The SEC and BaFin –

US and German capital market supervision in comparison

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Veronika Fischer

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Erstgutachter: Prof. Dr. Thomas M.J. Möllers
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Abbreviations

AAER	Accounting and Auditing Enforcement Releases
AG	Die Aktiengesellschaft (journal)
AICPA	American Institute of Certified Public Accountants
ALJ	Administrative Law Judge
AltZertG	Private Pension Plan Contracts Certification Act (Altersvorsorgeverträge-Zertifizierungsgesetz)
AMEX	American Stock Exchange
APB	Accounting Principle Board
ASR	Accounting Series Release
ATS	Alternative Trading System
AuslInvG	Foreign Investment Act (Auslandsinvestment-Gesetz)
BaFin	Federal Financial Supervisory Authority (Bundesamt für Finanzdienstleistungsaufsicht)
BAKred	Federal Banking Supervisory Office (Bundesaufsichtsamt für Kreditwesen)
BAWe	Federal Securities Supervisory Office (Bundesaufsichtsamt für den Wertpapierhandel)
BAV	Federal Insurance Commission (Bundesaufsichtsamt für das Versicherungswesen)
BauSparkG	Building and Loan Associations Act (Bausparkssengesetz)
BB	Betriebsberater (journal)
BCBS	Basel Committee on Banking Supervision
BdB	Federal Association of German Banks (Bundesverband deutscher Banken)
BDSG	Federal Data Protection Act (Bundesdatenschutzgesetz)
BilKoG	Balance Sheet Control Act (Bilanzkontrollgesetz)
BIS	Bank for International Settlements
BKR	Zeitschrift für Bank- und Kapitalmarktrecht (journal)
BMF	Federal Ministry of the Treasury Bundesfinanzministerium
BörsG	Stock Exchanges Act (Börsengesetz)
BOX	Boston Stock Exchange
BSC	Banking Supervision Committee
BTR	Blackout Trade Restriction
BPPAS	Budget and Program Performance Analysis System
CAP	Committee on Accounting Procedure
CEA	Commodities Exchange Act
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CESR	European Securities Regulators Comittee
CFTC	Commodity Futures Trading Commission
CHX	Chicago Stock Exchange

CPA	Certified Public Accountant
DAI	German Institute for Shareholding (Deutsches Aktieninstitut)
DAIS	German Institution for the Protection of Investors (Deutsches Institut für Anlegerschutz)
DepotG	Securities Deposit Act (Depotgesetz)
DStR	Deutsches Steuerrecht (journal)
DPR	Inspection Authority for Accounting (Deutsche Prüfstelle für Rechnungslegung)
ECFR	European Company and Financial Law Review (journal)
ECN	Electronic Communications Network
EdB	German Banks' Compensation Scheme Ltd (Entschädigungseinrichtung deutscher Banken GmbH)
EDGAR	Electronic Data Gathering Analysis and Retrieval System
EdW	Securities Trading Firms' Compensation Scheme (Entschädigungseinrichtung der Wertpapierhandelsunternehmen)
EGV	Treaty of the European Community (Vertrag zur Gründung der Europäischen Gemeinschaft)
EITF	Emerging Issues Task Force
ESAEG	Deposit Protection and Investor Compensation Act (Einlagensicherungs- und Anlegerentschädigungsgesetz)
ESEC	European Securities and Exchange Commision
EuZW	Europäische Zeitschrift für Wirtschaftsrecht (journal)
EWS	Europäisches Wirtschafts – und Steuerrecht (journal)
FASB	Financial Accounting Standards Board
FATF	Financial Task Force on Money Loundering
FAZ	Frankfurter Allgemeine Zeitung (daily paper)
FCPA	Foreign Corrupt Practices Act
FED	Federal Reserve Bank
FESCO	Forum of European Securities Commission
FinDAG	Act Establishing the Federal Financial Supervisory Authority (Finanzdienstleistungsaufsichtsgesetz)
FinDAGKostV	Regulation Concerning the Costs Incurred by the Act Establishing the Federal Financial Supervisory Authority (Finanzdienstleistungsaufsichtsgesetz-Kostenverordnung)
FINRA	Financial Industry Regulatory Authority
FISMA	Federal Information Security Management Act
FMFIA	Federal Manager's Financial Integrity Act
FRR	Financial Reporting Release
FRRP	Financial Reporting Review Panel
FRUG	Act Implementing MiFID (Finanzmarktrichtlinie-Umsetzungsgesetz)
FSA	Financial Service Authority
FSAS	Financial Sector Assessment Program
FSF	Financial Stability Forum
FTC	Federal Trade Commission Act
FTD	Financial Times Deutschland (daily paper)

FTE	Full time equivalent (aggregated number of full time and part time employees)
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standards
GAO	Government Accountability Office
GG	Basic Consitutional Law (Grundgesetz)
GITSA	Government in the Sunshine Act
GLBA	Gramm-Leach Biley Act
GwG	Money Laundering Act (Geldwäschegesetz)
HBG	Mortgage Banks Act (Hypothekenbankgesetz)
IAIS	International Association of Insurance Supervisors
IARD	Investment Adviser Registration Depository'
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offering
InvG	Investment Act (Investmentgesetz)
IFG	Freedom of Information Act (Informationsfreiheitsgesetz)
IFSC	Integrated Financial Supervisors Conference
IStR	Internationales Steuerrecht (journal)
JuS	Juristische Schulung (journal)
KAGG	Investement Companies Act (Kapitalanlagegesellschaftengesetz)
KapMuG	Capital Markets Model Case Act (Gesetz über Musterverfahren in kapitalmarktrechtlichen Streitig-keiten)
KWG	Banking Act (Kreditwesengesetz)
MAD	Market Abuse Directive
MaK	Minimal requirements for the credit business of credit institutions (Mindestanforderungen an das Kreditgeschäft der Kreditinstitute)
MaH	Minimal requirements for the trading activities of credit institutions (Mindestanforderungen für das Betreiben von Handelsgeschäften)
MaIR	Minimal requirements for the internal audit function of credit institutions (Mindestanforderungen an die Ausgestaltung der internen Revision)
MaKonV	Regulation on Market Manipulation (Verordnung zur Konkretisierung des Verbots der Marktmanipulation)
MiFID	Markets in Financial Instruments Directive
MLAT	Mutual Legal Assistance Treaty
MMOU	Multilateral Memorandum of Understanding
MOU	Memorandum of Understanding
MSRB	Municipal Securities Rulemaking Board

NASD	National Association of Security Dealers
NASDAQ	National Association of Security Dealers' Automated Quotation System
NBBO	National Best Bid or Offer
NJW	Neue Juristische Wochenschrift (journal)
NSMIA	National Securities Market Improvement Act
NVersZ	Neue Versicherungszeitung (journal)
NYSE	New York Stock Exchange
NZG	Neue Zeitschrift für Gesellschaftsrecht (journal)
OECD	Organisationion for Economic Cooperation and Development
OWiG	Regulatory Offenses Act (Ordnungswidrigkeiten-Gesetz)
PCAOB	Public Companies Accounting Oversight Board
PfandBG	Mortgage Banks Act (Pfandbriefgesetz)
PfandG	Act relating to Mortgage Bonds and Similar Public-Law Credit Institution Bonds (Gesetz über die Pfandbriefe und verwandten Schuldverschreibungen öffentlich-rechtlicher Kreditanstalten)
PHLX	Philadelphia Stock Exchange
PTS	Proprietary Trading Systems
PUHCA	Public Utility Holding Company Act
SA	Securities Act of 1933
SAB	Staff Accounting Bulletin
SAS	Statements on Auditing Standards
SEA	Securities Exchange Act of 1934
SEC	Securities and Exchange Commission
SFAC	Statements of Financial Accounting Concepts
SIPC	Securities Investor Protection Corporation
SOX	Sarbanes-Oxley Public Company Accounting Reform And Investor Protection Act
SRO	Self-regulation organization
StGB	Criminal Code (Strafgesetzbuch)
TEHG	Act on the Trade of Greenhouse Gas Emissions Treibhausgas-Emissionshandelsgesetz
VAG	Insurance Supervision Act (Versicherungsaufsichtsgesetz)
VerkProspG	Act on the Prosepectus of Securities offered for Sale (Wertpapier-Verkaufsprospektgesetz)
VVG	Insurance Contract Act (Versicherungsvertragsgesetz)
VwVG	Administrative Enforcement Act (Verwaltungs-Vollstreckungsgesetz)
VZBV	Federal Association of Consumer Advice Centers (Bundesverband der Verbraucherzentralen)

WM	Wertpapiermitteilungen (journal)
WpHG	Securities Trading Act (Wertpapierhandelsgesetz)
WpÜG	Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz)
WpPG	Securities Prospectus Act (Wertpapier-Prospektgesetz)
Wrp	Wettbewerb in Recht und Praxis (journal)
ZfBf	Schmalenbachs Zeitschrift für betriebswirtschaftliche Forschung (journal)
ZFR	Zeitschrift für Referendare (journal)
ZGR	Zeitschrift für Unternehmens- und Gesellschaftsrecht (journal)
ZHR	Zeitschrift für das gesamte Handels- und Wirtschaftsrecht (journal)
ZRP	Zeitschrift für Rechtspolitik (journal)

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Outline

A. Introduction

a. Motivation

A free market economy with continuous growth and sufficient economic stability is dependent on a steady influx of capital to sustain investment.[1] In most cases, such capital investments are effectuated over stock markets, and the shareholders[2] need to ensure proper administration of their investment with a company. Government's interest being a strong economy with stable investment, it assumes responsibility and institutes public authorities to help current and prospective shareholders control that companies – or rather their management – duly administer and foster their investment. Both the US and Germany, being free market economies, established public authorities for such purpose: the Securities and Exchange Commission (SEC) and the Federal Financial Supervisory Authority (BaFin). However, whereas the SEC has been installed already in 1934, BaFin's predecessor BaWe was only called into existence in 1994, and BaFin itself in 2002. As US capital market law, and its administration, is used as a model worldwide[3], an analysis of both agencies with the aim of their comparison, especially under the efficiency criterion, will lead to suggestions for further development and improvement of the German authority.

The following chapter will pave the way for this analysis in giving a short introduction to the empirical relevance of this topic, the reasons for capital market supervision, the legal means employed and the aims pursued. At last, supervisory efficiency will be defined as to establish common ground for later discussion.

b. Stock market participation in the US and in Germany

Investment in shares has become the favorite saving vehicle of US citizens – over 57 million citizens directly own stock[4], and a much bigger proportion of the population indirectly, so that overall more than 50% of all citizens are engaged in the stock market.[5] This is not only due to the fact that the US social system relies much more on individual financial precautions and thus sets incentives for private investments, but also on the fact that from the very beginnings

[1] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, Preface vii.
[2] As so-called "absentee owners"; *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, Preface vii.
[3] *Hirte*, in *Hirte/Möllers*, Kölner Kommentar zum WpHG, 2007, Introduction, marginal 129, p.62.
[4] *Securities and Exchange Commission*, 2006 Performance and Accountability Report, p.2.
[5] *The economist*, online-version, http://www.economist.com/finance/displaystory.cfm?story_id=9217849 (page impression of June 11th, 2007); *Securities and Exchange Commission,* SEC Performance Budget for 2008, http://www.sec.gov/about/2008budgetperform.pdf (page impression of August 1st, 2007), p.144 speaks of 48%.

of industrial activity, companies would rely on own funds (raised by shares) rather than on debt.[6]

On the contrary, Germans are rather reticent in their stock investments: although the spread of stock ownership has been almost doubled since 1997, still only 10.8 million households – or 16.7% of the population – confide their fortunes in the stock market.[7] However, a steady increase is expected for the future: the "'graying' of the population […] and the resulting need for investment options"[8] will most likely spur share market participation in Germany.

This long-term development is also reflected by the trading volumes: the overall turnover in Germany is less than 1/5 of NASDAQ alone, not counting turnover on NYSE and other US exchanges.[9]

Chart 1: Exchange turnover of national and foreign stocks

Another measurement is market capitalization of domestic shares as ration of the GDP, which measures the importance of equity markets and its relevance for the economy. Whereas the Euro area, among it Germany, has improved its ration from 21% to 89% in the time frame between 1990 and 2000, the United States has reached a soaring 152% by 2000.[10] Evidently,

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[6] Indeed, several surveys prove that a business's site of business determines the level of debt, and that the latter is much lower in the US (due to a higher share quorum) than in Germany; *Frankfort/Rudolph*, Zur Entwicklung der Kapitalstrukturen in Deutschland und in den Vereinigten Staaten von Amerika, in zfbf 1992 1059, p.1060 et seq. The same is revealed by the high importance of IPOs in the US and other so-called market-based financial systems; *Möllers*, Creating Standards in a Global Financial Market – the Sarbanes-Oxley Act and her Activities: What Europeans and Americans could and should learn from each other", in ECFR 2007 173, p.174.

[7] *Deutsches Aktieninstitut e.V.*, DAI Kurzstudie 3/2005; available on http://www.dai.de (page impression of April 7th, 2007)

[8] *Kung,* The Regulation of Corporate Bond Offerings: A Comparative Analysis, in 26 U Pa. J. Int'l Econ. L. 409, p.453.

[9] Data derived from *Deutsches Aktieninstitut e.V.*, DAI Factbook 2006, 06-3-3-a; available on http://www.dai.de (page impression of April 7th, 2007)

[10] *European Central Bank*, The Euro Equity markets, online publication 2001; http://www.ecb.int/pub/pdf/other/euroequitymarketen.pdf (download July 12th, 2007), p.10.

this is also reflected by the number of listed companies, which is almost one-and-a-half for the United States in comparison with the Euro area[11], whereas both areas comprise roughly the same number of inhabitants.[12]

Thus, empiricism indicates that the US enjoys a far higher level of stock market participation than Germany, and this by various measurements. Whether and how this is linked to the level of capital market supervision, will be one of the theses of this paper.

c. Necessity of capital market supervision

In nearly all economies, capital markets[13] are the most tightly regulated industries[14], whereas regulation, in this sense, must be understood as "the action of binding governmental authority as to avoid the processes and results of an unregulated market"[15] .This modification of the free market economy is often justified with the immense importance of the capital market to the economic and financial stability of a country, and the high importance of its integrity to the people, as they rely on the capital market for investing their fortunes. Also, the safeguarding of capital influx – both on the side of national investors and international participants on the capital market – are of high importance for the general economy, and will only be realized if investors confide in the proper functioning of the capital market.[16] At last, economic theory suggests that in each field where market failures arise in high frequency, governmental action is of necessity.[17] As in securities trading, all three asymmetric information (with the relating

[11] 7,194 for the US and 4,914 for the Euro area at the end of 2000, *European Central Bank*, The Euro Equity markets, online publication 2001; http://www.ecb.int/pub/pdf/other/ euroequitymarketen.pdf (download July 12th, 2007), p.11.

[12] As of 2006, 316,600,000 for the Euro area, as detailed in *Eurostat,* The new EU of 27 and the Euro area of 13, http://www.eds-destatis.de/en/tdm/downloads/2007_07/167-2006-12-19.pdf (download July 12th, 2007); 302,372,675 for the US, as detailed on *US Census Bureau*, U.S. and World Population Clocks – POPClocks, http://www.census.gov/main/www/popclock.html (downloaded July 18th, 2007). Numbers for 2000 have been comparable in their difference.

[13] For an in-depth discussion and definition of the term, see *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.30; *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.3.

[14] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.6; *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007), p.1.

[15] *Gemberg Wiesike,* Wohlverhaltensregeln beim Vertrieb von Wertpapier- und Versicherungsdienstleistungen, online-edition 2004, p.24.

[16] *Kress*, Effizienzorientierte Kapitalmarktregulierung: eine Analyse aus institutionenökonomischer Perspektive, 1996, p.81; *Kümpel*, Zur Neugestaltung der staatlichen Börsenaufsicht – von der Rechtsaufsicht zur Marktaufsicht, in WM 1992 381, p.383.

[17] *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007), p.5; *Hirschmann*, Exit, Voice and Loyalty, 1970, p.31; *Akerlof*.: The Market for "Lemons": Quality Uncertainty and the Market Mechanism, 84 Q J Econ 488, p. 497, 499.

problems of adverse selection of participants and insider trading), the problem of externalities (such as demand for liquidity, limited competition, the prisoner's dilemma and principle-agent conflicts between participants) and market power[18] occur, this necessity must be assumed.

In detail, two core concepts of justification for governmental involvement exist: "exit" and "voice". "Voice" relates to the voting right of the shareholder, which the latter needs to employ to participate in the decision process of the business. All questions of business strategy and, most important, financing, are detailed and executed internally, meaning that management would have to find investors and offer them a right to participate in the business. In this model, information would not have to be published, but rather be distributed among the (few) shareholders, so that the execution of "voice" as the most powerful means of shareholder involvement is a merely internal affair.[19] However, history of stock markets has shown that a mere internal information policy leads to investor discrimination (in both relationship to management and within the group, i.e. between investors with bigger and smaller share proportions) and hinders flexibility, as all questions of strategic and financial relevance would have to be discussed with a huge plenum. In this model, governmental involvement in capital market law would be superfluous, as internal entrepreneurial processes are not subjected to supervision.

"Exit", on the contrary, allows for financing to be effectuated externally, i.e. on a capital market. Inevitably, such an opening creates a higher spread of investors, more financing flexibility in terms of a higher base of capital offerors and also flexibility in such that old investors are free to exit their investment by sale and new investors may join.[20] Furthermore, external shareholding sets management incentives for diligence and sustainability by the introduction of an additional, i.e. the shareholders', perspective. However, the "exit" concept will succeed only in the case of investors' being able to evaluate the business – or, having appropriate information. Thus, information which in the "voice" concept would be spread only internally will now have to be published to the market, and the latter will have to be supervised in order

[18] *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007), p.18 et seq.
[19] *Hirschmann*, Exit, Voice and Loyalty, 1970, p.30ff.
[20] *Hirschmann*, Exit, Voice and Loyalty, 1970, p.21ff, 28f.

to ensure the compliance with the principles of free and fair trade. The latter as compound are capital market law – and thus call for governmental involvement.[21]

A further – but subordinated – reason for capital market regulation is the protection of investors, who are confronted with several risks[22]: the prudential risk is that of losing the total value of the investment due to a breakdown of the company as a whole, whereas the bad faith risk is realized when the investor is intentionally mislead by the issuer or an intermediary. However, the protective provisions must to be overlooking the fact that participation in the capital market – and the expectation of gains – is the reward for the so-called market risk, so that "retail investors cannot and should not be protected against making losses, taking risks or making mistakes."[23]

German scholars only slowly come to terms with capital market law: until recently not recognized as a distinct field of law, "problems and questions which capital market law tries to regulate and solve […] have, until recent years, been associated to different sectors of the legal body"[24] such as general civil law, securities law, banking law or – most important – company law and stock exchange law[25]. Thus, until the late 1960s[26], capital market law in Germany consisted exclusively of stock exchanges regulation and company law, and only slowly and through constant involvement of European directives, developed to a market-oriented body of law.[27] However, it must be understood that those links to other fields of law certainly exist and are one of the most striking challenges.

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[21] *Hirschmann*, Exit, Voice and Loyalty, 1970, p.29; *Heinze*, Europäisches Kapitalmarktrecht – Recht des Primärmarkts, 1999, p.4.

[22] This description follows *Caspari*, Anlegerschutz in Deutschland im Lichte der Brüsseler Richtlinien, in NZG 2005 98, p.98.

[23] *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007), p.27.

[24] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.1; *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.39.

[25] *Buxbaum/Hopt*, Legal Harmonization and the Business Enterprise, 1988, p.191 et seq.

[26] Or even later – even the late 1980 according to *Möllers*, Creating Standards in a Global Financial Market – the Sarbanes-Oxley Act and her Activities: What Europeans and Americans could and should learn from each other", in ECFR 2007 173, p.176.

[27] *Bartsch*, Effektives Kapitalmarktrecht – zur Rechtsfolgenseite der Richtlinien im Europäischen Kapitalmarktrecht, online-edition 2005, p.9. However, it must be mentioned that only some other European member states, such das Belgium or France, developed a body of capital market law earlier; *Buxbaum/Hopt*, Legal Harmonization and the Business Enterprise, 1988, p.189 et seq.

American capital market law, on the very contrary, has seen almost 80 years of contingent legislation and supervision[28] – a time lag that easily explains why much of the European/German capital market law is oriented on the US standard. Thus, although the necessity for a capital market supervisory authority was discussed as early as 1873[29], a supervisory authority for banking was introduced in the 1960 and for securities transactions only in 1994.

The paper does not intend to fully evaluate the capital market law system in both countries, especially as extensive studies in this field exist[30], but rather focuses on the evaluation of securities market supervision. This emphasis on the administration of law – and its supposed link to overall efficiency – is also backed up by a current hypothesis established by empiric researchers: "what really counts is not the content of the substantive law, but the adequacy of the enforcement mechanisms that underlie it"[31].

d. Introduction to capital market law

Capital market law, both in Germany and the US, can be summarized as "all norms and regulations which deal with the public sales and distribution of participations [and] certified monetary claims […] and which ensure functioning of the capital market and investor protection"[32].

German capital market law is so-called cross-sectional law: its norms are not enacted in one coherent codex, but rather dispersed in various legal and sub-legal regulations. The situation in the US is quite the same: whereas securities regulation is covered mainly by two enactments, the Securities Act 1933 and the Securities Exchange Act 1934, multiple other enactments cover questions of accounting, disclosure, corporate governance. Thus, another definition of capital market law describes it as "the compound of all norms and principles which

[28] *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.6.
[29] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.1.
[30] Some claiming that common law legal systems – especially in the mattters of capital market law – generally outperform civil law legal systems; some claiming that the individual embodiment is pertinent. For an overview, see *Coffee*, Privatization and Corporate Governance: the Lessons from Securities Market Failure, in 25 Iowa J. Corp.L. 1, p.1.
[31] *Coffee*, Privatization and Corporate Governance: the Lessons from Securities Market Failure, in 25 Iowa J. Corp.L. 1, p.3.
[32] *Schwarz*, Kapitalmarktrecht – ein Überblick, in DStR 2003 1930, p.1930; *Hirte*, in *Hirte/Möllers*, Kölner Kommentar zum WpHG, 2007, Introduction, marginal 4, p.3.

relate to procedures at or beyond exchanges"[33]. In this regard, capital market law is also characterized by the simultaneous regulation of matters in both civil and public law.[34]

Capital market law itself is divided into several sub-categories: organizational law, which covers the structure of exchanges and electronic trading systems, rules for proper conduct and for the conduction of transactions, and finally rules on transparency and disclosure.[35] Other differentiations name, besides organizational law, supervisory law, which is "related to the market procedure according to which all participants and their behavior is controlled"[36]. All in all, those rules relate to two general regulative areas: "the regulation of the sale of securities to investors and second, the regulation of securities markets"[37] as the trading facilities for the transactions.

e. Aim of capital market supervision and criteria for evaluation

The aim of capital market law, both in Germany and US, is the same and is best described as the compound of investor protection and safeguarding of the functioning of capital markets. Thus, capital market regulation serves both a public and private interest: the public interest is such that only efficient and functioning capital market ensures international competitiveness and sufficient resources for business, whereas private interests lie in the protection of the invested funds against fraud and manipulation. However, the latter goal cannot be seen as the core task, but must be understood as supplementary and subordinated to the first[38], which is also underlined in such that investor protection will be rather pursued indirectly by an institutional approach[39] instead of individual protection[40].[41] Additionally, investor protection must be seen as protection of the compound of investors, or the investing public, as such and not as the protection of individual investors.[42]

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[33] *Schwarz*, Kapitalmarktrecht – ein Überblick, in DStR 2003 1930, p.1930.
[34] *Hirte/Möllers*, Kölner Kommentar zum WpHG, 2007, marginal 6, p.5.
[35] *Schwarz*, Kapitalmarktrecht – ein Überblick, in DStR 2003 1930, p.1931 et seq.
[36] *Hirte*, in *Hirte/Möllers*, Kölner Kommentar zum WpHG, 2007, Introduction, marginal 5, p.5.
[37] *Kitch*, in *Buxbaum et al.*, European Business Law – Legal and Economic Analyses on Integration and Harmonization, 1991, p.46.
[38] *Möllers,* Thomas M.J.: Anlegerschutz durch Aktien- und Kapitalmarktrecht – Harmonisierungsmöglichkeiten nach geltendem und künftigem Recht, in ZGR 1997, 334, p. 337, 354; *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.18.
[39] Such as rules for accounting, publication and disclosure.
[40] Such as claims for damages, which is only granted in a limited number of situations with a narrow range of requirements; *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.25.
[41] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.383.
[42] *Bartsch*, Effektives Kapitalmarktrecht – zur Rechtsfolgenseite der Richtlinien im Europäischen Kapitalmarktrecht, online-edition 2005, p.25; *Kress*, Effizienzorientierte Kapitalmarktregulierung: eine Analyse aus institutionenökonomischer Perspektive, 1996, p.79.

Thus, the practical approach to reach those goals is two-fold: on the one hand, it consists of the provision of information pertinent to investment decisions[43], on the other hand in the sanctioning of behavior which is likely to impede capital market integrity and stability.[44]

By scholarly definition, such an ideal market reaches scores high in all three transparency, efficiency and integrity.[45] Whereas transparency and integrity are self-explanatory, efficiency can be detailed into three sub-aspects, which run as follows:
Most important is allocative efficiency, i.e. the fact that capital is attributed to those places where it is most urgently needed and receives a compensation appropriate with the risk the investor incurs.[46] The means of reaching such allocative efficiency must therefore be the dissemination of information about the securities traded, because in this fashion, investors will confide in the capital market and be willing to offer capital. Thus, capital market law must ensure that companies disclose valuable, correct and sufficient information about their business and securities offered, and that this information reaches investors in an unabridged and unaltered fashion.

A further point of vivid interest is operational efficiency, or the minimization of the transactional costs[47] (i.e., cost for information gathering and trade) for all three issuers, investors and potential intermediaries. This is also connected to allocative efficiency in such that low transactional costs increase interest, so that investors have a higher incentive for their engagement. Capital market law, in this regard, must strive to avoid barriers for entry into the capital market, and must likewise impose costs to those which are to be deemed the cheapest cost avoiders. Thus, the most relevant actions are the decrease of issuer's costs for IPOs and further cost of having their securities traded, of investor's costs for the acquisition and sale of shares[48], whereas those two goals, unfortunately, conflict with each other: the more cost of information

[43] Which is multi-layered: initial information through prospectuses timed at the market entry, periodical information about the development of business, and information for special events if need be; *Büche*, Die Pflicht zur Ad-hoc-Publizität als Baustein eines integeren Finanzmarkts, 2005, p.35 et seq.
[44] *Köhler et al.,* Umsetzungsstand des 10-Punkte-Plans der Bundesregierung zur Stärkung des Anlegerschutzes und der Unternehmensintegrität, in BB 2004 2623, p.2623. However, it must be understood that both aims are tightly intertwined: by ensuring investor protection, e.g. with imposing liability of issuers and managers to investors, also capital market integrity is enhances by the deterring effect of such liability. Indeed, studies suggest that "private enforcement" (i.e. by liability) is more effective that "public enforcement" (i.e. by sanctioning only); *Black*, The Legal and Institutional Preconditions for Strong Securities Markets, in 49 UCLA L. Rev. 781, p.800.
[45] *Büche*, Die Pflicht zur Ad-hoc-Publizität als Baustein eines integeren Finanzmarkts, 2005, p.29.
[46] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.19; *Kümpel*, Zur Neugestaltung der staatlichen Börsenaufsicht – von der Rechtsaufsicht zur Marktaufsicht, in WM 1992 381, p.383; *Möllers*, Thomas M.J.: Effizienz als Maßstab des Kapitalmarkts, ACP 208 (in printing), p. 7.
[47] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.20.
[48] *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.20 et seq.

gathering is saved to the investor by obliging the issuer to disclose, the higher the costs to the latter grow. Thus, a sensible balance has to be found and maintained.

At last, institutional efficiency is the most effluent category, existing when the "basic principles for and efficient mechanism of market segments"[49] are reached. Vital steps to this are investor confidence in the capital market, easy and free market entry to all participants, and a certain set of typed securities with a high degree of transferability and sufficient liquidity[50]. Rules and regulations relative to institutional efficiency are insider trading prohibition, mechanisms to disclose majority and voting prevalence shareholders, codes of conduct for financial intermediaries and avoidance of conflicts of interests in their fields of work, as well as governmental market supervision.[51]

From all of the above can be derived that the aims of capital market law are closely entangled with allocative, operational and institutional efficiency: the higher those three are realized, the more likely investor protection and functioning of the capital market are to be safeguarded. A further differentiation distinguishes between "external" capital market efficiency, which is based on the valuation of shares on the capital market as in Fama's famous efficient market hypothesis, and "internal" efficiency, which is evaluated along market organization, transaction costs and transaction time.[52] Also, the key characteristics of the capital market – "flow and distribution of money and securities, [existence of] mechanisms for transactions, evaluation and pricing"[53] will be realized. Empiric studies back up this theory: "the size, depth and liquidity of securities markets [and thus the outcomes of allocative, operational and institutional efficiency] correlates directly with the quality of the legal protections given to shareholders"[54], and thus may serve as indicators for a high level of capital market efficiency[55].

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[49] *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.15.
[50] Measured as broath (variety of offers) and depth (number of investors and amount of capital) of the capital market; *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.20; *Kümpel*, Zur Neugestaltung der staatlichen Börsenaufsicht – von der Rechtsaufsicht zur Marktaufsicht, in WM 992 381, p.387.
[51] *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.17 et seq.; in Germany, the principle of market supervision instead of mere legal compliance control was introduced only with the foundation of BAW; *Bundesminister der Finanzen*, Konzept Finanzplatz Deutschland, in WM 1992 420, p.423.
[52] *Kress*, Effizienzorientierte Kapitalmarktregulierung: eine Analyse aus institutionenökonomischer Perspektive, 1996, p.39.
[53] *Heinze*, Europäisches Kapitalmarktrecht – Recht des Primärmarkts, 1999, p.7.
[54] *Coffee*, Privatization and Corporate Governance: the Lessons from Securities Market Failure, in 25 Iowa J. Corp.L. 1, p.1; *Black*, The Legal and Institutional Preconditions for Strong Securities Markets, in 49 UCLA L. Rev. 781, p. 834.
[55] *Möllers*, Thomas M.J.: Effizienz als Maßstab des Kapitalmarkts, ACP 208 (in printing), p. 2, 4.

Regardless of which concept is followed, it becomes obvious that the availability of the information, and its correctness, is the key factor for efficiency – and thus, the lever of which regulatory action should turn.

Recent studies established proof that all flourishing capital markets find their success based on two principles, i.e. "that minority shareholders (1) receive good information about the value of a company's business and (2) have confidence that a company's managers and controlling shareholders won't cheat them out of […] the value of their investment"[56]. Others concur as to the information side and add fair behavior on the market[57] or efficient price formation with a reasonable amount of competition[58] as a key success factor for a capital market that is likewise accepted with intermediaries and national and international investors.

However, this activity has to be administered, and this by "a securities regulator [….] that (a) is honest; and (b) has the staff, skill, and budget to pursue complex securities disclosure cases"[59]. Both countries, the USA and Germany, opted for control by a governmental agency, which is independent from the supervised entities in both legal and factual regard.

f. Effectiveness and efficiency in capital market supervision

Whereas capital market law, in the early days of its existence, strived to reach stability, nowadays effectiveness and efficiency are in the focus of both the regulating governments and the administering agencies.[60] The following overview will detail those two principles and outline their meaning in the realm of capital market law. Effective, in this sense, is "an action of doing the right thing"[61], i.e. of fulfilling the above-mentioned aims of capital market law. In organizational theory, effectiveness will not be reached by market powers, as too many counter-

[56] *Black*, The Legal and Institutional Preconditions for Strong Securities Markets, in 49 UCLA L. Rev. 781, p.781.
[57] *Caspari*, Anlegerschutz in Deutschland im Lichte der Brüsseler Richtlinien, in NZG 2005 98, p.98.
[58] *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007), p.24.
[59] *Black*, The Legal and Institutional Preconditions for Strong Securities Markets, in 49 UCLA L. Rev. 781, p.790, also *Coffee*, Privatization and Corporate Governance: the Lessons from Securities Market Failure, in 25 Iowa J. Corp.L. 1, p.4; *Heinze*, Europäisches Kapitalmarktrecht – Recht des Primärmarkts, 1999, p.360.
[60] *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007), p.1.
[61] *Bartsch*, Effektives Kapitalmarktrecht – zur Rechtsfolgenseite der Richtlinien im Europäischen Kapitalmarktrecht, online-edition 2005, p.24.

incentives exist.[62] Thus, it is the task of a regulator to define effectiveness (or goals) the market should achieve, and to impose and supervise control mechanisms. Effectiveness thus could be defined as achievement of set targets.[63]

After having determined effectiveness, i.e. which of several alternatives would be the most beneficial, efficiency comes into play: efficiency ask for optimization of the relation of costs and benefits, or, whether the same outcome could have been reached with lower expenditures (input/output relation[64]). In the capital market environment, effectiveness can be analyzed alongside several paths: efficiency of regulation (i.e. is the way of regulation and its supervision most easy to administer and least cumbersome to the supervised entities) and efficiency of regulatory body (i.e. does the agency use its resources to the highest extent).

This paper does not intend to evaluate the effectiveness and efficiency of capital market law as such, as extensive studies in this realm exist.[65] In short, it is often criticized that the legislatively prescribed flow of information by far outweighs the demand of such by the market, creating an information overkill both detrimental to the businesses (due to publishing cost) and the market participants (due to the cost of absorbing the information).[66] Also, this paper is not to analyze the level of acceptance of the specific regulation, which contributes highly to efficiency[67], but is difficult to assess and quantify. Rather, the thesis aims at an evaluation of the two authorities' administration of their given body of law, and judge on how well they operate under the given conditions, i.e. the efficiency of operation, or whether the approach and the employment of means of one agency supports the achievement of its goal. Thus, the following two chapters will analyze the two agencies along given criteria, and a third chapter will summarize the findings.

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[62] E.g, market participants would be able to reap extraordinary gains by not fulfilling actions commonly deemed as effective, and thus strive to hinder their achievement, whereas a free market economy with sufficient competition is a key actor for achievement of efficiency; *Radermacher*, Globalisierung gestalten, 2006, p.18.
[63] *Radermacher*, Globalisierung gestalten, 2006, p.18.
[64] *Radermacher*, Globalisierung gestalten, 2006, p.18.
[65] A listing is contained in *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007). For the efficiency of international/European regulation; specifics are treated in *Bartsch*, Effektives Kapitalmarktrecht – zur Rechtsfolgenseite der Richtlinien im Europäischen Kapitalmarktrecht, online-edition 2005, but also *Kress*, Effizienzorientierte Kapitalmarktregulierung: eine Analyse aus institutionenökonomischer Perspektive, 1996 and *Heinze*, Europäisches Kapitalmarktrecht – Recht des Primärmarkts, 1999, p.363 et seq.
[66] *Heinze*, Europäisches Kapitalmarktrecht – Recht des Primärmarkts, 1999, p.362.
[67] *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007), p.33.

B. The US Securities and Exchange Commission (SEC)

The Securities and Exchange Commission (SEC), a US federal agency for capital market supervision, is to protect investors, ensure capital market integrity and efficiency and to facilitate capital formation. Installed already 1934[68], the SEC has collected a wide array of experiences, whose knowledge and analysis is helpful for a comparison with the BaFin's current path. Thus, the following chapter details the SEC's historical development from the early 1930s until today, its organizational structure combined with mission and performance measurement. Also, the SEC's governing laws and the operations and legal means derived from those will be outlined. At last, current challenges of the organization will be determined and the organization's effectiveness and efficiency will be analyzed.

a. Historical development

The institution of the SEC is the consequence of a huge success story in the 1920s of the last century, and its sudden and dramatic end. The SEC, entrusted with the supervision of the capital market, was to ensure its integrity and efficiency. After a successful beginning and the notion of its excellent functioning, however, public recognition for the SEC, and by consequence its power, sank gradually. By a repetition of history – the soaring stock markets in the 1990s and their downturn in the early 2000s – the power of the SEC was reinforced, and has remained strong since. This chapter will detail the historical events that led to the foundation of the SEC in the 1930s, outline its development from then until the turn of the century and comment on the events in the early 2000s that fortified its position – a continuous "interplay of regulation, deregulation and re-regulation"[69].

i. Establishment of capital markets and early development

The history of US capital markets is as ancient as any: to safeguard the young democracy's financial means, already the first Congress between 1789 and 1791 issued gilt-edged securities, and allowed for trade with those shares to establish with banks in New York and Philadelphia, and later with professional dealers.[70]

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[68] By means of the Securities Exchange Act 1934.
[69] *Becker*, in *Hopt et al.*, Börsenreform – eine ökonomische, rechtsvergleichende und rechtspolitische Untersuchung, 1997, p.762.
[70] *Altendorfer*, Die US-amerikanische Kapitalmarktaufsicht (SEC) – Ein Modell für Österreich? 1995, p.3; *Koslow*, The Securities and Exchange Commission, 1990, p.17.

Also, in the late days of the industrial revolution, commercial enterprises grew in size and number. Thus, both the start-ups of those days, especially railway constructors and gold-mining companies[71], and the incumbents discovered need for capital, which could most easily be covered by investors – people who would be willing to assume the risk of business, but unable or unwilling to actively manage a company. New financial instruments were developed and sold, so that the separation of ownership and management allowed for a broad financial basis on the side of the company and for a spread of risk on the side of investors. However, it created need for a market place – capital markets.

As early as 1792[72], the New York Stock Exchange (NYSE) was founded, and enjoyed a rapid growth of participation. Both government and businesspeople were convinced that the exchanges "had a vested interest in maintaining the confidence of investors and thus would see that the activities of their members were honest"[73], so that, in the early days of stock exchanges, no securities regulation was deemed necessary.

Frequently recurring[74] experiences of business "panics", mostly triggered by manipulation of stock prices and conspiracies[75] by a few investors, taught early investors that their remoteness from the core business significantly increased the need for objectively gathered and verified data disclosure[76]. Crusading reporters, called muckrakers, exposed share scandals and other then common fields of business exploitation[77], and triggered a public uproar, so that Congress saw necessity for action.

Initially, the Federal Trade Commission Act (FTC) 1914 and the Clayton Antitrust Act 1914 established that disclosure of material information about publicly traded companies be mandatory and comprise annual financials.[78] Early attempts of so-called blue sky laws[79], i.e. state

[71] *Altendorfer*, Die US-amerikanische Kapitalmarktaufsicht (SEC) – Ein Modell für Österreich? 1995, p.4.
[72] *Koslow*, The Securities and Exchange Commission, 1990, p.18; *Becker*, in *Hopt et al.*, Börsenreform – eine ökonomische, rechtsvergleichende und rechtspolitische Untersuchung, 1997, p.761.
[73] *Koslow*, The Securities and Exchange Commission, 1990, p.19.
[74] Most notably, in the years 1837, 1853, 1857, 1869, 1873, 1893, 1907; *Koslow*, The Securities and Exchange Commission, 1990, p.20.
[75] Expecially, the so-called bear raids, or collective short selling of securities, which would drive market prices down, so that the short-seller would reap benefits at the expense of other shareholders; *Koslow*, The Securities and Exchange Commission, 1990, p.20.
[76] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.28; for deliberation on the theoretical background of this conflict of interest, see *Frankfort/Rudolph*, Zur Entwicklung der Kapitalstrukturen in Deutschland und in den Vereinigten Staaten von Amerika, in zfbf 1992 1059, p.1060.
[77] *Koslow*, The Securities and Exchange Commission, 1990, p.22.
[78] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.29; *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.44.

regulation for security markets, followed and were enacted mainly in two categories: the prevention of fraud and the enforcement of registration and permission prior to the sale of shares and bonds for brokers and dealers as well as for issuers.[80]

In 1918, it became obvious that state efforts did not pay off[81], however, a suggestion by the Capital Issues Committee, which would have required "the actual licensing of securities issues, subject to penalties"[82], was watered down to a mere investigative duty, and ensuing enactments only covered limited industrial branches[83], but still established, for the first time, national regulation for securities.

ii. Stock market growth in the 1920s and crash in 1929

In the post-war 1920s, the US economy flourished and displayed huge growth potential, which could only be realized by capital investments to enhance production facilities. Close to 20 million[84] Americans, eager to "participate in the booming economy"[85] and to acquire fortune seemingly unreachable by a life of work, placed money in the stock market to realize the promises of "rags to riches"[86]. Securities were especially popular with minor investors, because small denominations made them affordable to everyone, and the dividends, which would often top 20%[87], gave an instant reward for the investment. Also, the high dividends allowed for stock acquisition on credit, as they would assure yearly inflow for credit repayment, so that virtually everyone was able to acquire stock. Thus, the stock market grew exponentially until late 1929 – from 200,000 investors before the First World War to 20 million after, from 511 different shares in 1914 to 6,417 new emissions in 1929[88].

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[79] Called such after Hall v. Geiger-Jones, 242 U.S. 539, 550 (1917), which denounced some current practices as "speculative schemes which have no more basis than so many feet of blue sky". Kansas, in 1911, was the first state to regulate securities trade, and 22 more states followed until 1913; *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.46.
[80] *Ratner*, Securities Regulation, 2nd edition 1980, p.5.
[81] Reasons were the incontinuency of law, which allowed for improper operations across state borders, vast exemptions and lax enforcement, as well as investor's willingness to settle prior to a judgment.
[82] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.26.
[83] Such as the Transportation Act 1920 for railway transport, or the Federal Water Power Act 1920; *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.27.
[84] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction vii; *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.45.
[85] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.1.
[86] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction vii.
[87] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.31.
[88] *Altendorfer*, Die US-amerikanische Kapitalmarktaufsicht (SEC) – Ein Modell für Österreich? 1995, p.5.

Triggered by large stock sales by traders[89], the stock market crash of October 1929, or so-called Black Friday led to a plummeting compound market value until it reached the bottom with 17% of its height in 1932.[90] The Dow-Jones industry average fell even sharper: 89% in a 5-year period from 1929 till 1933[91].

The reasons for the market crash are widely discussed[92]: unwariness, exaggerated expectations and excessive use of credit financing on the side of the investors, but also intentional misrepresentations and abuse of information on the side of issuers and management, and price manipulation by brokers. Of course, those defrauding practices were only possible because the traders and those administering NYSE were reluctant to investigate into and uncover non-compliance with duties of disclosure or frauds.[93]

The stock market crash not only annihilated close to $ 25 billion in stock worth, but also destroyed huge sums of money with the banking sector[94]: as investors feared that in the current situation, a payback of their savings would not be possible for the banks, they stormed the banks, instantly claiming all their investments in cash and thus provoking bankruptcies.

iii. Foundation and SEC's gain of acceptance

Naturally, the loss of billions of personal investments led to a huge distrust by both American and foreign investors – as much as 55% of personal savings[95] had been invested in shares during the 1920s, and now had to be realized as losses. Additionally to those personal experiences, the discovery of corporate scandals and the extensive press coverage enhanced the feeling of insecurity and distrust with the capital market, so that most former and potential investors would restrain from further buying stocks and bonds, or even cut back current investments as to prevent further expected losses.

Government had to fear for investment becoming insufficient to cover the demands of the still growing economy, and for public savings being consumed without beneficial results.[96] The

[89] *Koslow*, The Securities and Exchange Commission, 1990, p.24.
[90] Data derived from *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.28.
[91] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.32.
[92] A comprehensive overview can be found in *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.1.
[93] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.46.
[94] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction vii.
[95] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.32.
[96] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.32.

individual states' blue sky laws, as indicated above, had not proven effective, so that demand for a federal, "paternalistic"[97] approach was high. Thus, Government decided to establish federal securities regulation and, shortly later[98], that a succinct administrative institution needed to be created to restore confidence – the SEC, which was founded in 1934.

In its early years, the SEC had to gain insight into the laws it was to administer and control, to establish legal interpretations and to create its administrative structure and processes. As securities regulation was new to the US economy, the industry reacted with denial, so that the SEC had to struggle for the correct and due implementation of law and also to fight for public recognition. To foster those activities, the organization hired to both Commission and high-level executive staff "some of the ablest people in the American public life"[99].

iv. Succession of loss of influence and re-surge 1940-1990

Since the US entry into the war in 1941, the SEC lost severely its influence: securities regulation was considered of minor importance, all resources were re-allocated to foster wart-related agencies, so that the SEC faced a staff cut of 500 and lost their office in Washington, DC for Philadelphia.[100] The next decade, i.e. the 1950s, would not develop more favorably for the SEC: the Republicans, and especially President Eisenhower, did not feel comfortable with a high amount of government regulation, but relied on the economic forces for recovery.[101]

In 1956, a venture was started to uniform the 50 states' blue sky laws by the promulgation of the Uniform Securities Act 1956 – an enactment covering antifraud provisions, broker/dealer registration, securities registration and a final section of definitions, exemptions and administrative provisions.[102] The states were free to adopt the Uniform Securities Act partially or as a whole, which a majority did. However, some of the most important states[103] as to economic influence did not join in; others modified the proposed textual content, so that an overall unification of codification failed. Moreover, legal interpretation of the statues until today varies

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[97] *Kitch*, Proposals for Reform on Securities Regulation: an Overview, online publication http://papers.ssrn.com/sol3/papers.cfm?abstract_id=269126 (page impression as of 6th of June, 2007), 2001, p.2; *Ratner*, Securities Regulation, 2nd edition 1980, p.10.

[98] Prior to this, the Securities Act 1933 was administered by the FTC; *Koslow*, The Securities and Exchange Commission, 1990, p.33.

[99] *Ratner*, Securities Regulation, 2nd edition 1980, p.11.

[100] *Koslow*, The Securities and Exchange Commission, 1990, p.50.

[101] *Koslow*, The Securities and Exchange Commission, 1990, p.52.

[102] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.10; *Altendorfer*, Die US-amerikanische Kapitalmarktaufsicht (SEC) – Ein Modell für Österreich? 1995, p.7.

[103] To name, New York, California, Illinois, Texas; *Ratner*, Securities Regulation, 2nd edition 1980, p.6.

from state to state[104], so that – even if statutory uniformity were given – administrative and judicial differences prevail. Nevertheless, the adoption of the Uniform Securities act is deemed beneficial for creating a "much more rational and consistent pattern of regulation"[105].

With President Kennedy's election in 1960, the SEC resurrected – especially as the president was the first Chairman's son and thus had a substantial understanding of the agency's importance. The nomination of three experts – William L. Cary, a professor of law, and two renowned SEC staffers – as Chairmen and Commissioners, the extension of the SEC's staff base and the conduction of several studies helped the SEC to re-surge from 20 years of public inactivity.[106] Also, the market break of 1962, ending a short period of speculation, reassigned some public importance to the SEC.

However, this was not of long duration: President Johnson opted for cooperation with business instead of control[107], and regulatory restraint[108] was the order of the day, leading to cut-back's of SEC's power during the late 1960. The SEC's strength re-surged in late 1970 by the assignment of new duties, when the bankruptcy of several large NYSE firms proved that stricter and independent regulation was needed.

Under President Reagan, and his politics of stimulating unhindered economic growth by relaxing restrictions, the SEC faced anew cut-backs in budget and influence[109] until the dramatic market decline on October 18th, 1987, on which Dow Jones dropped 22.6%.[110]

In the early 1990s, many formerly unknown technologies spurred financial market growth, as did deregulation[111]. A dramatic expansion of the securities business – measurable in almost every aspect – had happened since the late 1970s, and kept on growing during the early 1990s. Similar to the 1920s, the stock market was en vogue – a money machine, a means to climb from rags to riches. Again, the investing public increased; and again, the same faults

[104] *Ratner*, Securities Regulation, 2nd edition 1980, p.6.
[105] *Ratner*, Securities Regulation, 2nd edition 1980, p.6; *Buxbaum/Hopt*, Legal Harmonization and the Business Enterprise, 1988, p.131.
[106] *Koslow*, The Securities and Exchange Commission, 1990, p.54.
[107] *Koslow*, The Securities and Exchange Commission, 1990, p.58 .
[108] *Hall*, A Legal Solution to Government Gridlock, 2nd edition 1998, p.109.
[109] *Koslow*, The Securities and Exchange Commission, 1990, p.67.
[110] Mainly triggered by high market volatility, trading strategies based on derivatives and lax control of corporate information; *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.33.
[111] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.2.

would be made: investors would entrust money to both incumbents and start-ups without examining the securities those corporations could provide in exchange for the invested money.

v. Stock market crash in 2001/2002

The market crash of 2001/2002 was triggered by the scandals around corporate giants, of which the Enron case[112] is one of the most striking examples. After the discovery of their practices, mainly due to an investigation by the SEC, Enron collapsed – as did other corporate giants such as Tyco, WorldCom or Xerox. Also, auditing and accounting companies such as Arthur Andersen and Merrill Lynch faced charges for obstruction of justice and undisclosed relationships with investment banks.[113] After the staggering public disclosure of those events, the Dow Jones dropped severely, and "a market wide dampening of stock prices"[114] was observed ranging over $ 7 trillion[115].

The reasons of the burst of the market bubble are quite similar to the ones that caused the stock market crash in 1929[116]: over-estimation of the importance of the new economy compared to the traditional fields of economic activity, inflated earning and gain expectations, in short: investors' greed, leading to fraud and intentional misrepresentation of accounting figures[117]. Additionally, management in those times was often compensated by stock or stock options[118], so that a misrepresentation would not only sustain their position, but also enhance their personal fortune. As well, the tremendous growth of the last decades and the long-term bull-market made people forget the risks of the share business and decreased demand for disclosure[119], so that corporate frauds had an easy ground.

In the aftermath of the scandals, investors lost confidence into the capital market, and severe doubts about the "integrity of the entire system of public ownership and accountability"[120] were uttered. Bankruptcies through all industries left shareholders with huge losses, and rapid

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[112] Featuring, among others, increased revenue forecasts by overstated forecasting assumptions, selling of deficient businesses to "outside investors" – mainly sub-companies belonging to Enron itself – for inflated prices, and finally the reporting of large, but totally fictitious profits. External auditors seemingly did not discover those improper practices, or failed to disclose them due to conflicts of interests, Enron being one of their main customers.
[113] *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.623.
[114] *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.623.
[115] As indicated by the drop of the Wishire Total Market Index from $ 17.25 trillion to $ 10.03 trillion between March 2000 and July 2002; *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.624.
[116] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.2.
[117] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.3.
[118] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.6.
[119] *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.623.
[120] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.5.

sales by frightened small investors pushed prices to bottom levels – again, a capitial market crisis.

vi. Reinforced authority and today's security markets

Like in the early 1930s, government and Congress had to strive to restore investor's confidence, which was assumed by the legislation of the Sarbanes-Oxley Public Company Accounting Reform and Investor Protection Act (SOX) in 2002, with a regulatory emphasis on corporate governance, financial reporting and rules of behavior for investment services entities and persons.[121] Those reforms would, once again, be administered and monitored by the SEC. Beginning in 2003, the SEC worked avidly to effectuate regulation of enhanced disclosure, supervision and auditing within companies, so that after the gradual recovery of the economy in 2003/2004 also the stock market (both exchange markets[122] and over-the-counter markets[123]) recovered.

vii. Summary

The history of the SEC displays a series of cycles[124] – enthusiastic foundation and early years, several phases of decline and resurges in its growth phase, finally revival and sustained strength in its maturity. Through all its history, crises of the stock market reinforced SEC's position, especially with the investing public.

As the capital market has grown more complex during the last years, and as this development severely increased the likelihood of defrauding action, it can be expected that, also in the future, the SEC will maintain a strong position within the US political and public landscape.

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[121] *Regelin/Fisher*, Zum Stand der Umsetzung des Sarbanes-Oxley Act aus deutscher Sicht, in IStR 2003 276, p.276; *Atkins*, Speech at Cologne University on Februray 5th, 2003, http://www.sec.gov/news/speech/spch020503psag.htm (page impression of March 28th, 2007)

[122] On which stocks are traded in a physical facility. Currently, five exchanges are active in trading: the New York Stock Exchange (NYSE), the American Stock Exchange (AMEX), the Chicago Stock Exchange (CHX), the Philadelphia Stock Exchange (PHLX), the Boston Stock Exchange (BOX); *Altendorfer*, Die US-amerikanische Kapitalmarktaufsicht (SEC) – Ein Modell für Österreich? 1995, p.17.

[123] On which stocks are traded without direct contract, generally over a telephone and/or internet communication network, most importantly NASDAQ. Over-the-counter-markets were subjected to SEC's supervision in 1938 by the so-called Maloney Act, which introduced Securities Exchange Act 1934, sec. 15 (a).

[124] *Hall*, A Legal Solution to Government Gridlock, 2nd edition 1998, p.10.

b. Organizational structure

To gain an understanding of the SEC's operations and task fulfillment, it is indispensable to first outline the organizational basis for the organization. Thus, the following chapter will detail the SEC's internal organizational structure of head of organization, divisions and offices, its funding, its reporting responsibility to Congress and finally the public-private and state partnerships the SEC engages in.

i. Head of organization

The SEC is a federal, autonomous[125] regulatory agency headquartered in Washington, DC with 11 regional offices. It is presided by a Commission, whose five members serve 5-year-terms after being nominated by the President and confirmed by the Senate[126]. "Once sworn in, the commissioners cannot be dismissed by the president before the expiration of their […] term"[127], and the five Commissioners' terms expire in a staggering fashion, so that continuity of SEC's policy is safeguarded. Non-partisanship is ensured by the demand that not more than three Commissioners belong to the same political party.[128] However, if, during a SEC's president's term, a new president of the opposite party is elected, the president will traditionally ask for removal from his position, so that the new president may determine and better cooperate with a chairman of his own political orientation.[129]

Currently, the appointed persons are Chairman Christopher Cox, and Commissioners Paul S. Atkins, Roel C. Campos, Annette L. Nazareth and Kathleen L. Casey.[130] The commission is a deliberative collegial body[131], meaning that the Commissioners hold frequent meetings to exchange opinions, whereas however each of them holds responsibility for a specific resort.

The Chairman, designated by the president, assumes direction of all administrative functions, among them personnel issues, internal organization and fund expenditure.[132] All policy and regulative procedures are decided by the majority vote of the Commission.[133] Main issues of discussion, mostly effectuated in meetings open to the public and the press, are how to "inter-

[125] *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.214.
[126] Securities Exchange Act 1934, sec. 4 (a).
[127] *Koslow*, The Securities and Exchange Commission, 1990, p.75.
[128] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.150.
[129] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.43, 127.
[130] http://www.sec.gov/about/commissioner.shtml (page impression of November 7th, 2006)
[131] *Soderquist/Gabaldon*, Securities Regulation, 4th edition 1999, p.9.
[132] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.57.
[133] *Koslow*, The Securities and Exchange Commission, 1990, p.75.

pret federal securities laws, amend existing rules, and propose new rules to address changing market conditions, and/or enforce rules and laws"[134]. Day-to-day administrative operations lie within the four divisions and 18 offices[135] in Washington, and furthermore with the regional offices.[136]

ii. The divisions

The internal organizational structure encompasses roughly 3,865 employees[137], mainly accountants, examiners, lawyers and security analysts in the following proportion:[138]

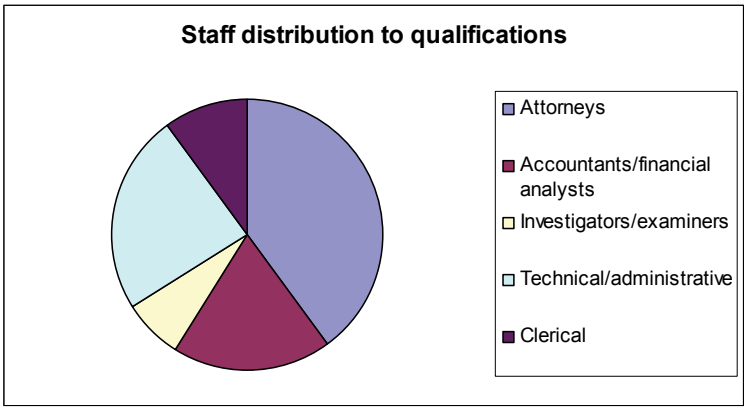

Chart 2: SEC staff distribution relative to qualifications

The employees are assigned to the four divisions and also distributed among the regional offices, whereas approximately two-thirds work in the headquarters.[139] The organizational structure of the SEC, thus, is functional[140] with four divisions disposing of overlapping authority.

The Division of Corporation Finacne is mainly concerned with advising and monitoring financial accounting in private and public enterprises. Thus, it assists the Commission in setting standards for economic and financial reporting, and administers corporations' compliance.[141] The primary part of everyday works consists in the revision of company's registration statements such as prospectuses, quarterly and annual reports (or, so-called 10-K and 10-Q

[134] http://www.sec.gov/about/whatwedo.shtml (page impression of November 7th, 2006) sub "Organization of the SEC".
[135] http://www.sec.gov/about/whatwedo.shtml (page impression of November 7th, 2006) sub "Organization of the SEC".
[136] For a detailed description, see below.
[137] *Securities and Exchange Commission*, 2005 Performance and Accountability Report, p.6.
[138] Data of 1999, derived from http://www.sec.gov/about/gpra1999-2000.shtml (page impression of November 7th, 2006) sub "Resources Required to Meet the Plan's Performance Goals".
[139] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.38.
[140] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.58; for discussion of the concept, see *Scholz*, Strategische Organisation: Prinzipien zur Vitalisierung und Virtualisierung, 1997, p.149.
[141] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.40.

forms[142]) and sales brochures[143], whereas revision includes investigations, examinations and formal hearings in case of a suspected misrepresentation. The division also offers advisory service to those who fall under the security law it administers, i.e. training for issuers, accountants, lawyers and underwriters[144].

The Division of Market Regulation, by virtue of the SEA[145], is responsible for establishing and maintaining "standards for fair, orderly and efficient markets"[146], which is ensured by regulation of national security exchanges, and of the brokers and dealers acting on those markets under registration according to the Investment Advisers Act 1940 and of the SROs founded on the brokers and dealers behalf.[147] The division also "assumes […] statistical accumulation functions and is generally responsible for policing the securities markets"[148], generally by surveilling both first access to market (by issuance supervision) and current trading[149], also for brokers and dealers.

