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Disclosure of Inside Information

Law Working Paper N° 422/2018
Revised August 2019

Jennifer Payne
University of Oxford and ECGI

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This paper can be downloaded without charge from:
https://doi.org/10.67929/ecgi-law-422-2018

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ECGI Working Paper Series in Law

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Abstract

The disclosure of inside information is a core component of EU capital market regulation. It underpins the market abuse regime, providing information to investors, and robbing it of its "inside" quality. Different regimes tackle the issue of inside information disclosure in distinct ways. The EU regime of continuous disclosure stands in sharp contrast to the approach adopted in the US and this paper considers the pros and cons of the EU's approach. This paper argues that the EU provisions are preferable, and are more likely to promote market efficiency, but the EU regime also creates potential dangers and disadvantages for companies who are the subject of the disclosure obligations. Sufficient flexibility is therefore needed to capture the benefits of continuous disclosure without imposing undue burdens on issuers in the process.

Keywords: disclosure, inside information, market abuse, EU financial markets, Market Abuse Regulation

JEL Classifications: K22

Jennifer Payne*
Professor of Corporate Finance Law
University of Oxford, Faculty of Law
St. Cross Road
Oxford OX1 3UL, United Kingdom
e-mail: jennifer.payne@merton.ox.ac.uk

*Corresponding Author

Disclosure of inside information

Jennifer Payne

I. Introduction

The EU Market Abuse Regulation (MAR) places an obligation on issuers of financial instruments[1] to disclose inside information to the market 'as soon as possible'.[2] This must be done in a way that 'enables fast access and complete, correct and timely assessment of the information by the public.'[3] The information must be disseminated to the public simultaneously, or as nearly as possible, in all EEA Member States.[4] This obligation is one of the cornerstones of EU securities market regulation.

The EU regime, based on the notion of prompt disclosure, suggests that the information does not belong to the issuer at all, but rather that, as a general matter, it can be regarded as belonging to all investors and therefore should be shared with the investing public.[5] This approach is distinct from that of other jurisdictions, most notably the US. In particular the EU regime adopts a concept of continuous disclosure, which is much broader than the obligation to disclose inside information imposed on issuers in the US. Furthermore, the EU regime seeks to achieve two goals via the obligation to disclose inside information, namely to inform investors about the company and its business and also to reduce the opportunities for insider trading by robbing information of its inside character. There is thus a close relationship between the disclosure obligation and the prohibition of insider dealing. This approach is again distinct from that of the US. These differences will be explored in this paper.

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[1] Under the Market Abuse Directive, Directive 2003/6/EC ('2003 MAD') the obligation was placed on issuers admitted to regulated markets, but this was broadened considerably under the Market Abuse Regulation, Regulation (EU) No 596/2014 ('MAR') to include not only issuers that have requested or approved the admission of their financial instruments to trading on a regulated market in a Member State but also, in the case of financial instruments traded on an MTF or OTF, issuers who have approved the MTF/OTF trading or request the admission to trading of their financial instrument on an MTF in a Member State: MAR, Art 2(1). A similar disclosure obligation applies to emission allowances market participants (Art 17(2)).

[2] MAR, Art 17. This obligation to disclose inside information as soon as possible was introduced in 2003 (see 2003 MAD, Art 6). The previous obligation, found in Directive 89/592/EEC, Art 7 imposed an ongoing disclosure obligation in relation to material ad hoc disclosures, but Member States varied considerably in relation to their interpretation and implementation of this requirement.

[3] Ibid, Art 17(1)

[4] Directive 2004/109/EC as amended by Directive 2013/50/EU (Transparency Directive), Art 21. Information is required to be displayed on the company's website (although see MAR, Art 17(9) for a concession for SMEs) but in order to ensure that the information is disclosed simultaneously to all market participants, additional dissemination will be needed via some form of news service, such as, in the UK, a "Primary Information Provider" approved by the Financial Conduct Authority which carries news about all companies in the market and so does not favour those who happen to be logged onto a company's website at the time the information is posted.

[5] This is subject to some exemptions eg delay, discussed below at section II.3.

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In section II the breadth of the obligation to disclose information in the EU is analysed and compared to the position in the US. In section III the relationship between this disclosure obligation and the prohibition of insider dealing is discussed, again by reference to the US position. The EU approach brings with it some major benefits, not least a potential increase in market efficiency and investor protection, but also raises difficulties and challenges that must be addressed. The breadth of the continuous disclosure obligation in the EU creates potential costs for issuers and investors. The close relationship between inside information disclosure and the prohibition on insider dealing also raises potential concerns since these forms of regulation operate in quite different ways and yoking them together could have the effect of reducing market efficiency. To some extent MAR anticipates these problems and tackles them, but some concerns remain, particularly regarding the early disclosure of information. The EU continuous disclosure regime is to be welcomed but needs to be operated with care in order to ensure that the benefits of such an approach are not accompanied by undue costs for issuers and investors.

II. The breadth of the obligation to disclose inside information in the EU

Information disclosure is widely used as a technique to regulate the financial markets. It is a cheap regulatory tool, requiring little if any governmental expenditure, and it preserves the notion of empowered investors making their own investment decisions, avoiding the difficult issues of paternalism that sometimes creep into debates about financial product regulation.[6] The purpose of information disclosure in the capital markets is first and foremost to provide investors with protection.[7] It is well understood that securities are intangible goods which cannot be inspected in the same way as other consumer products. They are claims to the future income of companies, ie the value of securities is largely contingent on the expected future performance of the issuing company. The return on the investment is therefore uncertain and the quality of these securities cannot be fully assessed in advance. Regulators and policymakers often focus on the need to provide investors with the information they need to make rational investment decisions and to remove asymmetries of information as between insiders and outsiders in the capital markets.

[6] See O Ben-Shahar and C Schneider, 'The Failure of Mandated Disclosure' (2011) 159 *University of Pennsylvania Law Review* 647.

[7] In addition to providing protection for investors, information disclosure can be seen as providing assistance to shareholders, ie mandatory disclosure has also been said to perform an important function regarding the governance of public companies. It is even suggested by some commentators that the governance functions of mandatory disclosure are its most important functions: RH Kraakman, 'Disclosure and Corporate Governance: An Overview Essay' in G Ferrarini et al (eds), *Reforming Company and Takeover Law in Europe* (Oxford, Oxford University Press, 2004), 96.

