Abstract

This thesis examines disclosure requirements for mutual funds, bonds and retail derivatives in the Canadian, Swiss and German legal frameworks. By comparing the partially divergent Canadian and European approaches to regulating transparency in relation to these investment products, the paper aims at evaluating whether the present transparency requirements of the above jurisdictions provide investors with adequate information on the risks incurring from certain investments and enable them to compare different products and their characteristics with each other. In particular, the author argues that regulations establish adequate transparency only if they ensure that prospectuses disclose essential product characteristics in a timely manner and enable investors to clearly delimit different types of investment products from each other. The thesis demonstrates that the above goals can be best attained under a substantive approach to product regulation. However, slight modifications to the principle “same business, same risks, same rules” may be appropriate in relation to derivative structures whose characteristics require efficient procedures and simple disclosure documentation. Further, the thesis suggests that the implementation of transparency requirements is not always an adequate means to achieve an appropriate level of investor protection. Rather, transparency measures should be supported by the introduction of suitability assessments at the point of sale.
## Abstract

The study aims to analyze the objectives of securities regulation, product categories, and regulatory disclosure frameworks in Canada, Switzerland, and Germany. The research compares these aspects to evaluate the preconditions for transparent capital markets.

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Chapter one Introduction

1 Research Purpose

This paper focuses on disclosure requirements for mutual funds, bonds\(^1\) and retail derivatives in the Canadian, Swiss and German\(^2\) legal frameworks. By comparing the partially divergent Canadian and European approaches to regulating transparency in relation to these investment products, the paper aims at evaluating whether the present transparency requirements of the above jurisdictions provide investors with adequate information on the risks incurring from certain investments and enable them to compare different products and their characteristics with each other. In particular, the author argues that regulations establish adequate transparency only if they ensure that prospectuses disclose essential product characteristics in a timely manner and enable investors to clearly delimit different types of investment products from each other. This thesis will demonstrate that the above goals can be best attained under a substantive approach to product regulation. As a general rule, economically similar products should have to comply with the same regulatory requirements. However, slight modifications may be appropriate in relation to derivative structures whose characteristics require efficient procedures and simple disclosure documentation. Further, the thesis suggests that the implementation of transparency requirements is not always an adequate means to achieve an appropriate level of investor protection. Rather, transparency measures should be supported by the introduction of suitability assessments at the point of sale.

The thesis will focus on primary and secondary market disclosure for retail investment products. Questions on the need to regulate derivative transactions between sophisticated investors will be touched on only briefly. Further, the ongoing discussion on tighter regulation of hedge funds and related transparency issues will not be the object of this thesis. In view of governmental struggles worldwide to overcome the effects of these trades’ non-regulation, a substantial understanding and analysis of these issues would go beyond the scope of this paper. As Swiss and German regulatory requirements often bear a substantial resemblance to each other, German regulations are discussed only if they differ significantly from their Swiss counterparts.

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1 The term ‘bond’ will be used in a wide sense, including short-term debt securities such as bills, papers and notes, see also LAURENCE BOOTH/SEAN W. CLEARY, Introduction to Corporate Finance (Mississauga. John Wiley and Sons, 2008), p. 212.

2 Representing countries which are - in contrast to Switzerland - members of the European Union and, therefore, implement its legal provisions.
The starting point of the research consists of a brief outline of the theoretical fundamentals encompassing disclosure requirements for the above financial instruments. In particular, chapter two describes (i) the objectives of Canadian, Swiss and German Capital Markets Regulations, (ii) the relevant regulatory product categories of each jurisdiction, and (iii) the basic principles of their respective disclosure frameworks.

Chapter three then introduces four fundamental preconditions for transparency in capital markets. First, securities regulations distinguish between different types of financial instruments and, accordingly, set forth different disclosure requirements or investment restrictions. In order to take informed decisions about their financial investments, investors must be able to recognize these different product types and the risks generally ensuing from the products’ characteristics. As a consequence, financial instruments with differing legal structures have to be clearly delimitable. Second, the risks involved with investments in a specific type of financial instrument must be outlined clearly and precisely. Due to the complexity of financial instruments, retail investors in particular do not have the means and time to recognize all significant risks related to their investments. While current legislative approaches suggest that advisors consider their customers’ expertise, funds and risk-propensity in an unbiased manner before recommending or selling any products, investors must still be provided with relevant information of a product’s characteristics and risks. Advisors are required to disclose any monetary benefits they receive from third parties for selling securities to their customers. Further, they are not allowed to keep these earnings without their clients’ approval. However, implications and incentives of relationships between advisors and third parties are often subtle, complex and concealed. As a consequence, disclosure of relevant product and issuer risks remains an essential feature of securities regulation and cannot simply be replaced by a tighter framework at the so-called point of sale. Third, as financial transactions are often time-critical, information has to be easily and quickly available. If retail investors and their advisors are not able to get hold of relevant information as soon as their more sophisticated or powerful counterparts, their response to significant information will be delayed and, therefore, put them at a significant disadvantage. The fourth precondition for transparent markets exists in the comparability of

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3 See, for example, FINANCIAL SERVICES AUTHORITY, “Distribution of retail investments. Delivering the RDR”, Consultation Paper 09/18 (June 2009), p. 25, expressing FSA’s “desire for adviser firms to charge for their services, rather than to be paid by commission set by product providers”.

4 i.e. no kickbacks.

5 See NI 31-101, s.3.7 - 3.13 on referral arrangements; the decision of the Swiss Supreme Court 4C.432/2005 of March 22, 2006, on kickbacks; and the decision of the German Federal Court of Justice (BGH AZ. XI ZR 56/05) of December 19, 2006 on kickbacks.

6 See below, chapter six.
different products and their characteristics. Investors must be given the opportunity of comparing similar products of different issuers, or different types of investment vehicles with similar investment themes to each other. If these comparisons are hampered by non-uniform presentations and different calculation criteria, disclosed data might become distorted and, as a result, would no longer enhance investors’ understanding of the transactions they are entering into.

Considering the above four core principles of transparent markets, chapter four provides an overview of the Canadian, Swiss and German prospectus requirements. For the sake of clarity, this analysis will be confined to the issue of bonds, derivatives and mutual funds. Further, as prospectus requirements for equity securities generally provide the basis for prospectus provisions of other investment products, a brief examination of prospectus requirements for shares will also be included. Present legal frameworks feature major differences between the prospectus requirements for different types of investment products. While some of them can be explained by the underlying economic principles of the products concerned, others have resulted from the historical development of these provisions and have to be abolished. By means of an in-depth comparison of the Canadian, Swiss and German prospectus requirements, chapter four will point out aspects of the different disclosure regimes that are in need of improvement and suggest possible remedies to address these issues.

Canadian, Swiss and German regulations feature continuous disclosure duties for issuers of securities. The extent of these requirements varies considerably and, therefore, requires further investigation. In particular, chapter five deliberates the question of whether the current absence of continuous disclosure requirements for structured derivatives should be replaced by disclosure duties similar to those that apply to equity securities and mutual funds.

In addition to the above prospectus requirements and continuous disclosure provisions, securities regulations have implemented further provisions that should safeguard transparency in capital markets. Chapter six analyzes present and proposed regulations of the point of sale of securities and deals with disclosure obligations and suitability assessments of advisors and asset managers vis-à-vis their customers.

The final chapter of this thesis considers the findings of the previous sections and discusses possible consequences. In particular, chapter seven consolidates the previous chapters’ preliminary answers to

7 I.e. those requirements that issuers have to fulfill when distributing investment products.
delimitability issues and point of sale regulation. Further, the chapter tries to assess the degree of disclosure that is required in relation to structured investments.

II Methodology

As outlined above, this thesis is based on a comparison between the regulation of different financial instruments in the legal frameworks of Canada, Switzerland and Germany. The point of departure for interpreting the regulatory framework for the financial instruments concerned will be the wording and systematic of law. Swiss\(^8\), German\(^9\) and European\(^10\) legislation can be accessed via the internet. Canadian securities regulation is published by the provinces and can be largely found via the CSA-homepage\(^11\) and the homepages of the provincial securities commissions.\(^12\) Until recently, Canadian securities regulation has been considered to fall exclusively within the remit of the provinces. In order to harmonize the key aspects of provincial securities regulations, provincial securities administrators have drafted National Instruments (NI)\(^13\) or Multinational Instruments (MI).\(^14\) Although these instruments are not legally binding per se, provincial securities administrators can adopt them as rules or regulations of their securities frameworks.\(^15\) Current National Instruments contain the main features and concepts of Canadian provincial securities legislation. In July 2009, however, the Canadian Government appointed the Canadian Securities Transition Office (CSTO)\(^16\) “to assist in establishing a Canadian securities regulator”. On May 26, 2010, the Government of Canada released the proposed Canadian Securities Act (Proposed Act) and “referred the following question about the proposed Canadian Securities Act to the SCC [Supreme Court of Canada]: Is the annexed Proposed Canadian Securities Act within the legislative authority of the Parliament of Canada?”\(^18\) As this thesis has been written prior to the Supreme Court’s decision, the following analysis will be based on the currently effective provincial

\(^12\) See, for example, <http://www.bcsc.bc.ca>, and <http://www.osc.gov.on.ca>.
\(^13\) And, in addition, National Policies (NP).
\(^14\) Instruments that have been adopted by some but not all provincial securities administrators (GILLEN (fn. 40), p. 101).
\(^16\) The CSTO was established by the Government of Canada in July 2009. Its mandate is to assist the Government in establishing a Canadian securities regulator. The CSTO consults with the Advisory Committee of Participating Provinces and Territories, creates a national draft Securities Act and develops a roadmap for the establishment of a national regulator (see online. <http://www.csto.ca/en/about-csto.aspx>).
\(^18\) <http://www.fin.gc.ca/n10/data/10-051_3-eng.asp>.
frameworks. The proposed Canadian Securities Act will be mentioned only if its provisions differ significantly from current regulations.

Further insight can be gained by considering the genesis of legal provisions. An analysis of legislative material\textsuperscript{19} is therefore an important factor in this thesis. When establishing the current differences between the legal provisions of Canada, Switzerland and Germany in relation to financial instruments, the research will pay careful attention to the reasoning behind their respective laws. Only an interpretation in accordance with the spirit and purpose of the regulatory framework can lead to an accurate understanding and classification of inconsistencies between different legal provisions. An essential prerequisite to integrating the differences located in the regulation of financial instruments consists, therefore, in the basic knowledge of the underlying objectives of securities regulation, information on which is available in legal commentaries on securities law.\textsuperscript{20}

Relevant information on all these aspects will be extracted from both legal provisions and periodicals and/or standard references on capital markets law.\textsuperscript{21} Furthermore, the interpretation of legal provisions will be enhanced by reference to court rulings and following up on their conclusions. Further information in scientific papers and books focusing on investor’s protection and market transparency will be studied. In particular, the objectives of securities legislation have been a topic of discussion in a large number of scholarly publications. Relevant publications under Swiss law have been written, for instance, by Georg G. Gotschev\textsuperscript{22} and Rolf Watter.\textsuperscript{23} In Germany, Detlef Kleindiek,\textsuperscript{24} Jens Ekkenga\textsuperscript{25} and Petra Buck-Heeb\textsuperscript{26} have contributed to the analyses of the objectives of capital markets law. The objectives of Canadian securities regulation have been examined by Mary Condon/Anita Anand/Janis

\textsuperscript{19} Materials are available on the websites mentioned in fn. 8, 9, 11.
\textsuperscript{21} For Switzerland e.g. DIETER ZOBL/STEFAN KRAMER, Schweizerisches Kapitalmarktrecht (Zürich. Schulthess, 2004); for Germany WOLFGANG GROSS, Kapitalmarktrecht, third edition (Munich. Verlag C.H. Beck, 2006); for Canada JOHNSTON, DAVID/ROCKWELL, KATHLEEN DOYLE. Canadian Securities Regulation, 4th edition (Markham. Butterworths, 2006).
\textsuperscript{22} GEORG G. GOTSCHEV, Koordiniertes Aktionärsverhalten im Börsenrecht - Eine ökonomische und rechtsvergleichende Analyse der organisierten Gruppe gemäß Börsengesetz (Zürich. Schulthess, 2005), p. 64 et seq.
\textsuperscript{23} ROLF WATTER, Investorenschutz im Kapitalmarkt, AIP 1997, p. 269 et seq.
\textsuperscript{25} JENS EKKENGA, Anlegerschutz, Rechnungslegung und Kapitalmarkt. eine vergleichende Studie zum europäischen, deutschen und britischen Bilanz-, Gesellschafts- und Kapitalmarktrecht (Tübingen. Mohr Siebeck, 1998).
\textsuperscript{26} PETRA BUCK-HEEB, Kapitalmarktrecht, 3rd edition (Heidelberg. C.F. Müller Verlag, 2009).
Sarra and Mark Gillen. Other authors have explored the information standards requested by current legislation. In addition, the thesis will consider internet tools such as lexisnexis, westlaw or swisslex.ch. Recent Swiss and German publications are available via internet; others I have taken along for my studies in Canada.

While drawing on the above-mentioned research, the originality of this work will be found in both its perspective and its outcome. Whereas existing scholarly papers confine themselves to describing provisions for prospectuses or continuous disclosure, the aim of this thesis is to compare the regulation of different financial instruments with respect to transparency issues. The analysis will particularly consider differences between the three analyzed national legal systems. Moreover, the thesis will question whether these differences can be explained by logical reasoning – e.g. by looking at the divergent economic characteristics of the instruments concerned – or by accidental inconsistencies.

Throughout the thesis, the below terms will be used as follows. The term ‘security’ is defined in chapter two, sections II.1, III.1 and IV.1 for each jurisdiction separately. If used without a particular connection to one of the national frameworks, it will follow the meaning of ‘security’ in Canadian securities regulation, albeit in its broadest form, i.e. including retail derivatives and mutual fund units. The terms ‘investment product’, ‘financial instrument’ and ‘investment vehicle’ will be used as synonyms to the above understanding of the term ‘security’.

The term ‘mutual fund’ is used in accordance with the general terminology in Canadian Securities Acts and literature. In contrast to closed-end investment funds, mutual funds are open-ended, i.e. if investors wish “to liquidate their investment in the fund”, the mutual fund’s “securities can be redeemed” and the investors receive, on demand or within a certain time period after such demand, an amount that equals the net asset value per share of the fund.

The expression ‘derivative security’ is used in accordance with general corporate finance terminology and refers to a security “that derives its value from other underlying variables such as the price of a

27 See above, fn. 20.
29 For Canada see Gillen (fn. 28), p. 111 et seq.; for Switzerland e.g. ZOBL/KRAMER, (fn. 21), p. 181, p. 292 et seq., p. 417 et seq.; for Germany see BUCK-HEEB (fn. 26).
30 See, for example, Securities Act, RSBC 1996, c. 418 (BCSA), Definitions, “mutual fund”; Securities Act, R.S.O. 1990, c. S.5 (OSA), Definitions, “mutual fund”.
31 GILLENG (fn. 28), p. 524.
32 Closed-end funds are often referred to as non-redeemable funds.
33 GILLENG (fn. 28), p. 524.
34 See OSA, Definitions, “mutual fund”. 

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security or commodity or the level of an index such as stock exchange index”.

If the term is used in the context of regulations whose definitions give a different meaning to the expression, this will be mentioned specifically in the text.

In relation to the purchase of a specific investment product, the term ‘risk’ refers to the risk that an investor may sustain a loss of a part or the entirety of its initial investment. This risk generally consists of two components, namely the risks inherent to the chosen product structure itself and the risks related to the product’s issuer. ‘Systemic risk’, on the other hand, refers to “the risk that (i) an economic shock such as market or institutional failure triggers (through a panic or otherwise) either (X) the failure of a chain of markets or institutions or (Y) a chain of significant losses to financial institutions, (ii) resulting in increases in the cost of capital or decreases in its availability, often evidenced by substantial financial-market price volatility”.

35 Gilien (fn. 28), p. 23.
36 I.e. limited or unlimited potential for loss, reference to conditional or full capital protection, reference to possible early redemption options, indication that bid and offer prices can differ to a greater or lesser extent during the term of the investment (see, for example, the Swiss Bankers Association Guidelines on Informing Investors about Structured Products, <http://www.swissbanking.org/en/999989_e.pdf>).
37 I.e. counterparty credit risk.
Chapter two  Theoretical Fundamentals

I  Introduction

The content of legal provisions protecting investors can be twofold. If legislators consider that investors cannot, in certain circumstances, reach a reasonable decision, they tend to restrain liberty of action with respect to the transactions involved. On the other hand, investors can be considered mature market participants, capable of conducting transactions of all kinds. Their protection, in this case, is secured by informing them comprehensively about the nature and risks of possible transactions. Canadian, Swiss and German capital markets laws are all based on the latter conception of investors’ protection.\textsuperscript{39} Their core element of efficient and active capital markets consists, therefore, in investors’ confidence in getting trustworthy information about financial instruments.

However, prospectus requirements and continuous disclosure provisions of the three jurisdictions feature major differences. Further, disclosure provisions are generally accompanied by additional protective measures that allow supervisory authorities “to assess the merit of securities offered under a prospectus”.\textsuperscript{40} Although Canadian, Swiss and German merit discretion regulations show significant similarities,\textsuperscript{41} the extent to which the issue of securities can be prohibited for public interest reasons\textsuperscript{42} does not always correlate in the above jurisdictions.\textsuperscript{43} Moreover, disclosure regulation is not confined to prospectus provisions and continuous disclosure requirements. Rather, Canadian, Swiss and German securities regulations have implemented rules in relation to point of sale disclosure. Although these provisions might not fully compensate for gaps in prospectus disclosure, point of sale regulation can complement issuers’ disclosure obligations in a significant way and, therefore, must be considered when comparing prospectus requirements of the above jurisdictions.

In order to ensure that the below investigations of disclosure requirements do not neglect or misconceive the above peculiarities of Canadian, Swiss or German securities regulations, the following

\textsuperscript{39} See below, sections II.1, III.1, and IV.1.
\textsuperscript{41} See, for example, s. 62 (2)(d) \textit{OSA} and, in relation to mutual funds, s. 14 (1)(d) \textit{CISA}.
\textsuperscript{42} See \textit{Gillen} (fn. 40), p. 143, fn. 133.
\textsuperscript{43} Whereas Canadian securities regulations provide supervisory authorities with general public interest discretion at the issue of securities (see, for example, s. 62 (2) \textit{OSA}) or in the course of their term time (see, for instance, s. 127 \textit{OSA}), public interest considerations of the Swiss legal framework tend to be integrated in the authorization procedures of specific product types (see, for example, \textit{FINMA Guidelines on the application for authorization of a fund management company}, March 1, 2009, section 4) and, as a consequence, give typically less leeway to discretion of supervisory authorities.
sections will briefly outline (i) the objectives of Canadian, Swiss and German capital markets regulation, (ii) its main product categories, and (iii) related disclosure provisions.

II Canada

1. Objectives of Securities Regulation

Canadian securities regulation features two core objectives, which are “to provide investor protection and to foster fair and efficient capital markets and confidence in such markets”. These goals can be strengthened by maintaining and enhancing investors’ confidence in the integrity of capital markets. Such confidence, in turn, may be particularly enhanced if financial markets are transparent and informational imbalances are reduced as far as possible. As a result, investors’ confidence in the integrity of capital markets can be considered a link between investor protection and efficient markets.

However, creating transparency in capital markets is not always the most appropriate means to achieve securities regulation’s key goals. In particular, Canadian scholars point out that disclosure should never “impose excessive costs”. Further, recent experience has shown that the complexity of innovative financial instruments might overstrain investors’ capacities to understand and classify a specific transaction and the risks involved. Bearing this in mind, disclosure provisions have to be read in connection with other protective measures; for example, the regulation of key players in capital markets or the introduction of behavioural constraints for more powerful, sophisticated parties.


48 GILLEN (fn. 40), p. 93.

49 As, for example, securities dealers, portfolio managers, fund management companies etc. See GILLEN (fn. 40), p. 94.

50 See, for example, FINANCIAL SERVICES AUTHORITY (fn. 3), aiming to abolish kickbacks.
In addition, the current financial crisis has made regulators aware of the importance of protecting markets against systemic risks.\(^{51}\) Whereas the Expert Panel\(^{52}\) still refrained from identifying systemic risk reduction as a key purpose of Canadian securities regulation,\(^{53}\) the Canadian Securities Transition Office (CSTO) states in section 9 (c) of the Proposed Act that the Act’s third purpose consists of contributing, “as part of the Canadian financial regulatory framework, to the integrity and stability of the financial system”. In view of this explicit commitment, the currently prevailing perception of the two core objectives of securities regulation as complimentary and closely connected elements could shift towards a slightly more protective and paternalistic stance of supervisory authorities which, in turn, may restrain the currently prevailing assumption that investor protection is generally achieved by creating transparency in capital markets.\(^{54}\) In spite of these considerations, disclosure in Canadian securities markets will remain an essential means to enhance retail investors’ ability to act as mature market participants.

2. Product Categories

Definitions of ‘securities’ in Canadian Securities Acts typically contain the following three elements. First, “any document, instrument or writing commonly known as a security”\(^{55}\) is considered to be a security. Commonly known securities include “a bond, debenture, note or other evidence of indebtedness or a share, stock, unit, unit certificate, participation certificate, certificate of share or interest, preorganization certificate or subscription”.\(^{56}\) Further ‘common’ securities are, for example,

\(^{51}\) See INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (IOSCO), “Objectives and Principles of Securities Regulation” (May 2003), online. <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>, p. 6, which states the reduction of systemic risk as one of the key objective of securities regulation.

\(^{52}\) The Expert Panel on Securities Regulation in Canada was appointed in February 2008 by the federal Minister of Finance. The Panel was mandated to provide advice and recommendations on how Canada could best advance proportionate and principles-based securities regulation. The Panel delivered its final report and a draft Canadian Securities Act on January 12, 2009 (see online. <http://www.expertpanel.ca/eng/reports/index.html>). These documents have been written in consideration of several related research studies.

\(^{53}\) See s. 11 DSA. See, however, s. 14 (k) DSA, which obligates the Securities Commission to consider systemic risk reduction when pursuing the objectives of securities regulation.

\(^{54}\) See LARRY P. SCHWARTZ, “Objectives, Outcomes and Performance Measures in Securities Regulation”, A Research Study for the Expert Panel on Securities Regulation in Canada”, p. 64, who points out that investor protection should not “be pursued at the expense of [(…) other] goals” of securities regulation and, consequently, must be clearly defined.

\(^{55}\) S. 1 (1) (a) OSA. See, however, also s. 1 (1) (e) OSA which covers a considerable range of conventional types of securities [see also MARY CONDON/ANITA ANANO/ JANIS SARRA, Securities law in Canada, Cases and Commentary (Toronto. Emond Montgomery, 2005), p. 187]. Further, see s. 2, ‘security’, (b) of the Proposed Act.

\(^{56}\) S. 1 (1) (e) OSA.
stock options, warrants or mutual fund units. Second, securities acts qualify other items as securities if they “involve an initial payment that will be used to produce some further returns”. In particular, certificates of interest in commodities or documents “constituting evidence of an interest in a scholarship or educational plan or trusts” are considered securities and, consequently, have to be distributed in accordance with the provisions of securities regulation. Third, definitions of the term ‘security’ are open-ended insofar as (i) the listed items do not necessarily constrain the scope of the term, and (ii) some of the listed items are formulated so widely that their interpretation can comprise all transactions that should - from a purposive perspective - qualify as securities. If an investment product is considered a security, disclosure provisions apply only if said product is conveyed in a trade and if this trade constitutes a distribution. A trade of a security includes “any sale or disposition of a security for valuable consideration, whether the terms of payment be on margin, instalment or otherwise”. A distribution of securities is defined as “a trade in securities of an issuer that have not been previously issued”, but also includes the resale of securities that have been returned to the issuer and other relevant secondary market sales of securities.

Given the above wide scope of the term ‘security’ in Canadian securities regulation, a strict categorization of the items listed in Canadian Securities Acts would hardly be successful. Accordingly, Canadian Securities Acts have refrained from grouping the listed items in accordance with their distinctive legal features. However, following the principles of corporate finance, securities are generally classified as either (1) debt or (2) equity securities. Further, Canadian securities regulations provide tailored rules for specific types of securities, in (3) particular mutual funds and (4) derivatives, and

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57 See GILLEN (fn. 40), p. 117.
58 GILLEN (fn. 40), p. 118. See, for example. S. 2, ‘security’, (g) and (h) of the Proposed Act.
59 GILLEN (fn. 40), p. 118.
60 See, for example, the term ‘investment contract’ and its judicial interpretation, BORDEN LADNER GERVAIS LLP, Securities Law and Practice, 3rd edition (Toronto. Carswell, 2003), § Int.1.42 (n). The term is also included in s. 2, ‘security’, (f) of the Proposed Act.
61 GILLEN (fn. 40), p. 115.
62 S. 1 (1), „trade“, OSA. See also s. 2, „trade“, of the Proposed Act.
63 S. 1 (1), „distribution“, OSA. See also s. 2, „distribution“, of the Proposed Act.
64 See BORDEN LADNER GERVAIS LLP (fn. 60), §Int.1.12.
65 See GILLEN (fn. 40), p. 3 and 7. Due to the emergence of so called hybrid instrument - i.e. securities with elements of both equity and debt instruments (see BOOTH/CLEARY (fn. 1), p. 741 et seq.) - a clear delimitation between equity and debt securities may be difficult. However, a hybrid security is governed by disclosure requirements for either debt or equity securities, depending on its main economic characteristics, and is generally not subject to a specific set of rules. Therefore, this category will not be examined separately in this thesis.
66 NI 81-101, NI 81-102, NI 81-107, and other fund-specific national and regional regulations.
67 See the following section.
thus indicate that these investment vehicles should be considered separate product categories in predefined circumstances.

In spite of its very broad scope, Canadian securities regulation features major inconsistencies in its strategy of how to deal with derivatives. The majority of Canadian jurisdictions do not contain a comprehensive derivatives framework\(^{68}\) and securities regulators are increasingly concerned that this fragmentary approach does not give adequate consideration to issues arising in relation to derivative transactions. In its Final Report and Recommendations,\(^{69}\) the Expert Panel suggests that exchange-traded derivatives should be nationally regulated in accordance with present approaches pursued in British Columbia, Alberta and Ontario securities regulations.\(^{70}\) In particular, the Panel supports a regulation of exchange contracts that “would extend primarily to exchanges, clearers, and other intermediaries operating in a particular jurisdiction in the derivatives area”,\(^{71}\) whereas the issuers of these contracts would not be subject to disclosure requirements and further constraints. With respect to OTC derivatives, the Expert Panel has so far refrained from bringing forward concrete regulatory suggestions.\(^{72}\) Currently, no Canadian Securities Act features consistent regulation of OTC derivatives and some jurisdictions are doubtful whether OTC derivatives should be subsumed under their definitions of the term ‘security’ at all.\(^{73}\) As the Proposed Act contains “broad substantive requirements”\(^{74}\) and does not determine any “technical requirements”,\(^{75}\) it does not fully clarify the regulator’s concept of future Canadian derivatives regulation. However, section 89 of the Proposed Act determines that exchange-traded derivatives will be governed by regulations in accordance with the above suggestions of the Expert Panel. In particular, the Act focuses on monitoring exchanges where

\(^{68}\) See Expert Panel, Final Report (fn. 45), Appendix 5, p. 75.
\(^{69}\) Expert Panel, Final Report (fn. 45).
\(^{71}\) Expert Panel, Final Report Final Report (fn. 45), Appendix 5, p. 78.
\(^{72}\) See Expert Panel, Final Report Final Report (fn. 45), Appendix 5, p. 78.
\(^{73}\) See Expert Panel, Final Report Final Report (fn. 45), Appendix 5, p. 77. THOMAS WERLEN/STEFAN SULZER, “U.S. legislation on Over-the-Counter Derivatives”, caplaw 2009 n. 58, p. 2, with regard to the U.S. proposed legislation for OTC derivatives. “The proposed legislation would add securitybased swaps to the definition of "security" under the Exchange Act and would give the SEC the authority to define certain securitybased swaps as conferring beneficial ownership of the underlying securities for reporting purposes under Section 13(d) and (g) of the Exchange Act”. See also MARGARET GROTTENTHALER/PHILIP J.HENDERSON, The Law of Financial Derivatives in Canada, (Toronto. Thomson Carswell, 1999), § 10.2.3, on the question when derivatives are considered securities. See also OSC Staff Notice 91-702, p. 4, with further reference to relevant Canadian case law.
\(^{74}\) <http://www.fin.gc.ca/n10/data/10-051_1-eng.asp>.
\(^{75}\) <http://www.fin.gc.ca/n10/data/10-051_1-eng.asp>. Technical requirements and exemptions to the Act’s substantive provisions will be regulated by regulations.
derivatives are traded and does not require extensive prospectus documentation. Further, section 90 of the Proposed Act introduces the concept of designated derivatives. These derivatives can be distributed only if a prescribed disclosure document has been accepted by the regulator. The Proposed Act does not elaborate on the content of this disclosure document but clearly states that the document is not a prospectus in accordance with Part 6 of the Act. Derivatives that are neither exchange-traded nor designated derivatives but qualify as securities in the sense of section 2, ‘security’, of the Proposed Act must follow the disclosure requirements for securities stated in the Act and its regulations.

Finally, recent Federal Regulations on principal protected notes (PPNs) have introduced specific disclosure provisions for these capital-protected investment products. If PPNs qualify as evidence of deposit issued by a savings institution, they are regularly exempt from provincial securities regulations and their disclosure requirements and, as a consequence, are not considered securities in the sense of these provisions.

In view of the above, the following analysis will distinguish between equity securities, debt securities, mutual funds and derivatives. As these key categories contain a multitude of different investment instruments, the below examination will be confined to typical representatives of the above four main categories.

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76 S. 91 of the Proposed Act specifies that Part 6 of the Act do not apply in relation to exchange-traded derivatives.
77 S. 2, ‘designated derivative’, of the Proposed Act sets forth that "a ‘designated derivative’ means a derivative that is (a) designated under subsection 237(2) to be a designated derivative; or (b) within a class of derivatives that are designated by the regulations to be designated derivatives”. The Act does not specify what kinds of derivatives may be subsumed under this particular category.
78 S. 91 of the Proposed Act.
79 Further, s. 92 of the Proposed Act determines that certain provisions of the Act can apply to derivatives that do not qualify as securities if this is set out in the Act or its regulations.
80 Principal protected notes are investment vehicles that offer “an investor potential returns based on the performance of an underlying investment and a guarantee that the investor will receive, on maturity of the PPN, not less than the principal amount invested” (CSA Notice 46-305 - Second Update on Principal Protected Notes of August 29, 2008, p. 1).
81 See, for example, s. 1 BCSA, ‘security’.
82 In spite of the legislator’s decision to qualify PPNs as evidences of deposit, PPN regulation is discussed under the title ‘derivatives’.
83 See below, chapter four.
3. Regulatory Disclosure Framework

Until recently, Canadian securities regulation has been considered to fall exclusively within the remit of the provinces. Consequently, provinces have enacted provincial securities acts and issued policy statements. Further, provincial securities administrators adopt co-operatively drafted National Instruments (NI) or Multinational Instruments (MI) which allow the harmonization of certain aspects of provincial securities regulation.

The disclosure framework of Canadian securities regulation has been harmonized to a large extent. NI 41-101 sets forth that most securities can be distributed only if a prospectus has been issued prior to the actual distribution. Further, NI 51-102 states continuous disclosure requirements for reporting issuers. In particular, they have to file periodic information such as their annual and interim financial statements, a management discussion and analysis and annual information forms. In addition, issuers have to disclose in a timely manner any “significant business acquired by the issuer and the effect of the acquisitions on the issuer” and are required to report any material changes.

Canadian disclosure requirements are not imposed on issuers only. Moreover, insiders have to report “(a) direct or indirect beneficial ownership of, or control or direction over, securities of the reporting issuer, and (b) interest in, or right or obligation associated with, a related financial instrument involving...

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84 In July 2009, however, the Canadian Government established the Canadian Securities Transition Office “to assist in establishing a Canadian securities regulator” (http://www.csto.ca/en/links.aspx). Should these efforts to establish a national securities regulator succeed, securities regulation would then become a responsibility of the Canadian Government.
85 And, in addition, National Policies (NP).
87 NI 41-101, s. 2 (1).
88 The key feature of the definition of ‘reporting issuer’ is that it is an issuer that has issued securities under a prospectus in the province” (GILLEN (fn. 40), p. 183, 184).
89 „MD&A provides a narrative explanation from the perspective of management of how the reporting issuer performed during the financial year or interim period to which the MD&A relates” (GILLEN (fn. 40), p. 191).
90 „The AIF draws (...) information together on an annual basis providing material information about the issuer and its business as at the end of the issuer’s most recently completed financial year in the context of its historical and possible future development. It describes the issuer, its operations and prospects, and notes risks and other external factors that impact the issuer” (GILLEN (fn. 40), p. 193, 194).
91 GILLEN (fn. 40), p. 207.
92 A ‘material change’ is“(a) a change in the business, operations or capital of the reporting issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the reporting issuer; or (b) a decision to implement a change referred to in paragraph (a) made by the board of directors or other persons acting in a similar capacity or by senior management of the reporting issuer who believe that confirmation of the decision by the board of directors or any other persons acting in a similar capacity is probable” (NI 52-102, s. 1.1).
a security of the reporting issuer". Further, the management of the issuer and third parties soliciting “proxies from registered holders of voting securities” must send forms of proxy and information circulars to registered shareholders. Also, the Canadian early warning provisions state that every person “who acquires beneficial ownership of, or control or direction over, voting or equity securities” has to disclose such transfer if it, “together with the acquiror’s securities of that class, would constitute 10% or more of the outstanding securities of that class”. In case of a public takeover offer, “a bid circular must be sent to all holders in the province of the securities sought”. Finally, Canadian securities regulation features specific disclosure provisions for mutual funds and - to a certain extent - derivatives. Whereas mutual fund disclosure is basically a more customized version of general disclosure regulation, derivative-specific regulation provides issuers with numerous forms of relief and, as a result, leaves investors considerably less protected than the general disclosure framework.

Canadian securities regulation features several exemptions to its disclosure requirements. lists constellations where issuers are exempt from prospectus requirements or registration duties. The rationale for these exemptions is generally based on one of the following four elements. First, exemptions are introduced in cases where counterparties are sufficiently sophisticated and powerful to obtain the information they need to assess the value of securities. Second, waives the duty to issue a prospectus if these documents do not feature any relevant additional information. Third, if

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93 S. 3.3 of NI 55-104.
94 NI 51-102, s. 9.1 (2).
95 NI 51-102, s. 9.1. “If management of a reporting issuer gives notice of a meeting to its registered holders of voting securities, management must, at the same time as or before giving that notice, send to each registered holder of voting securities who is entitled to notice of the meeting a form of proxy for use at the meeting”.
96 See GILLEN (fn. 40), p. 197 - 201.
97 MI 62-104, s. 5.2, and s. 102 OSA.
98 MI 62-104, s. 5.2 (1).
99 MI 62-104, s. 5.2 (1).
100 A definition of the term ‘take-over bid’ can be found, for example, in MI 62-104, s. 1.1, ‘take-over bid’.
101 GILLEN (fn. 40), p. 442.
102 See, in particular, NI 81-101 on Mutual Fund Prospectus Disclosure, and NI 81-106 on Investment Fund Continuous Disclosure.
103 A more detailed account of disclosure provisions in relation to derivatives will be given below, chapter four, section 3.
104 See GILLEN (fn. 40), p. 534, 535, who explains that the simplified prospectus requirements intend to ensure that unsophisticated investors understand the prospectus’s content.
105 See, for example, the recently implemented Principal Protected Notes Regulations, Consolidation, SOR/2008-180 (PPN Regulations). See below, chapter four, section 3.
106 NI 45-106.
107 See GILLEN (fn. 40), p. 251.
an investment is considered comparatively safe, its issuer is exempt from distributing a prospectus.\footnote{gil\textsuperscript{en} (fn. 40), p. 257.} Fourth, Canadian disclosure policies rely on the principle of proportionate regulation;\footnote{schwartz (fn. 54), p. 64.} as a consequence, if disclosure generates considerably more costs than benefits, securities regulation tends to partially waive disclosure requirements.\footnote{gil\textsuperscript{en} (fn. 40), p. 257, with respect to constellations where few investors, small monetary value or venture capital issuers are concerned. An in-depth study of the relation between proportionate regulation, the goals of Canadian securities regulation and adequate disclosure requirements for junior issuers can be found in sarra, \textit{Proportionate Regulation} (fn. 47), p. 12 et seq.}

The Canadian disclosure framework follows a closed-system approach. Securities that have been distributed under one of the above exemptions cannot be resold unless (i) a regulatory exemption applies, or (ii) a prospectus is distributed prior to the transaction.\footnote{gil\textsuperscript{en} (fn. 40), p. 135, 135, and p. 243 - 250.} Consequently, issuers cannot avoid disclosure requirements by distributing securities to related parties in the exempt market before these parties, in turn, resell the same securities to the public.\footnote{see also gil\textsuperscript{en} (fn. 40), p. 134, on prospectus requirements in the case of a resale of securities that have been returned to the issuer and sales by control persons.} As mentioned in chapter one, section II above, the Government of Canada released a proposed Canadian \textit{Securities Act} on May 26, 2010. The Act’s key innovations consist in establishing a national securities regulator\footnote{This national regulator would be established as a Crown Corporation and have two divisions, i.e. a regulatory division and the Canadian securities tribunal. While the regulatory division would regulate Canadian capital markets, the tribunal’s “primary function would be to adjudicate matters arising from the CSRA, including administrative enforcement actions and reviews of regulatory decisions” (<http://www.fin.gc.ca/n10/data/10-051_1-eng.asp>).} and a national framework for securities. This framework builds on the content of current National Instruments. As a result, the above outline of Canadian disclosure regulation is largely mirrored in the \textit{Proposed Act}. Part 6 of the Act requires that a “person must not distribute a security unless a preliminary prospectus and a prospectus have been filed with the Chief Regulator and the Chief Regulator has issued a receipt for each of them”. The Act does not specify the prospectus requirements. However, it can be assumed that its regulations will closely track the prospectus requirements of the currently effective National Instruments.

\begin{footnotesize}
\begin{enumerate}
\item \footnotesize{gil\textsuperscript{en} (fn. 40), p. 257.}
\item \footnotesize{schwartz (fn. 54), p. 64.}
\item \footnotesize{gil\textsuperscript{en} (fn. 40), p. 257, with respect to constellations where few investors, small monetary value or venture capital issuers are concerned. An in-depth study of the relation between proportionate regulation, the goals of Canadian securities regulation and adequate disclosure requirements for junior issuers can be found in sarra, \textit{Proportionate Regulation} (fn. 47), p. 12 et seq.}
\item \footnotesize{gil\textsuperscript{en} (fn. 40), p. 135, 135, and p. 243 - 250.}
\item \footnotesize{see also gil\textsuperscript{en} (fn. 40), p. 134, on prospectus requirements in the case of a resale of securities that have been returned to the issuer and sales by control persons.}
\item \footnotesize{This national regulator would be established as a Crown Corporation and have two divisions, i.e. a regulatory division and the Canadian securities tribunal. While the regulatory division would regulate Canadian capital markets, the tribunal’s “primary function would be to adjudicate matters arising from the CSRA, including administrative enforcement actions and reviews of regulatory decisions” (<http://www.fin.gc.ca/n10/data/10-051_1-eng.asp>).}
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III Switzerland

1. Objectives of Securities Regulation

Section 1 SESTA\(^{115}\) states that its provisions shall “ensure transparency and equality of treatment of investors (...) and the proper functioning of the securities markets”. According to the prevailing Swiss doctrine, Swiss securities regulation aims at (i) protecting investors\(^{116}\) and (ii) ensuring the efficient functioning of securities markets.\(^{117}\) Similar to Canadian securities regulation, Swiss securities law does not intend to protect investors from taking risky and potentially loss-generating investments. In fact, section 1 SESTA points out that its core instruments for protecting investors consist in creating transparency in capital markets and guaranteeing equal treatment of investors. As a result, investor protection and market functionality do not compete against each other but, in most cases, can be pursued by establishing transparency and, consequently, investors’ confidence in capital markets.\(^{118}\)

However, as already mentioned under section II.1, investor protection and market functionality cannot always be fully achieved by requiring transparent behaviour of all market participants. Like the Canadian regulatory framework, Swiss securities regulation has therefore introduced registration and reporting requirements for particularly sensitive market participants such as dealers,\(^{119}\) issuers and managers of mutual funds\(^{120}\) and other investment products.

Swiss securities regulation has so far largely refrained from assuming responsibility for systemic risks. Although the regulator seeks to avoid market disruptions due to undercapitalization,\(^{121}\) a comprehensive regulation of systemic risk is neither mirrored in current regulation, nor are there any palpable indications that the legislator will implement such principles in the near future.\(^{122}\)


\(^{116}\) ROLF WATTER, Basler Kommentar zum Börsengesetz (Basel. Helbing Lichtenhahn, 2007), s. 1 n. 9.

\(^{117}\) BSK-WATTER (fn. 116), s. 1, n. 14. The provision’s draft wording explicitly stated these two main objectives. However, the wording was changed during the parliamentary debate so as not to raise any expectations that investors would be protected from taking ‘wrong’ investment decisions (BSK-WATTER (fn. 116), s. 1, n. 2, and MIRIAM EGGEN, Das Verhältnis der Angebotspflicht nach Art. 32 BEHG zum Fusions- und Kartellgesetz (Bern. Stämpfli Verlag, 2007), p. 18).

\(^{118}\) BSK-WATTER (fn. 116), s. 1 n. 10. See, however, EGGEN, Angebotspflicht (fn. 117), p. 21, who points out single provisions protecting investors that do not fully comply with the objective of enhancing the proper functioning of securities markets.

\(^{119}\) See s. 10 et seq. SESTA.

\(^{120}\) See s. 13 CISA.

\(^{121}\) See capital requirements for banks and mutual fund management companies in s. 3 (2)(b) BankA and s. 28 (2) CISA.

\(^{122}\) Unlike the vast majority of countries that have been hit by the financial crisis, the Swiss regulator has not been actively involved in the question surrounding the regulation of CDOs and other high-risk instruments.
2. Product Categories

Section 2 (a) SESTA defines securities as “standardized certificates which are suitable for mass trading, rights not represented by a certificate with similar functions (book-entry securities) and derivatives”. Whether a document or right qualifies as a ‘certificate’, ‘book-entry security’ or ‘derivative’ has to be determined in accordance with the applicable law.\(^{123}\) Swiss law defines a certificate as “any document in which a right is incorporated in such a way that it cannot be claimed nor transferred to others without the document”.\(^{124}\) Swiss law contains no definition of the term ‘book-entry securities’. As a rule, book-entry securities are “created through registration with the issuer” and - for lack of a paper certificate - “can neither be physically presented to the issuer (...) nor transferred by delivery or endorsement”.\(^{125}\) In the absence of regulatory restrictions, book-entry securities can represent those rights that can be issued as certificates.\(^{126}\) Derivatives are, according to the Message SESTA,\(^{127}\) financial contracts whose value derives from the price of another asset, which constitutes the base value of the derivative.\(^{128}\) Among others, forward contracts, financial futures, options or swaps qualify as derivative instruments.\(^{129}\)

Although important aspects of Swiss securities regulation are outlined in the SESTA, the Act does not contain any primary market disclosure provisions. Rather, disclosure and registration requirements related to the issue of securities are dispersed over several product-specific Statutes. As a consequence of this segmented approach to regulation, the Swiss securities framework requires a clear distinction between different types of securities. Legal definitions of specific product categories largely follow the

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\(^{123}\) According to the Swiss Federal Act on Private International Law and related prevailing doctrine, the qualification of documents representing ownership rights as standardized certificates is “governed by the law of the state under whose law [the company in question is (…)] organized”. Whether documents representing debt claims qualify as standardized certificates is determined by the law chosen by the parties or, in the absence of such choice of law, the state where the documents have been issued (see Daniel Daeniker/Stefan Waller, Basler Kommentar zum Börsengesetz (Basel. Helbing Lichtenhahn, 2007), s. 2 lit. a-c, n. 19).

