma.europa.eu*, p. 14].

[32]This is the situation in Belgium, Cyprus, Denmark, Hungary, Iceland, Ireland, Luxembourg, Norway and the United Kingdom [more details in K.J.HOPT, *European Takeover Reform of 2012/2013 –Time to Re-Examine the Mandatory Bid*, in *EBOR*, 2014, p. 185 ss.].

[33]See, among others, MOSCA, *Azione di concerto e OPA obbligatoria*, Milano, EGEA, 2013, p. 1 s.; TUCCI, "*Acquisto di concerto" e "azione di concerto"*, in *Riv. dir. comm.*, 2010, I, p. 915 s.

governance and without seeking to acquire or exercise control over the companies in which they have invested, for instance discussing together issues that could be raised with the board, making representations to the board on those issues, or tabling or voting together on particular resolutions.[34] In such circumstances ESMA clarified that cooperation among shareholders will not «*in and of itself*» lead to a conclusion that they are acting in concert for the purposes of the Takeover Bids Directive[35], provided that if shareholders cooperate to engage in an activity which is not included on the white-list, that fact will not, in and of itself, mean that those shareholders will be regarded as persons acting in concert.[36]

This promotes an open shareholders' activism, in line with the EU and international trends and policy-makers' goals aimed at fostering the effective engagement of shareholders in listed companies and financial institutions[37] for the purpose of strengthening their monitoring actions vis-à-vis the appointed directors and managers and, thus, in the interest of a long-term development of the participated entity.[38] In other words, the encouragement of investor engagement

[34]As pointed out by GHETTI, *Acting in Concert in EU Company Law: How Safe Harbours can Reduce Interference with the Exercise of Shareholder Rights*, in *ECFR*, 2014, p. 599, excessively broad acting-in-concert rules would clearly have a detrimental effect on monitoring cooperation considering that activist shareholders could have to comply with burdensome transparency requirements, and, in certain circumstances, would be forced to launch a costly mandatory bid.

[35]In this terms see the white-list drafted by ESMA, *Information on shareholder cooperation and acting in concert under the Takeover Bids Directive – 1st update*, June 2014, available at *www.esma.europa.eu*, p. 5 ss.

[36]The above mentioned white-list has been substantially mirrored by the one drafted by the ESAs for the purposes (highlighted in the previous par. 2) of the prudential assessment of acquisitions and increases of qualifying holdings in the financial sectors.

[37]See, among others, BEBCHUK, *The Myth that Insulating Boards Serves Long-Term Value*, in *Colum. Law Rev.*, 2013, p. 1637 s.; BEBCHUK et al., *The Long-Term Effects of Hedge Fund Activism*, in *Colum. Law Rev.*, 2015, p. 1085 s.; KASTIEL, *Against All Odds: Hedge Fund Activism in Controlled Companies*, in Colum. Bus. Law Rev., 2016, 60 s.; COFFEE JR. and PALIA, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance* available at *www.ssrn.com*, 2015; PACCES, *Exit, Voice and Loyalty from the Perspective of Hedge Funds Activism in Corporate Governance*, in *Erasmus Law Review*, 2016, p. 199 s..

[38]See in this respect GOSHEN and SQUIRE, *Principal Costs: A New Theory for Corporate Law and Governance*, available at *www.ssrn.com*, p. 3 s.; CREMERS, GIAMBONA, SEPE and WANG, *Hedge Fund Activism and Long-Term Firm Value*, available at *www.ssrn.com*, 2015, p. 5 s.; SACCO GINEVRI, *The Rise of Long-Term Minority Shareholders' Rights in Publicly Held Corporations and Its Effect on Corporate Governance*, in *EBOR*, 2011, p. 587 s.

both at European[39] and national level (mainly through voluntary codes and other soft-pressure tools), seems likely to increase shareholders' activism, which will become a stable element of the corporate background, to be taken into account by boardroom and companies.[40]

An interesting example of multiple level regulation of the "acting in concert" issue – under a takeover bids' perspective – is offered by the Italian Legislative Decree No. 58 of 1998 (the "Italian Securities Act") at Articles 101-*bis*, 109 and 122 (implementing the Takeover Bids Directive). The "acting in concert" notion provided by such provisions is based on a general principle which, in turn, is further developed by a black-list of persons *deemed* "acting in concert", by a grey-list of persons *presumed* acting in concert and finally by a white-list of exempted relationships.

The general principle – stated by pursuant to Article 101-*bis*, par. 4, of the Italian Securities Act – states that "person acting in concert" mean persons «*who act on the basis of an explicit or tacit agreement, verbal or in writing, even if invalid or without effects, for the purpose of acquiring, maintaining or strengthening control over the [listed] target or for the purpose of frustrating a tender offer or an exchange tender offer*».[41]

Without prejudice to the above, *in any event* the following persons are considered to be acting in concert (by a *iuris et de iure* presumption): *(i)* the parties of a shareholders' agreement, even if void, mentioned under Article 122 (paragraphs

[39] See, for instance, the *Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement* and *Directive 2013/34/EU as regards certain elements of the corporate governance statement*.

[40] See CAPRIGLIONE and MASERA, *Bank Corporate Governance: A New Paradigm*, in *Open Review of Management, Banking and Finance*, 2016, p. 5 s., highlighting the «*significant role of the shareholders in the definition of banking's strategies as well as in the identification of those who must be held responsible for the corporate management*».

[41] According to the UK Takeover Code, par. C1, September 12, 2016, persons acting in concert comprise persons who, pursuant to an agreement or understanding (whether formal or informal), co-operate to obtain or consolidate control (as defined below) of a company or to frustrate the successful outcome of an offer for a company. A person and each of its affiliated persons will be deemed to be acting in concert all with each other.

1 and 5, letters a, b, c and d) of the Italian Securities Act 42, *(ii)* any entity, its controlling entity and its controlled companies, *(iii)* companies subject to joint control, and/or *(iv)* a company and its directors, members of the management board or of the supervisory board or general managers (the "black-list").

Just a presumption (*iuris tantum*) of "acting in concert is triggered in case of familiar relationships[43]; and/or between a person and his/her financial advisors for transactions relating to the issuer (the "grey-list").[44]

In the following circumstances a cooperation among persons is not considered, in itself, a relevant acting in concert, being index of collaboration among minority investors: *(a)* coordination among shareholders for the purpose of implementing the actions and exercising the rights typically granted by the Italian law to minority shareholders; *(b)* agreements for the submission of slates of candidates for the election of the corporate bodies, provided that such slates include a number of candidates that is less than half of the total members to be elected (or are designated to achieve a representation of minority interests); *(c)* cooperation

[42]All the shareholders' agreements indicated under Article 122, paragraphs 1 and 5, letters a), b), c) and d) of the Italian Securities Act trigger a *iuris et de iure* presumption of "acting in concert" among the contractual parties [*i.e.* agreements, in whatsoever form concluded, that: a) create obligations of consultation prior to the exercise of voting rights in companies with listed shares or companies that control them; b) set limits on the transfer of the related shares or of financial instruments that entitle holders to buy or subscribe for them; c) provide for the purchase of shares or financial instruments referred to in paragraph b); d) have as their object or effect the exercise, jointly or otherwise, of a dominant influence on such companies]. However, Article 122, paragraph 5, letter d)-*bis* of the Italian Securities Act mentions an additional class of shareholders' agreements, which includes those agreements aimed at favoring or at frustrating the achievement of the goals of a tender offer over a listed company. Such class of shareholders' agreements is not "literally" included among those classes triggering *iuris et de iure* the "acting in concert" presumption (mentioned by Article 101-*bis*). Thus, in such circumstances, an "acting in concert" conduct may be triggered only if the specific agreement triggers the general notion of acting in concert, such as in the case that the agreement's provisions show the mutual intent of the parties to acquire, maintain or strengthen a control position over the Target. It shall be noted that – according to Article 122 of the Italian Securities Act – a shareholders' agreement is considered executed by the parties for the purpose of the acting in concert (and of the disclosure duties) even if the agreement has been reached by them either orally or *per facta concludentia*.

[43]Such as in case of a person and his/her spouse, cohabiting partner, persons related by consanguinity or affinity, and direct relatives and relatives up to the second degree, and children of his/her spouse or cohabiting partner.

[44]Just in case such advisors (or companies belonging to their group), after awarding the appointment or in the month prior, had made purchases of issuer securities outside the trading on own behalf carried out according to ordinary operations and at market conditions. See Art. 44-*quater*, par. 1, of Consob Regulation on issuers No. 11971 of 1999, as amended from time to time.

among shareholders to prevent the approval of a resolution of the shareholders' meeting on corporate bodies compensations, related parties' transactions, authorization to compete for directors or derogation to the passivity rule; or *(d)* cooperation among shareholders to approve a shareholders' meeting resolution concerning derivative actions, proposals coming from minorities or converging voting on minority slates.[45]

In short, the Italian model implements - in a sophisticated manner - the main guidelines developed at the EU level, considering that on the one hand it leave flexibility to the competent authority to deal with the specific circumstances from case to case but, on the other hand, indicate to the relevant or potential shareholders the activities which are always considered an index of acting in concert, allowing them to structure their transactions and agreements either in a safe way or sharing since the beginning costs and responsibilities arising from a mandatory tender offer over an Italian listed company.

4. As anticipated above, Article 10, par. 1, let. a), of the Transparency Directive (on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market) – concerning in particular the acquisition or disposal of major proportions of voting rights – contains another sectoral notion of "acting in concert", providing that the notification duties mentioned therein apply to a natural person or legal entity to the extent it is entitled to acquire, to dispose of, or to exercise voting rights in the issuer. For such a purpose the EU legislator includes also «*voting rights held by a third party with whom that person or entity has concluded an agreement, which obliges them to adopt, by concerted exercise of the voting rights they hold, a lasting common policy towards the management of the issuer in ques-*

[45] See Art. 44-*quater*, par. 1, of Consob Regulation on issuers N. 11971 of 1999, as amended from time to time.

tion».[46]

In other terms, when a shareholder – or persons acting in concert - exceeds certain voting right thresholds as a consequence of the acquisition or disposal of shares (or as a result of events changing the distribution of voting rights), such circumstance shall be made public. Also in this context when the cooperation is based only on discussions among shareholders of a listed company, there is no acting in concert as there is no agreement among them, but when there is such an agreement we may face a signal that the shareholders have moved from simple cooperation to activism.[47]

For the purpose of the Transparency Directive, the notification duties aim at identifying who is controlling the way in which voting rights are exercised, both by detecting additional voting rights that shareholders may have under certain circumstances listed in Art. 10 of such directive[48] (for the purposes of aggregation with the shares they hold) and by identifying an additional set of natural persons or legal entities that need to make notifications on major entitlements to voting rights (i.e. persons acting in concert).[49]

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[46]Such notion of acting in concert substantially mirrors that established by Article 92(c) of the Directive 2001/34/EC of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities, published in O.J.E.U. n. L 184, July 6, 2001, p. 1 ss.

[47]MAZARS, *Transparency Directive Assessment Report*, available at *www.europa.eu*, p. 109 s.

[48]Pursuant to Art. 10 of the Transparency Directive, the notification requirements shall also apply to a natural person or legal entity to the extent it is entitled to acquire, to dispose of, or to exercise voting rights in any of the following cases or a combination of them: (…) (b) voting rights held by a third party under an agreement concluded with that person or entity providing for the temporary transfer for consideration of the voting rights in question; (c) voting rights attaching to shares which are lodged as collateral with that person or entity, provided the person or entity controls the voting rights and declares its intention of exercising them; (d) voting rights attaching to shares in which that person or entity has the life interest; (e) voting rights which are held, or may be exercised within the meaning of points (a) to (d), by an undertaking controlled by that person or entity; (f) voting rights attaching to shares deposited with that person or entity which the person or entity can exercise at its discretion in the absence of specific instructions from the shareholders; (g) voting rights held by a third party in its own name on behalf of that person or entity; (h) voting rights which that person or entity may exercise as a proxy where the person or entity can exercise the voting rights at its discretion in the absence of specific instructions from the shareholders.

[49]CESR, *Final Technical Advice on Possible Implementing Measures of the Transparency Directive*, CESR/05-407, June 2005, p. 29. As pointed out by ENRIQUES, GARGANTINI and NOVEMBRE, *Mandatory and Contract-Based Shareholding Disclosure*, in *Uniform Law Review*, 2010, p. 720, ownership disclosure ("OD") «*is particularly relevant both for the market and for*

In a nutshell, the objective of the notification requirements in the Transparency Directive is to disclose to the market major holdings of voting rights and continuing changes in such holdings, when the proportion of voting rights reaches, exceeds or falls below a notification threshold (even though shares are not acquired or disposed of).[50]

Under Art. 10(a) of the Transparency Directive, existing shareholders (or holders of voting rights) that enter into an *agreement* without acquiring additional voting rights are also covered by the notification duty set forth therein.[51] As pointed out by some commentators, these tools might help catch and aggregate undisclosed positions which formally belong to different actors [52], even if the notion at hand does not require *actual* concerted action (but only a binding obligation to act pursuant to a concert agreement) – being aimed at informing the market before the exercise of the voting rights – and cover only *voting* agreements concerning shares *already acquired* by the parties.[53]

In addition, the agreement must be aimed at establishing a *lasting common policy towards the management of the issuer,* implying a high degree of commitment with reference to the duration of the relationship.[54] Therefore, agreements without long-lasting effects or not addressed to influence the management of an

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the regulators in that it allows to understand who has or may have an influence over management, thus facilitating the monitoring of blockholders' use and abuse of control power. Also, OD allows investors to understand the nature of controlling blockholders and other significant shareholders. Most of the time, this constitutes key information to enable investors to make an informed assessment of firms' value». See also PEDERSEN and THOMSEN, *Ownership Structure and Value of the Largest European Firms: the Importance of Owner Identity*, in *Journal of Management and Governance*, 2003, p. 27 s.; ZETZSCHE, *Hidden Ownership in Europe: BAFin's Decision in Schaeffler v. Continental*, in *EBOR*, 2009, p. 115 s.

[50] CESR, *Final Technical Advice on Possible Implementing Measures of the Transparency Directive*, CESR/05-407, June 2005, p. 29.

[51] CESR, *Final Technical Advice on Possible Implementing Measures of the Transparency Directive*, CESR/05-407, June 2005, p. 29.

[52] See ENRIQUES, GARGANTINI and NOVEMBRE, *Mandatory and Contract-Based Shareholding Disclosure*, in *Uniform Law Review*, 2010, p. 723.

[53] See GHETTI, *Acting in Concert in EU Company Law: How Safe Harbours can Reduce Interference with the Exercise of Shareholder Rights*, in *ECFR*, 2014, p. 602 s.

[54] See GHETTI, *Acting in Concert in EU Company Law: How Safe Harbours can Reduce Interference with the Exercise of Shareholder Rights*, in *ECFR*, 2014, p. 602 s.; ENRIQUES, GARGANTINI and NOVEMBRE, *Mandatory and Contract-Based Shareholding Disclosure*, in *Uniform Law Review*, 2010, p. 713 s.

issuer (such as, for instance, those concerning the payment of dividends or the removal of a minority member of the Board) do not trigger the requirement above mentioned.[55]

5. The notion of "persons acting in concert" is widely used also by the US securities regulation, according to which requiring immediate disclosure of the accumulation of outside blocks of public-company stock will improve market transparency.[56] In particular, under Section 13(d) of the U.S. Securities Exchange Act of 1934 – as amended by the Williams Act of 1968 – any person who (after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is registered) exceeds 5 per centum of such class shall, within ten days after such acquisition must disclose certain information to the U.S. Securities and Exchange Commission ("SEC") as necessary or appropriate *in the public interest or for the protection of investors*.[57] The purpose of this rule is to enable investors to make intelligent investments decisions by providing them with information concerning shifts in corporate ownership which portend a change in control.[58]

In addition, pursuant to Section 13(d)(3) of the U.S. Securities Exchange Act of 1934, when two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a ''person'' for the purposes of this disclosure rule. This extension of the definition of "person" would prevent a group of persons who seek to pool their voting or other interests in the securities of an issuer from evading the provisions of the statute because no one

[55]MAZARS, *Transparency Directive Assessment Report*, available at *www.europa.eu*, p. 109 ss.
[56]See BEBCHUCK and JACKSON, *The Law and Economics of Blockholder Disclosure*, in *Harvard Business Law Review*, 2012, p. 109 s.; see also EMMERICH et al., *Fair Markets and Fair Disclosure: Some Thoughts on the Law and Economics of Blockholder Disclosure, and the Use and Abuse of Shareholder Power*, in *Harvard Business Law Review*, 2013, p. 135 s.
[57]If any material change occurs in the facts set forth in the statement filed with the Commission, an amendment shall be filed with the SEC, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
[58]See POWELL, *"Acquisitions" and "Groups" Under Section 13(d) of the Securities Exchange Act of 1934*, in *Boston College Law Review*, 1971, p. 149 s.

individual owns more than the relevant threshold of the securities. [59]

According to SEC Rule 13d–5(b)(1) «*[w]hen two or more persons agree to act together for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer, the group formed thereby shall be deemed to have acquired beneficial ownership (…) as of the date of such agreement, of all equity securities of that issuer beneficially owned by any such persons*».[60]

On July 18, 2011, the U.S. Court of Appeals, Second Circuit, rendered its decision in *CSX Corporation v. The Children's Investment Fund Management (UK) LLP*[61], clarifying the SEC rule mentioned above. In particular, the Second Circuit – reaffirming that the touchstone of a group within the meaning of section 13(d) is that the members combined in furtherance of a common objective[62] – recognized that whether a group exists under section 13(d)(3) of the Securities and Exchange Act turns on whether there is sufficient direct or circumstantial evidence to support the inference of a formal or informal understanding between members for the purpose of acquiring, holding, or disposing of securities.63 More in particular, the Second Circuit stated that SEC Rule 13d–5(b)(1) applies only to groups formed for the purpose of acquiring, holding, voting or disposing of securities of the target firm; therefore, according to the Court, such Rule does not encompass all "concerted action" with an aim to change a target firm's policies even while retaining an option to wage a proxy fight or engage in some other control transaction at a later time (indeed, the Rule does not encompass "concerted action" with a change of control aim that does not involve one or more of the specified acts).

Consistently, the SEC has also clarified that, in order for one party to a vot-

[59]In this sense see the section-by-section summary of the House Report on the of the Williams Act, reported in U.S. Code Cong. & Ad. News, 1968, p. 2811 ss. [«*This provision is designed to obtain full disclosure of the identity of any person or group obtaining the benefits of ownership of securities by reason of any contract, understanding, relationship, agreement or other arrangement*»].
[60]Available at *www.sec.gov*.
[61]Available at *www.whitecase.com*.
[62]See Roth v. Jennings, 489 F.3d 499, 508 (2d Cir.2007) (quoting Wellman v. Dickinson, 682 F.2d 355, 363 (2d Cir.1982)).
[63]See CSX I, 562 F.Supp.2d at 552 (quoting Hallwood Realty Partners, L.P. v. Gotham Partners, L.P., 286 F.3d 613, 617 (2d Cir.2002).

ing agreement to be treated as having or sharing beneficial ownership of securities held by any other party to the voting agreement, evidence beyond formation of the *group* would need to exist. For example, if a party to the voting agreement has the right to designate one or more director nominees for whom the other parties have agreed to vote, the party with that designation right becomes a beneficial owner of the securities beneficially owned by the other parties, because the agreement gives that person the power to direct the voting of the other parties' securities. Similarly, if a voting agreement confers the power to vote securities pursuant to a bona fide irrevocable proxy, the person to whom voting power has been granted becomes a beneficial owner of the securities under Rule 13d-3. Conversely, parties that do not have or share the power to vote or direct the vote of other parties' shares would not beneficially own such shares solely as a result of entering into the voting agreement.[64]

6. As previously pointed out, the definitions of "persons acting in concert", accompanied by examples provided by EU and US legislations as well as by national regulations, may be similar in wording across sectoral legislation but in practice there is no generally accepted definition of the notion of "acting in concert". Diversities in the notion of "acting in concert" can be explained also in light of the public interests protected by the different legal frameworks.

For instance, the "Takeover Bids Directive" and the "Transparency Directive" – as well as the disclosure duties set forth by the US Securities and Exchange Act – are mainly focused on voting rights, whereas the aim of the banking and financial framework is to also have transparency regarding the capital stakes in the target institution.[65]

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[64]See SEC, *Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting*, July 14, 2016, available at www.sec.gov.