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Although the rhetoric around information disclosure often concerns investor protection of this rather direct sort, ie regulating the relationship between issuer and investor, such a discussion fits most comfortably with disclosure obligations in the primary market, rather than disclosure in the secondary market, which is the focus of this chapter. In the secondary market investors are purchasing their securities not from the issuer but from other investors and investor protection is provided indirectly, by ensuring that markets operate as efficiently as possible. It is not that information asymmetries do not exist in the secondary market, they clearly do; investors with more information (including those with inside knowledge of the company, engaged in insider trading) will enjoy systematically greater returns at the expense of uninformed investors in the market. However, dealing with these asymmetries, and providing investors with protection, is achieved not by regulating the relationship between seller and buyer per se but rather by ensuring that prices reflect as closely as possible the underlying value of the assets.

The efficient capital market hypothesis posits that prices within the market at any given time 'fully reflect' available information.[8] EU and US regulators have been strongly influenced by the idea of semi-strong form efficiency whereby all publicly available information about a security is reflected in its price. The fact that insiders trading in the company's shares are able to produce systematically higher returns undermines the strong version of the efficient capital market hypothesis. On the basis of the semi-strong form of the efficient capital market hypothesis, requiring issuers to produce information about themselves and their securities can promote informational efficiency, since that information, once publicly available, will help to move the prices of the securities to a new equilibrium which reflects that new information. On this analysis, investors do not need to actually read and digest the information in order to take advantage of the disclosure.[9] The analysis function is instead performed to a large extent by securities analysts and other market professionals, such as arbitrageurs, researchers, brokers and portfolio managers who spend their time acquiring and evaluating information regarding issuers and their securities. The trading by these professionals moves the market price and thereby allows the information to be assimilated. In an efficient market, unsophisticated investors can thus free ride on the efforts of more sophisticated ones.

This provides investors with protection when they trade in securities since the market price reflects all publicly available information and thus ensures that they will receive a fair price in whatever

[8] EF Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work' (1970) 25 *Journal of Finance* 383. The information being "fully reflected" in the price means that the price moves to a new equilibrium, rather than the fact that the price necessarily reflects the value of the underlying assets, ie this is about informational efficiency rather than price accuracy.

[9] See R Gilson and RH Kraakman, 'The Mechanisms of Market Efficiency' (1984) 70 *Virginia Law Review* 549 for a detailed discussion of how information becomes "fully reflected" in the prices of securities.

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transaction they engage. Of course, this does not mean that market prices reflect the fundamental value of the assets, and neither does it mean that unsophisticated investors can never 'lose' in a semi-strong form efficient market. In particular, unsophisticated investors, and indeed sophisticated investors such as securities analysts, can still lose out to insiders to the extent that those insiders have information that is not publicly available and then trade in the market while in possession of that information. For this reason, it is common for jurisdictions to put in place some form of prohibition on this behaviour, something which is discussed further in section III below.

As a consequence of this approach the EU, in common with the US, places various disclosure obligations on issuers in the secondary market. Both the US and the EU mandate the periodic disclosure of significant financial information about the company, including their financial statements. In the EU, companies with securities traded on regulated markets are required to publish their audited financial statements annually[10] and a slightly lighter set of disclosures half yearly.[11] In the US, companies are under an obligation to publish annually a significant amount of information about the company, including their audited financial statements, via a form 10-K.[12] In addition, there is a requirement to file a form 10-Q on a quarterly basis.

In addition, both the US and the EU require ad hoc disclosures. In the EU this consists of a number of requirements to disclose, including the obligation to disclose the interests in securities of a company held by those discharging managerial responsibilities for those companies, and those connected with them,[13] and also the major shareholdings of a company.[14] At the centre of these obligations, however, is the requirement to disclose inside information 'as soon as possible'. This obligation has been described as the 'bedrock' of the EU regime.[15] It creates a continuous disclosure obligation, and by creating a very broad concept of information which must be publicly disclosed it may be regarded as advancing the goal of price accuracy in the EU. The EU approach is often described as being about providing parity of information, or equality of information to the market, and in one sense it does so, maximising the amount of information made available to the public, ensuring that information is released to the market as simultaneously as possible, and reducing the opportunities for selective disclosure. All investors have the potential to receive the same information at the same time, although

[10] Transparency Directive, Art 4.
[11] Ibid, Art 5 (the requirement for quarterly reporting was abolished by Directive 2013/50/EU).
[12] See Regulation S-X.
[13] MAR, Art 19(1).
[14] Transparency Directive 2004/109/EC as amended by 2013/50/EU, Art 9(1).
[15] See L Enriques and S Gilotta, 'Disclosure and Financial Market Regulation' in N Moloney, E Ferran and J Payne (eds), *The Oxford Handbook of Financial Regulation* (Oxford, Oxford University Press, 2015), 519.

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some investors (retail investors) rarely if ever read the disclosures. This concept of market egalitarianism is valuable therefore for the support it provides to market efficiency.

This stands in contrast to the US which, while it contains an obligation for ad hoc disclosures, does not operate a continuous disclosure regime.[16] In the US there is an obligation to publish 'on a rapid and current basis' updates to the market concerning material changes in issuers' fortunes that occur between the required quarterly reports. The obligation to file a form 8-K, to update the market as to these material changes, is linked to a list of specified events that trigger the requirement for disclosure, such as the issuer filing for bankruptcy or receivership, a material modification of the rights of security holders, or significant acquisitions or dispositions. This contrasts with the EU approach which does not specify the events that trigger disclosure but focuses instead on the consequences of the events on the share price. In the US, there is therefore no requirement to disclose inside information that arises between the quarterly filings and which falls outside this specific list of events. In other words, there is no general duty to disclose all material information to the market. The US regime is therefore said to be a system of periodic disclosure rather than continuous disclosure.[17]

The difference between the US and EU regimes may not be quite as stark as it first appears. Issuers can choose to disclose material information falling outside the specified categories if they wish to do so, and many issuers in the US do appear to make use of optional disclosure between Form 10-Q filings. In relation to inside information, day-to-day circumstances can impose an affirmative obligation to disclose on US issuers, stemming from inquiries from the investment community for information and the issuer's motivation to keep that community apprised of current developments. Many US issuers consequently adopt an affirmative policy of disclosing material information, subject to exceptions such as the necessity of keeping information confidential or protection of a legitimate