The Division of Investment Management is entrusted with the supervision of investment companies and dealers under the provisions of the Investment Company Act[150] and the Investment Advisers Act. It conducts investigations and inspections, reviews filings by investment companies and advisors and grants no-action letters or other forms of exemptive relief in case of prior consultation.[151] Additionally, it engages in rulemaking and reviews enforcement matters as concerning investment companies.

At last, the Division of Enforcement does no engage in any supervisory activity, but directs the enforcement activities of regional offices and of its fellow divisions. Thus, with about 500 employees[152], it conducts investigations or supervises investigatory procedures by other Divisions, initiates injunctive actions if need be and decides whether a particular case is supported

[142] http://www.sec.gov/about/whatwedo.shtml (page impression of November 7th, 2006) sub "Organization of the SEC".
[143] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.40.
[144] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.40.
[145] Securities Exchange Act 1934, sec. 2 and internal task distribution.
[146] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xvi.
[147] http://www.sec.gov/about/whatwedo.shtml (page impression of November 7th, 2006) sub "Organization of the SEC".
[148] *Herz et al.*, The Coopers & Lybrand SEC Manual, 7th edition 1997, p.25.
[149] *Koslow*, The Securities and Exchange Commission, 1990, p.83.
[150] Investment Company Act 1940, sec.1 i-iii and internal task distribution.
[151] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xvii.
[152] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.34.

by sufficient evidence to be successfully pursued in court.[153] It also represents the SEC's position in a federal or administrative court, and has authority to negotiate settlements on its behalf.[154] Evidence of possible violations come from many sources, mostly the divisions' own surveillance activities, other divisions, the SROs and investor complaints.[155]

iii. The offices

1. Regional offices

As indicated above, the SEC holds eleven offices to serve as field representatives for supervision and enforcement. In detail, five regional offices encompass in their regions also the six district offices[156], so that the following regional distribution of responsibility arises:[157]

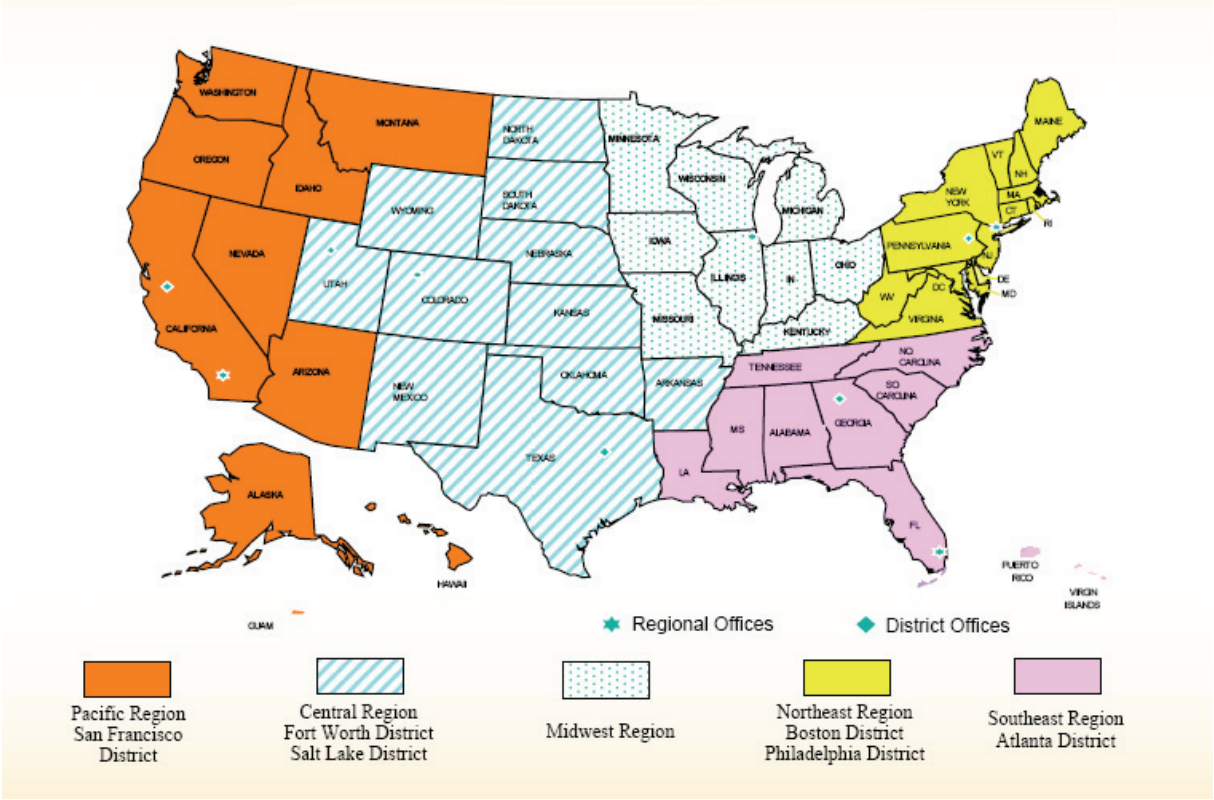

Chart 3: SEC regional and district offices

The Federal Securities Law Report cites the following as functions or regional offices: "Investigate transactions in securities, examine members of exchanges, broker-dealers, transfer agents, investment advisors, and investment companies, prosecute injunctive actions, render

[153] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.41.
[154] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xviii.
[155] http://www.sec.gov/about/whatwedo.shtml (page impression of November 7th, 2006) sub "Organization of the SEC".
[156] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.148.
[157] *Securities and Exchange Commission,* Annual Report 2003, p.99. Publication by courtesy of the SEC, as granted in 17 U.S.C. 105.

assistance to U.S. attorneys in criminal cases […], and make the Commission's facilities more readily available to the general public of that region."[158]

Thus, it becomes obvious that the regional offices do not only promote the SEC's goals within their region and transfer all material work to the headquarters, but have a high degree of power and responsibility. Obviously, this will not relate to nationwide traded securities as much as to brokers and dealer performing their services in the area of a regional SEC office. Additionally to federal law, the regional offices serve as advisors on the individual states' blue sky laws.

2. Functional offices

Functional offices comprise the Office of the Chief Accountant (head of all activities in the realm of financial accounting and auditing), the Office of the General Counsel (chief legal officer of the SEC), the Office of Compliance Inspections and Examinations (examination and inspection of registered self-regulatory organizations) and the Office of Econommic Analysis (provision of economic, empirical and statistical research, data gathering and compilation). Further support is provided by the Office of Administrative Law Judges, the Office of Legislative Affairs, and the Office of Municipal Securities coordinates SEC activities in the municipal securities markets, i.e. concerning securities raised by states, cities and other political actors.[159] Further internal offices coordinate and organize SEC's task, whereas a comprehensive overview has already been provided in literature. [160]

iv. Funding

As SEC's service only benefits some members of the US society[161], Congress felt that the cost of such activity should not be attributed to the general public, but rather to those profiting from SEC's work. Thus, the SEC's funding is based on registering fees for initial emission of securities, fees for certain voting right amendments and the re-buy of own securities, and – last but most important – transaction fees for each and every business effectuated at national

[158] Federal Securities Law Reports, Vol.I, quoted according to *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.42.
[159] Whereas those can be either obligation securities, covered by full faith and credit of taxing power, or revenue securities covered by the revenue of a specific project such as an airport, a bridge and the like; *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.613.
[160] For a comprehensive overview of all offices and their functions, see *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xxi et seq.
[161] I.e. those investing in publicly traded shares, and those corporations who engage as issuers.

exchanges.[162] Disgorgements and penalties do not count among the SEC's funds, but, once collected, are transferred to the General Fund of the Treasury or distributed to harmed investors.[163] Although the percentage amounts seem very low, "the bull market of recent years has boosted the amounts collected dramatically"[164], so that the SEC collected often over five times of their allowed budget:[165]

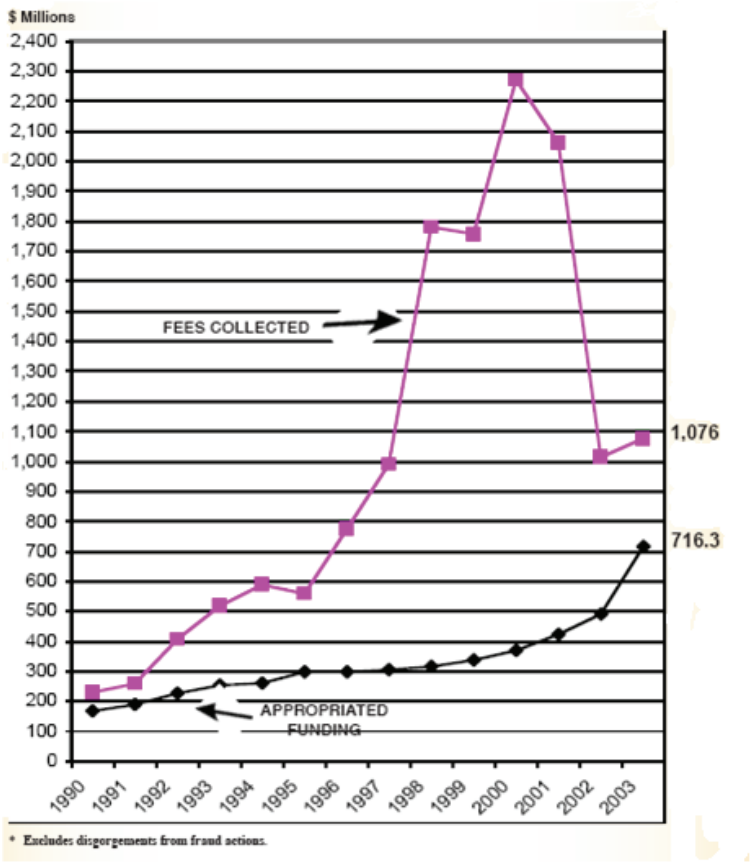

Chart 4: SEC comparison of appropriated funding and fees collected

Due to political considerations, the registration fee[166], constituting the main proportion of SEC's budget, had steadily declined for the last 15 years and was prescribed to continue in

[162] A percentage of the value (1/300 of 1%; Securities Exchange Act 1934, sec. 31) of stock and stock option sales effectuated on exchanges or over-the-counter markets, to be paid by the seller, and a percentage of the value (1/50 of 1%; Securities Act 1933, sec. 6 (b)) of new stocks and bonds, to be paid by the issuer. In addition, corporate takeovers and tender offers are charged with a percentage value[162] (1/50 of 1%; Securities Act 1933, sec. 6 (b)) of the proposed transaction. For a detailed outline, see *Jickling* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.21 and *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.98.

[163] *Securities and Exchange Commission,* 2006 Performance and Accountability Report, p.33.

[164] *Jickling* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.21.

[165] *Securities and Exchange Commission,* Annual Report 2003, p.141. Publication by courtesy of the SEC, as granted in 17 U.S.C. 105.

[166] Registration fee is comprised of: securities registered under the Securities Act 1933 (75%), transaction of covered exchange-listed securities (17%), tender offer and merger filings (7%) and other (1%); *Wilder*, The Securities and Exchange Commission (SEC), 2003, Preface ix.

such way upon pressure of Congress. A congressional enactment[167] in 2002 prescribed further declines for the years from 2002 to 2007, as the graphic[168] indicates. Fees being the main source of SEC's budget, this decline will lead to a sharp decrease of SEC's collected revenue until it equals its budget: [169]

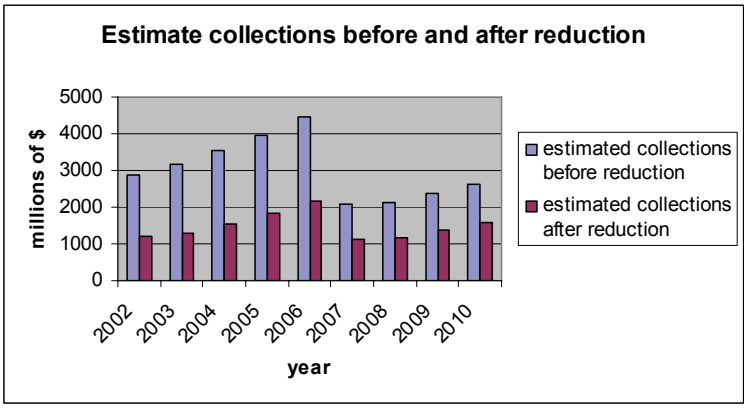

Chart 5: SEC estimate collections

By the end of those reductions, SEC budget and collections are estimated to equal each other. Generally, the SEC has to establish its annual budget, and apply for congressional review and approval. Only the granted amount is to be employed, so that over-covering of the budget by the collected revenues does not help the SEC's budget situation. The SEC's annual budget has reached $ 913 million in 2006, and the organization prepares annual financial statements to be filed with congress and open to public inspection.[170]

v. Congressional control

The SEC is directly responsible to Congress, which is expressed by the congressional decision about the SEC's budget appropriation and by the SEC filing an annual report for control and, generally, several special reports on subjects of interest upon request.[171] Financial statement audits have to be prepared in consistency with the Accountability of Tax Dollars Act 2002, involving fair presentation in all material respects and with regard to GAAP, and are conducted by the Government Accountability Office (GAO) since 2005.[172]

[167] National Securities Market Improvement Act 1996, sec. 104-290.
[168] Data derived from *Bloomenthal/Wolff*, Sarbanes-Oxley Act in Perspective, 2nd edition 2005, p.121.
[169] Data derived from *Jickling* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.25.
[170] *Securities and Exchange Commission,* 2006 Performance and Accountability Report, p.33.
[171] *Koslow*, The Securities and Exchange Commission, 1990, p.76.
[172] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.31.

Furthermore, the SEC finds itself governed by several rules and regulations for federal agencies, among them the Federal Manager's Financial Integrity Act 1982 (FMFIA), which requires the agency to "annually evaluate their system of internal control and report to the President and Congress on whether it complies with the standards and objectives set forth"[173], and whether the accounting system complies with the principles of the US Comptroller General. Those informal reviews have been, since installation in 2004, conducted with success[174] and yielded a high level of compliance, whereas, however, some weaknesses[175] have been observed and needed to be corrected. In 2006 audits, all deficiencies were reported to have been erased, so that full compliance is ensured.[176]

Additionally, the SEC decided to voluntarily conduct an organizational assessment with regard to the Federal Information Security Management Act 2002 (FISMA), which concerns the field of IT security, which again resulted in high scores for compliance, but also in the detection of minor deficiencies which called for instant remediation.[177] Other acts under which the SEC is subjected include the Prompt Payment Act 1999 "requires federal agencies to report on their efforts to make timely payments to vendors, including interest penalties"[178] as to ensure that governmental branches are subjected to the same rules as the general economy. The Improper Payments Information Act 2002 is to ensure identification and repayment of erroneous payments, and the Debt Collection Improvement Act 1996 prescribes how the administration, collection, compromise and suspension of collection actions have to be administered.[179] In all those fields, the SEC yielded a superior or above-average performance.

vi. State partnerships, partnerships with federal agencies and private-public cooperation

The SEC, indeed, is integrated into the US administrational system not only by its responsibility to Congress, but also by close ties to other federal and state authorities. Thus, it cooperates with such agencies in order to increase its influence on the market, and to create effects of size and scope while sharing tasks and responsibilities.

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[173] *Securities and Exchange Commission*, 2004 Performance and Accountability Report, p.35.
[174] *Securities and Exchange Commission*, 2004 Performance and Accountability Report, p.36.
[175] Such as lacking internal information exchange about penalties and disgorgement collection management, or lacking technical safeguards for the protection of information; *Securities and Exchange Commission*, 2004 Performance and Accountability Report, p.36-39.
[176] *Securities and Exchange Commission*, 2006 Performance and Accountability Report, p.3.
[177] *Securities and Exchange Commission*, 2004 Performance and Accountability Report, p.40.
[178] *Securities and Exchange Commission*, 2004 Performance and Accountability Report, p.40.
[179] *Securities and Exchange Commission*, 2004 Performance and Accountability Report, p.41.

On the one hand, this encompasses cooperation with the states in the field of joint examinations and enforcement – an area that has increased in importance with the passing of the National Securities Market Improvement Act (NSMIA) in 1996.[180] This act "eliminates redundant registration of mutual funds by the states, preempts state blue-sky registration of "covered securities", retains state securities registration of certain securities"[181], so that double-registration and control are avoided and henceforth conferred to the SEC. Regulation of small-size[182] investment advisers, on the contrary, is subjected under state responsibility, whereas with all others, it rests with the SEC.[183] Thus, close cooperation is necessary to ensure that all entities are covered by supervision while avoiding double and triple registration and control.

On the other hand, the SEC also partners with other federal agencies, first and foremost the Department of Justice for all matters of criminal prosecution of security law violations. This is especially pursued with internet-related enforcement efforts[184], as this new field requires joint action of the fact-collecting and specialist department (SEC) with the enforcement side (SEC Division on Enforcement and Department of Justice) to ensure a quick solution. Other examples for non-steady cooperation are the Office of the Comptroller of the Currency for surveys, the Federal Insurance Corporation to examine banking institutions engaged in securities trade, the Commodity Futures Trading Commission (CFTC) and the Treasury Department[185] as well as the Federal Reserve System[186] for a joint effort in the field of banking supervision and introduction of financial modernization.

Especially the Commodity Futures Trading Commission (CFTC) is of high importance. Created by the homonymous act in 1974, regulates commodities exchanges and brokers[187], and thus engages in the very same tasks as the SEC, but on a much narrower field. Also, its structure and organizational design are much alike with the SEC's, although its staff base is con-

[180] http://www.sec.gov/about/gpra1999-2000.shtml (page impression of November 7th, 2006) sub "State Partnerships"
[181] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xxxiii.
[182] I.e. under $ 25 million of managed capital.
[183] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xxxiii.
[184] http://www.sec.gov/about/gpra1999-2000.shtml (page impression of November 7th, 2006) sub "Partnerships with Federal Agencies"
[185] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xxxiv.
[186] http://www.sec.gov/about/gpra1999-2000.shtml (page impression of November 7th, 2006) sub "Partnerships with Federal Agencies"
[187] Including "futures commission merchant, floor broker, commodity trading advisor, commodity pool operator, commodity option dealer, leverage transaction merchant; *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.222.

siderably smaller and its mandate more specific. Administering the Commodity Exchange Act 1936, it regulates and supervises the commodities exchanges, but also delegates some of its powers on the National Futures Association, a SRO, and the exchanges.[188] As, in the recent years, many hybrid financial instruments were created, the SEC and the CFTC had to engage into discussions, eventually leading into jurisdictional disputes, whether a certain financial instrument constitutes a security (and is thus monitored by the SEC) or a commodity (and is thus monitored by the CFTC).[189] This overlapping authority makes matching in their respective approaches and cooperation in some fields necessary so as to create a unified regulatory environment to issuers.

Being a relatively small public agency[190] with an exponentially growing number of supervised entities, the SEC earlier than most agencies embraced the idea of private-public partnerships with self-regulated organizations (SROs) to alleviate the workload and create effects of size and scope as well as gain higher acceptance with the supervised entities. Also, the SEC relies on the SROs' expertise in matters of their scope, and asks advice and recommendation for further legislation and/or administrative action. The system of "shared responsibility and shared regulation"[191] was also extended to market participants and others.

Furthermore, the US capital market system provides for a number of regulatory agencies and private standard-setters, all of which have their own membership criteria, operations and sanctioning procedures, whereas such governing rules are subjected to SEC review.[192] All entities considered national securities associations must register with the SEC[193], and so must their umbrella organizations.

To name, the Financial Accounting Standard Board (FASB) ensures that financial information reaches the public in a uniform and recognizable form. By its Statements of Financial Accounting Concepts (SFAC)[194], it creates the body of Generally Accepted Accounting Principles (GAAP), compliance with which is obligatory to corporations. The EITF, a subcommittee comprised of CPAs and business representatives, issues comments on questions of

[188] *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.222.
[189] *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.222.f
[190] http://www.sec.gov/about/gpra1999-2000.shtml (page impression of November 7th, 2006) sub "Public-Private Partnerships"
[191] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xxxii.
[192] *Hazen,* Federal Securities Law, 2nd edition 2003, p.5.
[193] Securities Exchange Act 1934, sec. 15 (a).
[194] *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.223.

urgent importance, so that a quick official reaction to business's concern is ensured.[195] Being a non-governmental agency comprised of businesspeople, academics and accounting professionals, the FASB lacks legal oversight or enforcement authority[196], so that recognized non-compliance is referred and then pursued and sanctioned by the SEC. Additionally, the SEC has the power of endorsement, i.e. correcting FASB's rules and regulations, and can dictate FASB's agenda, if they lack rules in a certain area of interest.[197] This necessary cooperation has severely improved SEC's relationship to the FASB, which, with FASB's predecessors, had not been very favorable.[198]

Furthermore, the American Institute of Certified Public Accountants (AICPA) unites all Certified Public Accountants (CPAs) in a private professional organization, and as such set standards for accounting (GAAP) and auditing (GAAS) in its Statements of Auditing Standards (SAS).[199] In the aftermath of the numerous accounting scandals in the early 2000s, the AICPA was blamed for failing its role as self-regulating body and thus lost oversight authority over publicly traded companies to the PCAOB. From 2003 on, it serves only as a standard-setter for non-public entities[200] and thus has lost significantly in officially attributed importance; however, the body is still very active in the development of the GAAP.[201]

Its successor, the Public Companies Accounting Oversight Board (PCAOB) was introduced by SOX 2002[202] and oversees firms that conduct audits in publicly traded companies, mostly organizations comprised of CPAs. It is also of high relevance for international auditors intending to work in the US.[203] The SEC sets organizational and authorizing releases for the PCAOB[204] and can overrule the PCAOB's rules and regulations.[205]

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[195] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.53.
[196] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.21.
[197] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.54.
[198] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.53.
[199] *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.223.
[200] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.21.
[201] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.50.
[202] For a detailed description, see below.
[203] *Lanfermann/Maul*, Auswirkungen des Sarbanes-Oxley Acts in Deutschland, in DB 2002 1725, p.1725.
[204] Such as the PCAOB Release No. 2003-07, which prescribed registration of accounting firms with the board, or the PCAOB Release No. 2003-19, which conferred the authority of inspection onto the PCAOB.
[205] *Hamilton/Trautman*, Sarbanes-Oxley Act of 2002, 2002, chapter 706.

The Securities Investor Protection Corporation (SIPC)[206], a non-profit organization administering a fund for reimbursement of investors in case of bankruptcy or financial breakdown of a brokerage firm, helps the SEC with the liquidation of such cases. They do not only administer the reimbursement of investors, but also the distribution of the available securities among the account holders. As this task which would be genuinely conferred to the SEC, the institution does have supervisory authority over the SIPC and cooperates with it, especially if the SEC was called before court as advisor in a bankruptcy proceeding.

Another cooperation partner is the FINRA[207] (formerly National Association of Securities Dealers (NASD)), whose creation was provided for in an amendment to SEA.[208] Existing since 1938, it is the only self-regulating body for brokerage firms[209] and intends to strengthen the self-regulatory character of the investment industry by ensuring market integrity. Its engagement encompasses education and supervision concerning a voluntary code of business ethics, promotion of "just and equitable principles of trade"[210] and reasonable underwriting fees, engagement in mediation and arbitration[211] and resolution of conflicts of interest between its members (i.e. brokers and dealers) and an issuer. Also, the FINRA has to review and consent to each registration statement and issue a so-called no-objections letter before the SEC can declare it effective.[212] This review also generates the FINRA's funding: per filed offering, the body demands a filing fee[213] to be paid by the issuer.

To follow, a further SEC auxiliary is the Municipal Securities Rulemaking Board (MSRB), a body comprised of municipal security brokers or bank representatives[214] and installed by SEA[215]. It issues rules relating to the qualifications of brokers and dealers and their staff, internal sanctions for illicit and/or fraudulent behavior and the establishment of codes of best practices and fair and equitable principles of trade[216]. Hereby, it does not only take into ac-

[206] For a detailed description of the body and its authority, see above.
[207] For a description of the authority's name change, see http://www.finra.org/AboutFINRA/CorporateInformation/index.htm (page impression of October 4th, 2007).
[208] *Budd/Wolfson*, Securities Regulation, 1984, p.5.
[209] http://www.nasd.com (page impression of October 20th, 2006) sub "About us"; *Gemberg-Wiesike,* Wohlverhaltensregeln beim Vertrieb von Wertpapier- und Versicherungsdienstleistungen, online-edition 2004, p.119.
[210] *Budd/Wolfson*, Securities Regulation, 1984, p.5.
[211] http://www.nasd.com (page impression of October 20th, 2006) sub "About us"
[212] *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.219.
[213] Currently equalling $ 500 + 0.01% of the gross dollar amount of the offering, up to a maximum of $ 30,500; *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.219.
[214] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.155.
[215] In detail, Securities Exchange Act 1934, sec. 15 (b).
[216] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.155.

count federal securities law, but also the states' blue-sky laws and the regulations of the individual exchanges.

All in all, the SEC holds a vast array of cooperative partners in the US capital market environment, on which it relies especially in the field of accounting, just occasionally superseding the bodies' rules by own regulation or disciplining accounting firms in case the professional organizations did not engage in doing so.[217] However, the SEC does not only cooperate in the field of standard-setting, but also shares and partially delegates some tasks of supervision, as by itself, it would not be able to effectuate all day-to-day supervisory work.[218] Despite the cooperativeness, the SEC holds certain authority over the SROs: besides registration, the SEC on the one hand controls the regulations and the enforcement as effectuated by the SROs, on the other hand, those supervised by SROs can appeal with SEC.[219] At last, the SEC can sanction SROs, which is especially important as the SROs are dependent on public recognition and as a critique or even shaming by the SEC would ensue in members fleeing the organization.[220]

The great advantage such boards and professional organizations offer the SEC is that their members are – at least partially – business people and thus peers to the supervised persons. Thus, such peer-by-peer supervision is more respected by the supervised entities than by total strangers to their business, so that compliance and cooperation is more likely. Also, former professionals are intimate with both the practical difficulties, which they will take into account when setting standards, and know the possibilities of fraudulent behavior and improper practices, which they will easier discover when exerting their supervisory authority.

vii. International cooperation

The SEC, of course, also engages in international cooperative circles of securities supervisors, as to share their experience, exchange best practices and reach agreements on cooperation. Indeed, the SEC claims that international cooperation is the most important factor for an effective investigation and enfocement: as money is easily transferred electronically these days,

[217] *Ratner*, Securities Regulation, 2nd edition 1980, p.17.
[218] Most notably, the Division of Market Regulation pursues its task of supervision of brokers and dealers by supervising their self-regulated organizations, such as the FINRA (former NASD).
[219] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.63.
[220] For example, in 1996, the SEC sanctioned NASD (today's FINRA) for non-stringent supervision of market makers and requested reforms; *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.63.

criminals move abroad and connect. As "it takes an network to catch a network"[221], the SEC very readily engages in joint efforts with foreign supervisory and law enforcement regulatories, as well as with international bodies.

Most important, in this regard, is IOSCO: founded already in 1983[222], it resides during annual meetings in Madrid[223] and is an unofficial group without any advising, legislative or other function, and consists of members of 183 countries.[224] The aim is to promote the exchange of information and best practices, as well as to foster active cooperation between the national securities supervisory authorities. By this, supervisory arbitrage is to be avoided and also emerging markets are fostered, so that they will develop into secure and transparent ones.[225]

Therefore, the group has determined resolutions and standards, issues reports[226] on various questions and engages into the process of self-evaluation.[227] Also, the exchange of information and best practices has been a good means of ensuring high standards for both national and the global capital market. In 2005, IOSCO developed a multilateral MOU (MMOU), to be concluded until the end of 2009, which will then determinate all inter-state relationships and make bilateral MOUs unnecessary.[228] Due to the unanimity principle, all participants must be included in the final decision, which also guarantees that bigger states or organizations cannot determine IOSCO's policies on their own.[229]

Also, the SEC has entered in an array of bilateral agreements which have developed to "a significant means of enforcing domestic securities laws"[230], as foreign supervisory authorities are

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[221] Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.
[222] *Strupp,* Aktien-, börsen- und wertpapierrechtliche Fragen des Umlaufs von Aktien an ausländischen Börsen, online-edition 2003, p.65; http://www.iosco.org/about/ (page impression of June 11th, 2007) sub "IOSCO Historical Background".
[223] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.33.
[224] http://www.iosco.org/about/ (page impression of June 11th, 2007) sub "IOSCO Historical Background"; for a detail of founding procedure, see *Kung,* The Regulation of Corporate Bond Offerings: A Comparative Analysis, in 26 U Pa. J. Int'l Econ. L.409, p.411.
[225] *Sommer*, IOSCO: Its mission and achievement, in 17 NW. J. Int'l L. & Bus. 15, p.20; *Kung,* The Regulation of Corporate Bond Offerings: A Comparative Analysis, in 26 U Pa. J. Int'l Econ. L.409, p.410.
[226] Not only of importance for individual states, but have consulted by governemts for legislation, e.g., those reports have been consulted during the European process of developing the prospectus directive; *Seitz*, Die Integration der europäischen Wertpapiermärkte und die Finanzmarktgesetzgebung in Deutschland, in BKR 2002 340, p.345.
[227] http://www.iosco.org/about/ (page impression of June 11th, 2007) sub "IOSCO Historical Background", *Bergsträsser* in *Ferrarini*, European Securities Markets – the Investment Services Directive and Beyond, 1998, p.373.
[228] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2005, p.59; http://www.iosco.org/about/ (page impression of June 11th, 2007) sub "IOSCO Historical Background".
[229] *Sommer*, IOSCO: Its mission and achievement, in 17 NW. J. Int'l L. & Bus. 15, p.22f.
[230] *Mann/Barry* in *Grabar*, Foreign Issuers & the US Securities Laws 2006, 2006, p.184.

willing to use their authority to support the SEC's tasks, if granted help with their enforcement[231]. Although the SEC would be entitled to enforce national securities law against any offender notwithstanding its current place of business[232], practically this poses severe problems, so that cooperation proves advantageous. The most common form to do so are memoranda of understanding (MOUs), which define rules on the sharing of information, the seizing of evidence and help with enforcement. Entitled by a congressional relief do to so[233], the SEC has currently entered into more than 30 of such agreements with states with a large amount of cross-country securities trading, and adherent mutual legal assistance treaties (MLATs).[234]

With the German BAWe, predecessor of the BaFin, the SEC entered into a MOU in 1997, which "addresses cooperation in connection with the enforcement of securities laws and regulations, including […] insider trading, misrepresentation or manipulative practices in connection with the offer, purchase or sale of any security or in the conduct of an investment business"[235]. More specifically, this concerns mutual assistance in interviewing, conducting other investigations and analyzing information as to determine whether and which securities law violation had been committed. Also, regular consultations among the SEC and the German counterpart were prescribed, so as to ensure that both parties would be aware of recent developments in their respective countries.

viii. Summary

The previous chapter detailed the SEC's internal organizational structure with four divisions, multiple functional and regional offices and a presiding Commission. It furthermore elaborated on the SEC's funding and responsibility towards Congress, and its outside partnerships with federal and state agencies. Thus, it became obvious that the SEC is tied into a close network of interrelationships involving responsibility, supervision and cooperation that help to ensure the effective fulfillment of its tasks.

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[231] SEC is entitled to grant such help by Securities Exchange Act 1934, sec. 21 a, even if the reason for the investigation (i.e. the alleged securities law violation) would not constitute such in US securities law.
[232] Or, as stated by Securities Exchange Act 1934, sec. 22a, proceed against "wherever the defendant may be found".
[233] Under the Securities Fraud Enforcement Act 1988; *Soderquist/Gabaldon*, Securities Law, 2nd edition 2004, p.195.
[234] A specific example is Switzerland, with which no MOU could be reached, but an MLAT allows for "obtain[ing] information located in Switzerland, including detailed banking information"; *Mann/Barry* in *Grabar*, Foreign Issuers & the US Securities Laws 2006, 2006, p.184.
[235] *Mann/Barry* in *Grabar*, Foreign Issuers & the US Securities Laws 2006, 2006, p.191.

c. Vision, mission and performance measurement

Whereas the last chapter detailed the outer organizational basis, the next chapter will elaborate on those soft factors that internally unite the organization and its employees and link the organization to its congressionally prescribed tasks within the US administrative system: the SEC's vision, its mission with several sub-missions, derived goals and valued for task fulfillment and finally the measurements conceived to evaluate the SEC's performance.

i. Vision and mission

The SEC defined its vision as follows: "The Securities and Exchange Commission aims to be the standard against which federal agencies are measured. The SEC's vision is to strengthen the integrity and soundness of U.S. securities markets for the benefit of investors and other market participants and to conduct its work in a manner that is as sophisticated, flexible and dynamic as the securities markets it regulates".[236]

Vision, defined as "possible and desirable future state of the organization"[237], is a concept of organizational theora and has been deemed crucial for an entity's success, as it provides employees with a clear strategic orientation on the entity's intended state and achievements. Thus, staff motivation is higher, and so is performance. Having such proves especially valuable in entities with a multitude of division and/or department with heavily differing tasks, as those might have differing sub-goals and intentions. In this case, a vision serves as strategic focus and presents a consistent internal and public approach. Thus, as well public perception of an entity is stronger and more positive if it is connected to a vision statement.

As the SEC has a very fragmented organizational structure with four divisions, 19 offices, regional sites and headquarters, the definition of a vision for the SEC seems a very diligent approach as to orient all employees, regardless of the field in which they work and the person they report to, to one common goal. Furthermore, the SEC's vision is an excellent short description of the organization, which helps the general public to rapidly understand the organizational scope and tasks of the organization. Thus, it is also a powerful marketing tool. A short assessment of the SEC's visions displays that the agency is aware of its primary "clients", i.e. the investors and other market participants, and puts heavy emphasis on organizational excellence, especially in its rapidly changing environment.

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[236] *Securities and Exchange Commission*, 2006 Performance and Accountability Report, p.4.
[237] *Campbell/Devine/Young*, Vision, Mission, Strategie, 1992, p.60.

In economic literature, the concept of a mission statement is controversially discussed. Whereas some claim that it is the wording of a business approach, naming the strengths and identity and success factors of a company, whereas others consider it as a philosophic wording of the business's internal culture.[238] A mission, in the corporate environment, is generally used to determine the purpose of an organization as to orient daily operations on it, and thus serves less as a common denominator of long-term aims, but rather as a practical guide for the effectuation of work.[239]
For the SEC, the following mission statement was conceived: "The Securities and Exchange Commission is a law enforcement agency. Its mission is to administer and enforce the federal securities laws in order to protect investors, and to maintain fair, honest and efficient markets."[240] Thus, it can be analyzed in its three sub-points:

First of all, this is the protection of investors, which already in early times became apparent, as the SEC was founded to oversee companies whose ownership lies with shareholders, and to protect the latter from misinformation.[241] This comprises the promotion of informed investment decisions by requiring "full and fair disclosure of all material facts concerning securities offered for public investment"[242]. Also, the SEC needs to deter fraud and other illegal activities within the securities industry, and, thirdly, support this goal by educating investors so that the latter help with the prevention and detection of suspected fraud cases.[243] At last, investor protection is safeguarded most in an industry with high standards, so that the SEC actively engages into the establishment, maintenance and control of professional standards and the continuous education within the securities industry.[244]

While pursuing its primary mission, the SEC strives likewise to maintain the integrity of exchange markets[245], which must be seen as complimentary goal to investor protection: if the first is safeguarded, the integrity of the exchange market as a whole will be high. Integrity, for such purposes, is often defined as "fair, honest, and efficient"[246].

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[238] *Campbell/Devine/Young*, Vision, Mission, Strategie, 1992, p.34.
[239] *Campbell/Devine/Young*, Vision, Mission, Strategie, 1992, p.60.
[240] http://www.sec.gov/about/gpra1999-2000.shtml (page impression of November 7th, 2006) sub "SEC Mission"
[241] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.7.
[242] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.34; http://www.sec.gov/about/gpra1999-2000.shtml (page impression of November 7th, 2006) sub "SEC Mission Statement".
[243] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xxxix.
[244] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xl.
[245] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.7.
[246] http://www.sec.gov/about/gpra1999-2000.shtml (page impression of November 7th, 2006) sub "SEC Mission Statement".

For this, the SEC aims at "promot[ing] and enhance[ing] self-regulation of the securities markets as a means of assuring compliance with securities laws"[247], and both on their own and in cooperation with various SROs establish improvements of current market structures so as to increase competition and of operations so as to facilitate supervision. As brokers and dealers as well as clearing agencies manage the majority of market contacts of small investors, integrity of exchange markets must also encompass this stage, so that the SEC supervises financial responsibility and stability as well as adequate capitalization of individual broker-dealers and broker-dealer firms.[248]

However, it must be understood that the integrity of exchange markets is a goal that not only can be pursued by the SEC, as its achievement to a high level depends on the action of various other public authorities. For this reason, the SEC maintains close relationships to federal, state and international authorities in order to enhance understanding of securities law and regulation and to promote assistance.

At last, the SEC must aim at the facilitation of capital formation, because an overregulated capital market too burdensome to serve for issuers is prone to dry out, and thus might severely damage the overall economy. Thus, it lies in the SEC's interest to choose and adapt the measures taken to foster its first two goals in a way that ensures high participation in the capital market. Thus, the organization watches to "eliminate or streamline existing rules and regulation where possible to reduce unnecessary costs and assist […] capital-raising efforts"[249], and conceives regulations to promote access to foreign issuers and financial intermediaries as demanded by various government initiatives, most importantly by GAO releases[250]. Also, the use of novel financial instruments, of technology used by market participants for their transactions and the continuous effort to maintain the regulatory environment flexible and effective, count among the SEC's strategies.[251]

ii. Goals

Evolving from its mission, the SEC undertook the effort of determining goals – specific desired outcomes and criteria for the success of mission fulfillment, which read as follows: "To

[247] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xli.
[248] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xlii.
[249] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xliii; *Securities and Exchange Commission*, 2004 Performance and Accountability Report, p.10, 13.
[250] Among others, also *Hillman*, Preliminary Observations on SEC Spending and Strategic Planning, in GAO-03-969T 2003, p.8.
[251] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xliv.

enforce compliance with federal securities law, to sustain an effective and flexible regulatory environment, to encourage and promote informed investment decision making, to maximize the use of SEC resources".[252] The goals were furthermore subjected to internal discussion, resulting in the definition of an array for outcome measures for each of them[253], so that the SEC is able to monitor its performance. Also, the SEC's goals have been assigned internal priorities by the way budget and staff resources are distributed:[254]

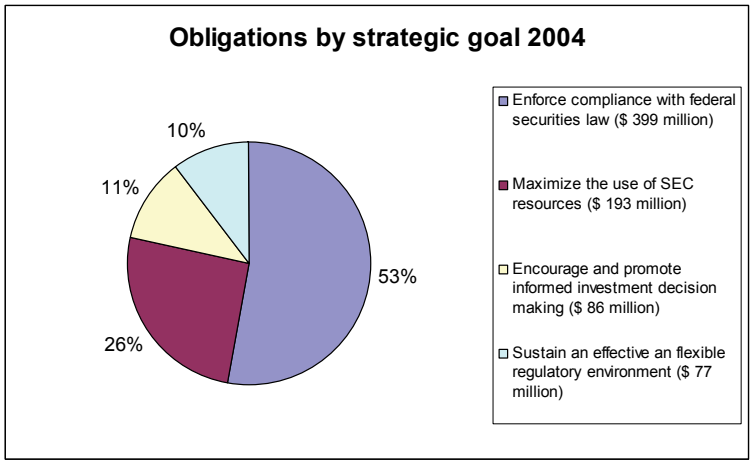

Chart 6: SEC obligations by strategic goal

Whereas the first three goals are intuitive consequences from the SEC's mission, and were already detailed above, resource optimization and ensuing organizational excellence is as well a key goal of the SEC[255], as the organization believes that "an efficient, well-managed, proactive SEC is critical for protecting investors and the markets"[256]. This approach seems to have been successful in the past: the SEC has always been viewed as one of the most successful, approachable and efficient federal agencies – a perception and reputation built on a variety of factors. Most important, in this regard, is the fact that the SEC constantly keeps this goal in mind, and orients its operational and organizational design around. Initiatives for resource allocation optimization, efficient staff assignment and the like are integrated in the SEC's operational planning, and encounter recognition by both staff and Congress as the SEC's authorizing body.

[252] *Securities and Exchange Commission*, 2004 Performance and Accountability Report, p.9.
[253] Examples include, for the goal of compliance with securities law, the number of investment advisers and investment companies examined and the number of requests to and by foreign regulators for enforcement assistance; *Securities and Exchange Commission*, 2004 Performance and Accountability Report, p.57-60. For a detailed outline, see below.
[254] Data derived from *Securities and Exchange Commission*, 2004 Performance and Accountability Report, p.12.
[255] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.85.
[256] *Securities and Exchange Commission*, 2004 Performance and Accountability Report, p.9.

iii. Values

For the endeavor of mission fulfillment, the SEC also accomplished a definition of its values – a practice often seen with corporations. Such definition of internal codes sets codes of conduct for employees and facilitates the orientation of daily operations on the broad but somewhat vague picture of organizational excellence. Thus, the SEC relies on the values of integrity, fairness, accountability, resourcefulness, teamwork and commitment to excellence.[257]

The organization interprets its values and their orientation as follows: "integrity" demands staff to observe the principles of personal responsibility and a high ethical standard, "fairness" strives to maintain a healthy balance among the SEC's powers of regulation and enforcement and their different clients, i.e. investors and market participants, and is to ensure diversity and respect among staff.[258] "Accountability" involves acceptance of the responsibility with which the SEC is charged and personal responsibility to the public, whereas "resourcefulness" expresses the SEC's commitment to a creative and proactive approach towards the securities market and a thriving for innovation as to ensure effectiveness and efficiency.[259] "Teamwork" is setting standards for employee cooperation, which should be based on "trust, hard work, cooperation and communication"[260], but also relates to the SEC's relationship with the government, other agencies, SROs, businesses and authorities abroad. At last, "commitment to excellence" expresses that the SEC "demands the highest standards of excellence, integrity, commitment and dedication from its staff"[261].

Whereas the first three values are oriented on contact with the supervised entities and investors, the latter clearly underline the high expectations the SEC has in its staff, so that both the internal and external perspective upon the organization is respected.

iv. Performance measurement

As indicated above, the SEC has developed performance measurements used to assess the agency's level of goal fulfillment. As stipulated by the Government Performance and Results Act 1993[262], the agency determined quantified indicators, which are all systematically tracked and allow for the determination of current trends and necessary adaptations of processes

[257] *Securities and Exchange Commission*, 2004 Performance and Accountability Report, p.8.
[258] *Securities and Exchange Commission,* Annual Report 2003, p.1.
[259] *Securities and Exchange Commission,* Annual Report 2003, p.2.
[260] *Securities and Exchange Commission,* Annual Report 2003, p.2.
[261] *Securities and Exchange Commission,* Annual Report 2003, p.2.
[262] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.37.

and/or structures if goal fulfillment is not reached. Those are detailed alongside the SEC's goals, and measured empirically. For instance, the first goal of "enforcement of compliance with federal securities law", is measured, among others, with the following parameters:

- Investment advisers and investment companies examined (5-year average: 1493 for investment advisers, declining; 481 for investment companies[263], slowly declining in 2006/2007[264])
- Percentage of first enforcement cases filed within two years (4-year average 58%[265], increasing to 66% in 2006/2007[266])
- Enforcement cases successfully resolved[267] (3-year average: 89%[268], stagnating[269])
- Monetary disgorgements and penalties ordered and the amount and percentage collected by the SEC (ordered 1.9 billion $, collected 96% in 2005; ordered 1.2 billion $, collected 82% in 2006)[270]
- Number of requests to an by foreign regulators for enforcement action (5-year-average: requests to foreign regulators: 427, requests from foreign regulators: 347[271], both slowly increasing[272])
- Distribution of cases across core enforcement areas:[273]

[263] Data derived from *Securities and Exchange Commission,* SEC Performance Budget for 2006, http://www.sec.gov/about/2006budgetperform.pdf (page impression of August 1st, 2007), p.4.
[264] *Securities and Exchange Commission,* SEC Performance Budget for 2008, http://www.sec.gov/about/2008budgetperform.pdf (page impression of August 1st, 2007), p.137.
[265] Data derived from *Securities and Exchange Commission,* SEC Performance Budget for 2006, http://www.sec.gov/about/2006budgetperform.pdf (page impression of August 1st, 2007), p.5.
[266] *Securities and Exchange Commission,* SEC Performance Budget for 2008, http://www.sec.gov/about/2008budgetperform.pdf (page impression of August 1st, 2007), p.134.
[267] I.e. resulting in a favourable or default judgment or a settlement.
[268] Data derived from *Securities and Exchange Commission,* SEC Performance Budget for 2006, http://www.sec.gov/about/2006budgetperform.pdf (page impression of August 1st, 2007), p.5.
[269] *Securities and Exchange Commission,* SEC Performance Budget for 2008, http://www.sec.gov/about/2008budgetperform.pdf (page impression of August 1st, 2007), p.134.
[270] *Securities and Exchange Commission,* SEC Performance Budget for 2008, http://www.sec.gov/about/2008budgetperform.pdf (page impression of August 1st, 2007), p.157.
[271] Data derived from *Securities and Exchange Commission*, 2006 Performance and Accountability Report, p.42.
[272] *Securities and Exchange Commission,* SEC Performance Budget for 2008, http://www.sec.gov/about/2008budgetperform.pdf (page impression of August 1st, 2007), p.135.
[273] *Securities and Exchange Commission,* SEC Performance Budget for 2006, http://www.sec.gov/about/2006budgetperform.pdf (page impression of August 1st, 2007), p.8; no recent data available.

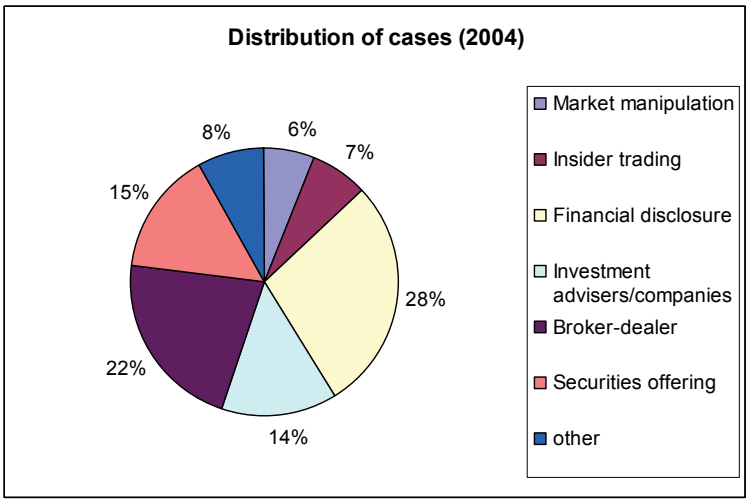

Chart 7: SEC distribution of cases across enforcement areas

Similar is given for all other goals. Although it is a valid anchor for critique that the performance measurement often focus on outputs instead of outcomes[274], it must be underlined that since their installation in 2004, performance measurements within the SEC seem to have raised not only internal, but also public awareness on the extraordinarily high level of task fulfillment and efficiency within the organization. Thus, this approach has paid off and seems a good preparation for challenges to come.

v. Summary

As detailed in the previous chapter, the SEC possesses a strong set of internal points for orientation: its vision and its mission, or the overall strategic orientation and the purpose for its existence, are consistent and oriented towards the organization's "clients", i.e. the entities it supervises and the investors it protects. Its goals relate to the mission, and the values drive employee behavior to support the overall strategic orientation. Also, the performance measurements, although somewhat vague, deliver sensible anchors for control of task fulfillment both within divisions and for the SEC as an organization. As the strategic fit and conceptual coincidence of mission and vision are seen as the determinants of organizational excellence, it becomes obvious that, overall, the SEC's organizational setting is one of the drivers of its efficiency.

[274] For a detailed analysis, see below.

d. Governing law and SEC's authority

The SEC's power derives uniquely from statutory enactments, as there is not federal common law of securities.[275] Generally, rulemaking in the field of securities law is a two-fold process: at first, it comprises those pieces of legislation Congress passes and the President signs into law[276] – statutes of broad applicability establishing basic principles, goals of legislation and objectives. Then, subsequent regulation by the SEC interprets and clarifies the enactment and amends it to the changing situation in the capital market. These rules and regulations also count among genuine securities law.

In the following, a short introduction of the applicability of US securities law will be given. Furthermore, all relevant enactments governing the work of the SEC will be detailed, and be linked to the rules and regulations the SEC composed out of the authority transferred to it.

i. Applicability of US securities law

The applicability of US securities law is a broad one: all companies whose shares are traded at national security exchanges, in over-the-counter markets or are otherwise widely held, are required to register under US law, whereas non-US companies have to supply additional "home-country information" covering requirements of home country stock exchange regulation, securities law requirements and the like.[277] For all other fields of SEC supervision, the constitutional interstate commerce clause guarantees federal responsibility, which is then transferred upon SEC as federal agency.[278]

In the field of anti-fraud provisions, US securities law is not only applied to any transaction performed in the United States, but also on transactions which have and effect on the US economic situation.[279] Thus, also international transaction partially fall under US securities law, even if they are conducted abroad or via communication networks such as the internet. Thus, the "two classic principles of territorial jurisdiction"[280], i.e. the conduct test and the effects test, allow that the safeguarding of US investors is also guaranteed for a certain number of international transactions. The conducts test, in this regard, means that "a country can assert

[275] *Ratner*, Securities Regulation, 2nd edition 1980, p.18.
[276] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xv.
[277] *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.3.
[278] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.64.
[279] *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.217.
[280] *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.217.

jurisdiction over significant conduct within its territory"[281], whereas the effects test states that action is justified insofar as the purpose of the relevant body of law, i.e. investor protection in securities law, is affected.

However, the SEC may encounter difficulties in its investigation procedure if data concerning the violation have to be gathered abroad, as certain states[282] have enacted prohibitions of the circulation of financial or accounting information or banking secrecy laws, which both prevent the SEC from conducting investigations. Thus, the organization entered into a vast array of bilateral agreements[283] covering mutual assistance and exchange of information with either countries[284] or their financial agencies.

As to brokers and dealers, their activities automatically fall under US law as soon as interstate – and thus also international – commerce is effectuated, whereas exemptions within SEC regulation exist so that registration is only necessary for sale of US securities within the US territory conducted without a registered second intermediary.[285]

Enforcement of US securities law is conferred upon federal courts, so that they hold the so-called exclusive jurisdiction, for all individual claims arising out of provisions of the Securities Exchange act[286], whereas court actions claiming the lesion of the Securities Act are conferred upon federal and state courts in so-called concurring jurisdiction.[287] However, if a single lawsuit contains claims which would have to be pursued before both federal and state courts, the principle of pendent jurisdiction allows for consolidation of all claims in one lawsuit.[288]

Class actions, a civil lawsuit started by one or several claimants who represent the interest of a bigger group of persons concerned, are also pursued with federal courts.

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[281] *Soderquist/Gabaldon*, Securities Law, 2nd edition 2004, p.193; *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.88.
[282] E.g. France, the United Kingdom, Canada, Switzerland, Liechtenstein; *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.218.
[283] Most important, in this regard, are Memoranda of Understanding (MOU), covering problems of international securities transactions such as insider trading or supervision; *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.218.
[284] Among them Australia, Brazil, Canada, China, France, the United Kingdom; *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.218.
[285] *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.228.
[286] Securities Exchange Act 1934, sec. 27.
[287] Securities Act 1933, sec. 22 (a).
[288] *Becker*, in *Hopt et al.*, Börsenreform – eine ökonomische, rechtsvergleichende und rechtspolitische Untersuchung, 1997, p.857.

Claims arising out of the states' blue sky laws are competing with those arising out of federal law, and thus could be pursued at the same time[289], whereas practically, this is rarely done, as blue sky laws generally have higher requirements relative to the burden of proof.

ii. Acts instituting the SEC

1. Securities Act 1933

The SA, passed as one of the core enactments of President Roosevelt's "New Deal" politics[290], was meant to protect investors from misinformation by regulating the initial public offering and sale of securities. The Act's by-name "truth-in-securities-law"[291] indicates that its basic objectives are to ensure the disclosure of all material information, and to prohibit misrepresentation.[292] The process of control only extends to the primary market, i.e. the initial sale of securities, and is two-fold: on the one hand, mandatory filing of a registration statement with the SEC and the provision of a prospectus to potential investors; on the other hand, civil liability in the case of fraud or deceit.[293] The SA 1933 has, on this account, also been entitled a "disclosure statute"[294] regulating the distribution of truthful and pertinent information, but not restraining the exchange of securities or guaranteeing the truth of the disclosure. All of its rules are mandatory in such as they cannot be ceded or otherwise mutated by individual conditions or agreement.[295]

a. Mandatory registration and disclosure

Before offering securities publicly, the issuer has to file a registration statement outlining all material to the SEC, and to provide most of this information also to potential investors. The registration forms require information on "the company's properties and businesses, a description of the security to be offered for sale; information about the management of the company and financial statements certified by independent accountants"[296].

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[289] Securities Act 1933, sec. 22 a; *Becker*, in *Hopt et al.*, Börsenreform – eine ökonomische, rechtsvergleichende und rechtspolitische Untersuchung, 1997, p.859 displays a specific reasoning on this question.
[290] *Soderquist/Gabaldon*, Securities Regulation, 4th edition 1999, p.2.
[291] http://www.sec.gov/about/whatwedo.shtml (page impression of November 7th, 2006) sub "The laws that govern the securities industry"; *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.48.
[292] *Budd/Wolfson*, Securities Regulation, 1984, p.2.
[293] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xxvi.
[294] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.50.
[295] Securities Act 1933, sec. 14.
[296] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xxvi.

Only after this statement has become effective, the security is allowed to be sold.[297] This process ensures that the potential investors can make informed choices about a security and its underlying value, whereas the control by the SEC safeguards investors from misrepresentation. Legislative exemptions for certain issuers exist[298]; also the SEC is entitled[299] to conditionally or unconditionally exempt persons or securities from registration. Thus, the aim of registration is to provide information for the investors so that they can judge the value of a security, and it is not to prevent speculative securities from appearance on the market, or safeguard against securities backed up by doubtful values.[300] As long as information in due form is given, the SEC will not prevent the market entry of any security. Furthermore, such a process cannot guarantee that the published information corresponds with the actual truth – the amount of information is impossible for the SEC to verify. However, severe penalties for the distribution and registration of misstatements have proven effective in preventing issuers from disclosing false or misleading information; and the right to claim losses through legal action protects investors sufficiently.

b. Civil liability for misrepresentation

To prevent intentional misrepresentation of company data, the SA details civil liability for submitting a false registration[301] and misleading by false statements or omission of pertinent information[302], whereas the latter also applies to non-registered securities. This civil liability does not only enable investors to seek relief for incurred losses, but also serves as a deterring factor for issuers, as civil liability can be tied to high punitive damages and thus is likely to exceed the amount of expected benefits by providing faulty information.

2. Securities Exchange Act 1934

As the SA only regulates the primary market, Congress had to make a second effort to protect market participants from abusive practices in security trading after their initial offering[303]. Basically, SEA extends the doctrine of "truth in securities" to the secondary market, so that all companies registered on national securities exchanges and traded on over-the-counter mar-

[297] *Ratner*, Securities Regulation, 2nd edition 1980, p.7.
[298] Such as offerings to a limited number of persons possessing private information, offerings limited to the territory of one state, securities issued by state authorities, offerings below a certain amount in "small business investment companies"; as detailed in Securities Act 1933, sec. 3; *Soderquist,Gabaldon*, Securities Regulation, 4th edition 1999, p.4.
[299] National Securities Markets Improvement Act 1996, sec. 28; *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.38.
[300] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.50.
[301] Securities Act 1933, sec. 11.
[302] Securities Act 1933, sec. 12.
[303] Or, on the so-called secondary market.

kets[304] have to provide full and fair disclosure about all material information. Likewise, it was realized that an organization with authority to administer the newly enacted securities laws was needed to ensure their functioning. Thus, SEA also established[305] the SEC as the "authority to regulate securities trading on the national exchanges"[306]. As with the Securities Act, all rules of the SEA are mandatory[307], whereas the most important provisions of the act cover the following areas:

a. Registration of security issuers

Likewise as prescribed by the SA 1933, also companies traded on secondary markets are required[308] to register with the SEC, and to provide similar, but less extensive[309] information about the company, the shares and the underlying securities. The same is applicable with securities traded over-the-counter.[310] As the trade on the secondary market is not an one-time event as trading on the primary market, those data have to be updated with periodic reports[311], the so-called 10-K/10-Q forms for annual/quarterly reports. The information as registered with the SEC is considered public information[312] and will be made available to investors in SEC offices[313] and online documentation. Exceptions to this duty of registration exist for companies of minor size and scope[314] and can be granted individually by the SEC[315].

Although of similar conception, it is important to note that the requirements of the SA 1933 and SEA 1934 are independent of one another and that, therefore, a company which meets the registration requirements of one act not necessarily meets those of the other.

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[304] This only since the Amendment to SEA of 1964.
[305] Securities Exchange Act 1934, sec. 4.
[306] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.54.
[307] Securities Exchange Act 1934, sec. 29 (a)
[308] Securities Exchange Act 1934, sec. 12 (a).
[309] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.54.
[310] *Budd/Wolfson*, Securities Regulation, 1984, p.3.
[311] Securities Exchange Act 1934, sec. 13.
[312] Securities Exchange Act 1934, sec. 6 (d); also *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.54.
[313] Where the data can be obtained by current or potential investors at nominal cost; *Budd/Wolfson*, Securities Regulation, 1984, p.3.
[314] Namely, companies must have $ 10 million in total assets and 500 or more shareholders for those regulations to apply, *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.54.
[315] National Securities Markets Improvement Act 1996, sec. 28; *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.39.

b. Registration of exchanges, associations and others[316]

A further provision of SEA 1934 demands that national security exchanges[317], as well as brokers and dealers[318] acting in interstate commerce, transfer agents[319], clearing agencies,[320] municipal brokers and dealers and security information processors[321] be registered with the SEC. This is especially pertinent for security exchanges, which are SROs[322] and could, lacking this duty of registration, have acted on virtually no rules or sanctioning in case of lesion of securities law. According to SEA, they have to detail their "rules of […] exchange and scope of […] operation"[323] and to state agreement with all provisions of SEA 1934 as well as the enforcement of compliance concerning all brokers trading on the exchange, which is rules for expulsion, suspension or other disciplining of broker-dealers[324] and other market participants in case of non-compliance with legal provisions. The exchange will only be granted permission if, to the SEC's best belief, it is organized and controlled in a fashion that ensures adherence to both law and the handed-in rules of operation. Likewise as with issuers, the exchanges' registration has to be updated continually, so that the SEC can supervise their operations[325] in a time- and cost-saving way. Thus, the exchanges still are independent and have full opportunity to establish self-regulation[326], but the investing public is guaranteed that the self-regulation is effective and coincides with the investor protection of the federal law.