[65]See Art. 22, par. 1, of the Directive 2013/36/EU of 26 June 2013 ("CRD4"). See in this respect CAPRIGLIONE, *Banking Governance within Company Interests and Prudential Regulation. (European Regulation and Specific Italian Rules)*, in *Law and Economics Yearly Review*, 2014, vol. I, p. 65 s.; SEPE, *A crisis, public policies, banking governance, expectations & rule reform: when*

This also explains why, under the Transparency Directive, also future concerted acquisitions fall within the definition of acting in concert, since comparing the provisions on the acting in concert set forth by the takeover bids and transparency legal frameworks with those provided by the prudential regulations comes to light a dissimilar scope justified by a different range of interests protected by the respective sets of rules.[66] In other words, while takeover provisions generally apply to changes in the control of the company and transparency rules typically look at the disposal of voting rights over a listed target, on the other hand stability and prudential provisions also include less shocking events, such as the non-control-granting and increase of a shareholder's stake in a company.[67]

Such picture is consistent with a consolidated legal regulation on the ownership structure of banks and other financial institutions, according to which the competent authorities are directed to appraise the suitability of the shareholders – and possibly to reject any particular shareholder structure as improper when the institution is being formed – for the purpose of enabling the supervisory authorities to assess, and as they see fit to reject, any inappropriate group structure that could be detrimental to safe and sound banking management.[68]

In conclusion, since "*the beginning of wisdom is the definition of terms*" (Socrates), the notion of "persons acting in concert" should remain flexible and adaptable to the different goals pursued in the various sets of rules by the anti-

will the horse go back to drink?, in *Law and Economics Yearly Review*, 2014, vol. I, p. 210 s.; BINDER, *The Banking Union and the Governance of Credit Institution: a Legal Perspective*, in *EBOR*, 2015, p. 478 s.; TRÖGER, *Organizational Choices of Banks and the Effective Supervision of Transnational Financial Institutions*, in *Tex. Intern. and Comp. Law Rev*., 2013, p. 177 s.

[66]For instance, as pointed put by the EUROPEAN COMMISSION, *Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Application of Directive 2004/25/EC on takeover bids*, June 2012, available at: *www.europa.eu*, p. 6, «*The broad definition of the term, included in the Acquisitions Directive's level 3 guidance, is however not used by regulators in connection with takeover bids*».

[67]See GHETTI, *Acting in Concert in EU Company Law: How Safe Harbours can Reduce Interference with the Exercise of Shareholder Rights*, in *ECFR*, 2014, p. 601 s.

[68]See EU COMMISSION, *Proposal for a Second Council Directive*, COM (87) 715 final, February 16, 1988, section 11.2(b); GRUSON and NIKOWITZ, *The Second Banking Directive of the European Economic Community and Its Importance for Non-EEC Banks, in Fordham International Law Journal*, 1988, p. 224 s.

avoidance provisions which introduced, from case by case, such subjective extension. However, other forms of collaboration among investors – not aimed at threatening the interests protected by the relevant financial regulations – should not be considered as “acting in concert” conducts for such a purpose, since an overreaching of activities triggering an acting in concert presumption might discourage an effective exercise of monitoring rights attached to minority stakes, thus affecting the best governance of financial institutions and public companies.

BEHAVIOURAL FINANCE AND MARKETS EFFICIENCY: IS THERE A DIALOGUE?

A preliminary reflection on Regulation 596/2014/EU

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ABSTRACT: *The paper analyzes the application of the market abuse regulation in Europe, by using tools taken not only from the "efficient capital markets theory" (ECMH) but also from "behavioral finance and economics theories". Indeed, even if ECMH represents the main pattern in Europe on market abuse regulation, this paper explores the possibility to use in such context instruments coming from other fields, without necessarily re-thinking the architecture of European market abuse regulation. Finally, this paper concludes that the approach suggested herein could lead to a positive improvement of regulation on market abuse in Europe also by reducing the risk of «over-shooting» or «under-shooting».*

1. Market abuse enters the arena of EU securities regulation in 2003, with Directive 2003/6/ EC ("MAD"), articulated, right from the start, into the two classical strands of the mandatory disclosure and insider trading regime, on the one side, and of market manipulation prevention and repression, on the other side.

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The process of reshaping European securities regulation following the financial crisis - according to the path traced by the Report drafted by the Commission de La Rosière - led, in 2014, to the replacement of MAD with EU Regulation 596/2014 ("MAR"), accompanied by Directive 2014/57/EU, which came into force on July 3, 2016.

Market abuse regulation has been the subject, over the past decades, of intense debate, both theoretical, as well as at a more practical level, mainly because of the complex implications that it carries[1]. The same foundations of market abuse regulation have been frequently challenged, questioning whether mandatory regimes should actually address those issues[2].

Within EU Law, it is, however, now a long establised belief that free market forces are unable by themselves to prevent market abuses. The trend in recent years is clearly in this direction: from the first nucleus of regulations regarding insider trading elaborated at national level (first crystallized, in EU Law, in Directive 89/592/ EEC), to MAD[3], the European Union has introduced pervasive rules (whether of a preventive, or repressive nature) intended to fight against market abuse, and foster the "proper" functioning of the market.

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[1]See, MOLONEY, *EU Securities and Financial Markets Regulation*, 3rd ed., Oxford University Press, 2014, 706.

[2] The classical debate concerns, in particular, insider trading, but also market manipulation regulation has been challenged on different grounds: for an overview, AVGOUELAS, *The Mechanics and Regulation of Market Abuse*, Oxford University Press, 2005, 30 ss.; FISCHEL and ROSS, *Should The Law Prohibit 'Manipulation' in Financial Markets*, (1991) 105 Harv. L. Rev. 503, pp.503-553.

[3]See FERRARINI, *The European Market Abuse Directive*, (2004) 41 CMLR 711; HANSEN, *MAD in A Hurry: The Swift and Promising Adoption of the EU Market Abuse Directive*, (2004) EBLR 183; REYNOLDS - RUTTER, *Market Abuse-A Pan European Approach*, (2004) 12 KFRC 306; COFFEY - OVERETT - SOMNIER, *The Market Abuse Directive-The First Use of the Lamfalussy Process*, (2003) JIBLR 370; ODAGESCU, *Analyses of the EU Market Abuse Directive: A Need to Review*, BULETINUL Vol. LX No.3/2008, pp.63-72; AA.VV., *Special Report: The EU's New Market Abuse Regime, World Securities Law Report, August 19, 2014*. China Securities Regulatory Commission, China Capital Markets Development Report, China Financial Publishing House, 2008; SIEMS, *The EU Market Abuse Directive: A Case-Based Analysis*, in *Law and Financial Markets Review*, Vol. 2, No. 1, 2008, pp. 39-49. On the process that led to MAR, SIEMS - NELEMANS, *The Reform of the EU Market Abuse Law: Revolution or Evolution*, in *The Maastricht Journal of European and Comparative Law*, vol 19 (2012), pp 195-205; RUEDIGER - KOCH, *Towards a Uniform European Capital Markets Law: Proposals of the Commission to Reform Market Abuse*, (February 2, 2012), Bucerius Law School Working Paper No. 1/2012.

MAR fits perfectly into the groove of the previous measures, introducing, however, some new elements, including the scope of its application, now extended to all instruments trades on Multilateral Trading Facilities, as well as to emission tradings.

As to insider trading, MAR remains rooted in settings what already emerged from earlier texts, confirming the three classical prohibitions that apply in this field: according to Article 14 a person shall not (i) engage or attempt to engage in insider dealing; (ii) recommend that another person engage in insider dealing or induce another person to engage in insider dealing, or (iii) unlawfully disclose inside information.

In particular, insofar as the prohibition on *engaging in trading*, Article 8 MAR provides that "insider dealing arises where a person possesses inside information and uses that information by acquiring or disposing of, for its own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates." A new provision, not contained in MAD (but not entirely clear) is the one on the basis of which "the use of inside information by cancelling or amending an order concerning a financial instrument to which the information relates where the order was placed before the person concerned possessed the inside information, shall also be considered to be insider dealing". On closer inspection, this is a provision with uncertain boundaries, as the unfairness of such conduct seems to be more directly linked to issues of market manipulation, rather than insider dealing.

Recommending that another person engage in insider dealing, or *inducing* another person to engage in insider dealing, arises where the person possesses inside information and:

(a) recommends, on the basis of that information, that another person acquire or dispose of financial instruments to which that information relates, or induces that person to make such an acquisition or disposal, or

(b) recommends, on the basis of that information, that another person cancel or amend an order concerning a financial instrument to which that information relates, or induces that person to make such a cancellation or amendment. The use of the recommendations or inducements referred to above, amounts to insider dealing where the person using the recommendation or inducement knows or ought to know that it is based upon inside information. (Article 8, paragraph 3).

Finally, *unlawful disclosure* of inside information arises where a person possesses inside information and discloses that information to any other person, except where the disclosure is made in the normal exercise of an employment, a profession or duties.

Confirming the basic architecture of MAD, MAR also sticks to the classical distinction between primary and secondary insiders (Article 8, paragraph 4, MAR). Primary insiders are, therefore, persons who possess inside information as a result of: (a) being a member of the administrative, management or supervisory bodies of the issuer or emission allowance market participant; (b) having a holding in the capital of the issuer or emission allowance market participant; (c) having access to the information through the exercise of an employment, profession or duties; or (d) being involved in criminal activities. Prohibitions on insider trading, however, also extend to secondary insiders, i.e. to any person who possesses inside information under circumstances other than those referred to above, where that person knows or ought to know that it is inside information.

Rules on market manipulation too are mostly replicated from MAD, including the structure of the relative definitions: there are cases which *do result* in manipulation; cases that might be manipulation, depending on the circumstances; there are also a set of possible "indicators" on the basis of which one may raise the suspect that the market is being manipulated.

2. Market abuse regulatory framework has been often investigated as a case of concretization by Law of specific economic theories on the functioning of

financial markets, and - in particular – of the efficient capial markets theory (ECMH). Although the latter, with its paradigms of rationality, does impact many topics that fall within European securities regulation, there is, in fact, no doubt that the impact of ECMH on market abuse regulation is indeed very significant: it is not by chance, therefore, that literature which deals with market abuse frequently refers to postulates of ECMH as the general framework and paradigm of the discipline[4].

In effect, and as we shall show, the Gordian knot between ECMH and market abuse is strong, and cannot be severed, at least in the current stauts of EU legislation. Unless one wishes to elaborate on purely prospective evolutions of the Law, this is a finding that has to be accepted.

However, there are nevertheless some elements that, already under the current set of EU market abuse discipline, may allow for a more articulate approach: schemes and lines of reasoning that come from other strands may prove useful and may be applied, albeit with caution, in the context of market abuse analysis, in particular those coming from behavioura finance theories .

ECMH is based on the idea that markets, and thereby investors, are basically rational in processing information and in taking investment decisions. Their behaviour incorporates and reflects all available information, and therefore markets are, tendentially, always in equilibrium: prices reflect and incorporate all available information, or at least most of it[5]. The assumptions at the basis of behavioural finance are, instead, quite different. This field of analysis, in fact,

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[4]Lately, AUSTIN, *What Exactly Is Market Integrity? An Analysis of One of the Core Objectives of Securities Regulation*, available at https://ssrn.com/abstract=2814986; LOKE, *From the fiduciary theory to information abuse: the changing fabric of insider trading law in the U.K., Australia, and Singapore*, (2006) 54 Am. J. Comp. L. 213; DAVIES, *The European Community's Directive on Insider Dealing: From Company Law to Securities Market Regulation* (1991) 11 OJLS 92.

[5]According to ECMH, stocks always trade at their fair value, making it impossible for investors to either purchase undervalued stocks or sell stocks for inflated prices. In short, there are however three variants of the hypothesis: "weak", "semi-strong", and "strong" form. The weak form of the ECMH claims that prices on already reflect all strong form past publicly available information. The semi-strong form of the ECMH claims both that prices reflect all publicly available information and that prices instantly change to reflect new public information. The strong form of the ECMH additionally claims that prices instantly reflect even hidden "insider" information.

studies how people actually might behave differently in their decisions, and how markets are, to some degree, inefficient.

The rise of behavioural economy is a phenomena of roughly the last three decades, which has run through finance, economics and, lately, law. Many analysis, in different fields - including securities regulation - now focus on the impact of biased judgments, depending on the context and topic to be analysed[6]. At least some of the leading theories on topics such as investor behaviour, portfolio management, investment advisors, corporate investment, are, in one way or the other, influenced by the impact and analysis of psychological factors.

We hereby set forth a preliminary reflection on the application of market abuse legislation in the EU, that might eventually further expand in the future into more articulated paths of research. Beyond the background settings, certain aspects of the most qualifying rules on market abuse might, in fact, be reconstrued by applying, albeit carefully, methods and concepts taken not only from ECMH, but from behavioura finance theories as well. This approach might contribute to lead to a better understanding of the current legal regime, and also reduce the risk of over or undershooting, without prejudicing the basic, fundamental framework of market abuse legislation. ECMH - although it rests on assumption that continue to be discussed quite intensely[7] – is still, and remains, the backbone of market abuse regulation, and of wider areas of securities regulation[8]. However, recognising that markets and investors might not always be ra-

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[6]See SHLEIFER, *Inefficient Markets: An Introduction to Behavioural Finance*, Oxford University Press, November 2003; BARBERIS - THALER, *A Survey of Behavioural Finance*, NBER Working Paper No. w9222, 2002, available at SSRN:https://ssrn.com/abstract=332266. For another alternative reading of market abuse rules, derived from antitrust legislation, see, amongst others, HAMBURGER, *Crowding the Market: Is There Room for Antitrust in Market Manipulation Case?*, in *Int. Trade Law and Reg.*, n. 4., 2015, 120.

[7]See, RUBENSTEIN, M. (2001), *Rational Markets: Yes or No? The Affirmative Case*, in *Fin. Analysts J.*, May-June 2001.

[8]See LANGEVOORT, notes that "What is impressive in the case against market efficiency is not the strength of any individual claim but their aggregate weight. As one proponent of market efficiency conceded recently "[t]he weight of paper in academic journals supporting anomalies is now much heavier than the evidence to the contrary. If far from dead, market efficiency is at least more contestable than ever": LANGEVOORT, *Behavioural Approaches to Corporate Law*, availa- ble at http://ssrn.com/abstract=2042009.

tional may prove useful and, at least, may stimulate reflections on the effective ability of the prevailing interpretation of market abuse legislation to effectively address all the issues involved.

3. As of today, and notwithstanding articulated debates, ECMH is still the most respected approach to describing the functioning of financial markets. ECMH is based on the assumption that markets are "rational". This model assumes that, when market participants receive new information, they update their opinions and act correctly. In such model, investors and market participants generally take decisions that are able to increase their subjective utility[9]. ECMH is, however, often ad odds with the way in which, concretely, financial actors seem to operate and markets seem to function.

Behavioural finance wishes to provide a way to overcome the difficulty in applying the rational approach to investors behaviour and markets functioning. The underlying assumption is that certain dynamics of financial markets are more intelligible if one assumes a paradigm of limited rationality. We do not intend to take position in the huge debate between the two approaches, that is far from being settled: on the one side, behavioural finance critics the rational markets model, and the ECM theory, as being unrealistic, and far from reality. On the other side, the basic criticism that behavioural finance meets is that, even if one were to consider that markets are not fully rational, in the end rational agents will act so as to neutralize, overtime, the effects of non-rational decisions, through a process generally described as "arbitrage". However, the counterargument to this is that, before rationality prevails, irrationality can have a lasting effect on price formation and market functioning.

Behavioural economists also widely employ the results of analysis and experiments based on cognitive psychology. This is sometimes regarded as a limitation, since excessive recourse to experimentation might hinder or limit the possibility of elaborating a general framework or a general theory: empirical approaches may, in fact, appear less coherent than theoretical ones. Experiments and empirical observation are used in order to detect, describe and possibly understand, the many different biases that human beings, and particularly investors, undergo in their decision-making process. Beliefs, emotions, preferences, habits, are just some of the many, multi-faceted factors that come into consideration. This field of research now treats many different subjects, and this is not the right place to even try to address all of them. However, as a way of introduction, reference can be made to some of the fundamental topics covered by behavioural finance analysis. What follows does not therefore mean to provide neither a comprehensive description of all the topics involved in behavioural finance generally (which is obvious), nor of all the topics that might, ultimately, be relevant in the context of market abuse analysis. Neither it is our intention here to discuss and develop fully the topics that have been selected, especially taking into account the wide and comprehensive range of literature available, and the consequent debate. The following paragraph should therefore be considered like a first-hand, very limited, inventory of certain possible points of observation of behavioural finance theories, that might prove useful in the interpretation of market abuse legislation.

4. Considering the various, multi-faceted phenomena that behavioural finance deals with, *limits to arbitrage* is probably one of the most important or, at least, it is often the starting point of significant strands of the debate. In a rational market model, the price of a security should correspond to its fundamental value, whereby prices reflect all the available information. ECMH assumes that “prices are right”: in an efficient market, no investment strategy can earn excess average returns, or average returns greater than those that reflect the underlying risk associated to different securities, or classes of securities. Behavioural finance looks at things differently: prices diverge normally from fundamental values, due to the presence of market actors that do not act in a perfectly efficient or rational way.

The difference between the two approaches is, naturally, very significant. According to ECMH, if there is a mispricing in the market, rational traders will act quickly in order to take advantage of the situation, and the price will return to its fundamental value[10]. If, for example, the price of a stock goes above its fundamental value because of the pressure activated by non-rational traders ("noise traders"), those investors who act rationally should see this as an opportunity to sell their securities. Those rational investors shall also engage in hedging activity, for example by building a long position on stocks that have similar risk-returns to the one that is being considered: due to the combination of these activities on the market, the price of the stock will therefore rapidly return at its correct level. However, one of the main objections to this scheme is that rational traders do not necessarily and always engage in activities that correct market mispricings, nor that they do this quickly and rapidly. This is because of various kinds of rigidities, including the fact that arbitrage can be expensive and risky.

Amongst the various risks that arbitrageurs face, one of the most relevant might be that good news is disclosed in the meantime, that may cause the price to increase further, thus raising the risk of depriving the trader of the extra profits. Naturally, this is the reason why arbitrageurs hedge their positions in correlated securities, but hedging strategies do not eliminate risk entirely. Also transaction costs may make it less interesting for arbitrageurs to take advantage of market mispricings: these might include commissions, spreads and regulatory constraints (such as, for example, restrictions on short sales). Some analysis also point to the fact that, overtime, arbitrageurs may prefer to trade in the same direction of noise traders, and therefore exacerbate mispricing[11].

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[10]See FRIEDMAN, *The case for flexible exchange rates*, in, Essays in Positive Economics, University of Chicago Press, 1953 pp. 157–203. For a different view, several years later, that has had wide resonance, SHLEIFER –VISHVY, *The Limits of Arbitrage*, in *The Journal of Finance*, Vol. 52, No. 1. (Mar., 1997), pp. 35-55.

[11]Some Authors consider an economy with positive feedback traders, who buy more of an asset in a certain period if it performed well the last period. If noise traders push an asset's price above its

Non-ECMH theories also question the fact that the presence of mispricing is not always immediately evident: it is, in fact, only in a few cases that this is effectively so. This is what behavioural finance has been calling the "joint hypothesis problem"[12], basically described as an issue that arises from the absence of a proper, universally valid model of discounting and price-evaluation.

Limited rationality, in behavioural models, calls into action various biases that may impact on people's choices, basically deriving from beliefs and preferences. Relationship between behavioural finance, psychology, experimental analysis and, lately, neurology is therefore quite intense.[13].

One of the main findings in this area is investors' *overconfidence*, i.e. the natural tendency of placing too much trust in one's own capacities and skills. Overconfidence, which seems to be a constant or at least very frequent, trait in human behaviour, may also arise from two other biases: *self-attribution* and *hindsight*.

Self-attribution is people's tendency to ascribe any success they have in some activity to their own talents, while blaming failure on bad luck, rather than on their incapacity. This may lead people to believe that they are very talented; investors may become overconfident after having had a period of success in in-

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fundamental value, arbitrageurs might not sell or short the asset. Rather, they might buy it, because they expect that more investors might buy the asset due to the earlier increase in price. This will, naturally, lead to further increases in prices. See DE LONG - SHLEIFER - SUMMERS - WALDMANN, *Positive feedback investment strategies and destabilizing rational speculation*, in *Journal of Finance*, 1990, 45:375−395.

[12]See FAMA, *Efficient capital markets: a review of theory and empirical work*, in *Journal of Finance*, 1970, 25:383−417; Ch. SAARI, *The Efficient Capital Market Hypothesis, Economic Theory and the Regulation of the Securities Industry*, in *Stanford Law Review*, May 1977, 29 Stan. L. Rev. 1031, pp.1031-1076.

[13]See CAMERER, *Individual decision making*, in, KAGEL and ROTH, eds., *Handbook of Experimental Economics*, Princeton University Press, 1995; RABIN, *Psychology and economics*, in *Journal of Economic Literature*, 1998, 36:11−46; KAHNEMAN - SLOVIC - TVERSKY, eds., *Judgment Under Uncertainty: Heuristics and Biases*, Cambridge University Press, 1982; KAHNEMAN - TVERSKY, eds., *Choices, Values and Frames*, Cambridge University Press, 2000; GILOVICH - GRIFFIN - KAHNEMAN, eds., *Heuristics and Biases: The Psychology of Intuitive Judgment*, Cambridge University Press, 2002. For a brief review of neurological aspects, J.J. XIAO, *Handbook of Consumer Finance Research*, New York, Springer, 2008.

vesting, and exceed in self-attribution. This may, in turn, lead to excessive trading, inadequate exposure to risk, and potential losses.