[16] Whether or not a US company conducts a public offering, it may, upon reaching a certain size or having a specific number of shareholders, be required to register its securities with the SEC under section 12(b), 12(g) or 15(d) of the SEA, subjecting it to the same ongoing requirements as if it had made a public offering.[5] Conducting a public offering or registering securities under the SEA triggers timely and current reporting requirements, including filing of annual, quarterly and current reports to the SEC (Forms 10-K, 10-Q and 8-K, respectively). These reports mandate the disclosure of financial and non-financial information and require that public companies report certain material information on a periodic basis. US companies registering pursuant to section 12(b) or 12(g) of the SEA are subject to other requirements including beneficial ownership reporting, short-swing trading rules and tender offer and proxy rules, pursuant to sections 16, 13(d) and 12(e) of the SEA, respectively. Certain recordkeeping requirements, internal accounting controls and prohibitions on foreign corrupt practices also apply to these issuers.

[17] See eg *Gallagher v Abbott Laboratories, Inc* 269 F.2d 806 97th Cir, 2001) per Judge Easterbrook.

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business interest.[18] Furthermore, US stock exchanges can require listed companies to promptly disclose to the public information that is material to a reasonable investor.[19]

There are some potentially significant advantages to the EU approach. In particular, if it is correct that the markets in the EU operate in accordance with the semi-strong form of the efficient capital market hypothesis, then in theory the more information that is disclosed to the market the better, since that will enable to price of the securities to move closer to the underlying value of the assets, providing investors with protection when they trade in the securities at the market price. The use of mandatory disclosure comes with costs, however, both for investors, if the information produced is too voluminous to be useful or is simply of the wrong kind, and for issuers, since mandatory disclosure can impose both direct and indirect costs on them. The broad EU approach to the disclosure of inside information therefore needs to be assessed not only according to the potential benefits of the regime, but must also take account of the costs and disadvantages that it can bring.

Five potential problems with the broad EU approach to disclosure of inside information are considered here. The first two may be regarded as principally concerns for the recipients of the information, namely (1) that the information provided may be too technical, too voluminous or otherwise less beneficial for investors than intended; and (2) the EU approach may interfere with the incentives of sophisticated investors, particularly analysts, to gather and utilise information about an issuer. The remaining problems raise concern for issuers, namely (3) that the requirement to disclose information as soon as possible may damage issuers' ability to conduct their business, unless they have the ability to delay disclosure in some circumstances; (4) the cost of disclosure may cause problems for certain issuers, particularly SMEs, who may be excluded from the capital markets as a result of the cost of mandated disclosure; and (5) the mandatory disclosure of inside information may bring with it an enhanced litigation risk for issuers.

1. The benefit of inside information disclosure to investors

One concern that is sometimes raised regarding mandatory disclosure is that it may not be as beneficial to investors as intended. This might be because the technical and/or voluminous nature of the information makes it difficult for investors to utilise, or because it is simply the wrong sort of information and therefore not valuable to investors. There has been increasing recognition in recent

[18] For discussion see D Oesterle, 'The Inexorable March Toward a Continuous Disclosure Requirement for Publicly Traded Corporations: Are We There Yet?' (1998) 20 *Cardozo Law Review* 135.
[19] See eg NYSE Company Manual, Fed Sec L Rep (CCH) ¶ 23, 121 (1977).

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years that simply providing investors, particularly retail investors, with all relevant information will not necessarily enable them to make optimal investment decisions. Issues of bounded rationality and information overload, in particular, can be problematic.[20] Within the EU, regulators have responded to these concerns in the primary market by requiring that the prospectus published by the issuer at the IPO stage be accompanied by a summary which is short,[21] easy to read, and is written in comprehensible, non-technical language.[22] Furthermore, the required content and format is intended to provide investors with the information they will find most useful. The 2017 Prospectus Regulation, for example, limits the risk factors to only those specific to the issuer and/or the securities which are material to investors.[23]

The requirements for disclosing inside information, in common with other disclosures in the secondary market, are not subject to similar protections, but this should not be regarded as overly problematic. Inside information disclosed to the market 'as soon as possible' will still be valuable for sophisticated investors, even if it is not read and utilised directly by retail investors. As discussed, it is sophisticated investors that are the main users of information disclosures in the secondary market, turning information into market prices that operate as a protection for less sophisticated market participants. The market in the aggregate is capable of processing technical and voluminous information even if individual retail investors are not. Retail investors therefore receive indirect protection even if they do not read or understand the disclosures being produced by issuers.

Another concern about the value and utility of the information disclosures required of issuers is that it is regulators and policymakers that determine the information that needs to be disclosed. They are therefore making decisions about what investors will find valuable, and there are a range of reasons why policymakers may not perform this task well, including regulatory capture, cognitive biases, and the regulatory regime being a response to populism. Some disclosure rules can be questioned on this basis. For example, the obligation in EU law to disclose to the public any short position higher than 0.5 per cent of a company's shares[24] may be regarded as being motivated, as least in part, by a popular desire to constrain short sellers in the aftermath of the financial crisis. This low threshold can be regarded as operating as a potential curb on short selling and therefore as having a potentially negative effect on market efficiency.[25]

[20] See eg T Paredes, 'Blinded by the Light: Information Overload and its Consequences for Securities Regulation' (2003) 81 *Washington University Law Quarterly* 417.
[21] The limit is seven A4-size pages: Regulation (EU) 2017/1129, Art 7(3).
[22] Regulation (EU) 2017/1129, Art 7(3).
[23] Ibid, Art 7.
[24] Regulation (EU) No 236/2012, Art 6.
[25] J Payne, 'The Regulation of Short Selling and its Reform in Europe' (2012) 13 *EBOR* 413.