The same rules are applicable on brokers and dealers acting in interstate commerce and municipally in over-the-counter markets[327]: they have to register and to hand in periodic reports, among others listing the transactions effectuated. Additionally, a minimum capital require-

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[316] As to the different tasks of brokers and dealers: a broker serves as the investor's agent when buying or selling securities FOR him, whereas a dealer buys securities FROM or sells them TO investors. Thus, a broker owes the customer a fiduciary duty of care; *Budd/Wolfson*, Securities Regulation, 1984, p.7.
[317] Securities Exchange Act 1934, sec. 5, sec. 6, sec. 19.
[318] Securities Exchange Act 1934, sec. 15.
[319] I.e. people engaged in "monitoring security issuances, countersigning securities certificates upon issuance, keeping the books […] and recording the exchange and transfer of securities", mostly within and investment firm; *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.234. Registration is mandatory under Securities Exchange Act 1934, sec. 17 (a).
[320] I.e. either depositories, or limited purpose trust companies, or clearing corporations, which are non-trusts; *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.235.Registration is mandatory under Securities Exchange Act 1934, sec. 17 (b).
[321] *Budd/Wolfson*, Securities Regulation, 1984, p.5.
[322] *Budd/Wolfson*, Securities Regulation, 1984, p.5.
[323] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.55.
[324] *Soderquist/Gabaldon*, Securities Regulation, 4th edition 1999, p.8.
[325] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.55.
[326] *Budd/Wolfson*, Securities Regulation, 1984, p.5.
[327] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.55.

ment has been established[328] as to ensure sufficient coverage of transactions. SEC's releases[329] further specify how and when the data have to be conceived, stored and registered.

c. Protective provisions for investors

Additionally to initial and continuous control of issuers and exchanges/brokers, SEA 1934 contains a vast array of protective provisions for investors, the most important of which will be outlined in the following. Generally, it can be said that the act – especially in its section 10 – prohibits any fraud or fraudulent scheme conceived to "manipulate the market for temporary advantage"[330], and establishes the thread of personal liability in case of non-compliance.

In detail, the use of interstate mails or national security exchanges for any "manipulative or deceptive device or contrivance"[331], which would violate any legal provision or rules of the SEC, is forbidden. Wash sales and matched orders[332] are explicitly prohibited, and so are churning, i.e. the generation of "large-scale in-and-out transactions for the customer's account"[333], which creates increased commissions for brokers and dealers while providing minimal or no benefits to the customer.

Likewise, trading by false statements is prohibited to maintain integrity of the capital market, which also necessitates close control of accountants: As they prepare or help to prepare informative statements for their clients, it must be ensured that they do not participate in fraud instituted by them. Thus, the SEC needs to approve of their work, and can issue censorship if it does not.[334]

SEA 1934 also prohibits[335] the use of insider trading, or the use of still undisclosed, but material information, for the realization of a profit or the avoidance of a loss. To foster control, any officer, director or other individual who owns more than 10% of shares must file an initial report with the SEC and the exchange on which the security in question is listed[336], and up-

[328] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.55.
[329] Such as the Accounting Release Series (ARS) No. 156 and the Financial Reporting Release No.1.
[330] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.56.
[331] Securities Exchange Act 1934, sec. 10 (b).
[332] i.e. practices, in which a rapid succession of fictitious buy and sales orders gives the impression of active trading, and thus fuels sales; see above.
[333] *Budd/Wolfson*, Securities Regulation, 1984, p.6.
[334] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.58.
[335] Securities Exchange Act 1934, sec. 16.
[336] *Budd/Wolfson*, Securities Regulation, 1984, p.4.

date those data with the exchange where the securities are traded.[337] For equal reasons, the acquisition of more than 5% of a stock, also indirect ownership and voting power has to be registered with the SEC within 10 days[338] and if any change in the ownership structure occurs. Likewise, for such insiders, short sales are prohibited.[339] Those provisions are strengthened by the right of the issuing company, or any of its owners[340] to recover losses incurred by such tactics.

Furthermore, the instrument of proxy solicitation[341] is bound to compliance with rules and regulations established by the SEC[342], so that neither institutional investors nor management can increase the support for their decisions by defrauding smaller private investors. This means had not only been widely used for approval of concrete corporate action, but even for election of directors or the board[343], so that management had proxy solicitation from shareholders to elect themselves and to approve of their very own actions – a substantial lack of control. The subsequent rules and regulations by the SEC safeguard investors' informed choice of whether to consent or not by prescribing that all material facts concerning the decision must be disclosed[344], and that the votes must be individual for each question[345], so that bundling of a package of actions is no longer possible.

Prior to tender offers[346] or planned stock acquisitions of more than 5% of equity[347], the prospective buyer must disclose its principal business and the purpose of the transaction, as well as the source of funds used. The same is applicable for "any persons soliciting shareholders to accept or reject a tender offer"[348]. This provision is intended to discourage surprise takeovers, and give both the share issuer and the current shareholders sufficient information to consider motives of the tender offer. As takeovers are known to often decline the net worth of an in-

[337] Securities Exchange Act 1934, sec. 12 (b), sec. 16.
[338] Securities Exchange Act 1934, sec. 13 (d).
[339] *Budd/Wolfson*, Securities Regulation, 1984, p.4.
[340] I.e. its shareholders.
[341] Proxy solicitation is "the process by which investors or management can solicit shareholders for proxy voting rights at one or more shareholder meetings"; *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.57.
[342] Securities Exchange Act 1934, sec. 14.
[343] *Budd/Wolfson*, Securities Regulation, 1984, p.3.
[344] To both the SEC and the investing public; *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xxvii.
[345] *Budd/Wolfson*, Securities Regulation, 1984, p.3.
[346] Tender offers are invitations to current shareholders to buy more of the stock at a specified price, often made in preparation of a surprise take-over.
[347] In the amendment of 1968, this proportion was 10%, but was reduced in 1970; *Budd/Wolfson*, Securities Regulation, 1984, p.4.
[348] *Budd/Wolfson*, Securities Regulation, 1984, p.4.

vestment, such disclosure measures once again maintain investors' interest by allowing them informed choices.[349]

At last, the Federal Reserve System, by its body Board of Governors, is entitled[350] to control the use of margins[351] in security trading, so that tendencies of investment on credit exclusively, which have proven to accelerate tendencies of rapid price decline on the share market, can be prevented. Thus, the excessive use of credit for the acquisition of shares and stocks is prevented[352], and additionally, the margin control and restriction is a powerful means of economic politics, as raised margins stimulate investment, and lower margins restrict it.

d. SEC authority for further rules and regulation

Additionally, SEA confers authority to the SEC to conceive and promulgate further regulation for the implementation of the act. Among those, there are regulations defining "manipulative or deceptive device or contrivance" as prohibited by the statute, rules to regulate short selling, stabilizing transactions, hypothecation of securities and rules for financial responsibility of brokers and dealers[353], but also administrative statutes as to define the terms, forms and deadlines of filings and the like.

iii. Further acts governing the work of the SEC

1. Enactments of minor scope

The Public Utility Holding Company Act (PUHCA) of 1935 requires registration[354] of utility holding companies, and thus allows for control of their capital structures, so that doubtful financial practices and monopolistic behavior, as uncovered before the enactment, can be supervised.

The Trust Indenture Act 1939 protects the holders of debt securities to a stronger extent than previously, i.e. it "supplements the 1933 [Securities] Act when a distribution consists of debt securities"[355] with similar regulative means.

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[349] *Budd/Wolfson*, Securities Regulation, 1984, p.4.
[350] Securities Exchange Act 1934, sec. 7, sec. 8.
[351] A margin is the percentage of equity investment an investor holds while buying other securities with credit.
[352] *Budd/Wolfson*, Securities Regulation, 1984, p.4.
[353] *Budd/Wolfson*, Securities Regulation, 1984, p.5.
[354] Detailing organization, financial structure and operations of both the holding company and its subsidiaries; *Budd/Wolfson*, Securities Regulation, 1984, p.9.
[355] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.39.

The Investment Company Act 1940 extends shareholder protection to investment companies with the demand of registration (again, similar as in SA 1933 and SEA 1934[356]) and disclosure of the financial condition and investment policies, whereas the Investment Adivers Act 1940 stipulates likewise for dealers and brokers[357].

The Securities Investor Protection Act 1970 creates a fund to cover losses incurred by brokers' or dealers' bankruptcy, whereas the Securities Investor Protection Corporation (SIPC), a non-profit organization, administeres those funds on behalf of the SEC, but file annually, are inspected[358] confer enforcement.

The Foreign Corrupt Practices Act 1977 prohibits the current practice of foreign payments or bribery for the promotion of business interests[359], and is also part of SEC's supervisory taks, as well as the Bankruptcy Act 1966 and the Bankruptcy Reform Act 1978, which both are applied with the SEC as advisory[360] to courts as to the realization of securities and the fair distribution of assets among investors.

The Insider Trading Sanctions Act 1984, and the Insider Trading and Securities Fraud Enforcement Act 1988 substantially increase penalties against persons who profit from insider knowledge and confer on the SEC the power to seek civil fines to the greater of $ 1 million or up to three times the illegal trading profits.[361] Additionally, criminal penalties have been increased to fines up to $ 1 million or 10 years of imprisonment[362].

At last, the Private Securities Litigation Reform Act 1998 introduced significant changes into securities fraud litigation, mainly by introducing the principle of proportionate liability[363] instead of joint and several liability[364] for auditors as well as more extensive reasonding prior to court proceedings[365], as to avoid frivolous claims[366].

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[356] Whereas, nevertheless, the registration process is independent: companies have to file different forms for compliance with all three acts.
[357] *Ratner*, Securities Regulation, 2nd edition 1980, p.10.
[358] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.51.
[359] The act is integrated into SEA, so that the pertinent provision is Securities Exchange Act 1934, sec. 30 (a).
[360] *Budd/Wolfson*, Securities Regulation, 1984, p.14.
[361] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.36.
[362] Reaching up to 10% of the amount imposed as civil penalty for the informer; *Seitzinger* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.19; *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.617.
[363] I.e. that each auditor is liable for the damage in the proportionate amount of his or her work that caused it.
[364] I.e. that each auditor is liable for the full amount to the plaintiff, and can only afterwards claim compensation by the fellow defendants. Nevertheless, joint and several liability is still applied in cases where auditors know-

2. Sarbanes-Oxley Public Company Accounting Reform and Investor Protection Act 2002

Among the further acts governing the SEC's work, SOX is unquestionable the most important, as it presents far-reaching reforms as a reaction to the scandals of the years 2001 and 2002[367]. However, it has been criticized, especially by foreign scholars, that SOX was developed in utmost urgency and thus does not include all necessary and sensible changes, but rather overreacts in some fields and neglects others.[368] As in the early times of the SEC, the main objective of this enactment is to maintain capital market integrity and to restore investor confidence, which was sought after by the regulation of several fields:

a. Increase of SEC authority and funding

Generally, SOX increased SEC's authority in regulating public companies in three provisions: primarily, the SEC must now review filings at least every three years, which was prior to SOX not bound to any timetable. Second, the SEC is now entitled to bar individuals from serving as officers or directors, if it finds those to have violated antifraud provisions. Whereas previously, the SEC had to obtain the bar with a federal court, now it is allowed to "request the bar in an administrative cease-and-desist proceeding"[369]. Thirdly, the SEC can seek new forms of equitable relief from federal courts, such as freezing of extraordinary payments to officers and directors.[370]

As to rulemaking, SOX enhanced significantly the SEC's independence in such that the Congress did, in almost all fields of legislation, not specify the accounting and security rules which would execute the legal provisions.[371] Thus, it was up to the SEC to create those regulations, so that its authority was strengthened and quick reactions to changes on the capital market and its processes were fostered. Examples include all organizational and authorizing

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ingly violated rules and regulations; *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.84.

[365] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.84.

[366] *Becker*, in *Hopt et al.*, Börsenreform – eine ökonomische, rechtsvergleichende und rechtspolitische Untersuchung, 1997, p.765.

[367] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.59.

[368] *Lanfermann/Maul*, Auswirkungen des Sarbanes-Oxley Acts in Deutschland, in DB 2002 1725, p.1732.

[369] *Mahoney et al.* in *Kasner/Vanyo,* Securities Litigation & Enforcement institute 2004, 2004, p.400.

[370] In detail, this relates to the period of investigation of an alleged securities law violation, where the SEC can freeze extra payments to directors and officers for a 90-day-period at the longest by applying for a court order "requiring a public company to place in an interest-bearing escrow account" such compensation; *Bloomenthal/Wolff*, Sarbanes-Oxley Act in Perspective, 2nd edition 2005, p.122; *Hamilton/Trautman*, Sarbanes-Oxley Act of 2002, 2002, chapter 705.

[371] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.59.

releases for the PCAOB[372], regulations concerning auditors[373] and corporate responsibility[374]. The character of those rules as legally binding is ensured by the provision that a violation of such will be treated as a violation of the act itself[375], so that consistency between enactment and subsequent authorized ruling is safeguarded. Also, SOX confirms that the SEC is entitled to enforce the act directly without limitation by its own or the PCAOB's rules.[376]

This increase of authority called for a "booster shot funding"[377] of the SEC, as its tasks were extended in a way that made additional staff necessary. Thus, the agency was granted a one-time boost of $ 776 million for the fiscal 2003[378] used to institute pay parity between SEC staff and employees of federal banking agencies, to hire additional staff[379] and to enhance the use of information technology.[380] Additionally, SOX provides for coverage of the start-up expenses for the PCAOB, so that those extra expenses do not fall upon the SEC's budget.

b. Installation of the PCAOB[381]

Following the scandals of the years 2001 and 2002, the then standard-setting and supervising body AICPA, a professional organization which united all CPAs, faced severe critique as to the objectivity and stringency of control. Financed by and representing the accounting profession, doubt about the organization's integrity was raised, the more so as the board contained "members who were concurrently serving in prominent positions with their audit firms"[382]. Finally, these reproaches led to the deprivation of standard-setting authority[383], and required the institution of a succeeding authority, the PCAOB – a task for which SEC was conferred authority and also supervisory duty for its operations[384].

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[372] Such as the PCAOB Release No. 2003-07, which prescribed registration of accounting firms with the board, or the PCAOB Release No. 2003-19, which conferred the authority of inspection onto the PCAOB.
[373] Such as the SEC Release No. 33-8183, which defined pre-approval requirements, audit partner rotation and the treatment of incurring conflicts of interest.
[374] Such as the SEC Release No. 33-8220, which lists standards for listed company audit committees, or the SEC Release No. 33-8185, which implements standards of professional conduct for attorneys at law.
[375] *Hamilton/Trautman*, Sarbanes-Oxley Act of 2002, 2002, chapter 706.
[376] *Hamilton/Trautman*, Sarbanes-Oxley Act of 2002, 2002, chapter 706.
[377] *Bloomenthal/Wolff*, Sarbanes-Oxley Act in Perspective, 2nd edition 2005, p.121.
[378] Sarbanes-Oxley Act 2002, sec. 601.
[379] In detail, 200 qualified professionals for oversight of auditors and related services.
[380] *Bloomenthal/Wolff*, Sarbanes-Oxley Act in Perspective, 2nd edition 2005, p.122.
[381] Sarbanes-Oxley Act 2002, sec. 101-109.
[382] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.60.
[383] *Mahoney et al.* in *Kasner/Vanyo,* Securities Litigation & Enforcement institute 2004, 2004, p.390.
[384] *Lanfermann/Maul*, Auswirkungen des Sarbanes-Oxley Acts in Deutschland, in DB 2002 1725, p.1725.

The newly founded non-profit entity, which is "independent from the accounting profession as a whole"[385], sets standards[386] for auditors as to audit rules, quality control and independence. This was the board's free decision, which could have delegated the standard-setting authority to its predecessor AICPA, but decided to leave them only the authority for private companies[387] – a major change to the accounting industry, which had hence been widely self-regulated. Furthermore, the PCAOB is responsible for the mandatory registration[388] of public accounting firms, their inspection and, in case of any non-compliance with rules and regulations, the conduction of investigations and disciplinary proceedings. The SEC has supervision authority of the PCAOB[389], and is the main actor in its formation and execution and control of ongoing operations, as well as the source of the PCAOB's funding. Consisting of five members appointed by the SEC, non-partisanship is ensured by the demand that only two of them be or have been CPAs.[390]

c. Auditor independence[391]

As the 2001/2002 scandals had encompassed also auditing companies among the culprits, changes in the current corporate processes of auditing had to be enforced. To ensure independence of external audit firms, those are prohibited to conduct a vast array of additional services for their audit clients[392], which was beforehand a widely accepted practice. Other services, such as tax advice, are only allowed if pre-approved by the company's audit committee. Furthermore, communication between auditors and audit committees is forced to be more extended: auditors have to provide detailed information[393] and not an all-encompassing view of the company's state, as well as to retain records of all audit and preparatory work[394].

Furthermore, SOX and subsequent SEC regulation demand that the members of an audit committee[395] shall be independent of the company[396], which is enforced by a mandatory audit

[385] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.60.
[386] Among them the standard related to the audit of internal controls as set forward in the Sarbanes-Oxley Act 2002, sec. 404.
[387] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.60.
[388] Sarbanes-Oxley Act 2002, sec. 102 (a).
[389] Sarbanes-Oxley Act 2002, sec. 101 (a), 107 (a).
[390] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.60.
[391] Sarbanes-Oxley Act 2002, sec. 201-109.
[392] Such as bookkeeping and actuarial services, financial information system design, management or human resources, broker or dealer services, legal services; Sarbanes-Oxley Act 2002, sec. 201 (a).
[393] Such as reports of critical accounting practices, alternative GAAP treatments and their implications, all material written communication; Sarbanes-Oxley Act 2002, sec. 204, 206.
[394] Sarbanes-Oxley Act 2002, sec. 103 (a).
[395] As requested to be installed by SEC regulations since the 1970; *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.13.

partner rotation[397] system, and have amidst them at least one financial expert.[398] Also, the audit committee will be held responsible for appointing the external audit firm and controlling its work.[399]

d. Corporate responsibility[400]

A significant novelty of SOX was the strengthening of corporate officers and directors accountability for the companies' financial disclosures; a logical consequence of the scandals, in which the primary culprits had been corporate management. The SEC rules[401] based on SOX intend to ensure completeness and truthfulness of disclosures by holding corporate management accountable.

Both CEO and CFO must personally certify the accuracy of quarterly and yearly disclosed financial statements and other reports, as well as the existence and functioning of internal data gathering and control systems.[402] Non-compliance is threatened with criminal punishment up to 20 years of imprisonment and/or reimbursement of all profits gained for performance-based compensation.[403] The latter is extended to gains reaped by the sale of personally held company stock within a 12-month-period after filing of a statement not compliant with the certification, and by forfeiture of certain bonuses and additional compensation.[404]

Although provided under a different title[405], the prohibition of granting personal loans to directors and officers counts among rules which enhance corporate staffs' responsibility. Unless in a small number of listed circumstances[406], management will not be able to receive "loans"

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[396] Which is, mainly, expressed in a one-year employment restriction for audit firms to whom the current director belonged prior to his engagement, Sarbanes-Oxley Act 2002, sec. 206.
[397] Sarbanes-Oxley Act 2002, sec. 203. For a detailed description of the conduction of such rotation, see *Lanfermann/Maul*, Auswirkungen des Sarbanes-Oxley Acts in Deutschland, in DB 2002 1725, p.1726.
[398] *Mahoney et al.* in *Kasner/Vanyo,* Securities Litigation & Enforcement institute 2004, 2004, p.380, 393.
[399] Sarbanes-Oxley Act 2002, sec. 301.
[400] Sarbanes-Oxley Act 2002, sec. 301-308.
[401] Mainly SEC Release No. 33-8124 and SEC Release No. 34-47890.
[402] Sarbanes-Oxley Act 2002, sec. 302; more on the so-called Officer Certification Requirement in *Regelin/Fisher*, Zum Stand der Umsetzung des Sarbanes-Oxley Act aus deutscher Sicht, in IStR 2003 276, p.276; *Mahoney et al.* in *Kasner/Vanyo,* Securities Litigation & Enforcement institute 2004, 2004, p.376; for a comparison with German codes of business requirements, see *Lanfermann/Maul*, Auswirkungen des Sarbanes-Oxley Acts in Deutschland, in DB 2002 1725, p.1729; *Möllers*, Creating Standards in a Global Financial Market – the Sarbanes-Oxley Act and her Activities: What Europeans and Americans could and should learn from each other", in ECFR 2007 173, p.187.
[403] Sarbanes-Oxley Act 2002, sec. 906.
[404] *Mahoney et al.* in *Kasner/Vanyo,* Securities Litigation & Enforcement institute 2004, 2004, p.389.
[405] Sarbanes-Oxley Act 2002, sec. 402 (a).
[406] Such as home improvement loans, consumer credit, credit cards; *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.71; *Mahoney et al.* in *Kasner/Vanyo,* Securities Litigation & Enforcement institute 2004, 2004, p.375.

and later claim their forgiveness as additional remuneration.[407] Additionally, SOX prevents the acquisition, sale or other trade in the company's equity funds during a pension fund blackout period, if the director or officer acquired the security due to his services.[408] As the events showed, the disclosure of loans was not sufficient to prevent this practice, so that a prohibition was the means of choice to safeguard investment in the company, and not in management's private expenses.

e. Enhanced financial disclosures[409]

Investor confidence being built, to a large degree, on transparency of operations, SOX also enhances disclosure requirements for publicly traded companies. Most important, SOX established the principle of real-time disclosure, i.e. on a "rapid and current basis"[410] . As provisions are in widespread fields of securities law, so that only the most important ones will be mentioned in the following.

To begin with, annual and quarterly records are to contain all off-balance sheet transactions and contingent obligations which may have having material effect on the company and its future development[411]. Pro forma statements[412] are required to include all material facts, and must not contain any untrue statement; additionally, the pro forma prediction must be reconciled with the current performance of the issuer according to GAAP.[413] To foster SEC's possibilities of reaction to insider trading, registering of acquisition and sales of stock by insiders[414] with the SEC must now be effectuated in a substantially narrowed time-frame, i.e. two business days after the transaction.

Most striking are the new regulations concerning internal control. As described above, it is now the duty of corporate management to institute such an internal control system, and they are required to certify its functioning with every disclosure. This is double-checked by the

[407] *Mahoney et al.* in *Kasner/Vanyo,* Securities Litigation & Enforcement institute 2004, 2004, p.388.
[408] Sarbanes-Oxley Act 2002, sec. 306 (a). This general prohibition has been vastly interpreted by the SEC in Regulation BTR (Blackout Trade Restriction).
[409] Sarbanes-Oxley Act 2002, sec. 401-404.
[410] *Mahoney et al.* in *Kasner/Vanyo,* Securities Litigation & Enforcement institute 2004, 2004, p.382. On the importance of immediate disclosure, see *Möllers*, in *Berger* et al., Festschrift für Norbert Horn zum 70. Geburtstag, 2006, p. 473, 482.
[411] Sarbanes-Oxley Act 2002, sec. 401 – a result of the Enron scandal, a balance sheet fraud mainly based on unrecorded off-balance sheet transactions.
[412] Pro forma statements are predictions of future financial performance, based on assumptions (such as the development of interest rates) and expectations (such as the development of sales).
[413] Sarbanes-Oxley Act 2002, sec. 401 (a), (b).
[414] Defined as directors, executive officers and private persons holding more than 10% of a security.

mandatory attest of an accounting firm.[415] Additionally, the SEC requires that the control system be a recognized framework "established by a body or group that has followed due-process procedures"[416], and that it be at least quarterly reviewed for adaptation to changes in the company. To this also counts the introduction of a Code of Ethics within the company.[417] Requiring enormous effort in time and cost[418] by the companies, and also their accounting firms, those regulations are strongly criticized by business organizations.

Furthermore, disclosure is also required for codes of ethics[419] for senior financial officers regulating issues of "conflicts of interest, accurate and understandable disclosure in periodic reports, and compliance with governmental rules and regulation"[420], whereas the companies have to justify if they did not yet implement such. By this requirement to disclose and, moreover, to argue against a code, substantial pressure is put on companies. Subsequent SEC regulation extended this requirement from financial officers only to principal executives[421], so that it is applicable on all senior management.

f. Increased penalties

SOX also created new criminal statues and increased penalties for already existing standards. New field of sanctioning are all schemes and artifices to defraud in connection with securities or obtain money or property in connection with the sale of securities by means of fraudulent pretenses, representations or promises.[422] Increased penalties have been introduced for willful violation of securities law[423], and the funds available for distribution among defrauded investors have been substantially increased by adding bonuses or profit to the disgorgement the SEC could seek in civil action[424]. Also, elements of an offence leading to a sanction have been lowered[425].

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[415] Sarbanes-Oxley Act 2002, sec. 404 (b).
[416] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.73.
[417] *Regelin/Fisher*, Zum Stand der Umsetzung des Sarbanes-Oxley Act aus deutscher Sicht, in IStR 2003 276, p.283.
[418] The GAIN Flash Survey estimates between $ 50,000 and $ 10 million per company; *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.73.
[419] Sarbanes-Oxley Act 2002, sec. 406 (a).
[420] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.77.
[421] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.74.
[422] Sarbanes-Oxley Act 2002, sec. 807.
[423] In detail, increase of the maximum term of imprisonment from 10 to 20 years, and of the maximum fine from $ 1 to $ 5 million for natural persons, from $ 2.5 to $ 25 million for corporations; Sarbanes-Oxley Act 2002, sec. 1106.
[424] In detail, see above.
[425] An example being the Sarbanes-Oxley Act 2002 amendment of Rule 10b-5, for the fulfilment of which an officer must now only display "unfitness" to serve, no longer "substantial unfitness"; *Bloomenthal/Wolff*, Sarbanes-Oxley Act in Perspective, 2nd edition 2005, p.118.

This reinforcement of SEC authority is also pertinent for accounting firms and their employees: the SEC is now entitled[426] to disqualify them from practicing and subject them to "a checkered experience over appropriate standards"[427] supervised by the SEC. Thus, the SEC can now bar individuals from executing any service within the securities industry[428], as the past revealed that "fraud artists […] exploit[ed] gaps in federal and state regulatory systems [...] to move from one sector of the financial services industry to another"[429], while acting in utter disregard of the ban for one sector, and continuing lesions of securities law.

Likewise, this sanction for improper professional conduct is applicable on attorneys concerning their representation of public companies[430]. This unparalleled extension of SEC's power upon the legal profession encountered some suspicion and critique[431], but also public support as the past showed that self-regulation was not sufficient to ensure that the lawyers practicing with a firm would not only represent management, but the corporation as a whole – and thus act in the best interests of all stakeholders, especially the shareholders.

iv. Summary

The previous chapter elaborated on the SEC's governing law, thus detailing the acts instituting the SEC and conferring initial power onto the institution, and those enactments which broadened the SEC's authority and transferred its supervisory tasks to further areas. As noted, there are not only the enacted codes of law, but also regulation perceived by the SEC and codes of indirect law-making. Among those, the following hierarchy exists[432]: constitutional law, security statutes, rules and other pronouncements with force of law, policy and interpretative releases, staff bulletins and, at last, interpretative and no-action letters. Thus, SEC's work is governed by a well established body of law, and the agency has been attributed a high amount of competencies and authority. The next chapter is to elaborate on their execution.

[426] Sarbanes-Oxley Act 2002, sec. 3 (b) 3, sec. 1105 (f).
[427] *Bloomenthal/Wolff*, Sarbanes-Oxley Act in Perspective, 2nd edition 2005, p.114.
[428] Sarbanes-Oxley Act 2002, sec. 604.
[429] *Hamilton/Trautman*, Sarbanes-Oxley Act of 2002, 2002, chapter 704.
[430] *Hamilton/Trautman*, Sarbanes-Oxley Act of 2002, 2002, chapter 702.
[431] *Bloomenthal/Wolff*, Sarbanes-Oxley Act in Perspective, 2nd edition 2005, p.115.
[432] *Soderquist/Gabaldon*, Securities Law, 2nd edition 2004, p.16.

e. Operations and legal means

In the following, the different legal approaches the SEC currently administers will be discussed. Generally, SEC's activity takes two basic forms: direct regulation by the SEC through rule creation, orders and enforcement, and supervision of industry self-regulation.[433] Subjected to SEC's supervisory work are the following persons and entities[434]: issuers and their representatives (CEOs, CFOs, and others), members of the audit committee, SROs, brokers, dealers, underwriters and CPAs:

From this list, it becomes obvious that the SEC supervises a high number of different people and entities, so that different regulatory means and approaches are to be employed in order to create efficient supervision. In detail, this involves SEC's legislative engagement in rulemaking and standard-setting, but also its advisory role, but also mechanisms for auditing and supervision. Special emphasis will be put on the field of enforcement, for which the internal processes for both investigations and punitive proceedings and possible sanctions for a variety of security law violations will be detailed.

i. Rulemaking and standard-setting

As detailed above, Congress conferred vast authority on the SEC to conceive rules and regulations, which the organization readily employs.[435] Thus, capital market law often finds itself influenced more by the SEC releases than by actual enactments.[436] All six statues of governing law authorize the SEC to "adopt whatever rules and regulations may be necessary to carry out its statutory functions"[437].

The process of rulemaking involves several steps: usually, it starts with a rule proposal by SEC staff, whereas the SEC often seeks public input as to whether and which kind of regulation would be deemed adequate. The so-called concept release describes the points of interest, the goals of the regulation and the possible approaches, and then asks for the public's advice

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[433] *Hazen,* Federal Securities Law, 2nd edition 2003, p.4.
[434] The list follows *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.76.
[435] Thus, in 2005, the SEC itself created rules on nine major topics, a number to be topped in 2006 with releases covering such varied topics as executive compensation disclosure, electronic filing of transfer agent forms or the definition of "eligible portfolio company" under the Investment Company Act of 1940 (Release 33-8735 of August 29th, 2006, Release 34-543556 of August 24th, 2006, Release IC-275339 of October 25th, 2006, respectively; http://www.sec.gov/rules/proposed.shtml (page impression of November 7th, 2006))
[436] *Strupp,* Aktien-, börsen- und wertpapierrechtliche Fragen des Umlaufs von Aktien an ausländischen Börsen, online-edition 2003, p.53.
[437] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1425.

on specific questions.[438] After consideration of this feedback, a rule proposal is drafted comprising specific objectives and the methods to pursue them. After presentation before and approval of the Commission, the proposal is once again subjected to public review and feedback for a narrow timeframe[439], which is taken into account when drafting the final rule. Again, this final rule is presented to the Commission, and becomes, after approval, "part of the official rules that govern the securities industry"[440]. Publication with the Federal Register follows.[441] If of major importance, the rule can be subjected to review by the Congress and a congressional veto.[442]

Rules vary widely in nature, "from those which prescribe methods of business and trade activity to the most minute specification of the means whereby information is to be presented in a form, application or report"[443], whereas, however, three rough categories can be determined: substantive implementing rules of legislative (and not interpretative character), adjective implementing rules prescribing form and details of procedures, and interpretative/definitional rules clarifying legal terminology.[444]

The SEC has, generally spoken, two means of creation of standards: by issuing rules and regulations, and by reporting decided cases[445], which creates neither rules nor a common law body, but guidelines for the supervised entities – and thus is observed exactly as regulation would. A third way of standard-setting is so-called "informal law-making" and involves the uttering of the SEC's opinion on currently important questions, without stating legally binding regulation.[446] As supervised entities generally tend to comply with those rules to save time and effort, this approach proves highly efficient. To this, also the published[447] responses to individual requests as either exemptive orders[448] or no-action letters[449] can be counted.[450]

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[438] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xvi.
[439] Usually, between 30 and 60 days.
[440] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xvi.
[441] http://www.sec.gov/about/whatwedo.shtml (page impression of November 7th, 2006) sub "Organization of the SEC".
[442] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xvi.
[443] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1425.
[444] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1426.
[445] *Ratner*, Securities Regulation, 2nd edition 1980, p.18.
[446] Basically, of such category are all the publications of the SEC called "Release"; *Ratner*, Securities Regulation, 2nd edition 1980, p.19.
[447] Only since 1970, such non-actions letters are made public after a complaints by law firms denouncing this body of "secret law" unavailable by entities in similar situations than the recipient of the no-action letter; *Ratner*, Securities Regulation, 2nd edition 1980, p.19.
[448] I.e. the explicit permission that, with a certain behavior, the company will fall under a regulative exemption and thus will not be sanctioned.
[449] For a detailed explanation, see below.

Further standard-setting authority is delegated[451] by the SEC, but the agency still oversees this process and is the authority which enforces the use of the previously determined standards[452]. It must be underlined that the SEC's influence on the delegated parties is two-fold: on the one hand, it suggests changes[453] whenever it sees practical need or feels political or public pressure to do so. On the other hand, the SEC can overrule current decisions and standards, or create new ones, whenever it feels that the board had not decided in favor of the SEC's mission.[454] Especially this latter approach has been on the rise, as, to the SEC's belief, a more active role of assertive influence proves more efficient.[455]

All in all, the SEC has managed to enlarge and extend the body of capital market law substantially, and to its advantage, during all of its existence.[456] Its consistency and adaptation to the changing conditions of the markets are of high advantage to investors and supervised entities.

ii. Registration

Without any doubt, the main task of the SEC is the review of the corporate registration process. As detailed above, the various acts governing the US securities law require different forms of registration[457], which nevertheless have all to be filed with the SEC, and comprise the exchanges, the issuers of shares, brokers and dealers and such persons that conduct share trading business in a specific function, e.g. as directors or possible insiders.[458] Especially the initial registration process is complicated and consumes much time, but also the continuous updating and reporting needs substantial efforts of both the SEC and the filing company, especially as close to 15,000 companies[459] file with the SEC, often more than annually.

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[450] *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.215.
[451] For instance, Securities Act 1933, sec. 19 (a) in combination with Securities Exchange Act 1934, sec. 13 (b) demands setting accounting standards of the SEC – an authority which the SEC never assumed, but delegated; at first to the CAP, the then APB. Currently, the authority is split between the FASB for the publishing of information in a uniform form, and the PCAOB for setting rules and standards for accounting. Especially the latter – the change from self-regulation to a governmentally appointed standard setter – can be seen as "landmark shift" which had substantial impact on the accounting industry; *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.180.
[452] With the exception of inspections, which can be effectuated by command of the PCAOB alone; *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.180.
[453] Such as in the question of revenue recognition, leading to the Statement of Financial Accounting Concept (SFAC) No. 5; *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.191.
[454] Such as in the question of pro forma statements, where the SEC decided to issue its own regulation, Regulation G; *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.187.
[455] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.191.
[456] *Hirte*, in *Hirte/Möllers*, Kölner Kommentar zum WpHG, 2007, Introduction, marginal 130, p.63.
[457] To name a few: the Securities Act 1933 requires registration of new securities issued, the Securities Exchange Act 1934 of most actors on the capital market, the Public Utility Company Holding Act 1935 of interstate holding companies, the Sarbanes-Oxley Act 2002 of public-company auditors.
[458] *Altendorfer*, Die US-amerikanische Kapitalmarktaufsicht (SEC) – Ein Modell für Österreich? 1995, p.42.
[459] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.57.

Still, it must be understood that it is not the SEC's intent to prohibit poor investments form being traded on exchange markets. A security may be doubtful, but as long as the information is provided in the due form and presented fairly, the SEC will not prevent its trade.[460] Also, the registration and review process does guarantee neither correctness nor completeness of the filed information: the SEC can only determine whether there is any evidence for the filings not complying with securities law, and must confide in personal responsibility, effective principles of corporate governance and the deterring effect of the penalties for presenting misleading information. So, the SEC does not judge any security – but it controls with reasonable effort that the potential investor is given all means of doing so himself.

iii. Audit control

Auditing is the careful examination of "an organization's financial documents in order to determine if the records and reports are valid and if the information is fairly presented"[461], and is mostly conducted by a CPA independent of the company, who issues at the audit's conclusion an opinion stating the level of compliance. However, with many audit firms performing other services to their audit clients, independence was no longer safeguarded, and this interference caused or at least facilitated most cases of corporate fraud in the early 2000s. Thus, SEC's obligation to oversee corporate audits – as task that was once delegated to the AICPA, a self-regulatory body of the accounting business – was strengthened, and the AICPA was deprived of its position. Now, this authority is conferred to the PCAOB for public companies, and rests with the AICPA for all others, but still is under SEC's oversight.

This is especially pertinent as the task of audit control strongly correlates with the standard-setting authority: independent auditors generally rely on GAAS in their evaluation of firm's compliance, but also take into account the firm's previously issued financial statements, which use GAAP as guidelines.[462] Thus, high correlation of GAAS and GAAP standards is in the interest of auditors as well as of the SEC as a controlling agency to facilitate the workload and to enhance understanding of the records for the broad public.

iv. Counseling and advice

A large part of the SEC's work consists of advice to both the general public, comprising also potential and current investors, and the entities supervised. Especially the latter enjoy with the

[460] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.91.
[461] *Shorter* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.2.
[462] *Shorter* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.3.

SEC a public authority which is keen on close cooperation, and willing to share its experience beforehand. Thus, staff is made available for conferences of informal advice to organizations of issuers, broker and dealers, counseling on inquiries and investigation is offered and advice in individual cases is granted.[463] Almost no initial public offering, share deal or takeover is planned without prior SEC involvement. Companies are willing to accept the SEC as one of their consulting agencies, and also understand that cooperation proves more beneficial and time/cost-saving than own action. A means which has highly increased this confidence is the issuance of non-action letters: if, during negotiations, SEC staff comes to the conclusion that a certain course of action does not constitute a securities law violation, and if this point of view coincides with the opinion expressed by a legal counsel, the SEC staff states that, when being officially notified of the case and its facts, and the recommended action has been taken, they will not recommend action to the SEC Commission.[464] Although the latter is not legally bound to this decision, it consents in the overwhelming majority of cases[465]. Also, publication of such no-actions letters, the facts on which the decision has been rendered and the Commission's final decision adds reference for other companies in similar situation, even though no-action letters, as such, do not "purport to involve interpretations and, hence, in theory do not constitute precedents"[466], so that they are not legally binding for following cases.

SEC counseling and education is also crucial to the investing public, to whom the SEC distributes a large amount of information and advice on securities matters – and not only for matters of their private welfare. According to former Chief Accountant of the SEC, John C. Burton, efficiency of the capital market is raised in two fashions: by "giving investors more confidence that they are getting the whole story and […] by encouraging the development of better tools of analysis"[467], which would eventually yield better information and thus higher market efficiency. The SEC, however, does not engage in private litigation such as claims for damage arisen of violation of securities law. Nevertheless, they offer counseling and support to all individuals injured by a violation of securities law.

[463] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.156.
[464] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.156.
[465] In fact, the only case in which the Commission has taken action against an enterprise despite the issuance of a no-action letter, displayed characteristics that made the Commission suspect that the no-action letter has been based on inaccurate facts; *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.156.
[466] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.156.
[467] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.35.

At last, the SEC frequently acts as amicus curiae, "presenting interpretative questions considered by it to be important in its own administration of the statutes"[468], so that, on the one hand, courts decide a case with an expert opinion heard, and, on the other hand, the court's decision corresponds with current administrative practices of the SEC and consistency is maintained. However, this advising function is restrained by the SEC itself to questions of the law the institution administers, and is not extended to general legal questions. This is especially pertinent in blue-sky law cases, because then the SEC's opinion will express if, and which provisions of state law "may indirectly impair the functioning of federal securities law"[469], so that, by interpretation and case law, those discrepancies can be erased.

v. Enforcement

SEA 1934[470] provides the SEC with a wide range of enforcement power, which is effectuated not only by the Division of Enforcement, but also by the regional offices[471], whereas SOX extends this enforcement even further.[472] Core areas of enforcement have in the past been the following, and as expected due to the rising numbers of securities trade and thus also securities fraud, SEC's enforcement activities have also been increasing in the last years:[473]

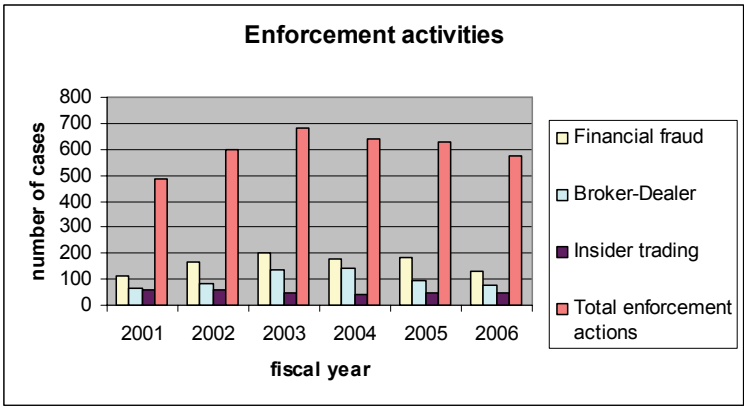

Chart 8: SEC number of enforcement activities

Consequent with the stagnating number of enforcement cases, but enhanced amounts of penalties in enactments, also the total amount of penalties ordered is on the rise[474]:[475]

[468] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1374.
[469] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1374.
[470] Securities Exchange Act 1934, sec. 12.
[471] *Budd/Wolfson*, Securities Regulation, 1984, p.6.
[472] *Hamilton/Trautman*, Sarbanes-Oxley Act of 2002, 2002, chapter 706.
[473] Data derived from *Bloomenthal/Wolff*, Emerging Trends in Securities Law, 2005-2006 edition, 2005, p.654 f; http://www.cfo.com/article.cfm/8127167?f=home_featured (page impression of November 20th, 2006)
[474] The drop in 2006 is, according to the SEC, not to be attributed to any special cause; *Securities and Exchange Commission*, 2006 Performance and Accountability Report, p.54.

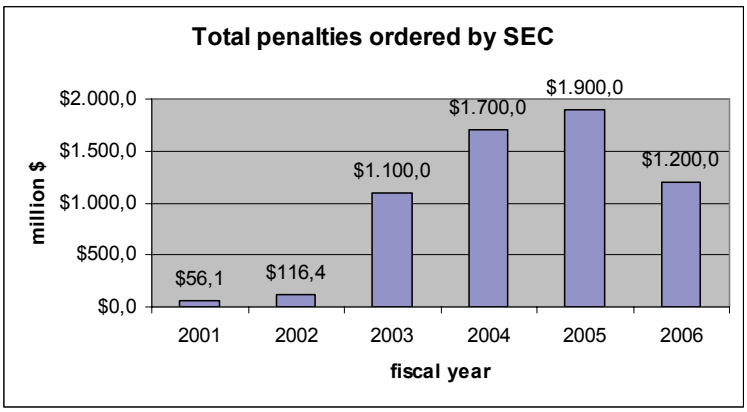

Chart 9: SEC amount of total penalties ordered

Generally, the SEC can choose to enforce either internally, i.e. before an administrative law judge in a so-called administrative proceeding, or externally, i.e. in a federal court as normal civil action.[476] However, the SEC's own enforcement power is limited to civil enforcement[477], and cases with a possible criminal background need to be referred to criminal law enforcement agencies. Considering which path to go, the Commission generally takes into account the following factors: "the seriousness of the wrongdoing, the technical nature of the matter, tactical considerations, and the type of sanction or relief to obtain"[478]. However, if the nature of the case mandates it, the SEC is free to engage in both proceedings for the same case. Generally, more than 95% of cases are pursuit in a civil lawsuit, and also, over 90% of cases are settled before the actual litigation by a settlement.[479]

1. Investigative power

The SEC's investigative power is founded on four acts: SEA permits the SEC, "in its discretion, to make such investigations as it deems necessary in order to determine whether a person has violated, is violating, or is about to violate the Act or any rule issued under the Act"[480]. Although the provisions under the SA and the Investment Advisers Act are, in their enacted form, materially stricter, case law has extended them to an equal reach. Under the same provisions, the SEC might decide not to investigate itself, but to require that the concerned person or entity file a statement concerning all facts and circumstances of the case, a rule applicable

[475] Data derived from *Bloomenthal/Wolff*, Emerging Trends in Securities Law, 2005-2006 edition, 2005, p.654 f; http://www.cfo.com/article.cfm/5435460?f=related (page impression of November 20th, 2006); *Securities and Exchange Commission*, 2006 Performance and Accountability Report, p.54.
[476] Securities Exchange Act, sec. 30A (d).
[477] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xvii.
[478] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xix.
[479] Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.
[480] Securities Exchange Act 1934, sec. 21 (a).

with minor changes to all acts the SEC administers.[481] Generally, such investigative proceedings are conducted with the aim of initiating SEC administrative proceedings[482], but they might also serve as pre-investigation for a criminal action.

Also, this original duty to file upon request of the SEC has found acceptance in SEC regulation[483] as a right: every person or entity under investigation is allowed to present its position before commencement of an enforcement procedure. Additionally, the SEC is entitled to publish not only compounded, but also individual information concerning the violation of securities law, if this is in its discretion[484] – a power sparingly used in the SEC's beginnings, but of increasing influence when the agency wants to express its opinion on a legal question[485] or sanction a wrong-doer by negative publicity.

Whereas the mentioned entitlements for investigation relate to a past alleged violation of securities law, the SEC also can use its investigative authorization for the determination of a fact base as how to regulate, enforce or otherwise influence securities law.[486] In all those fields, the SEC currently conducts about 1,000 investigations per year.[487]

a. Beginning of investigations

Investigations are triggered by several indicators: Primarily, this is complaints by investors, whistleblowers or the general public[488] for suspected non-compliance with protective clauses of securities law. Also, the regularly conducted surprise investigations with the supervised entities – exchanges, issuers, brokers and dealers – can provide evidence of a lesion of securities law, which will be pursued with an investigation.[489] Furthermore, the SEC continually runs market studies and security analyses, so that the organization will notice fluctuations in particular stocks. If those are not explainable by general or branch-specific market develop

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[481] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1393.
[482] *Hazen,* Federal Securities Law, 2nd edition 2003, p.17.
[483] Rules on Informal and Other Procedures, rule 5 (c).
[484] Securities Exchange Act 1934, sec. 21 (a).
[485] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1395.
[486] Securities Exchange Act 1934, sec. 21 (a); *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1396.
[487] In Fiscal Year 2005, the number amounted to 947; *Securities and Exchange Commission*, 2005 Performance and Accountability Report, p.7.
[488] As many as 72,000 complaints reached the SEC in 2005; http://www.sec.gov/about/gpra1999-2000.shtml (page impression of November 7th, 2006) sub "SEC Environment"; and approximately 1/5 of investigations are triggered by such; *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.82.
[489] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.158.

ment or events concerning the issuing company known to the SEC[490], an investigation is initiated in order to determine the reason for the fluctuation. Thus, "SEC's control comprises both proactive and reactive"[491] indicators for investigations, so that a high density of control is reached. Generally, in such cases an informal investigation would begin, whereas there is "no requirement that the targets of preliminary administrative investigations be given either actual or constructive notice"[492] of the proceedings. This is especially important if the SEC contacts third parties, i.e. the investigated entity's clients or other business contact: SEC's procedure can heavily damage reputation, but the entity itself is not even aware of this.

If the informal investigation shows a likelihood of violation, the Division of Enforcement "may request the SEC's General Counsel to authorize it to conduct a formal investigation"[493]. For such, the General Counsel must be convinced that the provisions of an act of the SEC's governing law, or any rule issued there under, have been violated.[494] This formal stage gives SEC staff the power of subpoena which can then be enforced by courts.[495] To discover, prove and finally sanction a violation of securities law, the SEC is empowered to different forms of investigation – on the one hand, private hearings, on the other hand formal investigations as public proceedings[496], which will both be detailed in the following:

b. Informal investigations (Private hearings)

The SEC can decide to conduct a private hearing, i.e. "without public notice until completion of the proceeding and rendering of the opinion"[497]. However, there are no clear guidelines or administrative rules for the exercise of this discretion whether to initiate private or public hearings, except that investigations under the Investment Advisers Act are required to be private.[498] Existing cases in other fields of securities law display the following common characteristic: private hearings are effectuated in "situations in which publicity […] may affect investor confidence"[499] and such proceedings is avoided whenever the SEC fear that "harmful publicity [… would be] used in lieu of sanctions provided by law[500]. Both characteristics are

[490] *Budd/Wolfson*, Securities Regulation, 1984, p.6.
[491] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.82.
[492] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.705.
[493] *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.216.
[494] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1393.
[495] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.706.
[496] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.186.
[497] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.186.
[498] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1400.
[499] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.186.
[500] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1401.

fulfilled when a broker-dealer firm, and not an individual issuer, is concerned. Additionally, private hearings are used in cases of the disqualification and denial/suspense of registration for accountants, brokers, dealers and attorneys as to protect the persons involved from public harassment. However, in the absence of special circumstances, cases concerned with lacking professional responsibility will be held publicly[501], as to warn investors of such behavior and to create a certain climate of deterrence for the respondent's peers, and, in the words of the Commission, to "promote awareness of the standards of ethical and professional conduct"[502].

Private information-gathering also includes, besides this informal inquiry, "interviewing witnesses, examining brokerage records, reviewing trade data and other methods"[503] prone to detect possible violations. However, general immunity provisions[504] hold that no individual will be criminally prosecuted for a testimony issued during an investigation, if this individual claimed the privilege.[505] Additionally, no individual can be forced to appear before the SEC and/or testify.[506] Investigations are conducted with the aim of determining whether prima facie evidence point to a securities law violation, and whether and which action should be taken[507], so that the omission of criminal prosecution seems a minor loss compared to the detection of the truth.

c. Formal investigations

Second, the SEC has the discretion to initiate formal investigations[508] when the SEC feels it necessary to discover whether securities law or SEC regulations have been violated. In case of a clear suspense and/or urgency, this is the path of choice, as the procedure allows for "compel[ling] witnesses by subpoena to testify and produce books, records and other relevant documents"[509], so that a quick investigation in the case – and thus early remediation – is ensured. For this power of subpoena, the investigation must not be of minor scope, so that only such investigations authorized by Congress with a specific purpose qualify.[510] Evidently, the

[501] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.186.
[502] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.186.
[503] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xviii.
[504] 18 U.S.C. § § 6001-6005; *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1406.
[505] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1406.
[506] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.83.
[507] *Budd/Wolfson*, Securities Regulation, 1984, p.7.
[508] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.58.
[509] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xviii.
[510] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.160.

piece of evidence sought after must be relevant to the inquiry[511], and not be available to the SEC by own research. It must be specified to the highest extent possible to the investigated person or entity. Additionally, the subpoena must not be unreasonable[512] in its monetary amount, considered both the relevance of the piece of evidence and the size and financial power of the investigated person or entity, so that the witness privilege known from constitutional and common law[513] is not violated. Also, the person or entity subpoenaed can appeal against this administrative decision.[514]

Non-compliance is qualified a misdemeanor and "subject to a year's imprisonment or a $ 1,000 fine or both, for any person without just cause"[515], however, enforcement does not happen often. Instead, the SEC will apply to a federal court, generally a district court, for an order[516] so that non-compliance can be punished as contempt of court.[517]

d. Legal protection of investigated persons/entities

However, during the process of investigation, the SEC is bound to observe the rules of the Freedom of Information Act (FOIA) 1966, which sets standards for requesting, obtaining and the use of private information[518] in a way that and unwarranted invasion of personal privacy is prevented, but also the interest of the agency in material information is satisfied.[519] Additionally, the obtained information must be disclosed to any person in writing if none of the exemptions or exclusions contained in the enactment applies[520], so that public information and control of the agency is ensured.[521] However, the most important exclusion is financial institutions[522], and is jurisdictionally extended to exchanges and financial advisory services.[523]

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[511] However, without requirement of showing a "probably cause"; *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1403.
[512] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.160.
[513] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1403.
[514] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1404.
[515] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1405.
[516] *Budd/Wolfson*, Securities Regulation, 1984, p.6.
[517] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1402.
[518] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.163.
[519] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1433.
[520] In 2002 and 2003, the SEC received 3,570/5,808 requests, respectively; *Securities and Exchange Commission,* Annual Report 2003, p.7.
[521] However, this procedure is not to serve as information-gathering for a trial (instead of pre-trial discovery); United States v. Weber Aircraft Corp., 465 U.S. 792 (1984), p. 798, 800. Reasons for this preclusion are found in the fact that the additional use of this means would create legislative inconsistency and be an injust extension of the plaintiff's right, who already has certain – but limited – possibilities to gather information.
[522] Freedom of Information Act 1966 (FOIA), sec. 552 b (8).
[523] *Möllers/Wenninger*, Informationsansprüche gegen die BaFin im Lichte des neuen Informationsfreiheitsgesetzes (IFG), in ZHR 2006 455, p.464.

Also, the Privacy Act 1974 on the contrary, prohibits disclosure of reports without any solicitation by written request or consent of person to whom the report relates, however this relates only to natural persons, not business entities[524]. Materially the same protection is granted by the Right to Federal Privacy Act as far as data of financial records of a natural person are concerned.[525] Additionally, state laws concerning public access apply and add yet another difficulty for the storage and/or distribution of information.

Generally, the SEC grants confidential treatment of information obtained, as it is authorized to by SEA[526]. Although the FOIA calls for the publication of investigatory records[527] in case of their leading to any action, SEA gives the SEC the power to decide otherwise, so that deletions for portions of the report – mostly on recommendations, opinions and internal processes – are made. If the investigation is closed without any enforcement or sanctioning action, public access to the records is generally denied[528] to safeguard the investigated person's or entity's privacy. This clear internal regulation corresponds with the vast power the SEC holds during investigation: although the organization is ready to invoke its power for finding of evidence in case of a suspected lesion of securities law, it does not want to fulfill public or official curiosity, especially in the case that the investigation did not prove any non-compliance. Thus, it is guaranteed that the right of the investigated person or entity is safeguarded, and possible loss of image in the public view is avoided.

Furthermore, the SEC has to respect the so-called client privilege, a legal institute complemented by a corollary doctrine[529] protecting a client of a supervised entity[530] of disclosure of their data. Thus, it might be that information about a lesion exists, but the SEC must not use or, at least, not disclose it to the public in order to safeguard a person's privacy.

e. End of investigations

As result of an investigation, the SEC can either decide to pursue the case in a civil court for injunctive action, or recommend criminal action by federal and/or state authorities, or it institute those administrative proceedings[531] to which it is authorized. This sanctioning power will

[524] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1438.
[525] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1441.
[526] In detail, Securities Exchange Act 1934, sec. 24.
[527] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.164.
[528] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.164.
[529] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.167.
[530] I.e. an investment company, investment advisor, broker or dealer.
[531] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1401.

be detailed in the following. Other possibilities of action are the referral of the matter to a stock exchange or SRO for disciplinary action, whereas all those processes can be combined with each other.[532]

Also, it is common practice[533] to negotiate an agreement between the investigated party and the SEC concerning the offending action, if the latter was non-criminal. Thus, the SEC can end the investigations if the defendants agree to stop certain offending behavior in future "without having to recognize that they are at fault and without admitting to the charges"[534], which is especially important to the defendant if it fears damage to its image and business development due to media coverage and public reaction. Also, the SEC saves substantial effort, so that it become obvious why 90% of all cases are resolved by an agreement.[535]

Of course, an investigation can also lead to the SEC dropping the case because no finding supported the suspected lesion of securities law. However, even in this case the SEC's investigation can have severe influence on the investigated party: shareholders, being aware of the case, might have decided to sue, or professional organizations to which the investigated party belongs may decide to apply their specific sanctions.[536] This is reinforced by the fact that the SEC may[537] publish the results of investigation, even if no finding of fault occurred.

2. Sanctioning power

As detailed above, the SEC's standard-setting authority is a strong one, but must be combined with sufficient authority and effective means of enforcement to ensure success. This is not only necessary to punish a concrete faulty behavior, but also to demonstrate the strengths of the institution in order to convey market integrity and stability to investors and SEC's relentlessness and severe sanctioning to other market participants.[538] Still, with all their actions, the SEC needs to respect that they have to "provide maximum investor protection with a mini-

[532] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1401.
[533] Indeed, more than 90% of cases are concluded in this way; Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.
[534] *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.216.
[535] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.91.
[536] Which is not dependent on any SEC proceeding, but likely to be spurred by public notice of such; *Bartos*, United States Securities Law: A Practical Guide, 2nd edition 2002, p.216.
[537] On the basis of Securities Exchange Act 1934, sec. 21 (a)
[538] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.182.

mum of interference"[539], so that a careful deliberation between the purpose and the choice of the means has to be made.

Since enactment of SOX in 2002, the SEC's policy is "real time enforcement"[540], i.e. the segmentation of cases to instantly identify and sanction wrongdoing, instead of waiting for a case's end and only then engaging into sanctioning. Additionally, the SEC encourages self-reporting by incentives of correction without sanction or the application of milder sanctions. However, the SEC practice is to invite the concerned party to outline their view on the subject matter and to respond to the Commission in so-called "Wells submissions"[541], which might contain a petition for the non-appliance of sanctions.

In the following, the three means of enforcement – civil action, referral for criminal action and SEC-internal administrative proceedings – will be detailed. Currently, the SEC engages in approximately 350 civil proceedings per year[542] and equal number of administrative ones[543].

a. Course of civil action

Civil action is a proceeding that allows the SEC to sanction both defendants registered with the organization and persons or entities not registered, but violating securities law, whereas administrative proceedings only apply to registered parties.[544] For such, the SEC holds so-called prosecutorial authority[545], which allows it to file a complaint with the adequate US District Court describing the case's fact base, conducted investigation and its findings, law and regulation pertinent for the case and a suggestion for sanction and/or remedial action[546], mostly injunction or ancillary relief. Those means of action are favourable to the SEC because they are much quicker enforced than the corresponding public-law remedies.