Overconfidence may also help to explain what seems as an anomaly, if tested against ECMH. In fact, one of the clearest indications of rational models of investing is that there should be low levels of trading: this is because, if rationality is effectively the rule, buyers would naturally be reluctant to buy from sellers. However, trading volume on capital markets is – if considered on a global basis - quite high, and several studies suggest that buyers and sellers effectively trade more than what would be justifiable on a rational basis. Certain analysis also seems to reach the conclusion that the result of excessive trading is sub-optimal, as the average return that investors receive is often, if not always, inferior to the return of selected benchmarks, not only because of transaction costs, but also because of poor investment decisions[14]. Overconfidence might, once again, provide at least a partial explanation to this: investors seem, actually, sometimes to believe that they possess sufficient information to trade. People who are more overconfident will, normally, trade more and, because of transaction costs, finally earn lower returns.

Hindsight bias is another bias frequently observed: this is the tendency that people may have to believe that they effectively did predict an event, after this has occurred. This may lead people to believe that they can effectively predict what shall happen in the future. This is a bias frequently observed in financial markets, and in investor behaviour, that naturally alters the way in which one should figure out the standard of an average investor[15].

Other biases observed by behavioural finance are *optimism* and *wishful thinking*. People seem to have a tendency to believe that they are better than

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[14]See BARBER - ODEAN, *Trading is hazardous to your wealth: the common stock performance of individual investors*, in *Journal of Financ*e, 2000, 55:773−806.

[15]On this tipic see GILSON –KRAAKMAN, *The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias* (October 2003). *Columbia Law and Economics Working Paper* No. 240; Stanford Law and Economics Olin Working Paper No. 270; Available at SSRN: https://ssrn.com /abstract=462786.

other in what they do[16], or that they can complete their tasks in a shorter period of time than what they can effectively achieve[17].

Belief perseverance is another form of cognitive bias: people seem to have a tendency to stick to their opinions for too long, and too tightly[18]. This is due to basically two factors: people are reluctant to take into account evidence that is against their beliefs, and when they do find such evidence they tend to undervalue or disregard it.

Some studies have highlighted another bias, which goes under the expression of the "anchoring" effect. People may sometimes form their judgements on arbitrary assumptions, and then correct this approach overtime. However, the adjustment takes place – at least some times - either two slowly, or in an insufficient way: people, therefore, tend to "anchor" too much to their initial evaluations.

Also *availability biases* may impact on peoples' choices: when taking decisions, relevant information is often looked for in one's memories, rather than in actual, current circumstances[19]. This can produce biases, because memories may not all be available, and fully retrievable. For example, more recent memories tend to obliterate or confuse old ones, and good memories may impact differently from bad memories.

The natural tendency to protect oneself from unpleasant situations, which is a typical cognitive bias that may lead to taking sub-optimal decisions, may make

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[16] See WEINSTEIN, *Unrealistic optimism about future life events*, in *Journal of Personality and Social Psychology*, 1980, 39:806–820.

[17] See BUEHLER - GRIFFIN - ROSS, *Exploring the planning fallacy: why people under- estimate their task completion times*, in *Journal of Personality and Social Psychology*, 1994, 67:366–381.

[18] See LORD - ROSS - LEPPER, *Biased assimilation and attitude polarization: the effects of prior theories on subsequently considered evidence*, in *Journal of Personality and Social Psychology*, 1979, 37:2098–2109.

[19] See KAHNEMAN - TVERSKY, *Judgment under uncertainty: heuristics and biases*, in *Science*, 1974, 185:1124–1131.

investors reluctant to sell securities that trade at a loss[20]. This attitude is difficult to explain fully on rational grounds, and basically two behavioural explanations have been suggested. The first is that investors may have a belief in mean-reversion, i.e. the fact that a stock's price will finally move back to the average price over time. A second explanation is based on prospect theory: people make decisions based on the potential value of losses and gains rather than on the final outcome, and people evaluate these losses and gains using certain heuristics. Another explanation which has been suggested is *narrow framing*: for example, an investor may suffer from narrow framing if he seems to make investment decisions without considering the context of his total portfolio. A narrow-framed investor may therefore ignore the potential benefits of diversification given his myopic approach to decision making.

Another cognitive bias is the so-called *disposition effect*: this relates to the tendency of investors to prefer selling securities whose price has increased, while keeping those that have dropped in value, hoping for a recovery[21].

Another cognitive identified in behavioural finance is *representativeness heuristic*[22]. People tend to judge the probability of an event by finding a 'comparable known' and assuming that the probabilities will be similar. The main fallacy of this is the assumption that similarity in one aspect, may lead to similarity in other aspects.

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[20]The phenomenon was labelled as the "disposition effect": SHEFRIN - STATMAN, *The disposition to sell winners too early and ride losers too long*, in *Journal of Finance*, 1985, 40:777−7 90.

[21]Disposition effect has been described as "[o]ne of the most robust facts about the trading of individual investors." The effect "has been documented in all the available large databases of individual investor trading activity and has been linked to important pricing phenomena such as post-earnings announcement drift and stock-level momentum. Disposition effects have also been uncovered in other settings—in the real estate market, for example, and in the exercise of executive stock options.": N. BARBERIS – W. XION, *What Drives the Disposition Effect? An Analysis of a Long-Standing Preference-Based Explanation*, in *The Journal of Finance*, vol. LXIV, n. 2, April 2009.

[22]See KAHNEMAN - TVERSKY, cit., 1124 ff.

The *law of small numbers* is another cognitive bias, represented by the belief that people might have that a small sample is representative of a much larger population[23].

Conservatism is another well-known bias: it occurs when people cling to their prior views or forecasts, disregarding or under-evaluating new information. Conservatism may lead to an overweight of old, non-updated information, and cause under reaction to new evidence, which is clearly against what one might expect on rational grounds. Conservatism-biased investors also generally react to new information more slowly than what one should expect. This, naturally, has an impact on several profiles of market abuse regulation, including the mandatory disclosure regime.

5. There are various aspects on which MAR actually confirms, or even strengthens, the lien between rules on market abuse and ECMH. One of the most significant is, naturally, the mandatory disclosure regime. Regulation 596/2014, in fact, stresses the role of mandatory disclosure by re-framing (albeit, under certain aspects, only formally) the notion of inside information and the duty of disclosure. Therefore, if one sees mandatory disclosure as a set of rules that pays homage to ECMH, the conclusion is that MAR tightens its relationship with theories on efficient markets.

As is known, provisions on mandatory disclosure as set out in MAR, are directly drawn from the ECJ Daimler Case[24], that clarified the scope of the duty to disclose under the 2003 MAD. On the basis of Article 7, paragraph 2, MAR, "infor-

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[23] See RABIN, *Inference by believers in the law of small numbers*, in *Quarterly Journal of Economics*, 2002, 117:775−816.

[24] Daimler (C-318/11 e C -19/11). On this decision see, amongst others, DI NOIA - GARGANTINI, *Issuers at Midstream: Disclosure of Multistage Events in the Current and in the Proposed EU Market Abuse Regime*, in *European Company and Financial Law Review*, Volume 9, Issue 4, Pages 484–529, December 2012; ENRIQUES – GILOTTA, *Disclosure and Financial Market Regulation*, European Corporate Governance Institute (ECGI) - Law Working Paper No. 252/2014; PAPADOPOULOS, *The Market Abuse Directive and the Notion of Inside Information - Case C-19/11 Markus Geltl v Daimler AG,* in *Hellenic Review of European Law*, Vol. 32, Issue 2-3 pages 257-264, 2012.

mation shall be deemed to be of a precise nature if it indicates a set of circumstances which exists or which may reasonably be expected to come into existence, or an event which has occurred or which may reasonably be expected to occur, where it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of the financial instruments or the related derivative financial instrument, the related spot commodity contracts, or the auctioned products based on the emission allowances". If this wording is very much in line with MAD, Article 7 adds that "in this respect in the case of a protracted process that is intended to bring about, or that results in, particular circumstances or a particular event, those future circumstances or that future event, and also the intermediate steps of that process which are connected with bringing about or resulting in those future circumstances or that future event, may be deemed to be precise information.".

Even if the situation before MAR was not identical in all Member States, the new wording of Article 7 might result in an expansion of the impact that the disclosure regime previously had in certain Member States. In fact, if there were few substantial differences in terms of identifying the perimeter of the notion of price-sensitive information in relation to the prohibition of insider trading, in certain Member States the duty of disclosure would have been triggered only when the information was sufficiently precise and defined, thus excluding information still in progress, or the intermediate phases of a lengthy process[25].

The new regulatory regime on market abuse is now built around a (formally) expanded notion of inside information, which may *clearly* trigger duty of disclosure even with regards to the intermediate stages of a process[26].

The new definition therefore widens the scope of mandatory disclosure obligations – an assumption perfectly in line, amongst other, with ECMH - even though the expansion effect is true only for those Member Stated that had

[25]Such was the case, for example, of how MAD had been implemented in Italy.
[26]See MOLONEY, *EU Securities and Financial Markets Regulation*, 3rd ed., Oxford, 2014, 717 .

adopted a more restrictive notion of price-sensitive information under the disclosure regime: or, rather, to those systems who had actually carved out, especially for multi-stage events, a dual notion of price-sensitive information, one relevant for the disclosure regime, and another for insider trading prohibitions[27].

The broad perimeter of MAR insofar as the disclosure regime is concerned required the introduction of certain carve-outs in order to limit its potential-over-reaching effect. The first, and most important relates to the new, quite complex, rules on the delay of disclosure of inside information: a context that has been re-defined by MAR, basically by reworking the scope of the provisions already contained in the MAD.

In this respect, Article 17 MAR now provides that "An issuer or an emission allowance market participant, may, on its own responsibility, delay disclosure to the public of inside information provided that all of the following conditions are met:

(a) immediate disclosure is likely to prejudice the legitimate interests of the issuer or emission allowance market participant;

(b) delay of disclosure is not likely to mislead the public;

(c) the issuer or emission allowance market participant is able to ensure the confidentiality of that information.

In the case of a protracted process that occurs in stages and that is intended to bring about, or that results in, a particular circumstance or a particular event, an issuer or an emission allowance market participant may on its own responsibility delay the public disclosure of inside information relating to this process, subject to points (a), (b) and (c) of the first subparagraph".

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[27]While these notes are basically concerned with disclosure connected to multi-stage events, MAR still maintains a double notion of price-sensitive information, in relation to other aspects of the definition of price-sensitive information different from multi-stage events. Therefore, the notion of price-sensitive information which applies in the context of the mandatory disclosure regime, and the one that applies in the context of insider trading prohibitions are different: for example, insider trading prohibitions also apply in relation to information which "indirectly" refers to the issuer or its financial instruments, while the disclosure regime only applies to direct information (see Article 7 vs. Article 17, MAR).

Where an issuer or emission allowance market participant has delayed the disclosure of inside information MAR provides a duty to inform the competent authority that disclosure of the information was delayed, and to provide a written explanation of how the conditions set out in this paragraph were met, immediately after the information is disclosed to the public. Alternatively, Member States may provide that a record of such an explanation is to be provided only upon the request of the competent authority[28]. Special rules on the delay of inside information notoriously apply under MAR to "credit institutions", in particular when: the disclosure of privileged information entails the risk of undermining the financial stability of the issuer and of the financial system; it is in the public interest to delay the communication; it is possible to ensure the confidentiality of information the competent authority has authorized the delay on the grounds that the above conditions are met.

Even though the decision to delay disclosure of certain sensitive information is subject to the concurrence of the conditions mentioned above, the continuing delay is permissible as long as the confidentiality of privileged information of the delay object is maintained. Hence, the need for the issuer to check the tightness over time of the confidentiality of the information, by implementing controls and appropriate monitoring.

A second carve-out from the general rules, is embodied by the new provisions on market sounding that allow, to a certain extent, selective disclosure of information that could, eventually or actually, be price-sensitive. Markets, in fact, already knew - in particular, in the aftermath of the Ehinorn affair [29] – the risks associated with an activity of pre-sounding (and its wall-crossing procedures), due to the interactions that may take place before the announcement of a transaction, in order to determine the interest of potential investors therein.

[28]On the subject, the Commission has recently issued the Implementing Regulation (EU) 2016/1055 as regards the technical means for appropriate public disclosure of inside information and to delay the public disclosure of inside information.
[29]Cfr. FSA, Press Release, FSA/PN/005/2012, 25 Jan 2012.

Market soundings may, however, be useful for the proper functioning of capital markets, even though they naturally reflect a situation which is far from being in line with ECMH assumptions, basically because it tolerates the existence of asimmetries of information. This is made clear by Whereas (12) MAR, that sets out that market soundings are “a highly valuable tool to gauge the opinion of potential investors, enhance shareholder dialogue, ensure that deals run smoothly, and that the views of issuers, existing shareholders and potential new investors are aligned. They may be particularly beneficial when markets lack confidence or a relevant benchmark, or are volatile. Thus the ability to conduct market soundings is important for the proper functioning of financial markets and market soundings should not in themselves be regarded as market abuse”.

6. Also the provisions of MAR aimed at prohibiting market manipulations are solidly grounded in ECMH: MAR, once again confirming the previous approach of MAD, assumes a market model that is, basically, set to work upon rules drafted on efficient capital markets models.

Article 15 MAR sets out that “A person shall not engage in or attempt to engage in market manipulation. The expression "market manipulation" ecompasses articulate behaviors, whose common feature is the distorted use (“manipulation") of the mechanisms on which markets function: spreading false information which may influence the behaviour investors; performing transactions whose effect is to disrupt the regular dynamics of the market; fictitious transactions, carried out in order to provide the appearance of conditions not otherwise available on the market (prices, quantities traded, etc.), or other conducts that might have similar objectives or effects.

The identification of the conduct that may fall within the notion of "market manipulation" is far from being unproblematic. Defining the boundary between normal speculative activity that takes place on the markets (in itself lawful) and conducts which, in turn, must be censored, demands and requires not only a clear identification of the conduct itslef, but also an evaluation of the upstream model on the basis of which a certain conduct should be censored. The substrate of the discipline of manipulation, therefore, lies not only in the general legal concepts of fraud, abuse, deceits, etc., but also in economic theories on the functioning of securities markets and, in this context, especially in ECMH": for this reason, market manipulation is an area in which conomic analysis and legal aspects are inseparably connected.

However, the identification of manipulative practices is far from offering elements always clear or suitable to unequivocally identify manipulative conducts: the notions of "abnormal levels", "artifice", "deception", etc. necessarily require further specification, to be held in the light of the securities market framework that one assumes as the foundation of market abuse discipline.

The approach offered by MAR on this point is, once again, essentially in line with the pre-existing Directive. MAR identifies conducts that would be considered as abuses[30]. Annex I also presents a list of indices to be considered in order to establish the existence of a manipulation[31], neither exhaustive nor conclusive.

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[30]Article 12, paragraph 1, MAR, sets out that market manipulation shall comprise the following activities: (a) entering into a transaction, placing an order to trade or any other behaviour which: (i) gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument, a related spot commodity contract or an auctioned product based on emission allowances; or (ii) secures, or is likely to secure, the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances at an abnormal or artificial level, unless the person entering into a transaction, placing an order to trade or engaging in any other behaviour establishes that such transaction, order or behaviour have been carried out for legitimate reasons, and conform with an accepted market practice as established in accordance with Article 13; (b) entering into a transaction, placing an order to trade or any other activity or behaviour which affects or is likely to affect the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances, which employs a fictitious device or any other form of deception or contrivance; (c) disseminating information through the media, including the internet, or by any other means, which gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument, a related spot commodity contract or an auctioned product based on emission allowances or secures, or is likely to secure, the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances at an abnormal or artificial level, including the dissemination of rumours, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading; (d) transmitting false or misleading information or providing false or misleading inputs in relation to a benchmark where the person who made the transmission or provided the input knew or ought to have known that it was false or misleading, or any other behaviour which manipulates the calculation of a

benchmark.
On the basis of Article 12, paragraph 2 the following behaviour shall, inter alia, be considered as market manipulation:
(a) the conduct by a person, or persons acting in collaboration, to secure a dominant position over the supply of or demand for a financial instrument, related spot commodity contracts or auctioned products based on emission allowances which has, or is likely to have, the effect of fixing, directly or indirectly, purchase or sale prices or creates, or is likely to create, other unfair trading conditions;
(b) the buying or selling of financial instruments, at the opening or closing of the market, which has or is likely to have the effect of misleading investors acting on the basis of the prices displayed, including the opening or closing prices;
(c) the placing of orders to a trading venue, including any cancellation or modification thereof, by any available means of trading, including by electronic means, such as algorithmic and high-frequency trading strategies, and which has one of the effects referred to in paragraph 1(a) or (b), by:
(i) disrupting or delaying the functioning of the trading system of the trading venue or being likely to do so;
(ii) making it more difficult for other persons to identify genuine orders on the trading system of the trading venue or being likely to do so, including by entering orders which result in the overloading or destabilisation of the order book; or
(iii) creating or being likely to create a false or misleading signal about the supply of, or demand for, or price of, a financial instrument, in particular by entering orders to initiate or exacerbate a trend;
(d) the taking advantage of occasional or regular access to the traditional or electronic media by voicing an opinion about a financial instrument, related spot commodity contract or an auctioned product based on emission allowances (or indirectly about its issuer) while having previously taken positions on that financial instrument, a related spot commodity contract or an auctioned product based on emission allowances and profiting subsequently from the impact of the opinions voiced on the price of that instrument, related spot commodity contract or an auctioned product based on emission allowances, without having simultaneously disclosed that conflict of interest to the public in a proper and effective way;
(e) the buying or selling on the secondary market of emission allowances or related derivatives prior to the auction held pursuant to Regulation (EU) No 1031/2010 with the effect of fixing the auction clearing price for the auctioned products at an abnormal or artificial level or misleading bidders bidding in the auctions.
[31]These are: a) the extent to which orders to trade given or transactions undertaken represent a significant proportion of the daily volume of transactions in the relevant financial instrument, related spot commodity contract, or auctioned product based on emission allowances, in particular when those activities lead to a significant change in their prices; b) the extent to which orders to trade given or transactions undertaken by persons with a significant buying or selling position in a financial instrument, a related spot commodity contract, or an auctioned product based on emission allowances, lead to significant changes in the price of that financial instrument, related spot commodity contract, or auctioned product based on emission allowances; c) whether transactions undertaken lead to no change in beneficial ownership of a financial instrument, a related spot commodity contract, or an auctioned product based on emission allowances; d) the extent to which orders to trade given or transactions undertaken or orders cancelled include position reversals in a short period and represent a significant proportion of the daily volume of transactions in the relevant financial instrument, a related spot commodity contract, or an auctioned product based on emission allowances, and might be associated with significant changes in the price of a financial instrument, a related spot commodity contract, or an auctioned product based on emission allowances; e) the extent to which orders to trade given or transactions undertaken are concentrated within a short time span in the trading session and lead to a price change which is subsequently reversed; d) the extent to which orders to trade given change the representation of the best bid or offer prices in a financial instrument, a related spot commodity contract, or an auctioned product

7. Most, if not all, of the cornerstone provisions of MAR can be read through the magnifying glasses of ECMH.

Reference to markets efficiency is not only a very clear cultural option of MAR, but it is directly set out in various provisions of the Regulation, starting from Whereas (2) which links market efficiency to market integrity by stating that "An integrated, efficient and transparent financial market requires market integrity. The smooth functioning of securities markets and public confidence in markets are prerequisites for economic growth and wealth. Market abuse harms the integrity of financial markets and public confidence in securities and derivatives.[32]"

Reference to market efficiency is also taken into account in several other provisions of the Regulation, for example, by Article 13, on accepted market practices. In evaluating a possible accepted market practice, competent authorities should in fact consider, among other elements, "whether the market practice has a positive impact on market liquidity and efficiency" (Article 13, letter c).

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based on emission allowances, or more generally the representation of the order book available to market participants, and are removed before they are executed; and e) the extent to which orders to trade are given or transactions are undertaken at or around a specific time when reference prices, settlement prices and valuations are calculated and lead to price changes which have an effect on such prices and valuations.

These various "indices" are each characterized by different elements: the distinctive feature is, most of the times, represented by the abnormal character "abnormal" of the operation, which in turn may consist in its size, the time of execution, its impact on the market, its being in conjunction with the dissemination of misleading information, etc.: manipulation distorts the functioning of the market through the completion of transactions, orders, or by means of conducts that do not conform to standards of transparency and efficiency.

[32]See also Whereas (23): "The essential characteristic of insider dealing consists in an unfair advantage being obtained from inside information to the detriment of third parties who are unaware of such information and, consequently, the undermining of the integrity of financial markets and investor confidence."; Whereas (24): "he question whether a person has infringed the prohibition on insider dealing or has attempted to commit insider dealing should be analysed in the light of the purpose of this Regulation, which is to protect the integrity of the financial market and to enhance investor confidence, which is based, in turn, on the assurance that investors will be placed on an equal footing and protected from the misuse of inside information." In setting out the subject matter of the Regulation, also Article 1 confirms the link between market efficiency and integrity: "This Regulation establishes a common regulatory framework on insider dealing, the unlawful disclosure of inside information and market manipulation (market abuse) as well as measures to prevent market abuse to ensure the integrity of financial markets in the Union and to enhance investor protection and confidence in those markets".