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The requirement to disclose inside information seems to avoid the worst of these concerns, however, since at the core of the concept of inside information is the notion of what a reasonable investor will want to know. Inside information, as defined by MAR, is

> '[i]nformation of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments,[26] and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.'[27]

Indeed, Article 7(4) specifically includes the concept of the 'reasonable investor' within the test of what constitutes inside information:

> 'For the purposes of [Article 7(1)], information which, if it were made public, would be likely to have a significant effect on the prices of financial instruments … shall mean information a reasonable investor would be likely to use as part of the basis of his or her investment decisions.'[28]

Tying the concept of inside information closely to the notion of what a reasonable investor will actually find useful and valuable avoids the difficulties inherent in policymakers and regulators attempting to determine this and specify it in advance.[29]

One difficult issue that has arisen relates to the question of when information about an ongoing or developing situation crosses the threshold to become inside information. This was discussed by the CJEU in *Geltl v Daimler AG*,[30] in which it was held that information may cross that threshold before the final situation has emerged. MAR codifies the approach in *Geltl*, stating that 'an intermediate step in a protracted process shall be deemed to be inside information if, by itself, it satisfies the criteria of

[26] Note therefore that the information does not need to relate to particular securities or a particular issuer of securities ie it could be information which has an impact on the securities markets generally.

[27] MAR, Art 7(1). As regards the concept of 'precise' for this purpose, Article 7(2) provides that information about events or circumstances 'shall be deemed to be of a precise nature…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'. An early draft of the Market Abuse Regulation (published 20 October 2011) had included an additional category of inside information relating to relevant information not generally available to the public (RINGA), on the basis that information can be abused before an issuer is under an obligation to disclose it. The inclusion of this category was controversial and RINGA does not appear in the final version of MAR.

[28] The CJEU has held that this "market impact" test can be satisfied even if the direction of the impact (up or down) cannot be predicted at the time of trading: Case C-628/13 *Lafonta v Autorité des marches financiers* [2015] Lloyd's Rep FC 113.

[29] In the US whether inside information satisfies the test of materiality also depends on the view of a reasonable investor, specifically, whether the information is substantially likely to be important to the reasonable investor in making an investment decision.

[30] Case C-19/11, 28 June 2012.

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inside information as referred to in this Article.'[31] Furthermore, inside information includes not only circumstances or events that already exist or have already occurred, but also those that 'may reasonably be expected'.[32]

There are a number of potential problems that arise from this judgment, including a concern for issuers if disclosure at too early a stage in events risks harming their legitimate interests, and a concern that this approach might harm market efficiency if early stage and potentially unreliable information is publicly disclosed. These issues are discussed below.[33] The focus here is on a potential investor protection problem. Requiring information about an evolving situation to be disclosed at too early a stage risks confusing investors, providing them with information about events that are still uncertain, still evolving and may well change. To some extent this can be addressed by provisions allowing issuers to delay disclosure in situations where disclosure is likely to cause confusion to investors, discussed in (iii) below, but the emphasis in the EU regime is very much in favour of early disclosure, and the ability to delay is heavily circumscribed.

2. The impact of information disclosure on analysts' incentives

The emphasis on equality of information which is at the heart of the EU regime comes at a potential cost regarding the role of analysts. As discussed, analysts and other information intermediaries have an important role in ensuring that markets operate efficiently, turning information about issuers and an assessment of their performance into share prices. Analysts will, of course, read and analyse publicly disclosed information published by issuers but will also seek other information about an issuer in order to give themselves a competitive advantage, and one source of such information is the directors and officers of an issuer.

The EU regime recognises that the use of analysts is a valuable means of ensuring that information is transmitted to the marketplace but seeks to ensure that issuers do not disclose selectively to one or a small number of analysts in a way that could undermine the concept of equality of information. Article 17(8) MAR requires an issuer (or a person acting on behalf of an issuer) which discloses any inside information to any third party in the normal course of the exercise of an employment, profession or duty, to make complete and effective public disclosure of the information,

[31] MAR, Art 7(2).
[32] Ibid, Art 7(2). In *Geltl* the CJEU considered the meaning of "reasonable expectation" and held that it should be equated with a realistic prospect of occurrence rather than a high probability of the event or circumstance taking place.
[33] See section II.3 and section III.

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simultaneously in the case of intended disclosure and promptly in the case of unintended disclosure.[34] Interestingly, this is one area in which the US regime takes a very similar approach: Regulation FD (Fair Disclosure) requires that information provided to one investor is disclosed generally to the market at the same time.

Market egalitarianism would suggest that all investors should receive information on an equal basis, ie the same information at the same time, and this is the driver behind the provisions regarding selective disclosure. However, these provisions may diminish the incentives of analysts to seek out such information, because they can obtain no competitive advantage thereby, and may also reduce an issuer's incentives to disclose to analysts. Information which an issuer may be happy to have in the hands of a small number of sophisticated investors, they may not be prepared to disclose publicly, leading them to deny disclosure to either group. Consequently, these provisions may reduce the flow of information from issuers and may increase analysts' costs.

3. The ability of issuers to delay disclosure

One concern that arises for all issuers regarding the obligation to disclose inside information is that of timing, and in particular the question when the duty to disclose crystallises. There is a danger that announcing matters at too early a stage may be problematic for issuers because it may damage the company's ability to conduct its business and because it relates to issues that are still changing. For example, where the company is in negotiations to sell a major holding of the company, early disclosure may make it more difficult for the company to conclude these negotiations. As discussed above, there may be an investor protection element too as the disclosure may in fact be more misleading to investors than silence. If the company discloses negotiations at too early a stage, this may also make it difficult for investors to determine how to react – specifically how likely it is that the negotiations will succeed. If they buy shares expecting the deal to be completed and then it is not, they may well feel misled.

The legislative provisions in MAR provide some leeway to companies in such circumstances. The obligation on companies is to disclose 'as soon as possible', rather than 'immediately', giving them some flexibility. Moreover, the legislative provisions allow issuers to delay disclosure in some circumstances. Specifically, issuers can 'on their own responsibility' delay disclosure in order to protect

[34] Note, though, that Article 17(8) is subject to a carve out: where the person to whom the information is disclosed is bound by a duty of confidentiality (eg lawyers, accountants) then disclosure to that individual won't trigger a general duty of disclosure. This for example allows the issuer to selectively share information with eg a controlling shareholder as long as the latter must keep the information confidential. The shareholder must however refrain from using the information to trade.