In most cases, the court is asked to issue an injunction intended to instantly stop the behavior violating securities law and/or SEC regulation.[547] A civil injunction is an order prescribing the

[539] *Budd/Wolfson*, Securities Regulation, 1984, p.9.
[540] *Mahoney et al.* in *Kasner/Vanyo,* Securities Litigation & Enforcement institute 2004, 2004, p.375.
[541] Called such after the lawyer John Wells, who instituted this proceeding within the SEC; *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.706; *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.83.
[542] In Fiscal Year 2005, the number amounted to 335; *Securities and Exchange Commission*, 2005 Performance and Accountability Report, p.7
[543] *Securities and Exchange Commission,* Annual Report 2003, p.17.
[544] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.703.
[545] *Hazen,* Federal Securities Law, 2nd edition 2003, p.4.
[546] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xix.
[547] Securities Exchange Act 1934, sec. 21 (d).

further execution of the "acts or practices alleged to violate the law or [SEC] rules"[548] and regulations. Thus, it instantly stops the wrongdoing, and protects investors and others involved from further damage.

In its decision of whether to follow the SEC's demand, the court or ALJ will assess the seriousness of the violation and the expected impact on the defendant, whereas secondary factors are "the degree of the defendant's culpability and the length of time between the acts complained of and the time of suit"[549]. Thus, the court ensures that the more serious the relief requested is, the higher the showing of violation and risk of occurrence, whereas, however, the Commission's position has certain preponderance[550].

However, for this procedure to be viable, the so-called demand of equity must be fulfilled: the action must have happened recently enough to assume that, no injunction being issued, the behavior violating securities law will be resumed[551], or, in other words, that there is "positive proof of a reasonable likelihood that past wrongdoing will occur"[552] also in the future. This is assessed by a multitude of factors, e.g. past violations, the degree of scienter with the violation, or acknowledgement of wrongdoing, because on the contrary to "normal" civil cases, in which an injunction is seen as prophylactic with a warning character, but no real influence, the Supreme Court considered an injunction in securities law as "a drastic remedy"[553] due to the fact that such legal action arouses public suspicion and usually leads to substantial deterioration of business. The latter is also strengthened by the SEC's practice to publicly issue ad so-called litigation release informing the public of the event. Although such practice seems doubtful, it has been ruled that it does not violate the defendant's due process rights[554], especially as the safeguarding of the investing public is considered prevalent. Also, an injunction issued does not end automatically, but the defendant must assume the burden of proof for reasons why it should be lifted[555] – an extremely difficult proof.

[548] *Budd/Wolfson*, Securities Regulation, 1984, p.7.
[549] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.698.
[550] Or, as decided in SEC v. International Heritage, Inc, that the court is to view evidence "in a light most favourable to the Commission", *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.699.
[551] http://www.sec.gov/about/whatwedo.shtml (page impression of November 7th, 2006) sub "Organization of the SEC".
[552] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.698.
[553] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1344.
[554] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.697.
[555] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.698.

Also, the court will, upon request of the SEC, order the conduction of audits, the delivery of documents or cooperation for other supervisory actions. In the past, the SEC has in the course of an injunctive action also applied for a so-called ancillary relief[556] – a completely new approach fashioned by the SEC and it courts on the basis of "the general equitable powers of the federal courts"[557]. Ancillary relief can take a vast variety of forms, most notably the disgorgement of profits, but also individual corrections such as the appointment of an independent majority on the board of directors or prohibitions against voting control, the appointment of specialized professionals to ensure compliance or the imposition of additional reporting requirements.[558]

Although the SEC is entitled to skim gains of illicit transaction, the agency is not a "collection agency"[559], which would claim damages from the violator on behalf of the injured party and then re-distribute it. However, ancillary relief can include relief intended to compensate damaged investors, especially in the case of disgorgement of profits, whereas it must be understood that the investors – although they have a strong interest in the conclusion of the case – are not considered a party to the proceeding.[560]

So, although the investors are the ones affected by SEC's action and the outcome of litigation, they would normally not be granted the right of appeal – a general rule adapted by a lenient court rule, which allows a private party standing to appeal if the following criteria are fulfilled: participation in district court proceedings by filing as interested parties, equities weighed in the private parties' favor due to affection by the distribution of funds, and thus personal stake in the outcome of the SEC suit.[561] To alleviate such cumbersome proceedings, and save investors the cost of separate actions, SOX entitled the SEC to claim for relief which it would then distribute among the damaged investors, so that the agency indeed does hold some restitute power. However, due to the administrational difficulties of fund distribution and the rare occasion of cases in which a multitude of investors is damaged, the SEC seldom uses this authority.[562]

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[556] *Ratner*, Securities Regulation, 2nd edition 1980, p.20.
[557] *Farrand*, Ancilliary Remedies in SEC Civil Enforcement Suits, Harvard Law Reports, cited after *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.699.
[558] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.700.
[559] *Ratner*, Securities Regulation, 2nd edition 1980, p.20.
[560] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.700.
[561] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.700.
[562] From 2002-2006, only $ 8 billion have been collected and distributed; *Securities and Exchange Commission*, 2006 Performance and Accountability Report, p.23.

The SEC can cooperate with other parties or agencies, if it deems such approach favorable in litigation. However, the consolidation of SEC and other action is prohibited[563] if not covered by the Commission's consent, even if those actions would involve the same factual decisions and determinations.[564] Third parties who fear for their interests may intervene in SEC actions, but cannot enforce a right to intervene or enforce SEC consent for consolidation.[565]

Other than for an injunction, the SEC can claim a civil penalty, whereas the amount is discretionary within the boundaries of a three-tier system: in the first tier, penalties are limited to $ 5,000 for natural persons and $ 50,000 for entities, or the gross amount of pecuniary gain. In case of more culpable conduct (second tier), the limits are $ 50,000/$ 250,000 or the gross amount of pecuniary gain; with the third tier, involving culpable conduct and severe impact on third parties, limits are $ 100,000/$ 500,000 or gross amount of pecuniary gain.[566] Penalties are payable to the US Treasury.

At last, the SEC is empowered[567] to seek bar orders for persons severely violating certain provisions of securities law[568], so that the can no longer act as directors and officers of a registered issuer either temporarily or permanently. This is relevant if the violator's conduct shows "a substantial unfitness to serve as an officer or director of any such issuer"[569], which demands for a high level of evidence concerning the violation and the likelihood of reoccurrence to be presented before court. Factors generally being taken into account for consideration are the egregiousness of the securities law violation, the defendant's role when engaging in the fraud, his degree of scienter and economic stake in the violation and whether the defendant is a repeat offender and the likelihood of recurrence.[570] Likewise, association with broker-dealers can be barred by court, whereas this – on the contrary to a director/officer bar – is also possible during administrative proceedings[571]. However, since SEC's power of cease-and-desist orders, bar orders have lost their importance. Related to bar orders, but of considerably higher impact is personal restructuring, which the SEC is also entitled to claim. In this case, the court would change or substitute the current board of management or install an ex-

[563] Securities Exchange Act 1934, sec. 21 (g).
[564] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.695.
[565] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.696.
[566] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.704.
[567] By Securities Act 1933, sec. 20 (b) and/or Securities Exchange Act 1934, sec. 21 (d).
[568] In detail, Securities Act 1933, sec. 17 (a) and/or Securities Exchange Act 1934, sec. 10 (b).
[569] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.704.
[570] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1424.
[571] Securities Exchange Act 1934, sec. 15 (b); for a detailed outline of the procedure, see *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.714.

ternal manager, so that "possible further misdemeanors in the past [would be] discovered by internal revision and future lesions of law [would be] avoided"[572].

Court orders will be enforced by federal agencies, and a person violating those "may be found in contempt and be subject to additional fines or imprisonment"[573], so that civil action is a very powerful means of enforcement. However, it involves outsiders to the SEC's daily work, and thus requires additional time and careful advice of the court in matters of securities law, so that this kind of proceeding is not always favoring the SEC's aim of immediate response to violations and quick remediation.

b. Course of criminal proceedings

Likewise as civil proceedings, criminal proceedings can be instituted against any party violating securities law or regulations, regardless of whether it falls under SEC supervision.[574] Thus, in case of willful and knowing[575] securities law violation, the SEC suggests this course of action to the Department of Justice[576], which will then order the necessary proceedings through their local attorneys. Thus, the SEC is engaged with the Attorney General, who at his discretion may institute criminal proceedings.[577] However, by supplying the necessary evidence[578] and providing the Attorney General with a stringent case, the SEC is able to determine the likelihood of criminal prosecution. The SEC, in various stages of a case, can make this referral accompanied by a so-called criminal reference report, an "exhaustive trial brief prepared by the Commission's staff"[579], which ensures that the collected evidence and testimonies can be transferred to the criminal proceedings.

At the referral, the Attorney General will determine whether the criminal proceeding is preferable to other punitive proceedings, and only after acceptance the case will be discussed be-

[572] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.95.
[573] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xix.
[574] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.703.
[575] Wilful being interpreted as knowing of the absence of documents to be filed or the falsity of a statement; knowing as being aware of the fact that the statement is false "for the purpose of inducing others to rely on it"; *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1349.
[576] *Budd/Wolfson*, Securities Regulation, 1984, p.7.
[577] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1351.
[578] Collected by SEC's work and/or by investigation, self-delivery after subpoena or discovery in a civil action; *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1353; *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.90.
[579] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.170.

fore a jury.[580] The usual criminal punishment for violation of securities law is imprisonment, fine or both[581], whereas an indictment can sought before a Federal grand jury. This course of action pursues two goals: on the one hand, it seeks to punish the wrongdoer by confiscating all gains made illegally and imposing an additional penalty. On the other hand, an incentive for future lawful behavior not only for the culprit, but also for its peers, is set. It must furthermore be noted that the recommendation of criminal proceedings does not hinter the SEC to seek civil action, and that the proceedings are parallel, not exclusive.[582]

Maximum penalties, for lesion of provisions of the Securities Act, are fines up to $ 10,000, and imprisonment up to five years[583], whereas scienter lesion of a provision of the Securities Exchange act is sanctionable with fines up to $ 5 million and/or imprisonment up to 20 years.[584]

c. Course of administrative proceedings

In the course of administrative proceedings, or internal enforcement, the SEC can only act against defendants who are in the scope of its supervision[585], i.e. broker-dealers, municipal and government security dealers, national security exchanges, investment companies, investment advisers, and public utility holdings.

The SEC follows its rules of practice, which are in accordance with the Administrative Procedure Act 1946 so that the demand of a due process – safeguarding of the rights and interests of all parties – is satisfied.[586] This includes, among others, timely notice of the intended proceedings and all deadlines, specification of the issue treated and/or the charges made, right to participate in hearings and to present evidence and/or witnesses and right of limited participation and/or intervention for other parties.[587] Thus, proceedings with the SEC are much similar to proceedings in "normal" courts. Before the hearing taken place, the respondent receives a notice covering time and place, the nature of the hearing, legal authority and jurisdiction under which the hearing is held, which also details the matters of fact and law and indicated the

[580] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.90.
[581] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.170; whereas generally, in case of ignorance of the provision of securities law violated, the penalty is limited to a fine; *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1349.
[582] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1351.
[583] Securities Act 1933, sec. 24.
[584] Securities Exchange Act 1934, sec. 32.
[585] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.703.
[586] *Budd/Wolfson*, Securities Regulation, 1984, p.14.
[587] *Budd/Wolfson*, Securities Regulation, 1984, p.14.

nature of relief or action intended.[588] Failure to appear to such a hearing or conference for which the party has been notified may be deemed in default.[589]

Non-bias is ensured as hearings are conducted before an independent administrative law judge (ALJ)[590], called Hearing Officer, who "rules on the admissibility of evidence and on other issues arising during the course of the hearing"[591]. The respondent may be accompanied and advised by a counsel of his choice[592] – a right possibly denied in case of willful[593] violation, or aiding and abetting the violation of securities law.[594] The counsel or attorney must not fulfill any criteria, but any attorney can be temporarily or permanently denied the right of appearing before the SEC in case of lacking the requisite qualifications for representation, lacking character or integrity or prior engagement in improper professional conduct or prior willful violation of federal securities law or aiding or abetting to such practice.[595]

Hearings will be held in the same procedure as a non-jury trial in equity, which includes cross-examination, whereas the ALJ "regulates the course of the hearing and rules on offers of proof and the admissibility of evidence"[596]. Not all common law rules of evidence are strictly applied, for instance irrelevant, immaterial or unduly repetitious will be excluded, but relevant hearsay evidence is accepted if it supports a conclusion.[597]

After termination of the hearing, all parties involved can detail specific findings of facts and legal conclusions in writing, to be presented to the ALJ, who then prepares an initial decision which is distributed to the parties.[598] All parties, and the SEC itself, may seek a review of the initial decision, in case of which an oral argument before the Commission takes place. Guided by the record and the finding of the argument, and based on consulting of the staff working with the case prior, which is possible due to the "separation-of-function"-provisions of Administrative Procedure Act 1946, the Commission issues its own decision as required by the

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[588] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1408.
[589] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1408.
[590] ALJs are "civil servants who conduct hearings for regulatory agencies"; *Koslow*, The Securities and Exchange Commission, 1990, p.81.
[591] *Budd/Wolfson*, Securities Regulation, 1984, p.14.
[592] Administrative Procedure Act 1946, sec. 555 (b).
[593] Defined as "intentionally committing the act which constitutes the violation", not necessarily to act with knowledge that the act is unlawful; *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.180.
[594] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.172.
[595] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1375.
[596] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1410.
[597] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1411.
[598] *Budd/Wolfson*, Securities Regulation, 1984, p.14.

act[599]. However, the scope of the review is limited to those points specified with the request.[600] This is an institutional administrative decision and thus, although typically prepared by one Commissioner, effectuated in the name of the Commission as a whole. If a participant is aggrieved also by this decision, it can seek further review with the US court of appeals.[601]

If no review is demanded, or the review by the Commission is not followed by an appeal before a state court, the decision becomes final and the ALJ's order is effective, and thus enforceable. However, many enforcement actions do not end with an administrative decision, but rather in settlement – consent to SEC's sanctions by the defendant without either admitting or denying the wrong-doing.[602] All decisions are made public upon their issuance; a final digest of all proceedings and decisions is printed after conclusion of the case and published in the Commission's "Decisions and Reports".[603] Contrarily to publication with the intent of shaming, such publication aims at the information of the public and likewise concerned entities only and not at the diffamation of the wrongdoer; the case might eve be annonymized.

Generally, the SEC "has taken the position that there is no statute of limitations that is generally applicable to the Commission's institution of administrative proceedings to enforce the act"[604], which is however accepted as a five-year statute of limitations if the SEC institutes administrative proceedings for civil fines or penalties.

d. Range of statutory sanctions

Its primary governing laws provide the SEC with a range of possible remedies in case an investigation determines a securities law violation, all of which are applicable against any person or entity who does not comply[605] with rules or regulations administered by the SEC. Additionally, the Securities Enforcement Remedies and Penny Stock Reform Act 1990 added three types of judicial and administrative remedies: both the Commission itself or any federal court may impose civil money penalties.[606] Additionally, the Commission can issue cease-and-desist orders, and apply to a federal court for barring individuals from serving as officer or director of a filing company and suspend any person of the right to practice before the

[599] Administrative Procedure Act 1946, § 556 (d).
[600] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1414.
[601] Securities Exchange Act 1934, sec. 25 (a).
[602] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.697.
[603] *Budd/Wolfson*, Securities Regulation, 1984, p.15.
[604] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.697.
[605] *Budd/Wolfson*, Securities Regulation, 1984, p.7.
[606] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1419; *Becker*, in *Hopt et al.*, Börsenreform – eine ökonomische, rechtsvergleichende und rechtspolitische Untersuchung, 1997, p.856.

Commission[607]. Those new forms of enforcement, especially administratively imposed civil fines, significantly enhance SEC's authority.[608]

Most statues of governing law[609] authorize the SEC to order a civil monetary penalty for the lesion of securities law or Commission cease-and-desist orders. Also, the SEC might decide to issue and asset freeze[610] and/or to issue a civil penalty.[611] Asset freezes have come especially handy as they preserve the financial status quo in order to "insure that the defendant's assets will be available to compensate public investors"[612]. Furthermore, the test for obtaining in asset freeze is only oriented on the likelihood of the success of the ensuing claim, so that it is less strict than with an injunction and relatively easily obtained.[613]

Such procedure demands, after notice to the possible defendant and opportunity to be heard, a willful violation of securities law or applicable rules of a SRO, willful material misstatements or omissions or willful failure to supervise persons.[614] Depending on the gravity of the violation and whether a natural person or other entity is concerned, civil penalties range between $ 5,000 for a natural person ($ 50,000 for others) and $ 100,000 ($ 500,000).[615] Additional sums can be claimed as disgorgement, i.e. the skimming of all monetary gains derived from a securities law violation. Generally, the decision of whether to or not to claim for a penalty is oriented on the following guidelines: involvement of fraud, deceit, manipulation or deliberate/reckless disregard of rules and regulations, resulting damage and extent of unjust enrichment, degree of recidivism, and need for deterrence.[616] Due to its mission of investor protection, the SEC is rather reticent in invoking fines if this procedure would lessen the defendant company's equity and thus deteriorate the investors' monetary position.[617]

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[607] SEC Rule of Practice 102 (e); *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.722.
[608] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1420.
[609] With the exception of the Holding Company Act and the Trust Indenture Act, *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1420.
[610] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.709.
[611] Only since the Securities Enforcement Remedies and Penny Stock Reform Act 1990, *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.711.
[612] *Gilchrist*, Commentary: Turning up the heat: the SEC's new temporary freeze authority, in 56 Ala. L. Rev. 873, p.875.
[613] *Gilchrist*, Commentary: Turning up the heat: the SEC's new temporary freeze authority, in 56 Ala. L. Rev. 873, p.875.
[614] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.711. For further conditions, see Securities Exchange Act, sec. 21 b.
[615] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1421.
[616] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1422.
[617] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.92.

The same statutes[618] attribute the SEC authority to issues temporary or permancent cease-and-desist orders as to quickly impose remedial action for illegal conduct. Its advantage over an injunction, which basically serves the same goal, is that no court needs to be engaged[619], which ensures swift action, and that the SEC can handle the case in-house[620]. Additionally, SEC rules for the issuance of a cease-and-desist order do not provide for the likelihood of a future violation as with an injunction[621], the degree of scienter can be lower, even negligence may suffice. Furthermore, a cease-and-desist order does not prove as damaging to the defendant, as it does not operate to disqualify him from serving as director or officer or registered broker[622], but rather serves as a last warning. However, a cease-and-desist order is not a court order, non-compliance does not lead to an automatic contempt, but needs extra steps.

At last, the SEC can issue denial, suspension or revocation of a registration, suspension or expulsion from participation in an exchange or in and over-the-counter association or individual censorship by barring a person from employment with a registered firm.[623] Undoubtedly, this is the quickest course of action, as the SEC can act itself without having to apply for support of other governmental institutions. Furthermore, both investor protection to the earliest moment possible and punishment and deterring effect are provided. This means, however, is generally only applied to persons or entities engaged in the securities business.[624]

As the sanctions available to the SEC are of different effect for the goal of investor protection and have different impact on the alleged culprit, the SEC combines them to reach a most efficient sanctioning package ensuring a deterring effect, punishment and instant investor protection. A virtual means of sanctioning – although not primarily intended as such – is the publication of the results of an investigation (and, possibly, the sanctions – so-called shaming), as provided for in the Securities Exchange Act[625]. Although vividly discussed both inside the SEC and by scholars, this procedure has proven efficient as means of deterring future wrong-

[618] Exemplarily, Securities Act 1933, sec. 8 (a), Securities Exchange Act 1934, sec. 21 (c) after the amendment by the Securities Enforcement Remedies and Penny Stock Reform Act 1990, *Gilchrist*, Commentary: Turning up the heat: the SEC's new temporary freeze authority, in 56 Ala. L. Rev. 873, p.876.
[619] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1423.
[620] Or even delegate the authority, as done with FINRA (former NASD); *Gilchrist*, Commentary: Turning up the heat: the SEC's new temporary freeze authority, in 56 Ala. L. Rev. 873, p.878.
[621] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.1423.
[622] *Gilchrist*, Commentary: Turning up the heat: the SEC's new temporary freeze authority, in 56 Ala. L. Rev. 873, p.877.
[623] *Budd/Wolfson*, Securities Regulation, 1984, p.7.
[624] *Budd/Wolfson*, Securities Regulation, 1984, p.7.
[625] Securities Exchange Act 1934, sec. 21 (a).

doers and raising public awareness.[626] The review of SEC sanctions is effectuated by courts of appeal, and based on the estimate of preponderance of evidence[627] concerning the SEC's findings, whereas review is deferential.[628]

vi. Summary

SEC's authority is set in a variety of fields: On the one hand, it is quasi-legislative[629] in such as the SEC acts as a standard setter when conceiving rules, regulations and general administrative guidelines of behavior for the securities industry; also, the act of interpreting statutes (at least priorily to court decisions) could be conceived as quasi-legislative. On the other hand, the SEC also "has a panoply of administrative powers"[630], mainly in the field of enforcement. In its judicial function, the sanctioning of securities law violations, the SEC involves in criminal[631], civil[632] and administrative[633] actions.[634] However, this quasi-judicial[635] power is limited when it comes to the adjudication of disputes between private parties.[636]

Most important is the fact that oftentimes, the prosecution is effectuated in-house, which results in a quick filing of cases[637] and thus ensures compelling results. Thus, the cases brought develop their full effect: they are "not only brought to fix the problem, but also to send a message"[638] – or, academically expressed, for both remedial and preventive function. Also, the fact that the SEC itself (as the regulator) handles case and does not have to refer them has been named one of the success factors of supervision: only by this it is ensured that the detailed knowledge, derived from an oftentimes time-consuming investigation, is used without further delay.[639]

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[626] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.716.
[627] As far as the Supreme Court rules, whereas many courts let the lower standard of substantial evidence suffice.
[628] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.711.
[629] *Schacht,*Die deutsche Kapitalmarktaufsicht im internationalen Vergleich, 1980, p.64.
[630] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.695.
[631] Such as fining, denial or suspense of registration.
[632] Such as seeking injunctions or other means of relief.
[633] Such as supporting private action, both injunctive and to cover damages, by investors.
[634] *Bloomenthal/Wolff*, Securities and Federal Corporate Law, 2nd edition 2005, p.188.
[635] *Schacht,*Die deutsche Kapitalmarktaufsicht im internationalen Vergleich, 1980, p.67.
[636] *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.695.
[637] Indeed, cases exist which had been filed in 24 hours since end of investigations; Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.
[638] Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.
[639] Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.

f. Current challenges

After discussing the SEC's governing law and operations, this chapter focuses on the fields that have proven a challenge, and demand special attention. Those are found both in the external environment, e.g. in the size and scope of the share market, and internally within the agency.

i. Novel types of securities

Since the late 1980s, more and more derivative[640] financial instruments, which also combine features of several traditional securities, have flooded the market. Securities trading, until then dominated by a small number of securities such as bonds, stocks and debentures, saw the rise of futures[641], options[642], swaps[643], collateral mortgage obligations and commercial papers[644], whereas most instruments are based on the principle of hedging against the risk of future price development. By being hybrid financial instruments, most do not fall under any regulation, or fall under regulation by two different agencies, which raises questions of cooperation and/or delegation of authority.[645]

Although this diversification adds tremendous opportunities for savvy individual investors to choose a security fitting their personal risk and future investment plans, the broad investing public did often not or not fully understand scope and risk of those new financial instruments. Large losses, as much as $ 6.4 billion by 1994, were reported[646] and raised concern about investor protection. Thus, the SEC had to objectively inform the investing public about the basic structure, obligations, risks and gain expectation of such securities, which has been a tremendous challenge[647]. In addition, new securities present new methods to defraud either individual investors and/or the whole securities market, and a growing number of such cases was

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[640] I.e. a security "whose market value is derived from the value of an underlying asset, rate or index", *Hall*, A Legal Solution to Government Gridlock, 2nd edition 1998, p.149.
[641] Futures provide for the delivery of a security, foreign currency, government security or stock index for today's price; *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.573.
[642] Options are the right to sell (put option) or to buy (call option) at a certain price within or at the end of a fixed period; *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.574.
[643] Swaps involve a contracts between two parties, whereas the one will effectuate fixed periodic payments to the other (fixed rate payor) in return for periodic payments varying within a benchmark of market interest rates such as LIBOR (floating rate payor), often in a foreign currency. Thus, parties hedge against interest rate and currency fluctuation; *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.575.
[644] *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.569.
[645] For instance, futures fall under regulation of the CFTC, options under SEC authority; swaps initially did not fall under either.
[646] *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.575.
[647] http://www.sec.gov/about/gpra1999-2000.shtml (page impression of November 7th, 2006) sub "SEC Environment"

reported[648], o that the SEC had to extend its control and conceive new methods of market research as to cover derivative instruments in its supervision.

But not only administrative supervision, also regulation had to be adapted[649], which proved burdensome, as no experience with the above-mentioned types of securities existed, neither in the US or worldwide. The delay in registration, and in the establishment of trading rules, has allegedly triggered the high market volatility in 1987/1988, and significantly contributed to the Black Monday in October 1987, so that the SEC saw high urgency for action and conceived rules for option and futures trade[650] and abolished a certain number of derivatives[651]. It can be expected that also in the future, investment firms will enter the market with innovative derivatives, so that SEC supervision has to extend in scope and constantly adapt current practices as to effectively cover those new financial instruments.

ii. Current market structure

Problems from the current market structure can be characterized with the term "market fragmentation"[652], or the decentralization of trading. Trends which foster this development are the internalization of customer orders[653], and the emergence of Electronic Communication Networks (ECNs)[654], and both lead to the creation and maintenance of several independent venues for trade in the same securities. Supposed side-effects of this are diminished price competition due to less comparison, and the scattering of trading interests, as the price-setting market mechanism becomes less efficient when applied to too many markets.[655]

Diminished price competition could arise when a market maker faces an order better than his current quotation: although an order could have been fulfilled in the market, to ensure his gain, the market maker would simply hold the transaction until his quotation equaled the order – and only then fulfill it. Thus, market makers would profit from "private options", or he spread between market price and customer order, at the customer's expense. This conflict, however, has been approached with so-called order handling rules demanding that orders

[648] *Hall*, A Legal Solution to Government Gridlock, 2nd edition 1998, p.149.
[649] *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.569.
[650] *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.591.
[651] Among them, financial index futures and index options, *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.593.
[652] *Jickling* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.45.
[653] I.e. the matching of sale and buy orders within an investment company between their clients, without appearance on the market.
[654] For a detailed description, see below.
[655] *Jickling* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.46.

must be displayed to the market within 30 seconds of receipt[656], so that this concern had been if not eliminated, then at least alleviated.

Still, the efficiency of the price-setting mechanism is questioned: when trading the same goods on several markets, information flows will not immediately influence the price, but take time until they reach all markets and thus lead to a slower price adaptation. Thus, by trading shares on several venues, the financial market becomes less liquid[657] and less information is absorbed in the prices, both leading to misallocation of capital and higher market volatility. Although both concerns are well-argued for, studies suggest that at least currently, and also with the expected growth of ECNs, they will not trigger "serious misallocation of capital or dangerous market volatility"[658].

Thus, government, instead of actively changing the market structure, rather relies on the SEC's modification of current practices[659] as to ensure capital market integrity and efficiency. However, this needs close supervision of the market structure, effects on the price mechanism and trading structures, which charges the SEC with a high additional workload.

iii. Continuous market expansion

Since its installation, the SEC faces continually growing capital markets, which continually expand the number of entities the SEC supervises. This phenomenon is due to a several factors: On the one hand, business activity in the US has grown rapidly, mostly due to the rise of technologies, the emergence of strong effects of size and scope, favorable market conditions, decreasing transaction costs and easy access to capital.

On the other hand, the US market has opened to the global economy, which brought a huge mass of foreign competition also to seek capital on the US market, an overwhelming proportion of which is generated by public investment[660]. Thus, the number of foreign companies registered almost doubled between 1990 and 1996 to a total of 843[661], and increased again to

[656] *Jickling* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.47.
[657] I.e. the appearance of a new buyer/seller or a new piece of information influences the price more severely than it would in one single market due to the greater spread of shares it would then influence; *Jickling* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.47.
[658] *Jickling* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.48.
[659] Such as the approaches proposed in SEC's concept release of 2000, suggesting among others higher disclosure requirements by market centers and brokers, restriction of internalization and required exposure of customer market orders; *Jickling* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.50.
[660] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.90.
[661] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xxxii.

more than 1300 by 2001[662]. Also, since the 1980, more and more small[663] investors discovered the securities market as savings vehicle, and this tendency has accelerated with retirement plans basing on mutual funds.[664] Many families invest in the market as to safe for a home or tuition.[665] Thus, the dollars invested by households "grew from $ 46 billion in 1980 to $ 3.3 trillion in 2000"[666], and the percentage of households investing in shares grew tremendously from 1,20% in 1929 to 47% in 2006[667].

Thus, the SEC is responsible for a growing numbers of issuers and investors, so that it has to continually educate the investing public and provide specific counseling to those starting investing in shares, but also to educate those national and foreign entities that enter the market as new issuers.

iv. Growing spread of investors

Furthermore, the SEC faces a vast array of different shareholder groups: private and institutional investors confer large or smaller sums for different investment aims to the capital market. Participation of institutional investors – investment companies, insurance corporations, pension or common trust funds, among others[668] – amounts to almost 60% of all equities outstanding, or more than 70% of the monetary amount of public trading.[669] This concentration onto institutional investors, and their professionalism – i.e. continuous information gathering, analysis and cooperation with issuer – leads to the fact that SEC regulation becomes obsolete for the majority of the investing public: institutional investors are well aware of the dangers of the capital market, they can "fend for themselves"[670]. The spread of investors poses also the problem of information asymmetries, as institutional investors are closer to inside information, and may even trigger cooperation and insider trading.

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[662] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.63; *Atkins*, Speech at Cologne University on Februray 5th, 2003, http://www.sec.gov/news/speech/spch020503psag.htm (page impression of March 28th, 2007)

[663] Actually, the average portfolio equalled, in 1990, $ 11,400, whereas 34% of portfolios were below $ 5,000; *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.570.

[664] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xxxv; *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007), p.58.

[665] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.56.

[666] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.60.

[667] Data derived from *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.570; *Wilder*, The Securities and Exchange Commission (SEC), 2003, Preface viii; *Securities and Exchange Commission*, 2006 Performance and Accountability Report, p.2.

[668] Also, foreign and nonprofit institutions and mutual savings banks hold a substantial amount of shares.

[669] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.5.

[670] *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.570.

Thus, the SEC must protect the growing group of small investors – although minor in size and importance – from institutional investors' superiority, so as to ensure fairness and the same initial conditions for every investor, while being criticized as superfluous by institutional investors, to whom every regulative enforcement is a mere disruption of their decisions.

v. Technological changes

Share trading in the last 15 years has undergone major changes, and thus "fundamentally changed the way markets and market participants operate, impacting regulatory and enforcement areas as well as administrative operations of the Commission"[671]: prior to the 1990, investors could administer transactions exclusively via intermediaries, i.e. brokers. Due to this unique relationship entered by sheer necessity and dominated by conflicts of interest[672], the brokerage profession was closely regulated and supervised both by federal and state law and SROs of the industry.[673]

In recent years, however, electronic communications networks (ECNs), also called alternative trading systems (ATSs), have emerged. By virtue of technology, they operate with a small staff basis, which allows them to handle large volumes without significant cost[674], and additionally generates cost cuts[675] as no brokerage commissions or dealer spreads are to be paid. However, the multitude of market places[676] inhibits price comparison, and might foster defrauding tactics as continuous supervision cannot be guaranteed – especially not if the trade takes place in a non-US online marketplace.

Thus, it is obvious that also ECNs need SEC supervision. As broker regulation is generally applicable on them[677], currently, ECNs can opt for facultative registration with the SEC like an exchange, or decide to operate without such, then operating under SEC Regulation ATS[678].

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[671] http://www.sec.gov/about/gpra1999-2000.shtml (page impression of November 7th, 2006) sub "Technological Changes"; also see *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007), p.55 for a description of the trend.
[672] Which is the fact that "the broker's incentive is to enrich himself, not necessarily the customer"; *Jickling* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.39.
[673] *Jickling* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.40.
[674] *Kitch*, Proposals for Reform on Securities Regulation: an Overview, online publication http://papers.ssrn.com/sol3/papers.cfm?abstract_id=269126 (page impression as of 6th of June, 2007), 2001, p.24.
[675] Often up to trading at no cost; *Jickling* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.37.
[676] Which amount to approximately 150 online brokerage firms; *Jickling* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.37.
[677] *Jickling* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.44.
[678] *Jickling* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.44.

Additional fields involved with new technology – information disclosure, dissemination and analysis, but also securities fraud, especially via the internet[679] – required changes in almost all fields of the SEC's work, especially regulatory issues, enforcement and operations[680], and continually does so for both necessity of new enactments and releases and internal operations.

vi. Inconsistency in governing law

As detailed above, governing law of the SEC consists of a vast array of congressional enactments, SEC rules and regulations, multiple federal and state judicial decisions and other documents of law. Thus, it is a grown body of law displaying "a great many inconsistencies, a considerable number of both gaps and overlaps, and in general needless complexity"[681]. This is also felt with the SEC, especially in times of growing workload: a few experts only understand the administration of each part of law, so that new staff must be trained in-house; reassignment of tasks within the organization is practically impossible.

Also, the inconsistency in statutes must be attributed to the cyclical[682] public (and, in consequence, political) support for the SEC, which generated ad body rather correcting current faults with regulation and supervision instead of creating a coherent and preventive legal framework for the SEC's work.

Scholars, for a long time, have suggested re-examination of the whole body of law, and incorporation of all necessary rules in one code replacing all existing statues, while also including parts of the administrative rulemakings and jurisprudence.[683] Although this initiative was commenced in 1968 and led to the suggestion of a code in 1978, enactment has not followed due to political differences[684], so that it can be expected that also in the future, the SEC will have to administer a large amount of statutes.

vii. Staffing

As previously discussed, the SEC's most important assets are its employees, because only their knowledge and expertise, assiduity and daily work can assure the agency excels expectations and is able to fulfill its mission. In recent years, however, qualified staff left the SEC for

[679] *Friedman*, Securities Regulation in Cyberspace, 3rd edition 2007, 2007 Supplement p.13-3.
[680] *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xxxiv.
[681] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.53.
[682] *Hall*, A Legal Solution to Government Gridlock, 2nd edition 1998, p.66.
[683] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.53.
[684] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.55.

private economy, mainly citing low compensation as primary incentive for leaving[685]: SEC's payment are not comparable to salaries paid with corporations, and, as previously discussed, has for a long time been uncompetitive compared to payments with the federal banking agencies. Additionally, as a federal agency, the SEC cannot offer as wide-spread career and advancement opportunities, and employees – especially in times of the annual registration filings or when a particular case is close to completion – have to engage in uncompensated overtime. Moreover, staff cannot receive a special pay rate for especially sought-after positions and/or locality pay adjustments, which go without saying in the private economy.[686]

As a consequence, turnover rates[687] with the SEC staff are extraordinarily high[688] and continually increasing: in 2002, it was at 5.8%, grew to 5.9%/6.3% in the following two years and reached 7.5% and 9.1% in 2005 and 2006, respectively[689]. Although those rates have significantly improved from the early 2000s[690], they are almost double[691] than with comparable positions government-wide, not only creating the necessity for continuous re-recruitment and costly adjustment to a new job[692], but also leaving a substantial number of positions unfilled.[693] Thus, the vacancy rate is consistently around 6-7%, reaching a one-time peak of 21.1% in 2003 because the positions created for administration of SOX could not be filled instantly.[694] Although new personnel can be found, lacking experience in both operational and industry issues, exacerbates the situation. This is exacerbated by the fact that the moderately growing staff base faces a sharply increasing number of registrations, reports and complaints.[695]

[685] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.59.
[686] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.59.
[687] Defined as number of employees leaving during the fiscal year divided by the total number of employees.
[688] More than three times the average in the financial services industry; Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.
[689] *Securities and Exchange Commission*, 2006 Performance and Accountability Report, p.49.
[690] In 2000, the rate was 13.7%, in 2001, still 9.1%; *Securities and Exchange Commission*, 2004 Performance and Accountability Report, , p.28.
[691] Close to 15% for overall staff in 2001, whereas the number improved until 2003 to a 6% figure – this partially due to the introduction of pay parity, but also to the "state of the economy and resulting changes in the job market"; *Hillman*, Preliminary Observations on SEC Spending and Strategic Planning, in GAO-03-969T 2003, p.12.
[692] This is especially pertinent as studies suggest that only after a 2-year period, staff becomes fully productive; *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.79
[693] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.78.
[694] *Securities and Exchange Commission*, 2004 Performance and Accountability Report, , p.28.
[695] Indeed, between 1991 and 2001, the number of reports grew more than 60%, the staff base only 29%; *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.130.

The SEC, however, has made efforts to improve the compensation issue: since 2001, the SEC has pay parity, so that their positions are equally paid to other governmental posts.[696] Furthermore, since 2003, pay-for-performance is practiced.[697] Additionally, the agency installed several work-life balance programs[698], such as scheduling flexibility, for staff's convenience, as well as training opportunities such as the SEC university.[699] By the expansion of on-campus recruiting, the SEC managed to receive a high number of applications, and will be able to satisfy its demand in employees. Seemingly, this has been successful: in a 2007 survey, the Securities and Exchange commission ranks 3rd with a 71.3% in employee satisfaction of all public agencies.[700]

However, experts recommend strongly introducing, within the agency, concepts of human resources management currently employed with the majority of corporations as to create similar conditions for staff, which would facilitate the decision for the SEC as initial employer and furthermore lead to a higher retention rate.[701]

viii. Summary

The last chapter detailed the challenges that currently occupy the SEC's attention. As most are generic, the agency vastly engages in remedial and/or proactive action, especially in regulation of novel types of securities and technological changes. Thus, overall, the agency has a clear understanding of its current and future challenges, and actively works towards their improvement.

[696] *Securities and Exchange Commission*, 2004 Performance and Accountability Report, p.28.
[697] *Securities and Exchange Commission,* Annual Report 2003, p.5.
[698] Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.
[699] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.59.
[700] *Partnership of Public Service*, Overall Index for Employee Satisfaction and Engagement, http://bestplacestowork.org./BPTW/rankings (page impression of August 3rd, 2007)
[701] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.59.

g. Effectiveness and efficiency

The following and last chapter will elaborate on whether the SEC is effective in pursuing its mission, and whether it employs its resources efficiently in doing so. At first, the critique of the agency and its course of action will be evaluated, and reasons for the SEC's perceived excellence will be detailed. The method employed will be economic analysis of law with a focus on those theories of efficiency detailed above. Well-established in the US since the 1950s, economic analysis of law has not been as readily embraced in Germany, but by legislative demand[702] found entry into the body of research methods.

i. Overall evaluation

Most scholars[703] consider the SEC as the "most successful regulatory agency […], the most auspicious […] and the strongest commission in government" and stress their high reputation in both business and government circles. Other claim that "the importance of the SEC and its dealings with the business community in general and the accounting profession in particular is […] unquestionable"[704] and furthermore judges it as beneficial in such that the aims of securities regulation – capital market integrity and investor confidence – are fulfilled to a high degree within the US – thus is praise as "preeminent protector of capital markets"[705].

A measure of such success, Ratner sees the SEC's reputation with professional peers and students, and lists reasons for such: the "level of intelligence and integrity of staff, the flexibility and informality of many of its procedures, and its avoidance of the political and economic pitfalls"[706]. As well, the mere fact of the continuous independence of the agency from political struggles[707] and industrial ties, the absence of scandals and the attraction to highly qualified staff serves as indicator for its success.

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[702] Especially in capital market law, where „efficiency" is oftentimes stated as primary purpose of the act, e.g. in the introductory considerations to Securities Trading Act. For a resoning of the use of economic analysis, see *Möllers*, Thomas M.J.: Effizienz als Maßstab des Kapitalmarkts, ACP 208 (in printing), p. 6.

[703] For a short overview, *Hall*, A Legal Solution to Government Gridlock, 2nd edition 1998, p.5; also *Gemberg Wiesike,* Wohlverhaltensregeln beim Vertrieb von Wertpapier- und Versicherungsdienstleistungen, online-edition 2004, p.119.

[704] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, Preface viii.

[705] *Shapiro*, quoted from *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.27.

[706] *Ratner*, Securities Regulation, 2nd edition 1980, p.15.

[707] As indicated by the fact that both parties supported it throughout history; *Stigler* in *Posner; Scott,* Economics of Corporation Law and Securities Regulation, 1980, p.347.

Also the investing public – both Americans and foreigners – applause the high level of disclosure and the stringent enforcement policy of the SEC.[708] This recognition has also been expressed by the steadily growing capital influx into the US. At last, in its relationship with the entities and persons it supervises, the SEC is known for its high level of professionalism, fairness and integrity. Thus, the economy does not perceive the SEC as an enemy, but rather as a cooperative partner to consult with, and as a means of sensible control economy-wide.

Other, i.e. quantified measurements of the SEC's success are difficult to conceive. Also, it is difficult to measure the positive effects of single acts or their administration: e.g. it is impossible to say whether the benefits of the registration and updating requirements complying with SEA 1934 are of any use to the public, and if, whether that benefit if efficient in that it outnumbers the cost of the companies which have to prepare the information and file it. Scholars, in general, strongly underline the cost caused to the individual companies[709], and it is also imaginable that such registration and publication requirements might deter otherwise successful companies from issuing share on the public market but rather in a smaller private form of capital procurement, so that chances for economic growth are lost. Futhermore, the SEC is not the only agency acting on the goal of capital market stability: also, the CFTC is involved, and so is the FED[710], so that in the resolution of a crisis cannot be attributed to the actions of one agency alone.

However, the historical development indicates that the agency did reach its goals: as previously mentioned, the SEC was instituted in a time when investor confidence was on its all-time low, expressing the distrust investors felt for a stock market where fraud and insider dealings reigned. Even in this critical situation, the newly founded authority proved worthy of its government's trust, and reached its aim: slowly, investor confidence was restored[711] and investors returned to the market. For the next 60 years, investors would trust the stock market to be a relatively secure and lucrative investment.[712] Even sharp price declines in the stock

[708] *Ratner*, Securities Regulation, 2nd edition 1980, p.15.
[709] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.55.
[710] For instance, in the current banking crisis, the FED prime rate, which pumped money into the banking market and thus prevented banks' insolvencies; *Schrörs*, Mark/*Osman*, Yasmin/*Maier*, Angela/*Müller*, Ulrike Heike: Krise zwingt FED zu Kehrtwende, http://www.ftd.de/boersen_maerkte/ marktberichte/254897.html (page impression of November 23rd, 2007). Whether the FED's action was prompted by the crisis of the industry it supervises, or whether the stabilisation of the capital market was its primary goal, cannot be determined.
[711] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.2.
[712] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.2.

market, such as on Oct. 18th, 1987, did not lead to a total collapse of the markets[713], shrinking market credibility with the investors or irrevocable damage to the economy.

It would be a fallacy to deduct SEC's efficiency from the occurrence of scandals or fraud on the capital market. As history has shown, times of a prospering economy bring about a cycle of growth, "excess, and then abuse, corporate scandal, and reform"[714]. It is unrealistic that the work of an organization could stop such cycles, which are based on typically human behavior, from happening, so that the SEC's work must not be measured on the existence of such cases. Rather, SEC's work must be judged according to the impact such averse development had on both the economy and the investing public. Since the SEC's installation, the belief in the integrity of the capital market has increased, and although shattered by severs scandals, has recovered quickly. Also, level of investment, especially of private persons, is on a high. This faith of the investors in the capital market must – at least partially – be attributed to successful federal legislation, and to the continuous work and control of the SEC.

ii. Specific criticism

Inevitably, the SEC also faces criticism; whereas it is interesting that the latter is not systematic[715], i.e. questioning the agency itself or its strategic orientation, but rather specific, i.e. on current approaches and/or a detailed course of action. This detail, once again, underlines the high level of acceptance the SEC has gained.

Primarily, small firms and individuals charged for violation of securities law complain about harsh treatment far inappropriate for the charged violation and its overall importance.[716] At first, the viability of this argument is somewhat questionable, as culprits rarely will accept and appreciate the sanctions they are charged with. Even if one considers such complaints as licit, it must be understood that in the field of securities law, a huge component of regulatory success is generated by the lever of deterrence. Thus, the sanction applied to a specific tortfeasor might be inappropriate to him, but necessary in order to deter the multitude of market participants who might consider engaging in similar lesion of law. Also, the securities industry complains that SEC's work and publicity emphasizes fraud and other wrongdoing in the industry, but does not promote positive development within the industry and help to make the

[713] *Koslow*, The Securities and Exchange Commission, 1990, p.18.
[714] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.69.
[715] *Posner/Scott,* Economics of Corporation Law and Securities Regulation, 1980, p.346.
[716] *Ratner*, Securities Regulation, 2nd edition 1980, p.15.

securities industry internationally competitive.[717] But, likewise as above, it must be underlined that the deterrence of other market participants, and also the raising of awareness within the investing public, is judged of higher value that the reputation of the securities industry, and that, within this consideration, the current path is justified.

Also, investor protection organizations utter that the disclosure policies do not provide investors with all information necessary to make sensible investment decision.[718] Among such can be counted the fact that EDGAR and IARD are able to provide for collection, storage and retrieval of data, but do not sort or analyze the information in a sensible way, e.g. by creating trends and developments.[719] This, of course, does not only inhibit investors, but also SEC officials who have either manually develop or to retrieve this kind of analysis with third parties' systems. However, also this is a political decision – SEC's budget currently covers maintenance and infrastructure needs, but does not provide for any system enhancement or additional staff to develop system enhancements.[720]

Furthermore, economists deem SEC's processes as lacking consideration for economic development and efficient capital allocation.[721] This relates, on the one hand, to the delay between filing, review and the issuance of interpretative guidance[722] and /or no-action letters, which has steadily increased during the last years[723], condemning issuers to not pursue their plans for a long period until SEC reaction took place. Such delays, especially with highly competitive branches relying on an internationally flexible market, can seriously harm competition and industry efficiency.[724]

Also, the choice of cases which are pursued often is criticized: on the one hand, high-ranking staff of the SEC has incentives to choose only cases with a certain publicity factor and/or a high amount of damages, so that a big and media-covered success would spur their careers[725], not necessarily inside the SEC, but also in business. Smaller cases of equal criminal intent and similar importance to the goal of investor protection might be omitted with those selection

[717] *Ratner*, Securities Regulation, 2nd edition 1980, p.15.
[718] *Ratner*, Securities Regulation, 2nd edition 1980, p.15.
[719] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.73.
[720] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.73.
[721] *Ratner*, Securities Regulation, 2nd edition 1980, p.15.
[722] Often also called "safe harbour" rules, as compliance is ensured when all the interpretative suggestions are followed; *Hazen,* Federal Securities Law, 2nd edition 2003, p.5.
[723] *Herz et al.*, The Coopers & Lybrand SEC Manual, 7th edition 1997, p.29.
[724] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.68.
[725] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.129.

parameters. On the other hand, external whistleblowers such as former employees or competitors might easily start investigations and thus occupy its resources on a case or a certain industry to the detriment of overall supervision. A reactive supervisory approach, thus, at least needs supplementary means of control, so that fairness in the choice of pursued cases is ensured.[726]

It must also be understood that SEC's work is a constant struggle between the highest possible security for investors and reasonable effort on the side of both the filing company and the SEC. Registration is a lengthy and costly process, so that it must be ensured that a company deciding to issue shares can do so without being totally absorbed by complying with registration instead of focusing on their daily business. Today, most corporations of a certain size maintain staff exclusively occupied to conform with SEC rules and regulation[727], which is a huge cost factor. Also, economic theory suggests that voluntary disclosure by companies would be in the best interests of stockholders, so that mandatory disclosure is judged as superfluous: when being free in their decision, management would publish only such and so much information that the cost of preparation and information supply would equal the marginal revenue to the stockholders derived from this disclosure.[728] However, such argumentation neglects that not only investor confidence, but also capital market integrity is the goal of securities regulation and SEC's daily operations, and that for fulfillment of such a premise a higher amount of information is necessary than just for providing a decision base for current stockholders.

Many complaints have arisen in the last years claiming that the SEC is overworked and cannot react as quickly as necessary for both economically sensible supervision and quick enforcement. Substantial delays in the turnaround-time for regulatory and oversight activities, and investigations, less frequent[729] and less thorough review of filings and selectiveness in enforcement actions have been observed[730] as to alleviate the workload. Unfortunately, these observations are justified: whereas SEC staff has grown between 9 and 166% in the last decade, the workload in different fields has increased from 60 to 264%[731] – a clear misalignment.

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[726] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.129.
[727] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.92.
[728] *Benston* in *Posner/Scott,* Economics of Corporation Law and Securities Regulation, 1980, p.364.
[729] Actually, in 2001, only 16% of all filings were reviewed, and thus the target of 30-35% was by far missed; *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.86.
[730] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.64.
[731] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.66.

However, reasons for this do not lie within the SEC: the decision on how much budget, and thus staff, is attributed to the organization is a political one. Thus, if corporations complain about high capital market regulation, and staff is deducted from the SEC, the SEC has to decide on which fields to allocate staff – which inevitably leads to some field being underrepresented.

Another point of criticism is the fact that securities law – unlike banking regulation[732] – requires that new products or other market innovations are approved before market issuance, so that the time the SEC takes to grant this approval severely slows down IPOs or other new issues in the securities market[733], especially as more and more such innovative ideas are developed and registered, and SEC work overload inhibits quick completion of the review process. However, it must be underlined that this structure was a legislative strategy: review prior to supervision ensures that offers on the market are subjected to a test of fairness and legitimacy as to investors, even if this process is cumbersome. Also, review and approval takes less resources[734] than constant and more in-depth market supervision as to determine newly introduced and potentially harmful products. This legislative decision standing, the only alleviation to issuers would be to enhance SEC resources as to speed review to a timeframe not (or less) impeding innovation.

Also, the critique regards the SEC's bearing dealings with stock exchanges, especially the powerful NYSE, and other important players of the security industry, such as big dealer-broker firms or investment advisors.[735] Criticism mainly comes from political actors, and from investor protection organizations who allege cooperation. Also, the SEC itself admits that its strategy of delegating authority to self-regulation "has resulted in frustration"[736] in the field of market regulation: exchanges make their own rules, so the SEC cannot institute the reforms it considers necessary unless the exchanges consent – or Congress prescribes those changes. Thus, immediate action is hindered or must be achieved by indirect rulemaking.[737]

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[732] Which generally tolerates all innovation, unless explicitly prohibited, so that a new product can be introduced and only then will be subjected to controls.
[733] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.81.
[734] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.81.
[735] *Ratner*, Securities Regulation, 2nd edition 1980, p.15.
[736] *Koslow*, The Securities and Exchange Commission, 1990, p.84.
[737] Such as the virtual "abolition" of floor trading in the 1960, which was achieved by prescribing an exam on NYSE and SEC regulations and daily reports of all trades; *Koslow*, The Securities and Exchange Commission, 1990, p.85.

At last, scholars criticize that such enormous power which rests with the Commissioners should be transferred by a vote, and not by appointment of the president. It is claimed that this procedure violates the very principle of democracy. However, this argument which is generally powerful, must be refuted insofar as the SEC is not a "general" agency, but works in a special field, so that it is essential for its success "to rely on a cops of professionals"[738] rather than on politicians. Also, a stable and continuous policy in the field of securities regulation can much easier be achieved when those administering securities law are not reliant on voters, and do not have to adapt their actions to the en-vogue political trends.

iii. Reasons for efficiency of operations

1. Employment policy and organizational design

The SEC has flourished in public recognition and effectiveness due to its excellent personnel, indeed, it has been said that its reputation as the best of the regulatory agencies "is […] due to the quality of the employees it has always managed to attract"[739]. From the very beginning of its existence until today, highly qualified lawyers, accountants and other academics feel drawn to the institution[740], and contribute to its continuous success story. Especially, the level of expertise among senior staff is remarkable.[741] Thus, the SEC holds the current experts in capital market law with the necessary knowledge and experience[742], which then also engage in the education of their successors, so that the high level of staff knowledge is maintained through SEC's history and also in the future.

Also, the SEC did not engage in the pitfalls of employing too many – or too few – staff: during its history, the number of employees grew with the increasing responsibility of the agency, and stagnated or dropped when no new fields of operation had to be handled:[743]

[738] *Koslow*, The Securities and Exchange Commission, 1990, p.76.
[739] *Koslow*, The Securities and Exchange Commission, 1990, p.93.
[740] *Ratner*, Securities Regulation, 2nd edition 1980, p.15.
[741] *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.619.
[742] *Altendorfer*, Die US-amerikanische Kapitalmarktaufsicht (SEC) – Ein Modell für Österreich? 1995, p.43.
[743] Data derived from *Ratner*, Securities Regulation, 2nd edition 1980, p.15; *Wilder*, The Securities and Exchange Commission (SEC), 2003, Introduction xiii, xxxvi; p.56; *Koslow*, The Securities and Exchange Commission, 1990, p.36.

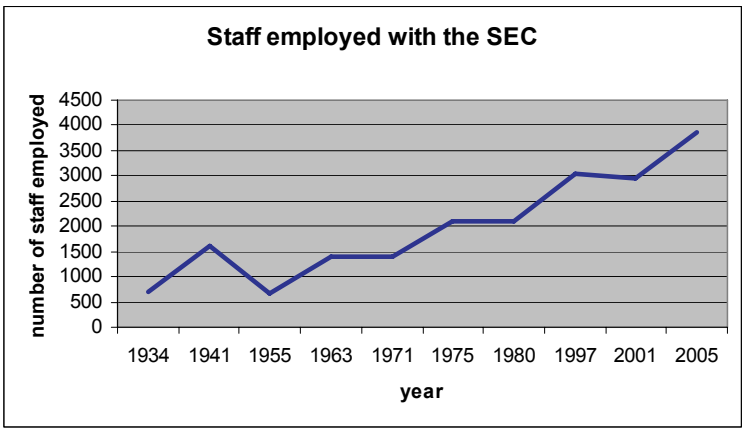

Chart 10: SEC staff employed

Thus, the SEC ensured efficiency in such that no resources were spent on additional staff in times when only routine tasks had to be effectuated – resources that were employed in times of need, and then enabled the agency to quickly add to their personnel and react to the challenges legislation or market development provided.

Furthermore, it must be underlined that the organizational design of the SEC provides for high efficiency of its work. The flexibility of the divisions is ensured by their variable organizational design: the Division of Corporation Finance, for example, is divided into industry lines and sectors, as those display differences in accounting and reporting needs. Thus, experts can answer to the demands of the respective sectors.

At last, the SEC has never surrendered to conflicts of interests, or corruption scandals that are day-to-day problems of many federal agencies. This is mainly due to comprehensive rules of conduct for employees existing since the beginnings of the SEC[744], and their strict enforcement. Rules relate to the acceptance of gifts or gratuities, the engagement in outside employment or the arising of conflicts out of personal financial interests; high-level employees must file with the Chairman of the Civil Service Commission their securities holdings, creditors and property interests.[745] Disciplinary action is taken as reaction to any non-compliance, not only relying to those statues, but to generally business practices: employees are expected to meet their debt appointments, and to file and pay their federal, state and local taxes in a proper and timely manner.[746]

[744] Actually, the first draft was adopted in 1953; *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.59.
[745] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.60.
[746] *Loss/Seligman*, Fundamentals of Securities Regulation, 4th edition 2003, p.61.

2. Administrative approach basing on cooperation

One of the most deciding factors of SEC's efficiency is its means of operations: the organization once opted for providing advice and interpretative help for those entities and professionals it supervises – in short, the display of a very "integrating approach"[747]. Thus, prior to the happening of any lesion of law, guidelines for correct behavior are given, and possible problems can be avoided. This counseling, which is not a core activity conferred to the SEC by law, has significant influence on SEC's status: on the one hand, the supervised entities highly appreciate the support and accept the non-adversarial[748] approach better than they would any strict supervision. On the other hand, conferring prior to problematic events and developments reduces the subsequent workload of a SEC division substantially.[749]

Also, the SEC relies heavily on "outsorcing"[750] supervision to SROs and other self-governing mechanisms, which is a supplement proven useful[751] to strong regulation in terms of both standard-setting and disciplining SRO members. The advantages of this approach are clear: besides expert knowledge and proximity to the market, SROs are flexible and intent on developing standards out of already accepted best practices, which contributes to high acceptance.[752] To this policy, also the encouragement of self-reporting and self-correction, by incentive of correction without sanction or milder sanctioning[753], can be counted. Indeed, as Hall claims, "the whole premise of the SEC is to depend on self-discipline, self-regulation and make it worthwhile for people in the industry to police themselves"[754]. However, this cooperative approach seems to be valid especially in matters of securities supervision, whereas in accounting and reporting matters, the SEC does not display much leniency or room for discussion as to the applicability of rules.[755]

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[747] *Altendorfer*, Die US-amerikanische Kapitalmarktaufsicht (SEC) – Ein Modell für Österreich? 1995, p.19.
[748] *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.620.
[749] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.41.
[750] Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.
[751] *Black*, The Legal and Institutional Preconditions for Strong Securities Markets, in 49 UCLA L. Rev. 781, p.800.
[752] *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007), p.46 et seq.
[753] The Commission's report details cooperation as follows: self-policing prior to discovery, disclosure to public, regulators and self-regulators, remediation and compensation, and cooperation with law enforcement authorities; *Bloomenthal/Wolff*, Emerging Trends in Securities Law, 2005-2006 edition, 2005, p.658 f. Other sources cite different criteria: existence of internal controls for a self-policing mechanism, prompt report, extent of cooperation with law enforcement authorities, disciplinary action against persons responsible; *Hazen*, The Law of Securities Regulation, 5th edition 2005, p.696.F
[754] *Hall*, A Legal Solution to Government Gridlock, 2nd edition 1998, p.110.
[755] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.78.