\(^{124}\) Section 965 SCO.


\(^{126}\) See Eggen, Wertrechte (fn. 125), p. 117. On January 1, 2010, the new Federal Law on the Custody and Transfer of Securities Held by an Intermediary has come into effect. The law sets forth procedures for the creation and transfer of book-entry securities.


\(^{128}\) Further, there has to exist a market for this base value (Message SESTA (fn. 127), 1395). See also the definition of derivatives in s. 5 SESTO.

\(^{129}\) BSK-Daeniker/Waller (fn. 123), s. 2 lit. a-c, n. 12. The prevailing Swiss doctrine does not qualify derivative contracts as certificates or book-entry securities [see Franca Contratto, Konzeptionelle Ansätze zur Regulierung von Derivaten im schweizerischen Recht (Diss) (Zürich/Basel/Genf. Schulthess, 2006), p. 148]. See, however, BSK-Daeniker/Waller (fn. 123), s. 2 lit. a-c, n. 12.
economically distinctive features of these products. (1) Equity securities are created in accordance with the legal framework for corporations. They can be issued as shares or participation certificates, and both can be either physical certificates or book-entry securities. Other companies’ equity rights, however, cannot be represented by securities, as applicable legal requirements oppose the creation of transferable equity certificates or book-entry securities.

(2) Debt securities are issued in the form of bonds, medium term bonds, mortgage bonds, and units of contractual funds. A bond is, under Swiss law, a loan that has been split into partial amounts. The obligor enters into a multitude of contracts with different creditors. These loan agreements are closed under uniform conditions and within a certain subscription period. Bonds are generally issued as certificates or book-entry securities. Medium term bonds are issued by banks on an ongoing basis. Mortgage bonds can be issued only by a restricted number of institutions and their restitution is secured by a particular system of statutory mortgages.

(3) Units of contractual funds represent the unit holders’ “claim against the fund management company to participate in the assets and income of the investment fund in accordance with the fund units they

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130 S. 683, 684 SCO.
131 S. 622 (1) SCO. “Shares shall be issued in the name of a holder or to bearer”. Shares entitle their owners to a proportionate share of the corporation’s profit and liquidation proceeds (s. 660 (1) SCO), and conveys to each shareholder “at least one vote” (s. 692 (2) SCO).
132 S. 656a SCO. „The articles of incorporation may provide for a participation capital divided into partial amounts (participation certificates). These participation certificates shall be issues against contribution. They have a par value and grant no voting rights“. See, in addition, DIETER ZOBL/STEFAN KRAMER, Schweizerisches Kapitalmarktrecht (Zürich/Basel/Genf. Schulthess, 2004), p. 202, n. 551, 552, who mention further equity securities, i.e. profit sharing certificates (s. 657 SCO) and preemptive rights (s. 652b SCO).
134 See for cooperatives, for example, s. 853 (3) SCO. “The participation certificates are issued in the name of the member. They cannot, however, be issued as negotiable instruments (Art. 96 et seq.), but only as evidentiary documents”. For limited liability companies see BEAT HESS/Corrado Rampini/Till Spellman, Basler Kommentar zum Obligationenrecht II, 3rd edition (Basel. Helbing Lichtenhahn, 2008), s. 774a SCO n. 11.
135 Anleiheobligationen.
136 Kassenobligationen.
137 Pfandbriefe.
138 ZOBL/KRAMER (fn. 132), p. 203 - 206. Mutual funds that are organized as corporations (see s. 36 - 52 CISA) issue equity securities (shares) to their investors.
140 However, there is no mandatory duty to do so (see BSK-WATTER/NOTH (fn. 139), s. 1156 SCO n. 3.
141 ZOBL/KRAMER (fn. 132), p. 204, n. 556.
142 ZOBL/KRAMER (fn. 132), p. 205, n. 558.
acquire”. Although mutual fund units other than those of exchange-traded ETFs are not traded in secondary markets, they are generally considered to be securities in the sense of section 2 (a) SESTA. As stated by section 2 (a) SESTA, (4) derivatives may also feature the characteristics of securities. Swiss securities regulation does not contain a comprehensive framework for derivatives, nor has it established a consistent legal definition of the term. However, section 5 CISA has introduced specific requirements for issuers of so-called ‘structured-products’. Taking into account the wide range of these products, the legislator has deliberately abstained from defining the term in the Statute. Generally speaking, “a structured product combines traditional financial investments - such as equities and bonds - with derivatives” and its “repayment value is derived from the performance of one or more of” these underlying investment products. Further derivative-specific rules are scattered rather erratically throughout the Swiss securities framework; they lack a consistent frame and feature considerable gaps.

Like the Canadian securities framework, Swiss securities regulation has established four key categories of investment instruments. i.e. equity securities, debt securities, mutual funds and derivatives. Considering the above sub-categories for equity and debt securities, the following analysis refrains from an exhaustive examination of all investment instruments. As a result, the below explanations relate to shares, bonds, mutual funds and a limited range of derivative instruments as key representatives of the four categories.

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143 S. 78 (1)(a) CISA.
144 See BSK-DAENIKER/WALLER (fn. 123), s. 2 lit. a-c SESTA n. 16, and ZOBL/KRAMER (fn. 132), p. 205.
145 See CONTRATTO (fn. 129), p. 392.
149 See, in particular, s. 15 CISO-FINMA, with respect to early warning duties in relation to derivative instruments.
150 See CONTRATTO (fn. 129), p. 435. In particular, the Swiss legal framework does not provide any prospectus requirements for non-listed derivatives other than structured products. Further, there are no civil liability provisions for damages occurred in relation to the issue of derivative instruments. The general civil liability framework is not an adequate substitute for this lack of a tailored set of rules.
151 See below, chapter four, sections II.3, III.3, and IV.3.
3. Regulatory Disclosure Framework

The Swiss disclosure framework for securities is contained in the SESTA and its Ordinances\textsuperscript{152} and in the Swiss Code of Obligations. Further, disclosure duties for mutual funds and structured products can be found in the CISA\textsuperscript{153} and its Ordinances.\textsuperscript{154} Finally, listed securities have to follow the Regulations set forth by the Swiss stock exchange, SIX Swiss Exchange.\textsuperscript{155}

Unlike the Canadian legal framework for securities, Swiss securities regulation does not offer prospectus requirements that apply to all kinds of securities. Rather, specific rules for different types of investment instruments are set forth in different Acts. Issuers of non-listed shares must comply with the provisions of section 652a SCO. If a corporation offers new shares publicly for subscription, it is required to publish a prospectus. Section 652a SCO does not state any further disclosure duties. In particular, there are no specific proxy or information circular requirements.\textsuperscript{156} Continuous disclosure requirements for non-listed shares obligate issuers to provide investors with basic periodic information such as annual financial statements and an annual report of the issuer’s business and economic and financial situation.\textsuperscript{157} However, unlike Canadian public companies, Swiss corporations are not obligated to inform investors about recent developments that might have an impact on the securities’ prices or on investors’ assessment of the securities as long as they are not listed at the Swiss stock exchange. Issuers of listed shares have to comply with the Listing Rules of SIX Swiss Exchange.\textsuperscript{158} These provisions require that issuers file a prospectus\textsuperscript{159} and disclose, upon request, further “information documents that affect the position of investors”.\textsuperscript{160} SIX provides Prospectus Schemes that issuers must use to disclose the above information\textsuperscript{161}. In addition, issuers of shares have to provide periodic information such as their

\textsuperscript{152} Ordinance of the Swiss Financial Market Supervisory Authority on Stock Exchanges and Securities Trading of October 25, 2008 (SR 954.193; Stock Exchange Ordinance-FINMA, SESTO-FINMA); Ordinance on Stock Exchanges and Securities Trading of December 2, 1996 (SR 954.11; Stock Exchange Ordinance, SESTO).
\textsuperscript{153} Federal Act on Collective Investment Schemes of June 23, 2006 (Collective Investment Schemes Act, SR 951.31).
\textsuperscript{154} Ordinance on Collective Investment Schemes of November 22, 2006 (Collective Investment Schemes Ordinance, CISO; SR 951.311); Ordinance of the Swiss Financial Market Supervisory Authority on Collective Investment Schemes of December 21, 2006 (FINMA Collective Investment Schemes Ordinance, CISO-FINMA; SR 951.312).
\textsuperscript{156} See s. 689b - e SCO.
\textsuperscript{157} S. 662 and 663d SCO.
\textsuperscript{158} Of October 29, 2008.
\textsuperscript{159} S. 27 - 32 Listing Rules, SIX Exchange Regulation, October 29, 2008.
\textsuperscript{160} S. 41 Listing Rules.
\textsuperscript{161} See, for example, Scheme A, Equity Securities, online. <http://www.six-exchange-regulation.com/admission_manual/04_03-SCHA_en.pdf>.
annual and semi-annual financial statements and a corporate calendar.\textsuperscript{162} In addition, an issuer has to inform the market in a timely manner “of any price-sensitive facts which have arisen in its sphere of activity”.\textsuperscript{163} Further, it must report management transactions in issuer’s shares or related instruments\textsuperscript{164} to SIX Swiss Exchange.\textsuperscript{165} The wide difference between disclosure requirements for exchange-traded shares and those for their non-listed counterparts can have both positive and negative consequences. On a positive note, investors are free to determine whether they want to invest in a highly transparent market or accept less transparency in favour of more corporate flexibility. However, while this choice may be legitimate with regard to smaller companies with few external shareholders, the moderate degree of disclosure required of section 652a SCO cannot provide appropriate protection for a widely dispersed circle of shareholders of large non-listed companies. While Canadian and European prospectus requirements account for the economic constraints of smaller corporations by creating respective exemptions or facilitations in their disclosure frameworks,\textsuperscript{166} the Swiss framework is based on the - sometimes incorrect\textsuperscript{167} - assumption that large corporations are generally listed on a stock exchange and, therefore, are subject to the strict disclosure requirements applicable for exchange-traded securities. This chasm between prospectus and continuous disclosure requirements for exchange-traded and non-listed securities impairs consistent transparency of capital markets and may ban investors from certain investments if they are not willing to accept the low disclosure standards for non-listed companies. Further, the lack of ad-hoc publicity favours investors who have personal connections to the management of the company and, therefore, have more profound knowledge of the company’s prospects than outside shareholders. As transparency is a key precondition for the implementation of the key objectives of Swiss securities regulation - i.e. investor protection and efficient functioning of securities markets - the lack of consistent disclosure requirements for similar types of securities is not satisfactory. Chapters four and five below will further examine these inconsistencies in

\textsuperscript{162} S. 52 Listing Rules. “The corporate calendar must give information on the dates in the issuer's year that are of major importance to investors, specifically the annual general meeting and the publication dates of the annual and interim financial statements”. The corporate calendar can be published by SIX (s. 52 (3) Listing Rules).

\textsuperscript{163} S. 53 (1) Listing Rules. “Price-sensitive facts are facts which are capable of triggering a significant change in market prices” (s. 53 (1) Listing Rules). See also SIX Directive on Ad hoc Publicity of July 1, 2009.

\textsuperscript{164} S. 56 Listing Rules.

\textsuperscript{165} Which then discloses this information to the public.

\textsuperscript{166} See s. 2.4 of NI 45-106 for private issuers and s. 2.10 for minimum amount investments. See also the current proposal for a review of the EU Prospectus Directive, online. <http://ec.europa.eu/internal_market/securities/prospectus/index_en.htm>, which intends to introduce less comprehensive disclosure requirements for small companies.

\textsuperscript{167} See, for example, Glencore International AG, a privately held Swiss company and, at the same time, one of the world’s largest suppliers of a range of commodities and raw materials (<www.glencore.com>).
Swiss securities regulation and determine the gaps that must be closed in order to establish an adequate degree of transparency in Swiss capital markets.

Issuers of non-listed bonds are required to follow the prospectus requirements set forth in section 1156 SCO. The content of a bond’s prospectus is based on the prospectus requirements for non-listed shares. In addition, it has to “contain the detailed information concerning the loan, especially the interest terms, terms of repayment, special security provided for the bonds [...]”\(^{168}\) Like non-listed shares, the issue of non-listed bonds does not entail any ad-hoc disclosure duties. Listed bonds have to consider the SIX Listing Rules and, in addition, the Additional Listing Rules for the Listing of Bonds.\(^{169}\) These additional rules state particular prospectus requirements for bonds.\(^{170}\) Continuous disclosure provisions for exchange-traded bonds are virtually the same as those set out for shares,\(^{171}\) however, issuers of bonds neither have to file any interim financial statements or corporate calendar, nor do they have to disclose management transactions.\(^{172}\)

Mutual funds are regulated by the CISA and its Ordinances.\(^{173}\) Sections 75 et seq. CISA require that the fund management company publishes a prospectus\(^{174}\) for each mutual fund. The prospectuses have to be updated as material changes occur, and in any event, at least once a year.\(^{175}\) Inter alia, the prospectus provisions contain requirements with regard to issue and redemption fees, management fees and the reimbursement of specific admissible expenses.\(^{176}\) In addition to the above prospectuses, Swiss mutual funds have to publish their annual and semi-annual reports.\(^{177}\) Further, the fund management company has to publish “the net asset values [per unit] at regular intervals”.\(^{178}\) Listed mutual funds, so-called exchange traded funds (ETFs), have to comply with the rules of SIX. However,}

\(^{168}\) S. 1156 (2) SCO.  
\(^{169}\) Of October 29, 2008.  
\(^{171}\) S. 28 Listing Rules Bonds.  
\(^{172}\) See above, fn. 154.  
\(^{173}\) A full prospectus and - in most cases - a simplified prospectus have to be published. Annex 1 and 2 of CISO contain the minimum contents of the prospectus and the contents of the simplified prospectus.  
\(^{174}\) S. 106 (3) CISO.  
\(^{175}\) S. 38 CISO. See also Guidelines on Transparency with regard to Management Fees, June 5, 2005, by the Swiss Funds Association (SFA).  
\(^{176}\) S. 89 CISA.  
\(^{177}\) S. 83 (4) CISA. Publication has to take place whenever units are issued or redeemed or, if there is no issue or redemption, twice a month (s. 79 (2) CISO-FINMA, and Pascal Portmann, Basler Kommentar zum Kollektivanlagengesetz (Basel. Helbing Lichtenhahn, 2009), s. 83 CISA n. 31 KAG).
due to the CISA provisions’ high level of detail, the SIX generally refers to these statutory provisions and has largely refrained from establishing additional rules.\(^{179}\)

Issuers of structured notes must offer prospectuses in accordance with section 5 \textit{CISA}. These simplified prospectuses bear considerably less information than prospectuses for mutual funds or listed shares or bonds. In particular, simplified prospectuses do not contain any detailed information about the issuer of the product. Further, disclosure of product charges is not regulated in detail by the section 5 \textit{CISA}. Moreover, issuers are not required to disclose additional information, be it at the issue of the product or on a continuous basis.\(^{180}\) Listed structured notes have to comply with the specific rules for derivatives set forth by SIX.\(^{181}\) Issuers of these products must disclose relevant information in a listing prospectus\(^{182}\) in accordance with \textit{Scheme F of SIX Regulation}.\(^{183}\) Continuous disclosure requirements are based on the general SIX provisions for maintaining listing. However, issuers of structured products do not have to file any interim reports or corporate calendars.\(^{184}\)

The Swiss disclosure framework does not feature any prospectus requirements for non-listed derivative instruments other than structured products\(^{185}\) in the sense of section 5 \textit{CISA}.\(^{186}\) Whereas the issue of shares and bonds is regulated by the Swiss Code of Obligations and mutual funds as well as structured products are regulated by the \textit{Swiss Collective Investment Schemes Act} and its \textit{Regulations}, the issue and distribution of non-listed derivative securities other than structured products are not governed by any legal or self-regulatory provisions. As a consequence, non-listed options, futures and contracts for difference can be distributed to retail investors without initial and continuous disclosure of the product characteristics and entailed risks. In practice, however, the majority of issuers have switched to providing issuers with basic prospectus documentation on a voluntary basis.\(^{187}\) The content and structure of these prospectuses are similar to simplified prospectuses in the sense of section 5 \textit{CISA}.

\(^{179}\) See, for example, s. 110 and s. 113 \textit{Listing Rules}.
\(^{180}\) In particular, issuers are not required to publish product prices in secondary markets and need not provide investors with periodic disclosure information such as annual or half-yearly reports.
\(^{181}\) See, in particular, the \textit{Additional Rules for the Listing of Derivatives}, SIX Exchange Regulation, October 29, 2008.
\(^{182}\) Prospectuses can be stand-alone prospectuses or prospectuses enfolded in issuance programmes (s. 21 \textit{Listing Rules Derivatives}).
\(^{184}\) S. 34 \textit{Listing Rules Derivatives}.
\(^{185}\) For a definition of the term in the Swiss regulatory framework see section 2 above.
\(^{187}\) See \textit{Contratto} (fn. 129), p. 269.
Exchange-traded derivatives, as the above structured products, have to comply with the disclosure requirements set forth in the *SIX Listing Rules for Derivatives*.

Swiss securities regulation, like the Canadian legal framework for securities, features an early warning requirement for shares and share-related securities. Section 20 *SESTA* requires that everyone who “acquires or sells for their own account shares or purchase or sale rights relating to shares in a company incorporated in Switzerland whose equity securities are listed, in whole or in part in Switzerland and thereby attains, falls below or exceeds the threshold percentages of 3, 5, 10, 15, 20, 25, 33 1/3, 50 or 66 2/3 of the voting rights (...), shall be obliged to notify the company and the stock exchanges on which the equity securities in question are listed”. Further, sections 22 et seq. *SESTA* list a variety of disclosure duties for persons who intend to make a public takeover offer. In particular, these offerors “shall publish [their] offer in a prospectus containing true and complete information”. Unlike Canadian regulations, the Swiss *SESTA* confines disclosure duties in the early warning and public takeover context to acquisitions of exchange-traded securities.

Disclosure exemptions are set out in the above product-specific Statutes and Regulations. Their rationale is generally in accordance with one of the four elements that have been stated as exemptions in Canadian disclosure regulation.

The Swiss disclosure regime for securities is not a closed system. If, for example, large-scale investors sell their equity securities to third parties, prospectus requirements of section 652a *SCO* do not apply.

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188 For derivative-specific disclosure provisions in the early warning context see s. 15 *CISO-FINMA*. Further, there are considerable differences between the Canadian and Swiss early warning frameworks, as the following brief outline clearly shows. Whereas Canadian early warning rules require disclosure of acquisitions, the corresponding Swiss provisions require that sales or writings of securities are disclosed as well. Further, the provisions contain different thresholds which trigger disclosure and reporting duties. Another major difference can be found in the fact that Swiss corporate law does not allow equity securities without attached voting rights. As a consequence, the beneficial ownership concept of Swiss securities regulation depends heavily on the question who has power over a security’s voting right. As Canadian corporate law recognizes equity securities without any voting rights attached, Canadian securities regulation’s criteria to determine beneficial ownership of securities cannot exclusively focus on the question of voting rights. Finally, the Canadian early warning rule is applicable to all publicly traded securities, whereas the Swiss early warning system applies only to securities traded on a Swiss stock exchange.

189 S. 24 (1) *SESTA*.

190 See above, section II.3. See, for example, s. 36 *Listing Rules*, or s. 2 (2) and s. 3 *CISA*. 
and, as a consequence, securities that have been issued to exempt parties\textsuperscript{191} can be resold to retail investors without providing adequate disclosure.\textsuperscript{192}

\section*{IV Germany}

\subsection*{1. Objectives of Securities Regulation}

Like the Canadian and Swiss regulatory frameworks for securities, German securities regulation features two core goals. First, its provisions seek to create prerequisites for functioning securities markets. According to prevailing legal doctrine, functioning securities markets require (i) liquidity and accessibility of markets, (ii) low transaction costs, and (iii) transparency and adequate information for investors.\textsuperscript{193} Second, German securities regulation features investor protection as another key objective of its provisions. Traditionally, Statutes and regulatory provisions have confined their scope to institutional protection of investors, i.e. provisions have primarily aimed at protecting investors as a group. In recent years, however, courts and regulators have set out increasingly to protect individual investors against inappropriate behaviour.\textsuperscript{194} Despite this emerging focus on the protection of individual rights and claims, German securities law does not intend to rid investors of the general risks that are inherent to all transactions in financial instruments.\textsuperscript{195}

As seen above in the context of Canadian and Swiss regulations, German securities regulation seeks to implement the above goals mainly by creating transparency for all market participants. In addition, it requires registration and reporting requirements for key market participants\textsuperscript{196} and certain investment products.\textsuperscript{197} Finally, BaFin,\textsuperscript{198} the German financial markets supervisory authority, aims at realizing the proper functioning and stability of German financial markets by monitoring and analyzing market risks and taking measures to safeguard the integrity of the financial system.\textsuperscript{199} Like Canadian and Swiss

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{191} I.e. not to the 'public'.
\item \textsuperscript{192} See also JÖRN KOWALEWSKI, „Prospekt- und Kapitalinformationshaftung in der Schweiz und den USA, 18. Kapital. Schweiz“, in. Klaus J. Hopt/Hans-Christoph Voigt (eds.), Prospekte- und Kapitalmarktinformationshaftung, p. 1008. The same formal argument also applies to redistributions of securities by the issuer, see KOWALEWSKI, p. 1009.
\item \textsuperscript{193} PETRA BUCK-HEEB, Kapitalmarktrecht, 3rd edition (Heidelberg. C.F. Müller Verlag, 2009), p. 4.
\item \textsuperscript{194} By awarding damages to harmed investors BUCK-HEEB (fn. 193), p. 4.
\item \textsuperscript{196} See BUCK-HEEB (fn. 193), p. 191.
\item \textsuperscript{197} For mutual fund companies see BUCK-HEEB (fn. 193), p. 246.
\item \textsuperscript{198} Bundesanstalt für Finanzdienstleistungsaufsicht.
\item \textsuperscript{199} http://www.bafin.de/nn_721644/EN/BaFin/Functions/Crosssectoralfunctions/crosssectoralfunctions_node.html?__nn=true#doc721650bodyText4.
\end{itemize}
\end{footnotesize}
securities regulations, German financial markets law has so far refrained from establishing a comprehensive regulation to cope with systemic risks.

2. Product Categories

The legal framework of German securities regulation is displayed in several Statutes. The majority of these regulations are based on European Directives. Unlike Swiss securities regulation, the German legal framework governing the issue and distribution of securities has largely refrained from scattering disclosure and registration requirements for different product types in different Acts. Rather, its Statutes are organized along the various aspects that have to be regulated for all types of securities. In particular, the German Securities Trading Act\(^\text{201}\) regulates insider surveillance,\(^\text{202}\) price manipulation issues,\(^\text{203}\) early warning duties\(^\text{204}\) and other transaction-related matters.\(^\text{205}\) The Stock Exchange Act\(^\text{206}\), on the other hand, mainly contains organizational rules for German stock exchanges, but also sporadic disclosure obligations and behavioural requirements.\(^\text{207}\) Finally, the Securities Prospectus Act\(^\text{208}\) states prospectus duties for securities that are offered to the public\(^\text{209}\) or are requested to be “admitted on a regulated market”.\(^\text{210}\) An exception to this topic-based conception of German securities law is the German Investment Act. This Statute regulates (i) the issue and distribution of mutual fund units and (ii) the supervision of mutual fund companies and related entities.\(^\text{211}\)


\(^{201}\) Gesetz über den Wertpapierhandel (WpHG), July 26, 1994.

\(^{202}\) § 12 - 20 WpHG.

\(^{203}\) § 20a, 20b WpHG.

\(^{204}\) § 21 - 30 WpHG.

\(^{205}\) BUCK-HEEB (fn. 193), p. 7.

\(^{206}\) Börsengesetz (BörsG), June 21, 2002.

\(^{207}\) BUCK-HEEB (fn. 193), p. 7.


\(^{209}\) For the definition of a public offering, see, § 2 (4) WpPG.

\(^{210}\) Recital 12 of the Directive 2003/71/EC (fn. 200). The term ‘regulated market’ is defined in § 2 (16) WpPG. Investments that are not securities in the sense of § 2 (1) WpPG have to comply with the prospectus requirements of the German Wertpapier-Verkaufsprospektgesetz, September 9, 1998.

\(^{211}\) Such as the custodian bank.
German securities regulation centers on several definitions of the term ‘security’. Generally, securities are paper certificates which incorporate a right in such a way that it can be claimed only by the holder of said certificate.\(^{212}\) However, within the scope of the \textit{WpHG}\(^{213}\) and the \textit{WpPG},\(^{214}\) the term has a slightly different meaning. Paragraph 2(1) \textit{WpHG} sets forth that “securities within the meaning of this Act, whether or not represented by a certificate, are (1) shares, (2) investment securities which are comparable to shares and certificates representing shares, and (3) debt securities (...), if they can be traded on a market”.\(^{215}\) Paragraph 2(1) \textit{WpPG} defines securities as transferable securities that can be traded on a market. Again, it is not decisive whether these securities are represented by a paper certificate or not.\(^{216}\)

Although the above definitions of the term ‘security’ in the \textit{WpHG} and the \textit{WpPG} do not entirely correspond, their key understanding of securities concurs with each other\(^{217}\) and, in addition, largely mirrors the definition of ‘transferable securities’ in section 4 (1)(18) of the \textit{European Prospectus Directive}.\(^{218}\) Further, both the \textit{WpHG} and the \textit{WpPG} feature a non-exclusive list of different types of securities. In particular, they mention (i) shares and similar investment securities,\(^{219}\) (ii) debt securities such as bonds or warrants,\(^{220}\) and (iii) any other securities that entitle somebody to buy or sell shares or similar investment securities or effect a cash payment depending on securities, currency prices, interest rates or other returns, indices or market prices of commodities.\(^{221}\) Paragraph 2(2) \textit{WpHG} specifies that derivatives “are forward transactions in the form of futures or option contracts whose price depends directly or indirectly on (1) the stock exchange or market price of securities; (2) the stock exchange or market price of money market instruments; (3) interest rates or other returns; (4) the stock exchange or market price of commodities or precious metals or (5) currency prices”.\(^{222}\) Further, paragraph 2 (1)(2) \textit{WpHG} implies that mutual fund units are not securities in the sense of this Act.\(^{223}\)

\(^{213}\) Securities Trading Act.
\(^{214}\) Securities Prospectus Act.
\(^{215}\) § 2(1) WpHG.
\(^{217}\) See also HABERSACK (fn. 216), p. 74 fn. 28.
\(^{219}\) § 2(1)(1), (2) WpHG, and § 2(1)(a) WpPG.
\(^{220}\) § 2 (1)(3)(a) WpHG, and § 2(1)(b) WpPG.
\(^{221}\) § 2 (1)(b) WpHG, and § 2(1)(c) WpPG.
\(^{222}\) [English text outdated!]
\(^{223}\) See also ASSMANN (fn. 218), § 2 N 33, 34. The definition of securities in § 2 (1) (2) \textit{WpHG} includes only units of closed-ended investment funds.
WpPG, on the other hand, sets forth that the provisions of the Securities Prospectus Act do not apply to mutual fund units but refrains from excluding the latter from the term ‘security’.

Although German securities regulation is not organized along the various types of investment instruments, its provisions frequently establish distinct product categories and define different duties for each category. In particular, paragraph 7 WpPG and sections 2 (1) and (2) of the European Prospectus Regulation feature a set of schedules and building blocks whose applicability depends on the characteristics of the issued products.\(^\text{224}\)

In view of the above survey of German securities categorization, the four key categories of investment instruments that have been found in Canadian and Swiss securities regulation have also been implemented in the German legal framework for securities.\(^\text{225}\) The fine-grained differentiation established under sections 2 (1) and (2) of the European Prospectus Regulation is still based on the main categories referred to in paragraph 2 WpHG, paragraph 2 WpPG and section 2 InvG, i.e. (1) equity and (2) debt securities, (3) derivatives and (4) mutual funds. In the following, shares, bonds, mutual funds and a limited range of different derivative instruments\(^\text{226}\) shall serve as examples of the above four categories of securities.

3. Regulatory Disclosure Framework

The German disclosure framework for securities is essentially set forth in the WpPG, the Verkaufsprospektgesetz, WpHG, AktG\(^\text{227}\), and the WpÜG\(^\text{228}\) and respective Ordinances. Predominantly, these provisions are based on European Directives\(^\text{229}\) or refer to European Regulations.\(^\text{230}\) In addition, listed securities have to comply with the requirements enacted by German stock exchanges.\(^\text{231}\)

\(^\text{224}\) The Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements (EU Prospectus Regulation) features 17 different schedules and building blocks which, in turn, can be combined in a multitude of ways [see WIEGEL, Die Prospektrichtlinie und Prospektverordnung. eine dogmatische, ökonomische und rechtsvergleichende Analyse (Berlin. de Gruyter Recht, 2008), p. 214].

\(^\text{225}\) See this section above.

\(^\text{226}\) See below, chapter four, sections II.3, III.3, and IV.3.

\(^\text{227}\) Aktiengesetz (AktG), September 6, 1965 (Stock Corporation Act).

\(^\text{228}\) Wertpapiererwerbs- und Übernahmegesetz (WpÜG), December 20, 2001 (Securities Acquisition and Takeover Act).

\(^\text{229}\) See above, fn. 200.

\(^\text{230}\) See, for example, § 7 WpPG, referring to the European prospectus regulation.

\(^\text{231}\) See, for example, <http://deutsche-boerse.com>, listing, rules and regulations.
Like the Canadian legal framework for securities, German securities regulation features basic prospectus requirements that apply to nearly all kinds of publicly traded investment products.\textsuperscript{232} As seen in section 2 above, the \textit{WpPG} governs the public issue of securities in the sense of paragraph 2 (1) \textit{WpPG}. According to the \textit{WpPG}, every prospectus has to be composed of three parts, which are (i) a registration document, (ii) a securities note, and (iii) a summary.\textsuperscript{233} Further provisions prescribe the format that prospectuses have to assume.\textsuperscript{234} Paragraph 7 \textit{WpPG} and section 2 of the \textit{European Prospectus Regulation} define the minimum content of a prospectus. Issuers of non-listed securities must comply with the same prospectus requirements as issuers of exchange-traded securities.\textsuperscript{235}

Following the issue of securities, issuers must disclose periodic information to investors and the public. This periodic disclosure documentation essentially consists of annual and half-yearly financial reports,\textsuperscript{236} quarterly interim management statements,\textsuperscript{237} and an annual document listing ad-hoc announcements, directors’ dealings and changes in the percentage of voting rights held by shareholders.\textsuperscript{238} In addition, an issuer has to inform the market “without undue delay” about “all inside information which directly concerns that issuer”.\textsuperscript{239} Inside information is any specific information about circumstances which are not public knowledge relating to one or more issuers of insider securities, or to the insider securities themselves, which, if it became publicly known, would be likely to have a significant effect on the stock exchange or market price of the insider security”.\textsuperscript{240} Further, persons “discharging managerial responsibilities within an issuer of shares, are obliged to notify the issuer and the Supervisory Authority of own transactions in shares of the issuer or financial instruments based on them, in particular

\textsuperscript{232} Exceptions are made for mutual fund units (see below) and for investment products that are not considered securities (see fn. 210 above). As the latter provisions are not relevant in relation to the financial instruments analyzed in this paper, they will not be further considered.

\textsuperscript{233} See recital 14 of the \textit{EU Prospectus Regulation}, and KEUNECKE (fn. 218), p. 123, as well as BUCK-HEEB (fn. 193), p. 58. On the content of these prospectus elements see below, chapter four, section IV.

\textsuperscript{234} See KEUNECKE (fn. 218), p. 126 - 133.


\textsuperscript{236} § 37v and 37w \textit{WpHG}.

\textsuperscript{237} § 37x \textit{WpHG}.

\textsuperscript{238} § 10 \textit{WpPG}.

\textsuperscript{239} § 15 (1) \textit{WpHG}.

\textsuperscript{240} § 13 (1) \textit{WpHG}. The provision further states that such “a likelihood is deemed to exist if a reasonable investor would take the information into account for investment decisions”. As a consequence, German standards in relation to ad hoc publicity follow - unlike Canadian and Swiss disclosure regulations - the so called investor impact approach [see also JANIS SARRA, “Modernizing Disclosure in Canadian Securities Law. An Assessment of Recent Developments in Canada and Selected Jurisdictions”, Research Study, Commissioned by the Task Force to Modernize Securities Regulation in Canada (May 29, 2006), p. 94].
derivatives, within five business days”. Issuers of the affected company have to publish this information “without undue delay”.

Like its Canadian and Swiss counterparts, German securities regulation features an early warning rule which - implementing the European Transparency Directive - requires that a person “whose shareholding in an issuer (...) reaches, exceeds or falls below” certain thresholds in relation to share voting rights must notify the relevant issuer who, in turn, has to publish this change in the percentage of voting rights. The Securities Acquisition and Takeover Act determines procedures of public takeover offers.

As seen above, the German legislator has decided to create a specific Statute for mutual funds, the Investment Act. Its provisions establish particular disclosure requirements for mutual fund units. In particular, they state that issuers have to create a simplified and long-form prospectus as well as the fund rules. These documents have to be updated with information of material importance. Further fund-specific disclosure duties largely mirror those of Swiss securities regulation.

Unlike the Swiss CISA, the German framework for securities does not feature specific rules for structured products. However, derivative instruments are subsumed under the term ‘securities’ of paragraph 2 (1) WpPG and paragraph 2 (1) WpHG and, consequently, the general disclosure requirements of WpPG and WpHG apply. In addition, the WpHG contains several provisions that apply exclusively to derivative instruments in the sense of paragraph 2 (2) WpHG. Nevertheless, these regulations are not suitable to create a cohesive and comprehensive regulatory framework for derivatives.

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241 § 15a (1) WpHG.
242 § 15a (4) WpHG.
243 See fn. 200.
244 § 21 (1) WpHG.
245 § 26 (1) WpHG.
247 See section 2 above.
249 § 42 (5) InvG. See also KEUNECKE (fn. 218), p. 405.
250 See above, section III.3.
251 See, for example, § 37d, 37g WpHG.
Exemptions to disclosure rules are set out in the Statutes and Regulations mentioned above. Their rationale is generally in accordance with one of the four elements that have been stated for exemptions in Canadian disclosure regulation.\textsuperscript{252}

The German disclosure framework qualifies as a closed system. Securities that have been issued under an exemption to the prospectus requirement can be resold only if (i) this second sale can be subsumed under another prospectus exemption, or (ii) the seller complies with general prospectus regulations.\textsuperscript{253}

\section*{V Conclusion}

In consideration of the above summary of Canadian, Swiss and German securities regulations, the following observations can be noted. First, definitions of the term ‘security’ vary significantly among the three jurisdictions. Whereas Canadian securities regulation has adapted a very broad understanding of the phrase, Swiss and German securities concepts have chosen a far narrower route.\textsuperscript{254} As this research paper focuses on transparency rules for bonds, mutual funds and derivatives in the retail market, these differences will arguably have no decisive impact on the following analysis.\textsuperscript{255} However, for clarity’s sake, they should be kept in mind when comparing different disclosure regulations.

Second, the three examined jurisdictions vary considerably with respect to their creation and use of different product categories. Canadian general disclosure regulation has largely refrained from establishing legally defined specific product categories. Exceptions have been made for mutual fund units and principal protected notes. Switzerland, on the other end of the scale, has established different legal forms for economically differing product types. Further, the Swiss disclosure framework distinguishes between listed and non-listed securities. German securities regulation, finally, has incorporated elaborate definitions of certain product categories\textsuperscript{256} and contains a highly differentiated regime to determine the form and content of prospectus disclosure. However, its disclosure framework is mostly consistent and has eliminated undue variations between different product types. Considering the above variety of regulatory approaches, the following analysis has to consider carefully whether

\textsuperscript{252} See above, section II.3. See, for example, s. 36 Listing Rules, or s. 2 (2) and s. 3 CISA.
\textsuperscript{253} \textsc{Keunecke} (fn. 218), p. 116.
\textsuperscript{254} See also \textsc{Wiegel} 224), p. 204, comparing the European and US definitions of ‘security’. Nevertheless, the Canadian framework features cases where its definition of ‘securities’ is narrower than its Swiss or German counterpart. Principal protected notes, for example, that are evidences of deposit issued by a savings institution (see s. 1 BCSA, ‘security’) are not considered as securities, whereas Swiss and German securities regulation do not contain similar exemptions.
\textsuperscript{255} Moreover, Canadian prospectus requirements apply only if a certain trade in securities qualifies as a distribution (\textsc{Gillen} (fn. 40), p. 130).
\textsuperscript{256} See, for example, the definition of ‘derivatives’ in s. 2 (2) \textsc{WpHG}.  

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some of these regulatory alternatives are better suited than others to create transparency and fair market conditions.

Third, Canadian, Swiss and German securities regulations require disclosure largely on the same occasions and by similar methods. In particular, the three jurisdictions feature prospectus requirements at the issue of securities and distinguish consistently between primary, periodic and timely disclosure measures. Although the contents and formats of disclosure might vary significantly, supervisory means to ensure transparent capital markets are not fundamentally different.

Fourth, probably the most striking divergence among the analyzed legal frameworks can be located in their different approaches to prospectus regulation. While Canadian securities regulation strives to create a single prospectus scheme for all types of securities, Swiss securities law features different prospectus schemes for different product types. German securities regulation, finally, has taken the middle road by listing general prospectus requirements but, at the same time, featuring a multitude of schedules and modules that can be combined depending on the particular product characteristics.

Fifth, all the examined jurisdictions have so far refrained from establishing comprehensive disclosure frameworks for derivative instruments. Although there exist sporadic regulations of specific products or constellations, they clearly do not comprise all derivative aspects in need of regulation in a consistent manner.

In view of these preliminary observations, the below examination will pay particular attention to the following aspects. Prospectuses play a decisive role in capital markets regulation. Consequently, an in-depth analysis of the different approaches to defining prospectus requirements is a key element for a thorough understanding of the transparency framework of the three examined jurisdictions. In addition, the above overview has made evident that Canadian and Swiss jurisdictions lack comprehensive transparency requirements for derivatives. Considering the existing fractions of a framework for derivative transparency and the more comprehensive German framework, the following analysis will investigate which of these rules could be implemented in one of the other jurisdictions and what aspects have to be considered when creating an inclusive transparency framework for retail derivative instruments.

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257 See below, chapters four and five.
258 And adds sporadic specifications for certain kinds of products (see Ni 41-101F1 Information Required in a Prospectus). See, however, chapter four, II.3.4 below.
259 See, for example, the Canadian regulation of PPNs or the Swiss legal framework for structured products.
Chapter three Preconditions for Transparent Capital Markets

I Introduction

If we aim at establishing transparent capital markets for retail investors, disclosure requirements have to be drafted with utmost care. In particular, unsophisticated investors might not be in a position to distinguish between valuable and insignificant information. Further, an overwhelming amount of data tends to confuse investors rather than guide them. As a consequence, prospectus provisions and continuous disclosure requirements cannot focus exclusively on the minimum content of these documents, but have to ensure that investors understand how certain investments may impact their funds and whether similar risks can occur with other investment products. The key aspects that have to be considered in order to create transparency in capital markets have already been mentioned under section I of chapter one. (i) Investment products must be delimitable,\(^\text{260}\) (ii) essential product risks have to be disclosed,\(^\text{261}\) (iii) relevant information has to be available in a timely and unobstructed manner\(^\text{262}\) and (iv) prospectuses have to facilitate product comparisons.\(^\text{263}\) A consistent implementation of the above criteria to disclosure provisions for issuers and intermediaries can pose a major challenge to securities regulators. Although current prospectus frameworks generally acknowledge the four preconditions mentioned above, they have not yet succeeded in fully abolishing all cumbersome factors and often struggle to prevail over the political influence of product issuers and the slowness of legislatory procedures.

The following chapter briefly outlines the main characteristics of the above four preconditions for transparent capital markets. Further, it examines several issues that have arisen in Canadian or Swiss securities markets due to an incomplete implementation of these principles. As recent market developments have revealed considerable deficiencies of present disclosure requirements in relation to product delimitability, the following analysis particularly addresses related problems. Product comparability and risk disclosure are mainly fostered through coherent prospectus structures and significant risk indications in the prospectus and other disclosure documents. Consequently, an in-depth analysis of these issues is of utmost importance.

\(^{260}\) See Miriam Egggen (fn. 186), on the necessity to distinguish between mutual funds and derivative instruments such as structured products.

\(^{261}\) See, for example, s. 1.15 of Appendix 1 to CISO, which requires disclosure of specific risks of a mutual fund. See also Sarra, Modernizing Disclosure (fn. 240), p. 17.

\(^{262}\) See also Zobl/Kramer (fn. 132), p. 61.

\(^{263}\) See the prospectus templates of SFA for mutual fund prospectuses.
assessment of comparability issues under present Canadian, Swiss and German securities regulation will be the object of chapter four below.

Finally, Swiss and German securities regulations feature similar product categories and, as a consequence, face similar challenges when delimiting or comparing different products. In view of this fact, the following analysis will be limited to an in-depth examination of the above issues under a Swiss and Canadian law perspective.

II Product Delimitability

1. Preliminary Remarks

Canadian securities regulation not only features a very broad understanding of the term ‘security’, but also includes disclosure requirements that apply, as a rule, for all financial instruments qualifying as securities. Considering these facts, one might be inclined to conclude that delimitability is no issue under Canadian securities law at all. However, past experience has shown that the above two characteristics cannot fully prevent discussions on product classification and, hence, on how different product categories can be distinguished from each other. First, as the term ‘securities’ is defined in a non-exclusive manner, issuers of products that are not mentioned in the statutory enumeration of securities cannot always assess with certainty whether they have to comply with the regulatory disclosure provisions for securities. Second, general disclosure requirements have been replaced by specific provisions for particular types of investment products, such as mutual funds or principal protected notes. Consequently, issuers of investment instruments must assess whether a specific product belongs to one of these particular categories. In order to establish certainty about issuers’ disclosure duties, the above product categories with specific disclosure provisions have to be clearly delimitable to other types of securities.

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264 See above, chapter two, section IV.2.
265 If German regulations achieve to solve issues arising under Swiss law, these aspects will be mentioned separately.
267 See, for example, s. 1(1) BCSA, ‘security’.
268 See below, section 2.1.a.
269 See, for example, NI 41-101, s. 2.1 (2). “This Instrument does not apply to a prospectus filed under NI 81-101 or a distribution of securities under such a prospectus.”
270 See Principal Protected Notes Regulations, s. 3. Although this provision requires written information about the principal protected note in question, its requirements considerably differ from the general prospectus requirements in NI 41-101.
As shown under sections III.2 and 3 of chapter two, Swiss securities regulation does not contain a disclosure regime that applies to all kinds of securities. In contrast to the Canadian disclosure framework, specific prospectus requirements and continuous disclosure provisions are designed separately for each product category. As a consequence of this lack of general disclosure rules, unambiguous delimitability of different product categories becomes a vital condition of transparent securities markets. If a product is distributed in accordance with inadequate disclosure requirements, investors may be misled with regard to the product’s characteristics and, hence, inadvertently take risks that conflict with their investment strategy and their available resources.

Considering the above, delimitability of different types of investment products is an important precondition to transparent capital markets both under Canadian and Swiss securities regulation. Whereas delimitability issues occasionally arise in the Canadian transparency framework, they come up on a more regular basis in the Swiss compartmentalized transparency regulation. The below sections will first outline current issues in Canadian and Swiss securities regulations that exemplify the above difficulties. Sections three and four will then provide first steps towards a solution for these matters.