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their 'legitimate interests'. These provisions provide issuers with some room to manoeuvre, especially where early disclosure might be misleading to investors. Article 17(4) MAR deals with the difficulty potentially created by *Geltl* by acknowledging that in a protracted process the issuer may delay the public disclosure of inside information. *Hannam v FCA*[35] provides a good example of such a scenario, though it was decided on the basis of the pre-MAR regime. It was suggested in that case that the issuer was within its rights to delay disclosure of inside information regarding drilling results on the basis that it was necessary to do so to protect its legitimate interests. Specifically, an expert witness asserted that such a delay was standard industry practice and therefore legitimised. While the Tribunal rejected the argument that an industry practice could justify delay, it did accept that it was reasonable for the issuer to delay announcement of the results until it could provide information that avoided misleading the market. On the facts, although the drilling results gave considerable confidence that oil was present, they were not definitive and the issuer was permitted to delay until definitive results were available. The Tribunal assumed that the results were inside information but stated that unless there is some exceptional event or fact that requires immediate disclosure then a listed company can reasonably delay reporting to ensure that an announcement is not misleading when it is made or to finalise its financial results.

The ability to delay is subject to some important caveats, however. The non-disclosure must not be likely to mislead the public and the company must be able to ensure confidentiality on the part of those to whom the information will have to be disclosed.[36] In addition, an issuer which delays the disclosure of information in this way must inform the relevant national competent authority that disclosure of the information was delayed and must provide a written explanation of how the conditions set out here were met, immediately after the information is disclosed to the public.[37]

In general, in regard to the issue of timing, investors' interests appear to have more weight than issuers' concerns. This is distinct from the US approach which is more issuer-focused. As discussed, companies in the US can disclose inside information voluntarily between the required quarterly reports, for example when there is good news to report, but they fall under no specific SEC obligation to disclose bad news, unless failing to do so will violate Rule 10b-5 because it would render another statement made a half-truth. Courts in the US have regarded the timing of disclosure between periodic reports as a matter for the directors' business judgement, so that disclosure may be delayed until the information is ripe, or withheld if a valid business reason exists, such as where premature disclosure

[35] [2014] UKUT 233 (TCC).
[36] MAR, Art 17(4).
[37] Ibid.

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would impair a contract.[38] In one scenario however, the balance is shifted in the EU in favour of the issuer. Where the issuer is a financial institution and the disclosure of the information would threaten the financial viability of the issuer and of the financial system, disclosure can be delayed, subject to the confidentiality test and a public interest test and the consent of the national competent authority.[39] The view is taken in this situation that the costs to the financial system as a whole outweigh the costs to investors of the issuer in question.

4. The impact of information disclosure on SMEs

Mandatory disclosure gives rise to significant fixed costs for issuers which may prove prohibitive for certain issuers, particularly SMEs. This is a general concern within the EU capital market regime, and a major plank of recent reform efforts regarding the prospectus regime has been a focus on ensuring that SMEs are not denied access of the capital markets.[40] Similar concerns arise in relation to the market abuse regime, particularly given the extension of this regime beyond regulated markets by MAR which brought numerous SME issuers within the regime, and thus subject to the inside information disclosure obligation that had previously been outside it. MAR makes some concessions to SMEs to tackle this concern. Article 17(9) MAR allows inside information relating to issuers whose financial instruments are admitted to trading on an 'SME growth market' to be disclosed on the market's website, rather than on the issuer's website, in some circumstances.' This is a minor concession, however.

5. Liability risk

Mandatory disclosure can increase the risk of litigation for issuers, leading to an increase in costs for disclosing firms, and a possible impact on market efficiency if it reduces firms' incentives to make voluntary disclosure of information which falls outside the mandatory regime, or slows down the production of mandated information. If firms fear litigation they may minimise this risk by taking a formalistic approach to the disclosures they are required to make and reducing the level of non-mandated disclosures. A prohibition on selective disclosure, such as exists in both the EU and US, can exacerbate these issues.

[38] For discussion see eg J Cox, R Hillman and D Langevoort, *Securities Regulation: Cases and Materials*, 5th edn (New York, Aspen Publishers, 2006).
[39] MAR, Art 17(5).
[40] See Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Region: Action Plan on Building a Capital Markets Union, 30 September 2015, COM/2015/0468 final.

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This depends to a large extent on the level of enforcement in a regime. Under MAR, as under the 2003 MAD, supervision and enforcement is carried out through a network of NCAs: each Member State must designate a single administrative competent authority for the purposes of MAR.[41] However, it is increasingly recognised that effective regulation of the capital markets within the EU requires a focus on supervisory co-operation and convergence. MAR makes provisions in both regards.

As regards supervisory cooperation, MAR requires NCAs to cooperate with each other and with ESMA where necessary for the purpose of the Regulation, unless a relevant exception applies.[42] In particular, NCAs are to render assistance to each other and to ESMA[43] and, without undue delay, exchange information, and to cooperate in investigation, supervision and enforcement activities. An NCA is also required to inform relevant NCAs and ESMA where it is convinced that acts contrary to MAR are being or have been carried out in the territory of another Member State or that acts are affecting financial instruments traded on a trading venue situated in another Member State.[44] MAR also addresses the issue of cooperation with third counties.[45]

As regards supervisory convergence, MAR addresses this is a number of ways. First, MAR specifies the supervisory and enforcement powers that NCAs need to have in place in order to fulfil their duties under MAR. These include a wide range of powers, such as the power to have access to documents and other data in any form, to require or demand information from any person, to carry out inspections or investigations at non-private premises with or without warning and to enter private premises in order to seize documents and any other data as long as prior authorisation has been obtained from judicial authorities and reasonable suspicion exists that the documents or other data may be relevant to prove that an offence has been committed.[46] Second, MAR seeks to reduce divergences in enforcement by addressing sanctioning powers directly. Member States are required to ensure that NCAs have the power to take appropriate administrative measures and sanctions.[47] Furthermore, MAR specifies the particular breaches of MAR which, as a minimum, must be subject to administrative sanctions[48] and also specifies the types of measure and sanction which must be available.[49] In relation to a breach of the obligation to disclose inside information as soon as possible,

[41] MAR, Art 22.
[42] MAR Art 25(1). The exceptions include where the communication might adversely affect the security of a Member State, and where compliance would be likely to adversely affect the NCAs own enforcement activities: Art 25(2).
[43] Art 24 specifically addresses the requirement for NCAs to cooperate with ESMA.
[44] MAR, Art 25(5).
[45] MAR, Art 26.
[46] MAR, Art 23(2).
[47] MAR, Art 30.
[48] MAR Art 30(1).
[49] MAR, Art 30(2).