Article 12, which is the founding provision of the entire section of MAR concerning market manipulation, uses expressions that clearly refer to a standard reference, easily identifiable with ECMH. The very concept of “misleading” is, obviously, based on the assumption of a reference model: “misleading” is the opposite of “accurate”, “truthful”, so one should first figure out what “accurate” and “truthful” mean. Terms such as “abnormal” or “artificial” clearly suppose that one identifies the notion of “normality” or “natural”: these are, so to say, value judgements, that need to be tested against a reference value system, and this system is, naturally, provided for by ECMH.

One can find additional, even though less strong evidence of the impact of ECMH in further provisions of MAR. Among the conducts that may amount to market manipulation, there is that of “entering into a transaction, placing an order to trade or any other activity or behaviour which affects or is likely to affect the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances, which *employs a fictitious device or any other form of deception or contrivanc*e”.

Reference to prices being fixed at an “abnormal” or “artificial” level appears again in Article 12, paragraph 1, letter c), on informative manipulation, defined as “disseminating information through the media, including the internet, or by any other means, which gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument, a related spot commodity contract or an auctioned product based on emission allowances or secures, or is likely to secure, the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances at an abnormal or artificial level, including the dissemination of rumours, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading”. Concepts like “fictitious”, “deceptive”, “abnormal”, “artificial”, only work if one has a standard terms of reference and, once again, the most immediately available one in the context of MAR, is the efficient capital markets hypothesis.

A reference model, or a benchmark, is in any case necessary in order to distinguish normal markets trading and speculation, from abuses. This is made clear by MAR, in particular in Whereas 31 whereby, with regards to insider trading, it is stated that "Acting on the basis of one's own plans and strategies for trading should not be considered as using inside information. However, none of those legal or natural persons should be protected by virtue of their professional function; they should only be protected if they act in a fit and proper manner, meeting both the standards expected of their profession and of this Regulation namely market integrity and investor protection. An infringement could still be deemed to have occurred if the competent authority established that there was an illegitimate reason behind those transactions or orders or that behaviour, or that the person used inside information".

Benchmarking against ECMH assumptions naturally impacts on the application of the market abuse regime, by « objectivizing » the evaluation of possible misconducts. Subjective elements are clearly de-valued: market functioning and market participants' behaviours are basically to be tested on an objective basis, whereby motives, or subjectivities, are relevant only when the rules specifically state so (this is the case, for example, when the prohibition is carved out in terms of acting « knowingly »).

By modelling market abuse principally on the ECMH approach, the relative rules could ultimately turn out to be not entirely satisfactory. Assuming that market structures are tailored to suit a model entirely derived from paradigms of efficiency may, in fact, provide for a benchmark that does not actually reflect markets reality. Market abuse regulation could therefore have either an overreaching, or an underraching effect: it may actually capture conducts that markets should consider physiological, and disregard conducts that, instead, should be prohibited.

An example of the risk of overshooting may be found in the accepted market practices regime, which already allows, in the context of MAR, for certain conducts to be accepted, even when, at least theoretically, they clash with models of pure markets rationality and efficiency. In this case the balance between the ECMH, and different value systems is provided for directly by the Law.

On the other hand, there might be a risk of undershooting: for example, uncertainties linked to the definition of what is "abnormal or artificial" may flaw the scope of EU market abuse legislation, and not take into consideration certain conducts which otherwise might be relevant.

We suggest that there might be some space for a more comprehensive appreciation of market abuse rules, *even* in the current regime, without necessarily thinking of reshaping the general architecture or approach of market abuse regulation. Rather than discussing – as sometimes happens - as to whether market abuse should be left to self-regulation, or not regulated at all, debate should consider turning to alternative reference models, so as to increase the expected utilities and returns. In this respect, a more articulated approach to market abuse regulations, that also takes into account suggestions arising from models alternative to ECMH, including behavioural finance, may prove to be effective, thus reducing the risk of over or under shooting.

A first attempt to re-define the notion of market abuse was actually put forward, some years ago, by E. Avgouleas, who already pointed out the possible relevance of alternative theories to that of ECMH for reconceptualising the same notion of market manipulation[33]. The Author's proposal seemed to be based on a series of articulated elements, among which behavioural finance appeared to be

[33]The definition proposed by the Author is the following: "Behaviour effected through any one, or a combination of any of the following: misrepresentations and other false statements or concealments, artificial transactions, and trading schemes, which are made or structured in such a way as to induce market participants to engage in the trading of financial investments or the exercise of rights in financial investments. Relevant trading must in such a direction or the exercise of rights must be effected in such a way, as to either lead the price of these investments to an artificial level, and/or enable the perpetrators of the behaviour to materialize, from interests held in the specific or related investments, financial gains that would not be possible, in the absence of such behaviour": AVGOULEAS, *The Mechanics…*, *cit.* p.12.

just one of the many, certainly not the most significant[34]. On another ground, in certain respects one could wonder whether this attempt to re-conceptualize the notion of market abuse was a matter of mere *interpretation* of existing legal provisions, or also a matter of re-conceptualization of the legal framework itself. In any case, the proposed re-conceptualization focuses on behaviours that would allow "financial gains that would not be possible in the absence" of manipulative behaviour, thus providing a benchmark that, once again, requires further qualification, and may make it problematic, once again, to distinguish between mere speculation, and manipulation.

Without prejudice to the above, there might, however, already be significant spaces, in the current market abuse regime, to combine market efficiency with other approaches, especially those arising from behavioural finance (in its broad sense). A few examples can be set upon the table, if only just as a matter for first reflections, to be further elaborated and explored in future contributions and analysis.

Naturally, a first element could be the pivotal notion of "reasonable" investor, used as the cornerstone for the definition of price-sensitive information and the insider trading prohibitions. Actually, this is one of the most debated concepts of market abuse regulation: notwithstanding the fact that the notion is central to the entire system, the 2003 MAD gave no clear indications as to how the standard of a reasonable investor should be construed, and the 2014 MAR is silent on this point as well. This has lead to uncertainties in the transposition and interpretation of the notion at national level, since the notion of "reasonable" investor may couple, or combine, with different notions that, under national law, are currently used in order to define a general, "common" standard of conduct. Reconstructing the value system can be, here, quite problematic, unless one simply wants the notion of "reasonable investor" to discolour in that price-sensitivity and price-impact.

[34] See extensively AVGOULEAS, *The Mechanics…*, cit., 156 ff.

Naturally, things work differently if, for example, one considers the standard as referring to the model of a “rational” investor (as would be identified, for example, under the ECMH), or to the model of an “average” – not necessarily rational - investor. In the first case, one should assume that information is to be considered price-sensitive only if, normally, a rational investor would effectively use it in its investment decision process: under the ECMH, investors should normally behave rationally, and therefore should, for example, disregard information that seems or looks imprecise, vague, or not sufficiently grounded on solid elements. For example, a potentially price-sensitive, *true* information which is leaked outside a company, which clearly contradicts other available and tested public information, and which does not appear to be trustworthy, should be disregarded by a rational investor, regardless of whether it then turns out to be true or false. Therefore, if the information is true, leaking it out should not be considered automatically as infringing MAR, since that information would not be *normally* and *immediately* used by an investor in a rational theoretical market model. On the other hand, framing the notion of “rational” investor on the basis of notions coming from the general body of contract or private law, such as the general parameter of “diligence”, or more precise figures taken mostly from the laws on agency, mandate, etc. may prove to be too generic, and give rise to high levels of uncertainty when it comes to enforcement: how does then one effectively define the standard of an “average” investor[35]? Once again, if one does not wish to have that notion

[35]The analysis of Italian jurisprudence confirms the difficulties in framing the notion: see ALESSANDRI, who observes that “In the judgments of the lower courts, the significant alteration is (again, as with the falsity and misleading) built in reference to the figure of the reasonable investor, meaning that would be attributed to criminal conduct “all those activities connoted by falsehood, by simulation or otherwise returnees for their deceptive objective value, which also have the characteristic of being able to influence appreciably the choices of an average operator who has the normal information about the financial instruments where it intends to invest or divest” confirming, in terms of evidence, the need to make a posthumous prognosis in relation to the specific context and factual situation: any empirical evidence on the performance of ex-post available market data can be an element of "material feedback that strengthens the judgment already reached on the relevance of the dangerous situation occurred" [Trib. Milan, 28 May 2011]. The passage is taken from ALESSANDRI, *Rassegna sugli abusi di mercato: la manipolazione di mercato*, in Giur. Comm, 2015, n. 3, Parte II, 415 ss., while the translation is ours.

simply discolour into that of price-sensitivity, an additional effort should, in fact, be done.

Behavioural finance could provide some useful insights in order to clarify this point: for example, by applying parameters such as over-confidence, optimism, wishful thinking, etc. the "reasonable" investor to which MAR refers might sometimes be probably better understood. For example, if a company's securities have undergone a significant period of price increase, supported by strong, generally available information, the leakage of a *negative* price-sensitive information, not supported by further evidence, would probably have to discount the over-confidence effect, before it is effectively incorporated in the decision-making process of an investor. Over-confidence, optimism and wishful thinkings, normally observable in behavioural finance approaches and lab experiments, may tell us that investors might disregard that information, at least for a certain period of time, and/or until it is consistent with further signals. All of these elements could have an impact as to how the disclosure regime and insider trading prohibitions need to be applied on a case-by-case basis.

Another area, without further pretending to any kind of exhaustiveness or completeness, may be gathered from the accepted market practices regime, that, as already said, provides for certain carve-outs from the general prohibitions on market manipulation. Sticking to an accepted market practice – once it is recognised under the MAR regime - does not, in itself, provide for a total safe harbour from market manipulation prohibitions: amongst other elements, it is in fact necessary that the conduct be supported by "legitimate reasons" (Article 13, MAR). Naturally, there are different elements on the basis of which one may identify what "legitimate reasons" are: for example, one might simply say that a reason is "legitimate" if it does not breach the scope, or the rationale of market abuse prohibitions. However, under this approach what is effectively relevant remains flawed, essentially because this line of reasoning is self-referential. Once again, ECMH may provide good and solid terms of reference in order to better qualify the notion of “legitimate reasons”, for example by setting, as a standard, the mechanism of price formation in an efficient market, and evaluating the use of the *accepted market practice* by applying *that* standard as the relevant value system. Sometimes, however this might result in an approach which could be either too broad or too narrow, if valued against more concrete, empirical observation. Models of conduct observed in behavioural finance schemes might, in fact, provide additional insights as to what “legitimate reasons” are, by showing that reasons are legitimate when, basically, they conform to the way in which, normally, market participants behave or are expected to behave, taking into account the general biases that experimental and theoretical analysis show. A legitimate reason may be, for example, due to overreaction to market conditions, irrationality of conduct, wishful thinkings, or other biases typically observable in behavioural finance. The “protection” afforded by accepted markets practices from market abuse violations could, therefore, work quite differently depending on the approach taken.

8. These very brief notes do not mean to suggest that the Gordian knot between ECMH and market abuse regulation should be severed: that knot, simply, *cannot* be severed – at this stage - at all. This is because of two main reasons. First, EU market abuse legislation clearly, and openly, uses efficient markets theories as its value system and reference. Second, ECMH does effectively provide - albeit with its limitations and contradictions - a strong gateway for enhancing levels of market integrity, and investors confidence[36]. Therefore, unless one wants to rethink, globally, market abuse regulations, and – more generally – securities or

[36]Recent findings seem to uphold this conclusion: see SHAHZAD - MERTENS, *The European Market Abuse Directive: Has it Worked?*, in *Journal of International Financial Management & Accounting*, Vol. 28, Issue 1, pp. 27-69, 2017, in which the Authors conclude that “in particular, we find that after the implementation of MAD, on average, (1) the volatility of stock prices around earnings announcement declines, (2) stock prices remain closer to their post earnings announcement level during the period before earnings announcement, (3) the accuracy of analyst forecasts improves, (4) the dispersion of analyst forecasts decreases, and (5) the number of analysts following a company declines”.

capital markets law[37], ECMH, as a reference and value system, remains a must in this area of financial markets Law.

However, without assuming, or pretending to assume, a re-foundation of market abuse principles, reverting to certain findings arising out of the huge debate on behavioural economics and behavioural finance may prove useful in order to improve the application of market abuse rules, reducing the risk of over-shooting or under-shooting[38]. Such approach is, in our view, already made possible on the basis of the current wording of EU market abuse rules, as recently re-framed by Regulation n. 596/2014/EU. The path could therefore be set for more extensive research in this field.

[37]Suggestions in this direction emerge from time to time. Lately, CROTTY, *The Realism of Assumptions Does Matter: Why Keynes-Minsky Theory Must Replace Efficient Market Theory as the Guide to Financial Regulation Policy*, Univ. Massachusetts, Working Paper, 2011, available at *people.umass.edu/crotty/Oxford_draft_April_27_2010_final.pdf.*
Further suggestions in AVGOULEAS, *The Global Financial Crisis and the Disclosure Paradigm in European Financial Regu- lation: The Case for Reform* , in European Company and Financial Law Review, Vol. 6, No. 4, 2009, ava- ilable at *SSRN: https://ssrn.com/abstract=1486302*.

[38]Gilson and Kraakman, rightly argue that "despite its heavy reliance on the psychology of cognitive bias, the principal contribution of behavioral finance is to enrich our understanding of market institutions rather than to present us with a fundamentally new paradigm of market behaviour. In particular, the cognitive limitations of individual investors or noise traders are likely to matter to pricing behaviour to the extent that they interact with - and are not offset by - the arbitrage mechanism in the market. The most important contribution of behavioural finance lies in sharpening our understanding of the limitations of the arbitrage mechanism. Even when cognitive bias does not have clear implications for securities prices, however, it may have important implications for policy. These implications are unlikely to arise in the area of corporate takeovers, as some have claimed, but they do arise in areas akin to consumer protection, as where cognitive bias might lead unsophisticated investors to construct dangerously undiversified retirement portfolios": GILSON - KRAAKMAN, *The Mechanism*], cit., abstract propositions.

INSIGHTS AND CHALLENGES FROM ITALIAN REGULATIONS FOR WOMEN EMPLOYMENT AND CAREER ADVANCEMENT: THE ROLE OF MENTORING PROGRAMS IN BANKING AND FINANCE INDUSTRY

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ABSTRACT: *The article examines the implications of the regulations on women in the Italian context regarding specific measures introduced to promote their access to work and professional career. The existing regulations about cross-gender workforce imply significant effects on the Human Resource Management (HRM) policies in any organizations, especially in some sectors traditionally recognized as male-dominated and personality intensive contexts, like banking, insurance, finance, or consulting sectors. The role of mentoring programs is investigated in order to provide a significant contribution in applying the measures and interventions proposed by the regulations in Italy making them more effective in supporting women at workplace. The regulations in supporting women at workplace are well known, but their implications for the overall organizations are still under researched, especially with reference to the adequate mechanisms that may be able to effectively manage and support women without any discriminations, recognized the added value and valorising the diversified workforce. This theoretical study, through a review of the literature and a deep analysis of the regulations on the phenomenon investigated, aims to provide a critical lens in reading the existing legislative framework in Italy, developing the literature on the issue and suggesting mentoring programs as effective tools to really adopt this set of rules on women at workplace overcoming any limits and barriers.*

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SUMMARY: 1. Introduction. – 2. Italian Regulations for women at workplace. – 3. Mentoring programs for effectively applying Italian regulations to support women at workplace. – 4. Concluding remarks.

1. During the last decades, all the organizations face many challenges because of the numerous changes occurred in the society, especially the increasing diversity of their workforce as the main consequence of the globalization. Although we observe an increasing diversified workforce, there are still many stereotypes, especially in the banking and finance industry, regarding gender that create barriers for women to succeed in male-dominated fields (Roberson & Kulik, 2007). Indeed, women are still in minority, especially in masculine fields like finance and banking, experiencing stereotype threat or also the concern of being negatively stereotyped at workplace (von Hippel, Sekaquaptewa & McFarlane, 2015). For instance, although thanks to many changes occurred in the gender composition of the workforce, women represent more than 50% of finance graduates, the proportion of women in the profession declines rapidly with seniority (Pokrajac & Moore, 2013; Soares *et al.*, 2013). Recent data from U.S. and Australia show that "women account for just 9.2% of corporate directorships of Australian Securities Exchange (ASX) 500-listed companies in Australia (Australian Government, 2012) compared to 17.6% of the executive officers in finance and insurance companies within the U.S. Fortune 500" (Catalyst, 2014; von Hippel, Sekaquaptewa, & McFarlane, 2015: 2). Further, despite the increasing representation of women at the entry level, gender discrimination for women at workplace in finance, banking and insurance, still exists in all worldwide counties, especially Australia and U.S. (Mortlock, 2012; Pokrajac & Moore, 2013; von Hippel, Sekaquaptewa, & McFarlane, 2015).

Most studies evidence that women are stereotyped as weak, emotional, sensitive and without leadership skills (Powell, Butterfield, & Parent, 2002; Schein, 2007), and also women are considered less committed to their careers because of their families (Correll, Benard, & Paik, 2007). As a consequence, women face many challenges and barriers for hiring in traditionally masculine domains, with very few promotion opportunities and less earnings than men (Lyness & Heilman, 2006; Schein, 2007; von Hippel, Sekaquaptewa & McFarlane, 2015).

Numerous organizations promote diversity and equity programs for addressing gender balance also through adequate interventions in the educational setting (von Hippel, Sekaquaptewa & McFarlane, 2015); mostly women in science, technology, engineering, and mathematics (STEM) have been the focus of many of these programs (National Academies, 2007; National Science Foundation, 2013). Scholars and practitioners have paid less attention to traditionally male-dominated non-STEM work sectors such as finance and banking, even though women in these fields experience very strong stereotyping processes (Catalyst, 2005).

Likewise, many local governments are worldwide trying to support women in their employment and career advancement at workplace, especially in the traditional masculine industries, through the introduction of specific regulations with targeted measures.

In the Italian context, the issue of the cross-gender workforce is becoming more and more significant also as a consequence of the international, European, and national regulations that have introduced a specific rules system to ensure and support women in achieving their goals at work. At the same time, this issue becomes more interesting in some service and high professional industries, still traditionally recognized as male-dominated sectors, like banking, insurance, finance or consulting industry.

Starting from these brief considerations, this paper aims to investigate the main implications and limits in their application of the regulations introduced in Italy about protecting and supporting women at workplace. In more details, in this theoretical study, starting from a deep analysis of the regulations on the phenomenon investigated and through a review of the literature on the topic, we aim to provide a critical lens in reading the existing legislative framework in Italy, suggesting mentoring programs as effective tools, to make a concrete adoption of this set of rules on women at workplace overcoming any limits and barriers.

The paper is organised as follows: Section 2 investigates the minorities discipline within the main regulations and code in the Italian context focused on women at work. Section 3 provides a brief review of the contributions of the literature on mentoring programs in managing gender diversity and evidences its role in facing the criticisms and limits derived by the regulations on the phenomenon. Finally, section 4 outlines some concluding remarks.

2. The European Union has issued a directive (2006/54/EC) in order to ensure the principle of equality, both as regards the promotion and vocational training and working conditions and salaries of men and women by avoiding and preventing any forms of gender discrimination. In order to ensure the effective and full equality between men and women in their working life (salary, career opportunities, employment at leading positions, etc.), the principle of equal treatment does not preclude a State member maintaining or adopting measures providing for specific advantages in facilitating the exercise of a professional activity by the under–represented gender or to prevent or compensate for disadvantages in professional careers.

In Italy, the National Committee for the implementation of the principles of equality is intended to remove any discriminatory behaviour related to sex and all obstacles to equality of women in access to employment and its development and control, implementing the EU law on equal opportunities (Legislative Decree 198/2006).

The positive actions, consisting of measures aimed at removing any obstacles and effectively preventing any forms of discrimination for women at workplace, are designed to significantly encourage their employment and achieve career success goals. The positive actions are particularly aimed at: (1) eliminating disparities in education and training, access to employment, in career advancement, in working life and in the mobility periods; (2) promoting the diversification of career choices for women through educational and vocational guidance and training tools; (3) facilitating access to self–employment and entrepreneurial training and professional qualification of the autonomous workers and entrepreneurs; (4) overcoming conditions, organization and distribution of work that cause different effects, according to gender, to employees with prejudice in education, in advancing professional and career development, or in wages and salary; (5) promoting the inclusion of women in professional activities in high standard fields and levels where they are usually underrepresented, particularly in technologically advanced sectors and finance sectors and high levels of responsibility; (6) encouraging, also by a different organization of work, conditions and working time, the balance between family and career responsibilities and a better distribution of these responsibilities between the two genders; (7) enhancing the professional content of the tasks to more strong female presence (article 42 of the Italian Code for Equal Opportunities).

In the private sector, especially in the traditional male-dominated organizations, like banking, finance and insurance, the adoption and the test of positive actions are entrusted essentially to the self–determination of the individuals identified by the legislature. There are specific and typical positive actions dedicated to the promotion of equal opportunities between men and women in the economic and entrepreneurial activity (Legislative Decree 198/2006, arts. 52-53-54). These positive activities are financed by special funds, encouraging the creation and the development of women entrepreneurship, including cooperatives, also by facilitating the access to credit for businesses predominantly run by women. Recently, the Italian government is paying a special attention to specific types of actions, that experience organizational measures in the workplace, aimed at reconciling work and personal life, involving either male and female workers (Law 53/2000).