2. Selected Delimitation Issues

2.1 Canada

a. Securities versus Non-Securities

As already explained in chapter two, section II.3, Canadian securities regulation features general prospectus requirements that apply, as a principle, to all kinds of securities. In consequence of this holistic approach, one of the most crucial questions prior to the distribution of an investment product is whether this product qualifies as a security and, as a result, has to comply with transparency requirements of securities regulation. Accordingly, a concise definition of the term ‘security’ has been the object of careful judicial consideration. In particular, courts have paid much attention to the scope of catch-all provisions such as ‘interest in property’ or ‘investment contract’. 271

In this context, Canadian case law has been significantly influenced by precedent U.S. court decisions. In SEC v. C.M. Joiner Leasing Corporation, 272 the court decided that the assignment of leases combined with the drill of a test well qualified as a sale of securities, because this business “had all the evils

271 Gillen (fn. 40), p. 119, 120.
inherent in the securities transactions which it was the aim of the Securities Act to end”.273 In SEC v. W.J. Howey Co.,274 the court modeled the ‘common enterprise’ test to establish whether a certain transaction should be classified as ‘investment contract’. The test required “(i) a contract, transaction or scheme whereby a person invests; (ii) that the investment be in a common enterprise; and (iii) that the person is led to expect profits solely from the efforts of a promoter or third party”.275 This common enterprise test was complemented in State of Hawaii v. Hawaii Market Center Inc.276 with the ‘risk capital’ test that distinguished itself from the test developed in the Howey case insofar as it did not require that the person expected “profits solely from the efforts of a promoter”277 but rather that “the offeree does not have the right to exercise practical and actual control over the managerial decisions of the enterprise”.278

In Pacific Coast Coin Exchange v. O.S.C.,279 the Supreme Court of Canada approved “the use of U.S. cases and adopted the Howey and Hawaii tests”.280 Further, the court clarified that the third party’s endeavors had to be “undeniably significant for the success of the enterprise”281 if the respective transaction should qualify as an ‘investment contract’. Moreover, the Supreme Court specified that the enterprise did not need to be “common to the investors between themselves”.282 Rather, the efforts of the promoter should aim at creating profit for both the investor and the promoter.283

The above synopsis of the currently prevailing positions of U.S. and Canadian courts in relation to investment contracts has shown the following. U.S. and Canadian courts have chosen a purposive284 interpretation of the term ‘security’.285 In accordance with the wide scope of Canadian securities
regulation,\textsuperscript{286} catch-all clauses of Canadian Securities Acts substantiating the term ‘security’ are generally given a wide scope of application.\textsuperscript{287} In addition, the above tests and further clarifications in \textit{Pacific Coast Coin Exchange v. O.S.C.} have made evident that an abstract definition of the terms ‘investment contract’ or ‘security’ is - under the present conception of Canadian securities law - neither feasible nor desired. Although the establishment of a narrowly defined abstract test would enhance predictability of legal decisions, it would at the same time conflict with the objective of Canadian securities regulation to capture all contracts, transactions or schemes that are “the type of transaction to which securities regulation was intended to be directed”.\textsuperscript{288} Whereas standard investment products are either mentioned in the statutory enumerations of vehicles qualifying as securities\textsuperscript{289} or can be positively subsumed under one of the broader clauses of said lists,\textsuperscript{290} it may not always be possible to determine with absolute certainty whether less standardized products qualify as securities or not. As a consequence, the qualification of these borderline cases is not definite until a respective court decision has been made.

b. Derivatives

aa. Provincial Derivatives Regulation

As outlined in chapter two, section II.3 above, Canadian securities regulation does not feature a comprehensive framework for derivatives.\textsuperscript{291} In addition, the provinces have so far refrained from harmonizing their fragmentary regulations governing derivatives. British Columbia and Alberta regulate exchange-traded derivatives\textsuperscript{292} and OTC derivatives\textsuperscript{293} “directly through their securities regulation”.\textsuperscript{294}

\textsuperscript{286} See, in contrast, the Swiss and German terminology of security and their considerably narrower scope of application of securities regulation, chapter two, sections III.2 and IV.2.
\textsuperscript{287} \textit{GILLEN} (fn. 40), p. 130.
\textsuperscript{288} \textit{GILLEN} (fn. 40), p. 129.
\textsuperscript{289} See, for example, s. 1 BCSA, ‘security’.
\textsuperscript{290} See, for example, \textit{GILLEN} (fn. 40), p. 117, who elaborates that warrants likely fall under the term ‘any document constituting evidence of an option, subscription or other interest in or to a security’ (s. 1 (1) BCSA, ‘security’).
\textsuperscript{291} See \textit{Ontario Securities Commission Rule 91-504 - Over-the-counter Derivatives and Companion Policy 91-504CP, Introduction}, for a definition of the term ‘derivative’. “Derivatives products are, generally speaking, instruments the value of which is dependent, wholly or partially, upon the price, level or value of an external benchmark such as a security, financial instrument, interest rate, foreign exchange rate, index or commodity price.”
\textsuperscript{292} Exchange traded derivatives are traded through exchanges or other intermediaries (see Expert Panel, \textit{Final Report} (fn. 45), p. 75).
\textsuperscript{293} Over-the counter derivatives (OTC derivatives) are “privately negotiated contracts entered into between the contracting parties directly” (Expert Panel, \textit{Final Report} (fn. 45), p. 75). See below, subsection bb.
\textsuperscript{294} Expert Panel, \textit{Final Report} (fn. 45), Appendix 5, p. 75.
Whereas exchange-traded derivatives qualify as exchange contracts and “are regulated (...) by the imposition of registration requirements”, OTC derivatives are considered to be securities in the sense of the Securities Acts. However, “the application of most aspects of securities legislation to OTC derivatives is clawed back through broadly applicable blanket exemptions”.

Ontario and Manitoba have enacted commodity futures legislation which governs exchange-traded commodity futures contracts and options. Other exchange-traded derivatives and OTC derivatives are subject to the rules of securities regulation (i) if they are considered to be securities in the sense of the respective Securities Act and (ii) if they do not fall into the scope of one of the broad exemption clauses. OTC derivatives that do not qualify as securities are, as a rule, not subject to provincial securities regulation. However, section 143 (1) OSA, paragraph 35, has been interpreted such that the commission may enact rules for derivatives usually regardless of whether they qualify as securities or not.

Québec, finally, has enacted a Derivatives Act that applies to OTC derivatives and exchange-traded derivatives irrespective of whether these instruments are traditionally considered as securities or not.

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295 And, as a consequence, are “not included in the definition of ‘security’” (Expert Panel, Final Report (fn. 45), Appendix 5, p. 75, 76).
296 Expert Panel, Final Report (fn. 45), Appendix 5, p. 76.
298 Expert Panel, Final Report (fn. 45), Appendix 5, p. 76. Consequently, these instruments do not qualify as securities any longer [see, however, Jeffrey MacIntosh/Christopher Nichols, Securities Law (Toronto. Irwin Law, 2002), p. 18, and Condon/Anand/Sarra (fn. 55), p. 190, subsuming options under the term ‘securities’].
299 This qualification is established (i) either by means of an explicit reference (see, for example, s. 1 OSA, ‘security’ (p), in relation to commodity futures contracts that are not “traded on a commodity futures exchange registered with or recognized by the Commission under the Commodity Futures Act”), (ii) or by subsuming specific derivatives under one of the more general clauses, in particular the term ‘investment contract’ (see Grottenthaler/Henderson (fn. 73), 10-10), (iii) or, finally, by considering a derivative a common type of security (see, Gilless (fn. 40), p. 117, with respect to warrants).
300 Expert Panel, Final Report (fn. 45), Appendix 5, p. 76.
301 Due to these exemptions, however, disclosure requirements do generally not apply to OTC derivatives that “fall within the scope of ‘securities’” (Expert Panel, Final Report (fn. 45), Appendix 5, p. 76).
302 And its statement that the Ontario Securities Commission can make rules with regard to derivatives.
303 Grottenthaler/Henderson (fn. 73), p. 10-14; Expert Panel, Final Report (fn. 45), Appendix 5, p. 76.
304 R.S.Q., chapter I-14.01.
305 S. 4 of the Derivatives Act sets forth a three-part-test with regard to the question whether hybrid products qualify as securities or derivatives. Policy Statement Respecting Hybrid Products of January 22, 2009, provides guidance in relation to the above test (see also Oslér, Québec Derivatives Act and Québec Derivatives Regulation Now In Force, February 3, 2009, <online. http://www.osler.com/resources.aspx?id=16830>). See also s. 3 (2) Derivatives Act, where a derivative “means an option, a swap, a futures contract or any other contract or instrument whose market price, value, or delivery or payment obligations are derived from, referenced to or based
However, “OTC derivatives and transactions [in OTC derivatives]\(^{306}\) involving ‘accredited counterparties’ are carved-out from the application of most of the substantive provisions of the legislation”\(^{307}\). Unlike the trade of securities, the issue of derivative instruments does not require a prospectus.\(^{308}\) Instead, dealers “must, before the first trade on behalf of a client, give the client the risk information document prescribed by regulation”\(^{309}\).

In consideration of the above outline of provincial approaches to the regulation of derivatives, the following delimitation issues attract immediate attention. All provincial regulations feature clauses that either (i) exempt certain derivative instruments from the scope of securities regulation,\(^{310}\) or (ii) relieve issuers of disclosure and registration duties.\(^{311}\) Whereas issuers of non-derivative instruments have to deal with similar uncertainties, the enormous diversity of derivative structures is bound to provoke more frequent and more fundamental ambiguities than conventionally designed products. In particular, the comparatively narrow concepts of the term ‘security’ in \textit{Ontario} and \textit{Québec Securities Acts} may compound issuers’ difficulties in assessing whether certain derivatives qualify as securities. Whereas Québec securities regulation has mitigated delimitability problems by introducing delimitation criteria for hybrid products,\(^{312}\) the Ontario securities commission still applies the above traditional tests\(^{313}\) in order to determine whether a derivative should be considered as a security in the sense of the \textit{Ontario Securities Act}.\(^{314}\) According to this assessment, a tailored and cash-settled OTC derivative “entered into between sophisticated parties (...) that is not marketed to the public”\(^{315}\) does not qualify as a security.\(^{316}\)

Although OTC derivatives with physical settlement may technically qualify as securities in the sense of

\[^{305}\text{See Osler (fn. 305); CHRISTINE DUBÉ, Canada. The Québec Derivatives Act Comes Into Force (February 19, 2009), online. <http://www.mondaq.com/canada/article.asp?articleid=74464>. See also Avis Concernant la Décision Générale Relative à la Dispense d’Application des Articles 54, 56 et du Premier Alinéa de l’Article 82 de la Loi sur les Instruments Dérivées (Décision N° 2009-PDG-0007).}\]
\[^{306}\text{See OSLER (fn. 305); CHRISTINE DUBÉ, Canada. The Québec Derivatives Act Comes Into Force (February 19, 2009), online. <http://www.mondaq.com/canada/article.asp?articleid=74464>.}\]
\[^{307}\text{See above, section 2.1.b.}\]
\[^{308}\text{See above, section 2.1.b.}\]
\[^{309}\text{See above, section 2.1.b.}\]
\[^{310}\text{See, in particular, BC Blanket Order 91-501 on Over-the-Counter Derivatives.}\]
\[^{311}\text{See, in particular, BC Blanket Order 91-501 on Over-the-Counter Derivatives.}\]
\[^{312}\text{See, in particular, BC Blanket Order 91-501 on Over-the-Counter Derivatives.}\]
\[^{313}\text{See, in particular, BC Blanket Order 91-501 on Over-the-Counter Derivatives.}\]
\[^{314}\text{See, in particular, BC Blanket Order 91-501 on Over-the-Counter Derivatives.}\]
\[^{315}\text{See, in particular, BC Blanket Order 91-501 on Over-the-Counter Derivatives.}\]
\[^{316}\text{See, in particular, BC Blanket Order 91-501 on Over-the-Counter Derivatives.}\]
section 1 OSA, their classification is controversial and opinions have been voiced that traditional criteria do not always produce appropriate qualifications of these products. Exchange-traded derivative warrants with cash-settlement, structured notes and similarly designed products, finally, “are likely to be properly characterized as securities because of their standardization, the nature of the purchasers, the manner of their distribution and other similarities with conventional securities”.  

bb. OTC Derivatives and Exchange-traded Derivatives

Canadian securities regulation distinguishes between exchange-traded and over-the-counter derivatives. Exchange-traded derivatives are generally described as instruments that are traded on an exchange, whereas OTC-derivatives are characterized as “privately negotiated contracts that may be transferred to a third party only under terms agreed to by the parties”. Originally, OTC derivatives were tailor-made products that were traded almost exclusively between sophisticated parties. As a result, the above derivative-specific distinction between OTC-derivatives and exchange-traded derivatives overlapped to a large extent with the widely accepted notion that sophisticated investors need less protection than retail investors. However, more recent product developments have made evident that non-listed derivative products may well be issued in a standardized form and then be distributed to retail investors. As a consequence, the above distinction between exchange-traded products and OTC derivatives has been questioned and, to some extent, amended by provincial securities regulators to address the new challenge. In particular, the recently enacted Québec Derivatives Act has replaced the conventional distinction between exchange-traded derivatives and OTC derivatives by introducing the class of ‘standardized derivatives’ “that [are] traded on a published market, whose intrinsic characteristics are determined by that market and whose [trades are] cleared and settled by a clearing house”.

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317 GROOTENTHALER/HENDERSON (fn. 73), p. 10-12.
321 SCAVONE ET AL. (fn. 319).
322 GILLEN (fn. 40), p. 251.
323 See, in particular, the growing sectors of PPNs and principal at risk notes.
324 S. 3 QDA, ‘standardized derivative’. See also BC Blanket Order 91-501 on Over-the-Counter Derivatives, Part two, which states. “The registration and prospectus requirements of sections 34 and 61 of the Act do not apply to a trade in an OTC derivative where each party to the trade is a Qualified Party acting as principal”, whereby the term ‘qualified party’ is defined in s. 1.1 of the Order. Further, see s.1 (d) Alberta Blanket Order 91-502 which includes
Considering the abundance of non-listed structured notes that have been distributed to retail investors in recent years, the following preliminary conclusions can be drawn from the above explanations. Delimiting OTC derivatives from other derivative investments is appropriate only if this distinction mirrors relevant differences in the product characteristics. In view of the above, the still predominant differentiation between exchange-traded and non-listed derivative products no longer seems an adequate way to structure the legal framework for derivatives. In fact, product developments mentioned in this section indicate that the approach chosen by Québec derivatives regulation - i.e. the delimitation of standardized derivative products from tailor-made derivative investments - is a more promising way to capture relevant differences in present derivative structures. However, it remains to be noted that the Québec Derivatives Act\(^\text{325}\) has so far confined its scope of standardized derivatives “whose intrinsic characteristics are determined by”\(^\text{326}\) the market they are traded on. Consequently, structured notes\(^\text{327}\) and exchange-traded options that are issued by investment banks, mostly in the form of book-entry securities or global notes, do not fall under the scope of the term ‘standard derivative’ and, consequently, issuers of such products would generally have to follow disclosure regulations for securities.\(^\text{328}\)

cc. Federal Principal Protected Notes Regulation

Another delimitation issue arises from the fact that provincial jurisdictions have largely refrained from applying their securities laws to principal protected notes and other evidence of deposit, be it by carving them “out from the definition of ‘securities’”\(^\text{329}\) or by creating exemptions from prospectus and registration obligations.\(^\text{330}\) In order to fill this regulatory gap, the federal government has issued disclosure requirements for PPNs\(^\text{331}\) which do not accord with prospectus requirements of provincial securities regulation. As a consequence, issuers of structured notes have to assess whether their products are PPNs and, therefore, subject to federal banking regulation, or whether they qualify as

\(^{325}\) As all the other provincial definitions of ‘exchange contracts’.

\(^{326}\) S. 3 QDA, ‘standardized derivative’.

\(^{327}\) See explicitly Policy Statement respecting Hybrid Products, February 1, 2009.

\(^{328}\) As far as can be seen, these instruments are not traded Canadian stock exchanges do not feature yet.


\(^{330}\) McMillan (fn.329).

\(^{331}\) Subsections 31(1) and (3) PPN Regulations.
another type of derivative which might require their compliance with disclosure provisions of provincial securities regulations.

dd. Proposed Canadian Securities Act

The Proposed Canadian Securities Act seeks to approach derivatives regulation in a more comprehensive manner than current provincial regulations. Part 7 of the Proposed Act clarifies that the new regulatory regime will uphold the currently predominant distinction between exchange-traded and OTC derivatives.\footnote{332} Further, derivative instruments that qualify as securities in the sense of section 2 of the Proposed Act - but are neither exchange-traded nor designated derivatives\footnote{333} - can be distributed only if their issuers comply with general disclosure requirements set forth in Part 6 of the Proposed Act. In order to tackle the delimitation issues described in sections (aa) and (bb) above, the Act introduces the category of ‘designated derivatives’. These types of derivative instruments are subject to specific disclosure requirements and do not have to follow general prospectus obligations. Moreover, section 92 of the Act enables the national regulator to govern specific derivative instruments that do not qualify as securities but are in need of supervision and adequate disclosure.

The CSTO’s effort to create a comprehensive framework for derivatives is a highly welcome development. In particular, the regulator’s awareness that different types of derivatives may require different levels of disclosure and tailored procedures is a promising step towards a coherent disclosure framework for derivatives. In addition, the Proposed Act recognizes that the qualification of a particular instrument as a ‘non-security’ must not bar the regulator from implementing appropriate disclosure rules in relation to the derivative in question. However, the provisions of the Proposed Act refrain from further defining the different types of derivatives and their respective disclosure requirements. Moreover, the Act does not determine the relationship between its derivatives regulations and Canadian PPN Regulations. Finally, the Proposed Act does not reveal whether its regulations will adopt - at least partially - the approach chosen by Québec derivatives regulation and implement different rules for standardized derivative products than for tailor-made derivative investments.\footnote{334} As a result, a

\footnote{332} See, in particular, s. 89 of the Proposed Act.
\footnote{333} See below in this section.
\footnote{334} The distinction between exchange-traded derivatives and other derivative instruments in s. 89 of the Proposed Act will not necessarily prevent the regulator from making the above delimitation. S. 2, ‘exchange-traded derivative’, defines this type of derivative as a “derivative that is traded on an exchange under standardized terms determined by the exchange or a clearing agency”. Consequently, structured notes and exchange-traded options that are issued by investment banks, mostly in the form of book-entry securities or global notes, do not fall under the scope of the term ‘exchange-traded derivative’ and, consequently, issuers of such products would generally have to follow prospectus requirements for securities or disclosure requirements for ‘designated derivatives’. As
The above survey of current delimitation issues in Canadian securities regulation has shown the following. If questions in relation to delimitation of investment categories arise on a regular basis, this is not necessarily a sign of lacking or flawed legislation. Rather, it can also be a manifestation of the legislator’s endeavour to acknowledge each case individually and to apply disclosure provisions only if required by the purposes of securities regulation. However, if uncertainties are not limited to individual cases but extend over an entire product category, the key objectives of securities regulation cannot be pursued in an effective manner anymore. Consequently, the displayed regulatory inconsistencies in relation to derivative instruments are not inevitable by-products of Canada’s purposive approach to securities regulation, but can be eliminated by the implementation of comprehensive and nationally streamlined disclosure rules for derivative instruments. Chapters four, five and seven below will put a particular focus on the question of how such a framework for derivatives should be designed.

2.2 Switzerland

a. Preliminary Remarks

As outlined in chapter two, section III.2 above, the Swiss legislator has introduced specific rules for ‘structured products’ without defining the term in the respective Statute.336 As a result of this definitory gap in the Swiss legal framework for structured products, their delimitation from other investment products has to be conducted by means of the key characteristics of these other products. The following sections will display current delimitation issues that have arisen between structured products and mutual funds. Further, uncertainties in relation to the categorization of mutual funds into index-related and actively-managed funds will be identified under section 2.2.c below.

335 I.e. protecting investors and creating efficient capital markets
336 CISA Message, p. 45.
b. Structured Products versus Mutual Funds

aa. General Delimitation Criteria

Section 7 (1) CISA states that mutual funds “are assets raised from investors for the purpose of collective investment, and which are managed for the account of such investors”. Hence, the core characteristics of mutual funds are (i) a separate pool of assets that are (ii) managed by a third party and (iii) serve as a collective investment. As mentioned under section 2.2.a above, Swiss legislation does not feature a definition of the term ‘structured product’. Consequently, delimitation of mutual funds from structured products has to be approached with the key characteristics of mutual funds as the decisive delimitation criteria. As issuers of mutual funds, unlike issuers of structured products, are required to keep the fund’s assets separated from their own moneys, asset pools may indicate that the issuer of the respective products has created mutual funds and not structured products. However, the non-existence of a separate asset pool does not necessarily mean that an investment product does not qualify as a mutual fund. Further, structured products can be managed passively or actively. If the issuer of a structured product continues to have discretion with regard to the product’s composition, this product is managed actively and in a similar way to a mutual fund. As a consequence, the management of assets by a third party is not suited to the delimitation of mutual funds from structured products either. However, in contrast to mutual funds, structured products never entail a collective investment of the raised moneys. Rather, the issue of structured products provides investors with a claim against the product’s issuer but does not commit the latter to invest the funds on behalf of the investors into the product’s underlying components. In view of this structural difference in the design of mutual funds and structured products, the key distinctive feature between these two investment vehicles consists of the fact that a mutual fund’s portfolio manager manages assets on behalf of the unitholders, whereas

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338 See also s. 35 CISA, which states that “in case of bankruptcy [of the fund management company], assets and rights belonging to the fund management company will be segregated in favor of the investors”.
339 Legislation requires that issuers of mutual funds keep the fund’s assets separate from their own assets. As a result, the creation of asset pools is a consequence of a mutual fund’s existence rather than a precondition (see also HASENBÖHLER (fn. 337), p. 211; SILVIO HUTTERLI, Strukturierte Produkte, Ausgestaltung, Emission und Handel aus rechtlicher Sicht (Zürich/St. Gallen. Dike Verlag, 2008)., p. 89; MATTHÄUS DEN OTTER, Kommentar zum Schweizerischen Anlagefondsgesetz (Zürich. Schulthess, 1997), s. 2 AFG n. 6)
340 HASENBÖHLER fn. 337), p. 211.
341 EGGEN, Structured Products (fn. 186), p. 382.
342 HUTTERLI (fn. 339), p. 91.
investors of structured products generally no longer have any relations to the issuer’s use of the invested moneys.\textsuperscript{343}

bb. Collateralization of Structured Products

i. Collateral Secured Instruments (COSI)

Following the Lehman bankruptcy, Swiss retail investors suffered considerable losses due to the counterparty risk inherent in structured products.\textsuperscript{344} In order to meet the concerns that investors have raised in relation to the reliability of such investments, issuers of structured products and the Swiss stock exchange SIX have introduced so-called collateral secured instruments (COSI). Issuers who have signed the Framework Agreement for Collateral Secured Instruments\textsuperscript{345} agree that a third party, called the ‘collateral provider’, “undertakes to grant SIX Swiss Exchange a right of lien on selected securities”.\textsuperscript{346} As soon as certain pre-defined events\textsuperscript{347} occur, “the collateral will be liquidated (…) and the COSI shall become due and payable within a certain time period”.\textsuperscript{348} The collateral is not allocated to specific issues of certificates\textsuperscript{349} and a partial collateralization is not approvable.\textsuperscript{350} Investors have no right of lien on the securities serving as collateral.\textsuperscript{351}

The above collateralization significantly reduces investors’ risks of facing a defaulting counterparty. However, in spite of this risk minimization in case of an issuer’s insolvency,\textsuperscript{352} COSI clearly neither entail a direct obligation that issuers invest investors’ moneys collectively, nor do they imply any indirect collective investment duty. In particular, investors do not have an individual right of lien on the

\textsuperscript{343} Recent product developments feature elaborate collateralization schemes and, consequently, issuers are contractually obligated to invest the investors’ money in a certain way. However, the products are not governed by mandatory requirements that might force issuers to invest these moneys in a certain way.
\textsuperscript{344} See \textit{Eggen}, Prospectus (fn. 147), p. 105.
\textsuperscript{345} See \textltt{http://www.six-swiss-exchange.com/download/admission/cosi/framework_agreement_cosi_de.pdf}\ for the German wording of the framework agreement. The agreement is concluded between (i) the issuer and collateral provider conclude and (ii) SIX Swiss Exchange and SIX SIS (see \textltt{http://www.six-swiss-exchange.com/admission/cosi/cosi_overview_en.html}).
\textsuperscript{346} Collateralization of certificates - a service of SIX Swiss Exchange, Information for investors in Collateral Secured Instruments, p. 2, online. \textltt{http://www.six-swiss-exchange.com/download/admission/cosi/ibt_fs_aug09_en.pdf}.
\textsuperscript{347} See Collateralization of certificates (fn. 346), p. 5.
\textsuperscript{348} Collateralization of certificates (fn. 346), p. 1.
\textsuperscript{349} See Framework Agreement (fn. 345), s. 4.1.6.
\textsuperscript{350} See Framework Agreement (fn. 345), s. 4.1.4.
\textsuperscript{351} Framework Agreement (fn. 345), s. 4.2.4, and Collateralization of certificates (fn. 346), p. 2.
\textsuperscript{352} Collateralization of certificates (fn. 346), p. 2.
collateral. In addition, an issuer’s collateral covers all its COSI and is not allocated to specific issues. As a consequence, COSI clearly qualify as structured products and disclosure rules of section 5 CISA apply.\textsuperscript{353}

\textit{Mitigation of Counterparty Risk by Compartmentalization}

In order to facilitate issuers’ ability to distinguish between structured products and mutual funds, FINMA has issued several non-binding\textsuperscript{354} Guidelines. In particular, FINMA has established criteria setting out how issuers should determine whether a foreign special purpose vehicle (SPV) qualifies as a mutual fund and, therefore, cannot follow the disclosure requirements of structured products. Among others, FINMA states that SPVs qualify as mutual fund vehicles if they issue only one product or if they issue several products whose assets are kept in legally separate compartments.\textsuperscript{355}

Since June 2007, DWS GO S.A. (DWS), a Luxembourgish securitization company,\textsuperscript{356} has issued structured products in Switzerland that are structured as follows. First, each product is issued from a legally separate compartment of DWS. Second, DWS GO S.A. has entered into an OTC swap agreement with Société Générale S.A. (OTC counterparty), a bank based in Paris. According to this agreement, DWS swaps the proceeds from the sale of a product for “assets [that] reflect the pay-out profile of the Structured Product and ensure that DWS GO is in a position to meet its obligations to the investor under the Structured Products at all times”.\textsuperscript{357} Third, counterparty risk is reduced by means of a further agreement between DWS and the OTC counterparty, committing the latter to deposit securities as collateral for the DWS compartments, either in an account at the OTC counterparty,\textsuperscript{358} or in an account at Deutsche Bank Luxembourg S.A, the custodian bank of DWS.\textsuperscript{359}

Considering the above non-binding Guidelines of FINMA, an infringement of these rules by the DWS GO products appears to be most likely. As the launch of the above products has been discussed with FINMA prior to the products’ distribution to investors, the example clearly shows that Swiss law has not yet found satisfactory delimitation criteria for compartmentalized structured products and mutual funds.

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\textsuperscript{353} See also Framework Agreement (fn. 345), s. 15.3.
\textsuperscript{354} See <http://www.finma.ch/E/FAQ/Pages/default.aspx>. “The information contained in the “Frequently Asked Questions” (FAQ) is purely informative, does not justify any legal right nor bind the FINMA in its decisions.”
\textsuperscript{356} And a member of the Deutsche Bank group.
\textsuperscript{358} Final conditions for the issue of DWS GO/Harvest 5-year Plan Beneficiaries TR Index Certificates, June 18, 207, p. 12, online. <http://www.dwsgo.ch/MediaLibrary/Auto/Document/DWS_GO_Harvest_5JahresPlan_Bedingungen.pdf>.
Whereas the issue of structured products whose assets (i) are kept separate from other moneys and (ii) are invested in line with the products’ components undoubtedly converges with the issue of a mutual fund, matters are more complex if only the first of the above criteria is met by the issued products. In such cases, product documentation does not limit issuers or issuers’ counterparties\footnote{As above with the products of DWS GO. See below, section 3, for an in-depth assessment of counterparty risk and their relevance in relation to product delimitation.} in their investment of the investors’ moneys. Rather, investors simply have a claim against the issuer for pay-out in accordance with product documentation. From a legal point of view, investors do not buy products whose structures are in accordance with the characteristics of mutual funds. However, if these pay-out obligations are secured such that the counterparty risk inherent to conventional structured products is almost eliminated,\footnote{See, for example, the DWS GO Safe products where a deposit at the issuer’s custodian bank is established.} the economic outcome and risk for investors buying these products is virtually the same as if they bought units of a mutual fund. In view of the above, the Swiss legislator has not yet decided whether a strict legal analysis shall prevail over a regulatory approach that is based on an economic assessment of the respective products.

iii. ETC

Swiss investors may also come across so called ETCs, i.e. Exchange Traded Commodities.\footnote{Source T-ETCs Commodity Handbook, online. <http://www.source.info/index.action>, p. 4.} These investment products mirror commodity indices and are traded on several European stock exchanges such as the Frankfurt Stock Exchange or the Swiss SIX Swiss Exchange.\footnote{See, for example, UBS-ETCs, online. http://www.ubs.com/4/investch/cmci/etc_content_e.html.} They qualify, from a Swiss law perspective, as structured products in the sense of section 5 CISA.\footnote{See, for example, Final Terms of UBS ETC on UBS Bloomberg CMCI Agriculture CHF Hedged Index, p. 3, online. <http://www.source.info/index.action>.} However, the complex structuring of some of these products causes similar delimitation issues as the DWS products mentioned under section ii above. In particular, T-ETCs\footnote{T-ETC Handbook (fn. 362), p. 4.} issued by Source Commodity Markets P.L.C. (Source CMP)\footnote{A public company incorporated in Ireland.} feature similar collateral structures to the above DWS products.\footnote{See Exchange Traded Products, Counterparty risk, online. <http://www.source.info/index.action>, p. 8.} In addition, Source CMP does not confine itself to passing the proceeds from the product sale to their swap counterparty, but rather invest these moneys in US treasury bills. The performance of these T-bills is then swapped for the total return performance of the relevant commodity index.\footnote{Treasury Bill Secured Exchange Traded Commodities.}
Considering the above product structure, delimitation of structured products from mutual funds has become even more intricate. By investing the investors’ moneys in US T-Bills, Source CMP appears to conduct a collective investment of the raised moneys. Although investors in T-Source ETCs technically still do not have a holding in a mutual fund but only a claim vis-à-vis the products’ issuer, they know how the issuer is going to invest the proceeds from the product sale and can successfully assert the contractually agreed proceedings in case of the issuer’s non-compliance with the promised investment and collateral strategy. As a result, the necessity for the legislator to decide whether a legal product assessment should prevail over an economic analysis grows even more acute than under section ii above.

cc. Sub-conclusion

Section b.aa above has outlined the prevailing approach to delimiting mutual fund vehicles from structured products and has identified the collective investment of investors’ moneys as the distinctive feature that enables investors to tell apart these two types of investment products. Whereas unitholders of mutual funds own a share of the mutual fund company or the contractual fund vehicle, investors in structured products have only contractual claims vis-à-vis the products’ issuer and, therefore, may face the counterparty risk in relation to the issuer. However, recent product developments have succeeded in mitigating this risk by introducing separate compartments for each product and requiring collateralization of third parties’ obligations toward the issuer. What is more, complex mutual fund structures often feature significant counterparty risks, albeit not in relation to the product’s issuer but with regard to swap counterparties of the mutual fund vehicle.  

As a consequence of the above evolution of both structured products and mutual fund structures, collateralized structured products may bear similar counterparty risks to those borne by mutual funds. In this setting it appears at least questionable whether a strictly legal assessment of the two product types is still adequate. In view of the economic convergence of structured products and mutual funds, one might be tempted to abandon the present categorization criteria in favour of the products’ underlying economic characteristics. Section 3 below will contemplate which approach seems to be more appropriate to create an adequate balance between the legal frameworks for mutual funds and structured products.

369 See Exchange Traded Products (fn. 367), p. 3.
c. Exchange Traded Funds

Section 7 CISA states that mutual funds “are assets (…) managed for the account of (…) investors”. Following this statutory definition, fund managers are free to manage the fund’s assets in their sole discretion as long as they comply with fund regulations and statutory provisions. Investors, on the other hand, are not allowed to interfere with managers’ investment decisions.

Exchange traded funds are “exchange-listed investment funds that have no fixed maturities and are continuously tradable during official exchange hours. In most cases, the objective of an ETF is to replicate a specific underlying index”. As a consequence, fund managers’ discretion in the management of the fund’s assets is virtually non-existent in relation to index-related ETFs. Following the above definition of mutual funds, opinions have been voiced that passively managed funds would not be managed by the fund managers but rather by the investors who had decided to invest in said fund. However, other authors have argued that managers of index funds still have an adequate amount of discretion, for example in relation to the amount of liquid assets of the fund or the point in time at which specific assets are sold. In view of the fact that FINMA qualifies ETFs as mutual funds on a regular basis, more recent publications have abstained from further commenting on this issue.

ETFs index structures bear another noteworthy delimitation issue. Although Federal Regulations and Stock-exchange Rules have so far not introduced specific rules for ETFs, SIX clearly distinguishes between passively managed ETFs and “actively managed” investment funds. However, SIX has so far refrained from disclosing to investors what kinds of changes in the index composition or the weighting of an individual index component are still acceptable if an issuer wants to label its mutual

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370 Or the fund contract.
371 FRANÇOIS RAYROUX/SHELBY R. DU PASQUIER, Basler Kommentar zum Kollektivanlagengesetz (Basel. Helbing Lichtenhahn, 2009), s. 7 CISA n. 16.
372 BSK-RAYROUX/DU PASQUIER (fn. 371), s. 7 CISA n. 17.
376 See, however, s. 106 Listing Rules which states that SIX “may issue implementing trading provisions for certain types of mutual funds, such as real estate funds and exchange-traded funds”.
379 The term is used for actively managed mutual funds in SIX regulations and does not relate to a legally defined particular type of mutual fund.
If issuers or related parties are able to influence the index structure in a discretionary manner and on a frequent basis, index-related products do not seem to be passively managed any longer. Further, indirect replication of the index entails that a fund manager’s discretion in relation to the fund’s assets goes far beyond a mere investment in securities which “form part of the relevant index”.

These uncertainties are even more pronounced in relation to non-listed index funds. Neither Federal Regulations nor Guidelines of FINMA clearly define the term of an index fund and, consequently, investors who are not sufficiently sophisticated to understand the index-related product documentation may never be fully certain whether they invest into an actively or passively managed product.

d. Sub-conclusion

Sections b and c above have analyzed two different delimitation issues in present Swiss securities legislation. While the search for adequate delimitation criteria in relation to structured products and mutual funds strives for a clear distinction between two product types with different regulatory frameworks, delimitation uncertainties discussed in section c refer to material differences within the same product category. However, both problems ask the legislator to choose between substance and form. The following section will briefly address this question by drawing on the above examination of Canadian and Swiss delimitation issues.

3. Genuine Distinguishing Features versus Duty to Label

The above analysis of current delimitation issues in Canadian and Swiss securities regulation has given the following insights. First, Canadian securities law lacks a streamlined approach to derivative instruments. The existing fragmentary frameworks are not suitable to establish adequate transparency in relation to disclosure procedures for derivatives. As a consequence, delimitation issues arise due to a lack of regulation, rather than as a consequence of conflicting rules. Further, the Canadian framework features one vital exception to its substantive approach to product regulation. National Instrument 81-101 and, in particular, the attached Form 81-101F1, list prospectus requirements that apply specifically to Canadian mutual funds. As a result of this deviation from the otherwise strictly substance-

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380 See, however, SIX Directive on Debt Securities with Specific Structures, October 29, 2008, online. <http://www.six-exchange-regulation.com/admission_manual/06_10-DDSS_en.pdf>, s. 11 (2). “For qualification as an AMC [Actively Managed Certificate], it is negligible whether a given product is directly based on a discretionary managed basket or indirectly based on an index as its underlying security.” Consequently, SIX has created specific rules and delimitation criteria with respect to listed debt securities.

381 See Exchange Traded Products (fn. 367), p. 3.

382 In addition, product exemptions exist for those instruments that are not considered securities, such as the PPNs mentioned above.
oriented regulatory approach, delimitation issues examined under section 2.2.b above might arise not only under the Swiss disclosure framework, but also in the context of Canadian mutual funds regulation. Second, unlike Canadian securities regulation, the Swiss disclosure framework for securities features a significant number of different product categories and respective disclosure provisions. As a result of this abundance of differing rules, delimitation problems arise when product categories converge and, consequently, several disclosure regimes start to compete for application. While Canadian securities regulation has largely chosen to assess products with a view to their economic structure and exposure, the Swiss legal framework still struggles to harmonize its formal legal typology of investment products with the products’ distinctive substantive features. As mentioned under section 2.d above, the Swiss legislator is bound to make a choice between substantive and formal product regulation. The above issues have made evident that the fast-paced evolution of investment products no longer allows the regulator to sufficiently streamline formal product categories and constant product innovation. Whether the Swiss legislator should take the path of Canadian securities regulation or whether it would be better advised to stick to a formalistic product typology is a tough question to answer. While responses prior to the global financial crisis might have encouraged the Swiss regulator to go forward with a formal disclosure regime, recent incidents have shown that the benefits of a more substantive approach should not be easily dismissed.

Third, when weighing the reasons in favour of a substantive approach to disclosure regulation against those in favour of a formal disclosure regime, legislators have to consider both key objectives of securities regulations, i.e. investor protection and fostering of efficient and fair capital markets. While a mere substantive approach satisfies the first goal by assessing the products from an economic perspective, the concept of formal product categorization enables investors to choose between thoroughly supervised products and their lightly regulated counterparts which, in turn, may allow issuers to respond in a timely and cost-effective manner to new market trends. If applied exclusively, both approaches succeed in reducing delimitability issues to a minimum, either by bypassing traditional product categorization or by accepting the issuer’s choice of legal form. However, a combination of

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383 And, thus, enable issuers and investors to choose between heavily regulated investment instruments and largely unsupervised and, therefore, more flexible investment products.
384 As, for example, the bankruptcy of Lehman and the ensuing loss of moneys by retail investors who were not aware of the basic characteristics of their investment products.
385 Substantive approach.
386 GILLEN (fn. 40), p. 92, 93.
387 GILLEN (fn. 40), p. 93.
substantive and formal elements might be the most successful means to keep an appropriate equilibrium between the above objectives of securities regulation.

In view of these observations, a decision in favour of or against a substantive or formal approach to securities disclosure appears to be more complex than originally assumed. In particular, legislators have to strike a balance between compulsory measures to protect investors and issuers’ freedom to structure investments in an efficient and innovative manner. As seen under sections 2.2.b and c, an exhaustive convergence of formal and substantive approaches to product regulation cannot be accomplished any longer under the constantly evolving market conditions. Consequently, if legislators want to combine elements of formal and substantive regulation, they must determine whether their principal approach is founded on substantive or formal regulation. Subsequently, they can define specific constellations where deviations from this principal approach are of vital importance to foster either investor protection or efficient and fair markets. If, for instance, the Swiss legislator should settle for a formal approach to securities regulation, it must, at the same time, define constellations where substantive product regulation should prevail over the overall formal framework. In particular, the Swiss legislator may choose to ban actively managed structured products for retail investors and, thus, constrain issuers to distribute all actively managed complex investment products under the same disclosure regulations. Under this regime, issuers would, however, still be allowed to create passively managed structured products and could choose, for example, between the issue of a thoroughly regulated mutual fund and a significantly less cumbersome origination of a structured product.

A less radical approach to the above problem would try to find ways to protect investors’ interests within the chosen formal approach. In particular, Swiss regulators might decide to implement a distinct and consistent labelling duty for issuers and, if applicable, a clear indication that a certain product is not monitored by supervisory authorities. By doing so, Swiss securities regulation would adhere to a largely formal approach to product regulation. Consequently, issuers could adapt product structures to the investors’ requirements as long as they comply with the legal requirements set forth in relation to the chosen product category. Their freedom of choice would be hampered only by their duty to apply

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388 Provided that it complies with the legal requirements that these predefined categories implicate (formal approach).
389 Beside the structural complexity of these products, managers’ continuous discretion on how the investors’ funds should be managed might require ongoing monitoring by supervisory authorities.
390 Such ban would effect that actively managed structured investment products would all be subject to the rules for mutual funds.
391 i.e. thorough regulation versus timeliness and cost-effectiveness of the product.
explicit labels and disclaimers in relation to the supervisory standards the respective product is subject to.

Due to their compromising character, neither alternative fully relieves issuers and regulators from their task to delimit certain product types from others. Nevertheless, they would provoke significantly fewer borderline cases than the present Swiss disclosure framework. Further, residual delimitability issues could be understood as manifestations of the legislation’s willingness to assess individual cases in a careful manner rather than dismiss them without close attention. Whether one of the above two alternatives is better fitted to solve the present dilemma in Swiss securities regulation cannot be answered without an in-depth analysis of the present disclosure framework. In addition, it might be worth considering whether Canadian disclosure regulation should seek to complement its substantive approach by selected formal elements.\(^{392}\) This could be particularly promising where Canadian law has already introduced formal product categories\(^ {393}\) and, therefore, might face similar delimitation issues to those encountered by the Swiss legal framework. These questions will be addressed - among others - in chapter seven, section II below.

4. Sub-conclusion

Reviewing the above explanations, two aspects have attracted particular attention. To begin with, Canadian and Swiss securities regulations have chosen different approaches to govern the issue of investment products. Whereas Canadian regulators focus on a substantive analysis of issued products, Swiss legislation has sought to establish formal product categories that mirror the economic characteristics of different product types. While Canadian securities regulation may continue with its chosen approach, the Swiss disclosure framework will not be able to sustain its concept of converging substantive and formal aspects into different product categories. Considering the different options the Swiss legislator might choose, section 3 above has found that an uncompromising implementation of either a substantive or formal approach to disclosure regulation might not be the most promising way to enhance investor protection and market efficiency. Instead, concise concessions to investors’ protection needs or issuers’ growing demand for flexibility and innovation appear to be better suited to accomplish a balanced pursuit of the key objectives of securities regulation.

\(^ {392}\) See also Fok Kam, IDA Task Force, p. 258. “We need to balance investor protection with the legitimate need of product structurers to seize business opportunities and launch new products expeditiously”.

\(^{393}\) I.e. in the field of mutual funds and PPNs.
III Disclosure of Essential Product Risks

1. Preliminary Remarks

Risk disclosure in relation to specific investments is generally contained in prospectuses and other key documents related to a product and its characteristics. In addition, supervisory authorities increasingly focus on the relationship between investors and intermediaries at the point of sale. The below explanations will (i) outline present Canadian and Swiss risk disclosure standards at both levels and (ii) briefly discuss in which direction possible amendments should move.

2. Issuer Risk Disclosure

2.1 Overview

In order to make informed decisions, investors have to be aware of the essential risks connected with a certain investment and its structure. Present Canadian and Swiss securities regulations acknowledge this need by stating risk disclosure requirements in their prospectus provisions. In particular, both legal frameworks require that relevant information about the product itself and its issuer are disclosed in prospectuses394 and continuous disclosure documentation.395 Further, a limited number of disclosure frameworks even require that (i) risks inherent to the chosen product structure and (ii) risks related to the product’s issuer are explicitly displayed in prospectuses.396 These statements are required either in a generic or product-specific form. However, the latter approach to risk disclosure has not been commonly adopted yet. In particular, Swiss prospectus requirements for shares and bonds do not feature explicit explanations in relation to inherent risks.397 In addition, Canadian Principal Protected Notes Regulations do not require that issuers inform investors about any issuer-related risk disclosure.398 Moreover, continuous disclosure obligations are not yet fully implemented in the above jurisdictions. Present Swiss disclosure documentation for non-listed shares and bonds does not contain any continuous disclosure requirements comparable to those for annual reports or management, discussion and analysis (MD&A) statements implemented in Canadian law.399 Finally, neither Swiss

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394 See, for example, NI 41-101F1, Information Required in a Prospectus, Items 4 to 10.
395 See, in particular, NI 51-102 and its requirement to disclose information on an ongoing basis.
396 See for Canada, in particular, Form 81-101F1, Part A, Item 4, and Part B, Item 9. For Switzerland, see Appendix 1 to CIS0, s. 1.15, or Guidelines on informing investors about structured products, s. 5.d.
397 S. 652a SCO and s. 1156 SCO. See, in contrast, NI 41-101F1, item 21.
398 See s. 3 (d) PPN Regulations which focuses on risk disclosure in relation to the respective note. This lack is particularly objectionable as PPNs are not “eligible for deposit insurance protection” [NICHOLLS, CHRISTOPHER C. Financial Institutions. The Regulatory Framework (Markham. LexisNexis, 2008), p. 174].
399 See, in particular, NI 41-101F1, Item 8; NI 51-102, Part 5.
structured product regulation nor Canadian provisions for principal protected notes include continuous disclosure obligations.