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MAR specifies that for natural personal the maximum administrative pecuniary sanction should be at least EUR 1 million, for legal persons it should be EUR 2.5 million or 2 per cent of the total annual turnover.[50] This is not a maximum harmonisation obligation: NCAs may have other sanctioning powers and may impose higher levels of pecuniary sanction.

Third, MAR specifies how administrative measures and sanctions are to be applied: NCAs are to take account of all relevant circumstances including a range of factors specified in Article 31 MAR such as the gravity and duration of the breach, the degree of responsibility of the relevant person, and the financial strength of the person.[51] Fourth, there is a requirement that every decision imposing an administrative sanction be published by the NCA on its website immediately after the person sanctioned is informed and ESMA is notified.[52] Finally, NCAs are required to provide to ESMA annually aggregate information regarding all administrative measures, sanctions and fines imposed under MAR, which must then be published by ESMA in an annual report.[53]

The level of attempted supervisory cooperation and convergence within the EU on this issue is therefore quite significant and this drive towards convergence looks set to continue. This does not, however, alter the fact that enforcement is performed at the level of the NCAs. There is evidence that suggests that the enforcement of measures within a market abuse regime can have quantifiable positive effects for markets,[54] however nothing in MAR actively seeks to increase the level of enforcement undertaken by NCAs. Most notably, however, the focus of the EU regime is on enforcement by a regulator and not private enforcement by individuals. This stands in sharp contrast to the US regime, under which private enforcement by individuals both in relation to breaches of insider dealing and in relation to the timing of disclosures is possible. It has been suggested that one of the reasons for the more restrictive periodic (as opposed to continuous) disclosure regime in place in the US is this expansive enforcement regime.[55] In particular, if a continuous disclosure standard were adopted in the US, it could expose corporations to excessive liability for failing to make timely disclosures. Uncertainty as to when information becomes material and must be disclosed is often a challenging issue in a continuous regime and could lead to second-guessing in litigation. On this

[50] MAR, Art 30(2)(i)(j).
[51] MAR, Art 31(1).
[52] MAR, Art 34(1), which also specifies that there are some circumstances in which NCAs can delay publication, publish on an anonymous basis, or not publish.
[53] MAR, Art 33.
[54] U Bhattacharya and H Daouk, 'The World Price of Insider Trading' (2002) 57 *Journal of Finance* 75; L Beny, 'Do Insider Trading Laws Matter? Some Preliminary Comparative Evidence' (2005) 7 *American Law & Economics Review* 144; U Bhattacharya and H Daouk, 'When No Law is better than a Good Law" (2009) 13 *Review of Finance* 577; N Fernandes and M Ferreira, 'Insider Trading Laws and Stock price Information' (2009) 22 *Review of Financial Studies* 1845
[55] E Greene and O Schmid, 'Duty-free Insider Trading?' (2013) *Columbia Business Law Review* 369.

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analysis the focus of the EU regime on enforcement by regulators fits well with the continuous disclosure regime that has been put in place. Despite the significant changes introduced by MAR regarding enforcement, it appears that liability risk for issuers is not significantly increased.

6. Summary

In summary, while the EU's approach to the disclosure of inside information brings with it potential benefits, particularly regarding market efficiency (and this investor protection), it also raises some potentially problematic issues, for both issuers and investors. The decision in *Geltl*, for example, brings potential difficulties for both issuers and investors; an over expansive view of inside information disclosure, especially regarding the timing of that disclosure could undermine the benefits of the EU regime, by increasing costs for issuers and reducing the value of information disclosure for investors. The position of SMEs, and the effect of the costs of this regime on them, also requires attention. MAR seeks to address these concerns to some extent, but only does so partially, and problems therefore remain.

III. The relationship between the disclosure of inside information and the prohibition on insider dealing

In addition to the function of inside information disclosure discussed in section II above, which is common to all forms of issuer disclosure in the secondary capital markets, namely investor protection via the concept of market efficiency, the disclosure of inside information in the EU is also intended to fulfil a second function. Specifically, the disclosure of inside information is intended to help prevent insider trading: by ensuring that the information is known to the market generally, any temptation for corporate insiders to trade on it will be removed.[56] In the EU there is thus a close link between disclosure and insider dealing regulation.

As discussed above, investor protection and market efficiency goals underlie the issuer disclosure regime. The same goals underpin the EU market abuse regime: investor confidence and the efficient operation of the market are stated in the recitals to MAR as being core objectives of the regulation of market abuse.[57] The adverse impact of market manipulation on market efficiency and on market pricing is obvious: market manipulation generally involves the dissemination of misleading information about an issuer or its securities, or artificial transactions intended to convey false information regarding the supply and demand for investments. The core of market manipulation is an interference with the market's normal price-forming mechanisms and thus market manipulation

[56] MAR, recital 49.
[57] MAR, recital 2.

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undermines informational efficiency. The relationship between insider trading and market efficiency requires a little more thought. After all, there are those that argue that if informational efficiency is the goal then insider trading should be allowed to take place without regulatory interference since insider trading provides a good method for channelling information into the market place, including information that companies may not disclose publicly.[58] Without insider trading, so it is claimed, some of this information (ie information that would not have been publicly disclosed) would not be factored into price since in the semi-strong form of the efficient capital market hypothesis only publicly available information is fully reflected in the price of securities. This claim is contentious. In particular, dealing alone is an inefficient way for information to be imparted to the marketplace since it requires analysts and others to recognise that insiders are trading in the market[59] and then to decode the nature of the underlying information from the fact that an insider is trading in the market.