In the public sector, the Italian legislature adopts a mandatory model: (1) the Government must prepare a three year plan for the realization of equal opportunities (Legislative Decree 198/2006, art. 48): they should be reserved for women at least a third of the seats component of the selection committees; (2) the Government must adopt its regulatory acts to ensure equality between men and women at work; (3) it must ensure the participation of the employees in training courses and professional development, in relation to their presence in the administration, taking all organizational measures to facilitate the participation and allowing the reconciliation between work and family life; (4) finally, Government should take all measures to implement the directives of the European Union in the field of equal opportunities (Legislative Decree 165/2001, art. 57).

In 2011, on August 12, with the entry into force of Law 120/2011 (Golfo-Mosca Law), significant and deep changes have been introduced in the Italian company discipline: The governing bodies of quoted companies must be renewed by reserving a share of at least one fifth of its members to the less represented gender: women. Women who, from the second and third renewal of the governing boards, will be at least one-third, to get to 2022, the date on which it raises the second major deadline set by this law: the depletion of its effectiveness. The Golfo-Mosca Law, therefore, has a timeframe of ten years, within which it is hoped to achieve the objective of removing barriers that until now have limited the access of women to leadership roles, fostering a culture renewal process in order to support greater meritocracy and growth opportunities for women.

In this scenario, the existing legislative system in supporting women employment and career success, especially helping them to overcome the traditional discrimination in being directors of corporate boards or top managers, tends to provide prescriptions and suggestions imposing to the overall organizations to guarantee specific quotas for the presence of women at workplace, but although there are these guaranteed quotas for women and other measures have been suggested, it is still not clear how to manage the main implications of these regulations especially in terms of their effective adoption by organizations with major focus on internal dynamics, like cultural orientation and the persistence of gender stereotyping behaviours. Hence, the main limitations that we can observe in interpreting the regulations about women for employing and advancing at workplace concern the liability of firms in stimulating deep changes in the organizational culture and climate, promoting more awareness of gender stereotyping behaviours, and training and educating all the workforce to face and manage any forms of discriminations.

Otherwise, this phenomenon, that is the criticisms related to the adoption of regulations on gender discrimination at workplace for overcoming the barriers faced by women in their employment and career process, is very spread in the service industry with high level of professionalism, especially in the traditional masculine contexts, mostly the banking, insurance and finance sectors.

On one side, organizations "quantitatively" respect the existing regulations, e.g. about the required and imposed quotas for women in boards of directors or, in general, at workplace, but there is not "qualitatively" an effective inclusion and active involvement of women in the decision-making processes and all the specific groups which are still primarily dominated by men. Women do not really participate to the all the organizational processes, where men are leaders without limitations, thus, they aren't recognized as part of the governance. On the other side, organizations which apply the existing regulations do not effectively support and apply the regulations against gender discrimination with adequate initiatives or practices able to stimulate changes in the organizational culture and an actual awareness of gender stereotypes at workplace.

3. Mentoring is conceived as "a relationship where there are two individuals, a senior person (mentor) who, thanks to his/her advanced experience and knowledge and maturity, has the duty to guide, to advise, to suggest junior individual (protégé/mentee) in his/her professional and personal development"; it is an exclusive relationship "person to person" between protégé and mentor, there is a dyadic personal and constant relationship (one-to-one) (Levinson *et al.*, 1978;

Kram, 1983, 1985, 1996; Burke, 1984; Thomas & Kram, 1988; Noe, 1988; Fagenson, 1989; Scandura, 1992).

Thus, mentoring provides two main functions: career development support, including coaching, sponsoring advancement, providing challenging assignments, protecting protégés from adverse forces, and foresting positive visibility, that is all the actions aimed to promote protégés protecting and helping them to face any challenges, and supporting them in their advancement process at workplace; psychosocial development support, involving such functions as personal support, friendship, acceptance, counselling, and role modelling (Kram, 1985). Positive outcomes have been mainly associated to mentoring in terms of higher levels of job satisfaction and promotions, recognizing mentoring within organizational settings as an effective instrument in socialization process, training and learning process and career development (Kram, 1985; Riley & Wrench, 1985; Fagenson, 1989).

Furthermore, formal or informal mentoring have been distinguished by scholars in terms of formality and length of the relationship, and purpose of the relationship meant like specific goals (Kram, 1985; Ragins, 1989; Ragins & Cotton, 1999; Lankau & Scandura, 2002). Protégés can build their relationships with mentor spontaneously without adopting formal rules and selecting themselves their mentors and vice versa (Kram, 1985; Ragins & Cotton, 1999); mentor and protégé can establish a mentoring relationship because of the direct intervention of their organization which promotes mentoring programs for achieving specific goals, like supporting to learning and training processes, Work Life Conflict (WLF) management, or diversity management (Kram, 1985; Ragins, 1989; Ragins & Cotton, 1999; Lankau & Scandura, 2002). The distinction between formal and informal mentoring (mentoring programs) is more important for women who encounter substantial barriers in developing informal relations; studies on the link between type of mentoring programs and gender composition of the report were conducted precisely in order to highlight these criticisms (Ragins & Cotton, 1991, 1999; Scott, 1992; Catalyst, 1993; Kram & Hall, 1996).

In this study we focus exclusively on mentoring programs in order to investigate their support in effectively apply regulations on women at workplace.

In research on mentoring, the existence of heterogeneity among the partners involved is the starting point for a relationship, so many contributions focus on diversity issue both in terms of composition of mentoring relationships and the role of mentoring to manage diversity investigating the main outcomes derived from mentoring for minorities, especially women.

For example, diversified mentoring relationships in organizations dominated by the male gender could be formed by mentor majority (white men) and protégé minority (women or members of different minorities for race or ethnicity). While, if less widespread, diversified mentoring relationships could also be made by a minority of mentor and protégé of majority (Turban *et al.*, 2002; Scandura & Williams, 2001; Sosik & Godshalk, 2000; Ragins & Cotton, 1999). Studies on mentoring also highlight the crucial nature of mentoring in the process of mobility of career guidance for non-white women and individuals who are working always under-represented categories in the environments especially elite (Ragins, 1989; Kram & Hall, 1996).

Existing research on mentoring suggests that male mentor are particularly influential on career advancement of protégé. For example, some scholars have pointed out that as a group, female mentors tend to be less powerful than the male mentor (Ragins & Sunstrom, 1989). According to other studies, indeed, male mentors provide greater support to the career of their protégé, while female mentors provide psychosocial services (Noe, 1988; Burke, 1984), also in relation to the type of program implemented. Thus, due to a minor position power for women, the latter could be pointed less effective in promoting the careers of protégé. Male mentors could be more able to confer legitimacy to their organizational protégé and provide the resources required for success, compared to women who are seen less powerful and with a lower status (Erkut & Mokroš, 1984; Ragins, 1989).

The various influence between individuals, males and females, significantly comes from the differences in the legitimacy of power that is inherent to the top organizational position. Otherwise, women, who still cannot be involved at high level positions and corporate boards, also face many challenges in participating in formal programs as protégés, reducing significantly their chance to advance at work and improve their position. Although the main impact of differences in authority between men and women can be related to the more influential formal power of men in providing support to the career, also the possess of a broader informal power play an important role, in fact women were not well integrated into the social networks of men who occupy predominant positions (Lincoln & Miller, 1979; Brass, 1985; Thomas, 1990; Ibarra, 1992).

In particular, in the context of the organizations mentoring is often asserted through informal relationships and those who perform the role of mentor to higher organizational levels are most commonly male individuals; this constitutes a restriction on the formation of joint mentoring relationships, as well as, a limitation to the development of opportunities for women. These factors restrict the possible manifestations of mentoring for the female category (role modeling, counseling, friendship, confirmation). Studies have identified and investigated extensively such circumstances (Phillips-Jones, 1982; Clawson & Kram, 1984; Noe, 1988; Ragins, 1989; Burke & McKeen, 1990; Dreher & Cox, 1996).

Thus, the main studies on the connection between mentoring and the glass ceiling phenomenon evidence that women are disadvantaged compared to men for their career, as well as, to get a mentor, also, if women play the role of mentor, the nature of mentoring and the results obtained are different (Noe, 1988; Ragins, 1989; O'Neill, 2002; Wanberg, Welsh & Hezlett, 2003). On the other side, the prevailing literature has shown that women have had the same chance of having a mentor as men (Hubbard & Robinson, 1988; Ragins, 1999; McGuire, 1999; Ragins & Cotton, 1999;Witt Smith *et al.*, 2000). Regarding the possible differences in the outcomes of mentoring for men and women, the literature has recognized that such differences might be present, since women require different functions to be able to achieve success in organizations, or because women are probably more involved in cross-gender relationships, and by virtue of the dynamics of these relations, it could be provided mentoring to a lesser extent (Ragins, 1997). In this area, the research has not yet definitive, hence, women can receive different and, in some cases, fewer benefits from mentoring than men (Koberg *et al.*, 1994; Ragins, 1999; McGuire, 1999), while in other cases women receive greater results than men (Sosik & Godshalk, 2000) or no significant differences (Burke, 1984; Noe, 1988; Burke *et al.* 1990; Ragins & McFarlin, 1990; Thomas, 1990; Turban & Dougherty, 1994; Ragins & Cotton, 1999; Witt Smith *et al.*, 2000; Scandura & Williams, 2001). In addition, studies have shown that women receive higher levels of psychosocial mentoring than men (Burke, 1984; McGuire, 1999; Noe, 1988), while others have found no such differences contributions (Ragins & McFarlin, 1990; Thomas, 1990; Turban & Dougherty, 1994; Koberg *et al*., 1998; Sosik & Godshalk, 2000b; Witt Smith *et al.*, 2000; Scandura & Williams, 2001). Finally, another study showed that women receive greater role modeling than men (Sosik & Godshalk, 2000), the opposite the results of other studies that did not show this difference (Burke, 1984; Ragins & McFarlin, 1990; Ragins & Cotton, 1999; Scandura & Williams, 2001).

Otherwise, other studies argue that gender diversity in mentoring have different effects for mentor and protégé. For the former, mentors, gender differences are more crucial and could activate more expectations creating interpersonal barriers or stereotypes in their performance (Ragins, 1997); for the latter, protégés, gender differences don’t play a crucial role because of their high trust and gratitude to their mentors in guiding and supporting them without paying too much attention to the composition of the relationship (Lankau *et al.*, 2005). At same time, in the last decades some authors argue the failure of mentoring programs in achieving gender equity at workplace, moving their attention to sponsorship that is recognized thanks to specific determinants and variables more effective for under-represented groups (Ibarra, Carter & Silva, 2010; Hewlett, Marshall

& Sherbin, 2011; Hewlett, Leader-Chivée & Sumberg, 2012; Hewlett *et al.*, 2013; Roberson & Varriale, under review).

The literature on mentoring programs and gender presents, therefore, mixed results that can be explained considering the possible action of the moderators on the relationship between gender of the protégé or mentor and mentoring received (Ragins & Cotton, 1999; Scandura & Williams, 2001; Turban, Dougherty & Lee, 2002), for example, women with male mentor reported more support functions to the career than pairs of female mentor-protégé (Sosik & Goshalk, 2000).

In summary, the debate on the effectiveness of mentoring programs for supporting employment and career advancement of women, especially their access and role in the corporate boards, is still open, because it has a profound limitation of research that primarily considers the compensation factor for the female protégé neglecting other important variables that could best explain some special circumstances, and also in other cases mentor is considered not effective without assuming mainly the role of sponsor. Specifically, an element that could significantly explain, at least in part, the difference between female and male mentor can be represented by the organizational position that these individuals occupy: female mentor, in fact, are often found at lower levels of the organization compared to male mentor (Federal Glass Ceiling Commission, 1995).

According to the prevalent literature on mentoring programs recognized mainly as effective practice in the diversity management policies, we suggest to develop and adopt mentoring programs in order to overcome the limitations and criticisms of regulations on the issue investigated especially within the traditional masculine fields, like banking and finance. Mentoring programs could represent the crucial key factor to effectively apply the regulations about gender discrimination at workplace, because these programs can guide, train and educate all the cross-gender workforce to accept women to receive promotion, to entrust and advance at work also at high level positions or as member of corporate boards.

Mentoring programs can play a crucial role in supporting women at workplace for two main reasons. First, they make the existing regulations more effective, supporting and really helping women to manage and overcome gender stereotypes, because they help women and the overall workforce to be trained and educated in managing cross-gender workforce, in fact, female mentors can lessen the threat of gender stereotypes for women working in male-dominated fields, such as finance and banking (Metz, 2003; von Hippel, Sekaquaptewa, & McFarlane, 2015). Second, mentoring programs adequately support women thanks to “role modeling”, able to overcome the “role conflict”, in fact “women working in male-dominated fields such as finance may experience conflict between their prescribed gender role requiring communal behaviors and the agentic demands of their work role, separating their prescribed feminine and communal identity (e.g., being nurturing, kind, and caring) from their work identity (e.g., being businesslike and rational)”(von Hippel, Issa, et al., 2011; von Hippel, Walsh, & Zouroudis, 2011; von Hippel, Sekaquaptewa, & McFarlane, 2015: 3). Otherwise, the presence of helpful roles models can really benefit women because they can provide inspiration and encouragement by other women considering their same working masculine fields (Young, Rudman, Buettner, & McLean, 2013).

Thanks to these programs, focusing on human side of the phenomenon and on objective career criteria without adopting stereotyping behaviours, it is possible to activate a deep and fundamental cultural and organizational change which aims to create an "inclusive" environment where differences between men and women are not a source of discrimination, but subject to real attention and listening. Otherwise, studies and practice on Diversity Management, as already evidenced, show that organizations derive benefits by angling the heterogeneity rather than homogeneity, and can respond more effectively to the changing environment.

Mentoring programs can significantly and effectively stimulate this changing process, making organizations to realize that they need to really “feel” the need to apply the regulations against gender discrimination, not because they impose certain behaviours, but because they think it is important and so they are involved directly in the cultural and organizational change process. In this direction, mentoring programs can support educational and training process in adopting the existing regulations.

4. Drawing from the Italian regulations in supporting women employment, career advancement and access to the top management positions and corporate boards, we have observed and described the main implications and limits of these regulations in terms of obligations and liabilities. The regulations, as already outlined, are still scarce in giving suggestions to organizations about which managerial practices they can adopt to guarantee gender equality at workplace. This study aims to "open the mind" of organizations through the development and adoption of mentoring programs, which invite to participate all the employees, males and females at any levels, in order to give a different "way to think about the role of women at work", without perceiving the related regulations only as easily one obligation. We argue that mentoring programs can be very useful in this effectively adopting the existing regulations within organizations because they can provide a training and educating growing path for the overall cross-gender workforce and also can involve women in being "role models" becoming positive examples for all females at workplace.

Indeed, the protection of women in particular, and all the minorities in general, requires something more than just the "non–discrimination" because it implies the adoption of special measures to support and protect members of minorities for preserving their particularity, requiring forms of "positive discrimination". The principle of equality established by the Italian Constitution (art. 3) states the same social dignity and equality for all citizens and prescribes the adoption of rules that positively remove the contextual situations which may arise discriminatory consequences (Judgments n. 159/2009 and n. 15/1996 of the Constitutional Court). In this direction, it is necessary to create the foundations not just for a “negative” protection of minorities, but also for a positive or “active” protection of minorities, like women.

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RISK PROFILING IN LIGHT OF BOUNDED RATIONALITY: FUTURE REGULATORY PROSPECTS *

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ABSTRACT: *The present study explores the main features of the cognitive processes involved in decision-making by investors, drawing on frontier studies in behavioral and experimental economics. After highlighting the main deviations of investment decisions from the case of perfect rationality, traditionally assumed by economic theory, the paper outlines implications for the study of the circumstances that influence the financial risk perception of the investors (whether they are experts or not), whence the examination of the regulatory instruments that are better able to allow a reliable evaluation of the risk attitudes, by financial intermediaries, of their clients, as mandated for instance by the MiFID regulation. It is indeed highly interesting from a policy perspective to identify the expedients suitable to reduce the exploitation of cognitive effects by unscrupulous parties to the detriment of clients in credit and financial relationships, as well as the techniques that may allow intermediaries to carry out an unbiased profiling of risk tolerance, based on a correct exchange of information. Our investigation is further aimed at verifying if, instead, with the introduction of recent disciplinary measures such as MiFID II and Mifir, regulators have born in mind the results from the cognitive studies on risk perception. The doubt still exists, however, that intermediaries, on the level of concreteness, are only required to guarantee the formal respect of the rules.*

Therefore, the research discusses the suitability of the current regulations and tackles the main challenges ahead, concerning the context in which financial

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communication and negotiation occur, the neutrality of subjects who define the context and supply information, the accessibility of unbiased information and the provision of an appropriate time for information processing and decision making. Moreover, we propose regulatory instruments that, in this context, could be more effective and fair than the existing ones in light of the cognitive distortions from which investors normally fall victim.

SUMMARY: 1. Introduction. – 2. The neoclassical overestimation of risk coping abilities. – 3. How investors actually make decisions: evidence from laboratory experiments. – 4. The reference disciplinary framework and the indications of behavioural economics. – 5. MiFID and investor risk profiling. – 6. MiFID II and the relevance of cognitive factors. – 7. The protection of retail investors. – 8. Concluding remarks on possible remedies.

1. Faced with an increasingly financialized world, wherein households are encouraged to participate directly or indirectly to volatile financial markets, and debt relationships spawn complex financial products (Dore 2008, Dosi et al. 2016), investors are more than ever in need of remedies to the inadequacy of the pre-crisis financial regulatory framework, including regulations, such as MiFID, mandating that financial intermediaries engage in risk profiling of their clients to identify the financial products that are most suitable for each category.

The design of the financial regulatory setting has traditionally rested upon results from neoclassical economics, the very same theoretical approach that, allegedly, has been unable to predict the financial crisis due to macroeconomic policies rooted in irrealistic behavioural assumptions. More specifically, financial regulation has built upon the economics of information and expected utility theory. The main character in both theoretical models is *homo oeconomicus*: a person endowed with rational expectations, rational preferences,[1] and rational decision-

[1]If the individual has a correct awareness of how the economic system works, his expectations for the future values of economic variables are generally correct, that is, forecast errors, on average, are zero. In this case we have rational expectations. Preferences are rational if they satisfy the axioms of completeness and transitivity. For the axiom of completeness, an individual can always de-

making capabilities. Individuals are assumed to possess enough cognitive abilities to optimize the use of the available information, however asymmetric, and to deal with measurable risk, namely, the probabilities of future outcomes are known in advance. Such assumptions of full rationality, though, collide with many econometric estimates of risk aversion parameters and investment patterns, while laboratory experiments involving human subjects have revealed various systematic deviations from expected utility theory, such as context-dependent preferences, limitations to computational abilities, biased estimation of probabilities against a background of Knightian uncertainty. Relatedly, one underplayed aspect is that information economics and expected utility theory intersect inasmuch as the contractual party possessing more information is able and willing to manipulate the other party's perception and assessment of probabilities.

The body of theory and empirical evidence labeled "behavioral economics", rooted in the concept of bounded rationality (Simon 1972), has only recently risen to the attention of financial regulatory authorities. Chiefly important in this respect are the studies by the European Commission (Van Bavel, Herrmann, Esposito, Proestakis 2013) and by Consob, the Italian stock market authority.[2] At the international level, it is also worth mentioning the *Executive Order* of September 15, 2015 outlining a new approach to public policy, duly taking account of the complex nature of human decision making. A recent special issue of *Economia Politica - Journal of Analytical and Institutional Economics*, edited by Bogliacino et al. (2016), is devoted to the economic policy implications of experimental and behavioral economics.

In this essay, we explore and discuss the value of an approach to financial regulation and to risk profiling that fully incorporates the implications of bounded

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fine an order of preference between alternatives or believe that the alternatives are indifferent. The transitivity of preferences guarantees their coherence and avoids circular choices. The choice is rational when it leads to the maximization of preferences while meeting the constraints to the field of choice.

[2]Since 2010 various *Notebooks* have been published regarding behavioral finance, which can be consulted on the Supervisory Authority's website (www.consob.it).

rationality, towards the goal of improving investor protection in an increasingly financialised world. Section 2 argues that, based on the existing econometric estimates, regulators applying the standard neoclassical models of asymmetric information and expected utility would underestimate the risk exposure of economic agents. Section 3 then goes on to illustrate the main cognitive features of decision making, with examples on financial transactions. Sections 4 builds upon the evidence to assess the adequacy of the current financial regulation framework, also in light of the MiFID directive (Section 5), paving the way to the analysis of how and whether the recent disciplinary measures such as MiFID II and Mifir have incorporated results from the cognitive studies on risk perceptions (Section 6 and 7, respectively). Section 8 concludes with proposals for regulatory instruments that could be robust with respect to the cognitive effects that may penalize the weaker contractors.

2. Risk profiling principles rooted in an inaccurate theory may err in two directions. They may imply rules that end up constraining the choices of investors who would otherwise be well positioned to manage risk. Conversely, they may be too optimistic on the agents' ability to cope with financial risk, in which case regulatory authorities would be too lax and leave investors without enough protection. With few exceptions, the econometric tests of neoclassical models with risk aversion suggest that the theory errs on the optimistic side, namely it overestimates the ability of economic agents to cope with the promises and threats of financialization.[3] Compared to a perfectly rational investor, indeed, real-world investors indulge in "mistakes" as summarised by Firth (2015) in his review of empirical facts on investment behaviours.