Considering the above inconsistencies in Canadian and Swiss risk disclosure, the following issues should be paid particular attention to.

2.2 Product-specific Risk Information and Product-specific Risk Assessments

Present securities regulation has made use of explicit risk statements mainly in relation to structured and complex investment products. This approach has been based on the notion that investors are generally able to assess product risks on their own if they have access to all the necessary information and, in addition, can gauge the product’s structure and its implications. However, today’s investors are confronted with a broad variety of different equity and debt instruments and with hybrid products featuring characteristics of both basic forms of investment instruments. Further, investors increasingly tend to invest their savings into salient investment products instead of keeping them in their bank accounts. As a consequence of these developments, a summary of key information and disclosure of product-specific risk information might enhance investors’ ability to evaluate the overall risk they take by buying a product. In particular, issuers should be required to disclose risks that may typically occur in relation to (i) the product structure itself or (ii) the product’s issuer. With regard to the former, risk disclosure should refer to risks that may arise from the product’s design and embedded relations to third parties. Issuer-related risk disclosure should advise investors of their counterparty risks vis-à-vis the issuer of the product and risks that typically emerge in the business and under the legal structure of the issuer.

Product-specific risk assessments in prospectuses, however, should be adopted only with caution. Detailed risk accounts may induce investors to rely heavily on issuers’ assessments and, therefore, shift the responsibility for their gains and losses on to the product’s issuer rather than maintaining their roles as mature market participants. Accurate valuation of an explicit product’s future performance is difficult to provide and, consequently, excessive reliance of investors on issuers’ statements should not

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400 See above, fn. 396.
401 See, for example, THOMAS WERLEN, Konzeptionelle Grundlagen des schweizerischen Kapitalmarktrechts (Zürich. Schulthess, 1994), p. 49.
402 See BOOTH/CLEARY (fn. 1), p. 738.
403 [source!]
404 See SARRA, Modernizing Disclosure (fn. 240), p. 80, in relation to secondary market disclosure.
405 As, for instance, relevant counterparties of a mutual fund vehicle. See also the swap agreements mentioned in section 2.2.b above.
406 See above, chapter two, sections II.1 and III.1.
be overly fostered. In addition, customized risk disclosure and evaluation are provided by those intermediaries who distribute securities to investors.\(^{407}\) Although a basic discussion of past and future risks that may arise in relation to the product or its issuer may constitute an adequate means to inform investors appropriately, more detailed information about specific risks is not desirable. As a consequence, the approach of Canadian securities regulation to require rough risk assessments in issuers’ prospectuses and MD&As appears to be the most promising way to enhance investor protection without inappropriately absolving them from their responsibility to make their own investment decisions.\(^{408}\)

2.3 Continuous Disclosure

Continuous disclosure requirements are set forth “to provide an equality of opportunity for all investors in the market place”.\(^{409}\) Retail investors are particularly dependent on this publicly available information, as they may lack adequate knowledge or sufficient funds to gather advice on specific investments. As a consequence, continuous disclosure measures should be implemented in relation to all products that allow investors to influence their investment’s performance by trading the respective products with third parties or by redeeming their units to the issuer.\(^{410}\) Continuous disclosure rules should therefore be implemented for Swiss non-listed shares, bonds and structured products as well as for Canadian principal protected notes.

In view of the present gaps in Canadian and Swiss continuous disclosure regulation, a comprehensive introduction of the above disclosure enhancements may be deemed a very ambitious goal. However, continuous updates in relation to product-specific developments appear to be crucial for investors and their investment decisions. As a result, exemptions should not be allowed without due consideration. In view of the fact that issuers of passively managed investment products\(^{411}\) are not able to influence the product’s design at their free discretion, relief, if any, might be established with regard to these kinds of products.\(^{412}\)

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\(^{407}\) See CONTRATTO (fn. 129), p. 236 et seq. And below, section 3.

\(^{408}\) As already seen under chapter two, sections II.1 and III.1 above, investor protection is not meant to protect investors from taking risky and potentially loss-generating investments.

\(^{409}\) GILLEN (fn. 40), p. 180.

\(^{410}\) Mutual fund units are redeemable investments, see GILLEN (fn. 40), p. 524.

\(^{411}\) Such as index-based PPNs or structured products.

\(^{412}\) For further explanations, see below, chapter five.
2.4 Display of Risk Degree

Retail investors are confronted with the continuous necessity to assess and understand an increasing variety of investment instruments. Due to incessant market evolvements, investors cannot rely on their established knowledge but have to adapt to recent market developments and understand respective implications on their product portfolios. While sophisticated investors gladly focus on new products and ensuing opportunities, retail investors may become strained by the burden of constantly updating their skills and knowledge. A possible approach to facilitate investors’ risk awareness could be found in the implementation of standardized risk labels. Similar to the widespread labelling of mutual funds or to labelling techniques of consumer law, issuers could be obligated to highlight the key risks of a product by placing respective risk identifiers, be it by using predefined color codes, or by choosing appropriate product designations. Although this very basic form of risk disclosure would by no means be suited to replace existing, more sophisticated risk indications, it could at least serve investors as initial aid in their assessment of a product and facilitate their first triage of available products.

In order to provide investors with a meaningful assessment of the risk degree of a specific product, risk labels must be confined to few key aspects that may impact the product value. In particular, risk labels should focus on the expected volatility of a product during its lifecycle. Less appropriate, on the other hand, are product labels that try to provide investors with an overall rating of the product, including its risks, the issuer’s liquidity, tradability of the product and any product-related charges. As such ratings do not reveal to investors how the single factors influence a particular rating, investors’ product assessment is hampered rather than enhanced by these statements.

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413 See, for example, s. 53 et seq. CISA, indicating the risk level of mutual funds by branding them as ‘securities funds’, ‘real estate funds’, ‘other funds for traditional investments’ and ‘other funds for alternative investments’.
414 See CONTRATTO (fn. 129), p. 412.
415 See s. 12 CISA as a first step into the introduction of labeling duties for issuers of investment products.
416 See above, sections 2.2 and 2.3.
417 See, for example, the “Indicator of Potential Risk and Reward” proposed in the context of the new Key Investor Information (KII) concept of the EU. This synthetic risk indicator “is based on the average frequency and size of the variations of the price of the fund’s assets [often called volatility] over the medium term” (Key investor information (KII) workshop of October 20, 2008, Materials tested, Variant N, online. <http://ec.europa.eu/internal_market/investment/docs/other_docs/materials_en.pdf>.
418 See, however, the certificate ratings provided by DDV, the German Derivatives Association, online. <http://www.deutscher-derivate-verband.de/DE/MediaLibrary/Document/Rating/Hintergrundinfo20zum20Rating.pdf>, which combine the above factors and provide investors with a rating indicator on a six-point-scale. See further information in chapter four, section IV.4.2 below.
3. Point of Sale Risk Disclosure

3.1 Overview

In addition to risk disclosure by issuers, Canadian and Swiss securities regulations require that parties who distribute securities to investors assume partial responsibility for adequate risk information of investors. In particular, distributors have to customize their behaviour to their customers’ knowledge and risk potential when selling specific securities to these parties.419

Although disclosure by intermediaries has established itself as a widespread means to protect retail investors from inadequate investments, important questions have not been entirely clarified. To begin with, specific disclosure requirements do not apply to all relevant intermediaries. In particular, Swiss securities regulation imposes disclosure duties on asset managers,420 but does not feature any specific disclosure duties for advisors.421

Further, the extent and form of Canadian and Swiss obligations of intermediaries do not fully correspond with each other. A Canadian intermediary “must take reasonable steps to ensure that, before it makes a recommendation to or accepts an instruction from a client to buy or sell a security, or make a purchase or sale of a security for a client’s managed account, the purchase or sale is suitable for the client”.422 Exemptions from this suitability obligation can be made for specific types of clients423 or if the intermediary is “a registered individual who is a dealing representative of a member of IIROC”.424 However, IIROC features similar suitability obligations for its members425 and, as a consequence, Canadian dealers, asset managers or advisors have to comply with suitability duties if they advise retail investors or manage their accounts. Swiss legislation distinguishes between duties of asset managers

419 See, for example, s. 11 SESTA, or NI 31-103, part 13.
420 See FINMA Circular 2009/1, Guidelines on asset management, December 18, 2008, s. 22 - 26. Entities qualify as asset managers if they make investment decisions on behalf of their clients and do not confine their activities to strictly advisory services (see HASENBÖHLER (fn. 337), p. 195, and ZOBL/KRAMER (fn. 132), p. 307.
421 See, however, disclosure duties for securities dealers in s. 11 SESTA. A securities dealer is “any natural person, legal entity or partnership who buys and sells securities, in a professional capacity, on the secondary market, either for its own account with the intent of reselling them within a short period of time or for the account of third parties, or makes public offers of securities to the public on the primary market, or creates derivatives and offers them to the public” (s. 2 (d) SESTA).
422 NI 31-103, s. 13.3 (1).
423 See s. 13.3 (3) and (4) of NI 31-103.
424 S. 3.16 (1) of NI 31-103.
425 See IIROC Dealer Member Rules, Rule 1300.1 (p) - (t). See also Rule 3200 and s. 13.3 Companion Policy 31-103CP. “SRO rules may also provide conditional exemptions from the suitability obligation, for example, for dealers who offer order execution only services”. 


and securities dealers. Asset managers must consider the investment strategy chosen by their clients and have to inform them “of the risks associated with the investment objectives and restrictions agreed with them. This information may be provided in a standardised form”. Asset managers are, unlike their Canadian counterparts, not required to assess whether investments comply with the “overall financial circumstances, including net worth, income, current investment holdings and employment status, and risk tolerance for various types of securities and investment portfolios, taking into account the client’s investment knowledge”. Swiss securities dealers can confine themselves to informing investors “of the risks associated with certain types of transactions”. The information can be conveyed in a standardized form. Investment advisors, finally, have to comply with general contractual duties unless they qualify as securities dealers and, consequently, must follow the above obligations.

3.2 Suitability Assessment versus Generic Risk Disclosure

The above explanations have shown different options of how intermediaries can protect investors from taking undue risks. Whereas Swiss regulation of point of sale behaviour is mainly focused on generic risk disclosure, Canadian provisions of NI 31-103 and respective SRO rules have moved on to require that intermediaries consider the investor’s personal situation when selling a product. In particular, “portfolio managers with discretionary authority” must assess the “overall financial circumstances” and “risk tolerance” of investors before they make investment decisions on behalf of their clients. These rules mirror an increased awareness of regulators that their hitherto predominant focus on

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426 FINMA Circular 2009/1, s. 16.
427 FINMA Circular 2009/1, s. 23.
428 s. 13.3 Companion Policy 31-103CP.
429 FINMA Circular 2009/1, s. 16.
430 FINMA Circular 2009/1, s. 23.
431 Companion Policy 31-103CP.
432 ERIC STUPP/DIETER DUBS, Basler Kommentar zum Börsengesetz (Basel. Helbing Lichtenhahn, 2007), s. 11 SESTA n. 44. S. 11 (2) requires that securities dealers take “the clients’ business expertise and professional knowledge” into account. However, clients are generally classified as inexperienced retail clients, experienced retail investors and institutional clients. Further, securities dealers often abstain from introducing different information strategies for these three different types of clients (ibid., s. 11 SESTA n. 44).
433 PHILIPPE A. HUBER, Basler Kommentar zum Börsengesetz (Basel. Helbing Lichtenhahn, 2007), s. 2 lit. d SESTA n. 58.
434 S. 11 (2) SESTA, however, requires that securities dealers take “the clients’ business expertise and professional knowledge” into account.
435 See above, section 3.1.
436 Companion Policy 31-103CP.
undifferentiated and general investor protection may not be sufficient to protect retail investors from misunderstanding investment products and their functionality.

In spite of the above insights, regulations have to be aware of the limits of suitability assessments. First, suitability duties must conform to the intermediary’s relationship to its client. Dealers offering order execution only services must not be obligated to address the suitability of every single transaction of a client. Rather, (i) generic documentation about risks in securities trading and (ii) the client’s written waiver of a suitability determination must be sufficient to establish appropriate protection of investors without forcing them to process their trades through professional advisory services and, thus, significantly increasing transaction prices. However, as soon as intermediaries assume advisory or even managerial duties in relation to a client’s assets, their obligations to examine suitability issues must go beyond the distribution of generic risk disclosure brochures.

Second, investors should be allowed to waive certain consequences of suitability assessments by intermediaries. In particular, they must be able to authorize transactions that their advisors or asset managers have advised them against. However, a waiver in relation to risk disclosure and suitability determination as such should be possible only if (i) investors are deemed to be sophisticated enough to do without further assistance, or if (ii) they are fully aware of their unprotected status. In the latter case, however, intermediaries should be forbidden from providing investors with voluntary and non-binding information and, thus, undermining statutory disclosure standards. Further, it seems at least questionable whether investors should be allowed to partially waive suitability assessments of advisors and asset managers. Whereas the still prevailing concept of investors as mature market participants suggests permitting graded disclosure and suitability duties of intermediaries, emerging concerns about

* ROLF WATTER, Basler Kommentar zum Börsengesetz (Basel. Helbing Lichtenhahn, 2007), s. 1 SESTA n. 9.
* See SARRA, Modernizing Disclosure (fn. 240), p. 9.
* See respective exemptions in IIROC Dealer Member Rules, Rule 1300.1 (r).
* See next section below.
* See, however, section V.3 below and its possible qualification of the above statement in relation to complexly structured products.
* See, for example, s. 13.3 (2) of NI 31-103. “If a client instructs a registrant to buy, sell or hold a security and in the registrant’s reasonable opinion following the instruction would not be suitable for the client, the registrant must inform the client of the registrant’s opinion and must not buy or sell the security unless the client instructs the registrant to proceed nonetheless.”
* See, for instance, s. 13.3 (4) of NI 31-103.
* See above, fn. 437.
* See, however, BSK-STUPP/DUBS (fn. 430), s. 11 SESTA n. 46 who claim that contractual agreements waiving disclosure duties of securities dealers are acceptable as long as they do not infringe the core content of this duty.
retail investors’ abilities to assess complex products tend to veer in the opposite direction. Chapter six below will take a closer look at this issue.

4. A Note on Different Types of Investors

As mentioned in chapter one, section I above, this thesis focuses on retail investment markets. As a result, the paper refrains from examining disclosure measures for institutional investors and, therefore, does not elaborate on the differences between disclosure requirements for retail investors and their counterparts for professional, more sophisticated market participants. However, it may be noted that issuers must design their disclosure documents in a manner that they are understandable and meaningful for sophisticated investors as well as retail market participants. In particular, information must be provided in a clear and simple language that can be understood by investors who are not familiar with technical terms and may not read the entire available documentation. Canadian, Swiss and European disclosure regulations explicitly state that information must be provided in a clear and simple manner. An important means to assist retail investors in their understanding of disclosure documents consists of the implementation of a prospectus summary. Chapter four will examine whether current regulations of the three jurisdictions have introduced summary requirements in a consistent manner. Further, the thesis will refer to recent initiatives that have been launched to provide retail investors with readily understandable information about specific products. In addition, it should be considered that retail investors are not a homogenous group of market participants. Their knowledge and experience may vary significantly and their investment objectives range from conservative investments to highly speculative activities. Issuers cannot consider these different positions in detail when drafting disclosure documents. Instead, investors’ personal circumstances must be taken into account by point of sale entities that are in direct contact with market participants. Disclosure duties at the point of sale should be dependent on the investor’s financial

446 SARRA (fn. 240), p. 38, 39.
447 See NI 41-101CP, s. 4.1.
448 See, for example, Guidelines on informing investors about structured products, Swiss Banking Organization (August 2007), p. 3, or s. 76 (3) CISA.
449 S. 5 (2) EU Prospectus Directive. See also the proposal for a review of the Prospectus Directive, which intends to improve the format and content of the prospectus summary (online. <http://ec.europa.eu/internal_market/securities/prospectus/index_en.htm>).
450 SARRA (fn. 240), p. 11.
circumstances and investment knowledge, the services provided by the point of sale entity and the complexity of the products involved. As seen above, Swiss regulation of point of sale behaviour is focused on generic risk disclosure and has not yet implemented comprehensive suitability requirements. The Canadian securities framework, on the other hand, has taken important steps to ensure that the suitability of a specific transaction is monitored by point of sale entities. Whether these measures are sufficient to establish an adequate level of investor protection at the point of sale and how German regulations govern point of sale disclosure will be examined in detail in chapter six below.

5. Sub-conclusion

The above analysis has provided the following insights. First, present Canadian and Swiss risk disclosure provisions require that issuers disclose relevant information in the products’ prospectuses and other key documents. As investors can assess a product’s risk only if they have continuous information about its characteristics and developments, continuous disclosure requirements should be implemented for all types of products. In addition, explicit risk considerations must be implemented in all prospectuses and may be further emphasized by introducing risk labels for investment products. Second, recent developments have shifted regulators’ focus on risk disclosure duties of intermediaries. While Canadian securities commissions and SROs have implemented suitability assessments for advisors and asset managers, Swiss regulations have so far adhered to generic risk disclosure duties. While suitability determination seems an adequate means to protect retail investors against serious errors or deception, regulations must still put investors in a position to opt out of some of the above assistance duties of intermediaries. In particular, they should still be free to pursue investments that are, according to their intermediaries, not suitable for their background and means. However, it remains to be determined to what extent asset managers and advisors should be able to exclude their personal assessment duties upon explicit contractual agreements with their clients.

IV Availability of Relevant Information

Retail investors depend on publicly available product and issuer information. If issuers do not impart relevant knowledge on a timely basis, investors are not able to make appropriate investment decisions. As indicated under section III.2.3 above, Canadian and Swiss securities regulations have taken this need into account by introducing continuous disclosure obligations for issuers. However, the

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452 See also SARRA, Modernizing Disclosure (fn. 240), p. 8.
above analysis has shown that Swiss disclosure requirements for non-listed shares and bonds still lag behind in terms of timely disclosure obligations. Further, Canadian and Swiss legal frameworks for derivative instruments have so far largely refrained from introducing continuous disclosure duties. These discrepancies do not reflect different needs of investors in relation to the above products. Rather, they are the results of fragmentary and uncoordinated legislation and, as a consequence, have to be adapted to general disclosure requirements.

Further, Canadian and Swiss continuous disclosure regulations have chosen different approaches to determine the trigger for ad hoc publicity duties of issuers. While Canadian securities regulation requires timely disclosure of ‘material changes’, Swiss regulations set forth that issuers have to inform the market in a timely manner “of any price-sensitive facts which have arisen in its sphere of activity”. The Canadian term ‘material change’ is narrower than its Swiss counterpart. A ‘material change’ is “(a) a change in the business, operations or capital of the reporting issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the reporting issuer; or (b) a decision to implement a change referred to in paragraph (a) made by the board of directors or other persons acting in a similar capacity or by senior management of the reporting issuer who believe that confirmation of the decision by the board of directors or any other persons acting in a similar capacity is probable”. Swiss ‘price sensitive facts’, in contrast, are any “facts which are capable of triggering a significant change in market prices”. As a result, Swiss listed companies have to disclose price relevant facts regardless of their root cause, whereas Canadian issuers can confine their ad hoc disclosure to changes related to their business, operations or capital. In view of the core purposes of both Canadian and Swiss securities regulations, communication of any price-relevant incidents appears to be meaningful for investors. Consequently, the Canadian differentiation between ‘material change’ and ‘material fact’ seems to be a redundant complication of investors’ needs to learn about price-sensitive developments. In accordance with this notion, the TSX Company Manual requires that listed

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453 Section III.2.1.
454 S. 53 (1) Listing Rules. See also SIX Directive on Ad hoc Publicity of July 1, 2009.
455 NI 52-102, s. 1.1.
456 S. 53 (1) Listing Rules.
457 The expression is used in relation to “disclosure requirements for a prospectus and in the context of the prohibition of insider trading” (GILLEN (fn. 40), p. 212).
issuers report ‘material changes’ and ‘material facts’ that might have an impact on the market price or the value of the issuer’s securities.\textsuperscript{459}

\section*{V Product Comparability}

\subsection*{1. Preliminary Remarks}

In order to make adequate investment decisions, investors have to be able to compare different products with each other. Comparability is hampered if (i) disclosure documentation is not appropriately streamlined, and if (ii) the complexity and variety of products’ designs complicate a simple juxtaposition of apparently similar products.

\subsection*{2. Comparability through Prospectus Disclosure}

Prospectuses generally contain the key data that investors need in order to compare different products and their key characteristics. As a consequence, comparability can be considerably facilitated or hampered by the structure and content of these documents. Canadian and Swiss prospectus requirements have largely considered the importance of coherent prospectus contents when implementing related rules. In particular, \textit{Form 41-101F1}\textsuperscript{460} lists items that all securities prospectuses have to feature. \textit{Form 81-101 F1}\textsuperscript{461} features requirements for simplified prospectuses of mutual funds. Swiss regulation lists the mandatory content of share\textsuperscript{462} and bond\textsuperscript{463} prospectuses, simplified prospectuses for structured products,\textsuperscript{464} and prospectus requirements for mutual funds.\textsuperscript{465} As a consequence of the above requirements, investors can find the same level of publicly available information in relation to all products that are subject to the same prospectus provisions. Difficulties may arise, however, if an investor tries to compare products that have to comply with different prospectus requirements. In view of the fact that Swiss securities regulation has not yet streamlined its product-specific prospectus standards, investment products issued under Swiss law are particularly prone to hamper comparisons of different types of products.\textsuperscript{466} Although Canadian securities regulation features a uniform prospectus requirement for the majority of securities, the fragmentary regulation of

\begin{footnotesize}
\begin{itemize}
\item F1 to NI 41-101, Information Required in a Prospectus.
\item F1 to NI 81-101, Contents of Simplified Prospectus.
\item S. 652a SCO.
\item S. 1156 SCO.
\item Appendices 1 and 2 of CISO.
\item See above, section II.2.2.
\end{itemize}
\end{footnotesize}
disclosure requirements for derivative instruments has caused inconsistencies in relation to the available knowledge about publicly distributed securities. In view of the above considerations, the implementation of a coherent prospectus framework would significantly enhance investors’ abilities to compare products of different structures in both the Canadian and the Swiss legal framework for securities.\footnote{See already \textsc{Contratto} (fn. 129), p. 402, with further reference to \textsc{Bürgi Wolfhart F./Nordmann-Zimmermann Ursula}, \textit{Zürcher Kommentar zum Schweizerischen Zivilgesetzbuch} (Zürich. Schulthess, 1979), s. 752 SCO n. 22, and \textsc{Zuffrey, Jean-Baptiste et al.}, \textit{Finanzmarktregulierung und -aufsicht in der Schweiz}, Schlussbericht (Bern, November 2000), p. 60.}

Product comparability does not depend only on the consistent content of prospectuses but is also considerably facilitated by consistent prospectus structures. Prime examples of uniform prospectus structures are the model prospectuses for mutual funds recognized by FINMA.\footnote{See SFA, online. <https://www.sfa.ch/self-regulation/fund-management?lang=en>.} It is common practice for issuers applying for authorization to point out where their documents differ from model documents. This enables FINMA to streamline its examination procedures and ensures that investors are provided with largely uniform prospectuses for different mutual funds of different providers. However, as mentioned above, product comparisons are not confined to products of the same legal form. Rather, investors must also be able to compare different product types which each other and, by doing so, detect the differing characteristics of each type. Therefore the structures of prospectuses for investment products should be standardized as far as possible. Considering the scattered disclosure provisions of Swiss securities regulation, it is not surprising that prospectus structures of different legal types of securities are not, to a large extent, consistent with each other. Canadian prospectus rules, in contrast, apply to a broad range of securities\footnote{Prospectus requirements for mutual funds are regulated separately and, consequently, their structures are not fully consistent with the general prospectus provisions set forth in NI 41-101F1. Whereas the majority of the substantive differences can be explained with the peculiarities of mutual funds, a more consistent structure of both prospectus types might be feasible without too many unnecessary constraints (see below, chapter four).} and, consequently, prospectus structures of different types of securities tend to be more consistent with each other than their Swiss counterparts. However, the recent introduction of \textit{Canadian Principal Protected Notes Regulations} constitutes a significant breakout of the so far largely consistent disclosure framework. Further, the considerable gaps in prospectus regulation in relation to derivative instruments have constrained an unhampered comparison of different product types. As a result, the examination of prospectus requirements in chapter four below will arguably reveal significant need for improvement in both Canadian and Swiss requirements with regard to prospectus structures.
3. Complexity as Obstruction?

Besides inconsistent requirements in relation to prospectuses’ content and structure, complex product designs can also impair product comparisons by retail investors. In particular, different maturities, differing underlyings or a different collateralization of products may influence a product’s performance without being noticeable for non-sophisticated investors. Indeed, today’s broad range of product structures makes a detailed comparison nearly impossible for non-professional investors. As a consequence, the creation of transparency might not be an adequate means to protect investors against inappropriate investment decisions.

What alternatives does capital markets law offer? In view of the positive impacts that complex product structures may have, a total ban of these structures or a prohibition of selling them to retail investors appear to be over-rigorous measures against the above comparability issues. However, a more gentle means to protect and inform investors may consist of the introduction of a mandatory consultation of advisors for retail investors who intend to buy complex products. Whether investors should be allowed to by-pass this additional step by buying their products from dealers offering order execution only services or by waiving advisory duties prior to their purchase cannot be assessed in an isolated manner. Therefore these issues will be further analyzed in chapter six and seven.

An additional way to enhance the comparison of different complex products can be adopted from mutual fund regulation. Canadian and Swiss regulations require that performance data is calculated and presented in a certain manner. In addition, Swiss mutual fund managers are obligated to publish on a regular basis either the net asset value or issue and redemption prices of a mutual fund. Further, Canadian and Swiss securities regulations state specific calculation methods in order to determine this

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470 If, for example, a structured product with a maturity of four years promises a minimum profit of 4%, it does not outclass a similar product with a maturity of one year and a minimum profit of 1%. However, investors might not perceive this easily.

471 Different maturities of similar underlyings can influence the product’s price and profit in a rather unobvious manner.

472 See above, section 2.2.b.

473 However, the above rejection of a ban of complex product structures does not imply that certain structures should not be forbidden (see, for instance, the suggestions above in chapter three, section II.2.2.b.

474 See s. 15.10 of NI 81-102 setting forth calculation standards for standard performance data, and Guidelines on the calculation and publication of performance data of collective investment schemes of May 16, 2008, by the Swiss Funds Association (SFA).

475 S. 83 (4) CISA.

476 S. 79 (1) CISO-FINMA.

477 Canadian mutual funds are not legally required to disclose the above information (see s. 14.2 (6) of NI 81-106). However, current standards imply regular publication of redemption and issue prices on the homepages of the mutual fund manager or the national press.
data.\textsuperscript{478} Although a product’s price and performance are significant indicators of its worth and potential future development, these factors obviously cannot replace a thorough analysis of the product’s characteristics and components. However, transparency in relation to prices and product performance might at least enable investors to recognize misconceptions that are closely related to product prices or annual coupon payments.\textsuperscript{479}

4. Sub-conclusion

The above explanations have shown that product comparisons largely depend on coherent prospectus regulation. In particular, prospectuses of different types of securities must be structured uniformly to the largest extent possible. Further, the mandatory components of prospectuses should vary only if some information is virtually irrelevant for one type of security whereas it is meaningful for a different type. In addition, section 3 above has demonstrated that coherent prospectus requirements are not suitable to address all issues arising in relation to product comparisons. In particular, today’s complexity of products would significantly hamper product comparability for retail investors even if all prospectuses were perfectly in accordance with each other’s structure and content. Possible answers to this problem could lie in (i) the implementation of mandatory professional advice for retail investors in relation to complex product purchases or (ii) additional disclosure requirements with regard to product prices and performance.

VI A Note on Regulatory Oversight

The implementation of the four key preconditions for transparent capital markets entails significant expense for market participants issuing securities. As a result, issuers may be tempted to shirk some of the more bothersome requirements or fail to establish professional and comprehensive disclosure documentation. In order to prevent serious deviations from the legally required format and content of disclosure documents, there are several measures that legislators can introduce. The most powerful means to ensure compliance with regulatory requirements consists of a comprehensive regulatory oversight of market behaviour and prospectus disclosure. This strategy is generally pursued by Canadian securities laws. All prospectuses distributed to the public must be vetted and approved by securities commissions.\textsuperscript{480} Although this vetting procedure may not detect all flaws with regard to the prospectus’s content, it ensures that the document complies with the basic requirements of prospectus disclosure.

\textsuperscript{478} For Switzerland, see s. 83 CISA, for Canada, see part 14 of \textit{NI 81-106}.
\textsuperscript{479} See the example of fn. 470.
\textsuperscript{480} \textsc{Gillen} (fn. 40), p. 136 et seq. The vetting can also be delegated to self-regulatory bodies such as stock exchanges (see below, chapter four, section III.1.1 for the vetting of Swiss listed shares by SIX Swiss Exchange).
and provides interested investors with all of the information they need to understand the prospects and risks of a product. Further, a comprehensive regulatory oversight includes the continuous monitoring of market participants. If securities regulators question a participant’s compliance with regulatory requirements, they may appoint “a person to conduct an investigation and make a report”\(^{481}\) about the participant’s compliance with securities regulation. Regulators can enforce regulatory compliance by means of administrative and penal sanctions.\(^{482}\)

Another, less thorough and, therefore, less costly and time-consuming alternative to ensure compliance with regulatory provisions is based on a selective approach to regulatory oversight. While the means of the regulator to enforce securities regulation are identical to those of the comprehensive approach, the regulator’s vetting of prospectuses is confined to new product types, random sample products or products that are particularly fraught with risk. This approach has been chosen by Canadian regulators in relation to prospectus supplements of linked notes distributed under a shelf prospectus. According to CSA Staff Notice 44-304, “before the securities regulators issue a final receipt for a base shelf prospectus that qualifies linked notes, issuers will be asked to file an undertaking to pre-clear prospectus supplements or templates for prospectus supplements pertaining to linked notes that the issuer has not previously distributed in a jurisdiction in Canada”.\(^{483}\) While a comprehensive oversight of securities markets and distributed documents is generally more favourable than this selective approach, there may be constellations where comprehensive vetting procedures would hamper a timely product issue in an inappropriate manner and, therefore, a selective oversight could be more beneficial for issuers and investors. In particular, reduced examinations may be adequate in relation to structured notes whose characteristics generally require a prompt and undelayed product issue.\(^{484}\)

Finally, regulatory compliance can also be enhanced by the introduction of civil sanctions for rescission or damages if an issuer fails to deliver a prospectus or makes a misrepresentation in prospectuses or other publicly distributed documents. Civil sanctions may be introduced in jurisdictions with comprehensive or selective regulatory oversight structures,\(^{485}\) but also in jurisdictions without any regulatory body governing the distribution of securities.\(^{486}\) In addition, a jurisdiction’s approach to regulatory oversight may vary in relation to different products. While Swiss securities regulation has

\(^{481}\) Gillen (fn. 40), p. 578.

\(^{482}\) For Canada, see Gillen (fn. 40), p. 567 - 575. See also Part 11, Divisions 5 and 6 of the Proposed Act.

\(^{483}\) CSA Staff Notice 44-304, Undertaking to pre-clear prospectus supplements.

\(^{484}\) See below, chapter four, sections II.3.2 and III.3.2.

\(^{485}\) See Gillen (fn. 40), p. 575, for Canada. See also Part 12 of the Proposed Act.

\(^{486}\) See, for non listed Swiss shares and bonds, chapter four, sections III.1 and III.2 below.
refrained from introducing comprehensive or selective regulatory oversight in relation to non-listed shares and bonds, exchange-traded equity and debt securities are vetted and monitored on a continuous basis by the Swiss stock exchange SIX.\textsuperscript{487} Generally, prospectus requirements should not be supported by civil sanctions only. Less sophisticated or prosperous investors may not be able to enforce securities law by means of civil actions and, as a result, are dependent on a regulatory body that oversees and monitors adequate behaviour in securities markets.

\textbf{VII Conclusion}

The above sections have outlined four important aspects that Canadian and Swiss disclosure frameworks for securities have to consider to be in accordance with the core goals of securities regulation, i.e. investor protection and efficient capital markets. Hereby, the following key findings have been discovered.

First, most disclosure frameworks have both substantive and formal components. While a substantive approach focuses on the economic characteristics of a product and not on its legal structure, a formal concept is guided instead by the legal form an issuer has chosen for its product. As different legal structures can involve different regulatory standards, the latter approach tends to enhance efficiency of capital markets. The substantive approach, however, focuses on investor protection and represents the view that economically similar products should have to comply with the same regulatory requirements. Unlike Canadian securities regulation, the Swiss disclosure framework for securities features several legally defined product categories with different disclosure provisions. The Swiss legislator has so far struggled to place products with similar substantive characteristics with one particular legal form. In view of the examinations under section II.2.2.b and c above, a convergence of substantive and formal elements appears to be no longer practicable. As a consequence, Swiss legislation must essentially follow either a substantive or a formal approach to product regulation. Further, both the Swiss and Canadian legal frameworks have to determine if and where they want to provide issuers and investors with a choice between different regulatory levels for economically similar products. Chapters four and seven will examine these issues in the context of present disclosure regulations of both jurisdictions.

Second, the above examination of Swiss and Canadian disclosure provisions has made evident that both frameworks still lack consistent continuous disclosure rules and risk statements in several product categories. Further, a brief outline of point of sale regulation has shown that generic risk disclosure by

\textsuperscript{487} See below, chapter four, sections III.1 and III.2.
advisors and asset managers may not be an adequate means to protect retail investors. Rather, the recently introduced focus of Canadian securities regulation on suitability assessments by the above intermediaries appears to be a significantly more promising manner in which to ensure adequate investor protection. Chapters five and six will deepen the conceptual framework of this approach by considering whether investors should be allowed (i) to waive suitability determination or (ii) to purchase complex products from dealers offering order execution only services.

Third, timely availability of relevant information mainly depends on investors’ unobstructed access to disclosure documentation and the implementation of effective continuous disclosure rules. Swiss securities regulation features serious gaps with regard to both aspects. Canadian securities regulation, on the other hand, is still not fully consistent on the circumstances that trigger issuers’ duty to disclose recent information. Chapters four and five of this paper will assess how these defects can be best corrected.

Forth, comparability of products is enhanced by consistent requirements in relation to structures and contents of prospectuses. Divergence of this uniform model should be introduced only if specific product characteristics require additional components or a differing format. Chapter four will assess how Swiss and Canadian prospectuses could be further streamlined in relation to substance and form.
Chapter four Prospectus Disclosure

I Introduction

Chapter three outlined four crucial preconditions for transparent capital markets. All of these elements are in some way related to disclosure provisions of securities regulation and make specific demands on the content or format of prospectus disclosure. The above outline of the Canadian, Swiss and German prospectus frameworks and the brief assessment of their compliance with the four preconditions for transparent markets have shown significant gaps and inconsistencies. Consequently, this chapter will focus on present prospectus provisions for shares, bonds, derivatives and mutual funds and analyze their fitness to enhance product delimitability and comparability and to provide investors with relevant risk information on a timely basis. As an examination of rules in relation to product delimitability is meaningful only if prospectus provisions of different product types can be contrasted with each other, this aspect is not discussed separately under each product type. Rather, it will be assessed for each jurisdiction from a comprehensive perspective at the end of sections II, III, and IV.

II Canada

1. Distribution of Shares

1.1 Overview

As mentioned under chapter two, section II.3, Canadian issuers are generally required to file a prospectus before they distribute securities to the public. If the issuer complies with the requirements set forth under section 2.2 of NI 44-101, it is allowed to issue a short form prospectus instead of the long form version set forth under NI 41-101. Short form prospectuses relieve an issuer of the obligation to disclose information in relation to its corporate structure, the development of its business and other financial and managerial information that has been disclosed to the public through continuous disclosure documents required under NI 51-102. Because investors are not deprived of the above information when issuers are allowed to offer a short form prospectus, the following outline will focus on the structure and content of long form prospectuses.

488 National Instrument 44-101, Short Form Prospectus Distributions. Basically, the issuer has to be a ‘reporting issuer’ (the term is defined, for example, in s. 1 (1) BCSA, ‘reporting issuer’), “an electronic filer under NI 13-101”, and its equity securities must be listed on a ‘short form eligible exchange’ (s. 1.1 of NI 44-101). Further, it must have filed all disclosure documents required in section 2.2 (c) and (d) of NI 44-101.

489 GILLEN (fn. 40).
To begin with, *Form 41-101F1* enjoins specific structural requirements. In particular, item 1 of the *Form* obligates the issuer to display essential product information such as the price of the distributed security, investors’ opportunities to trade the security on the secondary market, information on the underwriter and references to prospectus sections that describe risk factors “of an investment in the securities being distributed.” Further, items 2 and 3 of *Form 41-101F1* specify that long form prospectuses must feature a table of contents and a summary of the key information of the prospectus. Following these introductory pages, issuers have to provide detailed information about their corporate structure, their business and the securities’ characteristics. However, neither *NI 41-101* nor *Form 41-101F1* require that these elements are arranged in the order or under the headings of *Form 41-101F1*. Although the majority of issuers largely align their prospectus formats to the suggested sequence, they tend to adjust the form’s order to the specific issue of shares and do not always subsume relevant information under the suggested headings.

With regard to the content of long form prospectuses, *Form 41-101F1* distinguishes between issuer-related information and information about the shares themselves. In particular, item 5 obligates issuers to describe their business, including a brief overview of past and expected future developments, and its audit committee and corporate governance structure. Further, issuers must indicate “each of the principal purposes, with approximate amounts, for which (a) the net proceeds will be used by the issuer”.

In addition, issuers of shares have to describe these securities and their “material attributes and characteristics” such as dividend or voting rights, pre-emptive rights or conversion or exchange rights. Moreover, the prospectus must display previous price developments of the issuers’ securities and, if the shares are distributed by an underwriter, relevant information about the underwriter’s obligations and further related matters. Finally, item 21 of *Form 41-101F1* requires that issuers disclose “risk factors relating to the issuer and its business”, risks “that securityholders of the issuer may become liable to make an additional contribution beyond the price of the security”, and “any

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490 *Form 41-101F1*, s. 1.4 - 1.8.
491 *Form 41-101F1*, s. 1.9.
492 *Form 41-101F1*, s. 1.10.
493 See, in particular, items 4, 5 and 10 of *Form 41-101F*.
494 See, for example, the preliminary prospectus of Asian Resource Global Strategies Inc. of November 27, 2009, or the final prospectus of BE Resources Inc. of September 30, 2009, available on <www.sedar.com>.
495 *Form 41-101F1*, s. 19.
496 *Form 41-101F1*, s. 6.3 (1).
497 *Form 41-101F1*, s. 10.1.
498 *Form 41-101F1*, s. 10.1.
499 *Form 41-101F1*, s. 13.2.
500 *Form 41-101F1*, s. 20.1 - 20.13.
risk factors material to the issuer that a reasonable investor would consider relevant to an investment in the securities being distributed.\footnote{501}

1.2 Disclosure of Essential Product and Issuer Risks

Section III of chapter three above identified four alternatives to disclose risk in securities prospectuses. Two of them have been implemented by Canadian securities administrators in relation to share prospectuses. First, Canadian prospectus requirements provide investors with appropriate information on a product and its issuer. As mentioned above, issuers must describe their business and the product’s material features. Further, issuers are not allowed to confine disclosure to present information. Instead, \textit{Form 41-101F1} obligates them to relate relevant past developments and material forward-looking information.\footnote{502} Moreover, issuers are instructed to provide a summary of material information “near the beginning of the prospectus”.\footnote{503} Second, specific risk information stresses even more poignantly the risks that may be involved in the purchase of shares. Item 21 of \textit{Form 41-101F1} requires that issuers disclose risk factors “relating to the issuer and its business”.\footnote{504} Due to the nature of shares as “common, divided, participation interest[s] in the corporation’s business”,\footnote{505} share prices are closely related to the success or failure of a company. Consequently, the requirement of item 21 to disclose the issuer’s key risks covers, at the same time, virtually all essential risks that are related to the product as such.\footnote{506} As a result, the legislator’s decision to confine risk disclosure to risks that may arise in relation to the product’s issuer does not result in fragmentary risk-disclosure. However, it might be appropriate to call investors’ attention to (i) their position in case of the issuer’s insolvency\footnote{507} and (ii) the close relation between the issuer’s business and shareholders’ profits. Further, generic risk caveats should point out that price fluctuations may not always be explained by the issuer’s performance and, therefore, could create negative impacts on the investors’ portfolios without due premonition.\footnote{508}

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\footnote{501}{\textit{Form 41-101F1}, s. 21.1.}
\footnote{502}{See \textit{Form 41-101F1}, s. 5.2.}
\footnote{503}{\textit{Form 41-101F1}, item 3.}
\footnote{504}{\textit{Form 41-101F1}, s. 21.1 (1).}
\footnote{505}{CHRISTOPHER C. NICHOLLS, \textit{Corporate Law} (Toronto. Emond Montgomery, 2005), p. 355.}
\footnote{506}{Further, risks can arise in relation to shareholders’ standing compared to shareholders of other classes of shares. These risks are also disclosed - although not explicitly labeled as ‘risks’ - under section 10.1 of \textit{Form 41-101F1}.}
\footnote{507}{I.e. the ranking of their claims in insolvency proceedings and the risks inherent to such ranking. See, for example, FELICIA H. KUNG, “The Regulation of Corporate Bond Offerings. A Comparative Analysis” (2005) U. Pa. J. Int’l Econ. L., p. 429.}
\footnote{508}{See GILLEN (fn. 40), p. 64, on aspects that do not correspond with the efficiency of securities markets and, therefore, might influence prices in a ‘non-efficient’ manner.}
The third alternative mentioned under section III of chapter three consists of the implementation of risk assessments regarding issuer- and product-related risks. Canadian securities regulation has so far been cautious in the adoption of these evaluative disclosure mechanisms. In view of the respective considerations of chapter three, section III.2.2 above, this reservation appears to be appropriate.

Fourth, section III.2.4 of chapter three has raised the question of whether securities prospectuses should contain standardized risk indications, either by means of predetermined product names or other readily identifiable risk labels. However, as structures and characteristics of shares are mostly homogenous, these suggestions are not suitable for share prospectuses. Complexity in relation to shares does not generally derive from their product design, but is rather based on the issuer’s business and economic strength. As a consequence, the informative value of standardized risk labels would be moderate at best and, therefore, could not fulfill retail investors’ expectations in reliable indications of the overall product risk.

1.3 Availability of Relevant Information

Prospectuses must be filed with the competent securities administrator. Once the administrator agrees with the content and structure of the preliminary prospectus, the issuer can file the final prospectus and, upon a receipt of the administrator, begin to sell its securities. Selling and advertising activities between the submission of the preliminary prospectus and the receipt for the final prospectus are constrained by provisions limiting the issuer’s proactive efforts to sell its shares.

In view of the above, prospectus disclosure in Canadian securities regulation takes place on a timely basis. Considering issuers’ economic restraints to provide accurate information on pricing details prior to the actual distribution of shares, the exemptions of NI 41-101, section 7.2 in relation to non-fixed price offerings and reductions of the offering price do not excessively curtail investors’ interests in timely disclosure of relevant information.

\[509\] Form 51-102F1, part 2, 1.4 (g). See also Form 41-101F1, item 8.
\[510\] I.e. during the so called ‘waiting period’ (see, for example, s. 78 (1) BCSA).
\[511\] See, for example, allowed behaviors listed in s. 78 (2) BCSA. Further, see also CP 41-101, s. 6.5 (1), on advertising or marketing activities during the waiting period. See also GILLEN (fn. 40), p. 141, on procedures in national offerings and the passport system established in MI 11-102 of December 24, 2009.
\[512\] Form 51-102F1, part 2, 1.4 (g). See also Form 41-101F1, item 8.
1.4 Intra-Product Comparability

Shares are well-known investment instruments in securities markets. Consequently, investors are familiar with the central role that an issuer’s business and financial standing play with regard to the development of share prices. If investors have to make an investment decision in relation to shares, their choice will be significantly influenced by their preference of a certain business or market segment. At first glance, comparability of different shares might therefore seem a rather straightforward matter. As long as prospectuses provide investors with adequate business descriptions, the latter should be able to make appropriate investment decisions. However, a closer examination of the subject at hand reveals that a thorough comparison of different shares is more complex than originally assumed. To begin with, meaningful business comparisons can be drawn only if respective information is standardized to a certain extent. Otherwise, issuers might provide investors with fragmentary information which, in turn, would prevent them from a thorough assessment of different shares. Moreover, investors are confronted with a wide array of additional information relating to shares. In particular, corporations are free to create different classes of shares\textsuperscript{514} or to choose between various options of how to organize the shares’ distribution.\textsuperscript{515} Further, investors may be interested in the issuer’s corporate structure, its board members and executive officers and its corporate governance structure.