Instead, the EU approach is to prohibit insider dealing on the basis that such behaviour causes investors to lose confidence in the market, believing that the market is rigged against them. The parity of information approach requires that anyone who obtains material non-public information concerning an issuer or a security because of his professional activity, or misappropriates it, should either disclose it or abstain from trading, and those receiving such information from an insider (tippees) who are aware of the material and non-public nature of the information should also either disclose it or abstain from trading. This again requires a little thought. A significant component of this approach is market egalitarianism, ie the notion that investors should have equal access to information in the marketplace. This idea of market egalitarianism has been influential in forming the EU regime,[60] and requires that investors should have equal access to information and should not be unfairly disadvantaged by insiders dealing in the market on the basis of non-public information.

Of course, if an insider is in the market trading at a price that she knows to be inaccurate, for example selling shares that she knows are underpriced, that insider will make a gain and anyone selling in the market at that point will suffer a loss, but any other uninformed person who also happens to be in the market at that time will also make a windfall gain. It is also the case that noise traders who trade in the market are almost always going to be at an informational disadvantage, whether or not insiders

[58] See H Manne, *Insider trading and the Stock Market* (New York, NY, Free Press, 1966).
[59] The obligation for insiders to notify the market about their trades is limited to a narrow category of insiders in the EU, principally directors and those connected to them (MAR, Art 19), and even then the obligation to notify the market of the trades is not simultaneous with those trades, but has a significant time delay (the trade must be disclosed within three days), which significantly reduces the value of this information for analysts and others.
[60] N Moloney, *EU Securities and Financial Markets Regulation* 3rd edn, (OUP, 2014) 702.

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happen to be in the market. This is because information traders (analysts and other arbitrageurs) will generally know more than the noise traders and will make their profits by trading with those that are less informed. This form of inequality is not regulated; indeed, it is the basis of the efficient capital market hypothesis. This activity is what enables information to be turned into price and removing this informational advantage for information traders would reduce or remove their incentives to operate in a way which produces this beneficial effect. In reality then it is unlikely that it is the confidence of the noise traders that is crucial here. Instead it is the confidence of the information traders that is key. If insiders are in the market and are able to trade on the basis of information which they have but the information traders do not, then this reduces the incentives of the latter group to trade, or at least to trade without demanding some price for the additional risk that this brings. Furthermore, the presence of inside traders in the market is likely to cause systematic losses to market makers, and as a consequence market-makers will increase their bid-ask spreads in order to compensate themselves. These costs will be passed onto investors, making it more expensive for them to buy and sell securities. Both of these factors are likely to reduce the willingness of investors to participate in the market, and thus to increase issuers' cost of capital.[61]

This market-focused justification for prohibiting insider dealing is not adopted in all jurisdictions. In particular, the US adopts a relationship-based rationale for regulating insider dealing.[62] In the US, the offence of insider trading is not defined by statute. Instead it is based on judicial and administrative interpretations of the broad anti-fraud provisions set out in Rule 10b-5.[63] Its basis in an anti-fraud statute has various implications, including a focus on a breach of fiduciary duty of similar breach of trust or confidence in order to supply the necessary element of fraud.[64] This stands in contrast to the EU regime which focuses on the information which the person trading has, not how he obtained it or whether or not that person intended to violate the law. Further, there is no requirement in MAR to demonstrate that the conduct is deceptive or misleading, or that any breach of a fiduciary (or similar) duty is present. To emphasise this point, in MAR it is clear that the prohibition extends to anyone 'who

[61] There is empirical literature suggesting that the enforcement of insider trading prohibitions can lead to more liquid markets and a lower cost of capital for issuers: U Battacharya and H Daouk, 'The World price of Insider trading" (2002) 57 *Journal of Finance* 75, L Beny, 'Do Insider Trading Laws Matter? Some preliminary Comparative Evidence' (2005) 7 *American Law and Economics Review* 144.

[62] For a discussion of these two approaches see eg A Loke, 'From the Fiduciary Theory to Information Abuse: The Changing Fabric of Insider Trading Law in the UK, Australia and Singapore' (2006) 54 *American Journal of Comparative Law* 123.

[63] See also Section 16(b) of the Exchange Act which targets specific transactions by three categories of insiders (directors, officers and 10% shareholders) and provides opportunities to require disgorgement to the issuer of profits made buying or selling equity securities in certain circumstances.

[64] The parity of information approach has been rejected by the US courts as too broad in scope given that the US insider trading provisions are based on an anti-fraud provision: *Chiarella v United States*, 445 US 222 (1980), 234.

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possesses inside information which that person knows, or ought to have known, is inside information'[65] ie a passenger in a lift that overhears a conversation about a takeover offer and uses that information subsequently to purchase securities in the target company falls within MAR if they are aware, or ought to have been aware, that the information being discussed is inside information. There is no requirement that those having the conversation in the lift are in breach of a fiduciary duty.

There are difficulties inherent in the US approach as regards the framing of the prohibition on insider trading. In particular, the requirements of a breach of fiduciary duty and scienter, in order to establish the requirement of fraud, means that many circumstances that would fall within the concept of insider dealing in the EU, fall outside it in the US. For example, in the US if an employee in a financial printers manages to figure out the name of the target firm in a takeover as the takeover documents are being printed, despite the fact that codes are used, and uses this information to buy shares in the target before the bid was announced, obtaining a profit when the share price rises post-announcement, that individual will not be guilty of insider trading since there is no breach of fiduciary duty.[66] Furthermore, where a waitress in a restaurant overhears a CEO discussing inside information about her company, and trades on the basis of that information to make a profit, there will be no liability for the waitress or the CEO, providing the CEO tipped the waitress unintentionally, and expected no personal benefit in return for the disclosed information.[67] This will be the case even where the waitress knows that the CEO is an insider and that the information she overhears is inside information. These requirements make the US law on insider dealing very complex and can lead to unfortunate consequences. For instance, what if a computer hacker steals from a home computer the name and password that an employee (X) uses in connection with his employment at a company and then, using X's identity, he hacks into the company's computer system, obtains earnings information about the company in advance of its release, and then trades on the basis of this information and realises a substantial profit? There is no breach of fiduciary duty here so it appears to fall outside the ambit of insider dealing provisions. In order to deal with this kind of scenario the US courts have had to create a new form of insider trading liability based on obtaining information by means of an `affirmative misrepresentation', which would satisfy the element of deceit required for Section 10b liability to attach.[68] The US court explained that the outcome of a hacking case such as this depends on whether the computer system was hacked into using `deceitful' behaviour, such as the use of a fake identity, which would lead to

[65] MAR, Art 8(4).
[66] *US v Chiarella* 445 US 222 (1980) cf earlier caselaw which followed a "disclose or abstain" approach similar to that adopted in the EU market abuse regime, see eg *In the matter of Cady, Roberts & Co*, 40 SEC 907 (1961); *SEC v Texas Gulf Sulphur* 401 F.2d 833 (2nd Cir 1968).
[67] *SEC v Dirks*, 436 US 646 (1983). See also *United States v Newman* 773 F 3d 438 (2d Cir 2014); *Salman v United States*, 137 S Ct 420 (2016); *US v Martoma* (2d Cir, 2018).
[68] *SEC v Dorozhko*, 574 F.3d 42 (2d Cir. 2009).