For instance, econometric analyses since Gruber (1996) show, against theoretical expectations, that risk-corrected returns of actively managed mutual funds

[3]In some cases, short run volatility is actually overestimated, as in Arrow's (1971) example of myopic risk *aversion* (Benartzi and Thaler 1993), according to which investors overestimate the short run volatility even though the theory implies risk neutrality when small sums are at stake.

are below the returns yielded by a basket of market indices, and according to some estimates even below those of mutual funds that merely track stock market indices. It appears, thus, that agents underestimate the risk of portfolios which they do not directly manage, even though risk perceptions according to the theory should not be affected. Similarly, empirical evidence on financial advice surprisingly shows that returns are on average below fees (Forster et al. 2014), casting doubts on the adequacy of models based on perfect rationality and measurable risk. Further, in empirical tests of portfolio choice theories Huberman (2001), Kumar (2007) and others have detected *insufficient diversification,* specifically over-investment in risky assets or the over-representation of financial instruments issued by firms in the same sector, and thus positively correlated. A specific instance of such insufficient diversification is given by *home bias*, namely the revealed preference for domestic assets (French and Poterba 1991, Lewis 1999), presumably driven by a higher availability of information on local issuers, while generally suboptimal in terms of risk minimization.

The evidence on returns from financial advice and asset management, insufficient diversification, and home bias may be partly due to subpar financial literacy, see Lusardi and Mitchell (2014), Braunstein and Welch (2002). This may be again a failure of the standard theory, since financial losses should work as incentives towards financial knowledge accumulation by rational agents. Research on financial literacy has inspired a recent report by Consob (Linciano and Gentile 2016), wherein barely 40% of the Italian households being interviewed is able to correctly define basic notions such as inflation, the relationship between risk and returns, or risk diversification. This may be partly due to the occasional nature of some transactions, such as mortgages, and the considerable complexity of some recently introduced financial products, whose implications fail to be fully grasped even by the most sophisticated financial practitioners

Financial competence includes also the ability to correctly interpret results from the econometric literature, which is a crucial matter for the definition of appropriate risk profiling procedures. Regulatory tools are often designed having in mind categories of agents that are deemed “weak”, i.e. presumably more exposed to information asymmetries and less capable of dealing with risk, based on age, education level, and so forth. Because of the statistical error surrounding the econometric estimates, one can only grasp the statistical distribution of risk aversion within categories, however finely defined they may be. Applying the same regulatory tool to all individuals within a category, thus, is effective only with some probability. The statistical error, in this specific case, is due to the idiosyncratic traits of the clients; such traits are, however, related to how investors' cognition works in the context where decisions are made, a piece of information that is not recorded in financial datasets.

3. Evidence on financial literacy may hopefully trigger improvements in schooling, yet even when information is fully available, individuals face limitations in their information processing abilities. Consequently, in many common but complex circumstances, individuals are unable to come up with optimal decisions (Simon 1972; Conlisk 1996). Deviations from expected utility theory, elicited in laboratory experiments, may suggest that the risk aversion of real-world investors is more tenuous or, conversely, higher than theoretical predictions. It is most important for financial regulators to be aware of cases when risk is underestimated in ways triggering imprudent investment decisions. Let us briefly describe the main cognitive features of decision-making processes as highlighted by laboratory experiments. In doing so, we rely on Kahneman (2003), McFadden et al. (1999), Rabin and Thaler (2001).

Framing effects. Individual choice is affected by the way information is presented or “framed" (Diacon and Hasseldine 2007). Experimental results suggest that, for instance, a financial product is more likely sold if its prospectus highlights the potential returns from the investment plan while underplaying the saliency of losses. The order in which information is supplied and the terminology used also matter. *Anchoring effects* can be produced if numerical values are proposed by one of the parties, tilting the bargaining process towards contractual conditions in the ballpark of the initial numerical input, especially when there are informational asymmetries, competence gaps, or uncertainty around quantitative attributes that cannot be immediately verified.

Reference point effects. Individuals apparently formulate preferences with respect to gains and losses, not on wealth levels as typically assumed by neoclassical models. Moreover, and rather interestingly, they seem to be characterized by loss aversion, meaning that mild losses exercise a stronger impact on decisions than relatively larger gains. Loss aversion is central in *prospect theory*, a framework proposed by Kahneman and Tversky (1979) in order to explain the burgeoning evidence from experiments on choice under risk (see Barberis 2013 for a recent literature review, and List 2004 for a comparison with neoclassical theory). Preferences are asymmetric also due to the so-called *endowment effect*, i.e. the unwillingness to lose assets, so that the reservation selling price of a good is higher than the availability to pay for it. This effect has been observed independently of how long a certain asset has already been possessed (Kahneman et al. 1991, Tversky and Kahneman 1991).

Availability effects. Individuals overly trust information and attributes that are immediately or easily available, such as referrals from relatives, friends and colleagues, recent events, purely aesthetic traits (possibly “framed" by sellers), even if those may not convey any reliable information on the risk-return balance of an investment. Trusting a close person allows to save on the cognitive effort required in collecting information on an investment, even though the advice may not be itself trustworthy. Partly related to availability effects is the *segregation effect*, according to which the risky component of an investment plan is assessed separately from the certain one. For instance, if a financial intermediary presents the returns (uncertain) net of fees (that are fixed), chances to sell the financial product are higher, since one avoids highlighting that fees need to be paid regardless of the investment outcomes. Similarly when it comes to portfolios including bonds and stocks.

Other effects. *Superstition effects* include selective memory with respect to coincidence; the propensity to identify patterns and causal structures in random phenomena; the belief that counter-parties possess information advantages, which helps to rationalize ex-post adverse outcomes. *Process effects* show that the choice process itself can generate utility, e.g. time spent betting or tracking stock prices. Preferences of this kind need not lead to an optimal allocation of time. Finally, experimental subjects display a tendency to embed a choice in a wider context, involving social and ethical dimensions. Due to *projection effects*, individuals are influenced by the self-image they are wishing to convey, and may lead to decisions that depart from the neoclassical predictions (Grable et al. 2004, Kliger e Levy 2008).

Excessive exposure to financial risk can be due to process effects, as the process of betting, for instance, offsets the expected disutility of losses, for a given risk level; so that a better risk-return balance is perceived than the true one. Media often convey messages that push individuals to take risks even when they are apparently taking care of their future (e.g. with pension funds). On the other hand, risk aversion may be magnified by endowment effects and superstition effects. Framing effects can also work in ways that stimulate risk taking, e.g. by presenting information in such a way that certain aspects, e.g. volatility, are not easily grasped. Information is there, but it is not salient; whereas risky investments and slot machine rooms receive much space in advertising and are easily accessible.

While econometric models of risk aversion are built upon theoretical models assuming stable and context-independent preferences, laboratory experiments suggest that even individuals who are statistically more risk averse than average and better financially educated can end up taking too much risk if they face counterparties who learn new framing strategies.

Overall, the cognitive effects we have briefly reviewed are consistent with a theory according to which individuals faced with a complex problem replace it, more or less consciously, with a simpler, correlated one, which they are able to solve. This is a basic description of *choice through heuristics* (Prelec 1991, Ritter 2003, Camerer and Loewenstein 2004). Heuristic attributes are the attributes of the choice problem that most immediately come to the mind (Kahneman and Frederick 2002). Information on very recent events andthat collected through personal networks, in fact, constitute the heuristic attributes of many financial decisions. In most cases, the heuristic response is guided by what the cognitive literature calls the "intuitive system", yielding an outcome that is very close to the "rational" one, but nothing guarantees that deviations be small. Only if the "reasoning system" is activated can individual behavior approximate optimality (see Kahneman 2003, Gigerenzer and Gaissmaier 2011).

In the perspective of financial regulation, the value added from laboratory experiments rests upon the repertoire of games and questionnaires that regulators can use in order to draw indications on how to appropriately identify risk preferences and to shield the weaker contractual parties from the exploitation of cognitive effects by more sophisticated agents. Regulatory measures, or improvements of the existing rules, ought to concern the context in which financial communication and negotiation occur, the neutrality of subjects who define the context and supply information, the accessibility of unbiased information and the provision of an appropriate time window for information processing and decision making.

4. For some time now, legislators have been trying to assure a balance in contractual relationships characterized by informational asymmetry, namely relationships where one contractor has more information regarding the content of the agreement *(*so-called *strong contractor)* than the other contractor *(*so-called *weak contractor)*. It is relevant, in this regard, what is set out in art. 1341 of the Italian Civil Code concerning general contractual conditions; therein, indeed, the efficacy of the mentioned conditions «from one of the contracting parties, if at the conclu-

sion of the contract they were aware of them or should have been aware of them by due diligence» is laid down. It is clear, however, how particular importance has been given to the cognitive phase of the contents of the agreement; on which depends the efficacy of the contract (De Poli 2002).

As a matter of fact, the regulation contained in the 1942 Civil Code (still in force) is not aimed to specifically regulate the relationships between financial professionals and consumers, since it finds application whenever there is a contractual regulation biased towards one party for an application in series (Capriglione 2008). Moreover, it is clear how the legislator in that time did not pay sufficient attention to how the weakest contractor becomes aware of the content of the agreement. Indeed, the reference to the eventuality that the weakest contractor, in certain circumstances «should have» known the negotiating conditions, exonerates the professional from the responsibility of informing him. After all, the regulation entrusts the safeguard of the interests of the *weaker contractor* to the inefficacy of some clauses, exhaustively listed at the second comma of art. 1341 of the Italian Civil Code, possibly included in the contractual program. This safeguard is attenuated by the eventuality that the clauses acquire efficacy in the presence of a specific written approval by the weakest contractor.

Awareness of the inadequacy of the original disciplinary structure, and the necessity to identify new forms of protection suitable to regulate contractual relationships between intermediaries and consumers, lay behind the European directive 93/13/CEE regarding unfair clauses in contracts stipulated with consumers, recognized in Italy and then incorporated in the Italian Consumer Code. On this point, the disposition at art. 33 of the Italian Consumer Code is significant. According to it, in contracts between professionals and consumers «a term is considered unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer». This applies, more generally, to a disciplinary model in which particular attention is paid to the circumstances, established in the procedure, that consumers accept without due awareness, «passively in bulk, in the form proposed by the company» (Capozzi 2002). However, on this point one should recall art. 34, 4th comma of the Consumer Code, according to which the clauses, or the elements of clauses, that have been part of individual negotiations are not considered restrictive.

Therefore, information collection and exchange are given relevance in the legislation. Not by chance, a special section of the Consumer Code is specifically dedicated to financial education and information. The same attention is given, on this point, by European and national legislators in the area of finance. Indeed, in a context characterized by complexity and uncertainty – where the very notion of financial product is now uncertain (Vito Chionna 2011) - investors must be able to make decisions while being as aware as possible. However, our previous considerations rooted in the experimental literature imply that, especially in the presence of radical uncertainty, individuals face cognitive limitations in elaborating information and resort to heuristics in order to make decisions, deviating from the theoretical framework whose predictions have so far informed the regulatory activities and procedures.

5. Clearly, the above considerations on investor cognition interact with the juridical-financial sphere, given that European legislators have ascribed even more relevance to information exchange between intermediaries and clients than in other areas. We refer to the MiFID directive (2004/39/CE, and the second level directive 2006/73/CE) that has outlined a series of detailed rules to be observed when providing investment advice and performing portfolio management. It should be pointed out that this regulatory intervention is extended, amongst others domains, to encouraging and increasing the information flow in a biunique direction (from the intermediary to the client and from the latter to the former) and to facilitate the activity of the intermediary through client risk determination (finalized for the evaluation of the suitability of the operation for the investor). In

other words the legislator, being well aware of the complexity of the subject, believes it necessary that intermediaries would acquire information about the knowledge and experience that investors have in the relevant investment field, as well about their financial situation and investment goals, with the aim of advising suitable financial instruments for the investors' risk profile (Boskovic, Cerruti, Noel 2010; Moloney 2014).

It is worth remarking that legislators, notwithstanding having duly considered the principle of contractual transparency, apparently have not paid sufficient attention to the way information should circulate in light of the elaboration methods used by investors. The references of the regulation to the necessity that all information has to be «fair, clear and not misleading », as well as being provided «in a comprehensible form» (art. 19, comma 2, of the directive 2004/39/CE), are, in fact, mere statements of principles if suitable operational techniques for a correct information exchange and processing are not clearly identified in their concrete terms. In other words, a detailed analysis of the psychology of the investor is a prerequisite.

It is thus interesting to read the contributions published on the Consob website, which we have previously mentioned. In them, it is clear that the questionnaires given to clients by intermediaries to carry out the evaluation imposed by law, are unable to reveal the investment experience of investors, even if they conform to the disciplinary prescriptions: «the self-evaluation by the client is not well orientated to verify the knowledge of basic notions such as, for example, the risk-return relationship and the principle of portfolio diversification» (Linciano and Soccorso 2012).

Not by chance, according to a recent report published on the Consob website, and consistent with the econometric evidence on the returns from financial advice, investors tend to distrust the work of financial experts. Witnessing this, the above mentioned report shows that 62% of respondents declared to have made investments without the support of a professional; 28% have asked for simple advice from a professional, and only 10% delegated this task to an expert (Linciano and Gentile 2016). Therefore, the current regulatory system fails to ensure that investors trust the whole financial sector and overcome the so-called superstition effects.

In fact, MiFID does not seem to have given good account of itself during the financial crisis that has struck most countries worldwide since 2007. Part of the doctrine has identified, between the various triggering causes of the above mentioned emergency period, endogenous factors correlated to human behaviour (De Poli 2012). However, it is worth asking if directive n. 2014/65/EU on the market for financial instruments, that will enter into force in 2018, and the Regulation Miffed (Regulation EU n. 600 of 2014), redefining the regulation provided for by directive n. 2004/39/EC, have taken into account the implications of behavioral finance, notwithstanding the objective of « enhancing the conduct of business obligations in order to strengthen the protection of investors » (*recital* n. 70).

6. Once regulatory bodies acknowledge the contributions from cognitive science and behavioural finance (see the study of Van Bavel et al., 2013), it is worth involving experts of those fields in the deliberative phase of policy design (Rangone 2016). This makes the case for adopting the principle according to which social organizations have to deal with the indications coming from specialists. Hopefully the above mentioned approach should be followed by European legislators and independent authorities alike.

With specific regard to financial matters, the fact that also experts can make errors in evaluation should not be overlooked. However, MiFID has classified clients into three different categories: *retail* clients, professional clients, eligible counterparties. Each category is associated to one specific threshold of protection, based on the tenet that *retail* investors need more information for their financial decisions (Kruithof and Gerven 2010). Indeed, because of their experience, experts would be better positioned than others to elaborate the information they receive;

in other words, their marginal return from information on financial products would be relatively high for them, as they are better able to understand and process it. If this assumption is true, the choice, made by regulators, of reducing the information load of more expert clients would be wrong. On the other hand, the retail clients, because of their inexperience, have greater difficulties in processing information on financial products, hence a higher propensity to make investment choices that are "suboptimal".

Legislators seem to have taken these circumstances into consideration during the redefinition of the regulation (MiFID II). We refer, in particular, to *recital* n. 104 of the directive n. 2014/65/EU where it is stated that « The financial crisis has shown limits in the ability of non-retail clients to appreciate the risk of their investments »; from this it follows that, although the «conduct of business rules should be enforced in respect of those investors most in need of protection », it is necessary «to better calibrate the requirements applicable to different categories of clients ». From this we also descends the shared decision to extend « some information and reporting requirements to the relationship with eligible counterparties»; regarding, in particular « the safeguarding of client financial instruments and funds as well as information and reporting requirements concerning more complex financial instruments and transactions». Thus it seems that the European legislator has taken into account the circumstances for which more expert clients can use their skilsl to make a more informed decision.

7. In our opinion, in this framework some form of protection could come from the power attributed to Esma (*European Securities and Markets Authority*) under art. 40 of the Mifir Regulation. This refers, more precisely, to the so-called *intervention product,* that is, the faculty recognized of the above mentioned Supervisory Authorities to temporarily prohibit (or limit) the marketing, distribution or sale of certain financial instruments or a type of financial activity or practice (Moloney 2012). Such an important power of intervention is allowed, however,

only in the presence of certain conditions; among them the necessity to face «a significant investor protection concern or a threat to the orderly functioning and integrity of financial markets or commodity markets or to the stability of the whole or part of the financial system in the Union ». We should wonder, therefore, if among the causes that justify the action of Esma can be counted those that depend on the systematic *bias* of the investors concerning the evaluation of the characteristics of certain complex financial products. It goes without saying that the an affirmative answer to this question depends on the possibility of identifying, in terms of concreteness, suitable instruments to detect *cognitive biases* while receiving investment advice.

New forms of protection for investors are implied by the legal requirements regarding *product governance* (art. 16, par. 3, of the directive 2014/65/EU); we refer to the provisions aimed at guaranteeing coherence, from the phase of product generation, between the instruments issued and/or placed and the *target reference* clientele, in this way extending the evaluation of suitability of the financial instrument from the sales phase to that of production. In the same perspective are laws concerning internal organizational frameworks of the intermediaries; laws aimed at ensuring that the investment company implements a process of approval for each financial instrument used and for every significant modification of the preexisting ones, before their commercialization or distribution to their clientele.

Moreover, it should be noted how the temporal factor can assume specific relevance, due to the previously mentioned process effects and framing effects. There are, in this sense, studies relating the boundedly rational choices of individuals to the need of making complex decisions quickly. Interestingly, MiFiD II seems to take into account (*recital* nn. 83 and 84) that the client needs an adequate amount of time to be able to read and understand the information before making an investment decision; and that it is likely that for the investor «to review information given on a complex or unfamiliar product or service, or a product or service a client has no experience», further detailed investigations are necessary; there is the necessity to obtain «more time» with respect to that normally taken to evaluate «a simpler or more familiar product or service, or where the client has relevant prior experience». The longer time available offers the opportunity to those interested to consult impartial experts, as well as to make further investigations in a context that is different from that created by the intermediary and to trigger the "reasoning system" defined in the cognitive literature (e.g. Kahneman 2003 and references therein), able to counterbalance intuitive decision making. It is particularly interesting, then, that the company is allowed not to provide investors «in good time before a time specified in this Directive » all the information requested by law; in the same way the intermediaries are not obliged «to provide it either separately or by incorporating the information in a client agreement ».

Finally, and most interestingly, the regulation makes it necessary to guarantee the absence of conflicts of interest of the intermediaries during their relationships in which they deal; it is clear, indeed, that conflicts of interest impede the correct unfolding of negotiating dynamics. In this regard, the MiFID II strengthens independent consultancy on the one hand, and on the other, it prescribes for intermediaries the obligation of transparency on costs and commissions. The dispositions that impose appropriate skills for the counterparties of clients are decisive. Indeed, the *recital* n. 79 of the directive establishes that «given the complexity of investment products», it is necessary to « to ensure that staff who advise on or sell investment products to retail clients possess an appropriate level of knowledge and competence in relation to the products offered», notwithstanding this « Investment firms should allow their staff sufficient time and resources to achieve that knowledge and competence and to apply it in providing services to clients». It is clear, however, that the effectiveness of remedies to the possible *cognitive errors* committed by the investors requires high skills on the part of information providers and from intermediaries who need to evaluate risk profiles based on the information supplied by the client.

8. The limited spread of financial knowledge, as shown in the financial literacy field, calls for policy interventions towards strengthening financial education based on indications from behavioral finance. Clearly this approach, in itself, cannot be the only solution to the problem of risk profiling (Lacko and Pappallardo 2004). More specifically, with reference to relationships between financial intermediaries and clients, it is key to identify operational techniques that allow a fair progress of the negotiating dynamics and the pursuit of the regulatory objectives not just formally, but in terms of concreteness.

Keeping in mind that the MiFID questionnaire has proven inadequate to risk profiling, it would be worth modifying it in light of the evidence on the cognitive processes of investors. For this, investors should be on guard about making, in a given area and in the presence of specific circumstances, evaluation errors. It goes without saying that the efficacy of such protection for clients depends on the correct compilation of the questionnaire; this could possibly be imposed at the regulatory level, recommended to the intermediaries in their code of self-discipline, or contractually defined by the negotiating parties.

Another issue is the identification of specific procedures aimed at evaluating the correct risk propensity of investors; an evaluation that could be altered, as has been seen, because of various factors. A fact emerging from experiments regards, in particular, the lacking trust of investors concerning the absence of specific economic interest of the intermediaries. We have to consider, in this respect, that the efficacy of the MiFID questionnaire could be compromised by unscrupulous intermediaries induce inexperienced investors to overstate their risk propensities. Moreover, while it is true that MiFID advice is diffused above all between the people with a high level of education, the self-employed, the residents in northern Italy and the better off (Linciano, Gentile 2016), it is also true, as shown before, that in some cases the savers have to pay an excessive price.

The strengthened provisions on independent consulting, however, is going in the direction of better safeguarding the interests of the clients. It is yet essential to identify instruments able to carry out impartial evaluations of risk profiles. On this point, the use of questionnaires or *software* based on research in experimental economics would limit the discretional power of the intermediaries in their evaluations, ensure a correct circulation of information, and, as such, lead investors to trust the procedures.