In view of the above exemplary enumeration of information that might influence investment decisions of potential shareholders, streamlined and predefined prospectus structures are essential to cope with the information investors receive prior to their investment decisions. Canadian prospectus regulations essentially acknowledge the need for consistent prospectus contents and designs. As seen under section 1.1 above, Form 41-101F1 determines the material information that has to be displayed in prospectuses and obligates issuers to disclose essential facts on the cover page of a prospectus. Clarity is further enhanced by the form’s requirement to include a table of contents in each prospectus. However, neither Form 41-101F1 nor NI 41-101 or its companion policy\textsuperscript{516} define a sequence that issuers have to follow with regard to the required items. Further, regulatory provisions have so far refrained from establishing predefined and mandatory headings for the sections that are featured in Form 41-101F1. Considering the above necessity of comparable share prospectuses, the structural harmonization of disclosure documents is an essential means to further enhance comparability of share issues.

\textsuperscript{514} See, for example, s. 52 (2) BCCA.
\textsuperscript{515} Form 41-101F1, item 20.
\textsuperscript{516} S. 4.1 of CP 41-101 which requires that issuers “should apply plain language principles when they prepare a long form prospectus”. However, the document does not give further guidance in relation to the order and headings that issuers have to choose.
1.5 Sub-conclusion

The above analysis of the present Canadian prospectus framework has shown the following. Product-specific prospectus disclosure for shares informs investors about relevant risks and enables them to compare different share issues. Additional transparency could be achieved by implementing explicit notice of the implications that issuer-related developments can have on shareholders’ investments. Further, a fixed sequence of prospectus items and predefined headings would significantly improve investors’ ability to compare different products with each other.

2. Distribution of Bonds

2.1 Overview

Canadian disclosure provisions for debt securities do not vary considerably from those for equity securities. As a consequence, the requirements of Form 41-101F1 outlined under section 1.1 above must also be considered at the issue of bonds. This homogenous approach is based upon the view that “investors in debt securities (...) [have] the same informational needs as investors in shares”. Specific characteristics of debt securities are considered only if they require special emphasis or create a need for additional information. In particular, cover page disclosure has to include the effective yield of bonds “if held to maturity” and must display pricing details as percentages. Further, issuers of “debt securities having a term to maturity in excess of one year” must disclose earnings coverage ratios in accordance with section 9.1 of Form 41-101F1. Moreover, section 10.2 of the form points out the specific characteristics that must be considered in the prospectus description of debt securities.

Section II.3 of chapter two has shown that issuers do not have to follow disclosure requirements if one of the exemptions of NI 45-106 applies. Compared to disclosure reliefs for equity securities, exemptions applying to debt instruments affect a significantly larger number of the total of issued products. In particular, section 2.35 of NI 45-106 sets forth that the “prospectus requirement does not apply to a distribution of a negotiable promissory note or commercial paper maturing not more than one year from the date of the issue, if the note or commercial paper distributed (a) is not convertible or exchangeable into or accompanied by a right to purchase another security (...), and (b) has an approved

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517 See also KUNG (fn. 507), p. 428, comparing the U.S. prospectus regime to European prospectus regulations.
518 KUNG (fn. 507), p. 428, 429.
519 Form 41-101F1, s. 1.4 (5).
520 Form 41-101F1, s. 1.4, Instructions.
521 Form 41-101F1, s. 9.1 (1).
522 Prospectus and Registration Exemptions.
As a consequence of this rule, Canadian asset-backed commercial papers are largely exempt from the prospectus requirements of \textit{NI 41-101} and investors have no other choice but to rely on information that is provided by issuers on a voluntary basis.\footnote{Nicholls (fn. 398), p. 188.} Issues in relation to asset-backed commercial papers and credit derivatives in general will be examined under section II.3.3 below.

\textbf{2.2 Disclosure of Essential Product and Issuer Risks}

Like investors of equity securities, potential bondholders have access to essential information on issuers and distributed bonds. In addition, explicit risk statements highlight risks that might surface for investors after buying specific debt securities.\footnote{Form 41-101F1, s. 21.1.} However, section 21.1 confines the above statements to (i) “risk factors relating to the issuer and its business”,\footnote{Form 41-101F1, s. 21.1 (1).} the risk of additional contributions of investors\footnote{Form 41-101F1, s. 21.1 (2).} and any other “risk factors material to the issuer”.\footnote{Form 41-101F1, s. 21.1 (3).} Consequently, the obligations on issuers of debt securities are basically reduced to the disclosure of issuer-related risks to investors,\footnote{The French version of Form 41-101F1, s. 21.1 (3), requires that prospectuses describe “les facteurs de risque important pour l’émetteur” and, consequently, uses the same phrase as in s. 21.1 (1), which requires prospectuses to disclose “les facteurs de risque pour l’émetteur et ses activités”. It is not clearly conceivable what kinds of risks can be subsumed under subsection (3) that are not already included in subsection (1).} but issuers are not required to specifically refer to risks that arise from the product structure itself. Unlike shares, debt instruments may harbour risks that are not related to the securities’ issuers. In particular, investors face partial losses of the product’s principal or coupon payments if third parties or their securities do not perform in accordance with the issuer’s expectations.\footnote{See these risks in relation to asset-backed commercial papers in section 3.3 below.} Although information about these risks is implicitly\footnote{See, however, s. 10.3 (14) that requires a description of “any risk factors associated with the asset-backed securities”.} displayed under section 10.2\footnote{And, for asset-backed debt securities, in section 10.3.} of Form 41-101F1, retail investors might overly rely on the explicit risk cautions of securities prospectuses and, therefore, not associate the debt securities’ characteristics listed under section 10.2 to risks that might arise prior to or at maturity of these products. As a result, item 21 of Form 41-101F1 should not be confined to risks that arise from the debt instruments’ issuers. Rather, all material risks that are related to purchases of a specific product should be briefly explained under this prospectus section.
Drawing on the considerations about product-specific risk assessments in section 1.2 above, the implementation of brief risk evaluations can enhance investors’ abilities to take appropriate investment decisions. However, issuers should not be required to file risk evaluations in relation to third parties and their products. Investors who decide to invest in bonds that are collateralized by third parties or whose interest rate structures depend on other products’ developments must be able to assess related risks by consulting publicly available information about these products and respective risks. As product-specific risk information draws investors’ attention to risks that may arise in relation to third parties and their products, investors are adequately aware of their responsibility to investigate these factors. However, retail investors might benefit from additional risk labelling in relation to complex debt structures. In particular, debt securities whose principal repayment is dependent on the development of underlying investment instruments or third party-behaviour should be required to emphasize this additional risk by featuring respective product names or predetermined risk labels. Similar techniques should apply in relation to floating bonds, participating bonds or other structures whose coupon payments may considerably vary.

2.3 Availability of Relevant Information

Issuers of bonds are required to provide prospectus information on a timely basis. They must follow the same procedures as outlined for the issue of shares under section 1.3 above. Further, information contained in prospectuses covers - for the most part - all relevant information that investors need in order to make an informed decision in relation to the securities in question. As a consequence, investors can access relevant information on issued debt securities in a timely manner. However, this positive assessment is valid only if prospectus requirements of NI 41-101 are not abolished by an exemption under NI 45-106. In particular, the availability of relevant information is seriously hampered by the legislator’s decision to exempt short-termed debt securities from prospectus disclosure.

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532 Risk assessments in relation to third parties might be appropriate if the latter are not legally required to disclose information about themselves and their products. In such cases, investors do not have the means to assess risks related to third parties and, as a consequence, cannot gauge the overall risk related to the bond.
534 See, however, section 2.2 above and its conclusion that prospectuses of debt securities do not necessarily refer to all relevant risks factors under the present disclosure framework.
2.4 Intra-Product Comparability

Section 1.4 above established that product comparability can be enhanced by introducing prospectus schedules and mandatory headings for relevant sections of securities prospectuses. This basic statement applies not only to the issue of shares but also to distributions of debt securities. As investors must balance a significant number of different factors when taking their investment decisions, they are dependent on disclosure documentation that enables them to make efficient choices between the wide range of available products. Although the Canadian disclosure framework has taken important steps in this direction, the introduction of homogenous prospectus structures and harmonized designations of prospectus sections would be suitable to further improve comparability of debt securities.

2.5 Sub-conclusion

The above examination of prospectus disclosure in relation to bonds has shown that Canadian investors are provided with overall sound and comprehensive prospectus structures. However, the following amendments could additionally enhance transparency in primary markets for bonds. First, *Form 41-101F1*, section 21, confines risk disclosure in prospectuses to issuer-related risks. In view of the significant risks that investors may have to face irrespective of the issuer’s solvency or behaviour, issuers should be obligated to point out significant product-related risks. This approach has been implemented in relation to asset-backed debt securities. Issuers are required to disclose “any risk factors associated with the asset-backed securities, including disclosure of material risks associated with changes in interest rates or prepayment levels, and any circumstances where payments on the asset-backed securities could be impaired or disrupted as a result of any reasonably foreseeable event (...).”[^535] However, analogous issues may also arise in relation to other debt instruments. Consequently, similar risk statements should be required for all types of publicly distributed debt securities.

Second, more complex debt products might require the application of predefined risk labels, be it in the form of distinctive product names or by introducing standardized risk labels.

Third, section 2.4 above has made evident that comparisons between different bond products could be significantly improved by harmonizing prospectus structures and obligating issuers to follow predetermined section headings.

[^535]: *Form 41-101F1*, s. 10.3 (14).
3. Distribution of Derivatives

3.1 Options and Futures

a. Overview

As mentioned under chapter three, section II.2.1.b.aa, provincial securities regulations have established differing disclosure concepts for derivatives. In particular, Ontario, Manitoba and Québec have enacted Derivative Acts that govern the issue of futures and option contracts to a greater or lesser extent. Whereas Ontario and Manitoba confine the scope of their Commodity Futures Acts to commodity futures or option contracts that are traded on an exchange, Québec has abstained from similar fragmentations and the scope of its Derivatives Act extends, as a general rule, to all kinds of derivative contracts. British Columbia and Alberta, on the other hand, have refrained from creating separate Statutes for derivatives but have established specific rules for ‘exchange contracts’, i.e. exchange-traded futures or options contracts whose “performance is guaranteed by a clearing agency”.

Futures and options that do not fall under the scope of the above special rules qualify as securities. However, derivative-specific exemptions mostly relieve issuers of plain options of the obligation to issue respective prospectuses. In return, provinces impose registration requirements on dealers and advisors and obligate them to provide investors with risk disclosure statements.

In view of this great variety in Canadian disclosure regulation for options and futures, an exhaustive assessment of these complex and fragmentary frameworks would go beyond the scope of this paper. Consequently, the following examinations will focus on derivatives regulation in British Columbia. Other frameworks are mentioned only if their content differs significantly and fundamentally from the provisions set forth by the legislator of British Columbia.

536 Commodity Futures Act (R.S.O. 1990, Chapter C.20).
537 Commodity Futures Act (C.C.S.M. c. C152).
538 See fn. 304 above.
539 See above, chapter three, section II.2.1.b.aa, referring to the generous carve-out provisions for OTC-transactions involving accredited counterparties.
540 S. 1 (1), ‘exchange contract’.
541 See, in particular, BCI 91-505, and OSC Rule 91-502.
542 For Québec, see Expert Panel, Final Report (fn. Bookmark not defined.), p. 77; for British Columbia see s. 34 (a) and (b) BCSA and Grottenthaler/Henderson (fn. 73), 10-63.
543 See s. 70 QDA for Québec, BC FORM 91-903F for British Columbia, and 2.1 (b) of OSC Rule 91-502 for Ontario.
b. Disclosure of Essential Product and Issuer Risks

aa. Prospectus Exemptions

Exchange contracts do not qualify as securities544 and, consequently, their distribution does not trigger a prospectus obligation.545 However, investors are allowed to trade in exchange contracts only if these trades are conducted by registered dealers or advisors.546 Further, these intermediaries have “to provide each prospective client with a copy of the Risk Disclosure Statement (Exchange Contracts), prior to opening the client’s account”.547 Risk disclosure statements contain generic risk caveats548 informing investors on the principal risks that they take by investing in futures or options. In addition, they refer to risks that are not necessarily linked to the characteristics of options or futures but tend to arise in the course of such transactions. In particular, BC Form 91-903F requires that disclosure statements mention potential negative impacts of market illiquidity, fee charges, currency risks and risks related to deposits for derivative transactions.549

Call and put options550 that do not qualify as exchange contracts in accordance with section 1 (1) BCSA can still be exempt from the prospectus obligation of section 61 BCSA if their design complies with the requirements set forth in BC Instrument 91-505.551 Moreover, issuers of physically settled commodity futures are generally exempt from prospectus requirements of section 61 BCSA.552

Considering the above, the following can be concluded. First, the derivative framework of British Columbia does not require prospectus disclosure in relation to exchange traded futures and options contracts. Second, plain option structures are also exempt from prospectus disclosure. Third,

544 See s. 1 (1) BCSA, ‘security’. “security includes (…) whether or not any of the above relate to an issuer, but does not include an exchange contract”.
545 See s. 61 (1). “Unless exempted under this Act, a person must not distribute a security (…)”. Exchange contracts, however, are not mentioned under this section. See also s. 89 and 91 of the Proposed Act.
546 GROTTENTHALER/HENDERSON (fn. 73), 10-63, s. 34 BCSA.
547 BC form 91-903F, Instructions.
548 See chapter three, section III.2.2 above.
549 BC Form 91-903F, Contents of Form, Additional Risks Common to Futures and Options.
550 I.e. options “which permit the holder of the option to sell or purchase from the writer of the option a specified amount of securities at a specific price, on or before a specified date or the occurrence of a specified event” (BC Instrument 91-505).
551 Which are the following. “(a) the option has been written by or the performance under the option is guaranteed by a member of an exchange recognized by the commission for this purpose, (b) the securities that are the subject of the option are listed and posted for trading on an exchange recognized by the commission for this purpose, and (c) the option is in the required form” (BC Instrument 91-505).
552 See ONTARIO COMMODITY FUTURES ACT ADVISORY COMMITTEE. “Final Report” (January 2007), p. 12, on the definition of ‘commodity futures contract’ and the need for updating respective definitions. See also Blanket Order 91-503 (BC), part 1.

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commodity futures with physical settlement are exempt from the scope of the securities act. Fourth, futures and options for retail investors[^553] that do not fall under one of the above derivative-specific exemptions have to comply with general prospectus regulations. As a general rule, these instruments can be distributed only if respective prospectus disclosure has been provided to investors. However, prospectus exemptions of *NI 45-106* may relieve issuers of prospectus duties in significant ways.

**bb. Disclosure-related Concerns**

How do the above insights blend into the risk disclosure examinations of chapter three, section III? Issuers of futures and options that do not fall under a prospectus exemption have to comply with prospectus provisions of *NI 41-101*. As a result, these products face similar disclosure issues as listed under sections 1.2 and 2.2 above. In particular, prospectuses lack a mandatory structuring of their contents and risk-based labelling duties. However, section 10.4 (g) of *Form 41-101F1* requires that prospectuses display “the risk factors associated with the derivatives”. As a consequence, unlike prospectuses for shares and bonds, derivative prospectus disclosure includes significant risks that are related to the product in question.

Prospectus exemptions for commodity futures with physical settlement[^554] do not give cause for concern. Retail investors are generally not involved in these kinds of transactions; further, market participants concluding these transactions are driven by the need to physically acquire or sell commodities rather than by speculative reasons. Consequently, prospectus exemptions based on Blanket order 91-503 (BC) do not compromise transparency in securities markets.[^555] Moreover, the exemption meets international standard practice.[^556]

Prospectus exemptions of *BC Instrument 91-505* for call and put options on exchange-traded securities significantly facilitate and expedite the issue of plain options with physical settlement.[^557] As long as investors can find all relevant information in the option or futures contract forms set forth by 91-505F1

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[^553]: See, however, *BC Blanket Order 91-501* for broad exemptions in relation to OTC derivatives that are distributed to Qualified Parties as defined in the *Blanket Order*.

[^554]: See *BC Blanket Order 91-503*.

[^555]: See, however, the IOSCO TASK FORCE ON COMMODITY FUTURES MARKETS, “Final Report” (March 2009), p. 15, requiring that regulators may obtain additional information of issuers of commodity futures contract in order to assess the market’s functioning.


[^557]: Although there is no explicit statement in relation to the settlement of the option, the contracts under 91-505F1 and 91-505F2 implicate that the settlement is meant to be physical.
and 91-505F2, they are not necessarily disadvantaged by this lack of a prospectus. Further, relevant information on members “of an exchange recognised by the commission”\textsuperscript{558} can be found in publicly available continuous disclosure documentation of said entity.\textsuperscript{559} In view of the present form of 91-505F1 and 91-505F2, the following information might additionally improve transparency for investors. Unlike section 10.4 (g) of \textit{Form 41-101F1}, contract forms for put and call options do not point out any risks associated with the product’s issuers or its structure. Considering the design of call or put options with physical settlement, structural and issuer-specific risks do not significantly differ between different product issues. Consequently, the implementation of generic risk caveats in the option contracts would be sufficient to adequately inform investors of relevant risks.

Whereas the above prospectus exemptions are narrowly confined to specific constellations, the legislator’s decision to relieve exchange contracts of prospectus requirements deprives a wide range of investors of prospectus disclosure. Canadian exchange contracts are currently exclusively traded on the Montréal Exchange. They are issued by the Canadian Derivatives Clearing Corporation\textsuperscript{560} as soon as two parties have settled a transaction in an option\textsuperscript{561} or futures contract.\textsuperscript{562} Consequently, options or futures contracts are not mass-traded derivatives. Rather, these investment instruments do not come into existence until the settlement date of each single transaction.\textsuperscript{563} Capital market laws have so far not established a consistent understanding as to whether exchange contracts qualify as securities or not.\textsuperscript{564} However, within the three legal frameworks examined in this thesis, there is an implicit consensus that exchange contracts can be distributed without prospectus disclosure. Instead, the obligations of exchanges or issuers are confined to the disclosure of the conditions of the standardized contracts in a publicly available form.\textsuperscript{565} In addition, Canadian investors are protected by (i) the intermediaries’ duties to distribute risk disclosure statements to their clients and (ii) the fact that exchange contracts must be

\textsuperscript{558}BC Instrument 91-505, s. 2 (a).
\textsuperscript{559}See also the rationale for short-form prospectuses in GILLEN (fn. 40), p. 296, 297.
\textsuperscript{560}<www.cdcc.ca>.
\textsuperscript{562}CDCC Rules, Part C, Futures, C-105 (2), online. <http://www.cdcc.ca/f_rules_en/C-01.pdf>, i.e. CDCC produces “a Futures Consolidated Activity Report with respect to each account of a Clearing Member”.
\textsuperscript{563}See also CONTRATTO (fn. 129), p. 157.
\textsuperscript{565}See, for example, \textit{CDCC Rules}, Part B, Options, Rule B-5.
guaranteed by a clearing agency. In view of these additional safeguards, the absence of a general prospectus requirement for exchange contracts is largely absorbed by other effective measures and does not leave an undue gap in the transparency framework of Canadian securities regulation. For clarity’s sake, it remains to be noted that exchange-traded options that have been issued en masse by investment banks do not qualify as ‘exchange contracts’ and, therefore, have to comply with prospectus disclosure of securities regulation.

c. Availability of Relevant Information

Looking at the wide range of disclosure provisions for options and futures, availability of relevant information is largely dependent on the applicable disclosure framework. Investors in exchange-traded options and futures can rely on timely and trustworthy information provided by stock exchanges. Investors who acquire options subject to general prospectus requirements are able to gather information from the products’ prospectuses. As a result, investors can generally access information in a timely manner.

d. Intra-Product Comparability

Futures and options that are issued as exchange contracts are designed in a highly standardized manner. Information about these contracts can be found on the website of the Montréal Exchange and the Canadian Derivatives Clearing Corporation. As a consequence, product comparability is generally not problematic in relation to these products. Call and put options that are distributed in the form of 91-505F1 and 91-505F2 can be compared with each other without restriction. If issuers distribute options in accordance with prospectus requirements of NI 41-101, comparability could be enhanced as presented under sections 1.4 and 2.4 above.

566 For British Columbia, see s. 1 (1) BCSA, ‘exchange contract’. As mentioned above, exchange contracts can be traded on recognized exchanges only (see fn. 546).
567 See above, chapter three, section II.2.1.b.bb. Although these instruments are not traded at Canadian stock exchanges yet, they are fairly wide-spread in European markets (see, for example, Scoach, a European stock exchange for structured products, online. <http://www.scoach.ch/EN/Showpage.aspx?pageID=230>, where the products in question are called ‘warrants’).
568 See, however, exceptions for plain call and put options mentioned in section b.i above.
569 However, this assessment applies to options only if they are distributed to retail investors. If the trade is concluded between qualified parties, BC Blanket Order 91-501 largely exempts issuers from mandatory prospectus disclosure.
e. Sub-conclusion

The above examinations have provided the following insights. First, Canadian investors are confronted with nuanced disclosure provisions for futures and options. Whereas issuers of exchange contracts establish standardized contract specifications, information about plain call and put options can be found in the forms set forth by *Blanket Order 91-505 (BC)*. Other options and futures comply with the general prospectus provisions of Canadian securities regulation. Second, different disclosure standards do not necessarily imply that investors obtain too little information. If the product design or additional protective mechanisms result in a lower need for disclosure, issuers should be rewarded with streamlined and less costly disclosure provisions. Third, these differentiations do not overly constrain product comparability as long as information is accessible and presented in a well-structured manner. Fourth, present disclosure provisions for options and futures that are distributed to retail investors do not feature significant gaps. However, further improvements could be made by implementing risk disclosure for call and put options in Blanket order 91-505. Finally, the arguably most significant impediment for streamlined disclosure in relation to options and futures can be found in the non-harmonized provincial derivatives regulations.

3.2 Structured Notes

a. Overview

Structured notes can be issued either as principal protected notes (PPNs) or as principal at risk notes (PRNs).\(^{571}\) As seen in chapter two, section II.3, and chapter three, section II.2.1.b.cc, PPNs usually qualify as evidence of deposit\(^ {572}\) and, therefore, are exempt from prospectus requirements.\(^ {573}\) In view of the complex structures of these instruments and the lack of disclosure that results from the above exemptions, the Canadian Department of Finance has issued *Principal Protected Notes Regulations (PPN Regulations)*, determining the level of disclosure for the issue of PPNs. Among others, issuers of PPNs must disclose the term of the note, its charges, interest accrual and “any risks associated with the note.”\(^ {574}\) Information must be furnished orally and in writing,\(^ {575}\) and “in language that is clear and simple

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\(^{571}\) For a description of the design of structured notes, see André Fok Kam, „Implications of the Use of Investment Wrappers“, Research Study (May 12, 2006), p. 255.

\(^{572}\) See, for instance, s. 1 (1) BCSA, ‘security’.

\(^{573}\) See also Nicholls (fn. 398), p. 174. Another way to exempt PPNs from prospectus requirements is to qualify them as debt instruments issued by Canadian financial institutions (*NI 45-106, s. 2.34*). See CSA Notice 46-303 on the concerns arising in relation to PPNs.

\(^{574}\) *PPN Regulations*, s. 3.

\(^{575}\) *PPN Regulations*, s. 3.
and in a manner that is not misleading”. Further, issuers have to disclose the current net asset value of the note upon request of investors and must inform investors about impending amendments to a particular note. Exemptions to these requirements apply solely to the point in time when issuers have to disclose the above information, but do not relieve issuers of disclosure as such. Finally, it remains to be noted that PPN Regulations apply only if these instruments are issued by federal financial institutions. Other PPNs may either be subject to general prospectus requirements of NI 41-101 and NI 44-102 or fall under the scope of an exemption of NI 45-106.

PRNs are generally distributed under shelf prospectuses in accordance with NI 44-102. Shelf offerings allow reporting issuers to file a base shelf prospectus for securities that may be distributed within a predefined time period. These base prospectuses are short-form prospectuses and “must set out the aggregate amount of securities expected to be offered under the prospectus over a period of 25 months”. Basically, a base prospectus has to disclose all information that is normally contained in a short-form prospectus but can omit all aspects that relate to the offering of a certain tranche and are not known at the time when the prospectus is designed. In addition, issuers must issue a shelf prospectus supplement for each tranche that is distributed to the public. In relation to derivatives, NI 44-102 states that ‘novel’ derivatives can be distributed only if issuers have pre-cleared the content of prospectus supplements with the competent securities commission. Securities regulators point out certain disclosure-related issues that have to be complied with when distributing linked notes. Among others, the Staff Notice declares that an “issuer will generally find it difficult to meet the full, true and plain disclosure requirement without adequately disclosing the risks relating to the issuer and the particular linked note it is offering”. PRNs can be exempt from prospectus disclosure if a prospectus exemption of NI 45-106 applies. In particular, issuers may call on (i)

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576 PPN Regulations, s. 2.
577 PPN Regulations, s. 9.
578 PPN Regulations, s. 10.
579 See CSA Staff Notice 46-304 Update.
581 GILLEN (fn. 40), p. 309.
582 NI 44-102, s. 5.5 and 5.6.
583 NI 44-102, part 6. These supplements contain all information on a specific tranche that have been omitted in the base shelf prospectus in accordance with s. 5.6 of NI 44-102 (see s. 6.3 of NI 44-102).
584 A derivative is novel if its “type has not been distributed (...) before the proposed distribution, or (...) has been distributed” but features salient new components as described under NI 44-102, s. 1.1, ‘novel’, A.ii.
585 See also Companion Policy 44-102CP, s. 2.4, clarifying the meaning of ‘novel’ in relation to derivatives.
586 CSA Staff Notice 44-304.
587 CSA Staff Notice 44-304, General Disclosure Matters, lit. I.
section 2.3 when purchasers are ‘accredited investors’, (ii) section 2.10 if the cost of the investor amounts to a minimum of CAD 150,000, or (iii) section 2.34 if unsubordinated PRNs are issued or guaranteed by a Canadian financial institution or Schedule III bank.

b. Disclosure of Essential Product and Issuer Risks

aa. Principal Protected Notes

*PPN Regulations* require institutions to disclose the essential characteristics related to a specific issue of PPNs. Among other obligations, institutions have to describe the product and its main characteristics. Issuer-specific information, on the other hand, is scarce. As information on issuing institutions can be obtained from public sources, this absence of issuer-related disclosure does not seem critical per se. However, as PPNs are generally issued and distributed en masse, these instruments may well be issued by one institution and distributed by another. Although this segmentation does not yet represent the norm in current Canadian practice, legislation does not, as far as can be seen, bar issuers of PPNs from implementing such procedures in the future. In view of the distribution structures applied in European countries, it seems highly likely that Canadian banks will adopt similar proceedings. If issuers delegate their oral communication duties to the products’ distributors, investors might fail to notice that the product’s issuer is not identical to its distributor if issuer-related information is not clearly displayed in disclosure documentation of the respective PPN.

*PPN Regulations* further require that disclosure documentation refers to “risks associated with the note”. As a consequence, institutions have to draw attention to all product-related risks. In particular, they must inform about “the risk that no interest may accrue”. However, *PPN Regulations* abstain from requiring issuer-related risk disclosure.

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588 See s. 1.1, ‘accredited investor’.
589 *PPN Regulations*, s. 1, ‘institution’.
590 Subject to these rules are merely federal financial institutions as defined under *PPN Regulations*, s. 1.
592 These procedures and inadequate information led to significant losses of Swiss retail investors upon the bankruptcy of Lehman Brothers. Although the products had been distributed and labeled by Credit Suisse, they were issued by the later insolvent Lehman Brothers and, consequently, investors had to bear the issuer risk related to the notes.
593 As mentioned in fn. 592, similar settings have been accepted standards in Switzerland and other European countries for years.
594 *PPN Regulations*, s. 2.
595 *PPN Regulations*, s. 3 (d).
596 *PPN Regulations*, s. 3 (d).
597 See also FOK KAM (fn. 571), p. 255, on the importance of issuer-related risk disclosure.
labelling requirements. As both means could significantly enhance transparency for retail investors without overly constraining PPN issuers, they should be taken into account by the Canadian legislator.

Finally, \textit{PPN Regulations} confine their scope to the regulation of PPNs that are issued by federal financial institutions.\footnote{CSA Staff Notice 46-304, \textit{CSA’s Proposed Course of Action}. See also \textit{CSA Staff Notice 46-305, Conclusion}, in relation to PPNs that are distributed by financial institutions of Québec.} As a result, other issuers have to resort to general prospectus requirements and exemptions. This differentiation cannot be fully explained with characteristics inherent to the respective products. Rather, it is the result of competence issues in Canadian securities and banking regulations\footnote{See, \textit{GILLEN} (fn. 40), p. 77 et seq., on the constitutional division of powers with regard to Canadian securities regulation.} and lacks inherent persuasion.

\textbf{bb. Principal at Risk Notes}

Disclosure issues arising with regard to PRNs do not significantly defer from those mentioned in sections 1.2, 2.2 and 3.1.b above. Compared to disclosure provisions for shares and bonds, specific risk disclosure is enhanced by section 10.4 (g) of \textit{Form 41-101F1} and its requirement to disclose all “risk factors associated with the derivatives”\footnote{\textit{Form 41-101F1}. See also \textit{Form 44-101F1} for short-form prospectuses whose content has to be mirrored for shelf prospectuses as long as contents are not explicitly excluded by s. 5.6 of \textit{NI 44-102}.}. Further, \textit{CSA Staff Notice 44-304} points out that risk disclosure for linked notes generally requires the disclosure of risks that are related to issuers and a specific product.\footnote{CSA Staff Notice 44-304, \textit{General Disclosure Matters}, lit. l.} In view of this detailed account, product-specific risk information appears to be largely sufficient in relation to PRNs.

Prospectus requirements do not obligate issuers to apply pre-defined risk labels to their PRNs. As these investment instruments generally feature complex structures that are unfamiliar to retail investors, risk labels could considerably improve investors’ ability to correctly assess a product’s risks and its suitability for their investment purposes. Consequently, the lack of labelling duties appears to be particularly unsatisfactory. Finally, prospectus exemptions relieve issuers of prospectus requirements in various constellations. As prospectuses would generally be required if the underlying components of the products were distributed separately, these exemptions are highly problematic\footnote{See also \textit{NICHOLLS} (fn. 398), p. 174.} and should be abolished.\footnote{See \textit{FOK KAM} (fn. 571), p. 258.}
c. Availability of Relevant Information

Issuers of PPNs must provide information “at least two days before entering into an agreement to issue a principal protected note to an investor”.\footnote{PPN Regulations, s. 3 and 5.} If investors agree to receive information at a later date, section 4 of \textit{PPN Regulations} allows that issuers provide disclosure “at any time before entering into the agreement”.\footnote{Further, the issuer and the investor must conclude their agreement on the purchase of PPNs in person if the exemption of section 4 shall apply.} \textit{PPN Regulations} do not allow any content-related disclosure modifications and, therefore, investors of PPNs are always informed about the main characteristics of their investment prior to concluding the respective agreement with the product’s issuer. However, PPN documentation is not vetted by securities commissions or other independent bodies. Consequently, investors cannot fully rely on the information provided by a product’s issuer. Although systematic preventive supervision of each PPN issue might not be adequate for these flexible and fast moving products, random examinations could significantly increase investors’ confidence in disclosure documentation for PPNs.

PRN prospectuses are prepared and distributed in accordance with general prospectus requirements of \textit{NI 41-101}. In particular, investors are not allowed to enter any binding agreements prior to the issue of the final prospectus.\footnote{GILLEN (fn. 40), p. 136.} As a consequence, investors do not acquire a PRN until they are adequately informed about key details such as the exact product price. However, if issuers are exempt from issuing a prospectus for a specific product, investors have no guarantee that they will receive all relevant information prior to acquiring the product.

d. Intra-Product Comparability

\textit{PPN Regulations} do not set forth a specific structure that issuers have to follow when drafting the written information statement of section 3 \textit{PPN Regulations}. Consequently, issuers fulfill disclosure requirements if they use “clear and simple”\footnote{PPN Regulations, s. 2.} language and provide investors with the information required by section 3 \textit{PPN Regulation}. As long as issuers’ information statements are constrained to the minimum amount of information, comparability should not unreasonably suffer. However, issuers are not obliged to limit their statements to the minimum content set forth in section 3 \textit{PPN Regulations}. In fact, present PPN statements have proven to be of a similar length to short form prospectuses acting in accordance with \textit{Form 44-101}. In view of this considerable amount of information, investors’ abilities to compare different products by their prospectuses might become significantly hampered. Mandatory
structures and pre-defined headings could solve this problem without additional expenses by issuers. As a minimum, information statements for PPNs should have to apply the form-related requirements for short form prospectuses and provide investors with a harmonized front page, a table of contents and headings that clearly identify where significant information can be found in the document.

Comparability between different PRNs suffers the same drawbacks as those outlined under sections 1.4, 2.4 and 3.1.b above. As PRNs are designed in a complex manner and prospectuses refer to a multitude of formulae, data and sources, the lack of mandatory product structures is particularly apparent in relation to these products.

e. Sub-conclusion

The above analysis of the Canadian disclosure framework for PPNs and PRNs has shown the following. First, both PPNs and PRNs lack labels indicating the degree of risk investors take by buying certain types of products. Considering the complexity of these instruments, the absence of clearly visible risk signals is dissatisfactory. Moreover, disclosure regulations for both types of structured notes leave certain products outside their scope. In addition, *PPN Regulations* do not explicitly require that information statements disclose issuer-related risks. In view of the massive losses retail investors in Swiss and German markets suffered upon the bankruptcy of Lehman brothers, counterparty risks should be taken seriously and, consequently, related disclosure should be specifically required by *PPN Regulations*.

Second, information on PPNs and PRNs is disclosed in a timely manner. However, the above gaps in disclosure regulation mean that issuers cannot always access all relevant information in due time. Further, PPN documentation is not vetted by independent bodies and, consequently, incomplete or deficient information might be given to investors.

Third, comparability of structured notes could be enhanced by the introduction of structural requirements for prospectuses or information statements. In particular, predefined schemes would enable investors to find relevant information in an efficient manner and, moreover, to compare corresponding data.

Finally, concerns have been raised that current *PPN Regulations* follow an institutional rather than a functional approach. In particular, Fok Kam argues that “substance should prevail over legal form”.

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and, therefore, that structured notes should be regulated “according to the underlying investment”.\textsuperscript{610} Fok Kam\textquotesingle s recommendations are in accordance with the overall substantive approach of Canadian securities regulation.\textsuperscript{611} Whether this regulatory route is better suited for a satisfactory coordination of the needs of investors, product issuers and intermediaries than the present approach to PPN and PRN regulation will be investigated in section 5.1 below and in section II of chapter seven.

3.3 Credit Derivatives and Asset-backed Securities

a. Overview

aa. Preliminary Remarks

The global spread of complex credit derivative structures and asset-backed securities has proven to be one of the key reasons for the present financial crisis.\textsuperscript{612} The recent surge in demand for safe but lucrative investments and the market\textapos;s reaction by designing complex, highly leveraged products\textsuperscript{613} were crucial factors of market participants\textapos; loss of confidence in their counterparties and the consequential meltdown of financial markets. In view of the multi-faceted impacts of credit derivatives on financial markets and their participants,\textsuperscript{614} the implementation of adequate disclosure rules for credit derivatives and asset-backed debt instruments in the retail market can be no more than a drop in the ocean. However, if regulators and issuers decide to adhere to present models of debt securitization, disclosure regulation has to ensure that investors are provided with important information.\textsuperscript{615} Therefore, the present prospectus framework for retail credit derivatives and asset-backed debt securities will be briefly reviewed below.

Definitions of the term \textquotesingle credit derivative\textquotesingle are based on an economic background and do not necessarily fit into the existing legal framework. Further, the term has been applied to a variety of different

\textsuperscript{610} Fok Kam (fn. 571), p. 259.
\textsuperscript{611} See above, chapter three, section II.3.
\textsuperscript{613} The Turner Review (fn. 612), p. 14.
products. Arguably the most wide-spread form of unstructured credit derivatives are credit default swaps (CDS). However, these instruments are generally not distributed to retail investors without further structuring. Therefore, the legal provisions governing disclosure in relation to these products will not be discussed in this paper. If illiquid assets or cash flows deriving from assets are transformed into marketable securities, these products can be structured as credit-linked notes or asset-backed securities. While the former are clearly of a derivative nature and combine characteristics of debt securities with those of a CDS, the latter need not necessarily feature derivative characteristics. As a result of this diversity, the legal categorization of credit-linked debt securities has not settled yet.

However, credit-linked notes and asset-backed securities pose closely related challenges to present disclosure frameworks. Therefore, disclosure issues arising from these instruments will be discussed in parallel in sections b to e below, regardless of their classification as derivatives or non-derivative debt securities.

bb. Regulatory Disclosure Requirements

Credit linked notes qualify as structured notes considered in section 3.2 above. Consequently, credit linked notes have to follow disclosure rules for either PPNs or PRNs, depending on whether investors’ capital is protected or at risk.

In principle, asset-backed securities are subject to general Canadian prospectus requirements. In particular, section 10.3 of Form 41-101F1 sets forth specific requirements for this type of security. However, section 2.35 of NI 45-106 exempts issuers of commercial papers “maturing not more than one year from the date of issue” from the requirement to produce a prospectus in accordance with the provisions set forth in NI 41-101. Consequently, asset-backed commercial papers are largely exempt from prospectus disclosure.

617 CHRISTIAN STAUB, „Instrumente des Kreditrisikotransfers im schweizerischen Bankenaufsichtsrecht“, SZW 2009, p. 325.
618 STAUB (fn. 617), p. 325.
619 STAUB (fn. 617), p. 325.
620 See form 41-101F1, s. 10.3. For accounting purposes, asset-backed securities do not qualify as derivatives (see ACCOUNTING STANDARDS BOARD STAFF, “Non-Bank-Sponsored Asset-Backed Commercial Paper. Implementing the Restructuring Plan, Financial Reporting Commentary” (February 2, 2009), p. 3. This assessment is based mainly on the fact that the CICA Handbook, CICA Standards and Guidance Collection, Canadian Institute of Chartered Accountants, paragraph 3855.19 (e), sets forth, among others, that a derivative “requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors”.

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b. Disclosure of Essential Product and Issuer Risks

Principal-protected credit-linked notes are subject to the disclosure requirements of PPN Regulations. Consequently, the most noteworthy gaps in current disclosure regulation consist of the fact that PPN Regulations feature neither any risk labelling requirements nor the duty to disclose issuer-related risks. Credit-linked notes whose principal is at risk must comply with general disclosure requirements of NI 41-101. However, section 3.2.b.bb has shown that the numerous exemptions of NI 45-106 prevent an effective disclosure regime for complex debt securities. Further, those products that fall under the scope of NI 41-101 are not required to display pre-defined risk labels.

Issuers of asset-backed securities which are not exempt from prospectus regulation of NI 41-101 must inform investors about the material characteristics of the distributed securities. In addition, issuers have to describe risks that may arise from the products’ structure or issuer-related developments. In particular, section 10.3 (14) of Form 41-101F1 specifies that issuers must describe “any risk factors associated with the asset-backed securities, including disclosure of material risks associated with changes in interest rates or prepayment levels, and any circumstances where payments on the asset-backed securities could be impaired or disrupted as a result of any reasonably foreseeable event (...).” However, issuers of asset-backed securities do not have to apply pre-defined risk labels to their products. Finally, the above disclosure requirements do not apply to products that are exempt from prospectus disclosure. As a consequence, investors acquiring asset-backed commercial papers or other short-term debt instruments cannot access information on material risks related to the product in question or its issuer.

c. Availability of Relevant Information

Purchasers of credit-linked notes or asset-backed securities that are issued under a prospectus in accordance with NI 41-101 can obtain relevant prospectus information within an appropriate time frame. Investors who acquire products exempt from prospectus regulation, on the other hand, have no enforceable means to access trustworthy and comprehensive information. Finally, investors of capital-protected credit-linked notes may receive incorrect or fragmentary information due to the fact that PPN prospectuses are not vetted by any independent authority.

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621 See section 3.2.b.aa above.
622 In particular, s. 10.3 (3) requires that prospectuses feature “financial disclosure that describes the underlying pool of financial assets”.
623 S. 10.3 (14) of Form 41-101F1.
d. Intra-Product Comparability

Credit-linked notes or asset-backed securities whose main characteristics are disclosed in a prospectus or written PPN documentation can generally be compared with each other by means of the information disclosed in the above documents. However, comparability could be significantly enhanced by introducing a pre-determined prospectus structure and - in relation to principal-protected credit-linked notes - a central electronic platform where disclosure documents of different product issuers can be retrieved and compared. Moreover, credit-linked notes and asset-backed securities that are not accompanied by a prospectus can hardly be compared at all and retail investors may fail in choosing a product that fits their investment purposes.

e. Sub-conclusion

Considering the above observations, the following concerns have become apparent. First, products that are distributed under prospectus regulations of NI 41-101 or PPN Regulations lack risk labels and pre-defined prospectus structures. Second, the most pressing issue is the fact that a surprisingly large number of credit-linked securities are not subject to any disclosure regulation at all. As a consequence, investors lack timely information and cannot properly compare different products with each other. Third, due to the sometimes complex structuring of debt-linked securities, enhanced disclosure may not be sufficient to protect retail investors from inappropriate investments. Although further measures cannot be discussed in detail in this paper, they should be kept in mind when deliberating over adequate disclosure procedures.

3.4 A Note on the Québec Derivatives Act

As mentioned in section 3.1.a above, the Québec Derivatives Act abandons the widespread distinction between exchange-traded derivatives and OTC derivative products. Instead, the Act extends, as a general rule, to all kinds of derivative contracts. Further, the Québec Derivatives Act is focused on the regulation and continuous supervision of entities distributing derivative products rather than the establishment of tight disclosure obligations for issuers. In particular, standardized derivatives must be traded on a regulated published market which determines their intrinsic characteristics.

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624 See above, chapter three, section II.2.1.b.aa, referring to the generous carve-out provisions for OTC-transactions involving accredited counterparties.
625 See s. 12 Québec Derivatives Act.
626 I.e. “an exchange, an alternative trading system or any other derivatives market that (1) constitutes or maintains a system for bringing together buyers and sellers of standardized derivatives; (2) brings together the orders of multiple derivatives buyers and sellers; and (3) uses non-discretionary methods under which the orders
derivatives, on the other hand, are not traded on published markets. However, all persons who create or market OTC derivatives must be recognized regulated entities\(^{628}\) or “qualified by the Authority, as prescribed by regulation, before the derivative is offered to the public”\(^{629}\). Exemptions to these requirements apply if OTC transactions involve accredited counterparties.\(^{630}\)

Although the approach to derivatives regulation introduced by the Québec Derivatives Act clearly differs from other provincial derivatives frameworks, the differences are less pronounced than one would assume at first glance. To begin with, the implementation of NI 31-103 and its comprehensive registration requirements for dealers and advisors have significantly raised regulatory standards for intermediaries. While the disclosure requirements for derivatives dealers set forth by Division II.1 of the Québec Derivatives Regulation\(^{631}\) additionally enhance the general regulations of NI 31-103, they are no longer unique insofar as NI 31-103 requires virtually all securities dealers to comply with similar regulatory requirements. Further, as mentioned in chapter three, section II.2.1.b.bb, structured notes\(^{632}\) and exchange-traded options that are issued by investment banks, mostly in the form of book-entry securities or global notes, do not fall under the scope of the term ‘standardized derivative’ and, consequently, issuers of such products would generally have to follow disclosure regulations for securities. Therefore, the Québec Derivatives Act’s waiver of prospectus requirements for exchange-traded derivatives differs from the derivatives legislation of other Canadian jurisdictions only in relation to standardized derivative contracts that are traded on a published market other than an exchange.\(^{633}\)

As a result, the Québec Derivatives Act may be considered a valuable step towards a more consistent derivatives regulation. However, its design does not provide any comprehensive regulatory responses to disclosure issues in relation to structured notes, exchange-traded options issued by banks or asset-backed securities and, therefore, does not fill the key gaps identified in sections 3.1 to 3.3 above.\(^{634}\)

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\(^{627}\) S. 3, ‘standardized derivative’, Québec Derivatives Act.