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insider trading liability, or whether no deceit was used (so that, for example, the hacker exploited a weakness in the electronic code in order to access the information), in which case no insider liability would attach.[69] This scenario highlights some of the difficulties with the US relationship-based approach.

The relationship-based approach also means that in the US there is no unity of purpose between the disclosure regime and the insider dealing regime, so that they are regarded as separate and distinct aspects of the regulatory model: the opportunity to think about disclosure and prohibition as part of the same package is lost. There are some benefits to treating information disclosure and insider dealing regulation as two parts of a single system of capital market regulation, focused on the goal of market efficiency. There is a close complementarity between the two regimes which justifies the fact the inclusion of the prohibition on insider dealing and the requirement to disclose inside information in the same EU Regulation (MAR). In particular, as discussed, a potential cost of banning insider trading is the loss of a channel for the revelation of non-public information, as other investors 'decode' price movements triggered by insiders' trades. Mandating disclosure of material changes on an ongoing basis ensures that information is transmitted to the market in a timely manner and seeks to reduces this downside. The EU's continuous disclosure regime can therefore be seen as a clear complement to the decision to ban insider dealing in order to improve market efficiency and protect investors.

However, the EU approach of putting insider dealing prohibitions and inside information disclosure obligations into one package also creates potential difficulties.[70] While both the prohibition and the disclosure obligation seek to enhance market efficiency, they operate in different ways. Inside information disclosure seeks to ensure market efficiency via information regulation, ie market efficiency is enhanced via optimal information disclosure, while the prohibition is a form of conduct regulation, seeking to enhance market efficiency by prohibiting certain abusive behaviour. The latter form of regulation would suggest that as broad a concept of inside information as possible should be adopted, with little or no opportunity for companies to delay disclosure, since this would maximise the amount of publicly available information and reduce the amount of inside information to the greatest extent possible, thereby minimising the abusive behaviour which undermines market efficiency. However, there can be potential damage to market efficiency where an overly wide

[69] Ibid. MAR deals with this type of scenario by explicitly providing for the situation in which the information is obtained by criminal means: MAR, Art 8(4)(d).

[70] See J Hansen, 'The Hammer and the Saw: A short critique of the recent compromise proposal for a Market Abuse Regulation' (2012) at ssrn.com/abstract=2193871 and J Lau Hansen and D Moalem, 'The MAD Disclosure Regime and the Twofold notion of inside information: the available solution' (2009) *CMLJ* 323.

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disclosure obligation is adopted which prevents issuers being able to protect highly sensitive disclosures and where torrents of potentially unreliable disclosures may operate to feed market volatility, as discussed in section II above.

Before the introduction of MAR there were questions raised regarding the 2003 MAD, particularly about the inclusion of both the conduct regulation and information regulation concepts within the market abuse regime and about whether, for example, the definition of inside information should be the same for both purposes.[71] It had been hoped that the decision of the CJEU in *Geltl* might provide some much-needed clarity to this area, but it did not do so. The Court in *Geltl* did not address the dual nature of inside information within the 2003 MAD, and indeed the expansive view of inside information adopted by the CJEU in that decision (the idea that an intermediate step could constitute a set of circumstances or an event and so could be 'precise' for the purposes of the general definition of inside information[72]) potentially exacerbated the problems inherent in the dual function of inside information within the market abuse regime.

When MAR was negotiated, there was considerable pressure to adopt different definitions of inside information for the two different functions, in order to address these concerns.[73] This suggestion was not successful, however, and there is a single concept of inside information within MAR that is relevant both to issuer disclosure and the prohibition on insider dealing. Further, because MAR follows the ruling in *Geltl* and incorporates into the regime the idea that processes with multiple stages can generate inside information that needs to be disclosed at intermediate steps in the process,[74] the risk that issuers will be in breach of their disclosure obligations if they fail to disclose negotiations and other multiple stage processes progress is intensified. This linking of inside information disclosure and the prohibition on insider trading therefore potentially exacerbates the difficulties which were discussed in sections II.2 and II.4 above.

IV. **Conclusion**

The requirement to disclose inside information to the market 'as soon as possible' is a key aspect of EU capital market regulation. This continuous disclosure obligation is broadly defined and although it is subject to some exemptions, such as the ability of issuers to delay disclosure in certain circumstances, these exemptions are narrowly drawn. The emphasis is on investor protection,

[71] ESME, The Market Abuse EU Legal framework and its Implementation by Member States: A First Evaluation in July 2007, 6.
[72] *Geltl*, paras 33-36.
[73] This was the approach adopted by the Commission in its 2011 proposal, for example: COM (2011) 651, Art 12(3).
[74] MAR, Art 7(2).

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achieved by maximising market efficiency. The goal of the disclosure obligation is two fold: to ensure, as nearly as possible, that all investors have the same information about companies and their securities, and also to rob the information of its inside character, thus reducing the opportunity for insider dealing. As explored in this chapter, the EU regime has significant benefits attached to it, in terms of market efficiency and thus investor protection, but these benefits have to be weighed against the potential costs to issuers and investors which this regime may bring. There are some potentially problematic aspects to the obligation to disclosure inside information. The issue of early disclosure is a particular concern and the potential difficulties are exacerbated by attempting to yoke together two different regimes, namely disclosure regulation and conduct regulation. These concerns need to be understood and managed to ensure that the benefits of the EU regime are not undermined.

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