Most important, in recent days, has become the industry organization in SRO, while thus ensuring supervision and rule-making outside of the SEC itself.[756] The organization's strategy since the earliest days, but broadly advertised since the enactment of SOX[757], it saves the organization major resources, while leading to a high level of awareness of possible violations within companies, which finally promotes correction. Likewise, the SEC does not regulate all fields of securities law, but relies on self-regulating bodies of the industry and professional groups.[758] Although discussion arose whether this course of action is legal and how the procedural provisions could be safeguarded, and scandals in the 1970s and early 2000s raised doubt about the integrity of self-regulating bodies[759], the SEC has maintained this concept, but extended its supervision, due to the fact that it was deemed as overall beneficial: on the one hand, the SEC saves a gigantic workload, and in consequence personal and monetary resources. On the other hand, acceptance among the supervised entities and professionals is likely to be higher than with supervision of a governmental agency, because they trust their peers and confide in their integrity and professional expertise.

Moreover, the system of disclosure enforcement – instead of supervision of the actual company situation – has been a wise decision of how to attack securities regulation: it can "effectively deter improper conduct in financial dealings an increase the probability that, if such illegal conduct does occur, it will be corrected"[760] while it maintains flexibility, individuality in decision-making in revision and judicial control and an adequate amount of resources compared to the aim by the definition of unchangeable processes and the possibility of routine random sampling controls. Also, as hard as interpretations of the regulation may be contested among the supervised entities, the process of disclosure regulation and enforcement has never been criticized and also is not easily attacked by coalitions of lobbyists, industry leaders and the like.[761] Also, market participants generally appreciate the mandated disclosure because they have learned that it enhances their business, and that non-compliance damages their reputation and market power.[762] Thus, the one-time strategic decision for disclosure enforcement has led to reinforcing tendencies in securities regulation – and thus saves the SEC substantial effort, while ensuring a high level of efficiency.

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[756] http://www.sec.gov/about/gpra1999-2000.shtml (page impression of November 7th, 2006) sub "SEC Environment"
[757] The so-called Leon-Meredith Report defines guidelines for such action; *Mahoney et al.* in *Kasner/Vanyo,* Securities Litigation & Enforcement institute 2004, 2004, p.375, 407.
[758] For a detailed description of the entities involved, see above.
[759] *Ratner*, Securities Regulation, 2nd edition 1980, p.17.
[760] *Hall*, A Legal Solution to Government Gridlock, 2nd edition 1998, p.133.
[761] *Hall*, A Legal Solution to Government Gridlock, 2nd edition 1998, p.134.
[762] *Hall*, A Legal Solution to Government Gridlock, 2nd edition 1998, p.137.

This is also reinforced by the SEC's information policy towards the investing public: the agency vividly believes that well-informed investors are one of the most effective protection mechanisms against securities fraud. Thus, in various informative prospectuses, online information, meetings and other initiatives it educates investors, and is rewarded by higher awareness of the risks and closer monitoring by investors themselves. This does not only prevent some cases of fraud and other securities law violation, but also leads to a large number of investor complains, which are a very important source for investigation to the SEC.

3. High amount of independence

An additional factor which greatly enhances both effectiveness and efficiency is the vast authority Congress delegates to the SEC – some scholars, indeed, view the SEC as a kind of sub-government[763] or "superagency"[764] and thus as a substantial part of US political and administrative landscape. Especially with SOX[765], the SEC was responsible for the design of the rules and regulations, which would effectuate the enacted provisions. Thus, the SEC could provide for rules which, according to its knowledge, would meet the acceptance of their supervised entities, be practical and less burdensome to observe and easily to be administered.

This model is based on the close contact of the SEC and its supervised entities, and of its expertise in the supervision of regulations. It could only be established through close cooperation of the SEC's different divisions, and, even more important, of the SEC and affected parties, mostly industry representatives[766]. Also, the public is included[767] in the rule-making process by early publication and the possibility to comment and suggest changes. Likewise, enforcement is handled flexibly, as the SEC "possesses a broad range of devices that afford it significant flexibility in enforcing the federal securities law in a myriad of situations"[768].

Thus, the SEC's authority and flexibility displays several advantages: on the one hand, the SEC will issue rules as lenient or as strict as it perceives the necessity[769]. Thus, overruling is

[763] I.e. a "cluster of individuals that effectively make most of the routine decisions in a given substantive area of policy"; *Hall*, A Legal Solution to Government Gridlock, 2nd edition 1998, p.8.
[764] *Hazen,* Federal Securities Law, 2nd edition 2003, p.4.
[765] *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.59.
[766] *Budd/Wolfson*, Securities Regulation, 1984, p.2.
[767] *Budd/Wolfson*, Securities Regulation, 1984, p.2.
[768] *Gilchrist*, Commentary: Turning up the heat: the SEC's new temporary freeze authority, in 56 Ala. L. Rev. 873, p.879.
[769] As with several provisions of SOX, where the SEC issued regulation stricter than the act itself, e.g. sec. 802 stipulates a period of retention of journals of 5 years, the SEC regulation of 7 years; *Budd/Wolfson*, Securities Regulation, 1984, p.2.

avoided[770], and so is the involuntary creation of loopholes, which are both factors contributing to economic efficiency. Likewise, the irritation often caused by the trial-and-error system of rule enactment and rapid changes to adapt them to practice, can be avoided. Delegation of rule-making authority also allows quick adaptation of the enactment to the current situation: if the SEC conceives that the current rules are too strict or not stringent enough, it can rapidly change them without having to undergo the complete legislative process. Additionally, chances are that rules instituted by a body which is in close contact with its supervised entities will meet greater acceptance, and thus be observed to a higher degree. At last, the SEC itself knows best rules of which kind can be administered with the smallest effort and thus cost, and will thus strive to institute only such. The same argumentation is viable for SEC's power to further delegate regulatory and law-interpretative power, such as the PCAOB, and the agency's "wide discretion over the magnitude of penalties and rewards"[771].

Furthermore, SEC's sanctioning competencies are extraordinarily high: the agency can prevent brokers and dealers from acting on the capital market, defer the trading of a security, revoke the registration of a share and even close an exchange for a certain period of time. This quick action, which is conducted with administrative proceedings, enables the agency to quickly react to all developments which might endanger investors' interests and thus is a powerful means of action. In this regard, also authority for the commencement of civil action by the SEC must be mentioned[772], as the mere possibility of such enhances the deterring effect for wrongful behavior on the side of the supervised entities.

4. Evaluation of action

Another most significant factor for SEC's beneficial work is that the institution is aware of the immense impact of their supervision on the economy, and their constant effort[773] to eliminate negative consequences before action, or to minimize them if unavoidable. Thus, for all

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[770] A common example is Sarbanes-Oxley Act 2002, sec. 401, which requires disclosure of off-balance sheet transactions, which "may have" material effect on the company's performance [wording of the Act], changed by subsequent SEC rules to disclosure of such transactions only which are "reasonably likely" to have material effect. Thus, companies which have multiple legitimate off-balance sheet transactions must not disclose them – and save time and cost, as does the SEC; *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.72.
Another example are the multiple exemption the SEC grants to companies of minor size and scope, for instance the exemption from the audit rotation practice requested in Sarbanes-Oxley Act 2002, sec. 203, which the SEC allows for audit firms with less than 10 partners and serving less than five audit clients. Thus, difficulties in scheduling can be avoided. *Skousen*, An introduction to Corporate Governance and the SEC, 5th edition 2005, p.77.
[771] *Hall*, A Legal Solution to Government Gridlock, 2nd edition 1998, p.141.
[772] *Altendorfer*, Die US-amerikanische Kapitalmarktaufsicht (SEC) – Ein Modell für Österreich? 1995, p.43.
[773] *Ratner*, Securities Regulation, 2nd edition 1980, p.15.

legislative proposals, the development of rules and regulations and even for some individual SEC actions, an economic impact analysis is effectuated.[774] Oftentimes, when the result of such analysis is negative, it is still possible to adapt the originally intended course of action to a less detrimental one, so that the same aim is reached by less private[775] or social[776] cost involved. This constant watch-out for the best way drives a high effectiveness and efficiency, and avoids overruling as well as leniency. By this assessment of external factors, regulatory answer and reaction of the market, SEC's current approach could be called "a result of capital market crises"[777] – and their successful avoidance.

Also, the SEC employs the instrument of market analysis, economic analysis of law and scenario planning in order to determine current necessity of action and the best way of implementation. As early as 1963, a thorough studies of the securities market, its participants and the regulatory pattern[778] was ordered, which until today serves as a basis for debate of new legislation. The so-called Wheat-Report of 1967[779], and a second market study during the 1970s[780], updated this information and allowed to amend legislation to the changed situation in the securities industry. Also, for all new project and evaluation of work, the Directorate of Economic Analysis[781] is engaged in providing scientific research, scenario planning and evaluation of impact of the course of action, which frequently provide the groundwork for new legislation.[782]

Thus, is can be ensured that SEC's action, to the best of current scientific economic knowledge, is efficient and does, overall, not prove detrimental to the supervised entities/industries even if it sanctions sharply. Although such means of analysis exist for most fields of governmental engagement, most agencies do not at all or not as actively employ this means, so that the SEC's approach must be cited as exceptionally worthwhile. The same is valid for SEC's performance measurement system, which is not only a one-time attempt, but evolves and is continually evaluated and adjusted to mirror the agency's new approaches and the development of the capital market. Thus, the measurements "of the results of regulatory activity by

[774] Leading to a total of 124 reviews of proposed rules and 81 regulatory flexibility analyses in fiscal 2003, *Securities and Exchange Commission,* Annual Report 2003, p.81.
[775] I.e. on the side of the supervised entity.
[776] I.e. for the economy as a whole.
[777] Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.
[778] *Ratner*, Securities Regulation, 2nd edition 1980, p.11.
[779] *Ratner*, Securities Regulation, 2nd edition 1980, p.14.
[780] *Ratner*, Securities Regulation, 2nd edition 1980, p.13.
[781] For a detailed description, see above.
[782] *Seligman*, The Transformation of Wall Street, 3rd edition 2003, p.619.

macroeconomic indicators"[783] must be judged favorably for both reasons of internal performance control and information to the capital market and its participants. A strategic plan[784] – derived from previous performance measurements, and linked to SEC's goals and objectives, completes this picture of a strategically oriented and led agency.

iv. Recent initiative for further improvement

Scholars, based on the critiques presented above, have also uttered some way of how to improve SEC's performance. Most importantly, this touched the areas of budgeting[785] and human resources[786], for which a more strategic planning process is deemed necessary. Also, performance measurement was criticized for evaluating "outputs, not outcomes"[787], which sets adverse internal incentives. Concurring with the SEC's concern about organizational excellence, the suggestions have been readily embraced and currently face operational implementation within multiple initiatives.[788]

v. Summary

The previous chapter gave an overview about the current evaluation of the SEC's effectiveness and efficiency, and cited important critique as well as reasons for the organization's high reputation and seeming success. Thus, it can be concluded that the SEC, despite minor fields in which improvement could be effectuated, has reached a high level of excellence. As many current initiatives are aimed at maintaining and/or enhancing the latter, it can be expected that the organization will continue its success story also in the future.

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[783] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.42.
[784] Downloadable http://www.sec.gov/about/secstratplan0409.pdf (page impression of August 1st, 2007).
[785] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.82.
[786] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.84.
[787] *Hillman* in *Wilder*, The Securities and Exchange Commission (SEC), 2003, p.85.
[788] For instance, in July 2006, the SEC implemented its Budget and Program Performance Analysis System (BPPAS), which is based on the principle of activity-based costing and initiates budgeting on a performance basis; *Securities and Exchange Commission*, 2006 Performance and Accountability Report, p.19.

C. The German Federal Financial Supervisory Authority (BaFin)

The Federal Financial Supervisory Authority (BaFin) is a German federal agency with the capital market – banking, insurance and stock markets – as its field of action. The following chapter will elaborate on the history of BaFin's three predecessors and on BaFin's founding and development 2002. Also, the agency's organizational structure, its governing law and the ensuing operations will be outlined, and a short estimate of current challenges and success factors for effectiveness and efficiency will be given.

a. Historical development

Capital market supervision in Germany has traditionally been a weak field of governmental involvement[789]. Whereas banking and insurance supervision have been installed already in the early days of the last century, securities market supervision is a product of the latest days. Also, BaFin is a young public agency, being instituted May 1st, 2002 as successor of all three BAKred, BAWe and BAV. Whereas the latter acted independently while maintaining functional separation of tasks[790], BaFin will engage in all areas of "fair play" in financial markets.[791] In the following, the history of capital markets in Germany and the history of BaFin's three predecessors will be detailed.

i. Establishment of capital markets and early development

Stock trading, as all over Europe, has made early appeals in Germany: already in 1585, the Frankfurt stock exchange was founded[792], and has traded since then. By 1920, many regional exchanges had made their appearance, the most important being Berlin, Frankfurt, Hamburg, Essen, Dresden and Cologne with Berlin and Frankfurt acting as supervisor for the adjustment of engagement. This led to strong cooperation of the exchanges, so that they would act like a single market.[793] Participation was strong, and so was investor confidence – until the world-wide market crash in 1929.

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[789] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.71.
[790] Mainly, certification and solvency supervision by the BAKred and market supervision by BAWe, but also market supervision in opposition to supervision of individual entities.
[791] *Schieber*, Die Aufsicht über Finanzkonglomerate: das Aufsichtsrecht der Finanzdienstleistungsunternehmen im Spannungsfeld zwischen Gruppen- und Einzelinstitutsaufsicht; 1998, p.83.
[792] *Eichel*, Speech at the IOSCO Technical Committee Conference, 5th of October, 2005, as on the documentary CD-ROM of the conference, p.2.
[793] *Merkt*, in *Hopt et al.*, Börsenreform – eine ökonomische, rechtsvergleichende und rechtspolitische Untersuchung, 1997, p.100.

The closing of July 11th, 1931 until early 1932 due to financial instability and the later alignment of all exchanges in early 1934 initiated a phase of low participation in share trading, which was only ended after the Second World War by the successive re-opening of all exchanges in a span between 1945 and 1949[794]. Numerous enactments spurred the development of the capital market[795], however, only in the late 1950s, the exchanges and their stock trade slowly began to increase, but was still insufficiently frequented[796] to supply the recovering economy. A number of reforms to strengthen small investors' position, regulating, among others, publicity and transparency requirements, finally spurred the growth.

ii. The BAKred 1934-2002

Banking regulation, as in most countries worldwide, was introduced in Germany in 1934 as a result to the global economic crisis in the early 1930.[797] Thus the government provided rule sets for banks to maintain a certain level of own funds as to avoid the situation in which a bank would fall bankrupt due to lacking solvency. This protectionist legislation was not only due to the fact that a banking insolvency would crush the fortunes of its clients, but also as to guarantee system stability: as soon as people would become aware of such banking crises, they would avoid confiding their money to banks, thus the economy would suffer from a lack of capital influx.

Whereas the Federal Supervisory Authority for Banking (Reichsaufsichtsamt für das Kreditwesen) maintained supervision only from 1939 until 1945, it was the federal states with which authority for banking supervision laid during the period from 1948 to 1961, when BAKred, again a federal agency, evolved.[798] BAKred acted in so-called prudential regulation, i.e. the control of the supervised entities' solvency and internal organizational structure[799], concerning mainly provisions in the Banking Act (KWG). BAKred, due to the wide array of tasks, always had been a well-staffed agency: it employed, in late 2001, 620 people[800], all of which were transferred to BaFin.

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[794] Hamburg re-opened the over-the-counter market already on July 9th, 1945, others followed quickly; official quotation was only granted since 1949; *Merkt*, in *Hopt et al.*, Börsenreform – eine ökonomische, rechtsvergleichende und rechtspolitische Untersuchung, 1997, p.106.
[795] For details, see list on *Merkt*, in *Hopt et al.*, Börsenreform – eine ökonomische, rechtsvergleichende und rechtspolitische Untersuchung, 1997, p.108.
[796] *Merkt*, in *Hopt et al.*, Börsenreform – eine ökonomische, rechtsvergleichende und rechtspolitische Untersuchung, 1997, p.112.
[797] *Gemberg Wiesike,* Wohlverhaltensregeln beim Vertrieb von Wertpapier- und Versicherungsdienstleistungen, online-edition 2004, p.27; *Claussen*, Bank- und Börsenrecht, 3rd edition 2003, p.14, 51.
[798] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.72.
[799] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.128.
[800] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2002, p.174.

During all of its existence, BaKred cooperated closely with the German Federal Bank, as this institution is the second supervisor in the banking industry. In this regard, the BAKred was the main authority, and had only to consult the German Federal Bank in a certain range of matters.[801] However, after the introduction of the Euro as single currency, the German Federal Bank launched a public campaign to integrate BAKred into its organizational structure and to become, as a consequence, the one and only supervisor for the banking sector.[802] Although this strategy did not work out, it safeguarded the German Federal Bank's position as the second supervisor in the field of banking, which it maintains until today.

iii. The BAV 1901-2002

BAV, the supervisory authority for insurance, has existed for quite a while: already in 1901, the "Kaiserliches Reichsaufsichtsamt für die Privatversicherung" was founded[803], and since then has supervised the insurance business in a constant fashion, but under different names. Administering mainly the Insurance Supervision Act (VAG), the BAV had a clear focus on consumer protection and supervisory control to safeguard their legitimate interests. At last employing 300 supervisors[804], BAV was rather small compared to its set of tasks.

BAV assumed, for all three agencies and as well for the German Federal Bank, the coordination of international cooperation: in case of requests, all agencies would gather the needed information, and BAV would pass it on to the supervisory bodies in third countries or international cooperative councils such das IOSCO.[805]

iv. The BAWe 1994-2002

Already in 1873, both scholars of law and of economics recommended the institution of a supervisory agency for share trading, and reinforced their claim after the First World War, which caused a severe economic crisis.[806] Also, the reform of the law of shares and share trading in the late 1960s was an occasion at which a supervisory institution was discussed. However, the legislator opted for private control by reinforcing shareholders' rights. Thus, only in

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[801] *Herdegen*, Bundesbank und Bankenaufsicht: Verfassungsrechtliche Fragen, in WM 2000 2121, p.2121.
[802] *Schüler*, Integrated Financial Supervision in Germany, online publication 2004; ftp://ftp.zew.de/pub/zew-docs/dp/dp0435.pdf (download June 6th, 2007), p.12; *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.263 for extensive coverage of the subject matter.
[803] *Fricke*, Versicherungsaufsicht integriert – Versicherungsaufsicht unter dem Gesetz über die integrierte Finanzdienstleistungsaufsicht, in NVerZ 2002 337, p.337.
[804] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2002, p.174.
[805] *Siebel/zu Löwenstein*, German Capital Market Law, 1995, p.14.
[806] *Schacht,*Die deutsche Kapitalmarktaufsicht im internationalen Vergleich, 1980, p.1 et seq.

1994, the BAWe was founded[807] to begin operations on January 1st, 1995 with the aim to adapt the German market supervision to the global standard, especially with regard to insider trading.[808] It was organized as an independent higher federal authority and, likewise as today, had a Securities Council as advisory body.[809]

Administering uniquely[810] the Securities Trading Act (WpHG), the BAW held a mere 160 staff and had been a very small public agency.[811] It effectuated supervision of financial services agencies and also other entities which conducted business of a certain type[812] for their clients, so that the supervisory approach has been (and still is) both functional (concerning a range of products/services) and institutional (concerning a range of specified businesses).[813] However, was not to be classified as a general market supervision authority, as its competency was clearly limited and important participants of the market had already been under supervision of the BAKred, BAV and exchange authorities.[814]

v. Institution of the BaFin in 2002

Already in 1975, Richter urgently recommended to institute a supervisory authority with extensive competencies, among others in the field of ad-hoc disclosure and supervision of auditors, but also the maintenance of a central register for share-issuing companies.[815] But only in the course of issuance of various European directives on capital market law, it became obvious that the to-date supervision structure of the German capital market could not be maintained. Already in 1999, "intense discussion"[816] concerning the structure of German supervision with certain predisposition for banking supervision to lie with the German Federal Bank arose[817], but resulted in its loss of power and the decision for a one stop financial supervision due to its closer coherence with European legal provisions and a better practicability.

The merger of the three authorities had been prepared already in 2000, when they created and informal "Forum for Financial Supervision" to coordinate supervisory actions and exchange

[807] *Fenchel*, Das vierte Finanzmarktförderungsgesetz – ein Überblick, in DStR 2002 1355, p.1362.
[808] *Bundesminister der Finanzen*, Konzept Finanzplatz Deutschland, in WM 1992 420, p.422.
[809] *Siebel/zu Löwenstein*, German Capital Market Law, 1995, p.39.
[810] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.189.
[811] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2002, p.174.
[812] E.g. stock and share business, issue of securities, administration of portfolios, granting of credits and loans, investment advisory; see Securities Trading Act, sec. 2 III.
[813] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.91.
[814] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.187.
[815] *Schacht,*Die deutsche Kapitalmarktaufsicht im internationalen Vergleich, 1980, p.259.
[816] *Hagemeister*, Die neue Bundesanstalt für Finanzdienstleistungsaufsicht, in WM 2002 1773, p.1773.
[817] *Herdegen*, Bundesbank und Bankenaufsicht: Verfassungsrechtliche Fragen, in WM 2000 2121, p.2121.

knowledge and best practices[818]. A financial conglomerate merger[819] convinced both the legislator and the general public that supervision, to be effective, must maintain the same organizational structure as the corporate giants it controls. Thus, the conceived solution is based on three administrative layers: federal integrated supervision, federal states' supervision and self-regulation of exchanges, and furthermore ensures that all eight German exchanges are subjected to the same rules.[820]

Whereas federal states'[821] and self-regulatory supervision by exchanges is not in the focus of this paper, and thus will not be treated in the following, the federal central supervision for securities trade is of high interest. It had been source of vivid discussion whether such an agency should be federal or an umbrella organization of all the federal states' authorities, which then would have resided on a fourth administrative layer between federal and federal states' competencies.[822] However, time pressure and concerns about the international recognition and practicability of such a solution led to the current concept with a decentralized exchange supervision effectuated by federal states' authorities, and central market supervision effectuated by a federal agency. Such structure also favorites, by its very principle, close cooperation between the supervisory agencies.

Although a strategic decision of enormous impact, the establishment of BaFin did neither require nor include any change of the material body of law and supervisory law, as – due to the difference of the supervisory fields – BaFin's three directorates would continue as previously with supervisory tasks.[823] Thus, the decision to unify the three authorities was provided for in the Act Establishing the Federal Financial Supervisory Authority (FinDAG) and quickly realized with the founding of BaFin on May 1st, 2002.

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[818] *Binder*, Die geplante deutsche Allfinanzaufsicht und der britische Prototyp – ein vergleichender Blick auf den deutschen Referentenentwurf, in WM 2001 2230, p.2230.
[819] Of Allianz AG and Dresdner Bank AG; *Hagemeister*, Die neue Bundesanstalt für Finanzdienstleistungsaufsicht, in WM 2002 1773, p.1773.
[820] *Kümpel*, Bank- und Kapitalmarktrecht, 3rd edition 2004, p.2456.
[821] I.e. Exchange supervisory authorities (Börsenaufsichtsbehörden) in all eight federal states in which exchanges exist; for a listing see *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.287.
[822] *Kümpel*, Bank- und Kapitalmarktrecht, 3rd edition 2004, p.2457.
[823] *Binder*, Die geplante deutsche Allfinanzaufsicht und der britische Prototyp – ein vergleichender Blick auf den deutschen Referentenentwurf, in WM 2001 2230, p.2231; *Schieber*, Die Aufsicht über Finanzkonglomerate: das Aufsichtsrecht der Finanzdienstleistungsunternehmen im Spannungsfeld zwischen Gruppen- und Einzelinstitutsaufsicht; 1998, p.331. For a rationale of this decision and its evaluation, see below.

vi. Rationale

For the first time in its history, Germany has a single regulatory agency covering the supervision of credit institutions, financial services institution, insurance companies and securities traders[824], which is crucial to capital market stability: as the abovementioned fields become more and more integrated and as the German capital market virtually merges with the European and the global capital market, also supervision must opt for an integrated approach. This also was the predominant argumentation the German legislator gave for the enactment of the FinDAG.[825] This convergence does not only cover banking, securities, financial services and insurance products, but also with pension funds and other combinative or the cross-selling of products in different fields as effectuated by most entities in this industry.[826]

Also, this approach has been a response to the current structure of the financial services industry, which – by the means of mergers and acquisitions[827] – created a few financial conglomerates now being engaged into a multitude of transactions in different fields.[828] Branded by "Allfinanz"[829] or "bancassurance"[830], this development not only calls for a consistent, all-embracing corporate supervision by a single institution for reasons of consumer safety, but also out of justice considerations[831]: only a cross-sectoral supervision is aware of the economic similarity or identity of different transactions, and can guarantee identical and thus consistent treatment.

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[824] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "The Federal Financial Supervisory Authority".

[825] Gesetzesentwurf der Bundesregierung, Drucksache 14/7033, online-version http://www.jura.uni-augsburg.de/prof/ moellers/materialien/materialdateien/040_deutsche_gesetzgebungsgeschichte/findag_geschichte/ findag_pdfs/regentw_stellungn_br_findag_btdrs_14_7033.pdf (page impression of June 26th, 2007), p.1; also discussed by *Fricke*, Versicherungsaufsicht integriert – Versicherungsaufsicht unter dem Gesetz über die integrierte Finanzdienstleistungsaufsicht, in NVerZ 2002 337, p.337; *Binder*, Die geplante deutsche Allfinanzaufsicht und der britische Prototyp – ein vergleichender Blick auf den deutschen Referentenentwurf, in WM 2001 2230, p.2231.

[826] *Hagemeister*, Die neue Bundesanstalt für Finanzdienstleistungsaufsicht, in WM 2002 1773, p.1774.

[827] A famous example is the merger of the Allianz insurance with Dresdner Bank in 2001; *Schüler*, Integrated Financial Supervision in Germany, online publication 2004; ftp://ftp.zew.de/pub/zew-docs/dp/dp0435.pdf (download June 6th, 2007), p.4.

[828] *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.108.

[829] A vague term which is not unequivocally defined: whereas some deem it a marketing strategy with success potential due to cross selling and integrated financial services, others by listing types of companies engaged in Allfinanz (banks, insurances, financial services); *Schieber*, Die Aufsicht über Finanzkonglomerate: das Aufsichtsrecht der Finanzdienstleistungsunternehmen im Spannungsfeld zwischen Gruppen- und Einzelinstitutsaufsicht; 1998, p.51 et seq.

[830] *Schüler*, Integrated Financial Supervision in Germany, online publication 2004; ftp://ftp.zew.de/pub/zew-docs/dp/dp0435.pdf (download June 6th, 2007), p.1; for a critical comment on this topic, see *Hirdina*, Verfassungsrechtliche Aspekte zur Funktion einer reformierten Bundesbank bei der Allfinanzaufsicht, in BKR 2001 135, p.135 et seq.

[831] *Laars,* Bundesanstalt für Finanzdienstleistungsaufsicht, in NOMOS – Erläuterungen zum Deutschen Bundesrecht, CD-Rom version 2006, sub „Einleitung".

This structural change was also followed by regulation which now prescribes the same, or at least similar, measures of investor protection for businesses in formerly distinct branches – or, a rather "functional perspective"[832] on the regulative law. Thus, considerable parallels are recognizable in regulation of banking and securities brokers and investment companies as prescribed by the Banking and the Securities Trading Act.[833] With a one-stop agency, "regulatory arbitrage"[834] is much easier avoided, as only one agency acts and the treatment of a certain situation can be prescribed.

Furthermore, with the three independent agencies, specific regulation as to sharing information gathered by one agency, but in the realm and authority of the other, had to be followed.[835] This was especially pertinent with BAKred and BAW, both of them acting in capital market supervision („dichotomy of supervision"[836]), often to the expense of the supervised entities. With their unification, this protocol can be neglected and also the conjoined use of databases creates synergy effects. This first-hand information for all units alike did not only facilitate daily work, but also "has increased the quality of BaFin's preliminary analysis and investigations"[837], especially with regard to the spread of external experts' evaluations and statements, which now can be accessed by a broad range of employees. To the same extent, problems arising out of shared and/or unclear responsibility are avoided, because henceforth, only one agency is addressed.[838]

A further reason for integrated supervision has been the constant criticism of a multitude of international states, which deemed German capital market supervision as insufficient, and made both foreign investment services companies and individual investors somewhat reluctant to participate in the German capital market.[839] Although this situation improved tremendously with the installation of the BAWe, it was to be expected that a stronger market super-

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[832] *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007), p.7.
[833] Examples are provisions for organizational structure as in Banking Act (KWG), sec. 25a and Securities Trading Act (WpHG), sec. 33, 34a, or for safeguarding of IT-gained data as in Banking Act (KWG), sec. 25 I and Securities Trading Act (WpHG), sec. 33 I Nr.1; *Mülbert,* Bankenaufsicht und Corporate Governance – Neue Organisationsanforderungen im Finanzdienstleistungsbereich, in BKR 2006 349, p.353.
[834] *Schüler*, Integrated Financial Supervision in Germany, online publication 2004; ftp://ftp.zew.de/pub/zew-docs/dp/dp0435.pdf (download June 6th, 2007), p.3; argumenting along the same line, *Kümpel*, Zur Neugestaltung der staatlichen Börsenaufsicht – von der Rechtsaufsicht zur Marktaufsicht, in WM 1992 381, p.381.
[835] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.161.
[836] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.125.
[837] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2002, p.149.
[838] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.254.
[839] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.167.

vision agency, as created with BaFin, would also reinforce international interest in the German capital market. In the same line of argumentation lies the fact that, compared with giant international supervision agencies, the federal states' exchange supervision agencies and even BAWe could not come to level with. Also, this lack of a one-stop contact agency was said to cause irritations as requests from foreign authorities could not be directed to the pertinent agency.[840]

Additionally, most northern countries such as Norway, Denmark, Sweden and Finland had set examples of successfully operating integrated financial supervision agencies since the late 1980, a path that was followed by the UK and Austria.[841] Mainly the UK Financial Services Authority (FSA) was taken as positive example and role model[842]: integrated financial supervision is deemed an arising trend[843] in Europe, which Germany did not want to miss. Additionally, the German legislator could rely on those countries' experiences in terms of legislation, organizational design and factual operations, and thus avoid conceptual faults as well as those starting problems typical of novel governmental approaches.

At last, it was expected that the merger of three institutions would generate effects of size and scope, and thus lead both monetary savings and an enhancement of efficiency.[844] Especially as the supervised agencies, and thus indirectly the investors, have to cover those costs, it had been deemed as important to lower them as much as possible and appropriate[845], but also to grant the agency a budget sufficient for its cost. Also, supervised entities benefit from direct savings of cost and – more important – workload, as with an integrated supervision, certain notifications and reports have to be handed in only once instead of several times with different agencies.[846]

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[840] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.230.
[841] Norway established such an agency in 1986, Denmark, Sweden and Finland followed in 1988, 1991 and 1993, respectively, and the UK adopted the concept in 1997; http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Reasons for integrated financial market supervision".
[842] *Krammig/Gramlich*, Modelle (teil)integrierter Finanzmarktaufsicht in Europa – in der Schweiz und anderswo, in WM 2004 1657, p.1658; for an exhaustive description of its model character and the adopted principles for BaFin's formation, see *Binder*, Die geplante deutsche Allfinanzaufsicht und der britische Prototyp – ein vergleichender Blick auf den deutschen Referentenentwurf, in WM 2001 2230, p.2232.
[843] *Schüler*, Integrated Financial Supervision in Germany, online publication 2004; ftp://ftp.zew.de/pub/zew-docs/dp/dp0435.pdf (download June 6th, 2007), p.1; indeed, around 30% of all financial supervisors in all three sectors worldwide are have merged recently; a further 30% merged for at least two sectors; *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2004, p.9.
[844] *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.109.
[845] *Fürhoff/Schuster*, Entwicklung des Kapitalmarktaufsichtsrecht im Jahr 2002, in BKR 2003 134, p.134.
[846] *Binder*, Die geplante deutsche Allfinanzaufsicht und der britische Prototyp – ein vergleichender Blick auf den deutschen Referentenentwurf, in WM 2001 2230, p.2231.

Scholars[847] have criticized this rationale as to general and not being sufficient, and thus claim that the decision was already anticipated by further factors, such as the European directives. Also, it had been mentioned that conglomeration might well have invaded the banking and financial services sector, but did not touch as gravely the insurance business. Likewise, the aims of insurance and banking supervision are regarded as structurally so different that unified supervision seems unjustified as the aims of the two fields differ.[848] Further counter-arguments say that "unification could lead to lack of clarity; an integrated agency could suffer from diseconomies of scale; concentration of power could vitiate democratic policies; and moral hazard concerns could be extended across the whole financial sector"[849].
However, regardless of what the judgment on these refutations may be, the legislator has opted for the concept of Allfinanz, so that further discussion must rather focus on concrete suggestions for improvement than on the concept itself.[850]

vii. BaFin's development 2002-2007

Five years after its installation, it is too early to speak of BaFin's history. The agency grew in both amount of employees and tasks to observe, but mastered this challenge well. An unfortunate development – the arising of a case of corruption within the agency, and this in a field that had been reminded by Fin's auditors – led to a wave of public critique, not only concerning this incident, but also BaFin's general policies and course of action, as well as the core reason for its installation. It can, however, be said that the agency integrated successfully in the national supervisory system and also made its entry into the international cooperative bodies in a favorably viewed way.

As to the general market development, BaFin made its appearance in an unfortunate[851] time: in late 2002 and all through 2003, there were "often abrupt changes in direction on the international financial markets, many of which caught market participants unaware"[852] – a situation which proved to be difficult, as BaFin could not yet assume all its power and did yet have to find the most advantageous path of action. Also, the burst of the dot.com bubble and succeeding cases of fraud and accounting faults in both the US and Germany severely decreased

[847] *Fricke*, Versicherungsaufsicht integriert – Versicherungsaufsicht unter dem Gesetz über die integrierte Finanzdienstleistungsaufsicht, in NVerZ 2002 337, p.337.
[848] *Kümpel*, Zur Neugestaltung der staatlichen Börsenaufsicht – von der Rechtsaufsicht zur Marktaufsicht, in WM 1992 381, p.390.
[849] *Schüler*, Integrated Financial Supervision in Germany, online publication 2004; ftp://ftp.zew.de/pub/zew-docs/dp/dp0435.pdf (download June 6th, 2007), p.3.
[850] See below sub „Current challenges".
[851] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2002, p.5.
[852] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.13.

investor confidence[853] and let to an adverse public opinion on both the securities business and its regulators, which were perceived as helpless due to the fact that they had not "stopped" the faulty behavior. With BaFin as a new authority, this drop in confidence surely was not easily assumed, even more as the agency itself had not had the possibility of investigating into the scandals, but this had lain with the BAWe.

However, in late 2003 until today, the market stabilized[854], thus facilitating BaFin's action and also undeserved contributing to the image of a capable supervisor. Another factor which stressed BaFin's success was the audit by the IMF during the Financial Sector Assessment Program (FSAS), which aims at establishing comparative studies of IMF member countries, discover potential weaknesses of the financial system and suggest improvements.[855] The stress tests and scenarios, conducted by employees of supervisory authorities from all around the world, showed that the German supervisory approach was appropriate and also revealed high marks for BaFin in terms of adherence to international standards, supervisory approach and the principle of integrated supervision.[856]

viii. Summary

BaFin has been in action for a short time only, but has already acquired a high reputation with international peers and the international public, whereas in Germany, its reputation was severely damaged by an unfortunate occurrence of fraud within the agency. However, its positive influence on the German capital market is recognized not only by the professional public, but also reflected in higher investor participation and thus investor confidence. BaFin will have to strive to maintain and enhance this perception, and thus is expected to grow in public perception and importance in the years to come.

[853] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.101.
[854] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.13.
[855] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.23.
[856] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.24.

b. Organizational structure

Before elaborating on BaFin's governing law, it is necessary to first understand with which resources and organizational design the agency operates. Therefore, the following chapter will describe its organizational structure and also detail funding, governmental control and partnerships and cooperation the agency currently maintains.

i. Head of organization

BaFin is a public law institution and possesses legal capacity[857], i.e. can act in its name and under own responsibility. It is directly answerable to the federal government, and subjected to legal and functional supervision of the Federal Ministry of Finance (BMF).[858] The public law character of the institution, in this regard, is a novel: BaFin's predecessors did not have legal capacity, but BaFin's task necessitates independence as well as "flexibility with the forming of contracts of employment and the detachment from the rigid law of civil servants"[859]. BaFin is independent in such that the agency is neither with its organization nor with its functions bound to any ministry or other public agency.[860] Also, it is important to understand BaFin's concept as supervisory, not regulatory agency[861]: it controls market participants and their actions, but does not, or at least not primarily, strive to influence the market or its structure.

Internal structure prescribes a president[862], a post currently held by Jochen Sanio with the assistance of vice president Karl-Burkhard Caspari. Whereas in the past, the president was free to act on account of the agency, his competency is not limited in such that a majority vote of the vice president and the executive directors will be binding to his final decision.[863]

During BaFin's founding period, it had been lengthily discussed whether to opt for a presidential or collegial structure, whereas finally, the presidential structure was preferred: the legislator expected this to ensure not only a quick decision-making, but also a clear set of responsibilities and authority.[864] Additionally, only the presidential structure guarantees that the

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[857] As of Basic Consitutional Law (GG), sec. 87 III 1; *Kümpel*, Bank- und Kapitalmarktrecht, 3rd edition 2004, p.1385.
[858] Act establishing the Federal Financial Supervisory Authority (FinDAG), sec. 2.
[859] *Hagemeister*, Die neue Bundesanstalt für Finanzdienstleistungsaufsicht, in WM 2002 1773, p.1773.
[860] *Kümpel*, Bank- und Kapitalmarktrecht, 3rd edition 2004, p.1385.
[861] *Heyle*, Die Erhebung von Vorzugslasten durch die Wirtschaftsaufsichts- und Regulierungsbehörden; 2006, p.196.
[862] Act establishing the Federal Financial Supervisory Authority (FinDAG), sec. 9 II.
[863] *Jahn*, Mit kräftigem Biss, in FAZ of May 23rd, 2007.
[864] *Laars,* Bundesanstalt für Finanzdienstleistungsaufsicht, in NOMOS – Erläuterungen zum Deutschen Bundesrecht, CD-Rom version 2006, sub „Zu § 6 Leitung"; *Hagemeister*, Die neue Bundesanstalt für Finanzdienstleistungsaufsicht, in WM 2002 1773, p.1776.

president is able to directly instruct all the staff independent of the hierarchy.[865] Also, the sectors are not to be deemed independent, but united under one strategic orientation and business practice.

An administrative council (Verwaltungsrat)[866] supervises BaFin's operations and course of business. Most important, it is responsible for the annual review of BaFin's budget[867], controls BaFin's management and, also relieves, together with the Ministry of Finance, the President. In its structure similar to that of a publicly traded company, it does not hold authority to recall or appoint directors. Consisting of 21 members, the administrative council includes participants of the administrative branch, deputies, but also representatives of BaFin's supervised entities, so that the combined knowledge and experience of all those aids BaFin. By this structure, it is ensured that the supervised entities are granted a right to a say in this matter.[868]

Additionally, a case advisory board (Fachbeirat)[869] contains 24 scholarly members of law and finance, representatives of consumer protection organizations and the overall economy.[870] The board advises the directors on specific questions within its members' line of expertise, and thus ensures that BaFin's decisions are practicable. Also, they give advice on the future development of the regulatory environment and supervision.[871]

The federal states' participation is ensured by the establishment of an advisory group, the so-called securities council (Wertpapierrat)[872], which consists of representatives of all federal states and guest members of the ministries of finance, justice and economics/technologies[873]. It is at least annually informed about BaFin's supervisory activities, and communicates its opinion on current supervisory structure and regulations to come.

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[865] *Fricke*, Versicherungsaufsicht integriert – Versicherungsaufsicht unter dem Gesetz über die integrierte Finanzdienstleistungsaufsicht, in NVerZ 2002 337, p.339.
[866] For a list of current members, see *Bundesanstalt für Finanzdienstleistungsaufsicht*, Jahresbericht der Bundesanstalt für Finanzdienstleistungsaufsicht 2006, p.227.
[867] Act establishing the Federal Financial Supervisory Authority (FinDAG), sec. 7 I.
[868] *Laars*, Bundesanstalt für Finanzdienstleistungsaufsicht, in NOMOS – Erläuterungen zum Deutschen Bundesrecht, CD-Rom version 2006, sub „Zu § 7 Verwaltungsrat"; *Hagemeister*, Die neue Bundesanstalt für Finanzdienstleistungsaufsicht, in WM 2002 1773, p.1777.
[869] For a list of current members, see *Bundesanstalt für Finanzdienstleistungsaufsicht*, Jahresbericht der Bundesanstalt für Finanzdienstleistungsaufsicht 2006, p.228.
[870] Act establishing the Federal Financial Supervisory Authority (FinDAG), sec. 8 I.
[871] *Laars,* Bundesanstalt für Finanzdienstleistungsaufsicht, in NOMOS – Erläuterungen zum Deutschen Bundesrecht, CD-Rom version 2006, sub „Zu § 8 Fachbeirat".
[872] Securities Trading Act (WpHG), sec. 5.
[873] *Kümpel*, Bank- und Kapitalmarktrecht, 3rd edition 2004, p.2478.

ii. The directorates

Overall, BaFin is divided into 17 departments, three groups, 130 sections and four offices, which mostly operate under its three supervisory areas (i.e. the directorates). It must be understood that the directorates operate under very different premises: whereas securities and asset supervision is oriented alongside the market, and strives to maintain transparency and integrity within the market as a whole by regulating individual actors, banking supervision is individual in such that institutions are supervised and their specific fitting to provide services as to solvency and aptitude of management is controlled.[874]

The Directorate of Banking Supervision maintains a high priority within BaFin's supervisory tasks, as only a proper functioning banking systems guarantees adequate provision of financial resources to businesses and thus a high performing and successful national economy.[875] Thus, the responsibilities of the directorate can best be described in a negative way: they are to prevent and/or eliminate situations or developments which "endanger the safety of assets entrusted to institutions, adversely affect the orderly execution of banking transactions, or may substantially prejudice the economy generally"[876]. Banking, in this regard, does not only cover commercial banks, but encompasses also securities trading banks and individual stockbrokers authorized to act as financial service institutions[877]. Supervisoin is executed two-fold: one set of rules applies to newly established banks[878] (rules for minimum amount of own funds, specification for senior management[879], declaration of significant participating interests and submission of a business plan), the other part strives to control current operations (conduction of transactions and prevention of happenings that may "disrupt the smooth functioning of the banking system"[880]).

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[874] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.566.
[875] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Responsibilities and objectives of banking supervision".
[876] Banking Act (KWG), sec. 6; http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Responsibilities and objectives of banking supervision".
[877] Whereas corporate financial services institutions fall under the responsibility of the Directorate of Securities Supervision/Asset Management; http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Responsibilities and objectives of banking supervision".
[878] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Responsibilities and objectives of banking supervision".
[879] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Authorization and ongoing supervision – the phases of banking supervision".
[880] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Responsibilities and objectives of banking supervision".

In their supervisory activity, the Directorate of Banking Supervision shares responsibility with the German Federal Bank, who engages in the current supervision of all banks, but it is BaFin who issues regulative general dispositions and administrative decisions.[881]

The Directorate of Insurance Supervision aims – as defined by the Insurance Supervision Act[882] – at the safeguarding of the interests of policy holders, especially in such that the obligations arising under insurance agreements can be met at all times. In this regard, all private and public-law insurance companies regardless of their scope – comprising life insurers, health insurers, and property and casualty insurers[883] – with their principal place of business in Germany are subjected to supervision, and so are, since a legal amendment in 2002, pension funds.[884] Re-insurance business, however, is only concerned with a limited set of supervisory rules. As insurance supervision is effectuated by both the BaFin as a federal agency and by federal states' institutions[885], close cooperation, as detailed below, is necessary in order to avoid gaps of supervision on the one hand and double-checking on the other.

The Directorate of Securities/Asset Management Supervision, at last, is endowed with the most important and most wide-spread of BaFin's activities, and includes activities to monitor insider and director's dealing, ad-hoc disclosure, price manipulation and various others.[886] Their task is maily the detection of potential cases, so that monitoring of trading and price development, as well as accessability for and investigation of tip-offs by investors or third parties are of daily importance. As supervision of the stock exchanges is an exclusive competency of the federal states, the BaFin is not involved in their control mechanisms, but maintains cooperative links to those institutions as described below.

iii. Cross-sectoral and other departments

Whereas the three functional directorates follow the clear division of task as maintained prior with BaFin's three preceding institutions, the cross-sectoral departments work with all three

[881] *Hirdina*, Verfassungsrechtliche Aspekte zur Funktion einer reformierten Bundesbank bei der Allfinanzaufsicht, in BKR 2001 135, p.136.
[882] In detail, Insurance Supervision Act (VAG), sec. 81 I.
[883] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2005, p.72.
[884] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Coverage of insurance supervision".
[885] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Responsibilities and objectives of insurance supervision".
[886] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "The key responsibilities of BaFin's securities supervision".

directorates and thus operate in overlapping areas so that the interests and peculiarities of one field of supervision are respected and integrated into the other fields.

Risk Analysis and Financial Market Studies (Q1) mirrors most stringently the concept of a one-stop financial services agency, as this department handles the supervision of financial conglomerates, which operate in all three areas, and supervises accounting and disclosure of banks and insurance companies.[887] Also, national and global development on financial markets are subjected to analysis and projection.

Consumer and Investor Protection, Certification of Private Pension Plan Contracs; and legal (Q2) handles consumer complaints about banks, financial services institutions or insurance companies and answers queries for information.[888] Also, it is concerned with all the certification of private pension plan contracts according to the AltZertG[889] and the centralized auditing of existing protection schemes, such as deposit protection and compensatory schemes.

In their responsibility to safeguard the integrity of the whole financial system, Integrity of the Financial System (Q3) deals with issues of principle and legal matters relating to proceedings against unauthorized or prohibited banking and insurance business and financial services"[890] and engages into legal proceedings if need be. Thus, also this department is highly relevant as to the integration of supervision.

As of 2005, BaFin founded the International Department (INT), which is responsible for "bilateral and multilateral tasks and technical cooperation, i.e. a concentration of international activities in one department"[891], bundling BaFin's experience with foreign authorities.

Supportive departmens comprise the Central Administration Department (budgeting, cost-to-performance accounting, human resources and IT services892), the Anti-Money Laundering and Financing of Terrorism Group (supervision of possible funding of terrorist attacks and

[887] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Cross-sectoral departments (Querschnittsabteilungen)".
[888] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Cross-sectoral departments (Querschnittsabteilungen)".
[889] For a detailed outline of law and responsibilities, see below.
[890] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Cross-sectoral departments (Querschnittsabteilungen)".
[891] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2005, p.205.
[892] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "BaFin's organizational structure".

other engagements into money-laundering activities under the Money Laundering Act (GwG)), and the QRM Group (quantitative mathematics and statistics of the market, risk for offered products and/or services, operating and liquidity risks of the supervised entities[893]). Further positions of importance are the Press and Publicity/Internal Information Management Office and the Internal Audit Office.

iv. Offices and employee base

BaFin's offices are in Bonn and Frankfurt am Main (both of equal importance)[894], whereas in Bonn, mainly the task of banking and insurance supervision are performed and in Frankfurt asset and investment management supervision. However, the site for the commencement of an action against the agency is Frankfurt exclusively.[895] BaFin has enjoyed a steadily growing employee base with the increase of its responsibilities, so that it now employs a total of 1,679 staff[896], which grew as shown in the following chart:[897]

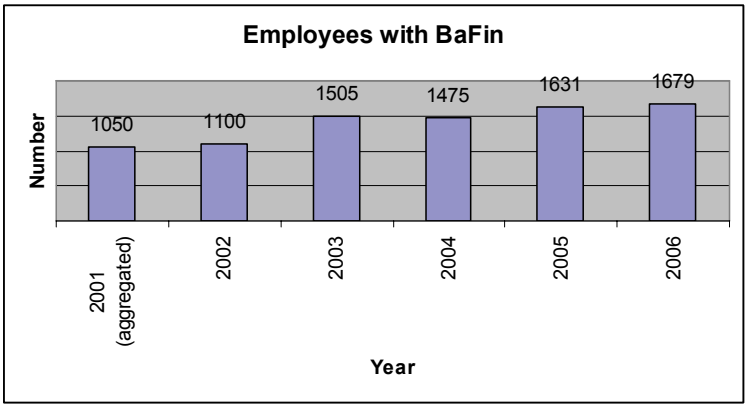

Chart 11: BaFin staff employed

The average age of employees is exceptionally low: over 75% are between 26 and 45 years of age[898], which is not only due to the fact that BaFin has had extensive recruiting, which would usually attract younger staff, but also to the agency's HR approach: it strives to train man-

[893] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "BaFin's organizational structure".
[894] *Laars,* Bundesanstalt für Finanzdienstleistungsaufsicht, in NOMOS – Erläuterungen zum Deutschen Bundesrecht, CD-Rom version 2006, sub „Zu § 1 Errichtung".
[895] Act Establishing the Federal Financial Supervisory Agency (FinDAG), sec. § 1 III; whereas there is no explanation for the fact that Bonn had not been chose, although the bigger part of the agency resides there: *Hagemeister*, Die neue Bundesanstalt für Finanzdienstleistungsaufsicht, in WM 2002 1773, p.1776.
[896] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Jahresbericht der Bundesanstalt für Finanzdienstleistungsaufsicht 2006, p.212.
[897] Data derived from *Bundesanstalt für Finanzdienstleistungsaufsicht*, Jahresbericht 2006, p.212; Annual Report 2005, p.203; Annual Report 2004, p.203, Annual Report 2002, p.176.
[898] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2004, p.203.

agement so as to have internal sources for top positions. However, specialized position such as experts for hedge funds or risk modeling must still be externally hired.[899]

Roughly 60% of employees hold a status of civil servants, which is "because as supervisors, they undertake sovereign tasks and have far-reaching powers of intervention"[900]. All in all, BaFin's employee base presents the following picture:[901]

Level	**Employees**			**Civil servants**	**Non-civil servants**
	Total	Women	Men		
Senior	599	222	377	528	71
Upper	573	265	308	412	161
Middle/lower	459	298	161	65	394

Chart 12: BaFin employee distribution as to gender and position

v. Funding

With FinDAG, the German legislator stated that the cost of supervision would be entirely shouldered by the supervised entities and would not rely on the federal budget.[902] Thus, the agency's € 126.8 million budget[903] is entirely funded out of fees and direct cost allocation to the supervised entities[904]. This is, besides consideration of cost attribution to beneficiaries, also due to the fact that the federal budget had been so strained: now, the important task of capital market supervision is only oriented on market needs and BaFin will be able to acquire as much budget as perceived tolerable by the market, and not be bound by considerations of thriftiness and cost-cutting on the governmental side.[905] However, the 100% cost contribution has also encountered criticism, as it provides risks for corruption[906] due to the fact that the entities supervised are responsible for the budget, and might request favors for contributing to a bigger extent.

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[899] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2004, p.203.
[900] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2005, p.203.
[901] Data derived from *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2005, p.204.
[902] Act Establishing the Federal Financial Supervisory Agency (FinDAG), sec. § 13 I; whereas BaFin's predecessor BAWe had a 10%-cost contribution by the federal budget; *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.169.
[903] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2006, p.214.
[904] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "The Federal Financial Supervisory Authority".
[905] *Laars,* Bundesanstalt für Finanzdienstleistungsaufsicht, in NOMOS – Erläuterungen zum Deutschen Bundesrecht, CD-Rom version 2006, sub „Einleitung"; *Fricke*, Versicherungsaufsicht integriert – Versicherungsaufsicht unter dem Gesetz über die integrierte Finanzdienstleistungsaufsicht, in NVerZ 2002 337, p.344.
[906] http://www.dias-ev.de/pressemit.php?newsid=48 (page impression of January 15th, 2007).

Also, this concept requires that the fees are colleted by BaFin itself, and are not added and later redistributed to the federal budget. Thus, it is safeguarded that the fees collected will only be used for the intended purpose, and not for the re-financing of other governmental activities. BaFin is required to conduct independent budgeting[907], a process which is detailed in the agency's bylaws. The budget for the last years had yielded the following calculation:[908]

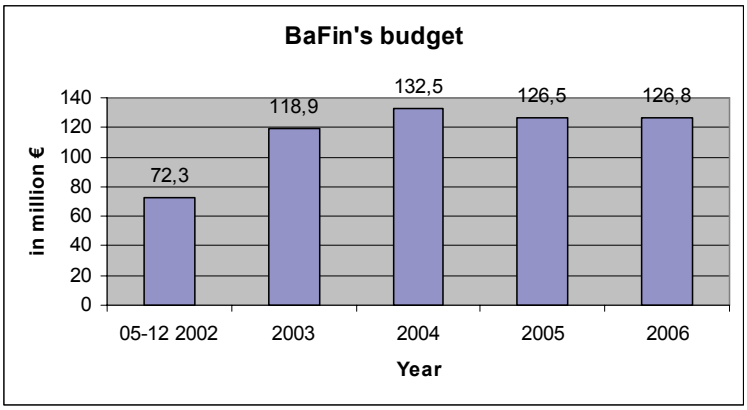

Chart 13: BaFin budget development

Contributions to the budget have been determined by a BMF directive[909], the execution of which led to the following cost structure:[910]

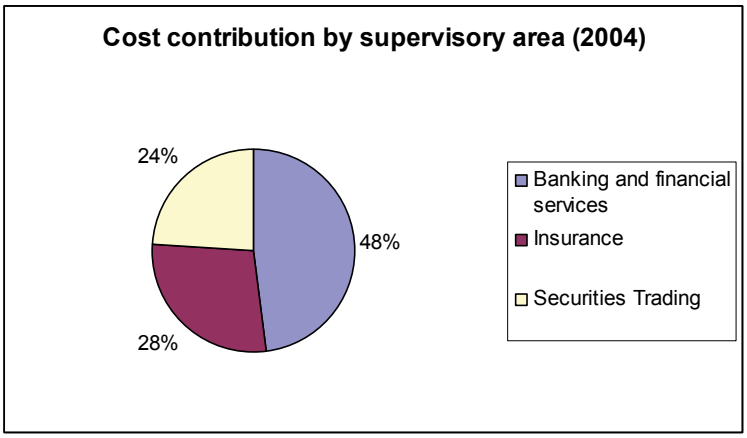

Chart 14: BaFin cost contribution by supervisory area

[907] Act Establishing the Federal Financial Supervisory Authority (FinDAG), sec. 12.
[908] Data derived from *Schüler*, Integrated Financial Supervision in Germany, online publication 2004; ftp://ftp.zew.de/pub/zew-docs/dp/dp0435.pdf (download June 6th, 2007), p.17; *Bundesanstalt für Finanzdienstleistungsaufsicht*, Jahresbericht 2006, p.213; Annual Report 2005, p.206; Annual Report 2003, p.217.
[909] The so-called FinDAGKostV; *Fricke*, Versicherungsaufsicht integriert – Versicherungsaufsicht unter dem Gesetz über die integrierte Finanzdienstleistungsaufsicht, in NVerZ 2002 337, p.343.
[910] Data derived from *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2005, p.207.

This cost attribution is valid for a financial year, and does not depend on any contract or other agreement between BaFin and the supervised entity, but agreement will be assumed due to operation.[911] Also, BaFin requires deposits estimated on the late year's contribution and will re-distribute the shortages and unpaid contributions. A detailed enlistment of amount, distribution quota and the timing of such is presented in the above-mentioned regulation.[912] In this regard, the costs of supervision are detailed in terms of directorates, and then coverage by the entities supervised is planned for[913], so that re-financing across industry lines is avoided for reasons of fairness.

Another source of funding is payment for official acts, which are attributed to the individual entity[914] and not transferred on the general public as to accommodate for different examination requirements, preparations and difficulties. A detailed listing of the official acts on which this is applicable and the incurred fees is provided by the Regulation Concerning the Costs Incurred by the Act Establishing the Federal Financial Supervisory Authority (FinDAG-KostV). These administrative revenues, also including fees, interests and the like, amount to 13% of BaFin's budget.[915]

vi. Governmental control

BaFin is subjected to supervision by the Federal Ministry of Treasury (BMF) in the execution of its tasks[916], whereas in cases, in which the legislator did not expressly prescribe supervision, BaFin's technical independence is legally assumed.[917] As a part of the federal administration, BaFin has to comply with the principles of basic constitutional law in all their activities, for which supervision by the BMF – both in terms of legal compliance and professional conduct – is an indication. The BMF, among others, has a right of information and holds deci-

[911] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.171.
[912] For an elaboration on this topic, see *Heyle*, Die Erhebung von Vorzugslasten durch die Wirtschaftsaufsichts- und Regulierungsbehörden; 2006, p.200 et seq.
[913] This detailed cost-attribution reaches the point where, also within a certain industry, a group can be requested to pay exclusively if they cause more than 1% of the cost to the budget; Regulation Concerning the Costs Incurred by the Act Establishing the Federal Financial Supervisory Authority (FinDAGKostV), sec. 5 II.
[914] Regulation Concerning the Costs Incurred by the Act Establishing the Federal Financial Supervisory Authority (FinDAGKostV), sec. 15, whereas an example of such are examinations according to Securities Trading Act, sec. 35, the issuance of no-action letters, the prescription of the sale or acquisition of a security and the like; for a detailed listing, see *Heyle*, Die Erhebung von Vorzugslasten durch die Wirtschaftsaufsichts- und Regulierungsbehörden; 2006, p.197 et seq.
[915] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2005, p.206.
[916] *Weber-Rey*, Rechts-Report Finanzmakrtaufsicht: Grundsätze für die Ausübung der Aufsicht des BMF über die BaFin, in AG 2005 R447, p.447. *Laars*, Bundesanstalt für Finanzdienstleistungsaufsicht, in NOMOS – Erläuterungen zum Deutschen Bundesrecht, CD-Rom version 2006*,* sub „Zu § 2 Rechts- und Fachaufsicht".
[917] *Hagemeister*, Die neue Bundesanstalt für Finanzdienstleistungsaufsicht, in WM 2002 1773, p.1776.

sional power over BaFin, although it is doubtful whether this will be invoked against such a strong agency.[918] However, this makes BaFin a non-autonomous agency.[919]

BaFin also has to respect several principles resulting out of basic constitutional law during its activities. Mainly, this is relevant as to informational self-determination, as BaFin investigates into fields that citizens might want to be kept private. This is especially important as the conditions for the initializing of an inquiry with BaFin are considerably lower than with the Public Prosecution Office, i.e. a mere clue of a law violation versus a clear suspicion.[920] However, scholars deem this appropriate due to the fact that the general interest in an integer capital market prevails over individual interests of privacy. For all data discovered by and disclosed to BaFin, a duty of confidentiality exists as it had been with its predecessor.[921]

During the course of its investigations, BaFin may safe, change and use the collected data insofar as this is necessary and appropriate for its current investigations, but also for international cooperation.[922] As soon as this requirement is no longer given, the data are to be destroyed. Also, data of natural persons are recorded in stored with identification numbers, so that conclusions from the identification number to the person are only made in a proven suspicion of a dishonest behavior.[923] Transactions of credit institutes, brokers and dealers and financial services, however, are recorded with the real name of the institution, as those do not hold privacy protection in their character of legal persons.