\(^{628}\) S. 2, ‘regulated entity’, Québec Derivatives Act.

\(^{629}\) S. 82 of the Québec Derivatives Act.

\(^{630}\) S. 7 Québec Derivatives Act.


\(^{632}\) See explicitly Policy Statement respecting Hybrid Products, February 1, 2009.

\(^{633}\) I.e. an alternative trading system or any other derivatives market in the sense of section 3, ‘published market’ of the Québec Derivatives Act.

\(^{634}\) This conclusion is further supported by the fact that the Proposed Act does not abstain from requiring disclosure documentation for derivative instruments. Rather, section 90 of the Act determines that designated
4. Distribution of Mutual Funds

4.1 Overview

Mutual fund distribution is subject to prospectus disclosure set forth in *NI 81-101*. Mutual fund prospectuses are called ‘simplified prospectuses’ and have to contain the information determined in *Form 81-101F1*. According to these provisions, simplified prospectuses must follow specific structural requirements. In particular, *Form 81-101F1* instructs issuers to “present each Item in the Part A section and each Item in the Part B section in the respective order provided for in this Form”. Further, each “Item shall be presented under the heading or sub-heading stipulated in this Form”. Finally, each simplified prospectus must feature a front cover, a table of contents and clear indications of where further information can be obtained.

The content of simplified prospectuses is determined by Part A and B of *Form 81-101F1*. Part A requires that prospectuses feature information about (i) risks that are generally linked to mutual fund investments, (ii) the fund’s organization and management, (iii) the processing of purchases and redemptions, and (iv) fees, expenses and compensations related to the fund. Part B specifies that prospectuses must disclose (i) the fund’s investment policy, (ii) its key objectives, (iii) risks related to these strategies, and (iv) suitability issues. Mutual fund regulation contains no significant exemptions from prospectus requirements. On June 19, 2009, the CSA proposed to introduce a so called fund facts document. The document would have to be distributed at the point of sale and would contain key information about the mutual fund such as the costs and risks involved when buying and owning mutual fund units. The draft document bears significant resemblance to the key investor information derivatives must not be traded unless a prescribed disclosure document has been delivered in accordance with the respective regulations.

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635 S. 2.4 of *NI 81-101*.
636 *Form 81-101F1, General Instructions*, (12).
637 *Form 81-101F1, General Instructions*, (6).
638 *Form 81-101F1, Part A, Item 1, Front Cover Disclosure*.
639 *Form 81-101F1, Part A, Item 1, Table of Contents*.
640 *Form 81-101F1, Part A, Item 3, Introductory Disclosure*.
641 *Form 81-101F1, Part A, Item 4, General Investment Risks*.
642 *Form 81-101F1, Part A, Item 5, Organization and Management Details for a Multiple SP*.
643 *Form 81-101F1, Part A, Item 6, Purchases, Switches and Redemptions*.
644 *Form 81-101F1, Part A, Items 8 and 9, Fees and Expenses and Dealer Compensation*.
645 *Form 81-101F1, Part B, Item 7, Investment Strategies*.
646 *Form 81-101F1, Part B, Item 6, Fundamental Investment Objectives*.
647 *Form 81-101F1, Part B, Item 9, Risks*.
648 See *NI 81-101 [Amendment Proposed]* and *Form 81-101F3*. 
document whose implementation into European mutual fund regulation has been proposed by the European Commission.\textsuperscript{649}

### 4.2 Disclosure of Essential Product and Issuer Risks

As outlined under section 4.1 above, mutual fund prospectuses provide investors with material fund-specific information. While Part A features general information and procedural details, Part B depicts the fund’s objectives and strategies and relates to characteristics investors should or should not have in order to invest into a specific fund. As mutual funds are regularly structured as trusts or, less frequently, as corporations,\textsuperscript{650} the funds’ assets are legally segregated from other funds and rights of the fund management company and third parties. As a consequence, investors are not necessarily disadvantaged by the lack of detailed information on the fund’s originator or fund manager.

Item 9 of Part B requires that prospectuses list “material risks associated with an investment in the mutual fund”.\textsuperscript{651} Moreover, item 4 of Part A sets forth that prospectuses must display generic risk caveats. \textit{Form 81-101F1} does not provide investors with explicit risk labels but takes first steps in this direction by stating that mutual funds must disclose the “type of mutual fund that the mutual fund is best characterized”.\textsuperscript{652}

### 4.3 Availability of Relevant Information

Mutual fund prospectuses have to be filed with securities commissions in the same manner as prospectuses of other securities.\textsuperscript{653} Consequently, mutual fund units cannot be distributed before the prospectus has been examined and approved by the relevant securities commission. Investors are therefore provided with material information prior to their investment.

### 4.4 Intra-Product Comparability

So far, the above comments on comparability of products with products of the same kind have found fault with the absence of comprehensive structural requirements for prospectuses. In particular, \textit{Form 41-101F1} does not feature any pre-defined headings or other instructions that would obligate issuers to

\textsuperscript{649} See <http://ec.europa.eu/internal_market/investment/investor_information_en.htm>.


\textsuperscript{651} \textit{Form 81-101F1}, Part B, Item 9, emphasis added. As mutual fund investors are protected against insolvency of the fund manager or originator by the segregation of the fund’s assets, assessments on the risks related to these parties do not appear necessary. Further assessments must be conducted by the investors themselves.

\textsuperscript{652} \textit{Form 81-101F1}, Part B, Item 5 (a).

\textsuperscript{653} \textsc{Gillen} (fn. 40), p. 532, \textit{NI 81-101}, s. 2.1.
align information in a clear manner. As outlined under section 4.1, this lack of structure does not arise in relation to mutual fund prospectuses. Rather, Form 81-101F1 instructs issuers of mutual fund units to use the headings provided for in the Form and states that “a simplified prospectus shall present each Item in the Part A section and each Item in the Part B section in the respective order provided for in this Form”.\footnote{Form 81-101F1, General Instructions, (12).} As a result of these clear structural standards, investors need less time and effort to find comparable information in different prospectuses. Comparisons between mutual funds are, therefore, considerably less cumbersome than comparisons between different issues of shares, bonds, futures or structured notes. Consequently, the approach followed in Form 81-101F1 should be kept in mind when considering how comparability of prospectuses could be enhanced.

4.5 Sub-conclusion

Prospectus provisions for mutual funds and general prospectus disclosure of \textit{NI 41-101} feature significant common characteristics. To begin with, both regulatory frameworks require that issuers disclose material facts to investors. Further, simplified prospectuses for mutual funds and prospectuses in accordance with Form 41-101F1 inform investors about risks that are related to the products in question. However, the above analysis has shown that mutual fund prospectuses contain a number of characteristics that further enhance disclosure for retail investors. First, simplified prospectuses must be designed in accordance with the structural requirements of Form 81-101F1. In particular, issuers have to adopt pre-determined headings and follow the order of items as displayed in Form 81-101F1. Second, mutual fund prospectuses contain generic risk caveats and first steps in the direction of risk labelling. Third, disclosure regulation for mutual funds offers no significant prospectus exemptions. As a result, problems from exemptions that are too broad arise less frequently than they do with other investment products.

5. Preliminary Results

5.1 Delimitability

The above examination of prospectus requirements for shares, bonds, derivatives and mutual funds has confirmed the preliminary conclusions of chapter three, section 2.2 above. While disclosure standards for shares and bonds are essentially consistent with each other, prospectus requirements for different derivative products vary considerably. On the one hand, the Canadian framework for securities facilitates disclosure for exchange contracts, plain put and call options, commodity futures and principal
protected notes. On the other hand, *NI 45-106* exempts derivative debt instruments from prospectus regulation without substitution. While the material characteristics of the former product types do not require the same degree of disclosure as other instruments, the exemptions applying to principal-at-risk notes, asset-backed securities and other complexly structured debt securities do not seem appropriate. By invoking exemptions such as sections 2.34 or 2.35 of *NI 45-106*, issuers have managed to issue complex derivative products without providing material information to investors. As a consequence, investors’ efforts to delimit different types of products and assess the benefits of an investment instrument have become considerably hampered.

How can the above inconsistencies be approached? Fōk Kām argues in his research study on Implications of the Use of Investment Wrappers for a consistent pursuit of the substantive approach in relation to derivative products. In particular, he suggests that structured notes “should be subject to the same disclosure and sales practices requirements as the underlying investment”. At first glance, this concept seems most convincing. Canadian prospectus regulation is based on a substantive approach. As a result, it seems logical that all products should be subject to disclosure rules that consider the products' inherent characteristics or - in the case of structured finance - the characteristics of their underlying components. However, there are a number of reasons that speak against an uncompromising implementation of this substantive approach. First, issuers of structured derivatives are commonly not identical to those of the underlying securities. Therefore, it would not be adequate if they were required to provide investors with the same prospectus information as the issuers of the underlying products. Second, today’s structured derivatives are often not confined to one single underlying. Rather, they refer to a multitude of different securities or to other wrapper products such as ETFs, hedge funds or credit-linked securities. In addition, product managers are sometimes allowed to restructure underlying securities during the life span of a product. As a consequence, full disclosure of all product components in the same manner as if these components were issued on a standalone basis may become too complex to manage. Third, structured products are complex debt securities. As a result, they do not necessarily have the same characteristics as their underlying instruments and investors may need different or additional information to those investing in the underlying products as such. Fourth, lean regulatory structures allow issuers of structured derivatives to react to market

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655 Specified debt.
656 Short-term debt.
657 See also Fōk Kām (fn. 571), p. 299.
658 Fōk Kām (fn. 571), p. 304.
developments and investors’ needs in a timely manner.\textsuperscript{659} The introduction of lengthy prospectus filing procedures could considerably hamper the development and timely issue of innovative investment instruments.

Considering the above assessment, the implementation of thoroughly substantive prospectus regulations for structured derivatives does not seem entirely satisfactory.\textsuperscript{660} Therefore, the introduction of separate disclosure procedures for certain instruments might be worth considering. While the form of disclosure could be consistent with current shelf prospectus requirements,\textsuperscript{661} the content should be amended to the products’ characteristics and risks. In particular, extensive disclosure of the underlying instruments is appropriate only if investors have no access to product information provided by the issuer of these instruments. Instead, disclosure of structured products should focus on appropriate risk information and refer to structural characteristics that might lessen investors’ prospects. However, areas of separate disclosure regulation must be narrowly defined to a delimitable range of products. Otherwise, issuers might take advantage of facilitated disclosure regulations and issue structured derivatives which are not suited to retail investors. In particular, actively managed structured derivatives tend to have similar characteristics to mutual funds. Mutual funds are highly regulated and price-transparent entities. It would be unsatisfactory and confusing for investors if identical economic characteristics could be achieved with considerably less regulated products. Consequently, the scope of structured derivatives should not extend to actively managed products. In addition, not all structured derivatives might be suited for retail investors. As a result, the introduction of mandatory consultation might be an adequate amendment to mere prospectus disclosure. This subject will be further considered in chapter seven of this thesis.

5.2 Risk Disclosure

The above examinations of prospectus requirements for shares, bonds, derivatives and mutual funds have shown the following. Disclosure documentation generally informs investors about the key risks that are involved with investments in a certain product. Nevertheless, there are a number of aspects that could significantly enhance investors’ risk awareness. In particular, prospectuses in accordance with Form 41-101F1 partially refrain from disclosing risks related to the structure of a certain product.\textsuperscript{662} PPN risk information statements, on the other hand, do not explicitly instruct investors to disclose issuer-
related risks inherent to these products. Moreover, no prospectuses other than those of mutual funds contain generic risk caveats or risk labels cautioning investors to be aware of the risks that may generally arise from investments in certain product types. Finally, prospectus exemptions of NI 45-106 compromise disclosure for investors of structured notes and asset-backed securities in a disproportionate manner.

5.3 Availability of Relevant Information

As mentioned under the above product-specific sections, prospectus information is generally available on a timely basis. However, products without adequate disclosure requirements do not provide issuers with necessary information. In particular, a multitude of complex structured notes or credit-linked securities can be issued without prospectus documentation. In such cases, investors have no access to key information and, consequently, cannot properly assess the risks that are related to these products.

5.4 Comparability

Comparisons between different product categories are feasible as long as these products are issued under the same disclosure regime. However, comparability is slightly hampered by the fact that neither NI 41-101 nor the information statements of section 3 of PPN Regulations obligate issuers to arrange information in a certain order or under pre-defined headings. These measures have been implemented in relation to mutual fund prospectuses and allow investors to compare different funds in an efficient manner. Although a comprehensive harmonization of headings or section orders might not be feasible in relation to all kinds of securities, an implementation of basic mandatory disclosure structures could make a considerable contribution to enhanced product comparability.

5.5 Sub-conclusion

In view of the above analysis of prospectus disclosure for shares, bonds, derivatives and mutual funds, the following conclusions can be drawn. First, Canadian securities regulation’s substantive approach to product regulation provides investors with relevant information and risk disclosure in most cases. However, limitations have been identified in relation to complex derivative and credit-linked products that make use of traditional prospectus exemptions to escape disclosure of material product and issuer risks. A possible strategy to eliminate these tendencies without unduly inhibiting innovative product strategies might be found in the implementation of derivative-specific prospectus requirements for

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663 Section 3.2.b.
664 See above, section 4.4.
structured products. First steps in this direction have already been taken by introducing *PPN Regulations* in July 2008. Second, disclosure could be further enhanced by risk labels and additional structural requirements for prospectuses. Although more complex comparisons might need the assistance of professional advisors or asset managers, well-arranged prospectus structures and risk indications can considerably increase investors’ abilities to assess the appropriateness of a specific product. Third, some product structures as, for example, actively managed structured notes might be too complex for the purposes of retail investors and, therefore, should be banned from mass trading. Canadian securities regulation has so far not chosen to introduce such prohibitions. Chapter seven, section II will return to these considerations.

III. Switzerland

1. Distribution of Shares

1.1 Overview

Section III.3 of chapter two has shown that Swiss securities regulation distinguishes between exchange-traded shares and shares that are not listed at a stock exchange. Issuers of non-listed shares do not have to produce a prospectus at the incorporation of the company.\(^{665}\) However, if a corporation raises its capital and distributes shares to the public,\(^{666}\) it must publish a so-called ‘issue prospectus’.\(^{667}\) Section 652a *SCO* does not provide any structural requirements for this document. With respect to the prospectus content, the provision sets forth that the issue prospectus must disclose information on (i) the corporation’s structure and share characteristics,\(^{668}\) (ii) “the latest financial statement (…) with the auditors’ report”,\(^{669}\) “dividends paid during the last five years”,\(^{670}\) and “the resolution on the issue of new shares”.\(^{671}\) Prospectuses for non-listed shares are not vetted or approved by any regulatory bodies and companies issuing non-listed shares are not subject to any oversight regulation. However, section 752 *SCO* introduces civil liabilities for any damage due to the fact that “statements have been made or disseminated which are incorrect, misleading or not complying with the legal requirements in issue prospectuses (Art. 652a) or similar instruments”.

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\(^{665}\) S. 629 *SCO* et seq.

\(^{666}\) See GAUDENZ G.ZINDEL/PETER R. ISLER, *Basler Kommentar zum Obligationenrecht II*, 3rd edition (Basel. Helbing Lichtenhahn, 2008), s. 652a *SCO*, n. 1 - 3b, and s. 652a (2) *SCO*.

\(^{667}\) S. 652a (1) *SCO*.

\(^{668}\) S. 652a (1)(1) - (4) *SCO*.

\(^{669}\) S. 652a (1)(5) *SCO*.

\(^{670}\) S. 652a (1)(6) *SCO*.

\(^{671}\) S. 652a (1)(7) *SCO*.
Issuers of exchange-traded shares have to follow far more detailed prospectus provisions. In particular, they must comply with *Scheme A* for equity securities of *SIX Regulation*[^672]. The scheme requires that issuers indicate “risk factors that are of key importance in assessing the market risk attached to the issuer, its sector and the securities that are being offered”[^673]. Further, share prospectuses have to inform investors about the issuer and its business activities[^674] and must contain the issuer’s financial statements “for the last three full financial years”[^675] and “material changes since the most recent annual or interim financial statements”[^676]. In addition, prospectuses must contain information on the shares themselves, in particular on the nature of the issue[^677], restrictions on transferability and tradability[^678], and the form[^679], number, type and par value of the distributed securities[^678]. *SIX Regulation* does not feature a prospectus summary or any structural requirements except that risk factors must be presented “in a prominent place” and “under a specific ‘Risk factors’ heading”[^681].

### 1.2 Disclosure of Essential Product and Issuer Risks

Prospectuses for non-listed shares fail to provide investors with adequate information. In particular, issuers are not required to provide information on the future prospects of the corporation[^682] or material developments since the most recent financial statements[^683]. Further, prospectuses acting in accordance with section 652a *SCO* do not call attention to any risk factors related to the issuer and the distributed shares. Considering the scarce information that investors can take from these prospectuses, section 652a *SCO* does not conform to international disclosure standards[^684] and is distinctly below the standard of the Canadian prospectus regulations outlined above.

[^673]: S. 1 of *Scheme A*, Equity Securities, SIX Swiss Exchange Regulation.
[^674]: S. 2.1 - 2.6 of *Scheme A*, Equity Securities, SIX Swiss Exchange Regulation.
[^675]: S. 2.7.1 of *Scheme A*, Equity Securities, SIX Swiss Exchange Regulation.
[^676]: S. 2.7.5 of *Scheme A*, Equity Securities, SIX Swiss Exchange Regulation.
[^677]: S. 3.2 of *Scheme A*, Equity Securities, SIX Swiss Exchange Regulation.
[^678]: S. 3.6 of *Scheme A*, Equity Securities, SIX Swiss Exchange Regulation.
[^679]: S. 3.11 of *Scheme A*, Equity Securities, SIX Swiss Exchange Regulation.
[^680]: S. 3.3 of *Scheme A*, Equity Securities, SIX Swiss Exchange Regulation.
[^681]: S. 1 of *Scheme A*, Equity Securities, SIX Swiss Exchange Regulation.
[^682]: Bericht zum Vorentwurf der Expertengruppe zur Ausarbeitung eines Bundesgesetzes über die Börsen- und den Effektenhandel of January 22, 1992, p. 22, CONTRATTO (fn. 129), p. 249. Unlike Canadian securities regulation (NI 51-102, Part 4a), the Swiss legal framework does not provide any standards if the company should publish information about its future prospects on a voluntary basis.
[^683]: BSK-ZINDEL/ISLER (fn. 666), s. 652a SCO, n. 5.
Prospectuses of exchange-traded shares inform investors about the essential aspects of the issuer’s business and the shares’ characteristics. Further, prospectuses must advise investors of risks that are related to the issuer and the shares. However, these risk statements do not comment on effectively impending risks and the probability of their occurrence. Rather, prospectus disclosure provides the tools for risk assessments but refrains from giving any indications of the issuer’s views on potential issues. Finally, prospectuses of exchange-traded shares do not contain any pre-defined risk labels. As section II.1.2 has shown, risk labels do not appear meaningful in relation to shares. As a consequence, Scheme A of SIX Regulation complies with the core disclosure strategies applicable in relation to shares. Improvement could be made by the introduction of brief MD&As discussing the likelihood that one of the displayed risks will actually occur.

1.3 Availability of Relevant Information

Prospectuses of non-listed shares are not vetted by any regulatory bodies. As a consequence, investors have no guarantee that they obtain information in the correct form and in good time. This lack of control has been explained with efficiency reasons and investors’ choice between supervised and largely unregulated securities markets. However, recent experience has shown that efficiency does not necessarily imply well-functioning and balanced markets. If investors have no appropriate access to relevant information, they are not able to make adequate investment decisions and are therefore entirely exposed to the issuer’s goodwill and honesty. Moreover, the absence of adequate risk disclosure and control is unique in securities regulation of European countries. As will be outlined under section IV below, member states of the European Union require that issuers provide elaborate prospectuses and have implemented prospectus due diligence by governmental authorities. If Swiss securities markets intend to keep up with global disclosure standards, the introduction of prospectus due diligence cannot be circumvented.

Issuers of prospectuses of exchange-traded shares must be filed with SIX Swiss Exchange. If the exchange approves the listing, issuers are required to publish the relevant documents “no later than

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688 See s. 42 - 48 of SIX Listing Rules for the listing procedure.
the day of listing”. Although prospectuses are not vetted by a government agency, the approval procedure of SIX seems to be adequately designed as to guarantee that investors obtain relevant information in due time.

1.4 Intra-Product Comparability

As outlined under section II.1.4 above, investors must be able to compare different share issues by means of the prospectuses accompanying these shares. Consequently, the implementation of harmonized and structured prospectus information is a key element of transparent capital markets. Swiss prospectus regulation for non-listed shares fails to provide investors with adequate information. In addition, it does not define a sequence that issuers have to follow with regard to the required items. Finally, prospectuses of non-listed shares are not available on a public platform but have to be requested from each issuer separately. In view of these hurdles that investors have to overcome in order to obtain meaningful information, the present legal framework does not enable product comparability in an adequate manner.

Prospectuses of exchange-traded shares, on the other hand, can be obtained on the website of SIX Swiss Exchange. However, availability is confined to a relatively short time span. Section 30 (4) SIX Listing Rules determines that the “Regulatory Board reserves the right to make approved and published listing prospectuses (...) available in suitable form via an electronic system”. The period of publication is not defined by any regulatory provision and is within the discretion of the SIX Regulatory Board. Generally, prospectuses are available for approximately six months to one year following the issue of the securities. As a result, investors who consider buying shares on the secondary market after this time period no longer have access to information provided in the prospectus. Further, SIX Regulation determines neither the order in which information must be arranged nor the headings that should be used to structure prospectuses.

689 S. 39 of SIX Listing Rules.
690 See above, sections 1.1 and 1.2.
692 In February 2010, for example, investors have access to prospectuses that have been issued between July 2009 and February 2010.
693 The requirement in S. 1 of Scheme A, Equity Securities, to describe relevant risk factors under the heading ‘Risk Factors’ is the only exemption to the above assessment.
1.5 Sub-conclusion

Taking into account the above insights, Swiss prospectus regulation in relation to publicly distributed shares features several gaps. First, prospectuses of non-listed shares lack crucial information such as the indication of relevant risk factors. Second, investors of exchange-traded shares do not obtain a brief risk prognosis as set forth in Canadian MD&As\textsuperscript{694} or a summary of all material prospectus information. Third, availability and comparability of prospectuses is seriously hampered by the fact that Swiss securities legislation has not introduced a centralized storage of public securities documents.\textsuperscript{695} Fourth, the Swiss prospectus framework for shares lacks provisions defining a clear design for share prospectuses. As a result, investors need more time and expertise to select comparable information from different prospectuses.

2. Distribution of Bonds

2.1 Overview

Swiss securities regulation does not feature a harmonized disclosure framework. As a consequence, legislation does not contain a uniform prospectus framework for all kinds of debt securities. Section 1156 \textit{SCO} specifies that non-listed bonds\textsuperscript{696} can be distributed to the public only if they are accompanied by a prospectus. The content of a bond’s prospectus is based on the prospectus requirements for non-listed shares. Further, the prospectus has to “contain the detailed information concerning the loan, especially the interest terms, terms of repayment, special security provided for the bonds (…)”.\textsuperscript{697} Prospectuses for non-listed bonds are not vetted or approved by any regulatory bodies.

SIX Swiss Exchange has implemented additional prospectus requirements in relation to exchange-traded bonds. \textit{Scheme E} requires that issuers disclose information on the issuer of the bonds\textsuperscript{698} and the distributed securities.\textsuperscript{699} While the issuer-related requirements are largely identical to those set out for exchange-traded shares, information relating to the product itself is customized to the general

\textsuperscript{694} See above, fn. 509.
\textsuperscript{695} See, in contrast, the Canadian SEDAR system on <www.sedar.com>. Although investors can access information on exchange-traded shares via the website of the Swiss stock exchange, there is no centralized database for Swiss corporations. In particular, the SIX website generally refers investors to homepages of listed companies and, thus, further complicates availability of documents.
\textsuperscript{696} See above, chapter two, section III.2, for the definition of a bond in Swiss securities regulation. As SIX \textit{Regulation} contains more detailed prospectus rules for listed bonds, requirements of s. 1156 \textit{SCO} are relevant in relation to non-listed bonds only.
\textsuperscript{697} S. 1156 (2) \textit{SCO}.
\textsuperscript{698} Section 1 of \textit{Scheme E}, Bonds, SIX Swiss Exchange Regulation.
\textsuperscript{699} Section 2 of Scheme E, Bonds, SIX Swiss Exchange Regulation.
characteristics of bonds. In particular, prospectuses must display the terms and conditions of the securities,\(^{700}\) such as the issue and redemption price,\(^ {701}\) the interest rate,\(^{702}\) and duration and “terms and conditions of repayment”.\(^ {703}\) Further, issues of convertible bonds or warrant bonds require additional disclosure.\(^ {704}\) Prospectuses of asset-backed bonds must feature a transaction summary\(^ {705}\) and risk disclosure in relation to legal risks, “risks associated with the structure of the transaction, including third-party risk”, and “all other significant risks associated with the structure and with the assets serving as collateral”.\(^ {706}\) Scheme E does not require a prospectus summary or any structural obligations in relation to bond prospectuses. Consequently, issuers are free to choose orders and headings at their discretion.

2.2 Disclosure of Essential Product and Issuer Risks

Prospectuses for non-listed bonds feature the same gaps as those described in relation to non-listed shares in section 1.2 above. In particular, they fail to provide information that would allow issuers to gauge issuer-related developments and assess risks that could arise from the purchase of the bonds.

Prospectuses of exchange-traded bonds enable investors to gain key information on the issuer’s business and the characteristics of the distributed securities. However, Scheme E generally does not require that prospectuses of bonds feature a summary of material information or display any risks that might arise in relation to the purchase of specific bond securities. As seen under section 2.1 above, risk information must be displayed only in prospectuses of asset-backed securities.\(^ {707}\) Prospectuses of listed bonds do not feature any risk assessments or pre-determined risk labels. As mentioned under section II.2.2 above, retail investors benefit from additional risk labeling in relation to complex debt structures. Although they are able to extract relevant information from bond prospectuses, the abundance of products and their different structures might hamper a timely assessment of appropriate products. Risk labels could facilitate these initial assessments.

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\(^{700}\) S. 2.3 of Scheme E, Bonds, SIX Swiss Exchange Regulation.
\(^{701}\) S. 2.3.5 of Scheme E, Bonds, SIX Swiss Exchange Regulation.
\(^{702}\) S. 2.3.6 and 2.3.7 of Scheme E, Bonds, SIX Swiss Exchange Regulation.
\(^{703}\) S. 2.3.8 and 2.3.9 of Scheme E, Bonds, SIX Swiss Exchange Regulation.
\(^{704}\) S. 2.5 and 2.6 of Scheme E, Bonds, SIX Swiss Exchange Regulation. In particular, if underlying securities are not listed at SIX Swiss Exchange, prospectuses must contain information on these securities (s. 2.5.3 of Scheme E). Due to the lack of transparency for non-listed securities in Swiss capital markets, investors would otherwise have no access to related information.
\(^{705}\) S. 3.1 of Scheme E, Bonds, SIX Swiss Exchange Regulation.
\(^{706}\) S. 3.2 of Scheme E, Bonds, SIX Swiss Exchange Regulation.
\(^{707}\) See below, section III.3.3.
2.3 Availability of Relevant Information

As seen with prospectus requirements for non-listed shares, section 1156 SCO does not provide any measures to safeguard a timely and comprehensive distribution of prospectuses to investors of non-listed bonds.\textsuperscript{708} This lack of disclosure does not comply with international standards and should be abolished.\textsuperscript{709}

Prospectuses of exchange-traded bonds must be filed with SIX Swiss Exchange in accordance with the general SIX Listing Rules.\textsuperscript{710} As a consequence, prospectuses have to be published at the day of listing or on an earlier date.\textsuperscript{711} In addition, their accordance with the requirements of Scheme E is assessed by the SIX admission board and, therefore, investors are protected against receiving inconsistent or fragmentary information.\textsuperscript{712}

2.4 Intra-Product Comparability

Comparisons between different non-listed Swiss bonds are seriously hampered by the lack of adequate information and the fact that disclosure documentation of non-listed securities is not accessible via an electronic and centralized platform.\textsuperscript{713} Further, section 1156 SCO does not require a specific sequence in which information on bonds has to be displayed in a prospectus. Comparisons of different non-listed bond securities could be significantly enhanced by filling the above gaps.

Investors in exchange-traded bonds do not suffer from hampered accessibility of information about these products. Prospectuses must be published in a national newspaper or provided by the issuer free of charge, either in printed or electronic form.\textsuperscript{714} However, prospectuses cannot be found on the SIX website and - unlike issuers of shares - issuers of bonds do not have to publish a listing notice if they decide against publication of prospectuses.\textsuperscript{715} As a consequence, investors may have difficulties finding relevant information on a timely basis. Finally, bond prospectuses lack a pre-determined order of subjects and do not provide standardized headings under which specific information can be found.

\textsuperscript{708} Prevailing doctrine assumes that prospectuses must be accessible at the time of the public offer (BSK-WATTER/NOTH (fn. 139), s. 1156 SCO, n. 11).
\textsuperscript{709} See also BSK-WATTER/NOTH (fn. 139), s. 1156 SCO, n. 11.
\textsuperscript{710} S. 23 of the SIX Additional Rules for the Listing of Bonds.
\textsuperscript{711} See fn. 689 above.
\textsuperscript{712} The standard of the information obtained in prospectuses of listed bonds conforms to international standards [see BSK-WATTER/NOTH (fn. 139), s. 1156 SCO n. 21].
\textsuperscript{713} See above, section 1.4.
\textsuperscript{714} S. 12 of the SIX Additional Rules for the Listing of Bonds, referring to s. 30 of SIX Listing Rules.
2.5 Sub-conclusion

In view of the above examination, prospectus disclosure for bonds shows the same inconsistencies listed under section 1.5 above. In addition, prospectuses of listed bonds fail to indicate issuer- and product-related risks and are not centrally published by SIX at the time of the listing. As a consequence, Swiss investors who consider purchasing bonds have even less information than potential shareholders. In addition, the complexity of certain bond structures could be significantly cushioned by the implementation of risk labels or prospectus summaries. Neither measure has so far found its way into Swiss prospectus regulation.

3. Distribution of Derivatives

3.1 Options and Futures

a. Overview

As mentioned in chapter two, section III.3, Swiss securities regulation lacks a comprehensive framework for derivatives. Unlike the Canadian disclosure framework, Swiss prospectus regulation is fragmentary and scattered over different Statutes. As a consequence, certain types of securities do not fall under the scope of prospectus requirements at all.

Exchange-traded options and futures contracts are traded on Eurex\(^{716}\) and are not included in Swiss prospectus regulations. Rather, transparency is guaranteed by a consistent standardization of these contracts. The content and form of options and futures contracts can be derived from Eurex contract specifications which, in turn, are accessible via each product on the Eurex website.\(^{717}\)

Unlike Canadian markets,\(^{718}\) Swiss capital markets feature exchange-traded options that do not follow the contract specifications of a stock exchange.\(^{719}\) These stand-alone warrants are issued by investment banks in the form of paper certificates or book-entry securities and have to comply with the prospectus requirements of SIX Swiss Exchange. *Scheme F*\(^{720}\) requires that issuers of derivatives present “the risks attached to investing in derivatives”.\(^{721}\) These risk factors have to be described in relation to the

\(^{716}\) [http://www.eurexchange.com].

\(^{717}\) See, for example, the contract specifications for Euro-Schatz Futures, on [http://www.eurexchange.com/trading/products/INT/FIX/FGBS_en.html].

\(^{718}\) See above, section II.3.1.b.

\(^{719}\) See, for example, the base listing prospectus for UBS warrants on. <http://warrants.ubs.com/home/html/basedoc/29010088(e13.00)book.pdf>.

\(^{720}\) *Scheme F*, Derivatives, SIX Swiss Exchange Regulation.

\(^{721}\) S. 1 of *Scheme F*, Derivatives, SIX Swiss Exchange Regulation.
respective product and cannot be confined to a generic description of derivative-related risks.\textsuperscript{722} Further, derivative prospectuses must contain information on the issuer of the products.\textsuperscript{723} Moreover, prospectuses have to describe the terms and conditions of the distributed products, such as their issue price, interest rate, duration, and redemption and exercise procedures.\textsuperscript{724} Finally, derivative prospectuses must contain information on the underlying securities.\textsuperscript{725} However, \textit{Scheme F} does not establish any structural requirements except its instruction that risk factors must be explained under a separate heading and in a prominent place.\textsuperscript{726}

Swiss securities regulation does not feature any specific prospectus requirements for non-listed options.\textsuperscript{727} As a consequence, the prevailing doctrine concludes that issuers of these products do not have to follow any prospectus requirements.\textsuperscript{728} However, current practice has started to produce prospectuses for these products on a voluntary basis.\textsuperscript{729} These voluntary prospectuses are neither vetted by SIX Swiss Exchange nor approved by any regulatory bodies.

b. Disclosure of Essential Product and Issuer Risks

Eurex contract specifications for exchange-traded futures and option contracts contain relevant information on the products’ terms and conditions.\textsuperscript{730} In addition, the clearing mechanism of Eurex largely protects investors against risks related to the potential insolvency of their counterparties.\textsuperscript{731} Moreover, Swiss retail investors are not allowed to trade derivative contracts on their own. Rather, they have to “obtain access through a bank or a broker who have a direct connection to the exchange”.\textsuperscript{732} In addition, securities dealers must inform their clients about “types of transactions and investments that

\begin{thebibliography}{99}
\item S. 1 of \textit{Scheme F}, Derivatives, SIX Swiss Exchange Regulation.\textsuperscript{722}
\item S. 2 of \textit{Scheme F}, Derivatives, SIX Swiss Exchange Regulation. This part of the prospectus is largely identical with share or bond prospectuses.\textsuperscript{723}
\item See s. 3.2 of \textit{Scheme F}, Derivatives, SIX Swiss Exchange Regulation.\textsuperscript{724}
\item S. 4 of \textit{Scheme F}, Derivatives, SIX Swiss Exchange Regulation.\textsuperscript{725}
\item S. 1 of \textit{Scheme F}, Derivatives, SIX Swiss Exchange Regulation.\textsuperscript{726}
\item Futures contracts are traded on futures exchanges, whereas forwards are conducted as OTC transactions (see STEFFEN TOLLE/BORIS HUTTER/PATRIK RÜTHEMANN/HANSPETER WOHLWEND, Strukturierte Produkte in der Vermögensverwaltung, 3rd edition (Zürich. Verlag Neue Zürcher Zeitung, 2007), p. 22. However, as forwards are generally not distributed to retail investors, the following observations will not dwell on these products.\textsuperscript{727} CONTRATTO (fn. 129), p. 269.
\item Further, some authors suggest that issuers of these products have - despite the present legal gap - a duty to produce prospectuses (See RALPH MALACRIDA/ROLF WATTER, \textit{SWISS Corporate Finance and Capital Markets - Legal Aspects} (Basel. Helbing & Lichtenhahn Verlag, 2001), p. 75 et seq.). See also CONTRATTO (fn. 129), p. 280.
\item I.e. on their price, their contract value and contract years.\textsuperscript{730}
\item See also CONTRATTO (fn. 129), p. 251.
\end{thebibliography}
may involve special risks”.\textsuperscript{733} This duty is generally performed by giving investors a brochure on ‘Special Risks in Securities Trading’ of the Swiss Bankers Association\textsuperscript{734} which displays transactions involving particular risks. Among others, the brochure informs investors on risks that are related to options and futures.\textsuperscript{735} In view of the highly standardized nature of these contracts, an implementation of risk labels does not appear to be mandatory. As a consequence, retail investors are adequately informed on exchange-traded futures and derivatives contracts. Further disclosure measures would not significantly enhance their standing in relation to product structurers or counterparties.

Issuers of exchange-traded warrants are required to disclose key information in relation to the issuer, the product itself and underlying securities. However, in view of the volume of information contained in these prospectuses, the implementation of a summary would enhance timely oversight of a specific product and its characteristics. Prospectuses of exchange-traded options must present risks related to an investment in the respective product. Considering the freedom of issuers to structure their derivative products, risks labels could additionally improve investors’ ability to determine whether a product would fit in their portfolio. Moreover, counterparty risks could be better assessed if prospectuses contained a brief risk prognosis as set forth in Canadian MD&As.

The lack of prospectus requirements for non-listed options affects investors’ abilities to obtain information on traded products even more strongly than the fragmentary prospectus requirements for non-listed shares in section 1.2 above. Therefore, the introduction of mandatory prospectus rules for option securities seems to be a particularly pressing issue in Swiss securities regulation.

c. Availability of Relevant Information

Investors have access to information on exchange-traded futures and option contracts on the website of Eurex. As a consequence, investors of exchange-traded options or futures can obtain relevant information in a timely manner. Issuers of exchange-traded warrants are required to publish their prospectuses no later “than the day of listing”.\textsuperscript{736} In addition, SIX Swiss Exchange monitors the content and format of prospectuses and makes sure that issuers comply with the requirements of \textit{Scheme F of SIX Regulation}. However, accessibility of prospectuses for warrants is complicated by the fact that


\textsuperscript{734} The brochure can be downloaded on. <http://www.swissbanking.org/en/home/shop.htm>.

\textsuperscript{735} P. 6 - 14 of the brochure.

\textsuperscript{736} S. 19 of \textit{SIX Additional Rules for the Listing of Derivatives}, referring to s. 31 SIX Listing Rules.
prospectuses cannot be accessed on the SIX website. Non-listed options are not accompanied by mandatory prospectuses. Further, even if issuers decide to produce prospectuses on a voluntary basis, these documents are not examined by any supervisory institution. As a consequence, investors of non-listed options have no reliable source to investigate product-specific characteristics and risks.

d. Intra-Product Comparability

Investors of exchange-traded options and futures contracts have access to the contract specifications on the Eurex website. Due to the radical standardization of these contracts, comparisons between different products can be conducted without difficulty. Likewise, investors of exchange-traded warrants obtain all relevant information on these products. However, prospectuses of these products lack a predetermined order and do not provide standardized headings. Further, they cannot be retrieved on an electronic and centralized platform. Consequently, investors may be significantly delayed when comparing different products. Comparisons between different non-listed options are seriously hampered by the lack of adequate prospectus requirements.

e. Sub-conclusion

Considering the above findings, Swiss prospectus regulation for options and futures features the following main characteristics. First, contract specifications for exchange-traded futures and options contracts and prospectuses of exchange-traded warrants provide investors in a timely manner with adequate information. Investors’ standing could be further improved by the introduction of structural guidelines and risk labels. Second, Swiss securities regulation does not contain a prospectus requirement for non-listed options. As a consequence, investors have no legal certainty that they can access all relevant information in due time. Third, the lack of a centralized platform where investors can retrieve disclosure documentation is a significant drawback of Swiss securities regulation and should be remedied as soon as practicable.

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737 See section 2.4 above in relation to exchange-bonds. Prospectuses must be published in a national newspaper or provided by the issuer free of charge, either in printed or electronic form (s. 19 of SIX Additional Rules for the Listing of Derivatives, referring to s. 30 of the SIX Listing Rules).

738 See above, section 1.4.
3.2 Structured Notes

a. Overview

Swiss structured notes generally qualify as structured products in the sense of section 5 CISA. Section 5 (1)(b) CISA requires that issuers of structured products provide investors with a simplified prospectus. The Swiss Bankers Association Guidelines on Informing Investors about Structured Products specify the minimum information that prospectuses of structured products must include. In particular, simplified prospectuses have to disclose the name and head office of the issuer, product details such as the issue price, exercise details, price setting and maturity, information on the underlying values, and a reference that structured products are neither mutual funds nor require the approval of a supervisory authority. In addition, prospectuses must inform investors on the significant product-specific and issuer-related risks that investors take when purchasing a structured product. However, these risk indications relate to possible risks in a rather generic way and do not elaborate on the probability that one of these risks will actually occur. The Swiss Structured Product Association (SVSP) has further developed a so-called Swiss Derivative Map. This document presents different types of structured products and assigns a number to each type. These numbers are applied to each prospectus and serve as risk labels for investors of structured products. In addition, investors are provided with a risk figure based on the Value at Risk approach. This risk figure is based on historic data and “aims to predict quantitatively market risk”. Moreover, FINMA requires that simplified prospectuses are divided into the following main sections: product description, profit and loss prospects, and significant risks for

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739 See below, section 3.3.a, on the qualification of credit linked notes.
741 Section 5 (a) of the Guidelines on informing investors about structured products, Swiss Bankers Association (August 2007).
742 Sections 5 (b) and (c) of the Guidelines on informing investors about structured products.
743 Section 5 (e) of the Guidelines on informing investors about structured products.
744 Section 5 (h) of the Guidelines on informing investors about structured products.
745 Section 5 (d) of the Guidelines on informing investors about structured products.
748 The map lists types such as ‘Uncapped Capital Protection’, Exchangeable Certificates’, ‘Capital Protection with Knock-Out’ etc.
750 <http://www.svsp-verband.ch/download/risikokennzahl/100201_svsp_var_informationen_en.pdf>. However, experts point out that the VaR-method does not provide investors to assess the appropriateness of a product without additional information (see interview with Paolo Vanini, NZZ am Sonntag, Spezial Derivate, p. 17.)
Simplified prospectuses of non-listed structured products are neither approved by any supervisory authority, nor can they be retrieved on a centralized electronic database. Investors have to approach issuers or intermediaries in order to obtain the relevant documentation.

SIX Swiss Exchange requires that issuers of exchange-traded structured products design their prospectuses in accordance with Scheme F of SIX Regulations as well as the above general requirements of section 5 CISA. Given that Scheme F goes beyond the requirements of section 5 CISA, exchange-traded structured products must largely adhere to the same standards as exchange-traded options. As a result of this convergence, reference can be made to section 3.1 above. The following explanations refer solely to non-listed structured products.

b. Disclosure of Essential Product and Issuer Risks

As seen in section (a) above, simplified prospectuses of structured products must disclose relevant information on the product, its underlying values and its issuer. Further, prospectuses have to disclose issuer-related and product-specific risks and label the product by assigning it to one of the product types listed by SVSP. Comprehensive risk assessments, however, are not part of the mandatory components of a simplified prospectus. Although the risk figures introduced by SVSP indicate the risk of a certain product to investors, their informative value is constrained by various factors and, so far, neither SVSP nor the Swiss legislator insists that issuers refer to these figures in the products’ prospectuses. In view of the fact that a full or partial repayment of the investment depends to a great extent on the solvency of the issuer or a related third party, issuer-related risk assessments would significantly facilitate respective investment decisions.

c. Availability of Relevant Information

Issuers are required to make simplified prospectuses “available free of charge to any interested person at the time the product is issued or a product agreement is signed.” As a result, investors are generally in a position to access relevant information on a timely basis. However, prospectuses are not vetted before their distribution and, consequently, may omit or distort important information.

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751 <http://www.finma.ch/e/faq/beaufsichtigte/pages/faq-strukturierte-produkte.aspx, s. 15>. The order of these sections is not predetermined by FINMA, as efforts in this regard were rejected by SVSP.

