Fordham International Law Journal

Volume 23, *Issue* 6 1999 *Article* 4

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Abstract

I have been asked to make a few remarks regarding Arthur Laby's presentation, but, as everyone knows, it is very hard to discuss anything with the Securities Exchange Commission ("SEC"). As far as I can see, the conceptual interplay of 'disclosure versus substantive rules,' or rather — in its historical order — 'substantive rules versus disclosure,' has not yet been widely discussed in Europe. Let me first set out what I mean by the two approaches as there are probably differences of definition between the United States and Europe, and, indeed, my understanding differs a bit from the one presented by my colleague, Mr. Laby. Let me try a rough definition: the substantive rule concept encompasses not only rules for disclosure of sufficient information to the client, but also requires that intermediaries owe further duties to the client in good faith. The client must be 'tutored,' even though the degree of such tutoring is subject to a variety of opinions.

THE CONCEPT OF DISCLOSURE WITHIN EUROPEAN FINANCIAL INSTITUTIONS

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Substantive rules require that a financial institution take a "protective" attitude. This situation is not always easy to describe in legal terms, but it conveys the idea that because the professional has superior knowledge and information, he must refrain from making use of these advantages to the detriment of his more simple client. A special legal relationship is somehow created that also prohibits the use of conflicts of interest to the detriment of the client. The concept of disclosure means, above all, providing sufficient information to permit a reasonable person to form a reasoned judgement. It is a kind of standardized approach, and it seems to me closer to market ideas, as an informed public makes better decisions.

In my view, both approaches are underpinned by the basic assumptions that prudential supervision cares for the soundness of financial institutions, such as in capital rules and credit rules, and that the responsible individuals within institutions are "fit and proper." The ideal situation of exclusive control through markets is still too remote to be seriously discussed and this

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reduces to some degree the impact of disclosure rule concepts. I might add here that a worldwide harmonization of such substantive rules is occurring within the Basle Committee on Banking Supervision[1] and the International Organisation of Securities Commissions ("IOSCO"). There should be no doubt, however, that markets themselves are an effective means of control.

Justice Louis D. Brandeis' words, "[s]unlight is said to be the best of disinfectants," from his early work *Other People's Money and How the Bankers Use It*,[2] have been quoted often. It seems to me that these words were, at the time, considered amusing rather than setting an early foundation for a belief in the "grown up" or even "enlightened investor," *mündiger Anleger*, who dominates the present scenery to an increasing degree. The aim of protection, however, has prevailed to the present day. This scenario means that the elaboration of substantive rules has also prevailed. Such an attitude was probably justified so long as banks and politics played a major role in the equity financing of firms and the markets remained underdeveloped. To cap it all, the finance industry was also full of cartels.

The evolution of the functioning of markets in the field of finance and other changes have, however, been remarkable over the last ten years, and disclosure rules have now come into their own and become predominant. Some of the changes include:

- Globalization has increased international competition, an idea now supported by the World Trade Organization and the General Agreement on Trade in Services Financial Service Agreement.[3]
- Internationally and generally accepted accounting standards have been adopted virtually across the world.
- Stock markets have become increasingly liberated from their status as state institutions; they are viewed as private,

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1. *Cf.* BASLE COMMITTEE ON BANKING SUPERVISION, COMPENDIUM OF DOCUMENTS PRODUCED BY THE BASLE COMMITTEE ON BANKING SUPERVISION APRIL 1997 (visited Sept. 21, 1999) <http://www.bis.org/publ/index.htm> (on file with the *Fordham International Law Journal*).

2. LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT (St. Martins Press 1995).

3. Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAYAN ROUND vol. 1 (1994), 33 I.L.M. 1125 (1994); WTO General Council, *Report of the Working Group on the Interaction Between Trade and Competition Policy to the General Council*, WTO Doc. WT/WGTCP/2 (Dec. 8, 1998).

self-regulating, market organizing bodies, although not yet in Germany.

- Regulation, though still adopting an overarching view of "banking" as a universal concept, is approaching the securities business in a separate manner. In Europe, this regulation is under the English influence. The Investment Services in the Securities Field Directive[4] ("Investment Services Directive" or "ISD"), it must be noted, also covers the provision of investment advice and contains certain rules of conduct. We speak here of "double rules" both in contract and in administrative law.
- The new phenomenon of sophisticated derivatives is regulated through both disclosure and substantive rules such as capital requirements. The instruments are, however, still considered to contain certain systemic risks, but they are also recognized as instruments for distributing risks.
- More and more special rules, schemes, and exemptions, are being created for professional, or "sophisticated," investors who seem to be able to take care of their own interests. In Switzerland, this development is remarkable.
- New substantive rules are being adopted in the field of criminal law with a clear focus on market protection, through controlling the behavior of financial intermediaries against insider trading, market manipulations, and money laundering. The emerging criminal law in the field of finance is still quite a new phenomenon in Europe.
- Practically all types of investments are currently available to the public if the necessary explanations and warnings are given. In Europe, people still seek meaningful—rather than complete—information. A U.S. memorandum can be so obscure that its reader is not sure if its main purpose is to provide information or to provide a basis to defend possible claims if anything goes wrong.
- The above points are set against the background of increasing competition among investment centers. Protective legislators are no longer able to control their subjects' investment choices.

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4. Council Directive No. 93/22/EEC on Investment Services in the Securities Field, O.J. L 141/27 (1993), *corrected by* O.J. L 170/32 and O.J. L 194/27 (1993).

- Although investor protection is key, a consumer protection movement in the field of finance—including the enforcement of straightforward product liability—has not yet become a major issue.
- The confidence in the investor's judgement and the belief in the efficiency of markets are increasing factors that influence regulation.

In my view, the above changes mean that disclosure is gaining more and more momentum. Substantive rules address more organizational issues. The rules of conduct sail in between.