Also, there are concerns whether the data collected by BaFin should be shared with the Public Prosecution Office, once there is a case which demands for its engagement, mainly in such as during a general tracing, incidental findings are used[924] whereas public prosecution would only allow for finding gathered due to a specified suspicion. Justification can be seen in the fact that, although far-reaching, BaFin's investigative authority is not as extensive as the public prosecution's.[925] The same concern exists for information sharing in international cooperative context.

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[918] *Laars,* Bundesanstalt für Finanzdienstleistungsaufsicht, in NOMOS – Erläuterungen zum Deutschen Bundesrecht, CD-Rom version 2006*,* sub „Zu § 2 Rechts- und Fachaufsicht".
[919] *Fricke*, Versicherungsaufsicht integriert – Versicherungsaufsicht unter dem Gesetz über die integrierte Finanzdienstleistungsaufsicht, in NVerZ 2002 337, p.339.
[920] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.198.
[921] *Siebel/zu Löwenstein*, German Capital Market Law, 1995, p.41.
[922] Securities Trading Act (WpHG), sec. 4 X.
[923] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.
[924] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.198.
[925] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.198.

Another prevention of information sharing exists as to internal revenue authorities, which mainly exists for practical reasons: BaFin must rely on the cooperativeness of their supervised entities, and those will only be willing to share information if they can make sure that no harm will arise to their clients. As a data sharing would possibly uncover tax fraud, and as also foreign authorities are prone to be unwilling to disclose data if not under such boundaries, the taxing interest has been deemed as subordinate to market supervision.[926] Thus, only in case of the suspicion of a tax offence, BaFin will satisfy a request for data disclosure.

Most important, all staff employed by BaFin and other experts called in must not disclose the information acquired during their occupation to other persons or entities than public prosecution or such that are concerned with supervision of stock or exchange markets.[927] This obligation of secrecy safeguards not only personal privacy, but also company and trade secrets[928] and prevents the use of such information for private aims. In case of non-compliance, this is punishable as a criminal offence[929] and the person concerned can claim for liability to the staff and the federal republic, if the lesion happened within the exercise of the staff's duty. Although originally aimed at BaFin's staff as individuals, it must be understood that the same is to be applied onto the institution as such.

vii. Partnerships and cooperation

1. State partnerships, partnerships with federal agencies and private-public cooperation

As capital market supervision is split between various authorities and institutions, cooperation and sharing of information is one of the most urgent demands in order to ensure a high efficiency of supervision, and thus also provided for in the Securities Trading Act[930]. This might range from a mere exchange or sharing of information up to a so-called authority lending (Organleihe), in which the authority not in charge of the case will act for the one who is, a situation especially common in between BaFin as a federal agency and the federal states' authorities.[931]

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[926] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.253.
[927] Securities Trading Act (WpHG), sec. 8 I, and likewise in the Stock Exchanges Act (BörsG), sec. 7 and in the Banking Act (KWG), sec. 9.
[928] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.246.
[929] Criminal Code (StGB), sec. 203 II, 204; *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.252.
[930] In detail, Securities Trading Act (WpHG), sec. 6 II-IV provides for cooperation of the BaFin, federal states' exchange supervisory authorities, the federal bank and the federal antitrust agency.
[931] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.562.

As stipulated by the Banking Act[932], the German Federal Bank (Deutsche Bundesbank) participates in banking supervision, mainly as to the analysis of regular reports on business and returns and as to the assessment of adequacy of a bank's capital resources and risk management.[933] Covered at first by law[934] and furthermore by a memorandum of understanding, BaFin and the German Federal Bank have distributed the responsibilities between them. So, the German Federal Bank is engaged into day-to-day supervision of the banking business, whereas BaFin assumes the more structural supervision and deliberations of future supervision, as well as interaction with the public and third parties.[935] This cooperation is coordinated and controlled by the Forum for Financial Market Supervision, organizing formalized meetings between senior management employees of both institutions.[936]

Most important is also BaFin's cooperation in the field of enforcement in accounting matters: the German inspection authority for accounting (DPR) has been installed in July 2005[937], and since then was involved into the two-stop accounting control process that legislation prescribes.[938] The DPR, an independent agency under private law, in the first step reviews a company's accounting, and reports its findings to BaFin and the company, whereas this is to happen every 4-5 years with companies listed on the most frequented exchanges. BaFin, in the second step, will decide how to correct faults detected by the DPR (or by own staff), whether to disclose them and how to enforce the remedy.[939] The cooperation, on the one hand, alleviates BaFin's workload, on the other hand also integrates external expertise into the agency's investigations. At last, the fact that two agencies independently review a company's accounting complicates collaboration and/or corruption intents.

Another means of coordination and cooperation is the Commission of Exchange Experts (Börsensachverständigenkommission), which meets several times annually to discuss various

[932] In detail, Banking Act (KWG), sec. 7.
[933] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Responsibilities and objectives of banking supervision".
[934] Banking Act (KWG), sec. 7.
[935] *Geerlings,* "Staatshaftung und Bankenaufsicht in Deutschland – Ein Rechtsvergleich mit England und den Vereinigten Staaten" in BKR 2003 889, p.889.
[936] *Schüler*, Integrated Financial Supervision in Germany, online publication 2004; ftp://ftp.zew.de/pub/zew-docs/dp/dp0435.pdf (download June 6th, 2007), p.18.
[937] By Balance Sheet Control Act (BilKoG); *Kämpfer*, Enforcementverfahren und Abschlussprüfer, in BB 2005 (addendum) 13, p.13.
[938] *Gahlen/Schäfer*, Bekanntmachung von fehlerhaften Rechnungslegungen im Rahmen des Enforcementverfahrens: Ritterschlag oder Pranger?, in BB 2006 1619, p.1619.
[939] *Gahlen/Schäfer*, Bekanntmachung von fehlerhaften Rechnungslegungen im Rahmen des Enforcementverfahrens: Ritterschlag oder Pranger?, in BB 2006 1619, p.1619; *Weber*, Die Entwicklung des Kapitalmarktrechts im Jahre 2005, in NJW 2005 3682, p.3688.

topics of interests and unites representatives of exchanges, business, scholars, institutional and private investors and the Ministry of the Treasury.[940] The federal states introduced separate discussion circles on this topic, and BaFin participates and informs members of current developments and intended changes.

Also, the federalist system provides for insurance supervision to be divided between the BaFin as a federal agency and federal states' institutions. For such purposes, BaFin effectuates the control of all "private insurance companies […] which are of material economic significance and the competing public-law insurance companies which operate across the borders of a Federal State"[941], leaving public-law insurance companies which operate only in one federal state and private insurance companies or minor size and/or significance to supervision by federal states' institutions. Furthermore, such insurance companies that have their principal place of business in other European member states, and operate in Germany under the freedom to provide services, are not subjected to BaFin's or federal states' control, but to control by the authorities of their principal place of business. Thus, BaFin enters into consultations which such foreign supervisory authorities if German law seems violated.[942]

As a responsibility of their self-administrative[943] character, stock exchanges provide with their office of trading supervision[944] the first and most basic step for supervision.[945] The office controls daily trades and execution of transactions, and thus helps to increase transparency and fair market conditions.[946] Furthermore, stock exchanges are attributed to supervision of the Federal States by the Stock Exchanges Act (BörsG)[947]. The states' institutions, generally the treasury or ministry of economics[948], in cooperation with the exchanges' surveillance departments, track pricing processes and control electronic and similar exchange trading systems, which are licensed for operation by credit institutions and securities services only.[949] However, other electronic trading systems, such as financial services institutions, fall under super-

[940] *BaFin*, Introductory Powerpoint Presentation (for internal purposes), p.10.
[941] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Division of responsibilities between the Federal Government and the Federal States (Länder)".
[942] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Coverage of insurance supervision".
[943] *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.58.
[944] Handelsüberwachungsstelle
[945] Stock Exchanges Act (BörsG), sec. 4 I.
[946] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.563.
[947] Stock Exchanges Act (BörsG), sec. 1 IV.
[948] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.565.
[949] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Responsibilities and objectives of the Securities Supervision/Asset Management Directorate".

vision of the BaFin, as does stock exchange regulation on an international level. Thus, BaFin maintains contracts to the relevant states' institutions and acts in cooperation with them should comprehensive problems occur, and also might decide to ask offices of trading supervision for support in certain cases, although no standing panel for general exchange of information and cooperation exists.

Additional administrative assistance – in case of the non-existence of an agreement covering the cooperation – can be sought after by BaFin following the guidelines of the Basic Constitutional Law[950], which includes agencies of both federal and state character, especially such in the field treasury and economics, exchanges, commercial regulatory authorities and the like.[951]

2. International cooperation

BaFin is entitled and requested[952] hold extensive contacts with foreign authorities that supervise markets for securities and derivatives, as the supervisory activities overlap both "on a European and international level and […] in sectoral committees"[953]. All in all, BaFin is represented in well over 100 international forums and/or working groups[954]; bonds mostly inherited from BaFin's predecessors.

The most important, International Organization of Securities Commissions (IOSCO) has already been detailed in the SEC's description, and will thus not find further notice.

The European Securities Regulators Committee (CESR) was formed in 2001[955] out of FESCO[956]. A main achievement was a mutual MOU, which regulates the share and exchange of information as well as cooperative issues as to investigations and supervision of exchange markets which allow for European (and not only national) trade.[957] Also, CESR issues guide-

[950] Basic Constitutional Law (GG), Art. 35.
[951] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.191.
[952] Securities Trading Act (WpHG), sec. 7, 19, 30 and alike dispositions in the Banking Act and Insurance Supervision Act; Act Establishing the Federal Financial Supervisory Authority (FinDAG) sec. 2 II is deemed as of merely declaratory purpose; *Laars,* Bundesanstalt für Finanzdienstleistungsaufsicht, in NOMOS – Erläuterungen zum Deutschen Bundesrecht, CD-Rom version 2006, sub „Zu § 4 Aufgaben und Zusammenarbeit".
[953] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2004, p.32.
[954] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2004, p.32.
[955] *Karpf/Weidinger-Sosdean/Zartl,* Die Integration der Finanzmärkte der EU – die Rolle von CESR, CEBS und CEIOPS im Lamfalussy-Prozess, in ZFR 2007 6, p.7.
[956] An unofficial gathering of representatives of all member states, Norway, Liechtenstein and Island with the aim of improving capital market integrity and transparency.
[957] *Wittich*, Zusammenwachsende europäische Märkte – eine Herausforderung für die Wertpapieraufsicht in Europa, in WM 1999 1613, p.1613.

lines[958] on accepted marking practices, so as to create a common understanding of interpretation and enforcement of a directive.[959]

CESR was conferred responsibility to advise the European legislators as to the common and harmonized implementation of capital market law, especially in the course of the Lamfalussy proceeding.[960] Thus, this assembly has gained in importance and delivers valuable contribution from daily supervisory practice as inspiration for further developments in European capital market law. Also, CESR serves as mediator between the different supervisory agencies.[961] CESR's peer committees CEBS and CEIOPS work in a similar fashion, but in the areas of banking and insurance supervision, respectively.[962]

Alongside this engagement, BaFin also enters into contact with individual states' agencies and negotiates agreements, so-called memoranda of understanding[963], as to sharing of information or joint enforcement. To this time, 31 MOUs in the field of banking supervision, eight in insurance supervision and 25 in securities supervision have been concluded.[964] Also, BaFin has entered in the MMOU provided as multilateral guideline[965], which establishes bonds between all IOSCO members participating, and a similar MMOU under CESR administration.[966] If necessary, special agreements are negotiated, for instance the agreement with the supervisory authority of Luxembourg for supervision of the Clearstream group.[967]

Another informal gathering is the Integrated Financial Supervisors Conference (IFSC), which unites most of the supervisors which have undergone a merger of the authorities for all or several financial sectors.[968] The conference is intended to provide a forum for exchange of experiences and best practices, and thus helps to optimize the supervisory approaches.

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[958] For instance, the CESR Papier Level (CESR/04-505).
[959] *BaFin,* Introductory Powerpoint Presentation (for internal purposes), p.178.
[960] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.562; *Karpf/Weidinger-Sosdean/Zartl,* Die Integration der Finanzmärkte der EU – die Rolle von CESR, CEBS und CEIOPS im Lamfalussy-Prozess, in ZFR 2007 6, p.7.
[961] *Karpf/Weidinger-Sosdean/Zartl,* Die Integration der Finanzmärkte der EU – die Rolle von CESR, CEBS und CEIOPS im Lamfalussy-Prozess, in ZFR 2007 6, p.9.
[962] For a detailed description, see *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2004, p.39 et seq.
[963] *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.111.
[964] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Jahresbericht der Bundesanstalt für Finanzdienstleistungsaufsicht 2006, p.62.
[965] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.55.
[966] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Jahresbericht der Bundesanstalt für Finanzdienstleistungsaufsicht 2006, p.63.
[967] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.55.
[968] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2004, p.10.

The Financial Stability Forum (FSF) is a joint meeting of national financial ministers, central banks and supervisory authorities, discussing questions of inter-sectoral cooperation. Founded in 1999 as a result to the crisis in the Asian securities market, it resides in Basel and meets several times annually.[969] Although not holding any authority, it has a high importance due to the fact that high-ranking members of all three areas participate[970] and also create non-binding standards that are often adopted by the countries due to their balance and reasonableness.

Whereas the above-mentioned committees act either in the field of securities supervision or in cross-sectoral fields, banking supervision, due to its high importance for the flourishing of national economies, has generated specific forums such as the Basel Committee on Banking Supervision (BCBS) or the Banking Supervision Committee (BSC), and so has the insurance sector with its International Association of Insurance Supervisors (IAIS). The Joint Forum, founded in 1996, comprises members of all three umbrella organizations[971], and is to foster integrated supervision on an international level.

Organizations established on a broader political basis, but nevertheless also concerned with financial supervisory activities and thus engaged into contact with BaFin are the Bank for International Settlements (BIS), which aides national central banks with the administration of their gold and currency reserves, the International Monetary Fund (IMF), a subcommittee of the United Nations engaged among others in assessment of different countries' financial systems, and the OECD, which is to foster economic growth in the 30 member states and the developing countries and thus also engages into financial market stabilization and growth.[972]

viii. Summary

BaFin is an agency with a clear organizational setting of three directorates, four cross-sectoral departments and a multitude of supporting offices. The agency, governed by a president, holds extensive contacts and cooperative partners both in Germany and abroad. Being funded entirely by its supervised entities, BaFin nevertheless finds itself governed by strong governmental control, which ensures its democratic legitimacy and safeguards both citizens' and supervised entities' basic constitutional rights.

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[969] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.29.
[970] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2004, p.36.
[971] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.31.
[972] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2004, p.38.

c. Vision, mission and performance measurement

BaFin's operations are strictly bound to the public interest[973], so that the agency acts only for public benefit and not for individual interests of either its supervised entities nor of investors or other clients of financial services. This orientation on their clientele, but as well the control by the BMF and the democratic principle, calls for BaFin to define their goals and the way they will be pursued and measured.

i. Vision and mission

On the contrary to the SEC, BaFin did not define a strategic development goal, i.e. a mission, for the organization, but rather integrated their goal set into their mission, which is to "ensure the proper functioning, stability and integrity of the entire financial system in Germany".[974]
As this is somewhat oblique, the missions of BaFin's predecessors – still prevalent as mission of the directorates – might be taken into account by determining its concrete meaning.

Banking business is aimed to ensure capital demand for investors, and capital supply for businesses, whereas the banking industry is subjected to the system-inherent risk: due to their links via various cash management systems, the collapse of one bank may engender the break-down of several more or even the whole industry. The ensuing loss of confidence would cause a "bank run" by investors and at last lead to severe dangers to the credit and monetary system due to the lack of cash reserves.[975] Thus, banking supervision's mission is the safeguarding of solvency and liquidity of banks, but in addition to this functional component also the safeguarding of the banks' clients.[976]

Insurance supervision, on the contrary, is much more focused on protection of customers than banking supervision; indeed, this is its main goal. As the gap of power between the company and the customer is wider than with banking, as the reasons for insurance is the leverage of individual risks and not the generation of monetary gains, and as insurance safeguards against existential risks, insurance supervision must control accruals and investment policy of insurers, so that customers' justified expectations can be met.[977]

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[973] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Objectives of German all-in-one financial supervision".
[974] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Objectives of German all-in-one financial supervision".
[975] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.50.
[976] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.51.
[977] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.53.

At last, the mission of capital market supervision is to safeguard the allocative, operational and institutional efficiency of the capital market. As this has been discussed broadly as the mission of all supervision[978] and also detailed for BaFin, further discussion will be omitted.

ii. Goals

Deriving from its mission, BaFin concluded that success of the latter is tied to the achievement of two objectives: solvency of banks, insurance companies and other financial services institutions and protection of financial services customers and investors by enforcement of standards of professional conduct.[979]

This consideration is also obvious in BaFin's organizational structure: solvency supervision and market supervision are important strategic lines within the institution. BaFin can thus be called a single regulator in such that "it combines both prudential and conduct of business aspects"[980]. The common objectives also "serve as braces between the three areas of supervision"[981], so that further bonds between the units are created and their common approach is stressed.

Further objectives are tied to BaFin's effectuation of tasks and public perception, e.g. service-oriented supervision, risk-affirmative supervision or preventive supervision.[982] However, those can only be judged as being of minor scope, as they do not relate to the primary fields of supervisory action.

iii. Performance measurement

For all its objectives, BaFin developed a range of measures, which are annually assessed and detailed with regard of fulfillment, reasons for lacking success and measures of improvement or adaptation of measures for the years to come.[983] Also, those numbers are discussed internally in all departments and individual responsibility for their achievement is attributed to either individual employees, managers or working groups.

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[978] See introduction.
[979] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Objectives of German all-in-one financial supervision".
[980] *Schüler*, Integrated Financial Supervision in Germany, online publication 2004; ftp://ftp.zew.de/pub/zew-docs/dp/dp0435.pdf (download June 6th, 2007), p.13.
[981] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2004, p.9.
[982] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.
[983] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.

However, BaFin is not legally obliged to publish those measurements, and has until now decided not to publish. This decision might, on the one hand, depend on the fact that the measures have only been in place for five years, and thus would not yield very telling results; moreover, the measurements are subjected to constant change in order to improve their significance. On the other hand, BaFin might fear for public critique if they did not reach their goals, especially if this happened for consecutive years, and the agency might prefer, for this reasons, to keep the numbers to themselves as not to alarm investors and foreign supervisory authorities.

However, especially in comparison with other international agencies which openly communicate their performance measurements, their level of achievement of objectives and improvements for the future, external communication with BaFin is scarce and calls for improvement.[984] Also, the public would appreciate BaFin's honesty in this matter, especially as BaFin as supervisor requires this openness of all its supervised entities. Thus, it can be hoped that BaFin, in near future, will opt for the publication of its performance measurements.

iv. Summary

As detailed above, BaFin has determined a powerful mission statement and has also defined objectives and performance measurement tools in order to assure that its mission is reached. This is of high significance to both external clients (supervised entities and investors), as they know what to expect, and internal staff, who now are able to orient daily behavior on the set of values and objectives. However, both groups would surely appreciate if BaFin published its set of performance measurement, and would allow to be held liable for the achievement of their goals. Also, this would spur employee compliance and set incentives for supervisory action in line with the overall mission.

[984] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.

d. Governing law and BaFin's authority

BaFin's authority it tied to its governing law, so that in the following, a short introduction in German securities law and its base, European directives in that field, will be given. It must be understood that the main bodies of capital market law – which is in the focus of this analysis, whereas banking and insurance supervision will be shortly touched – are very young indeed: 2002 proved to be the year of the most stringent reforms[985] in capital market law, and has introduced severe changes in this field.

i. European law

Concurring with the growing integration of the member states into the European Union, German supervisory law is to a high degree dictated by EU standards[986], either directly or after enactment into national law. The EU's main goal being integrated markets for products, persons, services and capital (or, the so-called four freedoms), regulation of capital markets are in the core area of EU involvement.[987] Already in 1966, the so-called Sengré report defined objectives and perimeters[988] – but only three decades later, the goal would come close to achievement. Authorized to legislate in this field[989], the aim of the European legislator has been to unify the European capital market, as similar conditions for capital market transactions will fortify the (general) single market.

Aims of European capital market regulation have been similar to the German approach: the safeguarding of both investors' interests and of the duties and responsibilities incumbent on the European finance. To reach those, the following points of legislative approach have been defined: creditworthiness of financial services, risk of default, control of transactions, safeguarding of a contingent and client-oriented advice and transparency for transactions and market price formation.[990]

Besides, inner-European competition has been fostered as to strengthen the European capital market as such: due to European unified securities law, issuers will chose the most liquid market for their shares. Profiting from the home-country principle, they will have their securi-

[985] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.28.
[986] Currently, more than 80% of commercial law is of European origin; *Möllers*, Die Rolle des Rechts im Rahmen der europäischen Integration: zur Notwendigkeit einer europäischen Gesetzgebungs- und Methodenlehre, 1999, p.49; also *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.6.
[987] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.42.
[988] *Heinze*, Europäisches Kapitalmarktrecht – Recht des Primärmarkts, 1999, p.3.
[989] Most important, Treaty of the Eurpean Community (EGV), Art. 2, Art. 3 I, Art. 18, Art. 44 I, *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.31.
[990] *Kurth*, Problematik grenzüberschreitener Wertpapieraufsicht, in WM 2000 1521, p.1525.

ties licensed and initially sold at the market that guarantees the inherent value of the security; and this price will be adopted by all other European markets.[991] This not only ensures competition of the various exchanges, but also price reliability, as security prices are conceived and checked by a wider investment public.

However, the European institutions did not opt for a positive and law-defining capital market approach, but rather simplified and/or amended individual states' capital market law in order to maintain freedom of capital transactions and services.[992] Although this procedure, unguided by a broader vision of a unified European capital market, has been vividly criticized[993], experience shows that the European action was not useless as the aims have been reached to a high degree, and also harmonization is as farther advanced than in any other field of law.

This is based, mostly, on the so-called single-license principle. As soon as an authorization for a certain activity is granted by the authority of one member state, the latter is recognized and valid also in all other member states[994] (so-called equivalence principle[995]). This is not only advantageous to issuers, who only have to comply with one set of rules and then can rely on a European "passport" for all share trades[996], but also saves substantial resources as local authorities can rely on the work already accomplished by foreign authorities. Of course, such recognition is only possible due to the fact that European directives and their implementation into national law have, in most areas of capital market law, created a same level playing field[997] so that it can be ensured that national investors are protected likewise by the approval of an investment business by a foreign authority. This strategic decision is also reinforced by the Markets in Financial Instruments Directive (MiFID), which will alleviate reporting requirements and the like for foreign participants in the stock market.[998]

In capital market law, the European legislator prefers to use an accelerated process due to the fact that the normal course of the legislative system was judged as "too slow" and producing

[991] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.
[992] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.30.
[993] *Heinze*, Europäisches Kapitalmarktrecht – Recht des Primärmarkts, 1999, p.6; *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.12.
[994] *Apfelbacher, Metzner*, Das Wertpapierprospektgesetz in der Praxis – Eine erste Bestandsaufnahme, in BKR 2006 81, p.81.
[995] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.43.
[996] *Kung,* The Regulation of Corporate Bond Offerings: A Comparative Analysis, in 26 U Pa. J. Int'l Econ. L.409, p.424; *Weber*, Die Entwicklung des Kapitalmarktrechts im Jahre 2003, in NJW 2004 28, p.32.
[997] *Weber*, Die Entwicklung des Kapitalmarktrechts im Jahre 2003, in NJW 2004 28, p.34.
[998] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Jahresbericht der Bundesanstalt für Finanzdienstleistungsaufsicht 2006, p.144.

"too many delays […] in the transposition and implementation of EU Directives by Member States"[999]. This is the so-called Lamfalussy proceeding[1000]: directives will only fix "goals of regulations and cornerstones of [later] national rules"[1001], which will then be filled in and transformed into national law by member states' legislators. Also, the so-called comitology decision is applied, which means that the Commission is to develop rules for implementation without further involvement of the Council or the Parliament.[1002] In this process, the above-mentioned CESR acts as advisor for enactments in capital market law, and has acquired a high reputation for expertise and consideration.

Most important, generally, has been the influence of European codifications on the Securities Trading Act (WpHG), the Act on the Prospectus of Securities offered for Sale (VerkProspG) and the regulation of the same name. However, as the scope of this paper lies with German, and not European capital market law, the directives related to capital market law will not be detailed further, as they have found entry into the German codifications and their material characteristics will be better described in this context.[1003]

ii. German law and applicability

Applicability of German securities law is limited to all those who participate in the German capital market[1004], or – in other words – whose shares are traded in exchanges or OTC markets. As soon as foreign companies participate, "they face all obligations arising out of the regulations and also the possibilities for sanctioning"[1005]. Certain extensions as to European

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[999] *Hertig/Lee*, Four Predictions about the Future of EU Securities Regulation, online publication 2003; www.effas.com/pdf/hertig_lee.pdf (download June 6th, 2007), p.4.

[1000] The Lamfalussy proceeding is as follows: at first, the basic body of law is enacted, then, detailed regulation as to the implementation are to be developed by two committees. CESR, one of the committees and described below, will then conceive interpretative rules and definitions, and the Commission will supervise that the member states integrate the enactment in their national legal body. *Seitz*, Die Integration der europäischen Wertpapiermärkte und die Finanzmarktgesetzgebung in Deutschland, in BKR 2002 340, p.341; *Fleischer*, Die Richtlinie über Märkte für Finanzinstrumente und das Finanzmarkt-Richtlinie-Umsetzungsgesetz – – Entstehung, Grundkonzeption, Regelungsschwerpunkte, in BKR 2006 389, p.390. A graphical description of this process is found on *Karpf/Weidinger-Sosdean/Zartl,* Die Integration der Finanzmärkte der EU – die Rolle von CESR, CEBS und CEIOPS im Lamfalussy-Prozess, in ZFR 2007 6, p.7.

[1001] *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.6.

[1002] *Seitz*, Die Integration der europäischen Wertpapiermärkte und die Finanzmarktgesetzgebung in Deutschland, in BKR 2002 340, p.341; *Büche*, Die Pflicht zur Ad-hoc-Publizität als Baustein eines integeren Finanzmarkts, 2005, p.56 et seq.

[1003] A full overview of all relevant European codifications is to be found at *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.12 et seq.

[1004] *Schreiter*, Die Anwendung von Kapitalmarktregeln auf ausländische Gesellschaften und ihr Management, online publication 2004; http://www.uni-leipzig.de/bankinstitut/dokumente/2004-02-06-01.pdf (download June 6th, 2007), p.15.

[1005] *Schreiter*, Die Anwendung von Kapitalmarktregeln auf ausländische Gesellschaften und ihr Management, online publication 2004; http://www.uni-leipzig.de/bankinstitut/dokumente/2004-02-06-01.pdf (download June 6th, 2007), p.22.

issuers and brokers/dealers exist as discussed above – of high importance, in this regard, is the "European passport" for securities, which allows for trading at all exchanges as soon as the security has been acknowledged in one member state.

For the Securities Trading Act, which is the main enactment in the field of securities regulation, applicability is defined as to types of shares according to legislative definition[1006]: shares, certificates standing in for shares, debenture bonds, profit-participating certificates, options and other securities in as far as they are similar to the above-mentioned and can be traded, be it either on an exchange or through other forms of markets, also most known derivatives such as floors, collars and swaps.[1007] Also, a fixed scope of investment services[1008] is covered, including all offers of credit institutions, financial services institutions and such entities that engage in securities transactions. Further detailed definitions relate to other capital market law enactments.[1009]

In the following, all national law relative to BaFin's responsibility will be introduced, whereas a clear focus is put on securities law. Organizational of BaFin itself will be shortly covered, whereas exchange organizational[1010] law – such as the Stock Exchanges Act (BörsG) will be omitted.

1. Act instituting the BaFin – FinDAG

Come into effect in May 2002, the FinDAG severely changed the structure of German capital market supervision by combining three formerly independent authorities to a one-in-all, cross-sectoral institution.[1011] The enactment, chiefly, provides for all organizational requirements of the BaFin as detailed above, but also contains changes of several other enactments necessary due to this.[1012] Also, it regulates that all duties and authorities from the predecessors will be automatically transferred upon BaFin, a so-called universal legal succession.

[1006] Securities Trading Act (WpHG), sec. 2 I and II.
[1007] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.483.
[1008] As defined by Securities Trading Act (WpHG), sec. 2 III and IIIa.
[1009] In detail, Banking Act (KWG), sec. 1 I and Ia, sec. 53 I 1; *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.486.
[1010] *Schreiter*, Die Anwendung von Kapitalmarktregeln auf ausländische Gesellschaften und ihr Management, online publication 2004; http://www.uni-leipzig.de/bankinstitut/dokumente/2004-02-06-01.pdf (download June 6th, 2007), p.17.
[1011] *Büche*, Die Pflicht zur Ad-hoc-Publizität als Baustein eines integeren Finanzmarkts, 2005, p.50.
[1012] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.554.

However, no change of the material law was made, so that the situation for the supervised entities continued as previously and FinDAG must be viewed as an exclusively organizational body of law.[1013] Thus, even though supervision now is effectuated in a one-stop approach, continuity of sector-specific rules and supervisory practices is granted, which does not only satisfy the demand of the supervised entities, which have adapted their structure and internal operations to the requirements of legislation, but also seemed justified as the enactments and practices had "stood the test of time"[1014] and proved their efficiency. Scholars view this favorable: as the sectors are quite different in their historic development and systematic legal regulation, total unification of the legal supervisory base would neither have proven effective nor equitable.[1015]

2. Acts governing the work of BaFin

a. Banking and insurance supervision

As both supervisory areas are not in the scope of this paper, the relevant enactments will be only enlisted in the following.

For banking superwision, the Banking Act (KWG) stipulates the control of each entity conducting banking business in Germany at its establishment and in an ongoing process during its operation. Thus, it provides for the necessity of written authorization for any party who intends to engage in the banking business[1016] bound to certain conditions: a minimum amount of funding capital, varying according to size and scope of the business[1017] and professional qualification, aptitude and moral integrity[1018] of senior management. Additionally, "the institution must also declare any holders of significant participating interests and the size of any

[1013] *Gemberg Wiesike,* Wohlverhaltensregeln beim Vertrieb von Wertpapier- und Versicherungsdienstleistungen, online-edition 2004, p.149.
[1014] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Reasons for integrated financial market supervision".
[1015] *Laars,* Bundesanstalt für Finanzdienstleistungsaufsicht, in NOMOS – Erläuterungen zum Deutschen Bundesrecht, CD-Rom version 2006*,* sub „Einleitung".
[1016] In detail, Banking Act (KWG), sec. 32 et seq.; the reasoning behind such necessity of approval lies with the protection of the common welfare; *Claussen*, Bank- und Börsenrecht, 3rd edition 2003, p.55.
[1017] For securities trading banks, this is € 730,000, for deposit-taking banks € 5 Mio.; http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Authorization and ongoing supervision – the phases of banking supervision".
[1018] Which the BaFin verifies by checking entries in the Federal Central Register (Bundeszentralregister) and the Central Trade Register (Gewerbezentralregister); http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Authorization and ongoing supervision – the phases of banking supervision". Recent discussion about this arose in re Ackermann *Geschwandtner*, Josef Ackermann im Visier der Bundesanstalt für Finanzdienstleistungsaufsicht – Wirtschaftlich erfolgreich! Persönlich unzuverlässig?, in NJW 2006 1571, p.1571 et seq.

such"[1019], so that possible conflicts of interests or a substantial unfitness of the owners to the banking business can be detected. At last, the bank's concept and strategy, including organizational designs and internal risk management and control systems, are reviewed. Also regular operations, especially the amount of own funds (varying with the risks the bank is willing to incur[1020]), and likewise of the liquidity reserves[1021], are constantly supervised, as well as the internal organization of the credit institution, which must be fit to the nature of the bank's business as to prevent system-inherent risks and conflicts of interests[1022]. Supervision is effectuated by review of annual accounts, and monthly updates[1023] which the institutions have to file with the BaFin, but also on external audit reports.[1024] Additionally, a certain range of events[1025] susceptible of severe influence on the bank's performance are to be reported.

In addition to the Banking Act, a broad body of specialized law for banking supervision exists, such as the Mortgage Banks Act (HBG), the Act relating to Mortgage Bonds and Similar Public-Law Credit Institution Bonds (PfandG), the Securities Deposit Act (DepotG) and the Building and Loan Associations Act (BauSparkG). Special emphasis should be attributed to the federal saving banks acts.

Insurance supervision is dominated by the Insurance Supervision Act (VAG), which already in 1901[1026] was enacted to prevent consumers from bankruptcy or insolvency of their insurance companies. Likewise as banking supervision, insurance supervision is based on the principles of initial authorization (specific legal form[1027], limitation of the scope of business[1028],

[1019] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Authorization and ongoing supervision – the phases of banking supervision".
[1020] In detail, at least 8% of risk-weighted assets must back up a bank's counterparty default risks and market price risks; Banking Act (KWG), sec. 10, 10a.
[1021] Banking Act (KWG), sec. 11.
[1022] Which are aimed at the credit business in general (Mindestanforderungen an das Kreditgeschäft der Kreditinstitute (MaK)), the trading activities (Mindestanforderungen für das Betreiben von Handelsgeschäften (MaH)) and at internal audit functions (Mindestanforderungen an die Ausgestaltung der internen Revision (MaIR)); http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Authorization and ongoing supervision – the phases of banking supervision".
[1023] Known as "monthly returns" and containing the most informative balance sheet positions and changes in the attribution of risk.
[1024] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Authorization and ongoing supervision – the phases of banking supervision".
[1025] Such as changes of senior management, projected net losses, changes in the branch network or the ownership structure and large exposures (so-called Millionenkredite, or loans of more than € 1.5 million); http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Authorization and ongoing supervision – the phases of banking supervision".
[1026] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Responsibilities and objectives of insurance supervision".
[1027] Either public limited company, mutual insurance society or public-law institution; http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Authorization and ongoing supervision – the phases of insurance supervision".

business plan with detailed outline of the reinsurance policy and available resources for daily business and sales[1029] and existence of a minimum capital[1030]) and ongoing supervision. (conduction of daily business in a proper manner and compliance with statutory and regulatory rules, premium and surplus attribution policy, solvency level, creation of technical reserves and reinsurance contracts, investment policy in terms of safety and profitability[1031]).
Supplementary to the Insurance Supervision Act, the Insurance Contracts Act (VVG) regulates with requirement for insurance contracts with consumer and defines mandatory clauses and such that are at the disposition of the parties. A reform in near time has been announced for January 1st, 2008.

b. Securities Trading Act (Wertpapierhandelsgesetz; WpHG)

The Securities Trading Act, being the main and prominent enactment[1032] in the field of securities law, covers a multitude of different fields, the most important of which will be outlined in the following. Enacted in 1995, it provided early guidelines for securities law and instituted several European directives in German law.[1033] Likewise as the development in the US, the Securities Trading Act has been the legislative answer to a series of severe scandals and a sharp decrease of investor confidence due to developments of the new market.[1034] It is primarily oriented on the secondary market[1035].

i. Ad-hoc disclosure

To create a high level of market efficiency, the Securities Trading Act[1036] prescribes the duty to publish new facts (ad-hoc disclosure) concerning corporate or business development as quickly as possible, so that such facts due to their possible impact on the company's financial position can be incorporated in the security's price. This is also structurally related to insider

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[1028] The so-called class-separation principle requires that, e.g., a life assurance company does not offer ill-health insurance; http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Authorization and ongoing supervision – the phases of insurance supervision".
[1029] Or, the so-called organization fund.
[1030] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Authorization and ongoing supervision – the phases of insurance supervision".
[1031] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Authorization and ongoing supervision – the phases of insurance supervision".
[1032] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.24, – as also shown by many titles the enactment was adorned: "Grundgesetz des deutschen Kapitalmarktrechts", "Nukleus des Kapitalmarktrechts", "wichtigstes kapitalmarktrechtliches Gesetz seit 100 Jahren" just to name a few; *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.481.
[1033] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.481.
[1034] *Fleischer*, Das vierte Finanzmarktförderungsgesetz, in NJW 2002 2977, p.2977.
[1035] *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.98.
[1036] Securities Trading Act (WpHG), sec. 15.

dealing, as published information will be incorporated in the price and thus annihilates the possibility of insider gains.[1037] Also, issuers are to excuse themselves and notice BaFin thereof if they deem a certain fact as touching their legitimate interests and thus not being necessary to publish yet.[1038] However, ad-hoc disclosure is only to be used to spread material news about the issuer and/or the security, and not as a means of promotion or advertising[1039], a practice that had been too readily employed by issuers, as ad-hoc disclosure raised a higher awareness than normal publications or advertisement.[1040] Furthermore, the Securities Trading Act provides, for the first time in German capital market law[1041], an independent basis for investors' claims of compensation in case of the duty of ad-hoc disclosure being neglected either in terms of truth or timeliness of disclosure, but limited to intent and gross negligence on the side of the liable issuer.[1042]

ii. Insider disclosure

Furthermore, insider dealing is prevented[1043] by statutory disclosure requirements imposed on both publicly traded companies and the persons deemed as insiders, so that former insider facts must be published and share trades reported, however on a restricted range of securities smaller than the above-mentioned.[1044] The insider status, furthermore, does not only relate to so-called primary insiders, i.e. corporate management or personnel, but also to secondary insiders, i.e. such persons who got notice of the fact by primary insiders.[1045] Furthermore, financial intermediaries suspecting a case of insider trade are to report this to BaFin, so that the agency saves a considerable effort in supervision. Non-compliance is sanctioned[1046] with fines or imprisonment up to five years.

[1037] *Struck*, Ad-hoc-Publizitätspflicht zum Schutz der Anleger vor vermögensschädigendem Wertpapierhandel, 2002, p.31.
[1038] Securities Trading Act (WpHG), sec.15 III. For this, they have to carefully consider both their interests and the relevance of the information in question to the capital market, e.g. results of on-going negotiations or such decisions for which approval of a governing body abides; *Merkner/Sustmann,* Insiderrecht und Ad-Hoc-Publizität – Das Anlegerschutzverbesserungsgesetz „in der Fassung durch den Emittentenleitfaden der BaFin, in NZG 18/2005 729, p.732. Prior to the Securities Trading Act's amendment, this excuse was granted by BaFin, for detailed description of this process see *Struck*, Ad-hoc-Publizitätspflicht zum Schutz der Anleger vor vermögensschädigendem Wertpapierhandel, 2002, p.139f.
[1039] Securities Trading Act (WpHG), sec. 15 I 4.
[1040] *Fenchel*, Das vierte Finanzmarktförderungsgesetz – ein Überblick, in DStR 2002 1355, p.1358; *Möllers*, in *Berger* et al., Festschrift für Norbert Horn zum 70. Geburtstag, 2006, p. 478.
[1041] *Fürhoff/Schuster*, Entwicklung des Kapitalmarktaufsichtsrecht im Jahr 2002, in BKR 2003 134, p.135.
[1042] Securities Trading Act (WpHG), sec. 37b, 37c.
[1043] Securities Trading Act (WpHG), sec. 14.
[1044] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.489.
[1045] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.489.
[1046] Securities Trading Act (WpHG), sec. 38.

iii. Director's dealing

Close to insider dealing is also the field of director's dealing, i.e. the acquisition and/or sale of securities of a company by members of its board of management or supervisory board. Such persons, as well as their spouses and relatives of 1st degree, are therefore obliged to report dealings to the issuer and to BaFin with short notice.[1047] Additionally, the issuer is to publish such dealings on its homepage or a supra-national newspaper, whereas BaFin offers an additional database for publication on its homepage.[1048] With a de-minimis threshold[1049], transactions of minor size and scope are exempted. Non-compliance with the duty to report is sanctioned as a misdemeanor. Already a legal principle for a long time in the US, and well established also in Italy and the Netherlands[1050], the prohibition of directors' dealing is to increase market integrity and transparency, as well as to ensure equal treatment of all shareholders, whether involved in a company or not.[1051] BaFin has, in this regard, published extensive material in questions of interpretation which transactions are deemed director's dealings and how to comply with the regulation.[1052]

iv. Publication of interests

As a further measure of transparency for smaller investors, the shareholder structure of a publicly traded company and significant changes therein are subjected to publication. Thus, any natural and legal person whose shares fall, by a transaction, above or below certain thresholds[1053], must notify the issuer and BaFin of this with the least possible delay.[1054] Likewise as with director's dealing, the issuer then has to engage in publication.

v. Prohibition of market price manipulation

The Securities Trading Act, in succession of a provision in the former Stock Exchanges Act[1055], also prohibits any market price manipulation: any dissemination of false information

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[1047] Securities Trading Act (WpHG), sec. 15a.
[1048] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "The key responsibilities of BaFin's securities supervision".
[1049] Compound transactions of less than € 5,000 in a year, formerly € 25,000 in 30 days; Securites Trading Act (WpHG), sec. 15 I 4.
[1050] *Hutter/Leppert,* Das 4. Finanzmarktförderungsgesetz aus Unternehmenssicht, in NZG 2002 649, p.656.
[1051] *Fleischer*, Das vierte Finanzmarktförderungsgesetz, in NJW 2002 2977, p.2978.
[1052] *Fürhoff/Schuster*, Entwicklung des Kapitalmarktaufsichtsrecht im Jahr 2002, in BKR 2003 134, p.135.
[1053] In detail, more than 5%, 10%, 25%, 50% or 75%; a threashold of 3% has been introduced with the amendmend in 2006; *Weber*, Die Entwicklung des Kapitalmarktrechts im Jahre 2006, in NJW 2006 3685, p.3686.
[1054] Securities Trading Act (WpHG), sec. 21.
[1055] Former Stock Exchanges Act (BörsG), sec. 88 I; *Hutter/Leppert,* Das 4. Finanzmarktförderungsgesetz aus Unternehmenssicht, in NZG 2002 649, p.651; *Schönhöft*, Die Strafbarkeit der Marktmanipulation gemäß § 20a WpHG, 2006, p.81.

or withholding of information concerning material factors of valuation[1056], and likewise any other act of deception[1057]. In determining a violation, the body of law uses the intent to influence the market prices (and not an intent to defraud) as relevant criterion, whereas an effected price manipulation is sanctioned as criminal offence with imprisonment up to 5 years, an attempt as mere misdemeanor, sanctionable only with a fine.[1058] However, the legal provision is rather unclear about the concrete behavior which constitutes a price manipulation – undoubtedly also the consequence of the minor importance and applicability this rule had, when still incorporated in the Stock Exchanges Act.[1059] Thus, the BMF is entitled to define this by a regulation, and has, in cooperation with BaFin, engaged into doing so.[1060]

vi. Rules for financial services institutions

Further rules extend to financial services institutions, also reaching out to banks[1061], which are prescribed[1062] rules of professional conduct relating e.g. to complete and correct information to clients before conduction of a transaction, corporate values and control mechanisms for "due diligence, expertise and consciousness in the interests of […] clients"[1063] and clear codes on conflicts of interests. Further organizational requirements relate to the existence of internal control systems and an organizational design susceptible of avoiding conflicts of interests, i.e. encompassing a clear separation of internal functions such as trading, customer acquisition, dispute settlements and internal controls. Compliance is ensured by yearly reviews by BaFin's employees, also special investigations in case of doubt about compliance can be effectuated.[1064] Non-compliance is sanctionable with fines up to € 200,000.

[1056] Securities Trading Act (WpHG), sec. 20a.

[1057] Encompassing, among others, defrauding trading practices such as wash-sales or pre-arranged trades, but also the abounding of rumors with likely influence on the share price http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "The key responsibilities of BaFin's securities supervision"; *Park*, Kapitalmarktstrafrechtliche Neuerungen des Vierten Finanzmarktförderungsgesetzes, in BB 2003 1513, p.1514.

[1058] *Fenchel*, Das vierte Finanzmarktförderungsgesetz – ein Überblick, in DStR 2002 1355, p.1358; *Schönhöft*, Die Strafbarkeit der Marktmanipulation gemäß § 20a WpHG, 2006, p.175.

[1059] *Park*, Kapitalmarktstrafrechtliche Neuerungen des Vierten Finanzmarktförderungsgesetzes, in BB 2003 1513, p.1513.

[1060] The so-called KuMaKV of November 18th, 2003; *Fleischer*, Das vierte Finanzmarktförderungsgesetz, in NJW 2002 2977, p.2980, which was, however, soon abolished and to the benefit of MaKonV; *Weber*, Die Entwicklung des Kapitalmarktrechts im Jahre 2004, in NJW 2004 3674, p.3675.

[1061] I. e. "credit institutions, financial services institutions and certain German branches of foreign companies that are subjected to the Banking Act", http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "The Federal Financial Supervisory Authority", also *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.90.

[1062] Securities Trading Act (WpHG), sec. 31 et seq.

[1063] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "The key responsibilities of BaFin's securities supervision".

[1064] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "The key responsibilities of BaFin's securities supervision".

vii. Rules for financial analyses

A second means to reach both market integrity and investor confidence is the control of financial analyses, which are most certainly at the core of every investment decision. Thus, the Securities Trade Act sets standards "for conscientiousness, neutrality and integrity of those who produce and disseminate financial analyses"[1065]: they must be prepared with sufficient expertise and presented in a way that conflicts of interest or relationships with analyzed security or issuer are disclosed.[1066] Furthermore, such persons or entities must strive to inform clients about their experiences and knowledge in the current field of investment, about the aim of their business and their financial standing.[1067] Additionally, they are to notify BaFin of such, whereas BaFin will supervise compliance with the different requirements. [1068] As the legislative provisions are somewhat vague, BaFin has published a bulletin defining the kind of analyses concerned and the compliant behavior.[1069]

To alleviate BaFin's regulatory duties, the legislator provided[1070] for the agency to release sub-legislative norms and regulations which would help to interpret the legislative context. Being non-binding to the public, and binding only within BaFin's internal organization, rules most often define codes of conducts or interpretative clauses. The Securities Trading Act will undergo major changes due to MiFID and the ensuing FRUG, which is to incorporate MiFID's material regulation in German law until November 1st, 2007.[1071]

c. Securities Prospectus Act (Wertpapier-Prospektgesetz, WpPG)

What ad-hoc disclosure provides for the secondary market, is regulated by the Securities Prospectus Act for the primary market[1072] – the publication of certain information by the issuer, so that the investing public is distributed the information it needs to decide about the purchase of the security.

[1065] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "The key responsibilities of BaFin's securities supervision".
[1066] Securities Trading Act (WpHG), sec. 34b.
[1067] Securities Trading Act (WpHG), sec. 31 II.
[1068] With the exception of investment services undertankings/investment companies and individual analysts employed by an undertaking investment company, as their engagement is already known to BaFin, and journalists, if they subjected to comparable self-regulation; http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "The key responsibilities of BaFin's securities supervision".
[1069] Bulletin as of March 11, 2003; *Weber*, Die Entwicklung des Kapitalmarktrechts im Jahre 2003, in NJW 2004 28, p.33.
[1070] In Securities Trading Act (WpHG), sec. 31, 32, 35 VI and others.
[1071] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Jahresbericht der Bundesanstalt für Finanzdienstleistungsaufsicht 2006, p.43.
[1072] *Teichmann,* Haftung für fehlerhafte Informationen am Kapitalmarkt, in JuS 2006 953, p.954.

Applicable for securities to be publicly traded at organized markets[1073], the issuer is to publish a sales prospectus covering all listed requirements, which BaFin has to approve before publication. Prospects have to fulfill criteria such as a comprehensive, understandable form[1074], declaration of responsibility[1075] further principles (minium information, format, publication) as stipulated by the adjacent directive[1076]. Also, the issuer of the prospectus is held liable for intentional faults or such happening by gross negligence.[1077]

BaFin's task, in this process, is the control of completeness of the information in the prospectus and look for obvious manipulation. If BaFin grants permission to publish, however, no check of correctness or judgment on the issuer is ensued, a fact separately to be disclosed in the prospectus as to avoid the so-called seal-of-approval effect[1078]. In case of non-compliance, the issuer and the responsible person are held liable according to Stock Exchanges Act (BörsG), sec. 44 I, so that investors' protection is maintained despite a lower level of content supervision.

With regard to the above, the Act on the Prospectus of Securities Offered for Sale (VerkProspG) fills the gap by relating to those shares that are offered for public sale, but not admitted to trading on a stock exchange, or the so-called grey market.[1079] Generally, likewise rules apply as on the primary market with BaFin's supervision.

d. Enactments of minor scope

The Securities Acquisition and Takeover Act is to ensure transparency and fairness of the takeover procedure for all investors[1080] by stipulating, differing with the quality of the offer, a certain procedure of the bidding process and minimum offers for shareholders. BaFin's task is the check of offer documents for completeness and apparent lesions of the Securities Acquisi-

[1073] Securities Prospectus Act (WpPG), sec. 1 I.
[1074] Securities Prospectus Act (WpPG), sec. 5, 7.
[1075] Securities Prospectus Act (WpPG), sec. 5 IV.
[1076] Prospectus Directive (ProspektVO).
[1077] Securities Prospectus Act (WpPG), sec. 13.
[1078] I.e. investors trusting the issuer because the prospectus is approved by BaFin as a public authority, whereas in reality, the checking procedure is a rather cursory one; *Spindler,* Kapitalmarktreform in Permanenz – Das Anlegerschutzverbesserungsgesetz, in NJW 2004 3449, p.3455; *Weber*, Die Entwicklung des Kapitalmarktrechts im Jahre 2005, in NJW 2005 3682, p.3687.
[1079] *Köhler et al.,* Umsetzungsstand des 10-Punkte-Plans der Bundesregierung zur Stärkung des Anlegerschutzes und der Unternehmensintegrität, in BB 2004 2623, p.2629. Due to high turnover, the grey market is of quite some economic significance, but also bears high risks due to its low level of organization and thus control.
[1080] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "The key responsibilities of BaFin's securities supervision".

tion and Takeover Act, whereas it can also decide on exemptive applications.[1081] Sanctions are up to € 1 million with an additional penalty payment up to € 500,000 and civil liability for all claims made in the offer documents.[1082]

The Investment Companies Act (KAAG) confers upon BaFin authority to supervise such entities that act as a collective fiduciary and administrate assets for their clients on a contractual basis.[1083] Control is effectuated by licensing the business with certain requirements (minimum asstes of € 730,000, internal control and risk management system, aptitude of their senior management), supervision of sales contracts (similar criteria as with prospectuses[1084]) and continuing review of compliance.

The Foreign Investment Act (AuslInvG) supplements the KAAG by stipulating similar conditions for funds subjected to foreign legislation.[1085] Such businesses have to name a representative to investors and guarantee certain minimum standards in their contracts.

iii. Summary

The previous chapter detailed BaFin's governing law in all three fields banking, insurance and securities supervision. As mentioned, most of the enactments have found interpretation in further statutes, so that BaFin is actively involved in the course of their administration. However, frequent changes and remodeling of the body of capital market law requires that BaFin adapts their supervisory approach and also engages in the interpretation of the existing law as well as in the creation of new codes.

[1081] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "The key responsibilities of BaFin's securities supervision".
[1082] *BaFin* Introductory Powerpoint Presentation (for internal purposes), p.40.
[1083] *BaFin* Introductory Powerpoint Presentation (for internal purposes), p.302.
[1084] *BaFin* Introductory Powerpoint Presentation (for internal purposes), p.307.
[1085] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.24.

e. Operations and legal means

After detailing the legal framework of BaFin's actions, the following will outline BaFin's operations and the legal means the institution employs as to ascertain its mission, however restricted to the field of securities/asset management supervision. Being a public authority, BaFin finds all its actions bound to the basic rights, so that they must be executed with commensurability, i.e. they must not exceed the indicated necessity.[1086] Furthermore, BaFin acts only in public interest, so that a lesion of this duty will not ensue in individual claims.[1087]

BaFin's authority can be described as a central supervisory agency for all securities and related products with a realm over all of Germany, or, as FinDAG[1088] norms it, as pursuing those supervisory tasks as indicated by WpHG. Securities Trading Act (WpHG), sec. 4 renders a general definition[1089]: BaFin supervises entities in the capital market with the aim of[1090] counteracting grievances, whereas it is entitled to order remedies which are to alleviate the grievances. However, this does not only relate to transactions, but also encompasses other actions prohibited by bodies of law, so that the agency has to fight all events which might impede securities transactions or lead to disadvantages for the capital market.[1091]

i. Rulemaking and standard-setting

As detailed above, BaFin is entitled to conceive sub-legislative norms and regulations, mostly in the form of so-called regulations (Rechtsverordnungen) and directives (Richtlinien). Authority may either been declared by law, or be delegated to BaFin at a later point in time. As German constitutional law only allows for delegation of powers to such authorities that are directly answerable to Parliament[1092], BaFin's power derives from so-called sub-delegation[1093] of those parties, mostly by the BMF, which also on its own releases directives. In this case, BaFin closely cooperates as to ensure that the directive will meet the practical needs of supervision and also integrate into the current body of regulation.[1094]

[1086] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.561.
[1087] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.556.
[1088] Finanzdienstleistungsaufsichtsgesetz (FinDAG), sec. 4 I and Securities Trading Act (WpHG), sec.4 I as a general norm, but also special fields of authority assigned.
[1089] *Weber*, Die Entwicklung des Kapitalmarktrechts im Jahre 2004, in NJW 2004 3674, p.3678.
[1090] For a detailed outline of the conditions for such actions, see *Hirte/Möllers*, Kölner Kommentar zum WpHG, 2007, § 4, marginal 21, p.179.
[1091] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.555.
[1092] Basic Constitutional Law (GG), sec. 80 I.
[1093] *Schädle*, Exekutive Normsetzung in der Finanzmarktaufsicht, 2007, p.55.
[1094] *Weber-Rey*, Rechts-Report Finanzmakrtaufsicht: Grundsätze für die Ausübung der Aufsicht des BMF über die BaFin, in AG 2005 447, p.447. Examples of such cooperation are the Regulation on Market Price Manipulation (Verordnung zur Marktpreismanipulation) on Securities Trading Act (WpHG), sec. 20a II, or the Regulation on Financial Analysis (Finanzanalyseverordnung).

Regulations integrate into the body of material law, so that they bind both the supervised entities and the bodies in charge of judicial control.[1095] With regard to directives, an intense scholarly discussion has arisen, mainly debating their norm-interpretative or norm-concretizing nature and whether they are mere internal administrative norms or unfold a presumption of conformity, especially in the form of a partial binding of judicial bodies.[1096]

Clarifying definitions, especially of norms of the WpHG[1097], are of major practical relevance. Examples are the Regulation on Reporting Requirements in Securities Trade (Wertpapierhande-Meldeverordnung) elaborating on Securities Trading Act (WpHG), sec. 9, or the Regulation on Auditing of Financial Services (Wertpapierdienstleistungs-Prüfungsverordnung) on Securities Trading Act (WpHG), sec. 36 V.[1098] Also, BaFin issues directives on which the institution clarifies its view on legal norms, possibly also in combination with a clear suggestion for compliant behavior.[1099] As to ensure acceptance with the industry and also practical viability, such releases are extensively discussed with industry circles and/or the German Federal Bank.[1100]

A last means of standard-setting is soft law, i.e. interpretative releases or circular letters, such as the one issued[1101] on insider dealing and the interpretation of this term, reporting requirements and the like. A further example might be the Guidelines for Issuers (Emittentenleitfaden) BaFin published in early 2005 and will update in 2007[1102], as it was issued without legislatively conferred authority to do so.

Being soft law without regulative character, those issuances are only binding within the institution, i.e. do not hold any legally binding character with supervised entities[1103], but merely inform about BaFin's interpretation of norms and principles according to which BaFin would decide in its discretion. Thus, such releases only bind employees in terms of public services

[1095] *Schädle*, Exekutive Normsetzung in der Finanzmarktaufsicht, 2007, p.79.
[1096] For a detailed review of the discussion, see *Schädle*, Exekutive Normsetzung in der Finanzmarktaufsicht, 2007, p.81 et seq.
[1097] As allowed by Securities Trading Act (WpHG), sec. 35 VI.
[1098] *BaFin* Introductory Powerpoint Presentation (for internal purposes), p.7.
[1099] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.561.
[1100] *Kümpel*, Bank- und Kapitalmarktrecht, 3rd edition 2004, p.2473.
[1101] In November 2002; for a detailed overview see *Bartsch*, Effektives Kapitalmarktrecht – zur Rechtsfolgenseite der Richtlinien im Europäischen Kapitalmarktrecht, online-edition 2005, p.105.
[1102] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.
[1103] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.27; *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.203.

law to apply the norms in the sense the release describes it.[1104] Still, if such a norm is violated, it will be supposed that the underlying legal code was violated, so that strong arguments recommend businesses to literarily observe them. Also, the judicial branch might rely on such publications for the interpretation of legislative norms. Furthermore, it is argued that if binding for one decision, the regulation comes into legal effect due to the equality principle in Basic Constitutional Law, sec. 3.[1105]

Even though the concept of soft law is criticized in terms of constitutional legality[1106] and also as to clarity and lucidity, this approach allows BaFin to provide for uniform rules in all sectors. Also, perceived necessary changes in the financial market or recognized lacks of regulation in daily work can be molded into quasi-legal rules, so that soft law offers a high level of flexibility and adaptation. Thus, BaFin's practice must be seen as quick and effective, and despite the constitutional concerns as a viable approach, which might be worth legislative facilitation.

ii. Registering

As indicated above, BaFin controls a wide array of entities and person who conduct business in the capital market and for reasons of supervision have to register and/or certify with BaFin before conduction of business. Most important, in this regard, are banks and financial services providers with their primary seat of business in Germany, as they will be asked to present the core strategy of their business, amount and origin of own funds and the biography of senior management.[1107]

Also, the requirement to have a securities sale prospectus checked by BaFin can be seen as a registering requirement, as BaFin will only then grant the right to issue the security. Although in this field, BaFin's supervision will only be in terms of completeness and unequivocalness, the check of the sales prospectus is an important step to assure that investors will receive due information and that only securities with a minimum range of security are traded.