752 See above, section 3.1.a.

753 Due to the brevity of simplified prospectuses, there is no need for a summary of the prospectus content.

754 See Vanini (fn. 750). In particular, VaR-values do not disclose the long-term risks of a product.

755 S. 5 (3) CISA.
d. Intra-Product Comparability

Simplified prospectuses generally contain all information that investors need in order to compare different structured products with each other. However, the lack of an electronic and centralized platform complicates investors’ knowledge of and access to prospectuses worth comparing. Further, structural requirements for simplified prospectuses are marginal. As efficient comparisons between different products can be time-consuming and confusing, retail investors would benefit from the introduction of a pre-defined sequence and arrangement of prospectus components.

e. Sub-conclusion

Simplified prospectuses for structured products are a lean and efficient means to inform investors about the key characteristics of a specific product. In particular, the description of issuer-related and product-specific risks and the product labels of SVSP are instructive measures that assist investors in their product assessment. However, additional disclosure could be achieved by introducing a pre-defined order for prospectus components and establishing a central electronic platform where disclosure documentation of all issuers could be retrieved by interested parties. Further, it is objectionable that simplified prospectuses of structured products are not vetted by a supervisory body. If systematic controls are deemed too cumbersome or retarding, supervisory authorities should at least be required to vet random sample prospectuses from time to time.

3.3 Credit Derivatives and Asset-backed Securities

a. Overview

The Swiss market for credit derivatives and asset-backed securities is still young. Typically, credit derivatives based on credits to Swiss companies are traded in the UK or US market. However, in recent years Swiss banks have taken first steps to establish a liquid Swiss market for credit derivatives. Due to the lack of transparency requirements, the dimension of this market cannot be determined.

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756 See above, section 1.4.
757 See also MARC LUGINBÜHL/PATRIC EYMANN, Der vereinfachte Prospekt für strukturierte Produkte auf dem Prüfstand - Eine gute Grundlage mit Potential zur Verbesserung, in. NZZ Sonderbeilage Derivative Produkte (August 26, 2009), p. 11.
758 CONTRATTO (fn. 129), p. 407.
759 See above, section II.3.2.d and II.5.1.
761 HENN-OVERBECK/MÜHLAUP/SCHMIDT/WEGMANN (fn. 760).
762 HORAT (fn. 616), p. 974.
During the last ten years, the Swiss market for securitized products has also gained some momentum. In particular, Swiss banks have taken up securitization activities in the commercial mortgage market.\textsuperscript{763} Transactions are generally conducted under a true sale structure.\textsuperscript{764} SIX has established particular requirements for the listing of asset backed securities.\textsuperscript{765}

b. Regulation

Swiss securities regulation does not feature any specific disclosure provisions for credit derivatives and asset-backed securities.\textsuperscript{766} Consequently, these instruments are subject to regulatory requirements for derivatives or bonds. The following section will briefly outline which of the above rules apply to different product structures and assess whether current regulation is able to govern these instruments in an appropriate manner.

Non-listed and non-structured derivatives such as credit default swaps or credit spread options\textsuperscript{767} are not subject to any prospectus regulations. Exchange-traded non-structured credit derivatives are subject to regulations of the respective stock exchange. In particular, credit swaps listed on Eurex have to follow the contract provisions set forth by this self-regulatory body. As these products are generally not distributed to retail investors, the below observations will focus on prospectus requirements for structured derivatives.

Non-listed asset-backed securities and structured credit derivatives, for example credit linked notes,\textsuperscript{768} must follow the disclosure provisions for bonds.\textsuperscript{769} Although synthetic structures would theoretically fall under the scope of section 5 \textit{CISA}, the Swiss Banking Organization clarifies that products “where the primary focus is on financing purposes or a risk transfer in the narrow sense, such as collateralized debt obligations, credit linked notes, asset backed securities (...) are not covered by (...) art. 5” \textit{CISA}.\textsuperscript{770}

\begin{thebibliography}{9}
\bibitem{763} \textsc{Johannes Bürgi/Thomas Meister}, “CMBS wave finally hits Switzerland”, Global Securitisation and Structured Finance 2007, p. 318.
\bibitem{764} See \textsc{christian staub}, \textit{Kreditrisikotransfer - Schweizerisches Aufsichtsrecht im Wandel}, Zürich/St. Gallen 2009, p. 41. The first public transaction came on the market in 1998 and was structured by UBS. The first synthetic structure was issued in 2000, by UBS as well (see Bürgi/Meister (fn. 763) p. 318, and <http://www.ubs.com/1/g/media_overview/media_global/search1/search10?newsId=59420>).
\bibitem{766} See, however, Scheme E, section 3 of SIX Regulations for exchange-traded asset-backed securities.
\bibitem{767} See Hutterli (fn. 339), p. 83.
\bibitem{768} See Hutterli (fn. 339), p. 84, and Zobl/kramer (fn. 132), p. 450.
\bibitem{769} See above, section 2.1.
\bibitem{770} \textit{Guidelines on Information Investors about Structured Products}, p. 4.
\end{thebibliography}
statement has been criticized by legal scholars\textsuperscript{771} and may not be upheld in future Swiss securities regulation. Exchange-traded asset-backed securities and structured credit derivatives qualify as bonds.\textsuperscript{772} If their performance is backed by a segregated pool of assets, they must adhere to the additional requirements set forth for asset-backed securities.\textsuperscript{773} Issuers of credit-linked notes, on the other hand, have to follow the provisions of Scheme F for derivative instruments.\textsuperscript{774}

In view of the above observations, Swiss regulation of credit derivatives features substantial inconsistencies. First, transparency needs of investors purchasing non-listed credit derivatives are not satisfactorily met by Swiss prospectus requirements. In particular, bond disclosure provisions of section 1156 SCO do not provide investors with adequate information on the product structure in question and, therefore, hamper thorough risk assessments and comparisons between different products. Second, the exclusion of non-listed structured credit derivatives from the prospectus requirements of section 5 CISA is not justified. If retail investors acquire an investment product, their need for information exists irrespective of the issuer’s purposes. Third, disclosure requirements of SIX Regulation do not provide uniform prospectus requirements for all types of credit derivatives or asset-backed securities. Once again, the product-specific categorization of Swiss law\textsuperscript{775} does not consider the economic characteristics of a product and, therefore, creates a potentially confusing coexistence of different prospectus provisions. Although the current prospectus requirements of SIX Regulation may arguably disclose all material facts and risks to investors, they do not achieve the establishment of a uniform framework for economically closely related products.

\textsuperscript{771} HU TTERLI (fn. 339), p. 82, BENEDIKT MAUREN BRECHER/STEFAN WALLER, „Prospekthaftung und strukturierte Produkte“, in. Thomas U. Reutter et al. (eds.), Kapitalmarktttransaktionen V, p. 61, and EGGEN (fn. 186), fn. 43.
\textsuperscript{773} See above, section 2.1. In particular, scheme E, section 3, contains additional requirements that issuer of asset-backed securities must follow.
\textsuperscript{775} This time in relation to bonds and derivatives.
4. Distribution of Mutual Funds

4.1 Overview

Swiss securities regulation features identical prospectus requirements in relation to exchange-traded and non-listed mutual funds. Sections 75 and 76 CISA require that fund management companies and SICAVs publish (i) a prospectus for each mutual fund, and (ii) a simplified prospectus for securities funds, real estate funds and other funds for traditional investments. The mandatory contents of these prospectuses are outlined in Annex I and II CISO. In particular, a prospectus has to contain information concerning (i) the mutual fund, (ii) the fund management company, (iii) the fund’s custodian bank, and (iv) third parties whose fees are charged to the mutual fund. Generally, mutual fund prospectuses also include the fund regulations, i.e. the fund contract in case of a contractual mutual fund. Simplified prospectuses allow investors to gather important information without being overwhelmed by the abundance of data in prospectuses. As a consequence, their content should be brief and “easily understood by the average investor”. Annex II to CISO specifies that simplified prospectuses must contain a “brief profile of the collective investment scheme”, information on the investment strategy and the risk profile of the mutual fund, disclosure of “the fees and costs charged to investors and the fund’s assets”, and details with regard to the trading of units. FINMA has

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776 S. 110 SIX Listing Rules sets forth that the “latest version of the prospectus authorised by FINMA is to be submitted as the listing prospectus” of exchange-traded mutual funds. Issuers must add to the existing prospectus additional technical information such as ISIN, trading currency, clearing agency and the form of the mutual fund.

777 The requirement of a simplified prospectus is meant to summarize the essential information of the full prospectus and “must be easily understood by the average investor” (s. 76(3) CISA). See also HASENBOHLER (fn. 337), p. 81, n. 323 et seq.

778 Se. s. 53 et seq. CISA on the above terms.

779 Section 1 of Annex I to CISO. In particular, prospectuses must disclose information on the fund’s formation, product details and conditions for redemption or repayment of units, the calculation of the fund’s net asset value and on the fees that issuers and the mutual fund vehicle must pay.

780 Section 2 of Annex I to CISO. In particular, the prospectus must disclosure the custodian bank’s primary activity.

781 Section 3 of Annex I to CISO. In particular, the prospectus must mention “Elements of the contract between [the fund management company] and third parties which are significant for the investors, except for fee arrangements” and “Other significant activities of the third parties”.

782 S. 75 (2) CISA and s. 8 (3) CISA.

783 ROLF H. WEBER, Basler Kommentar zum Kollektivanlagengesetz (Basel. Helbing Lichtenhahn, 2009), s. 76 CISA, , n. 1.

784 S. 76 (3) CISA.

785 S. 1 of Annex II to CISO.

786 S. 2 of Annex II to CISO.

787 S. 3 of Annex II to CISO.

788 S. 4 of Annex II to CISO.
acknowledged and accepted prospectus and fund regulation templates of the Swiss Funds Association (SFA) and requires a mark-up of any changes to the templates in the application documents. As a result, prospectuses of Swiss mutual funds generally feature a uniform content and a harmonized structure. Units can be distributed only if prospectuses are approved by FINMA.

Section 10 (5) CISA contains the provision that FINMA can exempt mutual funds of prospectus requirements if units are distributed to qualified investors.

4.2 Disclosure of Essential Product and Issuer Risks

Mutual fund prospectuses provide investors with relevant information about the mutual fund, its investment strategies and fee-related issues. The Swiss framework allows mutual funds to organize themselves as contractual funds or as investment companies with variable capital (SICAVs). If a fund is organized as a SICAV, its assets are held by a legal entity that is different from the fund management company or the fund’s originators. In the case of a contractual fund, the fund’s assets are segregated from the “assets and rights belonging to the fund management company” in case of bankruptcy of the latter. Consequently, prospectuses for mutual funds are not required to give an extensive account of the finances and business of the fund management company or the originator of a mutual fund.

Mutual fund prospectuses are further required to disclose any specific risks or high volatility inherent to a particular fund. In addition, fund regulations have to display risk specifications of the mutual fund and simplified prospectuses must provide investors with a brief risk profile of the mutual fund vehicle. Further, Swiss mutual fund regulation distinguishes between securities funds, real estate funds, other funds for traditional investments, and other funds for alternative investments. Issuers are

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793 See s. 10 (3) CISA on the term ‘qualified investor’. “Qualified investors pursuant to this Act specifically include: a. regulated financial intermediaries such as banks, securities dealers and fund management companies; b. regulated insurance institutions; c. public entities and retirement benefits institutions with professional treasury operations; d. companies with professional treasury operations; e. high-net-worth individuals; f. investors who have concluded a written discretionary management agreement with a financial intermediary as defined under a”.
794 S. 24 CISA and 36 CISA.
795 S. 1.15 of Annex I to CISO.
796 See § 15 of the SFA Model prospectus including model fund contract for a securities fund under Swiss law (for stand-alone funds), Part 2. Fund contract.
797 S. 53 CISA.
798 S. 58 CISA.
799 S. 70 CISA.
required to disclose which of the above labels applies to each fund. Moreover, section 12 CISA sets forth that the designation of a mutual fund “must not provide any grounds for confusion or deception, in particular in relation to the investments”. As a result, mutual fund designations are forbidden to implicate capital protection or conservative investment strategies when these attributes do not comply with the fund’s investment objectives and portfolio.

4.3 Availability of Relevant Information

Mutual fund prospectuses are vetted and approved by FINMA and “must be provided free of charge to interested persons prior to an agreement being concluded or prior to subscription”. Consequently, investors receive prospectuses that are in accordance with the legal requirements of sections 75 and 76 CISA.

4.4 Intra-Product Comparability

FINMA publishes a list of all approved Swiss mutual funds and information about mutual funds can be retrieved on one of the electronic platforms recognized by FINMA. Further, virtually all mutual fund prospectuses are structured in accordance with the templates provided by SFA and, consequently, investors can easily find comparable sections in different mutual fund prospectuses. As a result, comparisons between various mutual funds are significantly facilitated by the prospectus requirements of Swiss securities regulation.

4.5 Sub-conclusion

Mutual funds are by far the most regulated investment vehicles of Swiss capital markets. This high degree of regulation and supervision is mirrored by the detailed prospectus requirements set forth in sections 75 and 76 CISA, Annexes I and II to CISO and the prospectus templates of SFA. In particular, mutual fund regulation features concise structural requirements that must be followed by fund management companies issuing prospectuses. Moreover, mutual funds are labelled in accordance with their investment strategies. In addition, the issue of a separate simplified prospectus allows retail investors to obtain an impression of a specific mutual fund in an efficient and uncomplicated manner.

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800 S. 71 CISA.
801 S. 12 CISA.
802 S. 75 (3) CISA. However, prospectuses must be given to investors only upon their request.
805 See above, section 4.2 above.
Finally, exemptions to the prospectus requirement are narrow and must be approved on an individual basis by FINMA. As a consequence, they are unlikely to deprive investors of important information.

5. Preliminary Results

5.1 Delimitability

Chapter three, section II.2.2 has already shown that Swiss securities regulation has serious delimitability issues. In particular, actively managed derivative instruments and mutual funds feature similar characteristics that may cause confusion among issuers and investors. Further, the creation of the legal category ‘structured products’ has led to delimitability problems in relation to other kinds of debt securities, in particular credit-linked notes. Finally, issuers and investors of listed structured credit derivatives are confronted with different prospectus schemes for economically closely-related products. These and other delimitation problems cannot be solved under the current legislative regime. Rather, the Swiss legislator will have to opt for either a substantive or a formal approach to product regulation and shape prospectus requirements accordingly.

In view of the fact that global trends have been veering toward a substantive regulation of securities in recent years, the Swiss regulator is strongly recommended to take steps in the same direction. Considering the global character of today’s capital markets, material deviations from globally adopted principles are undesirable. Rather, jurisdictions should try to strengthen a coordinated regulatory approach to capital markets and their participants. Efficient coordination of supervisory control is possible only if the key principles of national securities laws are essentially consistent with each other. A convergence towards similar standards can be established by creating supranational rules with binding character for participating jurisdictions. However, this strict form of coordination is hard to achieve. Jurisdictions are generally reluctant to replace their existing norms by other regulatory schemes. As a result, this kind of coordinative effort is presumably most successful in constellations where several jurisdictions are already closely related with each other, be it on a political or economic basis. A gentler means to align national regulatory strategies may be found in enhanced international

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806 See above section II, for Canadian securities regulation. Substantive approaches are also applied in U.S. and European securities regulation (for Europe, see below, section IV).
807 See, for instance, the legal framework of the European Union with regard to transparency on securities markets.
coordination in the monitoring of globally operating market participants. Although national legal frameworks need not be entirely streamlined in order to establish these tight networks, they must at least be based on similar strategies and principles. This convergence can be strongly assisted by regulatory initiatives of international organizations and networks. In particular, the establishment of basic rules and principles by the International Organization of Securities Commissions (IOSCO) and subsequent surveys of the national implementation of these rules provide important guidelines for national regulators and advance the comprehension and acceptance of different concepts as long as they can be led back to the same standards and principles.

Considering the above, product regulation deferring from the globally prevailing substantive approach might discourage market participants to distribute or purchase securities governed by Swiss law. Further, a substantive approach to securities regulation generally adheres to the functional principle “same business, same risks, same rules” and, therefore, does not create misdirected incentives to circumvent rules by alternative product structuring. Finally, the substantive approach revolves around investor protection. If there is a recognized need for more structural freedom for issuers of certain products, formal elements can override the substantive framework of securities regulation in a well-directed and narrow manner. Consequently, the risk that investors are harmed by excessive structural autonomy of product issuers can be reduced to a minimum.

What amendments should be made in order to adapt Swiss securities regulation to the above substantive approach? First, prospectus requirements should not distinguish between exchange-traded and non-listed products. Retail investors purchasing publicly offered securities have a need for transparency irrespective of whether these securities are purchased through an exchange or in a different manner. If there is no need for mandatory disclosure in relation to certain types of securities,

808 G20 WORKING GROUP. “Reinforcing International Cooperation and Promoting Integrity in Financial Markets” (WG2), Final Report (March 27, 2009), p. 14, suggesting the establishment of supervisory colleges for major cross-border financial institutions.
811 See also G20 WORKING GROUP (fn. 808), p. 20.
812 See also CONTRATTO (fn. 129), p. 405.
813 CONTRATTO (fn. 129), p. 405.
814 See above, chapter three, section II.3.
specific exemptions may account for these special circumstances.\textsuperscript{815} Second, disclosure rules should be based on the basic distinction between equity and debt securities. As Swiss bond regulation only applies to securities whose principal is fully repaid at the end of the product’s duration, similarly structured securities may fall under the scope of different rules without apparent reason.\textsuperscript{816} Third, additional rules should be created in relation to structured securities such as structured derivatives and asset-backed securities. In particular, investors must be informed about the products’ structures and risks and key transactions related to specific securities.\textsuperscript{817}

Fourth, the following products should be subject to specific prospectus requirements and, consequently, be partially exempt from general regulations. Structured derivatives in the sense of section 5 \textit{CISA} have been within the scope of specific regulations for several years. As a rule, the creation of separate rules for flexible and innovative products can be advantageous for both investors and issuers.\textsuperscript{818} However, the timely issue of derivative products must not conflict with the need for adequate information for investors. Products whose underlyings can be actively managed by the issuer or third parties upon distribution of the securities\textsuperscript{819} hamper an appropriate assessment of the products and related risks. In particular, management activities may change the characteristics of a product without giving adequate notice to the product’s investors. Consequently, structured product regulation in accordance with section 5 \textit{CISA} should be confined to structured products with a passive management. As a result, the distinction between these products and mutual funds would become considerably less problematic. In addition, section 5 \textit{CISA} must include products “where the primary focus is on financing purposes or a risk transfer in the narrow sense”.\textsuperscript{820} As mentioned in section 3.3.a above, investors are indifferent toward the issuer’s primary objective when issuing an investment product. Consequently, prospectus regulation should not depend on issuers’ relations to the product but consider investors’ need for transparency. Finally, mutual fund regulation is another area of securities markets where general prospectus requirements should not apply. The legislator’s decision to provide particular protection for investments in these highly regulated entities must not be breached for uniformity’s sake. Rather,

\begin{flushright}
\textsuperscript{815} See, for example, the existing exemptions for exchange-traded futures and exchange contracts.
\textsuperscript{816} Although capital protection generally enhances investors’ positions, their need for adequate disclosure in relation to the product’s structure does not differ from the requirements of investors who own products with capital-at-risk structures.
\textsuperscript{817} As, for example, the assets backing asset backed securities and the parties involved in the transaction.
\textsuperscript{818} See above, section II.5.1.
\textsuperscript{819} I.e. the issuer or a related party can influence the composition of the product’s underlying after its distribution to investors.
\textsuperscript{820} \textit{Guidelines on Information Investors about Structured Products}, p. 4.
\end{flushright}
investors should be given the opportunity of investing their money in highly regulated investment vehicles that are closely monitored by the supervisory authority.

5.2 Risk Disclosure

Swiss securities regulation has so far largely abstained from introducing prospectus requirements for non-listed derivatives. In addition, disclosure provisions of sections 652a and 1156 SCO do not provide investors with any risk-related information. As a consequence, investors of non-listed bonds, shares and derivatives other than structured products do not obtain adequate information by current prospectus provisions. In particular, they are not able to gauge the risks that may arise from a specific investment.

Risk disclosure in relation to exchange-traded securities does not suffer from the above deficiencies. *Prospectus Schemes of SIX Regulation* generally stipulate explicit reference to risks that might ensue from an investment in certain instruments. Further, risk disclosure for exchange-traded products must refer to product-specific and issuer-specific risk factors.

As observed in section 3.2 above, prospectuses of non-listed structured products must present essential risks that can arise from the product structure or the product’s issuer. Further, SVSP has introduced labels for different product types that provide investors with a first indication on the risk level of a specific product. However, as prospectuses are neither regulated nor supervised by FINMA or another supervisory authority, investors must fully rely on issuers’ trustworthiness and do not have the reassurance of an independent third party monitoring the issue and distribution of these products. Although the vetting of each prospectus prior to the products’ distribution might inappropriately delay a timely circulation of innovative instruments, issuers should at least be obligated to give notice of new product issues to FINMA which, in turn, could conduct ex post controls by examining random prospectuses for their compliance with section 5 CISA.

Finally, mutual fund prospectuses feature all the elements that investors need in order to conduct meaningful risk assessments. In particular, prospectuses display relevant risk factors and specify the risks that the fund is willing to take in accordance with its investment objectives. Further, mutual fund prospectuses contain pre-defined labels that inform investors about the types of investments the fund is going to make. Finally, simplified prospectuses notify investors in clear and concise language of the risks that are related to an investment in a specific fund. As a result, mutual fund prospectuses are most suitable to disclose risks to retail investors in an adequate and easily comprehensible manner.
5.3 Availability of Relevant Information

Swiss securities regulation requires that prospectuses are available as soon as the products are distributed to investors. Consequently, investors are generally able to retrieve relevant information from the issuer’s disclosure documentation. However, a considerable number of prospectuses are not vetted by an independent body before their distribution to the public. In addition, the fragmentary character of Swiss prospectus regulation means that many products can be distributed without appropriate disclosure. In these cases, investors cannot fully rely on available information and have significant gaps in their knowledge of certain products.

5.4 Inter-Product Comparability

The numerous inconsistencies of Swiss prospectus disclosure considerably hamper product comparisons. While comparisons of different products under the same prospectus regime are generally feasible from a content-based perspective, evaluations of products that are subject to different disclosure frameworks may fail due to the lack of comparable information in one of the two documents. Further, prospectus structures of products other than mutual funds are not determined by securities regulation. As a result, the plurality of prospectus forms additionally impedes product comparisons. Moreover, prospectuses are not made available on a central electronic platform but are distributed by issuers or related intermediaries. As a consequence, investors are generally not encouraged to compare different products. Rather, they obtain information on a certain product from their securities dealer or local bank. Consequently, investors’ knowledge of available products might be incomplete or even biased. Although the implementation of a centralized platform would not remedy all of the above issues, it would be a significant improvement on the current situation.

5.5 Sub-conclusion

The following conclusions can be drawn from the above observations. First, the Swiss disclosure framework is fragmentary and inconsistent. In particular, prospectus provisions for non-listed securities are not suitable to achieve transparent markets for retail investors. Further, non-listed derivative securities other than structured products are not subject to prospectus regulations at all. As a consequence, investors can obtain relevant information only if issuers are prepared to impart this knowledge on a voluntary basis.

Second, with the exception of mutual funds, non-listed products are not vetted by supervisory authorities prior to their distribution to the public. This lack of adequate monitoring of issuers is virtually
unique in Europe\textsuperscript{821} and cannot be based on persuasive reasons. Consequently, future regulation must fill these gaps by implementing supervisory control duties that comply with international standards.

Third, delimitability issues of Swiss securities regulation have increased exponentially in recent years. These problems have been caused by the development of complexly structured instruments that cannot be assigned to conventional product categories. In view of these new product designs, the legislator’s efforts to converge formal and substantive approaches to product categorization cannot be further pursued. Rather, Swiss legislation has to implement prospectus requirements in accordance with a substantive approach to prospectus disclosure. Exemptions to these general rules must be narrowly formulated in order to avoid further delimitation problems. In particular, prospectus provisions for structured products of section 5 \textit{CISA} must be confined to passively managed products.

Fourth, Swiss prospectus regulation does not contain consistent structural requirements and centralized accessibility to prospectuses. As a consequence, comparisons of different products are hampered by practical issues. Unlike solutions to the above problems, these requirements could be introduced without a revision of the entire Swiss disclosure framework and, therefore, should be implemented without further delay.

\textbf{IV Germany}

1. Preliminary Remarks

As outlined in chapter two, section IV.3 above, German prospectus regulation features characteristics similar to the Canadian legal framework for securities. In particular, disclosure provisions for shares, bonds and derivatives follow a comprehensive approach; differences in the disclosure framework are based on material divergence and have been implemented on purpose. Further, prospectuses are vetted by an administrative authority prior to their distribution to the public\textsuperscript{822} and issuers have the opportunity to issue shelf prospectuses.\textsuperscript{823} These and other substantial similarities can be traced back to the fact that the implementation of \textit{EU Prospectus Regulation}\textsuperscript{824} has been closely aligned with international disclosure standards of IOSCO\textsuperscript{825} and North American primary market regulations.\textsuperscript{826}

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\textsuperscript{821} \textit{WERLEN} (fn. 687), p. 469.

\textsuperscript{822} \textit{Prospectus Directive}, s. 21 (1).

\textsuperscript{823} \textit{WERLEN} (fn. 687), p. 467.

\textsuperscript{824} Which applies to German prospectuses according to paragraph 7 WPpG.

\textsuperscript{825} \textit{INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS} (IOSCO). “International Disclosure Standards for Cross-border Offerings and Initial Listings by Foreign Issuers” (September 1998).

\textsuperscript{826} \textit{WERLEN} (fn. 687), p. 462.
However, unlike Form 41-101F1 of the Canadian framework for prospectus disclosure, EU Prospectus Regulation does not establish a prospectus schedule that can be applied to most kinds of securities. Rather, the regulation contains 18 different schedules and building blocks that can be combined in various manners\textsuperscript{827} and define the content of registration documents and securities notes for different types of securities. Consequently, investors and issuers are confronted with a considerable array of differently composed prospectus documents which leads to a series of applicability and delimitation issues\textsuperscript{828} similar to those that have been found in Swiss prospectus regulation.\textsuperscript{829}

In view of the above, an in-depth analysis of the entire German prospectus framework would not lead to material conclusions that have not already been made in relation to Canadian or Swiss prospectus regulations. However, unlike the Swiss and Canadian disclosure frameworks, EU Prospectus Regulation has established a comprehensive disclosure framework for derivative securities. A closer examination of these rules might therefore provide valuable information about appropriate regulation of disclosure requirements in relation to derivative products. Therefore, the below explanations will refrain from an exhaustive analysis of EU prospectus provisions for shares, bonds and mutual funds. Instead the following sections will provide a brief outline of the general principles governing EU Prospectus Regulation and prospectus requirements for derivative products.

2. EU Prospectus Regulation

2.1 Overview

According to recital 14 of EU Prospectus Regulation, securities can be issued only if they are accompanied by a prospectus that contains (i) a registration document, (ii) a securities note, and (iii) a summary.\textsuperscript{830} Exceptions to this rule are listed in sections 3 (2) and 4 of the EU Prospectus Directive and paragraphs 3 and 4 WpPG.\textsuperscript{831}

\textsuperscript{827} See, in particular, Annex XVIII.

\textsuperscript{828} See, among others, below, section IV.2.2 with regard to principal protected and principal at risk notes.

\textsuperscript{829} See above, chapter three, section II.2.2.b. See also WERLEN (fn. 687), p. 464, 465.

\textsuperscript{830} See recital 14 of EU Prospectus Regulation, and KEUNECKE (fn. 218), p. 123, as well as BUCK-HEEB (fn. 193), p. 58. On the content of these prospectus elements see below, chapter four, section IV.

\textsuperscript{831} See also KEUNECKE (fn. 218), p. 114 - 122. See further COMMISSION OF THE EUROPEAN COMMUNITIES, Proposal for a Directive of the European Parliament and of the Council amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (September 23, 2009), which seeks to clarify and extend prospectus exemptions of sections 3 (2) and 4 of the Prospectus Directive. Further, see WERLEN (fn. 218), p. 466, on the need for clarification of existing exemption clauses.

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The registration document contains information about the issuer of securities. In particular, all registration documents must display information on the issuer’s (i) finances, (ii) statutory auditor, (iii) risk factors, (iv) business, (v) organizational structure, (vi) management and major shareholders and (vii) material contracts.\(^{832}\) In addition, registration documents for shares feature an operating and financial review and information about capital resources similar to the MD&As of Canadian prospectus disclosure.\(^{833}\) The securities note provides “information on the securities to be offered”,\(^{834}\) the “terms and conditions of the offer”,\(^{835}\) “risk factors that are material to the securities being offered”\(^{836}\) and an “indication as to whether the securities offered are or will be the object of an application for admission to trading”.\(^{837}\) The prospectus summary displays the essential characteristics and risks that are related to the issuer, guarantors and the issued securities.\(^{838}\) Further, it contains several warning notices that instruct investors to consider the prospectus as a whole and to understand the summary as an introduction to the entire document.\(^{839}\)

Prospectuses can be arranged as single documents\(^{840}\) or “composed of separate documents”\(^{841}\) i.e. a registration document, a securities note and a prospectus summary.\(^{842}\) Both prospectus formats must comply with the order set forth in section 25 (1) and (2) EU Prospectus Regulation. In particular, the one-piece prospectus or, if the prospectus consists of several documents, the registration document and the securities note must be composed of a table of contents, a prospectus summary, issuer- and product-related risk factors and “the other information items included in the schedules and building blocks according to which the prospectus is drawn up”.\(^{843}\) Issuers are “free in defining the order in the presentation of the required information items included in the schedules and building blocks according to which the prospectus is drawn up”.\(^{844}\) Issuers of non-equity securities and warrants\(^{845}\) that fulfill the

\(^{832}\) See, in detail, WIEGEL (fn. 224), p. 215 et seq.

\(^{833}\) WERLEN (fn. 687), p. 459.

\(^{834}\) EU Prospectus Regulation, Annex III, s. 4.

\(^{835}\) EU Prospectus Regulation, Annex III, s. 5.

\(^{836}\) EU Prospectus Regulation, Annex III, s. 2.

\(^{837}\) EU Prospectus Regulation, Annex III, s. 6.1. See also WIEGEL (fn. 224), p. 263 et seq.

\(^{838}\) § 5 (2) WpPG.

\(^{839}\) § 5 (2) WpPG.

\(^{840}\) S. 25 (1) EU Prospectus Regulation.

\(^{841}\) S. 25 (2) EU Prospectus Regulation.

\(^{842}\) § 12 (1) WpPG.

\(^{843}\) S. 25 (1) EU Prospectus Regulation.

\(^{844}\) S. 25 (3) EU Prospectus Regulation. See also (4) which states that issuers of prospectuses that defer from the order envisaged in the regulation’s schedules and building blocks may be required to “provide a cross reference list” upon request of the competent authority.

\(^{845}\) S. 22 (6) EU Prospectus Regulation.
preconditions of paragraph 6 WpPG\textsuperscript{846} may choose to draw up base prospectuses and publish the final terms separately and at a later date.\textsuperscript{847} With the exception of the final terms of an issue of securities, base prospectuses must contain the same information as in one-piece prospectuses.\textsuperscript{848} Unlike base prospectuses and supplements, final terms do not require the approval of BaFin.\textsuperscript{849}

2.2 EU Passport System

Approvals of prospectuses are not made by a central European securities commission but by the national securities commissions of the home member state\textsuperscript{850} of the company issuing securities. If an issuer intends to publicly offer its securities in other member states of the EEA,\textsuperscript{851} it need not file the relevant prospectus documents in these so called host member states. Rather, article 17 of the \textit{EU Prospectus Directive} determines that, in this case, “the prospectus approved by the home Member State and any supplements thereto shall be valid for the public offer or the admission to trading in any number of host Member States”. Hence, instead of filing an application for approval in each member state where the securities will be offered, the issuer must notify the competent authority of its home member state that it intends to offer its securities in other member states as well. The home member state, in turn, attests to the relevant host member states that the prospectus complies with the provisions of the \textit{EU Prospectus Directive}.\textsuperscript{852} Host member states are not allowed to assess whether the prospectus complies with their own national framework for securities.

The above European passport system provides issuers with an accelerated access to European securities markets. By requiring that all prospectuses of products offered in European securities markets comply with the provisions of the \textit{EU Prospectus Directive} and its \textit{Regulation}, investors can be sure that prospectuses follow certain minimum substantive and formal standards.\textsuperscript{853} Further, sections 13 and 14 of the \textit{Directive} state certain requirements in relation to the approval and publication procedures that must be followed by issuers and the competent authorities of each member state. However, due to the

\textsuperscript{846} And s. 5 (IV)(a) and (b) \textit{Prospectus Directive}.
\textsuperscript{847} S. 26 (5) \textit{EU Prospectus Regulation}.
\textsuperscript{848} KEUNECKE (fn. 218), p. 130. As a rule, base prospectuses cannot be composed of three separate documents. However, s. 11 (I) \textit{Prospectus Directive} allows issuers of base prospectuses to refer to a registration document that has been published earlier (see also s. 26 (4) \textit{EU Prospectus Regulation}).
\textsuperscript{849} KEUNECKE (fn. 218), p. 129, fn. 297. However, the final terms have to be published \cite{WIEGEL (fn. 224), p. 321} and filed with BaFin (§ 14 WpPG).
\textsuperscript{850} See s. 2 (1)(m) \textit{EU Prospectus Directive}.
\textsuperscript{851} European Economic Association.
\textsuperscript{852} S. 18 \textit{EU Prospectus Directive}.
\textsuperscript{853} See s. 7 of the \textit{EU Prospectus Directive} in relation to the prospectuses’ minimum content and s. 25 EU Prospectus Regulation on the possible formats of prospectuses.
Directive’s sparse formal requirements and the member states’ freedom to introduce stricter or more elaborate substantive obligations, investors may be confronted with prospectuses whose content and format differ significantly from prospectuses of products issued and approved in their own jurisdiction. Further, disclosure systems of EEA member states are not harmonized by the EU Prospectus Directive or any other European regulations. Instead, issuers are required to comply with advertising and publication procedures of each member state where its securities are offered to the public. As a result, the EU Prospectus Directive does not establish a central platform where investors can retrieve information about all securities distributed in European markets. Consequently, market participants can fully benefit from the harmonized prospectus framework only if issuers decide to offer their securities in jurisdictions other than their home member state. The current proposal for the review of the EU Prospectus Directive does not envisage any changes to this fragmentation of European securities markets.

3. Options and Futures

3.1 Overview

Unlike the Canadian and Swiss disclosure frameworks, German securities regulation features comprehensive disclosure rules for derivative securities. Although current legislative developments show that these measures are not sufficient to protect retail investors in an exhaustive manner from inappropriate selling practices or inadequate disclosure measures, they manage to provide investors with adequate information on derivative securities in accordance with paragraph 2 (1) WpPG.

Exchange-traded options and futures contracts do not qualify as securities in the sense of paragraph 2 (1) WpPG. As in Switzerland, these products are traded on Eurex and transparency is provided by a consistent standardization of the contracts. The content and form of options and futures contracts can be derived from Eurex contract specifications which are accessible via each product on the Eurex

854 See also SARRA (fn. 240), p. 94.
857 Further measures have to be taken in order to streamline disclosure provisions for structured products such as mutual funds, investments packaged as life insurance policies, retail structured securities and structured term deposits. In addition, selling practices for the above products must be harmonized, too [see COMMISSION OF THE EUROPEAN COMMUNITIES. Packaged Retail Investment Products (April 30, 2009), online. <http://ec.europa.eu/internal_market/finservices-retail/docs/investment_products/29042009_communication_en.pdf>, p. 9 - 11].
858 See VAN GERVERN (fn. 564), p. 244, 254.
website. Further, paragraph 37g WpHG sets forth that certain transactions in relation to options or futures contracts can be prohibited by the German federal ministry of finance if required for reasons of investor protection.

As with Swiss capital markets, German markets feature exchange-traded options that do not follow the contract specifications of a stock exchange. These products as well as non-listed options are issued by investment banks in the form of single or global certificates. Unlike Swiss securities regulation, the German prospectus framework does not distinguish between non-listed and exchange-traded products. As a consequence, stand-alone warrants and their non-listed counterparts have to comply with prospectus requirements of EU Prospectus Regulation. As warrants are neither shares nor debt securities in the sense of section 8 (2) EU Prospectus Regulation, prospectuses must comply with the schedules for derivative securities, i.e. Annex IV and Annex XII. Annex IV requires that warrant prospectuses describe issuer-related risk factors, information about the issuer, its business and organizational structure, trend information and forecasts and information about the issuer’s management and major shareholders. Annex XII states that warrant prospectuses must inform about product-related risk factors, describe the offered securities, the terms and conditions of the offer.

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860 See, for example, the contract specifications for Euro-Schatz Futures, on <http://www.eurexchange.com/trading/products/INT/FIX/FGBS_en.html>.
861 I.e. warrants.
862 See, for example, the base prospectus for BNP Paribas warrants on <http://www.derivate.bnpparibas.com/DE/MediaLibrary/Document/BaseBrochure/BaProOS26022010%20elektr%20Version.pdf>.
864 I.e. warrants that have not been issued in relation to another instrument, typically shares (see Roth, § 2 WpHG n. 88, 89.
865 Scheme F, Derivatives, SIX Swiss Exchange Regulation. As non-listed options are generally not purchased by retail investors, the following comments will particularly focus on warrants.
866 The schedule applies to debt securities if “the issuer has an obligation arising on issue to pay the investor 100 % of the nominal value in addition to which there may be also an interest payment”.
867 Minimum disclosure requirements for the debt and derivative securities registration document (schedule).
868 Minimum Disclosure Requirements for the Securities Note for Derivative Securities (schedule). This schedule applies to all securities that cannot be subsumed under the definitions of shares or debt securities (see WIEGEL (fn. 224), p. 277, and THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS. “CESR Prospectus Consultation, Feedback Statement” (September 2003), § 58; recital 18 Prospectus Directive).
869 Annex IV, s. 4.
870 Annex IV, s. 5, 6 and 7.
871 Annex IV, s. 8 and 9.
872 Annex IV, s. 10, 11 and 12.
873 Annex XII, s. 2.
874 Annex XII, s. 4.
875 Annex XII, s. 5.
and the reasons for the offer as well as material interests involved.\textsuperscript{876} Except for the mandatory order set forth in section 25 (1) and (2) \textit{EU Prospectus Regulation},\textsuperscript{877} German disclosure provisions do not impose any structural requirements on issuers of derivative securities. Further, there are no pre-defined headings or risk-labels.\textsuperscript{878}

In view of the fact that German exchange-traded options and futures contracts are traded on the same exchange as their Swiss counterparts and must comply with the same disclosure provisions, the below observations will focus exclusively on the German disclosure framework of exchange-traded warrants.

3.2 Disclosure of Essential Product and Issuer Risks

As seen in section (a) above, issuers of warrants must disclose key information about themselves and the offered securities. Further, section 5 (2) \textit{Prospectus Directive} enhances investors’ understanding of derivative securities by requiring a summary of the material prospectus content. Moreover, prospectuses have to present the risks related to the product’s issue\textsuperscript{879} and its structure.\textsuperscript{880} In particular, issuers must disclose all risk factors that are material “to assess the market risk associated with these securities”\textsuperscript{881} as well as the fact that “investors may lose the value of their entire investment or part of it (...) and/or, if the investor’s liability is not limited to the value of his investment, a statement of that fact”.\textsuperscript{882} However, German prospectus regulation does not require that issuers of warrants display any pre-determined risk labels. In view of the considerable leverage opportunities inherent to warrants and their close relation to other, more complex derivative products, this absence constitutes an inadequacy that could be remedied with a comparatively small effort. Further, a brief risk prognosis in the MD&A section of a warrant prospectus\textsuperscript{883} could additionally improve investors’ ability to assess counterparty risks.

\begin{itemize}
  \item \textsuperscript{876}Annex XII, s. 3.
  \item \textsuperscript{877}See section 2 above.
  \item \textsuperscript{878}However, risk factors must be displayed under a separate section \cite{Wiegel2024}, p. 217.
  \item \textsuperscript{879}Annex IV, s. 4.
  \item \textsuperscript{880}Annex XII, s. 2.
  \item \textsuperscript{881}Annex XII, s. 2.
  \item \textsuperscript{882}Annex XII, s. 2. See also \textit{Wiegel} (fn. 224), s. 217, who states that this aspect is required only for derivative securities.
  \item \textsuperscript{883}Annex IV, s. 8.2 requires that prospectuses provide investors with information “on any know trends, uncertainties, demands, commitments or events that are reasonably likely to have a material effect on the issuer’s prospects for at least the current financial year”. However, issuers are not required to draw attention to potential risks that may arise from the above trends (see, in contrast, 51-102F1, s. 1 (a) which states that an MD&A must “discuss important trends and risks that have affected the financial statements, and trends and risks that are reasonably likely to affect them in the future”). See also \textit{Werlen} (fn. 218), p. 465, in relation to MD&As of US law.
\end{itemize}
3.3 Availability of Relevant Information

Issuers of warrants are required to publish prospectuses no later than the workday preceding the beginning of the offer. 884 Further, significant new information 885 has to be conveyed to investors by means of a prospectus supplement. 886 Both documents are vetted 887 by BaFin and cannot be published until BaFin has given its approval. 888 In addition, all approved prospectuses and supplements are accessible on the BaFin website during the twelve month period following their approval 889 and issuers must publish a notice informing investors where the prospectus for a specific issue of securities can be retrieved. 890 However, if warrants are issued under a base prospectus, their final terms are neither vetted by BaFin nor published on the authority’s website. 891 Although a comprehensive assessment of all final terms would slow the issue of these securities down in an undue manner and, therefore, would annihilate one of the prime advantages of base prospectuses, 892 the introduction of pre-clearance procedures for new product types 893 or random examinations could significantly increase investors’ confidence in disclosure documentation for warrants.

3.4 Intra-Product Comparability

Warrant prospectuses must follow the schedules established by EU Prospectus Regulation. Consequently, investors of warrants obtain adequate information in order to compare different products in a meaningful manner. Generally, comparisons are significantly facilitated if prospectuses are required to follow a pre-determined order or feature uniform headings. German prospectus regulation gives a rough order that issuers must follow when creating a prospectus. 894 Further, BaFin may require that issuers “provide a cross reference list” if “the order of the [prospectus] items does not coincide with the order of the information provided for in the schedules and building blocks according to which

884 KEUNECCE (fn. 218), p. 288.
885 See s. 16 Prospectus Directive on the question which information is perceived material and, consequently, has to be conveyed to investors.
886 See s. 16 Prospectus Directive and s. 25 (5) EU Prospectus Regulation.
887 BaFin examines the document for completeness, coherence and comprehensibility (§ 13 (1) WpPG).
888 KEUNECCE (fn. 218), p. 286.
889 KEUNECCE fn. (218), p. 288. See also http://www.bafin.de/cln_171/nn_720794/SharedDocs/Artikel/EN/Verbraucher/Recherche/database__verkprosp__010705.html#doc1606438bodyText3, the online prospectus database of BaFin.
890 § 14 (3) WpPG. Prospectuses can be published in a newspaper, on the issuer’s website or by having them in store at the issuer or paying agent [KEUNECCE (fn. 218), p. 289, 290].
891 See KEUNECCE (fn. 218), p. 129.
892 See WERLEN (fn. 218), p. 476.
893 See, for example, CSA Staff Notice 44-304.
894 Section 2 above and s. 25 (1) and (2) EU Prospectus Regulation.
the prospectus is drawn up”. However, this list is not accessible for investors and, consequently, they may come across prospectuses that do not follow the order set forth in the schedules and building blocks of EU Prospectus Regulation.

Moreover, as mentioned in section (c) above, issuers are not required to publish prospectuses, supplements and final terms on a central electronic platform. Although BaFin publishes all prospectuses and supplements for one year following their approval, this website does not provide investors with the final terms of warrants that are issued under a base prospectus. These gaps in the publication framework for warrant prospectuses, combined with issuers’ freedom in the structuring of their prospectuses, may lead to considerable delays in the assessment and comparison of different prospectuses and should be amended.