The complexity of the financial products, together with the considerable information load involved in financial contracts, most often does not allow clients to make really thought through choices. It is, therefore, necessary to rationalize the data with the identification of key information to be placed well in evidence at the time of counseling, using framing and availability effects in the interest of investor protection and preventing their exploitation by intermediaries.

In this regard, some indications could derive from the regulation in the matter of Undertakings for Collective Investment in Transferable Securities (UCITS); in this setting, the EU Regulation n. 583/2010 states that all the information has to be available in a single document to be presented to the client. Moreover, it is most significant that the essential information has to be concisely written in non-technical language and presented in such a way as to be reasonably understood by the client. Indeed, the document containing the key investor information cannot exceed certain quantitative limits.

A further issue is how to make best use of the evidence from behavioral finance towards identifying the regulatory instruments considered most suitable for investor protectione. On this matter, next to a first policy (*paternalistic*) (Baldwin and Cave 2012), according to which possibly misleading activities should be forbidden (as it happens, in our opinion, with the introduction of the so-called *product intervention*), there is another (Thaler and Sunstein 2009), using methods of *soft paternalism,* inducing the client to make a supposedly best choice without forbidding the alternative decisions. One method of this type is, moreover, suggested by the evidence from experimental economics, and consists in preparing the decisional context so that the investors lean towards better choices than in a context “framed” by unscrupulous intermediaries. This strategy, however, is effective within the limits in which the regulator can consider himself *better informed* and *less exposed* to cognitive distortions than the recipients of the disposition. This approach preserves the decisional power of investors, who are nonetheless free to *decide* and to commit their own errors (Moloney 2010). It is probable, to tell the truth, that no single regulatory instrument suits each circumstance. Hence the rationale behind the foreseen participation of experts in this sector in the design of regulatory instruments, contained in the *executive order* of 2015, which was mentioned before. The regulatory model characterized by *personalized default rules* (Sunstein 2013; Porat and Strahilevitz 2014) should be evaluated under the profile of legitimacy; a *differentiated regulation* should be *implemented* to determine relevant market groups that do not respond adequately to a general regulation. The danger of damaging the principle of constitutionally guaranteed equality is clear in this case.

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GENERAL THEORETICAL CONCEPT OF THE CONTRACT: A GLANCE FROM RUSSIAN CIVIL LAW

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ABSTRACT: *This article tells about the contract as a general theoretical notion, which is now used not only in civil law branch, but has become interdisciplinary. There are described theoretical features of contract that are applicable to a contract, which appears to be in every branch of Russian law system. The notion 'contract' is considered in three interlinked senses. First one is when it is understood as an act of regulation of social relationships. Second one is when we understand it as the legal relationship itself and the third one is when it is considered a legal fact – an origin which leads to a certain legal relationship.*

This point of view of the contract is now widespread in Russian legal doctrine and is a interdisciplinary summary of development of each branch of law and their doctrine.

1. It is well known that the term 'contract' was born as a civil law concept and is thoroughly developed by the science of civil law. With the development of branches of law such a narrowly specialized concept of contract no longer meets the economic realities, as well as the latest scientific developments. In recent years in Russian legal doctrine there has become a developed concept of contracts in

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administrative branch of law[1]. However, this administrative law doctrine has not yet been implemented in practice. In order to bring the concept of contract into a general theory of Russian law, it is necessary to go beyond the branch of civil law, as well as other branches of law, in which the concept of 'contract' is being developed.

At the same time the foundations of this concept have yet to be taken from the civil law, because it is there, where the concept of contract originated and has been developed for over two thousand years. The concept of contract is rooted in the civil law science as a concept that combines three disparate phenomena: 1) the contract is understood as a legal relationship; 2) the contract is understood as a transaction (if transcending the branch of civil law, this concept must be determined as 'legal fact', the origin of legal relationship); 3) the contract is also meant as an act of regulation of originated social relations. Some points of views on contract in administrative law doctrine should be highlighted further.

In the science of administrative law, the contract is understood as the origin of occurrence administrative legal relations. D.N. Bahrach defines the administrative contract as a multilateral act, based on the administrative legal norms, and generated as a result of the voluntary harmonization of the wills of two or more parties of administrative law, one of which acts as the subject of the government, establishing mutual rights and obligations of the parties[2].

A similar definition gives V.A. Yusupov, indicating the direction of the administrative contract on the occurrence of administrative relations[3].

Based on the consideration of the points of view of scientists Russian administrative law N.S. Klimkin displays signs of an administrative contract that distinguishes it from civil law contracts: 1) Administrative contracts, usually need to have an organizational content, their goal - the achievement of socially significant results; 2)

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[1]See, HUZHIN, 'Administrative contract in civil law' (Candidate thesis, St. Petersburg State University, 1994) 16-19.
[2]See, BAHRAH, '*Administrative law: student's book*' (Moscow: Bek, 1997) 171-173
[3]See, USUPOV, '*Law enforcement activity of administrative organs*' (Moscow: Legal literature, 1997) 73

Administrative contract serves as a form of business of parties, who have a certain independence, even taking into account the fact that these parties are in a relationship of power and subordination, and a mandatory party is a governing person; 3) administrative contract is not provided with judicial protection in Russia and breach of contract does not entail imposition of pecuniary sanctions on violators; 4) administrative contract is not an independent form of government, and is a subsidiary to the administrative act; 5) the regulatory framework of an administrative contract are the rules of the administrative and not the civil branch of law; 6) at the same time an administrative contract may replace an administrative act in some cases; 7) it is possible to use a variety of measures of responsibility for breach of contract; 8) there is suggested a classification of contracts on the contracts of competence, maintenance, on the implementation of governmental orders[4].

In order to develop the scientific knowledge, any definition, concept or classification should be subject to criticism and scrutiny. From the definitions of D.N. Bahrakh and V.A. Yusupov follows that the administrative contract is understood as the origin (basis) of occurrence of administrative legal relationships. The relationships themselves are merely a consequence of the administrative contract. In general, it can be concluded that the administrative contract is not understood in the sense of a special administrative contractual relationship and is understood only as a basis of occurrence of legal relationship, also it is understood as an act of legal regulation of social relationships (the source of the problems of legal regulation).

From the classification of N.S. Klimkin there does not follow a clear delineation of understanding of the contract in administrative law, but what is clear is that the administrative contract does not indicated on a special administrative law relationship.

Modern dissertations in administrative law use the concept of the administrative contract in the sense of a source of legal regulation, as well as an agreement that

[4]See, KLIMKIN, ‘Administrative contract in the system of legal relationships in Russian Federation’ (2014) 2 Social sciences. Politics and law 34-35.

leads to a certain legal consequences.

So S.V. Kurchevskaya gives the following definition of the administrative agreement: Administrative contract is an agreement of two or more subjects of administrative law, at least one of whom has public authority and administers management functions. This agreement sets, ceases or changes the administrative rights and obligations, is aimed at satisfaction of public interests and is regulated by administrative legal rules (norms) and also by the general provisions of the contract, established in civil law in so far as they are not contrary to public legal nature of the agreement. Further the author states that that administrative contract is generally understood as a normative contract and as an individual contract (depending on the range of subjects of the public legal relationships who are controlled by the contract)[5]. Here again, it can be stated that the administrative contract is not understood as a legal relationship.

While designing the concept of the administrative contract scientists often come to borrowing the achievements of civil law. U.N. Starilov brings the concept of the administrative contract from the general theoretical signs of contract such as voluntary conclusion of the contract; the legal equality of the participants; the consistency of all the essential conditions of the contract; equivalence of compensation; mutual responsibility of the parties for non-performance or improper performance of the obligations from the contract[6]. It is easy to be sure that these signs are not really general theoretical, but taken from civil law doctrine. Further, these attributes are applied mechanically to the administrative contract[7]. That is, in general, administrative legal science does not develops the doctrine of the administrative contract, but borrows from the science of civil law.

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[5]See, KURCHEVSKAYA, 'Administrative contract: the formation of modern theory and main problems' (Candidate thesis, Voronezh State University, 2002) 12-14.

[6]See, STARILOV, '*The treaty on administrative law*'. In 3 vol. Vol. 2: Governmental service. Governmental actions. Governmental acts. Administrative justice. (Moscow, NORMA publishing house, 2002) 450-451.

[7]See, STARILOV - DAVYDOV, 'Administrative contract in the system of governmental management: purpose, legal conditions, varieties' (2013) 5 Administrative law and procedure 4-9

This approach does not allow to bring the concept of contract onto a cross-branched and general theoretical level. The concept of the contract which is used in civil law, yet to enter the level of general theory of law, should be insulated from the exclusively civil law effects, in particularity the method of civil law regulation. It is thus not applicable to require, for example, that administrative branch law be embodied with the principle of equality of subjects of administrative law, even if they are bound with an administrative agreement.

General theoretical understanding of the contract is suggested by administrative law scientists A.P. Korenev and A.A. Abdurakhmanov: the contract is an agreement, understood as a manifestation of mutual and consensual will of the parties with respect to a single legal purpose permitted by law, based on the formal equality of the parties[8]. From this definition it follows that the agreement is understood as the basis of any legal consequences in general and it focuses on the formal equality of the parties. That is again the definition with civil law shade.

Approximately similar situation is observed in the labor law. The term ‘contract of employment’ is used in labor law. The basement for the allocation of such contracts in Russia laid the L.S. Tal work, named in the ‘Labor Contract: civil law research’. Contracts of employment (or labor contracts) at that time belonged to the institutions of civil law. Currently, as we know, there is a separate branch of labor law governing labor relations arising from the employment contract.

In contemporary labor law of the Russian Federation, as an independent branch of the Russian law system, there is also developed the concept of a contract in relation to the employment contract. The concept of the employment contract is determined by the rules of law. According to Art. 56 of the Labor Code of Russian Federation, the employment contract is an agreement between the employer and the employee, under which the employer undertakes to provide the employee with the work on a given employment function, provide the working conditions stipulated by

[8]See, KORENEV - ABDURAHMANOV, ‘Administrative contracts: the definition and varieties’ (1998) 7 Journal of Russian Law 45-54.

labor legislation and other normative legal acts containing rules of labor law, collective contracts, agreements, local regulations and by this agreement, to pay in a timely manner and in the whole amount the employee wages, and the employee undertakes to personally perform a certain labor function stipulated in this agreement, in the interests of employer, under the management and control of the employer, to comply with internal regulations, enacted in the employer's office (enterprise).

This legal definition is recognized unsatisfactory, because it cannot grasp the breadth of the concept of an employment contract. In science, a concept of an employment contract is offered to be understood as a form of realization of the right to work, as the basis of the emergence and existence of labor legal relationships, and also as labor law institution that brings together the legal rules of labor law governing labor relations[9].

With the development of labor law and the gradual development of such institutions, such as the collective agreement, an agreement on full liability, an agreement on the collective (brigade) liability, there has recently appeared the doctrine of labor transactions, also borrowed from the civil law. On the labor transaction there is meant volitional actions of individuals or entities, aimed at the establishment, modification or termination of employment rights and responsibilities in the area of wage and contractual labor. Labor deals (transactions) are a legal fact to which labor law rules associate the emergence, change or termination of social labor relations[10]. It is evident that it is told about agreements (contracts in the sense of transaction), in labor law. Such transactions can be roughly understood as a labor-contract in the sense of transaction in a broad sense. In any case, there is quite clearly traced the concept of the labor law transaction, as the legal fact, consistent with the concept of transaction in civil law doctrine.

The analysis of various definitions of contract in civil law can not be carried out

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[9]See, SMIRNOV, '*Labor law: student's book*' (Moscow, Avenue, 1996) 158; Anisimov L.N. '*Labor contract: rights and obligations of parties*' (Moscow, Business courtyard, 2009) 10

[10]See, LEBEDEV - VORONKOVA - MELNIKOVA, '*Modern labor law (An experience of comparative labor law). First book*' (Moscow, Statute, 2007) 254

in a single article. Philosophically any possible definition of the concept gives the limits of the concept, while, on the contrary, the use of a vast array of civil law knowledge on contract in civil law will throw a sufficiently broad look at the agreement, which can help bring general theoretical signs of the contract. General theoretical concept should be built on the achievements of the various sectoral legal sciences, but even in this case it can not be considered as true the excretion of general theoretical concept of the contract, combining in this concept different legal phenomena, in particularity, legal relationships, basis of occurrence of legal relationships and the act, regulating social relationships.

There is set a problem to be resolved by this paper - to bring the general theoretical concept of the contract, not allowing it to be a mixture of different legal phenomena, and also to bring the concept of 'agreement' (contract) from under the influence of a specific branch of legal sciences, from the subject and the method of legal regulation of a separate branch of law.

2. The contract can be understood as a legal act by means of which there is administered the regulation of social relations. The legislation doesn't give such a value to a contract directly, but this comes out directly from the structure of law acts and certain provisions (rules) of law.

In this sense, historically, the agreement has been fulfilling a dominant function in the regulation of social relations. And law act regulations take place of a subsidiary tool.

This is most clearly seen in the development of English contract law, which operates the most complete freedom of contract, and the law only establishes prohibitions and restrictions that cannot be regulated by the contract[11].

With the development of law and with the features of economic structure in

[11]See, KARAPETOV - SAVELYEV, '*Freedom of contract and its limits*'. In 2 volumes. Vol. 2: the limits of freedom of defining of contract terms in foreign and Russian law (Moscow, Statute, 2012) 3-4

Russia, there have happened significant changes, which brought the contract to a leading place among the regulatory instruments. However, the contract plays a secondary role to law, normative act, thereby taking a supporting role in the regulation of social relations.

A large number of imperative rules in the legislation put the contract on the second place. This withdrawal is easy to be seen by analyzing the individual provisions of the law act. For example, paragraph 1, of Art. 425 of the Civil Code of Russia explicitly provides that the contract must comply with the imperative rules mandatory for the parties. These rules are settled by a statute (law act) and other legal acts (imperative norms) and are in action at the time of the conclusion of the contract. This says that the very existence of imperative norms even in civil law is implied.

About the other branches of Russian law it can be strictly said that the contract only compensates the regulation, which is not fixed by law act. In labor law employment contract is created only to consolidate the existing labor law rules for certain parties (Art. 57 of the Labour Code). In the administrative law it is at all inconceivable that an administrative agreement would create a rule of conduct which would not be fixed by law act due to mandatory, permissive method of legal regulation of administrative branch of law.

For all branches of law it can be said that the contract is intended to individualize the law, to make it concrete. That is the value of the contract understood as an instrument of legal regulation. The contract is an individual legal act. Such an individual legal act should not necessarily fix the rules of law existing in the normative act - with the help of contract the rules of conduct can be established, however, they will not get the nature of a law norm (rule), since the essence of any rule of law is in its action for unspecified persons.

Although, it has become a very common a doctrine of the normative contracts. S.F. Kechekyan, N.G. Alexandrov recognized in particularity the fact that the contract may give rise to the rule of law[12].

The definition that has become common in science, was suggested by A.V. Demin. He defines normative contract as a contractual act establishing the rule of law (rules of conduct), mandatory for numerous and formally unspecified persons, designed for repeated application, and valid regardless of emergence or termination of any specific legal relationships[13].

By developing this definition, V.V. Ivanov indicates a normative contract parties: they are the subjects of law-making. V.V. Ivanov pays special attention on the order of the conclusion of the regulatory contract, underlining the necessity to harmonize the wills of the subjects of law-making[14]. This development of the definition says that the normative contract differs from any other law acts only by the procedure of its enactment and by the necessity to participate in its enactment of more than one law-making subject. But the legal essence of the normative contract is identical to any other law act, because it contains law rules (norms).

However, in law science there are studies that prove the fact that the regulatory (normative) contract is an independent form law, which exists in parallel with a normative act[15]. Those conclusions, which are contained in the thesis research of U.U. Kulakova, are quite remarkable. On the one hand, the normative contract as a form of law is an agreement, establishing rules, which are obligatory not only for the parties to the contract, but also for subjects whose will in this agreement is not directly expressed. Application of normative agreement is provided by the governmental power. On the other hand, the differences in between legal acts and normative contracts are caused by the differences in the genesis of the the legal

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[12]See, KECHEKIAN, '*About the definition of source of law*' (Moscow, MSU, 1946) 116; ALEXANDROV, '*To the question of the role of contract in legal regulation of social relationships*' (Moscow, Scientific notes VIUN, 1946) 61-62.
[13]See, DEMIN, '*General questions of the theory of administrative contract*' (Krasnoyarsk, Krasnoyarsk state university, 1998) 84.
[14]See, IVANOV, '*To the question of theory of normative contract*' (2000) 7 Journal of Russian law 45-55.
[15]See, KULAKOVA, '*Place of normative legal contract in the system of forms of law*' (2007) 8 History of state and law 5-7.

norms, which they contain, i.e. in the mechanism of creation and formation of the model of behavior, while it is in the process of legislation and appears to be just a rule which is not yet in action. By virtue of dissimilarity of processes in which one or another rule of behavior develops into shape, the normative contract stands as an independent form of law[16]. That is to say, that the mechanism of making the rule of law is a fundamental criterion for separating a normative act and normative contract.

This classification of the law norms, depending on the procedure of their enaction is acceptable for the theory of law, but under closer approximation, it concerns not the law norms themselves, but only that precedes their existence. Therefore, if you set aside the order acceptance (conclusion) of the normative contract, it can be recognized that the normative contract as a source of law norms (a form of the law) is just a kind of law act.

But if this is so, the question arises about the meaning of allocation of normative contracts and about how this relates to the fact that the contract should individualize the rule of law and be an individual legal act, which regulates the relations between individual subjects.

The analysis of both concepts suggests that there are no significant formal contradictions between them. This can be explained by the example of the international public law. In international public law, there is a sub-branch of law – the law of international contracts (covenants). That's where there is a rule that the international covenant is, on the one hand, a normative act, and on the other hand, it does not cover those states (subjects of international public law), which are not parties to this agreement[17]. It appears that the rules contained in the contract does not apply to the entities that do not participate in the covenant. This fact means that an international contract (covenant) is an individual act of application, acting in respect of states (other subjects of international public law), who participate in the contract. The nor-

[16]See, KULAKOVA, '*Normative contract in the system of forms of Russian law*' (Candidate thesis, Moscow university of the Ministry of Internal Affairs of the Russian Federation, 2005) 192 p.

[17]See, TALALAEV, '*Law of international contracts. General provisions*' (Moscow, International relations, 1980) 312 p.

mative nature of such a contract plays an indirect role in the regulation of relations between other subjects of law (those subjects who are not the subjects of international public law) – citizens, legal entities/ But these subjects of law are situated on a different level of legal regulation. They are the subjects of other branches of law.

The state is seen as some totality of citizens living on its territory. At the same time in international public law – it is a single entity. The combination of a plurality in unity allows to recognize the international law covenant as a normative contract and the individual contract, combined in one phenomena. The normative nature of the contract will take place for such subjects as citizens and legal entities, and individual nature – for the States (and other subjects of international public law) – parties the contract.

The same can also be applied to contracts concluded between, for example, the government and public corporations, among the subjects of the federation in the federal state, between the municipalities and so on. On the one hand, such agreements will be the individual contracts, on the other hand, they contain rules of conduct addressed to unspecified persons, but, for example, living on the territory of a particular subject of the federation, officials of the state corporations and so on.

The concept of a normative contract is thus transcendental – it covers the different levels of subjects, among which can be cross-sectoral barriers, the barriers between branches of law which settle legal state of the subjects of law. Only in this sense there is a possibility of existence of a notion of normative contract. It is not possible, for example, to allow some agreement between the Rostov Region and the Krasnodar region to spread its effect on the Stavropol region. Here it is the manifestation of the contract as an individual act of regulation.

The general theoretical concept of the contract must be built on these following postulates: the agreement as an act of regulation, which extends its effect only on individually-defined persons, whose legal state is determined by a certain branch of law. Normative nature of the contract thus does meet such criteria as the regulation of relationships between subjects whose legal status is determined by the different branches of law. For example, if the contract is concluded between the subjects of the Federation, it will play a normative sense only for persons who, for example, reside on the territory of the regions of Federation, who are the parties of this normative contract. If a civil contract is concluded between major legal entities, the normative nature of the contract will also play its role for the employees of these major entities and persons who are bound with these major entities with corporate legal relationships. But in no way can it be allowed that an international covenant be concluded between a specific individual and the state as a whole, which would establish the rule (norm) of law addressed to the same people, who have the same state as this individual. This is due to the fact that citizens are not subjects of international public law. The assumption of such agreements between the entities with different-legal status (determined by different branches of law) is nonsense and can not have a value for the theory of law.

Regarding the ideas, expressed earlier, the paragraph 1 of Article 450 of the Civil Code of Russian Federation seems strange. According to subparagraph 2 paragraph 1 article 450 of the Civil Code, a multilateral contract, the performance of which is linked with entrepreneurial activity, can make provisions that the change or cancelation of this contract can be made by an agreement of all or majority of participants of this multilateral contract, unless other is subscribed by a special law act.

Changing of the contract is typically represented as a separate contract. The case in which the contract change occurs not due to the will of all the participants, but only in connection with the will of the majority of them can not even recognize the change of contract as a separate contract. This is nothing but a decision of meeting. The possibility of such an expression of will in the frame of the decision of meeting must be prescribed in the initial multilateral contract.