[1104] *Merkner/Sustmann,* Insiderrecht und Ad-Hoc-Publizität – Das Anlegerschutzverbesserungsgesetz „in der Fassung durch den Emittentenleitfaden der BaFin, in NZG 2005 729, p.730.
[1105] *Mülbert,* Bankenaufsicht und Corporate Governance – Neue Organisationsanforderungen im Finanzdienstleistungsbereich, in BKR 2006 349, p.353.
[1106] For both BAKred and BAV *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.159; as the approach did not change with BaFin, the concerns are still valid.
[1107] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.136.

Acting without due permission is sanctioned as misdemeanor or felony, respectively, so that on the side of the supervised entity a strong necessity for compliance exists. Thus, BaFin shoulders a heavy workload in the area of registration.

iii. Counseling and advice

Likewise as the SEC, BaFin is a very approachable authority and aims at cooperation with its supervised entities. This does not only apply to counseling in their individual questions and cases, and also negotiations in case of a wrong-doing, but also reaches out to the organizations of workshops and informative events on which BaFin teaches either its supervised entities, the general investing public or journalists in topics of capital market supervision. For example, in late 2006 a workshop on the changes in the Securities Trading Act with regard to voting rights, which was attended by more than 350 participants.[1108]

iv. Supervisory power

The field of supervision is oriented on BaFin's defined goals, i.e. safeguarding of investor's rights and interests as well as transparency and integrity of the capital market. Thus, "a primary task […] is to control the action of banks and brokers on the market in terms of legality and truth and fairness"[1109] and enclosing not only security transactions, but also stock broking and depositing business. Furthermore, the price mechanism at stock trading is monitored, and this safeguards the capital market's competitiveness and recognition.

Market supervision, thus, is detailed in four main areas: control of compliance of banks with the Securities Trading Act in acting as financial intermediaries for their clients, discovery and prosecution of insider trading and share price manipulation, supervision of disclosure and cooperation with European and international authorities engaged in the same field.[1110] BaFin's solvency supervision and supervision of trustworthiness, on the contrary, relates only to financial intermediaries and credit institutions and checks whether the latter are capable of "safeguarding their continuing existence and the constant fulfillment of all due liabilities by both a fitting business policy and sufficient own funds"[1111].

[1108] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.
[1109] *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.106.
[1110] *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.110.
[1111] *Kümpel*, Bank- und Kapitalmarktrecht, 3rd edition 2004, p.2451.

All supervisory activities are based on the principle of cooperation of BaFin and the supervised entities. The entities which are subjected to inquiries and other controls are chosen on occasion or as random sample.[1112] Matters of supervision are the latest financial statements with all other business information, and the standards for such are all enactments including generally accepted accounting principles.

As detailed above in the fields of insider trading and price manipulation, BaFin closely cooperates with federal states' authorities and engages into so-called authority-lending (Organleihe), mainly to account for the necessary quickness of control and action, but also to enhance efficiency: federal states' authorities might have already extensively discovered the case, but were not to act due to lacking authority in this field. Thus, primary measures such as the safeguarding of data or other evidence, can[1113] be performed by federal states' institutions, although they would legally lack capacity to do so.

v. Investigative power

1. Beginning of investigations

BaFin usually starts its investigations after a suspicion of a violation of its governing law, which can consist in a multitude factors. In their supervisory work, BaFin's staff "routinely analyzes trading on the basis of the data on all securities transactions" that its supervised entities are obliged to report. In additional, rapid price movements or changes in turnover are compared with the information available on the security in question. However, this does relate mainly to fully conducted transactions, and not to such which are on the point of being concluded.[1114] Also, BaFin does not only rely on officially filed or disclosed data, but also supervises press publications and the like.

Furthermore, BaFin reviews a multitude of required reports of its supervised entities, which may present ambiguities or other indications for a lesion of law. Most important are the numerous ad-hoc disclosures[1115]: as this news is deemed to be price-sensitive, the risk that it has or has had side effects is considerable. Other clues are presented by investors or other market participants, most notably the exchanges and their supervisory units[1116], by general news or

[1112] *BaFin* Introductory Powerpoint Presentation (for internal purposes), p.44.
[1113] Securities Trading Act (WpHG), sec. 6 II.
[1114] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.195.
[1115] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.177.
[1116] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.177.

electronic media services.[1117] Also, the agencies with which BaFin cooperates often incite an investigation if, in the course of their supervision, they encounter irregularities.

2. Course of investigations

Its governing law[1118] confers upon BaFin the authority to request information any natural or legal person, i.e. of financial services agencies, brokers and dealers, issuers and other market participants[1119], as far reasonable suspicion for a lesion of law exists, which, however, is not to be as qualified as with the beginning of investigation by public prosecution[1120].

As far as persons or entities under duty to disclose information have been assigned and name their client, also the latter is concerned, and in case of suspected insider trading, BaFin may also interview such persons that are known to know the suspected tortfeasor[1121], or any other person whose contribution might be helpful regardless of a pending suspicion against them[1122]. This is applicable especially with regard to accountants, CPAs and other persons to whom the suspect delegated work in connection with the suspected violation of law – a provision severely impeding the obligation of secrecy, and thus violently criticized[1123].

Also, BaFin can request the submittal of information to gain insight into transactions of investors. Data prone to this procedure are not only account balances, but also orders, notes of discussions or electronic data.[1124] BaFin may, furthermore, enter the suspect's business site as to conduct investigations and gather evidence, or, as far as data are stored with other businesses, their site. However, this only covers entitlement to enter the site, not to search, so that practical relevance of this is somewhat lessened to the on-site request to be shown the data requested. Although such procedure might be against the client's wish of secrecy, clients cannot advise their bank or financial intermediary to act in contempt of BaFin's order, and neither can demand to be notified of such a procedure or the ensuing preliminary proceedings.[1125]

[1117] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.196.
[1118] To name, Securities Trading Act (WpHG), sec. 16 II, III, sec. 20b II, sec. 29 III, 35 I.
[1119] All persons and entities subjected to this are named in Securities Trading Act (WpHG), sec. 4 III.
[1120] *Hirte/Möllers*, Kölner Kommentar zum WpHG, 2007, § 4, marginal 111, p.209.
[1121] *Kümpel*, Bank- und Kapitalmarktrecht, 3rd edition 2004, p.2474.
[1122] *Hirte/Möllers*, Kölner Kommentar zum WpHG, 2007, § 4, marginal 113, p.210.
[1123] *Köhler et al.,*Umsetzungsstand des 10-Punkte-Plans der Bundesregierung zur Stärkung des Anlegerschutzes und der Unternehmensintegrität, in BB 2004 2623, p.2628.
[1124] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.202.
[1125] Securities Trading Act (WpHG), sec. 16 VIII.

In case of an investigation being conferred to the Public Prosecution Office, BaFin offers professional help, e.g. participation in searches or inquiries as expert witnesses, conduction of analyses or other written comments.[1126]

3. End of investigations

If, at the conclusion of an investigation, BaFin cannot find any faults, it will close the file with a final internal report, which will also be distributed to the entity in question. If, however, BaFin finds faults, it will notify the entity of such, which then is allowed to comment on the allegations and amend the faults, as far as possible. Also, a final report is issued and the entity has to publish the fault, its correction and the changes this is to incur.[1127]

Generally, BaFin "does not engage in investigations with criminal law background, but in investigations with administrative background"[1128]. Thus, only administrative offences are investigated deeply into the subject matter and later sanctioned by BaFin itself in a process detailed below. In case of a criminal suspicion being corroborated, BaFin reports – bound by a legal duty to do so[1129] – the offence to the adequate Public Prosecutor's Office, which will then engage into further investigation and/or prosecution. Due to the above-mentioned principle, this is effectuated in an early stage, as the investigative authority of prosecution is much farther reaching than BaFin's, so that early referral ensures a quicker and more thorough investigation.[1130] BaFin's involvement, at this point, ends ultimately[1131] and the Public Prosecutor's Office will then decide about future procedure and eventually legal action.

4. Legal protection of investigated persons/entities

The protection of investigated persons, especially in terms of data protection, is derived from a basic constitutional right[1132] and shaped in the Federal Data Protection Act (BDSG) and federal states' law in this field, as well as by multiple other enactments in special fields such as teleservice[1133]. Influenced by a European directive[1134], the act[1135] states a prohibition for the

[1126] *BaFin* Introductory Powerpoint Presentation (for internal purposes), p.95.
[1127] *BaFin* Introductory Powerpoint Presentation (for internal purposes), p.45.
[1128] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.204.
[1129] Securities Trading Act (WpHG), sec. 18 I, sec. 20b VI and others.
[1130] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.204.
[1131] Securities Trading Act (WpHG), sec. 4 V 3.
[1132] The prinicple of informational self-determination; *Durner*, Zur Einführung: Datenschutzrecht, in JuS 2006 213, p.214.
[1133] *Durner*, Zur Einführung: Datenschutzrecht, in JuS 2006 213, p.214.
[1134] Directive 95/46/EC; *Tinnefeld*, Die Novellierung des BDSG im Zeichen des Gemeinschaftsrechts, in NJW 2201 3078, p.3078.
[1135] Federal Data Protection Act (BDSG), sec. 4 I.

census, processing and use of individual-related data, unless permitted by law – a so-called reservation. Most important, in this regard, is sec. 13 I of the Federal Data Protection Act, which allows for the census of data if this is required for the completion of a public agency's task – thus, BaFin is allowed to collect data in the realm of its tasks as defined by the Securities Trading Act. The person concerned is granted multiple rights of disclosure, correction, deletion and inhibition of the data concerned.[1136]

Legal entities do not fall under this act[1137]; however, they are protected by the general privacy protection that governs BaFin's actions. A range of scholars requests that data protection be extended to legal entities as to ensure further cooperation with investigations[1138], i.e. to signal that that in case of cooperation, disclosed data will remain confidential.

Besides this special legislation, BaFin's governing law – most important, sec. 8 Securities Trading Act – stipulates discretion for all results of investigations, and also expresses that no duty of information exists towards financial authorities. However, disclosure towards Public Prosecution and jurisdiction is allowed, or else BaFin's goal of efficient supervision could not be met. The provision is valid for all information that should not be disclosed, i.e. for such facts for which "a third party can claim a legitimate interest of secrecy"[1139]. Furthermore, all persons who are granted a refusal to give evidence by privilege of rank, e.g. lawyers, CPA and tax consultants, can decide not to comply as to protect the interests of their clients.[1140]

Although numerous democratic principles safeguarded the investigated parties' interest during investigation and/or proceedings, only in 2006, the legislator enacted the Freedom of Information Act (IFG), which regulate that each party concerned is granted access to the relevant information available with an agency.[1141] Denial is limited to public concerns, the protection of individual-related data and the protection of business interests[1142], whereas the entity asked to disclose has a discretionary authority.[1143]

[1136] Federal Data Protection Act (BDSG), sec. 19ff.
[1137] *Tinnefeld*, Die Novellierung des BDSG im Zeichen des Gemeinschaftsrechts, in NJW 2201 3078, p.3079.
[1138] *Hirte/Möllers*, Kölner Kommentar zum WpHG, 2007, § 4, marginal 171, p.229.
[1139] *Möllers/Wenninger*, Informationsansprüche gegen die BaFin im Lichte des neuen Informationsfreiheitsgesetzes (IFG), in ZHR 2006 455, p.456.
[1140] *Hirte/Möllers*, Kölner Kommentar zum WpHG, 2007, § 4, marginal 122, p.213.
[1141] Freedom of Information Act (IFG), sec. 1.
[1142] Freedom of Information Act (IFG), sec. 3-6; also, this is guaranteed by the duties to keep confidential as – for BaFin - in Banking Act, sec.9, Securities Trading Act, sec. 8 and others; *Stabno*, Informationsfreiheitsgesetz – IFG – Online-Kommentar, http://www.recht-freundlich.de/ifg_stabno.pdf, p.84.
[1143] *Möllers/Wenninger*, Informationsansprüche gegen die BaFin im Lichte des neuen Informationsfreiheitsgesetzes (IFG), in ZHR 2006 455, p.468.

Practically, the information requested concerns in most cases the result of investigations and/or proceedings, but it also allows the aggrieved party to obtain information BaFin investigated.[1144] In case of many parties being interested in specific information, publication might be indicated[1145] – a landmark for further securities action. However, this is more or less a theoretical consideration, as currently, BaFin reacts rather reticently to information requests – and the first claims have been filed as to enforce the delivery of information.[1146]

vi. Remedial power

Of high importance to ensure the realization of BaFin's goals is BaFin's authority to prescribe law-abiding behavior to its supervised entities, or request the stop of certain activities[1147]. If the latter do not comply with either legal requirements or BaFin's regulation based on such, BaFin is entitled to release orders which are apt and necessary to alleviate the nuisance.[1148] Important, in this regard, is the legislative exclusion of deferral[1149], which in the cases named allows immediate enforcement of BaFin's remedy.

In case of suspected lesion of insider trading or price manipulation[1150], BaFin can prescribe or defer the trade of a security. Execution by substitution is a remedy most often applied when disclosure failed, as this ensures a quick market reaction and thus correction of the lacking incorporation of the information in the price. This can also be extended to any trade of the security, i.e. not only exchange, but also private transactions.[1151] In case of an omitted or untrue ad-hoc disclosure or a non-disclosure of director's dealings, BaFin itself can opt for the disclosure of the fact in its proper means of publication, i.e. through internet and/or relevant journals.[1152] The same is applicable on balance sheet faults detected by the DPR or BaFin, and not corrected instantly by the company.[1153]

[1144] *Möllers/Wenninger*, Informationsansprüche gegen die BaFin im Lichte des neuen Informationsfreiheitsgesetzes (IFG), in ZHR 2006 455, p.455.
[1145] *Möllers/Wenninger*, Informationsansprüche gegen die BaFin im Lichte des neuen Informationsfreiheitsgesetzes (IFG), in ZHR 2006 455, p.462.
[1146] Most notably, by the consumer organization VZBV; http://www.handelsblatt.com/News/Recht-Steuern/Meldungen/_pv/_p/204886/_t/ft/_b/1279705/default.aspx/verbraucherschuetzer-wollen-bafin-verklagen.html (page impression as of November 23rd, 2007).
[1147] Such as improper advertising of securities, e.g. cold calling: Securities Trading Act (WpHG), sec. 36 b.
[1148] Securities Trading Act (WpHG), sec. 4 I as general authorization; additionally, a variety of special authorizations exists, such as those detailed in *Hirte/Möllers*, Kölner Kommentar zum WpHG, 2007, § 4, marginal 103, p.205.
[1149] Securiteis Trading Act, sec. 4 VII.
[1150] I.e. Securities Trading Act, sec. 14 and 20a, respectively.
[1151] *Bartsch*, Effektives Kapitalmarktrecht – zur Rechtsfolgenseite der Richtlinien im Europäischen Kapitalmarktrecht, online-edition 2005, p.117.
[1152] *Kämpfer*, Enforcementverfahren und Abschlussprüfer, in BB 2005 (addendum) 13, p.14.
[1153] Securities Trading Act (WpHG), sec. 37q II.

The instant publishing is a very powerful means of remediation, because it ensures that the capital market quickly gains insight into the new situation, and that the price is adjusted accordingly. However, it must be understood that this means is a very drastic one and will severely damage an issuer's reputation on the market. Thus, scholars criticize that it is only bound to the principle of commensurability[1154], which means that for BaFin to stop the trade of a security, mere lesion of the legal provision suffices. With respect to this concern, BaFin employs this means very sparingly, i.e. practically only in cases in which the entity itself, usually due to bankruptcy, cannot take the necessary action by itself.[1155] Further remedial action refers to internal matters of the supervised entity. If BaFin suspects that audits are not or not duly committed, the agency can decide either to monitor the audit in both its procedure and the outcome, and may even appoint another auditor of its choice.[1156]

All of the above-mentioned remedial actions are enforced if not observed voluntarily, whereas BaFin is conferred authority[1157] to do so under the terms and conditions of the Administrative Enforcement Act (VwVG). [1158]

vii. Sanctioning power

As detailed above, BaFin is not endowed with sanctioning power as to criminal offences, but then refers the case to the adequate Public Prosecutor's Office. However, BaFin does hold authority to punish non-criminal, i.e. administrative offences. Sources of such authority are mainly found in the Securities Trading Act[1159], but also in other of BaFin's governing law[1160]. Fines, in this regard, are capped to € 1 million[1161] for deliberate violations, and usually can only be imposed in case of levity and not mere negligence.[1162] This is an important amendment to the law of administrative fines, which normally caps fines to € 10,000[1163] – mainly due to the fact that in capital market law, fines must hold a high preventive power, which is tied to a certain monetary amount of the fine.

[1154] *Spindler,* Kapitalmarktreform in Permanenz – Das Anlegerschutzverbesserungsgesetz, in NJW 2004 3449, p.3450.
[1155] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.
[1156] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.105.
[1157] Act Establishing the Federal Financial Supervisory Authority (FinDAG), sec. 17.
[1158] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.561.
[1159] In detail, Securities Trading Act (WpHG), sec. 38, 39 I-III.
[1160] Such as Securities Acquisition and Takeover Act (WpÜG), sec. 60 I, II; Investment Act (InvG), sec. 143 I-III; Securities Sales Prospectus Act (VerkaufsprospektG), sec. 17 I and others; as listed on *BaFin* Introductory Powerpoint Presentation (for internal purposes), p.50.
[1161] Securities Trading Act (WpHG), sec. 39 IV and Securities Acquisition and Takeover Act (WpÜG), sec. 60 III; other bodies of law provides for lower caps.
[1162] *BaFin* Introductory Powerpoint Presentation (for internal purposes), p.53.
[1163] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.

BaFin itself can issue a fine according to Regulatory Offenses Act (OwiG), sec. 65, 66, so that no involvement of the Public Prosecution Office is necessary. If the offender appeals, a so-called intermediary process will be conducted, consisting of a second examination of the subject matter. If this is not favorable, the case will be conferred to Public Prosecutor's Office.[1164]

Also, BaFin's fees can be seen as a sanction: for instance, for investigations into the unauthorized carrying-on of business, fees will amount to up to € 50,000, with additional expenses if a liquidator is appointed.[1165] Also for other investigatory and remedial action, BaFin is entitled to charge the offender. Furthermore, BaFin can sanction certain offences with disgorgement of profits, most notably insider trading and director's dealing.[1166] As those gains have been made on the expense of all shareholders, and as distribution of the disgorged profits is an administrative process far outreaching the benefit, it is the company – and thus indirectly all shareholders – to whom the disgorgement is distributed.

Another most notable form of sanctioning is the so-called shaming[1167], which consists in the publication of measures BaFin has taken against a tortfeasor and his/its name.[1168]

viii. Enforcement

For those orders and fines BaFin is entitled to impose, the agency also holds legal authority of enforcement within the realms of the Administrative Enforcement Act, and can also threaten this procedure for non-compliance, whereas penalty payments amount up to € 250,000.[1169] The aim of such action is to enforce compliance with enactments and other regulation, i.e. documentary obligations, tolerance of investigations or order to act.[1170]

BaFin, in this process, will threaten the violator with this procedure, and define a grace period. In case of this not being effective, BaFin can order execution by substitution, which is that BaFin itself will undertake the sought-after behavior and the entity not complying will

[1164] *BaFin* Introductory Powerpoint Presentation (for internal purposes), p.55.
[1165] http://www.bafin.de/bafin/aufgabenundziele_en.htm (page impression of December 7th, 2006) sub "Cross-sectoral departments (Querschnittsabteilungen)".
[1166] *Hutter/Leppert,* Das 4. Finanzmarktförderungsgesetz aus Unternehmenssicht, in NZG 2002 649, p.657.
[1167] For an in-depth analysis, see below.
[1168] Securities Trading Act (WpHG), sec. 40b; an example can be found in *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2002, p.20.
[1169] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.175.
[1170] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.177.

bear the cost.[1171] However, this remedy only applies if the entity not complying with BaFin's regulation does so in contempt of a legal requirement or any statutes issued by BaFin with authority to do so.

On a broader scale, also other measures intended to foster law-abiding behavior can be counted as enforcement. In this regard, the increasing influence of civil liability claims – as with insider trading or ad-hoc disclosure – has been recognized, and must be judged as influence of the US model.[1172]

ix. Summary

BaFin's authority is set in a multitude of settings: it is a standard-setting and thus quasi-legislative body, and holds executive functions in their supervisory and controlling role. Also, BaFin is entrusted with some judicial authority as to the administrative sanctioning of misdemeanors, whereas the lacking power in case of criminal offences is clearly intended by BaFin's body of governing law.

[1171] *Dreyling,* in *Assmann/Schneider*, Wertpapierhandelsgesetz, 4th edition, p.178.
[1172] *Möllers*, Creating Standards in a Global Financial Market – the Sarbanes-Oxley Act and her Activities: What Europeans and Americans could and should learn from each other", in ECFR 2007 173, p.173.

f. Current challenges

For the analysis of current challenges to BaFin, it must be understood that most developments have been in-sync with the US market, so that the descriptions given with SEC also apply to BaFin[1173]. Most important have been three key developments: "liberalization and globalization of financial markets and institutions, the growth of multifunctional banking, and the rapid innovation in financial instruments and techniques"[1174]. However, compared with the vivid, but moderate growth rates of participation in the stock market in the US, they have undergone a tremendous and very rapid development[1175], and also globalization impacts much heavier on the German capital market: whereas on NYSE, the peak of foreign issuers was reaches with some 15%, in Germany more than 80%[1176]. In the following, only such challenges not treated in the relevant topic with SEC will be discussed.

i. Spread in European capital market supervision

As detailed above, a vast degree of German capital market law, and likewise the regulations in other member states, is dictated by European directives. This is effectuated in order to harmonize the legal requirements and create similar standards for a unified and thus bigger and more trustworthy, European capital market.[1177] As the original approach – full harmonization with a centralized supervisory agency – did not succeed due to differing political opinions, now minimum harmonization going hand in hand with independence of the member states' capital markets[1178], is practiced.[1179] Going hand in hand with this, member states are bound to the single-license principle, which claims that a share or other financial product or service authorized in one member state shall have authorization likewise with all others.

Given the fact that, among the member states, a severe competition for capital exists, such regulation might lead to a race to the bottom[1180]: due to the principle of minimum harmonization, states have at least some legislative authority, and less successful states might decide to offer more lenient requirements of authorizations to businesses, which in turn would have

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[1173] *Gemberg Wiesike,* Wohlverhaltensregeln beim Vertrieb von Wertpapier- und Versicherungsdienstleistungen, online-edition 2004, p.9.
[1174] *Cranston* in *Ferrarini*, European Securities Markets – the Investment Services Directive and Beyond, 1998, p.45.
[1175] *Deutsches Aktieninstitut e.V.*, DAI Factbook 2006, 06-3-3-a; available on http://www.dai.de (page impression of April 7th, 2007)
[1176] *Strupp,* Aktien-, börsen- und wertpapierrechtliche Fragen des Umlaufs von Aktien an ausländischen Börsen, online-edition 2003, p.1.
[1177] *Kurth*, Problematik grenzüberschreitener Wertpapieraufsicht, in WM 2000 1521, p.1523.
[1178] *Heinze*, Europäisches Kapitalmarktrecht – Recht des Primärmarkts, 1999, p.387.
[1179] *Hoppmann*, Europäische Börsenaufsicht, in EWS 1999 204, p.204.
[1180] *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.6; *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.44; *Kung,* The Regulation of Corporate Bond Offerings: A Comparative Analysis, in 26 U Pa. J. Int'l Econ. L.409, p.413.

their primary seat of business and taxation in this country, but could operate in all member states. Evidently, this would lead to a severe drop in capital market integrity for all member states, as the lowest standard would be adopted as common: as member states would have to recognize registration due to the single-license principle, they might as well adopt the lower standard themselves as not to lose capital to their markets. A stringent example of such leniency is sanctioning, which is not detailed in some of the directives on capital market law[1181], so that the member states are free to determine sanctions on their own, thus creating differing standards.

However, integration of the European capital markets has been pushed with force, and, in 2005, been realized to a vast degree.[1182] For this aim to be maintained, both comparativeness of the standards and transparency of the differences is a key requirement.[1183] Thus, although member states might face the situation that companies with somewhat lesser requirements for authorization trade on their exchanges, at least the commonly defined standard is safeguarded.

ii. Legislative overflow

A vivid problem for BaFin is the legislative hyper-activism, spurred by years of lacking engagement in capital market law and the intention of keeping up, but as well by the intense involvement of the European Union. Especially the latter engaged in an enormous sum of regulations, often denounced as being of enormous "pragmatism, [but also] devoid of theory and/or a general concept"[1184]. Thus, capital market law provisions hardly stay in effect for a long time[1185], but rather are amended several times until an economically sensible and administratively practicable provision is finally found. Also the rapidity of reforms – often in very specific areas – is striking.[1186]

BaFin, in this regard, has to deal with a multitude of enactments, and their rapid change. This does not only relate to the correction of current enactments, but also to the imposture of new

[1181] Market Abuse Directive; *Seitz*, Die Integration der europäischen Wertpapiermärkte und die Finanzmarktgesetzgebung in Deutschland, in BKR 2002 340, p.344.
[1182] *Kümpel/Hammen/Ekkenga,* Kapitalmarktrecht, loose-leaf compilation as of 2006, p.6.
[1183] *Möllers*, Die Rolle des Rechts im Rahmen der europäischen Integration: zur Notwendigkeit einer europäischen Gesetzgebungs- und Methodenlehre, 1999, p.53.
[1184] *Heinze*, Europäisches Kapitalmarktrecht – Recht des Primärmarkts, 1999, p.6.
[1185] So-called legislative permanency (Gesetzgebung in Permanez); *Weber*, Die Entwicklung des Kapitalmarktrechts im Jahre 2004, in NJW 2004 3674, p.3674; *Schwarz*, Kapitalmarktrecht – ein Überblick, in DStR 2003 1930, p.1934.
[1186] *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007), p.1.

and more demanding responsibilities[1187] upon BaFin: as soon as the agency started operations, and did so successfully, more and more tasks were attributed to it, such as the supervision of financial conglomerates or the conception of more and farther reaching interpretative regulation, which creates a heavy workload and imposes serious difficulties, the more so as BaFin had to find its place in the regulatory environment.

On the one hand, such hectic action is likely to be detrimental to all market participants, investors likewise as issuers, as they cannot be sure whether their actions, which yesterday had been legal, are now violations of a body of law. On the other hand, BaFin has to change, or at least to adapt, its regulations and inner-organizational rules of conduct with every legislative revision, which creates high cost: not only publications have to be amended, but also employees have to be trained on the new effectuation of their tasks.

However, the problem is likely to diminish with time: as of this time, the most important changes in capital market law have been implemented, and even if the European Union continues with rapidly succeeding directives, it should be possible to integrate them into the Germany body of capital market law without far-reaching structural changes as previously necessary. At last, in can be expected that, as soon as all material points are covered, the European Union will stop its legislative initiatives in the field of capital market law, as to gain and understanding whether and how the current enactments have influenced the federal states' conditions.[1188]

iii. No own power of criminal prosecution

As detailed above, BaFin has to report criminal offences to the Office of the Public Prosecutor[1189], and can not of its own authority enforce proceedings. The competent authority, in each case, is the one at the suspected tortfeasor's site. This leads to the situation that all Public Prosecutor's Offices in Germany can be conferred with a case in securities law – a field in which very few lawyers have experiences, but expert knowledge is of urgent necessity.

So, those offices do not hold the specialized knowledge as BaFin does, and lengthy delays have been observed because the staff has to completely initiate to the case before action was started. This must certainly be deemed as detrimental for BaFin's effectiveness, as it wastes

[1187] *Weber*, Die Entwicklung des Kapitalmarktrechts im Jahre 2005, in NJW 2005 3682, p.3688.
[1188] *Weber*, Die Entwicklung des Kapitalmarktrechts im Jahre 2004, in NJW 2004 3674, p.3674.
[1189] Securities Trading Act (WpHG), sec. 18 I, sec. 20b VI and others.

time, monetary resources and also endangers the interests of investors, as the longer the delay between discovery and prosecution is, the likelier is also dissimulation of valuables and/or flight of the offenders. Also, the Public Prosecutor's Offices have no code of best practices, so that each office acts at own discretion if questions that have not yet been legally decided. In this regard, the General Office of the Public Prosecutor (Generalstaatsanwaltschaft) holds no decisional authority, although it does engage in the organization of discussion forums for the local offices and fosters conclusive and uniform interpretation of legal clauses. BaFin has noticed that generally, Public Prosecutor's Offices in the south of Germany are more likely to act on its demand, and thus stricter in regard of prosecution of securities crimes[1190] – a violation of the principle of equality.

BaFin itself engages actively into improving this situation by offering joint forums for the discussion of action in cases it is concerned with, the so-called Praxisdialog Wirtschaftskriminalität, for police agents, lawyers, public prosecutors and judges, whereas the initiative is rewarded with a high amount of participants.[1191] Plans for a strategic improvement of the situation are oftentimes discussed and will be mentioned below; however, they are far from realization yet. Only the future will show whether BaFin reaches a political understanding and will be awarded the chance to influence prosecution more stringently.

iv. Lacking power of exchange supervision and split of responsibility with the German Federal Bank for banking supervision

A point vividly criticized by most foreign[1192], but also some German scholars is the fact the even after BaFin's establishment, securities supervision lies with both the federal authority and the federal states' exchange supervision authorities.[1193] Especially foreign authorities, who generally hold supervisory power over all actors in the securities market, lament that BaFin is not entitled to regulate exchanges. Thus, the SEC in its MOU found that a broader base of cooperation, as would have been of need, could not be established as BaFin's predecessor BAWe was not entitled to negotiate on behalf of exchange regulation.[1194]

[1190] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.
[1191] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007; *Bundesanstalt für Finanzdienstleistungsaufsicht*, Jahresbericht der Bundesanstalt für Finanzdienstleistungsaufsicht 2006, p.216.
[1192] FASF evaluation of the German supervisory system; *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.24.
[1193] *Rudolph*, Viertes Finanzmarktförderungsgesetz – ist der Name Programm?, in BB 2002 1036, p.1040.
[1194] *Mann/Barry* in *Grabar*, Foreign Issuers & the US Securities Laws 2006, 2006, p.190.

Additionally, the federal states are keen on keeping supervisory power of their own and see their position strengthened by the Basic Constitutional Law (GG).[1195] More importantly, the approach of the federal states, which generally foster exchanges as a means of capital provision, and of BaFin, which would rather restrain activity if there were too many exchanges for reasons of efficiency and unity of prices, is structurally different and creates a gap which is difficult to cross.[1196] Also, the exchanges struggle with each other as all competitors would[1197], whereas the federal states cannot interfere as they do not hold authority about both exchanges, and BaFin cannot because it does not hold authority over neither. Thus, struggles continue for long, are conducted publicly and might contribute to a negative public image of exchanges in Germany.[1198]

However, this situation can be observed relaxing: more and more authorities are compounded on BaFin. For instance, in 2005, the new legislation on prospectuses was issued – and BaFin was conferred all the authority for their control and approval, whereas before, this had rested jointly with BaFin and the exchanges.[1199] Although this currently might be not as effective as the examples of other integrated supervisory systems claim to be, it must be understood that the German federal structure is a structural condition on which the legislator had and has to orient its action[1200], so that step by step, BaFin will be attributed more authority and eventually, exchanges will disappear from the supervising landscape.

The same applies to banking supervision, which is not effectuated by BaFin alone, but also by the German Federal Bank, necessitating cooperation and coordination of their activities. Well-planned as this might be, it must also be expected that some steps in the supervisory process are effectuated double.[1201] Also, the German Federal Bank is not a powerful supervisor, as they have not the power to decreed administrational decisions and thus must ask BaFin for cooperation in every individual case.[1202]

[1195] For a detailed outline of this legal principle, see *Herdegen*, Bundesbank und Bankenaufsicht: Verfassugsrechtliche Fragen, in WM 2000 2121.
[1196] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.
[1197] E.g. the question of transaction records between the exchanges of Frankfurt and Stuttgart, in which Frankfurt accused Stuttgart of double recording of certains transactions as to manipulate the exchange's trading figures; Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.
[1198] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.
[1199] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2005, p.9.
[1200] *Binder*, Die geplante deutsche Allfinanzaufsicht und der britische Prototyp – ein vergleichender Blick auf den deutschen Referentenentwurf, in WM 2001 2230, p.2238.
[1201] http://www.handelsblatt.com/news/Unternehmen/Banken-Versicherungen/_pv/_p/200039/_t/ft/_b/1165140/default.aspx/kreditinstitute-geben-bafin-schlechte-noten.html (page impression of January 15th, 2007).
[1202] *Hirdina*, Verfassungsrechtliche Aspekte zur Funktion einer reformierten Bundesbank bei der Allfinanzaufsicht, in BKR 2001 135, p.139.

As a study by the Central Banking Committee yielded that a merger of all banking supervision on the German central Bank would "also generate entirely practical effects of size and scope"[1203] with other tasks of the entity, it must be drawn the conclusion currently is not as efficient as possible. Also, some of the supervised banks, the German savings banks (Sparkassen) in the southern Germany, objected to this double supervision, which caused them additional cost and effort and, in their view, was superfluous[1204], as both entities would request the same data.

However grave the concerns may seem, the solution already is on the horizon: the BMF thinks of strengthening BaFin's role in banking supervision for all system-relevant banks, whose number would then be increased to 400 and comprise nearly all banks which are pertinent for business activities in Germany.[1205] This loss of influence of the German Federal Bank is a bitter rebuff for the agency, but would – as far as one could predict from current signs – be met with acceptance with the supervised entities and the international peers of BaFin.

v. Two sites

It has also been vividly criticized[1206] that BaFin – almost like its predecessors – maintains two sites of business. Whereas banking and insurance supervision is conducted in Bonn, securities supervision is headquartered in Frankfurt. This does not only impede the perception of the agency as a one-stop-shop, but also complicates judicial proceedings[1207] and is highly likely to generate additional expenses. Also, the majority of Germany banks have their primary sits of business in Frankfurt, and so does the German Federal Bank[1208], so that BaFin's banking supervision is ways apart from their supervised entities – a complication of contact.

However, despite all reasoning, also the political reality must be taken into account: Bonn, the current site of banking and insurance supervision, has severely suffered after the tenancy changeover of the government and parliament, so that it would have been difficult to argue for

[1203] *Herdegen*, Bundesbank und Bankenaufsicht: Verfassugsrechtliche Fragen, in WM 2000 2121, p.2121.
[1204] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.
[1205] *Anonymous*, Mehr Macht für die BaFin, in FAZ of May 2nd, 2007, p.14.
[1206] Among others, *Binder*, Die geplante deutsche Allfinanzaufsicht und der britische Prototyp – ein vergleichender Blick auf den deutschen Referentenentwurf, in WM 2001 2230, p.2230, p.2238.
[1207] This is, the site of the relevant directorate (Bonn or Frankfurt) is not necessarily the site for commencement of action (uniquely Frankfurt); Act Establishing the Federal Financial Supervisory Agency (FinDAG), sec. § 1 III.
[1208] *Schüler*, Integrated Financial Supervision in Germany, online publication 2004; ftp://ftp.zew.de/pub/zew-docs/dp/dp0435.pdf (download June 6th, 2007), p.15.

the move of the two agencies.[1209] This is also prescribed in the Bonn-Berlin Act.[1210] Securities supervision, however, must be in the focus of securities trading – and this is, to this day, Frankfurt.

Thus, a solution to the justified critique will be difficult to find. However, with the use of modern technologies and means of communication, and due to the fact that the directorates engage in different fields which only necessitate ever-so-often cooperation, the spreading loss by to business sites is likely to be "without disadvantage"[1211] or at least tolerably small. This is also reinforced by employees' point of view: whereas regular staff travels rarely, middle and upper management takes the trip at most twice a month, and arranges further meetings via video conferences or calls.[1212]

vi. Summary

As previously discussed, BaFin faces a multitude of factors are interfering with the agency's goals and current operations, and this in a point in time where the inner structure has yet to be strengthened. However, the agency has found ways to work with its challenges, and is expected, by general development and by its own prudence, to face much less during the years to come.

[1209] *Fricke*, Versicherungsaufsicht integriert – Versicherungsaufsicht unter dem Gesetz über die integrierte Finanzdienstleistungsaufsicht, in NVerZ 2002 337, p.338.
[1210] *Hagemeister*, Die neue Bundesanstalt für Finanzdienstleistungsaufsicht, in WM 2002 1773, p.1776.
[1211] *Hagemeister*, Die neue Bundesanstalt für Finanzdienstleistungsaufsicht, in WM 2002 1773, p.1776.
[1212] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.

g. Effectiveness and efficiency

Effectiveness and efficiency, in the words of BaFin's president Sanio, are increasingly expected of supervising agencies.[1213] Thus, after detailing BaFin's organizational design, legislative base and operations, the last chapter will try to evaluate its effectiveness and efficiency. However, it must be underlined that the five years of BaFin's action are too short to establish a well-founded analysis, so that only some factors which might positively or negatively affect BaFin's efficiency can be given.

i. Overall evaluation

Generally, BaFin has a high reputation for supervisory excellence with both its supervised entities and the international public.[1214] Examples of such exist many: IOSCO attributed it to BaFin to host its annual meeting in 2005; an honor which clearly shows BaFin's good standing. A both objective and well-founded evaluation was effectuated by the IMF in 2003 during its Financial Stability Assessment Program (FSAP), concluding that both BaFin as an agency and its supervisory approach are "comprehensive and effective"[1215]. This is of high relevance due to the fact that the IMF conducted the same evaluation with over 50 national supervisory authorities, and thus has high expertise in this field.

On the side of scholarly evaluation of BaFin's work, opinions are very few. Instead of a compound evaluation of BaFin, most engaged in an analysis of the expected gains of integrating the three formerly independent agencies. In this regard, scholars[1216] often doubt whether an integrated supervision generates effects of size and scope without detriment to the material quality of supervision under the premise that the principles of market stability and efficiency, the governing law of the three areas of supervision, and last but not least the legal means for supervisory action differ as sharply as they do in Germany. UK-based studies covering the same question for the FSA yielded that the combination of banking and securities market supervision poses some additional problems, and does not necessarily lead to either savings or efficiency[1217], so that the same might be expected as well for BaFin.

[1213] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2005, p.1.
[1214] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.
[1215] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.25.
[1216] *Schieber*, Die Aufsicht über Finanzkonglomerate: das Aufsichtsrecht der Finanzdienstleistungsunternehmen im Spannungsfeld zwischen Gruppen- und Einzelinstitutsaufsicht; 1998, p.331, who refers also to Knauth and others.
[1217] *Binder*, Die geplante deutsche Allfinanzaufsicht und der britische Prototyp – ein vergleichender Blick auf den deutschen Referentenentwurf, in WM 2001 2230, p.2237.

It has also been mentioned that the focus of the three fields of supervision is very different: whereas insurance supervision is entirely oriented on the welfare of the insurance takers/consumers, securities supervision takes into account the welfare of the general public and the businesses, and only as a sub-goal of investors/consumers. Banking supervision, at last, is to safeguard solvency for the sake of the economy, and does not at all safeguard individual welfare. This situation, indeed, constitutes a conflict of goals and must be addressed[1218], whereas both BaFin's mission and its daily practice give reason to suppose that the agency masters both.

BaFin itself claims that after the merger of the three formerly independent authorities positively affected efficiency: solvency supervision and customer protection was effectuated more quickly, and merged supervision "also proved a plus because most of the institutions and companies supervised faced similar problems"[1219]. Also, BaFin now is entitled to all the sanctions that formerly only could be pronounced by the most powerful agency, BAKred,[1220] and certain questions of responsibility, often leading to quarrels and sheathings[1221], are solved. It was also very positively accepted that now, the supervised entities only address one authority and that all agreements on sharing of information and mutual cooperation, such as consultations or briefing, of the former three supervisory authorities, are superfluous.[1222] However, this is a judgment from an external perspective only: within BaFin, the very same steps will be effectuated one way or the other between the different directorates.

ii. Specific criticism

Especially in 2004, harsh criticism of BaFin arose, whereas the two main arguments were "too much bureaucracy, too much supervision"[1223]. Bureaucracy, in this sense, can also be understood as the need of installing BaFin as a publicly well-perceived and efficient authority, or, as a critique puts it: BaFin is concerned too much by itself[1224] while omitting its primary task. As predominant as those needs of self-marketing and making the agency known with the

[1218] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007; *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.240.
[1219] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.9.
[1220] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.247 et seq.
[1221] E.g. the sanctions applied against certain direct banks in 2000, for which – due to consumer complaint to both BAKred and BAW both agencies acted, often in a different way; *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.242.
[1222] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.240.
[1223] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2004, p.5.
[1224] http://www.dias-ev.de/pressemit.php?newsid=48 (page impression of January 15th, 2007).

public might have been in the early times of its existence, after a certain time this goal should have been reached to a certain extent and not call for continuous attention.

Most important has also been the discovery of a series of corruptive incidents within BaFin, relating to the awarding of contracts, which led to severe reproaches against the agency and its inner organization[1225]. Certainly, it must be questioned how an agency can convey the picture of being an able and strict supervisor for fraud and corruption on the stock markets when within the very agency the behavior it is to sanction flourishes. However, the field in which the corruption happened has been structurally different from BaFin's supervision, and is one in which corruption – in all governmental agencies – is somewhat prone to happen. Thus, it is not overly strange that this should also happen with BaFin at one or the other point. However, it must be sharply criticized that the system-inherent faults had been discovered quite early, and also be pointed out to the responsible directors, whereas no action followed.[1226] BaFin reacted quickly and announced multiple organizational changes, among others a re-structuring and stronger staffing of internal revision, which was finalized in 2006[1227] and lets expect that similar incidents will not happen in near future.

Also, criticism is uttered concerning BaFin's course of action: at least in one case[1228], BaFin did have sufficient evidence to start remedies and/or judicial action, but waited until the entity in question would cooperate and self-report.[1229] This does not only impede immediate remedies for the damaged investors, but also sets faulty incentives for other market participants: with the impression of BaFin's leniency, the supposed deterring effect of the rules of capital market law and the conceived sanctioning will not come into effect. Further criticism relates to BaFin's practices of supervision in the area of banking supervision: in a comparison with the German Federal Bank, the supervised banks note that their own staff is much more competent and more savvy of the industry than BaFin's[1230], which also results in the banks relying more on the first if they need interpretative and similar help. Especially as the cooperative supervisory approach is highly valuated and seemingly a very effective means of control,

[1225] http://www.ftd.de/karriere_management/koepfe/113114.html (page impression of January 15th, 2007).
[1226] http://www.n-tv.de/708643.html (page impression of January 15th, 2007).
[1227] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Jahresbericht der Bundesanstalt für Finanzdienstleistungsaufsicht 2006, p.211.
[1228] Concerning the Phoenix Managed Account fund; http://www.dias-ev.de/pressemit.php?newsid=9 (page impression of January 15th, 2007).
[1229] http://www.dias-ev.de/pressemit.php?newsid=9 (page impression of January 15th, 2007).
[1230] http://www.handelsblatt.com/news/Unternehmen/Banken-Versicherungen/_pv/_p/200039/_t/ft/_b/1165140/default.aspx/kreditinstitute-geben-bafin-schlechte-noten.html (page impression of January 15th, 2007).

BaFin must therefore strive to enhance its in-house knowledge as to create a reputation of excellent staff and thus valuable advice to the supervised entities.

Another concrete point of criticism is that BaFin seemingly is not willing to accept cooperation or hints from non-governmental institutions and/or NGOs which work in the field of capital market law. So, both Warentest (a private law institution conducting tests of products and services) and the DAIS warned of specific companies or kinds of behavior, without BaFin taking the hint and investigating.[1231] Even worse, this is not only uttered by the concerned institutions, but also by judges involved in the investigation and judicial evaluation of cases, who see BaFin as "structurally incapable"[1232] of handling fraud on a big scale. Also, jurisdiction seemingly is not willing to rely on BaFin's discovery and/or the latter is not concise enough. So, with 53 cases of suspected insider trading referred to the Public Prosecutor's Office in 2002, only resulted in three convictions[1233], numbers in successive years being not more convincing.

iii. Possible success factors

As it is difficult to gain an insight in BaFin's effectiveness and efficiency, the following will list certain strategic decisions, which – evaluated in the light of best practices of the SEC and other supervisory agencies – are likely to help BaFin to reach success.

1. Structure of cross-sectoral and organizational departments

In BaFin's organizational structure, it becomes obvious that all cross-sectoral tasks, such as complaint management, money laundering and economic analysis, but also organizational departments such as human resources, budgeting and planning and IT have been spun off[1234], i.e. are found with BaFin's umbrella structure and not with the individual departments. Thus, far less staff and also capital intensive resources are needed. Furthermore, planning is more comprehensive and quick shifts of resources, e.g. in times of crises or shortages, can be effectuated, as the centralized planning has an overview about capacities and needs.

[1231] http://www.dias-ev.de/pressemit.php?newsid=48 (page impression of January 15th, 2007).
[1232] Court president of Frankfurt Landgericht, Jochen Müller, as quoted in http://www.dias-ev.de/pressemit.php?newsid=48 (page impression of January 15th, 2007).
[1233] http://www.welt.de/data/2003/02/15/42148.html (page impression of February 17th, 2007).
[1234] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.

2. Close cooperation of directorates

Especially in the employee's view, it becomes obvious how much cooperation between the former independent agencies has changed, now that they are integrated in BaFin: "Whereas before, the colleagues would not share information either due to legal necessities or due to the belief that this would not be of interest to us, now everyone is aware that synergies exist and shared information also raises awareness of dangers to the capital market as a whole. Today, a common focus exists"[1235], as one employee puts it.

This change of behavior was not an individual or collective decision, but was heavily fostered by managerial decisions: not only would the heads of directorates meet often and intensely, but also initiate meetings of all department heads on a twice-a-month basis and ask them to report the most important developments in their respective areas of work[1236], so that colleagues got first-hand information and insight into areas totally alienate to theirs.

3. Long-term planning

BaFin's cooperation with its supervised entities, and their involvement in the administrative council also ensures that necessary changes of law and supervisory structure are planned on a long-term basis and thus do not lead to disruptions of the market when they finally occur.

An example of such is the planned abolition of the issuer privilege for a certain group of German saving banks (Sparkassen), which will occur in 2009, and which will generate an enormous additional workload for BaFin. Due to the fact that BaFin communicated this change to the entities and established a dialogue about their planned emission as well as conducted a survey about concise numbers and dates of emissions, BaFin knew already in early 2007 the workload it would have to shoulder in late 2008 and early 2009, and thus can orient its resource and staff planning on those estimates.[1237]

4. Supervisory approach

Likewise as the SEC, BaFin aims at cooperating with its supervised entities rather than acting as a punitive opponent, so that cooperation and willingness to comply is fostered as paying-off behavior. Furthermore, "it attaches importance to making its supervision approach trans-

[1235] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.
[1236] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.
[1237] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.

parent and comprehensible"[1238], so that the entities can rely on a specific path of action and can trust in BaFin's long-term cooperativeness. This system has not only been deemed efficient by itself, but also in comparison with other concepts of supervision, as the FSAP audit group expressly stated.[1239]

Especially with insurance supervision, which has been in effect for more than 100 years, this concept has been employed for a long time. Thus, insurance companies rely on BaFin's advice in matters, and accept the outcome of consulting and/or negotiations, even if they are of legally non-binding character.[1240] This approach, thus, ensures quick and effective decisions, maintains both the supervised entities' and the clients' trust in supervision and the market in general, and saves the cost and effort of administrative and judicial decision-making.

Also, the principle of "moral persuasion"[1241], i.e. the issuance of interpretative releases and the trust in the supervised entities' compliance, has paid off: not only do the parties concerned appreciate this non-advisory approach, but also the level of compliance is higher than with enforcement and thus the necessity of actual control substantially lower.

Another factor enhancing this concept's success is approach of risk-oriented supervision[1242], matching the supervised entities inherent risk to the amount of supervisory resources used and the supervisory actions and implementations employed.[1243] The system is applied for banks, insurance companies, investment companies and financial services institutions, which are classified in a matrix structure according to system relevance and "quality" of the business[1244], so that BaFin gains a quick understanding of the risk of the business to the capital market as such and to investors. This strategy and the linked supervisory approach not only save BaFin's resources and thus add to the agency's efficiency, but also create incentives for the supervised entities to engage in behavior that decreases its risk so that also the burden of

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[1238] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2004, p.10.
[1239] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.25.
[1240] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.#
[1241] *Schädle*, Exekutive Normsetzung in der Finanzmarktaufsicht, 2007, p.91.
[1242] The concept being introduced by the FSA, the so-called RTO (risk-to-our-objectives) approach; *Schädle*, Exekutive Normsetzung in der Finanzmarktaufsicht, 2007, p.226. However, this is unique to European regulators – the SEC does not engage in risk-oriented or risk-based supervisory approaches; Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.
[1243] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2004, p.10. The classification of risk and system-relevance is connected to the supervisory approach pursued against the specific entity, and the number of investigations conducted among all those with the same risk; *Bundesanstalt für Finanzdienstleistungsaufsicht*, Jahresbericht der Bundesanstalt für Finanzdienstleistungsaufsicht 2006, p.72.
[1244] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Jahresbericht der Bundesanstalt für Finanzdienstleistungsaufsicht 2006, p.65.

supervision alleviates. This is also the reason for the establishment of the QRM, which produces scientific evaluations of both risk and appropriate supervisory actions.[1245]

5. Human resources concept

Furthermore, BaFin has developed a highly successful human resources concept: the agency employs young staff, and is keen on training them for higher management positions, so that in near future, those will be filled by insiders to the supervisory business as well as to the agency itself. With all this, BaFin has not forgotten that as of today, external expertise is still necessary, and has hired a range of specialists in the areas it feels the need of doing so.[1246]

Also, BaFin is known for its excellent staff development and its many programs of employee training. This has made them a sought-after employer, receiving more than 25 times as many applications as staff hired.[1247] Thus, it can be expected that in the future, BaFin will have no difficulty in filling positions with internal, experienced staff, and will also not suffer shortage of qualified personnel as other agencies do.

6. Cooperation and authority lending

As detailed above, BaFin's most important governing law commands on cooperation with other federal agencies – and BaFin has been quick to follow this advice.

An especially efficient example is authority lending (Organleihe), in which the authority not in charge of the case will act for the one who is. Mostly, federal states' exchange supervisory institutions will be conferred authority to act for BaFin, and to prosecute lesions of securities law on behalf of it.[1248] This is sensible, as the federal agencies in their normal activity apply substantial efforts to investigate such cases, and have specialist knowledge and experiences as to their prosecution. So, both the time of referral to BaFin as a subordinated federal agency and the time-consuming sharing of information can be saved.

The same principle is followed when tasks of federal states' exchange supervision are conferred upon another federal states' agency, as possible according to the Stock Exchanges Act[1249]: in this way, smaller exchange markets save the efforts of an advising authority, and

[1245] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2004, p.85.
[1246] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2004, p.203.
[1247] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2004, p.204.
[1248] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.562.
[1249] Stock Exchanges Act (BörsG), sec. 2 I.

those institutions who assume additional supervision grow in both size and experience, so that effects of size and scope apply.

iv. Summary

The previous chapter detailed BaFin's overall evaluation in terms of effectiveness and efficiency, listed possible success factors and shortly mentioned suggestions for further improvement of the agency, which will be re-discussed in the next chapter. Overall, BaFin's supervisory approach and operations can be seen as effective, although no quantitative evaluation yet exists. However, high respect among supervised entities and peer supervisory agencies lets suppose that this is justified.

D. Comparison and suggestions for improvement

The ensuing chapter will list differences of the legal framework and the administrative execution between the German and the US capital market supervision, with the aim of determining suggestions for the further development of BaFin. Reasons why such a comparison proves to be worthwhile are situated in a multitude of areas:

Generally, the US capital market law has strongly been recommended as a role model by scholars[1250], so that European law oftentimes is oriented on its regulative mechanisms. Furthermore, as similar development as happened in the US is also expected for the European capital market, the comparison of European legal systems with the US one is used as a lookout into the future.[1251] Also, as the US capital market has already transgressed through several steps the European capital market is bound to experience in near future. At last, "the relationship between economic theory and legal doctrine in general and in the particular field of corporate and capital market law"[1252] has been extensively discussed and allows drawing conclusions for the regulative setting in Europe and Germany.

a. Comparison

i. Similarities

As to the material capital market law, both systems are comparable. Both aims and legislative methods coincide, although the US system must be considered as more rigorous in terms of duties of disclosure and liability.[1253] However, the focus of this paper is to compare the two institutions that supervise the capital markets, and not primarily their legal framework. In this regard, both institutions do not only supervise legal compliance, but administer market supervision.[1254] Being a key principle to the US securities law, it might surprise that only in the earl 1990s, German supervision made the switch from compliance control (Rechtsaufsicht) of ex-

[1250] *Kitch*, Proposals for Reform on Securities Regulation: an Overview, online publication http://papers.ssrn.com/sol3/papers.cfm?abstract_id=269126 (page impression as of 6th of June, 2007), 2001, p.2.
[1251] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.27.
[1252] *Meier-Schatz*, in *Buxbaum et al.*, European Business Law – Legal and Economic Analyses on Integration and Harmonization, 1991, p.86.
[1253] *Heinze*, Europäisches Kapitalmarktrecht – Recht des Primärmarkts, 1999, p.391.
[1254] *Bundesminister der Finanzen*, Konzept Finanzplatz Deutschland, in WM 1992 420, p.423.

changes and their SRO supervisory actions to market supervision (Marktaufsicht)[1255] – or the supervision of the compound of market participants and their action.

ii. Specific differences

1. Historical development

As already discussed in the introduction, the US capital market has been the basis for economic activity: most businesses are financed with shares[1256] and most citizens rely on the private investments for the financing of their pensions. In Germany, on the contrary, most businesses are financed with equity, and pensions are arranged with governmental organizational interference, so that capital market participation has been low and thus supervision has traditionally been a weak field of governmental involvement[1257]. As a consequence, both public recognition of BaFin and estimated importance of their task are lower than with the SEC; potentially decreasing also the deterring factor of supervision and the incentive for cooperation on the part of supervised entities.

2. Field and amount of competencies

Generally, it is claimed that BaFin holds far less competencies than the SEC does.[1258] The SEC plays on three levels: it defines and regulates (legislative); it supervises compliance (executive), and sanctions administrative and criminal offences (judicial power). Thus, the agency does not operate according to the principle of separation of powers, which is to be deemed of considerable impact: effective control of the three powers cannot be maintained if their action is too tightly intertwined.[1259] Also, the SEC's position in the US political system and on the capital market is very strong – stronger than that of most other public agencies. More specifically, scholars criticize that the fact that judicial and executive power reside with the same authority poses the danger of overpowering individual defendants, who might face injustice and bias if the same agency that conducts investigations also presides the administrative proceedings for sanctioning.[1260]

[1255] I.e. „the provision of rules and regulations […] which directly relate to the acquisition and sale of […] securities" and compliance control thereof, *Kümpel*, Zur Neugestaltung der staatlichen Börsenaufsicht – von der Rechtsaufsicht zur Marktaufsicht, in WM 1992 381, p.383.

[1256] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.123.

[1257] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.71.

[1258] http://www.welt.de/data/2003/02/15/42148.html (page impression of February 17th, 2007).

[1259] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.121.

[1260] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.122.

BaFin, likewise as the SEC, engages in all three levels. In questions of quasi-legislative authority, both agencies have fair capacity of setting standards for the governing law they administer, and also in their executive and investigatory authority, differences are of minor importance. However, BaFin's judicial authority[1261] is substantially less: BaFin, by its governing law, is only conferred the authority to sanction administrative offences, whereas criminal offences must be referred.

In the comparison, the structure of both legal systems must be considered. Thus, the German legislator and the adminstration is constitutionally much stronger bound to the principle of separation of powers[1262] than the US equivalents, where "mergers" of administrative, judicial and legislative power[1263] are one of the key factors for regulative excellence.
However, the strategic decision of the Basic Constitutional Law must be taken into account when weighing those suggestions for an enhancement of BaFin's authority[1264]: it should be extended as much as reasonable under this limitation, but as far as necessary, as nay "difficulty in enforcing the [otherwise stringent and sufficient] regulation may make it useless"[1265].

Certainly, this comparatively low authority causes a certain irritation, when foreign authorities – especially the SEC – request BaFin to investigate in matters, and BaFin cannot satisfy this demand due to its lacking competencies. Especially pertinent is this is matters of investigation, where BaFin might investigate, but not seize the evidence (for which public prosecution only is entitled) or engage into proceedings such as asset freezes.

However, it must be underlined that even with its limited possibilities, BaFin is able to satisfy all demands of the standard MOUs of the IOSCO[1266], and even fulfils the MMOU with a wider range of required competencies. Thus, it must be concluded that, in international comparison alongside the commonly defined principles, BaFin's authority is absolutely sufficient for supervision, and also to satisfy demands for administrative assistance of foreign authorities. Rather, the SEC has an exceptionally high amount of competencies in an international

[1261] *Schacht,* Die deutsche Kapitalmarktaufsicht im internationalen Vergleich, 1980, p.67.
[1262] Basic Constitutional Law, sec.20.
[1263] *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007), p.36.
[1264] For a detailed discussion, see below.
[1265] *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007), p.36.
[1266] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.

comparison, which certainly enhances its efficiency and administrative vigor, but is not of compulsory for supervision.