With regard to the theoretical concept of the contract it can be determined that the contract has mandatory force only for parties who expressed their will and are the participants of the contract.

From the considerations, written above, the opposite conclusion follows regarding the ancillary action of the law norms, according to which the contract is concluded. These rules of law are at a different level of legal regulation. The contract is the direct act regulating relationships between subjects, the contract rules (conditions) are the closest. There are no mediating regulatory links between the contract and the social relationship, which is under regulation. Even when talking about the civil-law dispositive rules (soft law), it can not be right to say that such rules are canceled be the contract. Cancellation of such rules literally is possible only by the legal act of the same level. The contract only sets different rules of individual behavior. But even if the contractual rights (condition) corresponds to the content of a dispositive norm, this correspondence is only informative. The dispositive norm is mediated and concretized by the contract rule. The correspondence does not mean identity, since the identity can not be reached between the dispositive rule of law, settling abstract rules of conduct, and contractual conditions, which imposes a very specific and exact rule (model) of conduct.

The hierarchical subordination of contractual terms to the rules of law of a higher order is applicable to normative contracts, for example, the collective agreement (the normative nature of which is not disputed) must comply with the labor law rules, which are at the highest regulatory level (Article 40 of the Labor Code of Russian Federation).

General theoretical concept of the contract as an individual regulatory act may be defined as a document, containing law rules, which are subordinate to the rules with higher legal force, regulating relationships between the subjects – parties of the contract, or establishing the rules of law for the subjects with different legal status, set in the other branch of law. The latest subjects are subordinate to the parties of the contract.

3. Initially, it should be noted that the most acceptable view on the legal relationship is understanding the legal relationship as the ideal mental essence representing the dialectical unity of abstract rules of conduct (rule of law) and specific so-

cial relations, obtained by means of synthesis of mental representations of the rule of law and social relations. This view has thoroughly been developed in one of the monographs of the authors of this article[18].

Understanding of the contract as the legal relationship is inherent for Russian civil law. The most common is the view on the contract as a legal relationship of obligation[19]. This article does not have an aim to consider particularly obligation relationships. The aim is to take from civil law that common provisions about obligations, which can be spread on the general theoretical concept of the contract as a legal relationship. It is advisable to do put the accent especially on civil law doctrine, because this branch of law spawned the notion 'contract', thereat historically and essentially the contract is a civil law phenomenon.

In labor law employment contract may also be understood as an employment legal relationship. Based on some of the above views on the administrative contract, it is clear that in general, the administrative contract in science of administrative law is not meant as an administrative legal relationship.

However, there is a new trend in the science of administrative law: it is the concept of the administrative contractual obligations[20]. L.V. Shcherbakova introduces a classification of such administrative contractual obligations: 1) coordination obligations for cooperation and interaction (such obligations are extremely difficult to be distinguished from civil law organizational obligations); 2) administrative contractual obligations for the implementation of the public service, under which public entities are entitled to delegate the implementation of the public service (the right to hold any public works or the provision of public services) to other entities (both private and public). This group includes concession obligations and obligations of the public-private partnership (these obligations are similar in nature to the civil law obligations,

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[18]See, KAMYSHANSKY - KARNUSHIN, '*Civil legal relationship: socially psychological aspect*' (Moscow, Statute, 2016) 222 p.
[19]See, BRAGINSKY - VITRYANSKY, '*Contract law. General provisions*'. 3rd edition. Book 1 (Moscow, Statute, 2001) 279-280.
[20]See, SHERBAKOVA, '*Types of administrative-legal obligations: main criteria of classification*' (2013) 3 Administrative and municipal law 205-219

and concession obligations are often considered in science as belonging to civil law); 3) administrative contractual obligation to provide public needs. This group includes the obligations of state and municipal procurement, and obligations to dispossess public property. 4) as the next classification should cause separation of administrative and contractual obligations on the object on which the governing management is directed. These are obligations of economic development, social security, health care, science and education, culture and the arts, the environment, defense and security; 5) the following criterion for the classification of administrative contractual obligations is the delegation of public service[21].

It is easy to note that these suggested obligations do not differ with law branch purity. In particular, there is not given an answer for the question why these obligations are assigned to administrative law, and not to civil law. Especially now with the expansion of the subject of civil law and the inclusion in it a number of organizational relationships, it is not clear why the organizational relationship should be assigned to administrative law.

Organizational relationships are successfully treated nowadays as civil law relations. So S.U. Morozov, who successfully developed the theory of transport organizational obligations, directly proposes the inclusion of organizational relations in the subject of regulation of civil law[22]. It is almost impossible now to outline the range of relationships that would be regulated by means of a contract. In other words, it is impossible to determine the contractual nature of the relationship based only on the subject of the contract. The number of relations, included in possible subjects of contract is constantly growing. For example, in the Conception of development of civil law, and after it in the corresponding law bill, suggesting amendments to the Russian Civil Code, there is expressly stated that property rights arise from the contract, that could mean that there is a proprietary obligation legal relationship, which is a con-

[21] *Ibid*, at 7
[22] See, MOROZOV, '*Some problems, relating to the definition of legal nature of civil law organizational contracts*' (2015) 7 Russian Justice 11-14.

tractual legal relationship.

It is therefore futile to attempt to delineate the circle of relations which can be regulated by the contract. Right now it can be as property as non-property relations. Each historical period of development of law and society inheres a particular massive of relationships, which are regulated by the contract. Confirmation of this, said above, is the development, in recent years, of administrative and even constitutional contracts[23].

In modern law in general, the number of contractual relationships grows, the contractual relationships are formed completely independently from the method of legal regulation of the relevant branch of law.

Increasing the number of contractual relations should not lead to blurring of boundaries between branches of law. Contouring certain range of public relations and classifying them into one or another branch (e.g. by introducing such a concept as 'administrative obligation') without any views on the method of legal regulation makes the borders of any branch of law vague and leads, in particular, to the recognition of such entities as complexed branches of law. Such an approach is hardly true, because it doesn't differ with purity of the branch of law and does not fit into the harmony of the system of law.

Often the expansion of contractual regulation leads to the fact that a separate set of relationships rather randomly is assigned either to civil, or to administrative law: in this case if the contract is recognized as civil law concept, then contractual relationships are related to civil legal relations, if it is recognized as an administrative law notion, then the legal relationships from such a contract are assigned to administrative law.

This random assignment of relationships to different branches of law wouldn't have taken place if, while assigning legal relationship to one or another branch of law, the method of legal regulation had been thoroughly investigated. In particularity, this

[23]See, LEXIN, '*Contract between governmental organs as a source of constitutional law*' (Candidate thesis, Moscow State University, 2005) 263

concerns the method of regulation of one exact law norm on an exact social relationship. Such approach would allow a number of relations not to be assigned to civil law, because the method of treating such a relationship would not be a civil law method of legal regulation.

Analysis of relationships themselves and their understanding as the unity of abstract legal form and specific exact material content, which can only be achieved in the human psyche (mind), shows that the highest priority will be set to the ways of influencing on human psyche (mind) from the side of law rule and through the mind on the image of beheld social relationship from the law rule. These legal and psychological processes are directly relative to the method of legal regulation of each branch of law. That is to say the method of legal regulation plays a primary role in assigning legal relationships to one or another branch of law.

Contractual legal relationship stands somewhat apart from all law rules of any branch of law. It can be said, that it is ‘out’ and at the same time ‘under’ the method of legal regulation of a branch of law.

Contractual terms (and the contract as a whole) are subject to the norms of a particular branch of law, that can be distinguished as the contractual legal relationship is ‘under’ the method of legal regulation of a particular branch of law.

By the way there is another side of the same phenomenon. Previously, it was found that the contract as a regulatory act takes a special place in the hierarchy of rules of conduct. The contractual terms are of prior importance for the parties who have signed contract. Contract thus was assigned a special place in the mechanism of legal regulation, which is characterized by its proximity to most social relations (contractual terms are closest rules of conduct to conduct itself). This lets us say that in the presence of a contract, the influence on the mind of a subject will take place not directly from law rules, but through contractual terms. This will mean that the contract is out of method of law regulation of a particulate branch of law.

From the statements above, there is derived the conclusion that if there is a contract, it will be incorrect to speak of some particular assignment of contractual relationship to a branch of law. This is due to the fact that the method of legal regulation laid down in the law rules, will play almost no role, when there is a contract and contractual regulation of social relations. That is quite close to the doctrine of common law, where the contracts take a separate and independent role in legal doctrine[24].

Under the existing notion of contract, a contractual relationship, whatever branch of law it is allocated to, have common features. This legal relationship is always relative, because the contract itself is based on the agreement of individually specific subjects. Such a legal relationship can be treated as an obligation with some caution that obligations themselves are normally treated as civil law relationships. The term 'obligation' is not used in Russian theory of law. Thus, assuming the use of the concept of obligation relations in the general theory of law and other areas of law, it can be said that a general contractual legal relationship is an obligation. In this case, there still must be kept in mind that, for example, in the labor law the concept of 'employment obligation', 'labor legal obligation' is not used, but there is used a term 'employment legal relationship'. Just a few as awkward will look a term 'administrative obligation'. So in order to preserve the neutrality from notions used in particular branches of law the best choice will be to use a notion of a 'contractual legal relationship' as an cross-branched and general theoretical term. This legal relationship will simply be called a relative legal relationship.

There should be made a little deeper analysis on the nature of this legal relationship and on the impact of contractual terms on the mind of subjects. Once again it can be referred to English law. In English law there is a classification of the contractual terms on clearly expressed and embodied in the contract terms (express terms) and the expected terms (implied terms). Among the implied terms there are law rules (terms implied by statute)[25]. In Russian law we have the same action on social behavior either from the side of dispositive rules, if they are not changed by parties, or im-

[24]See, TREITEL, '*The law of contract*'. Eleventh edition (Sweet & Maxwell Limited, 2003) 9
[25]*Ibid*, at 9; Anson's law of contract 29th Edition (Oxford University press, 2010) 133-166.

perative rules, which are always in mandatory action.

Fixed contractual terms are the specific obligations (promises, responsibilities) of the parties. Even in the case of establishing the rights of the parties in the agreement, these rights are assumed to be directly addressed to the other side. Setting the contractual terms, the parties are bound to execute and comply with them. This means the special nature of the impact on the mind of the parties. Such a way of impact on mind is an attribute to administrative rules-orders, what can be described as mainly imperative way of contractual regulation of relationships.

The specifics of the contractual terms reinforces the imperativeness, because the more precisely contractual terms and conduct of the parties are defined, the more constrained in conduct freedom remain parties. Such a constraint depends entirely on the nature of the contract. It may be rather low, for example, if the lease contract does not specify a way of using the transmitted thing or if the works contract does not define a method of performing the works by contractor (para. 1, Art. 715 of the Civil Code, para. 3, Art. 748 of the Civil Code of Russian Federation). Restriction of freedom of discretion of the parties may be higher, for example, if the contract of carriage does specify route of movement of the carrier, the exact date, time and place of discharge, time of passing of certain points of the route of the carriage contract.

In any event, going beyond what is installed as a contractual duty is a breach of contract. This can be attributed to all contracts and extended to all contractual relationships.

Allocated criteria of equivalence and equality of the parties of a contractual legal relationship cannot be considered universal, since it depends wholly on the contract terms, which can ensure the interests of either one party or all parties. Depending on this, the interest of one or another party may be provided to a greater or lesser extent, that will no longer mean equality and equivalence.

It is noteworthy that even in the specialized dissertations a mechanism of contractual regulation is deemed a universal mechanism of legal regulation, applicable not only to the civil legal relationships. A.D. Koretsky indicates that the contractual regulation mechanism has similarities within all branches of law and therefore is an cross-branched category. Thus this mechanism should not be considered as a specific element of only the mechanism of civil law regulation, as it appears to be a category of a higher level, which directly enters the mechanism of legal governing and takes extra-branched, generally theoretical level[26].

4. Depending on which branch of law a notion of contract relates to, the contract as a reason of legal relationships is interpreted differently.

In labor law employment contract is understood as the basis of the emergence of labor legal relations (Art. 56 of the Labor Code).

In administrative law the contract is understood as the basis of the emergence, modification or termination of the administrative rights and obligations[27].

Still, the greatest development of the doctrine of the contract in the meaning of a transaction and, accordingly, the legal fact is achieved in the civil law, it is here, where the concept of contract as a transaction received legislative consolidation (Art. 154 of the Civil Code). While analyzing the transaction and the legal fact, for general theoretical concept of the contract as a legal fact there should be rejected all that is applicable solely to civil law and, accordingly, to the civil law transaction. And on contrary, those general features of a transaction should be extended on all contracts as legal facts. But this concerns only those features of a civil transaction which have theoretical and cross-branched sense.

In civil law, there is a developed doctrine on the terms of a transaction. Terms of the transaction make a transaction valid and give it the nature of legal fact, aimed at a particular legal relationship. In contrast, the doctrine of invalidity requires the viciousness of any terms of the transaction, that no longer allows to qualify such an in-

[26]See, KORETSKY, '*The theory of contractual regulation of civil legal relationships*' (Doctor thesis, North-Caucasian Academy of Public Administration, 2007) 492 p.
[27]See, BRATANOVSKY, '*Administrative law. General provisions: student's book*' (Moscow, Direct Media, 2013) 496

valid legal action as a transaction aimed at the emergence of certain legal relationships.

To the terms of the transaction they usually include ‘animus obligandi’ (intention to give legal effect to the transaction), free expression of will (expression of contractual freedom), the form of the transaction and the legitimacy of the goal of such a transaction[28].

All of these elements (except for the form of the transaction) indicate at the ideal nature of the transaction. In fact, the transaction is nothing tangible, it is an ideal entity. This concept of an ideal transaction is directly negotiated with the accepted concept of a legal relationship as an ideal essence, as soon as the transaction in the idealistic sense can produce the same idealistic legal link - legal relationship[29]. The external form of the transaction only unveils the inner being, ideal and covered in the transaction. Ideal elements of the transaction are a inseparable consistently developing system.

The main ideal prerequisite of the transaction are the interests of the parties of the transaction (agreement) with setting a goal of the transaction, then there happens the formation of will, then its implementation (expression of will), then the expression of will is embodied in the form of the transaction. The will of parties is an essential element of any transaction. When considering the will of the contract there must always be the will of at least two subjects (parties). This is the constitutive beginning of a contract. The presence of will in contract can be extended on a general theoretical concept of the contract. The will of parties of the contract merges, forming a united will, directed to a particular legal relationship.

Distinctness of possible relationship is the feature, that allows one to distinguish a legal contractual relationship from all other legal relationships. K.I. Sklovsky concludes that there may emerge obligations that the parties have not assumed

[28]See, GENKIN, ‘*Relative invalidity of transactions*’ (2014) 4 Civil law herald 190-220.
[29]See, SKLOVSKY, ‘*Transaction and its action*’ (Moscow, Statute, 2012) p. 78.

during making the transaction[30]. This point of view may be correct, but shall be recognized private, because the contract as transaction primarily establishes the boundaries of the emerging relationship, gives it the ultimate specifics by specific rules, which play a role of transaction terms. Multiple legal relationships, arising from the contract, which are not a direct consequence of the contractual terms and, accordingly, expressed or presumed will of the parties, cannot be called contractual legal relationships in the strict sense. These relationships just accompany a contract.

Will and its expression relate directly to a much-discussed issue in the science of civil law – the freedom of contract and freedom of will. For the consideration of general theoretical concept of the contract in the context of the notion of a contract as a legal fact, freedom of contract cannot have a general theoretical nature. This is due to the difference in formation of will not only in different branches of law, but also within the same branch of law. For example, a particular formation of will occurs in contracts of adhesion, when a party just joins the offered terms of contract. The will of joining party is fully subservient to the will of the offeror in the contract of adhesion ('adherence to the terms of the contract in total')[31].

When considering the contractual freedom, its understanding needs to be borrowed only in accordance with empowered law and legal phenomena. Freedom is the independence of the formation of will from the existing law rules. There is no need to consider non-free in the legal sense those actions, which, for example, are caused by difficult economic situation or some moral arrangements. Although such actions can be recognized as not free from philosophical positions, but they don't relate to the law directly. This broad philosophical concept of freedom does not belong to the law. In legal sense, freedom first of all and foremost consists of the opportunity of expression of will, incongruous with the legal provisions. That is the freedom in legal sense. In civil law, the level of legal contractual freedom is quite wide. The will of the parties

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[30]See, SKLOVSKY, '*About the correlation of contract and obligation*' (2013) 4 Civil law herald 4-18.

[31]See, CIPLENKOVA, '*Contract of adhesion as a specific category of civil law*' (Candidate thesis, Moscow state legal academy, 2002) 202 p.

does not depend fully on the existing legal norms. Parties have the right to enter into contracts, which are not prescribed by the rules of law, to choose contractors, establish the terms of the contract, provided by the law rules, concerning various contracts regulation (Art. 421 of the Civil Code).

In other branches of law, in particular in labor law, first of all, there is a limited list of labor-law relations, and, secondly conditions of such relationships are very clearly defined by law itself. The freedom in labor law is only in the selection of contractors.

The administrative law contracts are concluded only in accordance with the competence of the subject, the choice of suppliers (parties of the contract) is limited, in general, only those contracts may be concluded, which are permitted by permitory norms.

This means that freedom of will cannot play general theoretical sense. For general theoretical sense it is important just the presence of will of the parties to establish a contractual relationship. Whatever character and nature this will will have, anyway it is not an asset for the theory of law: either this will is subordinated to the will of governmental subject in administrative law, or the will is dictated by the will of an employer in labor law, or the will fully accepts the terms in the contract of adhesion, which is formulated by an entrepreneur, or this will be a free will, consented during negotiations before signing a contract.

The will is formed in the subconscious and is individualized and determined in consciousness. At the same time consciousness itself is a prerequisite of will. The consciousness is affected by various external factors, including rules of law. So it looks quite correct a recognition that will be recognized as dependent on the permitory or advisory law rules. The contract terms can be established in rules of law, the competence of entities (their capacity, efficiency), legal status, which allows or prohibits to enter into a contract.

Interdisciplinary term ‘contract’ should therefore not proceed from the principle of freedom of contract, but from the subordination of the contract to the norms of objective law. To say more is just to delve into the concept of contract, which is developed in some discipline, subjecting to research a branch of law.

Contract in general theoretical sense is a legal fact – an action, enshrined in the hypothesis of law norm. Recognition of the contract as a transaction in general theoretical terms is unacceptable, as some branches of law don't use the concept of transaction, therefore some notions of the contract, taken from a separate branch of law, do not fit into the civil law understanding of a transaction, that is to say, the concept of the transaction cannot be used in the general theory of law and must be recognized as civil law term.

Correlating a contract with the hypotheses of legal norms, there should be noted that in some cases the contract is not the sole and sufficient legal fact for the emergence of legal relationship. Often, the contract serves as an auxiliary legal fact, as an element of a complex legal factual structure. However, even in this case, the contract serves as the most immediate cause of a particular legal relationship. For example, in the field of municipal and state procurement before signing a contract there is applied a number of ways to determine the supplier, the executor. Only after these procedures the contract is concluded. In general, legal relations on state and municipal procurement can be regarded as the legal relations arising from a complex legal structure, but in any case, the contract immediately precedes these legal relationships.

On this account some objections can be heard regarding such cases as, for example, recently introduced in the civil law an institution of a framework contract (Art. 429.1 of the Civil Code). According to para. 1, Art. 429.1 of the Civil Code, a framework contract (a contract with open terms) is a contract that defines the general terms of obligations of the relationship, which can be fleshed out and clarified by the parties by entering into separate contracts, by means of filing one of the parties or otherwise under or pursuant to the execution of framework contract.

There can be specified in this case that even the very framework contract is accepted by law as a contract, it does not directly lead to a specific legal relationship, as for the emergence of these specific relationship there is required other contracts. But such an example is not fully correct, because the framework contract is a good example of the emergence of organizational relations, which are quite specific themselves as soon as the subject of an organizational contract is defined as well as the subject of any other contract[32].

The focus and clarity of will is achieved, by means of giving the contract a certain form. The form of the contract allows more clearly to define emerging legal relationship. However, there is no necessity to require a certain form of the contract, for example a written form. The form only helps to clarify the contents of the will and helps fix this will and give it the exactness. This is the only motif of such legal requirements to the form of contract. An example is the increasing number of contracts even in those areas which are currently not regulated by law, in particular in cyberspace[33]. The form of such contracts is rather uncertain (electronic virtual form), but the will most obviously is clarified from the virtual environment that does not allow to say of the absence of contractual relations.

5. 1. The contract is a general theoretical concept, surpassed the boundaries of a branch of law, such as civil.

2. The general theoretical concept of a contract is understood in three interrelated ways:

a) as an act of individual legal regulation of specific social relations of individual-specific subjects;

b) as the legal relationship, which is relative, and which is not an element of the mechanism of legal regulation of a single branch of the law;

c) as a legal fact - an action aimed at the emergence of a specific relative legal relation.

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[32]See, PODUZOVA, '*Framework contract in modern civil law*' (2013) 3 Actual problems of Russian law 299-304.

[33]See, SAVELIEV, '*Legal nature of virtual objects, purchased for real money in multiplayer games*' (2014) 1 Civil law herald 127-150.