3. Supervisory concept

From its very beginnings, capital market supervision in the USA had been oriented on the supervision on the market as a whole, resulting of the beginning of supervisory activity with a market crash that affected the market through all potential borders like industries, type of shares or exchanges on which the share was traded. Thus, the SEC sees itself rather a law enforcement agency than a regulatory agency.[1267] In Germany, on the other hand, supervision has gone a long path: from a mere institutional supervision, which would control specific organizations, it has evolved to a functional concept, which orients supervision on the type of business conducted.[1268] This was not only due to the market situation, which increasingly integrates the different businesses into conglomerates, but also to structural European decisions.

Thus, in comparing the legislative framework both agencies administer, and in evaluating their actions, the different starting point must be considered. To a certain extent, thus, the SEC has a more "integrated" supervision in such that it engages in likewise procedures all over the market, whereas BaFin with its functional approach will treat businesses of different scope differently. Nevertheless, it must be taken into account that the businesses traded in the US are, to a much higher extent than in Germany, of foreign origin, and thus possess far too different initial conditions to be sorted into functional criteria, if those must apply to all members of a group likewise. On the other hand, European history has made quite negative experiences with governmental involvement into market procedures, and thus strong objections could be expected if BaFin wanted to engage in overall market supervision. Even if BaFin's concept was considered more logical, and even if SEC's approach works perfectly, we must thus conclude that both approaches have been shaped by the initial conditions of the country, the exchanges and the issuers present on those, and are not applicable vice versa.

Also, the level of activity is different: the SEC "not only assumes a passive supervisory function […], but actively steers [… and] is the mainspring in the development of the US capital market, the direction of which is only roughly determined by Congress"[1269]. BaFin, on the contrary, works mainly in supervising concrete actions instead of influencing the supervised

[1267] Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.
[1268] *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.73.
[1269] *Altendorfer*, Die US-amerikanische Kapitalmarktaufsicht (SEC) – Ein Modell für Österreich? 1995, p.19.

entities' conduct, with the exception of such cases in which consultation with BaFin determines the entity's approach. It is the European and national legislator who will determine the path on which the German capital market will develop, and BaFin is to follow suit.

Clearly, also this difference originates in the cultural background and the ensuing legislative approach to capital market supervision: whereas in the US, active involvement, consultation and even bargaining of sanctions is the order of the day and not publicly ostracized, likewise comportment of BaFin would cause severe perturbation in Germany. Also, administrative entities are much stricter bound to the legislative and executive branch due to the control of powers, whereas in the US, many agencies are extremely powerful in their respective area and act more or less "by own authority".

At last, the "role of civil law in the regulation of the capital market is fairly underdeveloped"[1270] in Germany. In the US, civil liability claims – also with class action – are frequently pursued and serve as preventive action for capital market fraud. Indeed, the SEC brings 95% of its cases to a civil lawsuit, and only 5% are pursued on a criminal law background.[1271] In Germany such claims do not appeal to neither possible plaintiffs nor courts, so that they happen infrequently and to not display much of their sanctioning and preventive capacity. Also, "the absence of punitive damages and pre-trial discovery reduces the motivation of private parties to file claims"[1272]. Especially, the US punitive damages have created a climate which deploys high deterrence[1273], and thus has favorable impact on the willingness of parties to comply with regulations. Also, the fact that an injured party can inexpensively gather information which will allow to assess the risk and chances of a trial, and also prepare its argumentation, as given with the procedure of letters rogatory, pre-trial depositions and finally pre-trial discovery[1274], enhances the willingness of private parties to sue. On the contrary, many injured investors did not file against possible corporate tortfeasors in Germany for fear of the claim being refuted, but the investors carrying the cost of information gathering.

Civil claims, in this regard, help the SEC in fulfilling its duty by setting incentives for law-abiding behavior (or, vice-versa, allowing for severe (monetary) disadvantages if not doing

[1270] *Möllers*, Creating Standards in a Global Financial Market – the Sarbanes-Oxley Act and her Activities: What Europeans and Americans could and should learn from each other", in ECFR 2007 173, p.182.
[1271] Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.
[1272] *Möllers*, Creating Standards in a Global Financial Market – the Sarbanes-Oxley Act and her Activities: What Europeans and Americans could and should learn from each other", in ECFR 2007 173, p.185.
[1273] *Böhmer*, Spannungen im deutsch-amerikanischen Rechtsverkehr in Zivilsachen, in NJW 1990 3049, p. 3050.
[1274] *Böhmer*, Spannungen im deutsch-amerikanischen Rechtsverkehr in Zivilsachen, in NJW 1990 3049, p. 3052.

so) without causing supervisory costs. An additional factor is that such claims are not only brought before federal, but also before state courts.[1275] Although the distribution of the damages does, in most cases, not fulfill the criteria of efficiency[1276] and justice[1277], and although the risk for frivolous lawsuits is extended[1278], the overall benefit of this procedure must be accepted.

Evidently, the reason for this must be looked for in the difference of the legal systems (case law vs. civil law) and the ensuing development of the juridical processes. Thus, a direct transfer of this quite efficient supportive means of supervision will not be possible. However, in late 2005, the German legislator has made some approaches to allow for similar joint actions with KapMuG and related provisions. Whether such novel procedures will only be used for actions with a large number of plaintiffs for distributive purposes, or whether they will deploy real supervisory (and thus deterring) effect, must be determined in the years to come.

4. Involvement in integrated supervision

Whereas with BaFin, the concept of integrated supervision of all three areas banking, insurance and securities has been underlined and is achieved to a high degree, the SEC is not an example of strongly integrated supervision: in banking supervision, the FED is more heavily integrated as the German Federal Bank, and holds a multitude of competencies.[1279] Not even in securities supervision, the SEC holds all authority: as detailed above, all derivatives are regulated by the CFTC. Also, the BaFin is confronted with a wide array of supervisory cooperative partners, as compliance with capital market legislation is controlled and enforce by a wide array of institutions, among the BaFin itself, the exchanges, the German Federal Bank and the DPR.

Generally, such differing supervisory approaches do not pose problems as long as the two authorities are able to retrieve information and enforcement support with their cooperative partners, which can be deemed as given with both BaFin and the SEC. However, the sharp gap between the two agencies' concepts of supervision may lead to problems once changes in

[1275] *Kung,* The Regulation of Corporate Bond Offerings: A Comparative Analysis, in 26 U Pa. J. Int'l Econ. L. 409, p.433.
[1276] As – especially in the case of punitive damages – the sum is higher than the actual damage.
[1277] As not all injured parties are included in class action, and as those not involved may lose their right to sue.
[1278] *Kung,* The Regulation of Corporate Bond Offerings: A Comparative Analysis, in 26 U Pa. J. Int'l Econ. L.409, p.434.
[1279] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.

the markets require a joint approach.[1280] In this case, joint efforts would not only require reconcilement of two agencies' proceeding, but also involvement of further agencies, which slows down the process and also annihilates an easy approach, as each participant would request his concerns to be valuated. The engagement of BaFin in the European Union with the necessity to orient its action on European statues, CESR decisions and the like certainly does not appease this problem. However, current joint actions such as the increase of available liquidity on money markets[1281] by both the FED and the European Central Bank proved that quick action and cooperation is feasible, and let expect that a similar cooperation between BaFin and the SEC would work out, if the capital market required such.

5. Funding

Generally, it is claimed that the US authority can dispose of significantly higher resources as to budget, which also translates in staff available for investigations.

Although a detailed attribution of staff to the three areas banking, insurance and securities supervision is difficult due to the fact that many employees work in two related areas or in cross-sectoral tasks, the attribution of full term employees to the field of securities supervision yielded significant results, which the budget allowance for the area "securities supervision and enforcement of relevant cases" supports. The attribution of monetary resources and staff is not monitored in all relevant areas, but will only be analyzed for two core questions: how well can the agency monitor a business (i.e. how many resources are available per listed company) and how well can the agency protect investors (i.e. how many resources are available per person participating in the stock market). 2006 data[1282] yield the following picture:

[1280] Mr. Thomas Eufinger, Mr. Philipp Sudeck of BaFin during an interview on March 6th, 2007.
[1281] *Welter*, Was machen die Notenbanken?, in FAZ (online-edition) of August 23rd, 2007.
[1282] Data retrieved as follows:
For SEC employees *Securities and Exchange Commission*, Fiscal 2007 Congressional budget request, p.3 (aggregated number of employees in market regulation, investor education and economic analysis, plus 50% of employees in the area of enforcement), for SEC budget *Securities and Exchange Commission*, 2006 Performance and Accountability Report, p.2. p.61 (aggregated budget of Market Regulation and 50% of Enforcement), for SEC supervised entities *European Central Bank*, The Euro Equity markets, online publication 2001; http://www.ecb.int/pub/pdf/other/ euroequitymarketen.pdf (download July 12th, 2007), p.11.
For BaFin employees and budget allocation e-mail response by Ms. Anja Schuchhardt as of September 14th, 2007; for BaFin supervised entities *Bundesanstalt für Finanzdienstleistungsaufsicht*, Jahresbericht der Bundesanstalt für Finanzdienstleistungsaufsicht 2006, p.178. BaFin's €-based budget was calculated in $ using the factor of 1,3, which is the statistical average of the years 2005-2007.

	USA/SEC	Germany/BaFin
Number of listed companies	7.194	1.019
Number of households participating in shares	57.000.000	10.800.000
Total budget (2006)	$ 913.000.000	$ 167.000.000
Budget for securities supervision (2006)	$ 215.252.000	$ 28.392.000
Percentage	23,58%	17,00%
Total FTEs (Full time equivalents) (2006)	3.865	1.679
FTEs securities supervision (2006)	1.164	350
Percentage	30,10%	20,85%
Total budget per household	$ 16,02	$ 15,46
Total budget per listed company	$ 126.911,31	$ 163.886,16
Securities supervision budget per household	$ 3,78	$ 2,63
Securities supervision budget per listed company	$ 29.921,05	$ 27.862,61
Total FTEs per million households	68	155
Total FTEs per listed company	0,54	1,65
FTEs securities supervision per million households	20	32
FTEs securities supervision per listed company	0,16	0,34

Chart 15: Comparison of SEC's and BaFin's funding and employee base

Thus, we can conclude that the SEC's percentage of budget/employees for securities supervision in relation to the total of budget/employees is slightly higher. However, this is not indicative: as the current thesis did not evaluate the actions in banking and insurance supervision, a comparison of the workload of these areas has not been made and thus the appropriate distribution may differ in both countries. The comparison, in this regard, is not significant.

Furthermore, the SEC's securities supervision budget is significantly (1.43 times) higher per investing household, and slightly higher (1.07 times) per listed/supervised company. Whereas the difference per listed/supervised company must be deemed as insignificant, the varying amount per household calls for an explanation. On the one hand, the SEC is to protect an especially wide range of investors, because – as previously discussed – securities are an important means for saving and thus, a large proportion of the population participates in the stock market. On the contrary, BaFin engages for the welfare of a growing, but nevertheless currently narrow window of mostly well-educated investors, so that they require less engagement. On the other hand, the SEC number was calculated using the number of direct stock participants: as previously discussed, the actual number of stock participants, containing also all those participating indirectly via pension funds and the like, is much higher, so that SEC's overall securities supervision budget per household would be lower than BaFin's number.

In full term equivalent employee positions in securities supervision, BaFin significantly outperforms the SEC in both distributions to households (1.6 times) and listed companies (more than two times). As to the distribution onto listed/supervised companies, reasons may lie in the fact that the SEC has outsourced some of its supervisory tasks to SRO, whose employee positions are not reflected in the above calculation.

From all this, it becomes obvious that BaFin's monetary and staff resources are equal or in some fields even higher than the SEC's, so that the hypothesis that the US organization generally is much better endowed can be refuted. Although differences in the budged allowance for specific fields of supervision may exist, a general lacking comparability of BaFin's resources and thus an urgent need for amendment cannot be argued for.

6. Organizational setting

As to the agencies' organizational setting, it is important to note that the SEC is a collegial body, whereas the BaFin has a presidential governing structure. In current managerial organizational theory, collegial structures are preferred for organizations which have been operating for quite a while, whereas directorial structures are recommended for start-ups and in times of strategic turnaround: decision-making is quick and not cost-intensive[1283], but also flexible[1284] and thus ensures that action can be taken in due time and in one pre-set direction. Also, the contribution of responsibility for success or failure is clearly attributed to the decision-maker.[1285]

In arguing for BaFin's organizational setting, it must be underlined that this decision had not been made inconsiderately: discussions prior to the enactment of FinDAG had yielded that the presidential structure would be preferable, among others due to the above-mentioned criteria.

However, as previously indicated, recent incidents led to considerations to limit the presidential competency on a majority vote of the vice president and the executive directors.[1286] Al-

[1283] Besides the fact that only one person is actually planning, the steep learning curve effect of this person will foster efficient decision-making; *Laux/Liermann,* Grundlagen der Organisation: die Steuerung von Entscheidungen als Grundproblem der Betriebswirtschaftslehre, 5th edition 2005, p.103.
[1284] *Morgan*, Managing change: the strategies of making change work for you, 1972, p.134.
[1285] *Laux/Liermann,* Grundlagen der Organisation: die Steuerung von Entscheidungen als Grundproblem der Betriebswirtschaftslehre, 5th edition 2005, p.115.
[1286] *Jahn*, Mit kräftigem Biss, in FAZ of May 23rd, 2007.

though the concrete reasons for this step may have lain in other fields[1287], it can be supposed that the fact that BaFin established itself in the securities markets and in the international supervisory scene – i.e., has reached a mature organizational state – has contributed some reasons for this decision, especially as organizational redesign is a process occurring regularly with business organizations as well as agencies for reasons of efficiency enhancement[1288]. Thus, the discussion of "structure follows strategy" versus "strategy follows structure", as initiated by Chandler and recently restarted, finds a prime paradigm in BaFin's development.[1289]

As seen from SEC's operations, a controlled collegial structure in such that each head of department maintains power of decision, but informs his peers and orients major actions on their say, proves advantageous – and the German legislator made a step in the right direction for BaFin. BaFin's current structure, thus, is the best of two worlds: it combines the inclusion of as much information as available with all leading directors, but also avoids conflicts of interests between personal and the agency's preferences.[1290] Also, a high rate of participation[1291] distributes the successes and failures of the agency on more shoulders, and will become more and more important if BaFin might decide to merge the three directorates further.

b. Conclusions for further development of BaFin

By comparison of the two agencies, many differences in both structure and authority can be noted. Although US legislation might have some advantages over the German system in terms of legislative efficiency[1292], it must be considered that the body of law and the jurisdiction[1293] is structurally different, as is the constitutional law and the distribution of competencies between the national government and the federal states. Thus, a direct application of US princi-

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[1287] Supposedly, in the corruption affair that shook BaFin severely in 2004 and 2005; *Jahn*, Mit kräftigem Biss, in FAZ of May 23rd, 2007.
[1288] *Morgan*, Managing change: the strategies of making change work for you, 1972, p.128, 133.
[1289] Empirical evidence indicates that rather, the structure is oriented on the strategy – BaFin is one more example of how internal (lacking) decisions provoked a structural change; *Scholz*, Strategische Organisation: Prinzipien zur Vitalisierung und Virtualisierung, 1997, p.151.
[1290] *Laux/Liermann,* Grundlagen der Organisation: die Steuerung von Entscheidungen als Grundproblem der Betriebswirtschaftslehre, 5th edition 2005, p.91.
[1291] *Picot et al.,* Organisation. Eine ökonomische Perspektive, 2005, p.235.
[1292] Mainly based the following fact: due to its longer existence, US legislation has been frequently revised and adapted to current demands, so that loop-holes exist only in a few cases; also, it has been conceived by a single legislator on the contrary to the double-involvement of European and national/German legislator in Germany. At last, means of enforcement (class action, criminal sanctioning by administration) is, by constitutional law, more wiede-spread in the US, which the legislator employed to a full extent.
[1293] Especially in terms of the proceedings available (class action) and the course of proceedings (jury trial, specialized courts).

ples does not prove beneficial at any rate[1294], but it must be carefully considered which principles can be adopted, and how they can be integrated into the current legal structure. Also, a too strong Americanization of German and European law has met severe concerns[1295], especially for fear of lacking independence and balance of powers. Additionally, capital market supervision in Germany is founded on a federal states' and decentralized basis, i.e. the distribution of supervision onto three administrative layers BaFin, the federal states' exchange supervisory authorities and the SRO bodies of the exchanges.[1296] Due to the constitutional basis, a turnover of this structure is not possible, so that this fact has to be considered, too.

i. Attribution of standard-setting power

One area in which the SEC holds more competencies than BaFin does is standard-setting: whereas both can issue regulations and guidelines after referral of the legislator, the SEC hasquasi-legislative power to issue releases which are not mere soft law, on their own initiative. As detailed above, this is beneficial to the US capital market: the governing body of law can be changed quickly, and by those who are closest to its administration.

Thus, one might consider it necessary to attribute similar standard-setting power to BaFin for legislative, and not only sub-legislative/soft law norms. Most important, in this regard, is the fact that BaFin's regulatory authority is not very extended, which would, "for example, improve the supervision of investment services enterprises and strengthen the independence of listed company auditors"[1297], as BaFin could determine their approaches and consider best practices by far more than the legislator does. Also, more regulatory involvement of BaFin would ensure that necessary changes in legislation occur more quickly – such rule-making could happen in months, if not weeks, whereas the drafting of a bill and especially its passage in the two German legislative bodies adds up to years. Especially as the capital market is volatile, a quick standard-setting by BaFin, e.g. after an incident, would prohibit the occurrence of further detrimental incidents, so that more stability can be achieved.

[1294] *Seitz*, Die Integration der europäischen Wertpapiermärkte und die Finanzmarktgesetzgebung in Deutschland, in BKR 2002 340, p.347; *Möllers*, Creating Standards in a Global Financial Market – the Sarbanes-Oxley Act and her Activities: What Europeans and Americans could and should learn from each other", in ECFR 2007 173, p.177.

[1295] *Möllers*, Die Rolle des Rechts im Rahmen der europäischen Integration: zur Notwendigkeit einer europäischen Gesetzgebungs- und Methodenlehre, 1999, p.44.

[1296] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.136.

[1297] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.24.

However, hitherto, this is prohibited by the German Basic Constitutional Law (GG).[1298] This is even more critical as BaFin, as an agency, is not directly answerable to Parliament, and only holds its power by sub-delegation.[1299] A solution to this dilemma might be found alongside the following deliberations: on the one hand, a retroactive parliamentary control of BaFin's standard-setting activities, such as cassation or approval, on the other hand, "stronger involvement of citizens and interest groups"[1300]. Even though the latter does not ensure democratic legitimating, the strong involvement of citizens guarantees a democratic momentum and also moral legitimating with regard to expertise and the statement of citizens' interests. Also, the right of cassation solution would be similar to a parliamentary control mechanism in the well-established and so far successful Lamfalussy procedure.

ii. Attribution of power of prosecution

Furthermore, the problem of lacking power of prosecution – which cannot be amended due to constitutional basic principles – must be addressed. It is quite detrimental to incumbent investigations if BaFin only concludes primary investigations, but is not able to search business sites and seize evidence, but must refer the suspicion to the Public Prosecutor's Office. This procedure does not only lead to delays, which gives the suspected tortfeasor the opportunity to dissimulate evidence, but also complicates investigations: Public Prosecution often is not specialized in capital market delinquency, and thus needs extensive counseling by BaFin. Indeed, as the SEC claims its most distinguishing success factor to other securities regulators is the vigorosity of its enforcement[1301], the lacking of power of prosecution seems a pertinent factor for BaFin's success. The SEC itself handles the vast majority of cases in-house, and if they refer to Public Prosecution, again most cases can, either by legal dispositions or by settlement with the parties, brought before courts in Washington DC[1302], which are used to capital market law procedures and posess specific knowledge.

An oftentimes suggested solution for BaFin's current situation would be the formation of specialized Offices of the Public Prosecutor at the sites of exchanges[1303], possibly also combined with a specialized court. Also, this suggestion is backed up by international studies, which demand for effective capital market "specialization [in enforcement, because] few prosecutors

[1298] Basic Constitutional Law, sec.80 I.
[1299] *Schädle*, Exekutive Normsetzung in der Finanzmarktaufsicht, 2007, p.56.
[1300] *Schädle*, Exekutive Normsetzung in der Finanzmarktaufsicht, 2007, p.136.
[1301] Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.
[1302] Close to 90%; Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.
[1303] *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.558; *Möllers*/*Weichert*: Das Kapitalanleger-Musterverfahrensgesetz, in NJW 2005 2737, p. 2739.

have the skill or interest to bring securities fraud cases"[1304], which is urgently needed if the rules and regulations are to deploy their full deterring and sanctioning effect. As tortfeasors in the area of capital market law become more and more sophisticated in their actions, not only specialized administrative agencies – as BaFin and its peers – should investigate[1305], but likewise specialized agencies should enforce.

Especially as capital market law gains more and more awareness, and requires a high level of experience in the field, a similar decoupling as with labor law[1306] – but limited to one or two sites – might avail, as could the establishment of an office with administrative law judges exclusively assigned to cases BaFin investigated. Due to concerns about both practical feasibility and democratic legitimization of such a specialized office, action might be limited to some core areas, e.g. "disclosure obligations and certain […] insider dealing prohibitions [as well as] bar orders"[1307].

iii. Attribution of sanctioning power

Likewise, it is vividly discussed whether BaFin should be attributed more sanctioning power, especially for criminal offences, as it currently only holds limited authority to sanction administrative offences. Indeed, the SEC does well in this field[1308], and also the attribution of this power has proven to be one of the agency's reasons for efficiency. Especially as the agency has conducted the investigation, and the specific knowledge cannot be easily transmitted to an "outsider" like Public Prosecution, such an authority does make sense from an efficiency-oriented perspective.

However, it must be understood that Germany respects the principle of separation of powers[1309] very strictly, and that the attribution of so much authority in all three fields of governmental power would endanger this equilibrium. Although scholars[1310] confirm that such a

[1304] *Black*, The Legal and Institutional Preconditions for Strong Securities Markets, in UCLA Law Review 49 UCLA L. Rev.781, p.790.
[1305] *Kitch*, in *Buxbaum et al.*, European Business Law – Legal and Economic Analyses on Integration and Harmonization, 1991, p.46.
[1306] *Coffee*, Privatization and Corporate Governance: the Lessons from Securities Market Failure, in 25 Iowa J. Corp.L. 1, p.16.
[1307] *Coffee*, Privatization and Corporate Governance: the Lessons from Securities Market Failure, in 25 Iowa J. Corp.L. 1, p.17.
[1308] Employees name this authority one of the most important of the SEC's success factors; Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.
[1309] Basic Federal Law (GG), sec. 20 II and III.
[1310] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.149.

path would be possible without the lesion of principles, opposition from the supervised entities would have to be expected, and so would a long-term judicial control if the current amount of sanctioning powers would be enhanced to criminal offences.

An alternative frequently discussed is the attribution of sanctioning authority to a private body of law, which then would be supervised by a federal authority – most suggestively, BaFin. A powerful and until now successful example of such outsourcing is the British Financial Reporting Review Panel (FRRP) for the control, supervision and sanctioning of accounting issues.[1311] Although this solution seems to alleviate some of the concerns uttered as to the principle of separation of powers, it is doubtful whether such important authority as sanctioning should be laid in the hands of a private body. Corruption, abuse and lacking stringency could be expected with high certainty. Also, most evaluative criteria – such as investigative authority, confidentiality, conjunction of legislative and sanctioning power, but also financing of the entity and HR[1312] – speak for a public law institution. A similar argumentation can be applied to the attribution of sanctioning power to SROs, so that also this alternative does not prove worthwhile.

Thus, it must be expected that the current separation – BaFin for the investigation and sanctioning of administrative offences, Public Prosecution and courts for criminal offences – will be maintained. As to alleviate for the disadvantages, BaFin will have to work on close contacts with Public Prosecution and must strive to determine a common understanding of procedures as to ensure corresponding approaches.

Furthermore, the adequacy of both agency's sanctioning arsenal must be discussed: As detailed above, the SEC can order monetarily heavy fines[1313] or imprisonment up to 20 years.[1314] BaFin, on the contrary, faces a cap in fines[1315] and criminal sanctioning for capital market crimes is both limited to short-term sentences[1316] and actually uncommon.[1317]

[1311] *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.151.
[1312] For a detailed evaluation, see *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.177.
[1313] $ 5 million for both persons and entities plus disgorgement of profits; Securities Exchange Act 1934, sec. 32.
[1314] Sarbanes-Oxley Act 2002, sec. 906.
[1315] On € 1 million-threshold; Securities Trading Act (WpHG), sec. 39 IV.
[1316] Securities Trading Act, sec. 38 I provides for a term of five years only.
[1317] Whereas the cases of Comroad, Informatec and EM.TV led to imprisonment, in Mannesmann, the culprits were only fined; *Möllers*, Thomas M.J.: Effizienz als Maßstab des Kapitalmarkts, ACP 208 (in printing), p. 31.

Thus, the adequacy of sanctioning must be pondered in two ways: on the one hand, economic efficiency demands that the (monetary) risk of sanctioning equals the (monetary amount and possibility of) gains.[1318]

At first, it is highly questionable whether a mere € 1 million sanction creates a sufficiently deterring effect for unlawful behaviour. Especially as, in the US, the expectance of high civil and additional punitive damages must be added to the monetary amount of deterrence, BaFin's threat seems of minor importance given the fact that most listed issuers dispose of turnovers (let alone funds) more than 1000 times equalling this number[1319].[1320] Consequently, the legislator must be strongly advised to increase the maximum amount of penalties in the realm of capital market law to at least € 10 million. Although commensurability will be debated, the fact that capital market law crimes are capable of generating equally high gains through illicit behavior, and that an economically striking deterrence must at least equal[1321] the gain possibilities, should eradicate this concern.

Moreover, it is debatable whether imprisonment – especially if the sentence equals a lifetime – is appropriate to sanction capital market crimes, because such hard sanctioning speaks against the principle of commensurability[1322]: each sanction must, in its impact on the culprit, be in adequate in comparison to the extent of the offence and the liability. Although it must be admitted that fines – mostly taken over by either the company or a D&O insurance – are not a similarly powerful means to deter personal misconduct[1323], a prison sentence with an amount equalling murder[1324] must be deemed as inappropriate in the context of European law history.[1325] Furthermore, it must be considered that although an individual has acted in all cases, the majority of capital market crimes are not, or at least not exclusively, committed for per-

[1318] *Cooter/Ulen*, Law and economics, 4th edition 2004, p.321, 333.
[1319] E.g., all participants in DAX 30 have turnovers ranging in billions of euro (data derived from corporate homepages).
[1320] A current example is the fine against DaimlerChrysler, ordered by BaFin due to an omission of the publication of Jürgen Schrempp's termination. Whereas the fine amounts to more than € 100,000 (http://www.netzeitung.de/wirtschaft/unternehmen/732771.html (page impression of November 23rd, 2007)), DaimlerChrysler supposedly paid Jürgen Schrempp € 50 Mio in exchange for premature termination of his contract (http://www.stern.de/wirtschaft/unternehmen/unternehmen/601582.html?cp=12 (page impression of November 23rd, 2007))
[1321] *Stigler* in *Posne/Scott,* Economics of Corporation Law and Securities Regulation, 1980, p.347.
[1322] A principle derived from Basic Constitutional Law, Art. 20, and vastly interpreted by the German Supreme Court; *Möllers*, Thomas M.J.: Effizienz als Maßstab des Kapitalmarkts, ACP 208 (in printing), p. 31; *Lenenbach*, Kapitalmarkt- und Börsenrecht, 2002, p.561.
[1323] *Möllers*, Thomas M.J.: Effizienz als Maßstab des Kapitalmarkts, ACP 208 (in printing), p. 30.
[1324] Criminal Code (StGB), sec. 75.
[1325] Whereas – with the generally sharper sanctioning system of the US, which includes even capital punishment, a quasi-lifetime prison sentence for capital market crimes might not be incommensurate in comparison.

sonal enrichment, but on behalf of the company[1326], so that the latter must at least partially bear sanctioning. Also, the possibility of over-deterrence, i.e. the most excellent employees no longer being interested in senior management positions for fear of sanctioning for capital market crimes, must be considered.[1327]

Thus, for German capital market law, it can be concluded that commensurability, in both ways, must be re-thought: on the one hand, monetary sanctions are too low to generate sufficiently deterrence, and thus the current cap should be extended. On the other hand, even though punishment by long-term might set positive incentives on the avoidance of capital market delinquency, an extension of sanctions in the range as currently employed in the US is not imaginable under the current German Basic Constitutional Law.

iv. Extension of the use of novel types of sanctioning, especially shaming

As detailed above, both SEC[1328] and BaFin[1329] have the authority to publish the result of cases not only in a general and anonymized way, but also as a full-fact account with name, faults and sanction of the wrongdoer – so-called shaming. This is applicable on both entities and persons, and might be either done by publication in daily press, on the agency's homepage or also in annual reports, and has been employed by both agencies.[1330] Additionally, the SEC, in accordance with the Federal sentencing guidelines, can order the culprit to publish the offence and measures for avoidance of future re-occurrence itself.[1331]

The primary reason for shaming is deterrence[1332]: other persons prone to criminal behaviour will re-think their decision when being confronted with knowledge about the failed efforts of

[1326] As derived from the distribution of cases across core enforcement areas*; Securities and Exchange Commission,* SEC Performance Budget for 2006, http://www.sec.gov/ about/2006budgetperform.pdf (page impression of August 1st, 2007), p.8; no recent data available.
[1327] *Möllers*, Thomas M.J.: Effizienz als Maßstab des Kapitalmarkts, ACP 208 (in printing), p. 32.
[1328] As provided in Securities Exchange Act 1934, sec. 21 (a).
[1329] As provided by Art. 14 IV MAD and incorporated in Germany law by Securities Trading Act, sec. 40 (b). Similar provisions have been incorporated in Art. 51 III MiFiD.
[1330] For example, in 1996, the SEC sanctioned NASD (today's FINRA) for non-stringent supervision of market makers and requested reforms; *Kiefer*, Kritische Analyse der Kapitalmarktregulierung der U.S. Securities and Exchange Commission, 2003, p.63. BaFin published a range of wrongdoers in *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2006, p.168.
[1331] US. Federal Sentencing Guidelines 2007, chapter 8, http://www.ussc.gov/2007guid/GL2007.pdf (page impression of November 20th, 2007) allow the court "to order an organization, at its expense and in the format and media specified by the court, to publicize the offence committed, the fact of conviction, the nature of the punishment imposed, and the steps that will be taken to prevent the recurrence of similar offenses". For a short introduction to the provision see *Hirte/Möllers*, Kölner Kommentar zum WpHG, 2007, § 40b, marginal 9, p.2560.
[1332] *Fleischer*, Erweiterte Außenhaftung der Organmitglieder im europäischen Gesellschafts- und Kapitalmarktrecht, in ZGR 2004 437, p.476; *Hirte/Möllers*, Kölner Kommentar zum WpHG, 2007, § 40b, marginal 1, p.2557.

other parties and the sanctions imposed on them, and issuers will step back due to the high value of an intact reputation[1333] and the fact that a publication process in this fashion is highly likely to create negative publicity. Secondly, shaming contains a punitive aspect: by damaging the culprit's reputation, especially in a corporate background, the procedure might "affect consumer confidence in the corporation and compromise the corporation's autonomy" [1334].

A further consideration adds that public knowledge of sanctioning will lead damaged parties to the conclusion that they might claim for damages on a civil basis.[1335] Economic reasoning in capital market law adds that in those cases where incorrect pricing information is involved (insider trading, price manipulation), only publication to the trading public will lead to price adaptation. However, the risk of price overreaction is imminent to this procedure.[1336]

Further arguments in favour of shaming in capital market law are that the procedure is quite cheap in comparison to the admonition of an imprisonment term or the administration of a fine payment[1337]. However, "shaming sanctions work best in close-knit communities in which citizens interact frequently and share common values"[1338] – a disposition certainly true[1339] for the international capital market scene, where every issuer is known among its peers and to a huge crowd of investors and the general public.

Additionally, shaming has proven effective in the field of emission trade right[1340] and as a strategy against civil law torts, e.g. non-compliance with certain self-imposed standards[1341] or

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[1333] Law Reform Commission, Report 102 (2003) - Sentencing: Corporate offenders, http://www.lawlink.nsw.gov. au/lrc.nsf/pages/r102chp11 (page impression of November 20th, 2007).
[1334] Law Reform Commission, Report 102 (2003) - Sentencing: Corporate offenders, http://www.lawlink.nsw.gov. au/lrc.nsf/pages/r102chp11 (page impression of November 20th, 2007).
[1335] *Fleischer*, Erweiterte Außenhaftung der Organmitglieder im europäischen Gesellschafts- und Kapitalmarktrecht, in ZGR 2004 437, p.476; *Möllers*, Thomas M.J.: Effizienz als Maßstab des Kapitalmarkts, ACP 208 (in printing), p. 16.
[1336] *Möllers*, Thomas M.J.: Effizienz als Maßstab des Kapitalmarkts, ACP 208 (in printing), p. 16.
[1337] *Skeel*, David A.: Shaming in corporate law (Symposium on Norms and Corporate Law), University of Pennsylvania Law Review 6/1/2001, p.5.
[1338] *Skeel*, David A.: Shaming in corporate law (Symposium on Norms and Corporate Law), University of Pennsylvania Law Review 6/1/2001, p.1, 4.
[1339] *Barnard*, Jayne W.: Reintegrative Shaming in Coroprate Sentencing, in 72 Southern Calif. L. Rev. 959, p. 966.
[1340] Act on the Trade of Greenhouse Gas Emissions (TEHG), sec. 18; *Corino* et al., Der Handel mit Treibhausgas-Emissionsrechten – Das Kyoto-Protokoll, die geplante EG-Richtlinie und das Handelssystem in Großbritannien, in EuZW 2002 165, p. 168; *Michaelis/Holtwisch*, Die deutsche Umsetzung der europäischen Emissionshandelsrichtlinie, in NJW 2004 2127, p.2131.
[1341] *Bachmann*, Verwaltungsvollmacht und „Aktionärsdemokratie": Sebstregulative Ansätze für die Hauptversammlung, in AG 2001 , p.635.

ambush marketing[1342]. Especially as so-called re-integrative shaming, the procedure has also been discussed in a criminal law background and deemed as highly efficient[1343] if effectuated in a non-stigmatizing, but reintegrative fashion, as "superior moral qualities can decrease offending behaviour"[1344]. This somewhat moralistic and emotional approach is especially viable when it comes to "abstract" crimes, whose criminal character is not emotionally burdensome to the culprit[1345], and thus fits well with the extent of capital market delinquency. However, German scholars have refuted all those attempts[1346], at least for current criminal offences, due to concerns about democratic principles, especially informational self-determination.

As well, it must be considered that publication might lead to an image loss on the culprit's part which is by far inappropriate to the offence committed.[1347] Especially as the general public is not intimate with the provisions of capital market law, even minor offences, e.g. in the area of accounting, could be deemed as scandalous and thus lead to consumer boycotts or quick-selling of available sales (which then would lead to a severe price drop) on the side of minor individual investors.

The concerns have led to the conclusion that BaFin's authority for shaming is bound by double discretion: on the one hand, it must not damage the stability of the financial markets; on the other hand, it must not unreasonably burden the concerned parties[1348], so that BaFin must ponder advantages and risks in every single case. Furthermore, the publication is only to be effectuated when BaFin's measure has become incontestable.

[1342] *Wittneben*/Soldner, Der Schutz von Veranstaltern und Sponsoren vor Ambush Marketing bei Sportgroßveranstaltungen, in wrp 2006 1175, p. 1180.
[1343] *Kahan/Posner*, Shaming White-Collar Criminals: A Proposal for Reform of the Federal Sentencing Guidelines, 42 J.L. & Econ. 365, 385.
[1344] *Murphy/Harris*: Shaming, shame and recidivism: A test of reintegrative shaming theory in white-collar crime context, in 47 Brit. J. Criminology 900, p. 900.
[1345] *Murphy/Harris*: Shaming, shame and recidivism: A test of reintegrative shaming theory in white-collar crime context, in 47 Brit. J. Criminology 900, p. 913; *Barnard*, Jayne W.: Reintegrative Shaming in Coroprate Sentencing, in 72 Southern Calif. L. Rev. 959, p. 990, 996.
[1346] *Jung*, Zur Renaissance des Opfers – ein Lehrstück kriminalpolitischer Zeitgeschichte, in ZPR 2000 159, p. 162.
[1347] *Barnard*, Jayne W.: Reintegrative Shaming in Coroprate Sentencing, in 72 Southern Calif. L. Rev. 959, p. 1003, *Möllers*, Thomas M.J.: Effizienz als Maßstab des Kapitalmarkts, ACP 208 (in printing), p. 16, Law Reform Commission, Report 102 (2003) - Sentencing: Corporate offenders, http://www.lawlink.nsw.gov.au/lrc.nsf/pages/r102chp11 (page impression of November 20th, 2007).
[1348] Securities Trading Act (WpHG), sec. 40 (b), Begr. Des RegE, BT-DR 15/3174, p. 40f. The consideration has to include concerns about the prinicple of informational self-determination; *Durner*, Zur Einführung: Datenschutzrecht, in JuS 2006 213, p.214; *Spindler*, Kapitalmarktreform in Permanenz – Das Anlegerschutzverbesserungsgesetz, in NJW 2004 3449, p. 3454.

Whereas the SEC is similarly bound by a discretionary decision[1349], the agency uses this means to a higher degree, and considers it rather an additional means of sanctioning, whereas in Germany, shaming is deemed as not a sanctioning mechanism, but rather a preventive means only.[1350] On this prerogative, also the execution of BaFin's discretion must be oriented, so that the extent of preventive vigor and not the relationship between the offence and the consequences for the culprit is to be pondered[1351], so that actually, the requirements for a publication are quite restrictively interpreted.

As, in both the US capital market law and other fields of law, shaming has been proven highly effective not only as preventive means, but also as (additional) sanctioning mechanism, it must be re-thought carefully whether BaFin could enhance the current use. As the restrictive interpretation of the norm is indicated by its formulation, the legislator should not leave interpretation to BaFin itself or scholars, but rather, by a strategic decision, clarify the intent of this norm, and introduce shaming as an additional sanctioning mechanism.

v. Extension of competencies into company law, especially cease-and-desist authority

As detailed above, the SEC's cease-and-desist authority is one of its most striking means[1352] to ensure that managers will comply with regulations imposed: with the sanctioning of entities or the attribution of fines to such, eventually the investors are punished, because their fortunes will have to generate the fine. Thus, only personal liability sets sufficient incentives for correct behavior without imposing punishment on the wrong parties. Additionally, knowing that they are liable "with their future professional live" (which a ban of profession would ruin) and not only with monetary fines, managers will consider their professional future and thus retain from non-compliance with higher probability. Thus, since the extension of SEC's cease-and-desist authority by SOX[1353], more than 200 cases (priorily around 30) have been tackled.[1354]

BaFin, on the contrary, indeed has similar authority in some cases, but not as extensive as the SEC: in case of severe and repeated violation of regulations, especially in the field of ad-hoc disclosure and accounting, BaFin can prohibit a manager's further appointment to a position

[1349] Securities Exchange Act 1934, sec. 21 (a).
[1350] *Hirte/Möllers*, Kölner Kommentar zum WpHG, 2007, § 40b, marginal 4, p.2558.
[1351] *Hirte/Möllers*, Kölner Kommentar zum WpHG, 2007, § 40b, marginal 4, p.2558.
[1352] Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.
[1353] Actually, the burden of proof was alleviated: whereas before, a person must have been "substantially unfit" for the post, now being "unfit" suffices for a bar order.
[1354] Mr. Scott Birdwell of SEC during an interview on October 3rd, 2007.

in senior management, however only temporarily.[1355] In the field of banking supervision, BaFin holds competency to ban managers from further execution of a similar position[1356]. However, as a severe sanction, this is very rarely effectuated, as one prerequisite is personal unreliability, and negative effects on the business must be expected before BaFin could demand removal.[1357] A similar authority for temporary suspension due to non-compliance in securities law should be conferred to BaFin by the transformation of several European directives[1358] into German Law, but has not been effectuated so far.

This involvement of a federal supervisory agency in corporate law[1359] has been on a steady increase: both the reporting requirement concerning certain thresholds of share ownership and the provisions to prevent director's dealing are supervised by BaFin, as is ad-hoc disclosure with the risk of personal liability of directors.[1360] Thus, if BaFin was also entitled to a cease-and-desist procedure for all wrongdoings in the field of capital market law, the logical connection of investigation and enforcement would be maintained. The German legislator must be strongly advised to integrate cease-and-desist authority for BaFin in the future body of capital market law, even more so as European directives request such compliance.

vi. Tighter intertwining of supervision

In contemplating BaFin's three pillar structure and the spatial separation of the sites, one must come to the conclusion that BaFin still engages into supervision of three separated areas with three equally separated directorates. Although this structure is simple and easily to manage[1361], the concept of one-stop supervision (and thus, the very reason for BaFin's foundation) is not realized to a high degree.

However, it must be understood that the three areas of law are very distinct, and did not change materially with the establishment of BaFin. Thus, it could not be expected that the traditional ways of operation and supervision would change. Also, there is a common ten-

[1355] *Köhler et al.,* Umsetzungsstand des 10-Punkte-Plans der Bundesregierung zur Stärkung des Anlegerschutzes und der Unternehmensintegrität, in BB 2004 2623, p.2629.
[1356] Banking Act (KWG), sec. 36 I.
[1357] *Geschwandtner*, Josef Ackermann im Visier der Bundesanstalt für Finanzdienstleistungsaufsicht – Wirtschaftlich erfolgreich! Persönlich unzuverlässig?, in NJW 2006 1572, p.1572.
[1358] To name, the MAD sec. 12 II lit. h; MiFiD sec. 50 II lit g.
[1359] As such a ban must surely be classified, because BaFin would engage directly in organizational matters of the supervised entity.
[1360] *Buchta*, Die Haftung des Vorstands einer Aktiengesellschaft – aktuelle Entwicklungen in Gesetzgebung und Rechtsprechung (Teil II), in DStR 2003 740, p.740.
[1361] *Schüler*, Integrated Financial Supervision in Germany, online publication 2004; ftp://ftp.zew.de/pub/zew-docs/dp/dp0435.pdf (download June 6th, 2007), p.15.

dency to adhere to current procedures, especially in times of organizational change as undergone by the three formerly distinct areas.

Also, BaFin has not been operating for long and consecutive time span. Thus, the establishment of cross-sectoral departments, which engage into those issues of intertwined supervision, has been a good beginning. Within its development, BaFin might evolve to a matrix structure, which would allow the organization to maintain the traditional differentiation between the sectors, but also opt for a cooperative bond between those, e.g. the size of the supervised companies[1362].

vii. Extension of funding and staff base

As common with public services agencies, the workload is overpowering for the current staff level, so that it is often suggested that BaFin increase its employee base.[1363]

However, it must be considered that regardless of the number of employees, supervisory work will never be a control of all transactions, but rather random examination of samples. Additionally, BaFin seems to handle its current workload prudently, and come to terms with its task. Also in international comparison and in comparison with the SEC, BaFin's employee base must be judged as sufficient: BaFin holds more staff than the SEC per supervised company, and likewise holds more employees per household participating in the stock market.

Additionally, a severe increase of BaFin's staff would spur efficient cooperation, as more and more organizational and supportive functions related to the sharing of information and the practical matters of collaboration would be necessary. Most important, however, is the financial aspect: more positions would have to be financed by the supervised entities, which already shoulder a heavy burden. Even though more and stricter supervision might lead to benefits on their side resulting from higher investor confidence and more trade, the relation between cost contribution and benefits must remain healthy and costs must be set as low as possible for sufficient supervision. Thus, BaFin can maintain its current staff number, and certainly will have to extend it if the agency is attributed more and different tasks, but a general extension cannot be argued for.

[1362] *Schüler*, Integrated Financial Supervision in Germany, online publication 2004; ftp://ftp.zew.de/pub/zew-docs/dp/dp0435.pdf (download June 6th, 2007), p.15.
[1363] *Bundesanstalt für Finanzdienstleistungsaufsicht*, Annual Report 2003, p.25.

viii. Establishment of a European supervisory authority

Another path fairly often discussed in the time of capital market directives is the installation of a supranational European supervision authority, which would then partially or fully overtake the task of the national institutions.[1364] Such development was discussed a long time ago, especially by the Segré-Report in 1966[1365], Hopt in 1976[1366], and Hertig in 1993[1367] and has come up with ever new wave of capital market legislation. But not only scholars, also practicioners urgently request such an agency, especially for cross-border transactions, as they currently perceive negative impact on the capital market.[1368]

With the increasing harmonization of capital market law due to the Financial Services Action Plan[1369], such an agency would create synergies, cost savings[1370] as well as a more uniform representation towards foreign investors. Indeed, studies provided for a GDP increase of 1.1% uniquely due to integration of capital markets and a reduction of equity cost by 0.5%[1371], a number to be topped by a unified supervisory approach. Also, most businesses, and especially banks[1372], embrace this idea as saving them supervisory cost. The combined power of such a super-agency would equal that of the SEC – an important issue, if Europe wants to avoid "economic, cultural and legal dependence"[1373] and to engage in developing the future terms and conditions according to which the capital markets will operate. Further advantages include greater safety for investors by elimination of regulatory arbitrage for companies and more stringent refutation of financial crime as well as consistency for businesses which act in

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[1364] *Wittich*, Zusammenwachsende europäische Märkte – eine Herausforderung für die Wertpapieraufsicht in Europa, in WM 1999 1613, p.1613; indeed, *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.290 cites a survey according to which 68% of financial experts are in favor of such an agency.
[1365] *Hoppmann*, Europäische Börsenaufsicht, in EWS 1999 204, p.208.
[1366] *Hertig/Lee*, Four Predictions about the Future of EU Securities Regulation, online publication 2003; www.effas.com/pdf/hertig_lee.pdf (download June 6th, 2007), p.14.
[1367] *Hertig/Lee*, Four Predictions about the Future of EU Securities Regulation, online publication 2003; www.effas.com/pdf/hertig_lee.pdf (download June 6th, 2007), p.3.
[1368] *Wegen,* Speech and Q&A at the DAJV Annual Conference on German and American Law 2007 on October 4th, 2007.
[1369] *Kung,* The Regulation of Corporate Bond Offerings: A Comparative Analysis, in 26 U Pa. J. Int'l Econ. L.409, p.413.
[1370] *Hertig/Lee*, Four Predictions about the Future of EU Securities Regulation, online publication 2003; www.effas.com/pdf/hertig_lee.pdf (download June 6th, 2007), p.5.
[1371] Study by the London Economics and Center for Economic Policy Research (CEPR) as of November 2002, quoted from *Eichel*, Speech at the IOSCO Technical Committee Conference, 5th of October, 2005, as on the documentary CD-ROM of the conference, p.5.
[1372] *Bundesverband deutscher Banken*, Argumente zum Finanzmarkt: Fortsetzung der Integration der europäischen Finanzdienstleistungsmärkte, online publication 2004, http://www.bankenverband.de/pic/artikelpic/022007/0702_Integration_Finanzmaerkte_dt.pdf (downloaded July 12th, 2007), p.22.
[1373] *Möllers*, Die Rolle des Rechts im Rahmen der europäischen Integration: zur Notwendigkeit einer europäischen Gesetzgebungs- und Methodenlehre, 1999, p.43.

more than one European member state and, despite minimum harmonization, have to respect a multitude of national rules.[1374]

Although some scholars are confident about the installation of such an agency, which they even already name ESEC (European Securities and Exchange Commission)[1375] or EFSA (European Financial Supervisory Agency)[1376], it is doubtful that the member states would consent to the cutback of their competencies in such an important field of law. Although a fair number already has established a supreme financial supervisory authority[1377], most fear to give up authority about such an important field, especially in a time when the EU faces enlargement.[1378] Thus, "national protectionism and bureaucratic inertia"[1379] currently impede the foundation of a European supervisory agency.

Indeed, as even full harmonization of capital market law is not practiced ("harmony in disharmony"[1380]), and as the legal backing of such action is questionable[1381], a unification of supervision would at first need preparatory steps on the side of material law. Besides, the agency would need uniform sanctioning competencies, combined with streamlined administrative provisions and enforcement.[1382] Scholars suggest a unification of the canons of capital

[1374] *Lascelles*, Panel contribution at the IOSCO Technical Committee Conference, 5th of October, 2005, as on the documentary CD-ROM of the conference, p.2.
[1375] *Hertig/Lee*, Four Predictions about the Future of EU Securities Regulation, online publication 2003; www.effas.com/pdf/hertig_lee.pdf (download June 6th, 2007), p.12.
[1376] *Bundesverband deutscher Banken*, Argumente zum Finanzmarkt: Fortsetzung der Integration der europäischen Finanzdienstleistungsmärkte, online publication 2004, http://www.bankenverband.de/pic/artikelpic/022007/0702 _Integration_Finanzmaerkte_dt.pdf (downloaded July 12th, 2007), p.22.
[1377] *Möllers*, Creating Standards in a Global Financial Market – the Sarbanes-Oxley Act and her Activities: What Europeans and Americans could and should learn from each other", in ECFR 2007 173, p.184; *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007), p.30.
[1378] *Hertig/Lee*, Four Predictions about the Future of EU Securities Regulation, online publication 2003; www.effas.com/pdf/hertig_lee.pdf (download June 6th, 2007), p.11.
[1379] *Hertig/Lee*, Four Predictions about the Future of EU Securities Regulation, online publication 2003; www.effas.com/pdf/hertig_lee.pdf (download June 6th, 2007), p.12.
[1380] *Wegen,* Speech and Q&A at the DAJV Annual Conference on German and American Law 2007 on October 4th, 2007.
[1381] For a detailed evaluation, see *Hoppmann*, Europäische Börsenaufsicht, in EWS 1999 204, p.210 et seq.; *Bundesverband deutscher Banken*, Argumente zum Finanzmarkt: Fortsetzung der Integration der europäischen Finanzdienstleistungsmärkte, online publication 2004, http://www.bankenverband.de/pic/artikelpic/022007/0702 _Integration_Finanzmaerkte_dt.pdf (downloaded July 12th, 2007), p.22; *Höhns*, Die Aufsicht über Finanzdienstleister, 2002, p.294.
[1382] *Bundesverband deutscher Banken*, Argumente zum Finanzmarkt: Fortsetzung der Integration der europäischen Finanzdienstleistungsmärkte, online publication 2004, http://www.bankenverband.de/pic/artikelpic/022007/0702_Integration_Finanzmaerkte_dt.pdf (downloaded July 12th, 2007), p.23; *Lascelles*, Panel contribution at the IOSCO Technical Committee Conference, 5th of October, 2005, as on the documentary CD-ROM of the conference, p.4.

market law, so that in the future, a single "lead supervisor"[1383] at the financial services' site of business will conduct all supervisory tasks, which will be recognized as sufficient by all other authorities.

Further hindrances are the 20 different languages that are currently spoken in the EU area, which would generate not only immense costs of interpretation, but also delay the processes of supervision. Also, it must be feared for "inflated administration, missing flexibility, lacking closeness to citizens and a disproportional amount of bureaucracy"[1384]. Furthermore, the agency would have to be designed in a way that competition between the member states' capital markets – vital to the success of each of them – would still exist[1385], although their supervision is streamlined: a difficult prerequisite, as the efficiency of supervision is a main competitive factor. And even if this was guaranteed: domestic confidence in the supervisory body would be more precarious if this was not a national, but a supranational body[1386], thus setting inverse incentives for both businesses and investors. Additionally, it must be understood that exchanges will still be organized on a national level and governed by national law, which would still leave gaps for super-ordinate supervision.

Thus, practical alternatives include the assignment of the Commission with this task (as currently practiced in antitrust law), or the establishment of a body, which would supervise, but refer cases to national supervisory agencies for sanctioning and/or enforcement.[1387] Another distribution of tasks might be to have entities that act in all European states supervised by the European agency, and only authority for nationwide acting entities lying with national supervisory bodies – preferable especially as with this approach, subsidiary would be maintained[1388]. Regardless of the fact that the actual amount of cooperation in high and supportive

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[1383] *Krammig/Gramlich*, Modelle (teil)integrierter Finanzmarktaufsicht in Europa – in der Schweiz und anderswo, in WM 2004 1657, p.1665.
[1384] *Kurth*, Problematik grenzüberschreitener Wertpapieraufsicht, in WM 2000 1521, p.1528.
[1385] *Niemeyer*, An Economic Analysis of Securities Market Regulation and Supervision: Where to Go after the Lamfalussy Report?, online publication 2001; http://swopec.hhs.se/hastef/papers/hastef0482.pdf (download June 6th, 2007), p.3.
[1386] *Lascelles*, Panel contribution at the IOSCO Technical Committee Conference, 5th of October, 2005, as on the documentary CD-ROM of the conference, p.4.
[1387] *Hoppmann*, Europäische Börsenaufsicht, in EWS 1999 204, p.209; *Hertig/Lee*, Four Predictions about the Future of EU Securities Regulation, online publication 2003; www.effas.com/pdf/hertig_lee.pdf (download June 6th, 2007), p.17.
[1388] *Bundesverband deutscher Banken*, Argumente zum Finanzmarkt: Fortsetzung der Integration der europäischen Finanzdienstleistungsmärkte, online publication 2004, http://www.bankenverband.de/pic/artikel pic/022007/0702 _Integration_Finanzmaerkte_dt.pdf (downloaded July 12th, 2007), p.22; *Wegen,* Speech and Q&A at the DAJV Annual Conference on German and American Law 2007 on October 4th, 2007.

of capital market protection all over the European Union, those "rather loose frameworks"[1389], especially in the different interpretation and application of directives and releases, will not be sufficient for a financially viable future. Thus, even if political differences might hinder the short-term establishment of an European SEC, a market-driven[1390] approach to its foundation seems perfectly possible on a mid- to long-term perspective.

c. Summary in 13 theses

The comparison of the SEC with BaFin has yielded a fair amount of suggestions for further development of BaFin, which can be summarizes in the following theses:

1. The SEC and BaFin, although sharing the same range of tasks with almost identical goals of capital market functioning and investor protection, are situated in different legal systems. Due to this difference, mechanisms of operation and competencies differ.

2. Generally, the SEC's competencies are far more extended as to standard-setting and means of enforcement, i.e. the conduction of investigations and sanctioning of criminal offences. Although not detailed studies on SEC's overall efficiency exist, the fact that the SEC combines an array of powers must be counted among its most important success factors.

3. BaFin, as a recently installed agency, must strive to develop its governing law, organizational structure and means of supervision in a way that is most efficient with respect to its goal. Due to the fact that German and European capital market law is largely derived of the US capital market law body, the SEC might also serve as example of a successful supervisory agency.

4. A direct application of those principles that have been recognized as successful with the SEC is nevertheless not possible: differences in the structural body of law (case law vs. civil law), the administrative structure (national predominance vs. federal states' decentralized authority) and constitutional background (principle of separation of powers) call for a differentiated adoption and adaptation of US standards. Most important, in this regard, seem the following fields of action:

[1389] *Lascelles*, Panel contribution at the IOSCO Technical Committee Conference, 5th of October, 2005, as on the documentary CD-ROM of the conference, p.3.
[1390] *Wegen,* Speech and Q&A at the DAJV Annual Conference on German and American Law 2007 on October 4th, 2007.

5. BaFin's standard-setting competency for matters of capital market law must be extended from soft law to genuine norms and regulations in order to ensure quick, flexible and thus effective rule-making. To honor concerns of lacking democratic legitimacy, a parliamentary right of cassation and/or control should be manifested.

6. The efficient enforcement of BaFin-investigated capital market delinquency should be fostered by the referral of cases to offices of Public Prosecution specialized on this field of law; judicial proceedings should be brought before specialized courts, preferably on BaFin's site in Frankfurt.

7. Currently, BaFin's arsenal of monetary sanctions is insufficient, as the (monetary) risk of sanctioning does not equal the (monetary amount and possibility of) gains by capital market delinquency. Thus, the current cap on monetary sanctions should be extended to at least € 10 million. Although also the possibility for sanctioning by imprisonment and the length of possibly sentences differ sharply from the US system, an adaptation is not recommendable due to concerns of commensurability.

8. The preventive-only use of the means of shaming needlessly lessens the vigor of BaFin's arsenal of sanctioning means. As the process of publishing a culprit's offence has been deemed as both highly effective and efficient in the capital market environment, BaFin should, after consulting the legislator's strategic decision for the extension of the current interpretation, engage in the use of shaming as a means of sanctioning.

9. Furthermore, BaFin should be attributed, by legislative decision, a stronger cease-and-desist authority, which would enable the agency to sanction managerial non-compliance in a way that sets sufficiently strong inventives for correct behavior, and has proven efficient with other supervisory agencies. As the agency's involvement in corporate law has been on a steady increase, attribution of cease-and-desist authority would not only support current legislation in a coherent way.

10. Banking supervision being effectuated by both BaFin and the German Federal Bank, high costs for coordination and supposed double-checking occur. As the German Federal Bank, judged by its current authority, is not a strong supervisor, and as a merger of authorities

would generate effects of size and scope, banking supervision should be conferred upon BaFin alone while likewise re-distributing the German Federal Bank's resources.

11. When considering BaFin's organizational setting, the governing structure must be deemed as appropriate for the agencies' current state, as is combines a strong president with sufficient limitations of power. However, in comparison to the SEC, the definition of a vision and mission statement and control of their goals by performance measurement are less stringent with BaFin. As those have proven to be a veritable success factor with the SEC, BaFin should further develop into those techniques, especially in performance measurement, which, for even greater impact, should also be made available for the general public.

12. The comparison with SEC's budget, split per registered company and active investor, shows that BaFin is endowed with proportionally similar, or even higher funds. Thus, the agency is not comparatively under-funded and a general extension of BaFin's budget or staff base seems not necessary at the current point in time.

13. On the long run, considerations for a unified European supervisory authority, going hand in hand with full harmonization of the material body of law, will have to be discussed. Although currently, severe practical and political concerns speak against the installation of such an agency, the future of Europe as a competitive and well-frequented capital market will lie with a strong supervisory agency.

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List of charts