3.5 Sub-conclusion

Considering the above observations, German disclosure regulation for options and futures features the following main characteristics. First, exchange-traded options and futures contracts are not subject to prospectus requirements. However, their standardization and the fact that contract terms are published on the Eurex website provide investors with adequate information to assess whether a product is appropriate for their investment portfolio. Second, warrants and non-listed options must follow prospectus requirements set forth in EU Prospectus Regulation. Consequently, investors obtain reliable and comprehensive information about these products, their issuers and related material risks. Third, risk disclosure in relation to warrants could be further enhanced by introducing risk labels and brief risk prognoses similar to those required by Canadian MD&A provisions. Fourth, if warrants are issued under a base prospectus, their final terms are not vetted or pre-cleared by BaFin. While comprehensive assessments of all final terms might be too retarding, random examinations or pre-clearance requirements for new kinds of products could be adequate measures to enhance investor confidence without inappropriately delaying the issue of highly flexible and volatile investment instruments. Fifth, product comparability would be facilitated by the implementation of pre-determined prospectus structures or defined headings. Finally, the final terms of warrants that are distributed under a base prospectus should be made available on the BaFin website.

895 S. 25 (4) EU Prospectus Regulation.
4. Structured Notes

4.1 Overview

German structured notes are generally called ‘certificates’ and qualify as bearer bonds. Further, prospectus requirements of \textit{EU Prospectus Directive} and \textit{Regulation} apply to these products in the following way. If the principal of a certificate is protected, issuers have to comply with prospectus requirements for debt securities. If, on the other hand, certificates are structured as capital at risk notes, issuers must consider the requirements for derivative securities. In relation to the latter products, the above explanations for warrants apply accordingly. Issuers of capital-protected certificates, on the other hand, have to follow the obligations set forth by the securities note of Annex IV. In addition, they must adhere to the requirements of Annex V. In particular, prospectuses must feature product-related risk factors, information about the offered securities and the terms and conditions of the offer as well as the reasons for the offer and material interests involved. Further, as the interest rate is generally not fixed, prospectuses must describe “the underlying on which it [the interest rate] is based and of the method used to relate the two and an indication where information about the past and the further performance of the underlying and its volatility”.

Prospectuses of certificates have to follow the same structural requirements stated for warrants in section 3.1.a above. Further, they are vetted by BaFin prior to their publication.

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\textsuperscript{898} See Wiegel (fn. 224), p. 152.
\textsuperscript{899} I.e. “the issuer has an obligation arising on issue to pay the investor 100 % of the nominal value in addition to which there may be also an interest payment” (s. 8 (2) EU Prospectus Regulation).
\textsuperscript{901} I.e. Annex IV and XII. See also <http://www.zertifikateforum.at/kodex/anlegerinformation.pdf>.
\textsuperscript{902} Section 3.1.a.
\textsuperscript{903} See above, section 3.1.a.
\textsuperscript{904} I.e. the „Minimum disclosure requirements for the securities note related to debt securities”.
\textsuperscript{905} Annex V, s. 2.
\textsuperscript{906} Annex V, s. 4.
\textsuperscript{907} Annex V, s. 5.
\textsuperscript{908} Annex V, s. 3.
\textsuperscript{909} Annex V, s. 4.7. However, unlike prospectuses for derivative securities, prospectuses of capital-protected certificates are not required to provide information on the base value in the same comprehensive manner as set forth in s. 4.2 of Annex XII.
accompanied by stand-alone prospectuses or issued under a base prospectus in accordance with section 22 EU Prospectus Regulation. 

4.2 Disclosure of Essential Product and Issuer Risks

Prospectuses of certificates follow the requirements of EU Prospectus Regulation. As seen in section (a) above, these provisions oblige issuers to disclose key information about a certificate, its base value and its issuer. In addition, essential aspects are highlighted in a prospectus summary. Further, prospectuses must disclose issuer-related and product-specific risks in a separate section. Moreover, the Deutscher Derivativeverband (DDV) provides investors with a product classification map that displays the basic structures of certificates and outlines their essential characteristics. In addition, its code of conduct postulates that issuers of certificates provide investors with independent certificate ratings and value at risk calculations. However, DDV does not obligate issuers to refer to these risk labels in the prospectuses or final terms of the products and, therefore, investors may not be aware of this additional assistance. Finally, issuers are not required to establish any risk assessments in their prospectuses. Although the above certificate ratings are an important step in this direction, they do not disclose information on or assessments of specific risks but provide investors with an overall risk rating. In view of the complexity of derivative securities, it seems rather doubtful whether these ratings inform investors adequately. Although clear and simple indications of product-inherent risks are highly desirable, oversimplification can mislead investors rather than clarify their situation.

4.3 Availability of Relevant Information

Issuers are required to publish prospectuses in accordance with sections 29 et sequitur of EU Prospectus Regulation. As discussed in section 3.1.c above, these requirements enable investors to consult prospectuses in a timely manner. However, the final terms of certificates that are issued under a base prospectus are neither examined nor pre-cleared by BaFin and, consequently, investors may receive information that does not conform with the requirements of section 22 EU Prospectus Regulation.

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910 S. 5 (4)(a) and s. 2 (1)(k) Prospectus Directive.
911 See, for example, Annex V, s. 2.1.
912 German Derivative Association.
915 See, for example, the recently introduced nutritional declarations that inform consumers about calories, fat and sugar of food. Similar risk labels could also be created for certificates.
916 See section 3.1.c above.
4.4 Intra-product Comparability

Prospectuses according with *EU Prospectus Regulation* provide investors with all necessary information in order to compare different products with each other. However, as mentioned in section 3.1.d above, current structural requirements of the German disclosure framework do not sufficiently assist efficient comparisons. Prospectuses lack a clear sequence or pre-defined headings that could facilitate and expedite their examination. Further, disclosure documents cannot be retrieved on a central electronic platform. In particular, BaFin does not publish the final terms of certificates issued under a base prospectus on its website. Further, it withdraws prospectuses one year after its approval of these documents. As certificates often have a maturity of more than one year or are even open-ended, BaFin’s confinement of the publication period may be inappropriate in some circumstances.

Moreover, the strict separation of capital-protected certificates and certificates whose principal is at risk is based on the distinction between traditional debt securities and more recently developed derivative debt structures rather than on logical reasoning relating to the products as such. Although certificates that protect investors’ principal are generally less risky than principal at risk debt securities, investors of both instruments need to be made aware of the products’ structure and the factors that may influence their investment. As the key difference between principal protected products and securities whose principal is at risk consists of the additional risk that investors of principal at risk certificates bear in relation to their invested capital, a risk disclaimer drawing attention to this fact would be sufficient to distinguish these two kinds of certificates.

4.5 Sub-conclusion

Unlike Canadian and Swiss prospectus regulation, *EU Prospectus Regulation* has abstained from creating separate rules for certain kinds of structured notes but subsumes all these products under the prospectus requirements for debt or derivative securities. As *EU Prospectus Regulation* allows for certificates to be issued under a base prospectus, the timely issue of these securities is not overly hampered. However, the lack of tight structural prospectus requirements may delay investors’ grasp of the essential characteristics of a certain product. Further, observations in relation to Canadian and Swiss structured notes have shown that disclosure may not be sufficient to shield investors from

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917 SCHMIDT (fn. 896), p. 15.
918 Annex V.
919 Annex XII.
920 Annexes IV and V.
921 Annexes IV and XII.
inappropriate investments. Rather, the introduction of suitability assessments by intermediaries or even a ban on certain products might be more effective to achieve adequate protection of investors in capital markets.

5. Credit Derivatives and Asset-backed Securities

German securities regulation makes credit derivatives and asset-backed securities subject to its general disclosure and prospectus requirements for derivatives and bonds. Like their Swiss counterparts, non-structured exchange-traded credit derivatives are subject to disclosure rules of Eurex. Consequently, reference can be made to the observations of section III.3.3 above.

Structured credit derivatives, for example credit linked notes, must follow the general prospectus requirements for debt or derivative securities in accordance with Annexes IV, V and XII of EU Prospectus Regulation. Asset-backed securities other than mortgage bonds and other covered bonds must follow the disclosure provisions of Annexes IV, VII and VIII. In particular, issuers have to disclose whether they have “been established as a special purpose vehicle or entity for the purpose of issuing asset backed securities” and confirm “that the securitised assets backing the issue have characteristics that demonstrate capacity to produce funds to service any payments due and payable on the securities.” Additional information in relation to asset-backed securities is highly desirable.

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922 See also Packaged Retail Investment Products (fn. 857), p. 11.
923 Non-listed credit derivatives are generally not distributed to retail investors and, therefore, will not be further considered.
924 See HUTTERLI (fn. 339), p. 84, and ZOBL/KRAMER (fn. 132), p. 450.
925 Minimum disclosure requirements for the debt and derivative securities registration document (schedule).
926 Minimum disclosure requirements for the securities note related to debt securities (schedule).
927 Minimum disclosure requirements for the securities note for derivative securities (schedule).
929 Minimum disclosure requirements for asset-backed securities registration document (schedule).
930 Minimum disclosure requirements for the asset-backed securities (additional building block). See also Annex XVIII, Table of combinations, in relation to asset-backed securities.
931 Annex VII, s. 4.1.
932 Annex VIII, s. 2.1. Further information in relation to the underlying assets must be disclosed in accordance with section 2 of Annex VIII. See also KEUNECKE (fn. 218), p. 195 - 200, and WIEGEL (fn. 224), p. 258 - 260.
However, it remains to be noted that the current framework for asset-backed securities features several inconsistencies. In particular, ABS-specific prospectus schedules have so far abstained from requiring disclosure “relating to the servicing function or its rights and duties”. Further, the difference between the terms “special purpose vehicle” and “entity for the purpose of issuing asset backed securities” stated in section 4.1 of Annex VII is not clarified by EU Prospectus Regulation.

In view of the fact that disclosure requirements for asset-backed securities and credit-linked notes largely follow general prospectus requirements for debt or derivative securities, reference can be made to the observations of sections 3.1 and 3.2 above. In summary, the following conclusions can be drawn. First, unlike the Canadian or Swiss disclosure frameworks for credit-linked notes and asset-backed securities, EU disclosure regulation features a harmonized prospectus framework applying to the above types of securities. As a consequence, prospectuses generally provide investors with adequate information in order to assess the characteristics and risks related to a specific transaction. Second, prospectus provisions feature the same shortcomings as those outlined in sections 3.1 and 3.2 above in relation to warrants and structured notes. In particular, German prospectus regulation lacks tight structural requirements with regard to the mandatory elements of securities prospectuses and, thus, hampers comparisons between different products. Third, the additional requirements for asset-backed securities are important means to improve investors’ knowledge of the securities backing the specific issue. However, their current form leaves room for doubts and should be amended in relation to the aspects mentioned above.

6. Sub-conclusion

Due to the significantly abbreviated examination of German prospectus regulation, the above analysis does not allow an exhaustive assessment of product delimitability, inter-product comparability, risk disclosure and availability of relevant information with regard to the German disclosure framework. However, the brief overview of German disclosure requirements for derivative instruments has revealed the following key insights. First, German investors of derivative securities are protected by prospectus provisions similar to those applicable to bonds and shares. As a consequence, investors generally

933 TANEGA (fn. 928), p. 311.
934 WIEGEL (fn. 224), p. 259.
935 Whereas credit-linked notes are issued under base prospectuses, asset-backed securities are not likely to be issued in this form [WIEGEL (fn. 224), p. 317]. Consequently, relevant disclosure documents in relation to asset-backed securities are adequately vetted by the competent supervisory authority and published on the website of BaFin. Therefore, the respective criticism in sections 3.1 and 3.2 above does apply only in relation to credit-linked notes, but not with regard to asset-backed securities.
receive sufficient information in order to compare different products and assess a product’s characteristics and risks.

Second, comparisons between products issued in different European jurisdictions are seriously hampered by the fact that EU Prospectus Regulation features only high-level requirements in relation to the structure of prospectuses for securities. As German prospectus regulations do not specify additional structural requirements, comparisons between different products of the same kind or of different types may also be only possible to a limited degree within the German market itself. Although a strict realignment of all prospectus components might not be feasible, considerable improvements could be achieved by the implementation of further structural requirements or pre-determined section headings.

Third, the division of debt securities into those whose principal is protected by issuers[^936] and principal at risk securities[^937] is not fully convincing. Irrespective of the above distinction, investors of derivative securities must be informed of the design and characteristics of their investments. Therefore, the creation of two different schedules appears to be redundant. Rather, prospectuses could confine themselves to pointing out the additional risks of principal at risk notes in the ‘risk factors’-section of each prospectus.

Fourth, the German framework does not require that prospectuses are published on a central electronic platform. Although BaFin publishes prospectuses on its website, this measure is not appropriate to fully compensate the lack of such a platform. In particular, the final terms of securities issued under a base prospectus[^938] are not published on the website of BaFin. Further, prospectuses are removed from the authority’s website one year following their approval[^939]. As a consequence, investors cannot access all relevant information of different kinds of securities in an uncomplicated and efficient manner and may miss more appropriate or superior investment opportunities due to this information deficit.

Fifth, disclosure provisions for asset-backed securities provide investors with essential additional information. However, their current form does not adequately acknowledge all characteristics specific to transactions in asset-backed securities. Further, it remains to be seen whether the legislative distinction between asset-backed securities and covered bonds[^940] can be upheld in practice.

[^936]: Annex V.
[^937]: Annex XII.
[^938]: I.e. the pendants of Canadian prospectus supplements in accordance with NI 44-102, s. 6.3 (1). See GILLEN (fn. 40), p. 311.
[^939]: See above, section 2.
[^940]: See section 3.3 above.
Sixth, current legislative developments⁹⁴¹ show that prospectus disclosure may not be sufficient to ensure that retail investors are provided with adequate investment opportunities. As a consequence, prospectus provisions, particularly in relation to structured derivative instruments, must be complemented by further measures to protect investors. Whereas one possible step may consist of the ban of certain products⁹⁴² for retail investors, another means to enhance investor protection consists of strengthened duties of intermediaries to assess the suitability of a product in relation to specific clients. Both aspects will be further examined in chapters six and seven below.

V. Conclusion

The above analysis of Canadian, Swiss and German prospectus provisions for securities has made evident that the disclosure frameworks of the three jurisdictions feature major differences. While the issue of securities in all of the above jurisdictions is accompanied, in most cases, by prospectuses, the format, content and the availability of these documents differ considerably. Whereas more subtle distinctions can be found by comparing the above results of sections II, III and IV, the following insights are of particular importance and, therefore, will be briefly highlighted.

The Swiss prospectus framework features the least comprehensive regulatory basis for transparency among the three examined jurisdictions. In particular, the scattered and differing disclosure rules for different types of securities fail to form a consistent unit. Rather, they are evidence of the historical development of prospectus rules for different kinds of securities and the respective status quo of legislative perception and product innovation. Further, the lack of information for non-listed securities and the absence of prospectus assessments by a governmental authority do not accord with current international disclosure standards and, therefore, should be remedied as soon as practicable. On a more positive note, Swiss mutual fund regulation has proven to provide investors with adequate information; issuers of mutual funds and related parties are regulated and supervised by FINMA, the Swiss financial market supervisory authority. In addition, the chosen format for simplified prospectuses of structured products is easily understandable for retail investors and could act as a model for prospectus disclosure in relation to structured notes.⁹⁴³

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⁹⁴¹ See section 3.1.a above and FINANCIAL SERVICES AUTHORITY (fn. 3).
⁹⁴² See below, chapter seven.
⁹⁴³ However, as mentioned in section III.5.1 above, actively managed structured products may not be appropriate to be distributed to retail investors - be it under simplified or long form prospectuses (see also chapter seven below).
In terms of comprehensiveness and consistency, Canadian prospectus regulation occupies the middle ground between Swiss and German prospectus provisions. Particularly noteworthy is its electronic platform SEDAR where disclosure documents of all public companies can be accessed by investors in an unhampered and timely manner. Further, the Canadian securities framework acknowledges the need of investors to obtain the same information when investing in debt securities as when purchasing equity securities. Finally, unlike the German and Swiss frameworks, Canadian prospectus requirements abstain from drawing a strict line between capital protected and capital at risk debt securities. As the two types of investment instruments differ only in relation to the degree of risk that investors take, differences in the prospectus requirements should be confined to explanations of this additional risk factor. Finally, Canadian securities regulation leaves significant room for improvement with regard to its prospectus provisions for derivative products. In particular, the numerous exemptions that apply to structured notes and other derivative instruments enable issuers to distribute structured securities without adequate disclosure.944

The German prospectus framework is virtually identical to the prospectus provisions set forth by the European Union in 2003945 and 2004.946 Its rules establish the most comprehensive and consistent prospectus regulation out of the three examined jurisdictions. Its lead is particularly evident in relation to prospectus provisions for derivative securities. Unlike the Canadian and Swiss prospectus regulations, it manages to subject the majority of derivative instruments to identical or at least similar disclosure requirements. A significant drawback of European prospectus regulations can be found in the multitude of different schedules and building blocks that are combined in different manners, depending on the distributed securities and their characteristics. Although retail investors may not become aware of issuers’ struggles to align their prospectuses to the applicable schedules, they do not benefit from issuers’ uncertainties and delimitation issues. Further, in relation to certain flexible and fast moving retail products, a simplified version of the current prospectus format might be an efficient means to inform investors about salient product characteristics without prompting them to consult hundred-page base prospectuses before investing in a specific issue of securities.947

Looking at the results of this chapter, the following aspects of the analyzed jurisdictions are particularly outstanding and their implementation should be considered in relation to all three prospectus

944 These gaps may be closed by the proposed Canadian Securities Act which strives for a comprehensive approach to derivatives regulation.
945 Prospectus Directive.
946 EU Prospectus Regulation.
947 See below, chapter seven.
frameworks. First, prospectus regulations should feature comprehensive disclosure requirements for all types of securities distributed to retail investors. The most comprehensive disclosure provisions are found in German prospectus regulation. Consequently, Canadian and Swiss legislation could enhance its current disclosure framework by introducing an approach similarly comprehensive to the one pursued by the European legislator in its Prospectus Directive and Prospectus Regulation. Second, both Canadian and German Securities laws apply a substantive approach to product regulation. As this strategy follows the maxim “same business, same risks, same rules”\(^{948}\), it is generally better suited to enhance investor protection than its formal counterpart\(^{949}\) and should therefore be adapted by the Swiss disclosure framework as well. Nevertheless, slight modifications of this substantive approach may be appropriate in relation to derivative structures whose characteristics require efficient procedures and simple disclosure documentation. In particular, passively managed structured notes need not necessarily be subject to extensive prospectus regulation as is presently the case under German securities law. Rather, simpler prospectus structures as applied for Swiss structured products or Canadian PPNs could be introduced into the German prospectus framework in relation to clearly defined product categories. 

Third, the Canadian electronic platform SEDAR where investors can retrieve all relevant prospectus information of all issuers of Canadian securities should be transplanted to German and Swiss securities markets. Investors’ abilities to assess the characteristics and risks of specific products can be significantly enhanced by improved accessibility of relevant documentation. Fourth, prospectus disclosure is not always sufficient to protect investors from inappropriate investment opportunities. Chapter six below will investigate whether tightened regulation of suitability assessments - conducted by those entities distributing securities to retail investors - is an adequate means to complement existing or enhanced prospectus frameworks of Canada, Switzerland and Germany.

\(^{948}\) CONTRATTO (fn. 129), p. 405.

\(^{949}\) See above, section III.5.1.
Chapter five          Continuous Disclosure Requirements

I        Introduction

Canadian, Swiss and German disclosure frameworks feature provisions that are aimed at keeping investors informed about relevant activities in securities markets. These continuous disclosure requirements focus on developments in relation to product issuers and significant changes in ownership structures of public companies. While owners of unstructured investment instruments such as equity securities or traditional debt securities are generally satisfied with the above information, investors of structured securities are not able to adequately assess the performance of their products by means of information about the products’ issuers and related ownership proportions. As a result, the three jurisdictions have begun to introduce continuous disclosure duties that provide investors with updated information about their products’ structures. However, these requirements are not yet fully developed for all product types and, therefore, do not always manage to meet investors’ needs for comprehensive and up to date information. After an overview of current continuous disclosure requirements of issuers, securityholders and other parties, the following sections will analyze how continuous disclosure in relation to structured securities could be enhanced and assess whether further parties should be mandated to disclose current information to investors. The below examinations will not include takeover regulation.

II        Issuers’ Duty to Update Information

1.    Regulatory Overview

1.1    Canada

a.    Preliminary Remarks

Continuous disclosure regulations vary in content and format depending on the type of investment instrument. Securities subject to prospectus disclosure in accordance with NI 41-101 must comply with continuous disclosure regulations of NI 51-102. Continuous disclosure requirements for mutual funds are established in NI 81-106. PPNs must follow disclosure obligations of sections 9 to 12 PPN

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950 See chapter two, sections I.3, II.3, and III.3.
Regulations. Derivatives neither falling under the scope of *NI 51-102* nor qualifying as PPNs in accordance with *PPN Regulations* are not subject to continuous disclosure requirements.  

b. Continuous Disclosure for Shares and Bonds

Continuous disclosure obligations of issuers of shares, bonds and other securities falling under the scope of *NI 41-101* are consolidated in *NI 51-102*. Besides periodic information about their financial conditions and current strategic positions, reporting issuers must report any material changes occurring in relation to their affairs. As mentioned in chapter three, section IV, material changes in the secondary market must be reported only if they alter the “business, operations or capital of the reporting issuer” and if they are “expected to have a significant effect on the market price or value of any of the securities of the reporting issuer”. Considering the fact that there may well be changes to an issuer that have no impact on its business, operations or capital but, nevertheless, are highly price sensitive, the definition of material change in Canadian securities regulation appears to be too narrow in scope. As continuous disclosure should keep investors updated about all information that might be relevant in order to make an investment decision, a distinction between changes that are inherent to the issuer’s activities and others that are determined by external factors is not an appropriate criterion to filter out information.

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951 See, however, the continuous information requirements established by stock exchanges (*SIX Additional Rules for the Listing of Derivatives*, s. 34, 35).
952 See chapter two, section I.3 above.
953 *NI 51-102*, s. 7.1.
954 With respect to prospectus disclosure in primary markets, however, issuers must report all ‘material facts’ (*GILLEN* (fn. 40), p. 212).
955 *NI 51-102*, s. 1.1.
956 *NI 51-102*, s. 1.1. See *CONDON/ANAND/SARRA* (fn. 55), p. 269, 170, on the differences between the Canadian ‘market impact test’ and the U.S. ‘reasonable investor test’. In view of the fact that all changes that may have an impact on the issuer’s economic situation are likely to influence the securities’ prices, the differences between the two tests appear to be marginal.
957 See *CONDON/ANAND/SARRA* (fn. 55), p. 268. “For example, material facts are assumed to include facts ‘external’ to the business of the issuer that nonetheless might have a significant impact on that issuer. Most definitions of material change do not contain that element”.
958 See also *CONDON/ANAND/SARRA* (fn. 55), p. 269, citing the opinion that “the standard of ‘full, true and plain’ disclosure applicable to prospectuses is effectively the reasonable investor standard and (...) the same standard should be applied to trigger continuous disclosure and to its contents”.

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c. Continuous Disclosure in Relation to Mutual Funds

Although mutual fund units qualify as securities under Canadian securities regulation, legislators have introduced a special disclosure regime for these investment vehicles. Unlike equity or debt securities, mutual fund units are not issued at a given point in time but can be distributed to interested investors at all times. Further, investors are not primarily interested in the current business situation and financial standing of the originator or structurer of a particular mutual fund. Rather, their focus is on the fund’s structure, its investment purpose and strategy, risk profile, performance and costs charged to investors or the fund’s assets. As mutual fund prospectuses contain information about the above parameters, they tend to remain meaningful for investors far longer than prospectuses of shares or bonds; as long as the relevant parameters are not changed, updates need not be frequent. Canadian Regulators have taken these differences between mutual fund units and other securities into account by obligating mutual funds to amend prospectuses upon material changes in the fund’s business, operations or affairs. Further, mutual funds are generally required to file a new prospectus every year. In addition to these fund-specific disclosure mechanisms, NI 81-106, parts 2 to 6, establish that mutual funds must publish “audited annual financial statements, semi-annual interim financial statements, and management reports of fund performance”. Further, mutual funds must provide investors with “quarterly portfolio disclosure, an annual information form, proxy solicitation and information circulars, and material change reports”. Although mutual funds generally publish redemption and issue prices on a regular basis, Canadian mutual funds are not legally required to disclose the above information.

In view of the above continuous disclosure requirements for mutual funds, investors are generally provided with adequately updated information. However, current regulations could be further improved by widening the scope of constellations that require prospectus amendments in part 11 of NI 81-106, section 11.2 (1)(d). As explained above, mutual fund prospectuses do not focus on disclosure in relation to the product originator but provide investors with key data on the fund’s structure and its implications for investors’ standing. Consequently, prospectuses generally reflect the content of the mutual fund agreement concluded between investors and the seller of the fund units. Therefore, investors should be

959 GILLEN (fn. 40), p. 16.
960 As the assets of a mutual fund vehicle are segregated from the funds of its originator, manager or structurer, unitholders need not fear an insolvency of these entities.
961 NI 81-106, s. 1.1, ’material change’.
962 NI 81-106, s. 2.5.
963 GILLEN (fn. 40), p. 537.
964 GILLEN (fn. 40), p. 537.
965 See s. 14.2 (6) of NI 81-106.
informed in a timely manner if any material factors listed in the simplified prospectus have been amended by the mutual fund management, irrespective of whether they are related to the fund’s business, operations or affairs. Further, mutual funds should be required to publish their net asset values at regular intervals and on a timely basis. If investors have no access to related information, they cannot assess the current value of their investment and, consequently, cannot make informed investment decisions.

d. Continuous Disclosure in Relation to PPNs

Sections 9 to 12 of PPN Regulations contain continuous disclosure duties for federally-regulated issuers of PPNs. In particular, investors can request information about the PPN’s net asset value or the last available measure of its underlying value at any point in time. Further, amendments to PPNs must be disclosed “in writing to the investor”. Moreover, issuing institutions must inform investors about the note’s value in case of early redemption that is conducted “on the request of an investor”. Although these measures ensure that investors can obtain information about the PPN’s value and relevant amendments to the note, they are far less comprehensive than continuous disclosure requirements of NI 51-102 or NI 81-106. To begin with, issuers are neither required to provide periodic information about their financials and business, nor do they have to publish amendments to the PPN’s terms on a publicly accessible platform. While the former omission is offset by the fact that issuers of PPNs are federally regulated and, therefore, highly transparent institutions, the latter can cause significant obstacles for investors interested in buying PPNs on the secondary market. Like mutual funds and other structured securities, a PPN’s value does not exclusively depend on the business and operations of its issuer but rather derives from the development of its underlying values and components. As a result,

966 See below, sections (b.cc) and (c.cc) for respective provisions in Swiss and German mutual fund regulations. The concept of ‘material change’ has its roots in continuous disclosure regulation for traditional equity securities. As the value of these securities is directly linked to the development of the business and operations of their issuer, investors must be constantly informed about these developments. In relation to mutual funds, however, unit price developments largely depend on developments of the investments made by the mutual fund manager. As a consequence, the material changes in the business and operations of the mutual fund do not necessarily meet information needs of mutual fund investors in a comprehensive manner. Rather, these developments are mirrored in the net asset value (NAV) of the mutual fund. NAVs are published on a regular basis. Besides, investors should be informed about all relevant amendments to aspects contained in mutual fund prospectuses.

967 S. 9 PPN Regulations.
968 S. 10 PPN Regulations.
969 S. 12 PPN Regulations.

970 See s. 10 PPN Regulations that requests that “the institution must disclose the amendment, and its potential impact on the interest payable, in writing to the investor”. As PPNs are often traded in secondary markets, it is rather doubtful whether issuing institutions are aware of the current owners of all its PPNs. Further, interested participants in secondary markets should be able to access an updated version of the initial information statement.
secondary markets can be efficient only if participants are continuously and publicly informed about the product’s value and possible amendments to the product structure. Consequently, the publication of the product’s net asset value (NAV) and the provision of updated disclosure statements on a publicly accessible platform are essential means to enhance tradability of PPNs and, thus, investors’ standing in relation to product issuers.

e. Conclusion

Continuous disclosure requirements of Canadian securities regulation provide investors with relevant information about their investments. Further enhancements could be achieved by obligating issuers to update prospectuses of structured products. As the complexity of these investments requires detailed information about their design and components, investors are dependent on current prospectuses. In addition, derivatives that fall under the scope of neither NI 51-102 nor of Canadian PPN Regulations are not subject to any continuous disclosure obligations. While investors of exchange contracts have access to current disclosure on the relevant stock exchange, investors of PRNs or asset-backed securities have no opportunity to gather updated information. These shortcomings may significantly impair tradability of the products in secondary markets and investors’ abilities to manage their assets. As a result, they should be remedied along with the deficits of primary market disclosure for structured notes and other investment instruments that are exempt from disclosure provisions in Canadian securities regulation.

1.2 Switzerland

a. Preliminary Remarks

As already seen in relation to prospectus disclosure in primary markets, Swiss securities regulation does not feature a comprehensive disclosure framework. Consequently, continuous disclosure requirements are widely dispersed and highly fragmentary. The following overview does not contain a comprehensive list and in-depth assessment of these rules. Rather, it confines itself to pointing out the most significant gaps and showing possible alternatives to the disparate disclosure framework currently in force.

b. Continuous Disclosure for Shares and Bonds

Continuous disclosure requirements for non-listed shares and bonds obligate issuers to provide investors with basic periodic information such as annual financial statements and an annual report of the issuer’s business and economic and financial situation. However, issuers are not obligated to

971 S. 662 and 663d SCO. These documents are “made available (…) at the Company’s domicile” for shareholders no “later than twenty days prior to the ordinary general meeting of shareholders” (s. 696 SCO). Investors of bonds
inform investors about recent developments that might have an impact on the securities’ prices or on investors’ assessment of the securities. Listed shares and bonds are subject to continuous disclosure requirements of SIX Regulation. In particular, issuers must comply with the annual and interim periodic reporting requirements of sections 49 and 50 SIX Listing Rules and “inform the market of any price-sensitive facts which have arisen in [their] sphere of activity.”972 Ad hoc information is published by the companies whose securities are concerned973 and disclosed on the SIX website.974 Periodic information is published by the listed companies themselves and cannot be retrieved on the SIX website. Although the self-regulatory requirements of SIX Regulation ensure that investors are provided with significant information, the introduction of an electronic central platform where disclosure documents of all issuers could be retrieved would considerably facilitate investors’ access to timely information.975

c. Continuous Disclosure in Relation to Mutual Funds

Section 106 (3) CISA and section 107 (3) CISA require that mutual fund prospectuses are amended “in the event of material changes, but at least once a year”.976 Further, a summary of significant amendments to the fund contract or, in case of a SICAV, to the fund’s investment regulations must be published in advance and the full wording must be available for investors free of charge.977 Moreover, fund management companies or SICAVs are obligated to publish annual and semi-annual reports for each mutual fund in accordance with section 89 CISA. Finally, net asset values of mutual funds must be published “at regular intervals”.978 Listed mutual funds must also comply with the above disclosure requirements. In addition, they have to follow the disclosure provisions of SIX.979

have access to annual financial statements as these must be sent to them “one year after approval” (s. 697h SCO). However, they are not provided with information in relation to the annual report (BSK-NEUHAUS/BLÄTTLER, s. 662 SCO n. 20).

973 S. 7 of the Directive on Ad hoc Publicity.
975 See already above, chapter four, section III.5.4, where the lack of an independent platform was criticized in the context of primary market disclosure.
976 Unlike their Canadian counterparts, the provisions do not confine the scope of disclosure to material changes in relation to the fund’s business, operations and affairs.
977 S. 27 CISA and FRANÇOIS RAYROUX/LAURENCE VOGT SCHOLLER, Basler Kommentar zum Kollektivanlagengesetz (Basel. Helbing Lichtenhahn, 2009), s. 44 CISA n. 12.
978 S. 83 (4) CISA. Publication has to take place whenever units are issued or redeemed or, if there is no issue or redemption, twice a month (s. 79 (2) CISO-FINMA).
979 According to s. 113 SIX Listing Rules, the content of the annual and semi-annual reports is governed by the requirement of CISA.
As mentioned in chapter four, section III.4.4, information about mutual funds can be retrieved on one of the electronic platforms recognized by FINMA. Although investors would benefit from a single electronic platform such as the Canadian SEDAR site, the convergence of mutual fund information on three determined platforms positions investors of mutual funds significantly better than other participants in Swiss securities markets.

d. Continuous Disclosure in Relation to Structured Notes

Section 5 CISA does not require that issuers of structured notes provide investors with updated information during the term of the notes. However, section 5 (f) of the SBA states that prospectuses must refer “to a website on which unforeseen changes to the conditions for the structured product (…) will be announced”. Although these announcements inform investors about the most relevant changes to product structures, they neither provide them with updated prospectuses, nor do they aim at comprehensive disclosure of all material changes. Further, legal requirements do not ensure that all relevant data can be accessed on a central electronic platform. Finally, unlike their Canadian counterparts, issuers of structured notes do not need to publish the products’ net asset values. As secondary market prices are generally calculated by deconstructing a product “into its constituent economic parts”, investors would benefit greatly from mandatory disclosure of these values.

e. Conclusion

As mentioned in section (aa) above, the Swiss framework for continuous disclosure is even more fragmentary than Swiss disclosure regulation of primary markets. In particular, a need for improvement has been established in relation to non-listed shares, bonds and structured notes. Investors of all types of securities lack a central electronic platform where they can retrieve continuous information about securities that are distributed in Swiss securities markets.


981 See above, section (a.dd).


983 As the issuer of a structured note is not obliged to invest investors’ moneys into the components of the structured product, the product itself - unlike a mutual fund - does not feature any appraisable assets [THOMAS BISCHOF/ANDREA LAMPRECHT/RENATE SCHWOB, Basler Kommentar zum Kollektivanlagengesetz (Basel. Helbing Lichtenhahn, 2009), s. 5 CISA n. 7]. Nevertheless, the product’s value is calculated by means of its components’ values and, therefore, can be determined by calculating the ‘net asset value’ of the structured note.
1.3 Germany

a. Preliminary Remarks

German securities are subject to continuous disclosure requirements of the European Directive 2006/109/EC. Investment companies and management companies of collective investment schemes, on the other hand, must follow transparency rules of the European Directive 85/611/EEC and its amendments. As seen in chapter four, section IV.2 above, European disclosure regulation forms a comprehensive framework for securities that are publicly distributed in European markets. The below sections briefly present continuous disclosure requirements for shares, bonds, derivatives and mutual funds.

b. Continuous Disclosure in Relation to Shares and Bonds

Chapter two, section IV.3 outlined the key instruments of continuous disclosure established by the European Transparency Guidelines. Besides disclosing periodic information to investors, issuers must provide the public with “all inside information which directly concerns that issuer”. Unlike Canadian securities regulation, the European Directive does not confine ad hoc publicity to changes to the issuer’s business, operations and affairs. Its sole qualification is the fact that issuers must report information only if the relevant circumstances “are not public knowledge” at the time of the publication. Further, the above information has to be published in media that ensure its Europe-wide circulation.

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984 See chapter two, section IV.2 above on the term ‘security’ in German law.
987 Exchange-traded derivative contracts do not qualify as securities and are not subject to one of the two frameworks for continuous disclosure. However, investors have access to material information on the Eurex website.
988 See above, chapter two, section IV.3.
989 § 15 (1) WpHG.
990 § 13 (1) WpHG.
addition, paragraph 24 WpAIV\textsuperscript{992} and paragraph 15 (1)(1) WpHG require that financial reports and ad hoc information can be retrieved electronically in the German business register.\textsuperscript{993}

c. Continuous Disclosure in Relation to Mutual Funds

German mutual funds are subject to the disclosure requirements of section 27 of the European Directive 85/611/EEC and the German Investmentgesetz (InvG). Section 27 of the Directive requires that investment companies and management companies managing mutual funds publish annual and half-yearly reports for each mutual fund. Further, section 30 of the Directive specifies that prospectuses “must be kept up to date”.\textsuperscript{994} Material changes to the terms of the product must be published in accordance with paragraph 43 (5) InvG. Moreover, issue and redemption prices must be published at least twice a month in an adequately circulated newspaper or in the electronic media as specified in the prospectus.\textsuperscript{995}

Whereas periodic reports and material changes to the product terms must be published in the German electronic federal register,\textsuperscript{996} other continuous disclosure documentation - such as updated prospectuses and redemption prices - cannot necessarily be retrieved on the same electronic platform. Although the latter documents are otherwise accessible for interested investors, the introduction of an electronic platform with relevant information would further enhance investors’ abilities to monitor their mutual fund investments.

d. Continuous Disclosure in Relation to Structured Notes

Structured notes are subject to the continuous disclosure requirements of the European Transparency Directive and related German provisions. Consequently, investors receive adequate information about their products and related changes or amendments. However, issuers are not explicitly required to update their prospectuses once the products are traded in secondary markets. As a result, investors must consider all documents that have been published since the issue of a specific note. As structured notes may undergo significant changes in relation to their product structure, this obligation


\textsuperscript{993} <www.unternehmensregister.de>. See also HABERSACK (fn. 216), p. 179 and 230.

\textsuperscript{994} See § 42 (5) InvG. See also KEUNECKE (fn. 218), p. 405, in relation to the implementation of s. 30 of the European directive into German law.

\textsuperscript{995} § 36 (6) InvG.

\textsuperscript{996} <www.ebundesanzeiger.de>. See § 45 (1) InvG in relation to reports, and § 43 (5) in relation to amended contractual terms.
unnecessarily burdens investors and hampers their understanding of investments. Further, issuers are not required to publish the net asset values of their products at any time during the product’s term. Consequently, investors have little indication for fair prices in secondary markets.

e. Conclusion

German continuous disclosure regulations feature characteristics similar to their Canadian counterparts. While they generally provide investors with adequate information about publicly offered investment products, they have not adopted adequate disclosure requirements in relation to structured notes. Further, unlike Canadian disclosure regulation, the German regulatory framework has so far not established a central electronic platform where all relevant information of primary and secondary market disclosure can be retrieved by investors. Whereas the latter issue could be solved in accordance with the Canadian model, a revision of the fragmentary disclosure system for structured investments requires careful consideration. Based on the above results, the following section will examine what information should generally be provided to investors of structured securities.

2. Enhancing Continuous Disclosure of Structured Securities

Structured investment instruments combine the characteristics of several investment products. The value of these wrapper products\textsuperscript{997} is based on the performance of their components. Further, the legal wrapper of structured products may have a significant influence on the products’ characteristics and value. While mutual fund wrappers, for example, do not add additional risks to the combination of different products,\textsuperscript{998} structured notes additionally burden investors with the credit risk in relation to the products’ issuers. By wrapping product combinations in a specific legal form, product issuers can significantly influence the risk profiles of their products.

In view of the above observations, two key factors must be considered when investing in structured securities. First, investors must be aware of the products’ components, their development and their impact on product prices. As an enhancement in value of the product’s underlying values does not necessarily lead to an increased value of the structured product itself,\textsuperscript{999} investors should be informed about the net asset value of the product at any time during its term. Second, interested market

\textsuperscript{997} Fok Kam (fn. 571), p. 254.
\textsuperscript{998} I.e. the fund’s assets.
\textsuperscript{999} See, for example, Fok Kam (fn. 571), p. 276, on the possible path dependence of structured notes. Further, structured notes can also reward downturns in the value of the product’s underlying assets [see, for example, the pay-off diagram of so-called twin-win-certificates, where investors may benefit from a rise and fall in the underlying values of the product, in the Steffen Tolle/Boris Hutter/Patrik Rüthemann/Hanspeter Wohlwend, Swiss Derivative Guide (Zürich. Verlagsgruppe Handelszeitung, 2007).p. 50].
participants must be aware of the legal form of a structured product and its implications on the
product’s price. Unlike unstructured securities, structured products do not necessarily maintain identical
characteristics during their entire life cycle. Rather, issuers are regularly permitted to amend a product’s
conditions after its issue and, sometimes, have no choice but to implement “unforeseen changes to the
conditions for the structured product which were not agreed contractually but which arise during the
product’s term”. As a result, investors depend on updated information in order to keep up with
significant product developments.

In primary market regulation, the above particulars of structured investments are adequately
considered by disclosure requirements for these products. Initial information statements of PPNs or
prospectuses of PRNs or mutual funds are careful to disclose the products’ structures and risk profiles to
investors. However, the observations of sections 1.a.dd, 1.b.dd and 1.c.dd above have clearly shown
that legal frameworks for secondary market disclosure have not yet achieved a satisfactory level of
continuous and up-to-date information about the product’s structure and current value. In particular,
neither Swiss nor German disclosure provisions require that issuers of structured notes publish net asset
values of their products at regular intervals. Further, none of the above frameworks features
requirements to update prospectuses of structured notes following product amendments or other
developments. Although the publication of significant amendments informs investors in a reliable
fashion about relevant developments, market participants who have purchased their product in the
secondary market may have difficulties in tracing these changes in a comprehensive manner and
assessing their impact on the product’s structure and value.

Considering the above analysis, the complex design of structured investment instruments shifts the
focus of conventional disclosure measures in two ways. First, product characteristics are influenced by
the product’s components and its legal form. Therefore, investors must be able to get an overview of
current product features at any point in time. This can be best achieved by providing them with updated
prospectuses or information statements throughout the product’s life cycle. Second, if structured
investments are issued by a separate legal entity or a highly regulated institution, product prices are
generally less dependent on the credibility of the issuing entity than on the price development of the
product’s components. As a result, continuous information about the product’s issuer may be less
significant for investors than a constant display of product prices.

1000 SBA Guidelines (fn. 464), s. 5 (f). The SBA Guidelines, p. 10, cite as examples of such unforeseen changes.
“corporate actions affecting the underlying value, such as share splits, […] or par value redemptions”.
1001 See, for example, section 5 (f) of the SBA Guidelines or s. 10 PPN Regulations.
While mutual fund legislation widely acknowledges the above particularities of continuous disclosure for structure investments, disclosure regulations of structured notes have so far abstained from fully implementing respective measures. One reason for this lack of implementation can be found in securities regulators’ assumption that structured notes are adequately regulated by disclosure provisions for traditional securities; another cause is the financial industry’s insistence on regulatory distinctions between mutual funds and other structured securities.  

However, since the creation of structured notes with open-end terms and the implementation of secondary market trades in these securities, the need for adequate continuous disclosure has manifested itself in a palpable manner. If investors are neither able to determine the ‘true’ value of a structured note nor retrieve the product’s current design and configuration in an efficient manner, product trades on the secondary market can be dominated by product issuers and a small handful of sophisticated and well-informed professional market participants. As structured notes are distributed to retail investors on a regular basis, this informational imbalance is no longer acceptable and, therefore, should be abolished by implementing additional disclosure measures as outlined above.

III Other Persons’ Continuous Disclosure Duties

1. Preliminary Remarks

The brief overview of Canadian, Swiss and German disclosure regulations has shown that disclosure requirements are not confined to issuers of securities but also extend to third parties. In particular, relevant market participants such as insiders1003 and people acquiring a certain percentage of equity securities1004 must disclose their ownership positions in relation to certain securities. Besides, product intermediaries are obligated to disclose product risks to interested investors if they act as advisors or asset managers. Finally, continuous information is also disclosed by parties that are not directly involved in the distribution process of securities but rather assess the value of these products on behalf of investors.1005

1002 See, for example, BSK-BISCHOF/LAMPRECHT/SCHWOB (fn. 983), s. 5 CISA n. 11.
1003 See, for example, Canadian insider regulation in s. 3.3 of NI 55-104.
1004 See, for instance, the early warning requirements of MI 62-104, s. 5.2, and s. 102 OSA. Further, see GILLEN (fn. 40), p. 442, on take-over bids.
1005 Such as product analysts and raters, see below, section 3. As product ratings play an essential role in both primary and secondary markets, these parties’ duties are not confined to secondary market disclosure. However, as investors depend on a continuous updating of their assessments and ratings, the outline of respective duties in the context of continuous disclosure seems justified (see also HABERSACK (fn. 216), p. 512). Other sources of information are audit reports and the media spreading relevant information. However, these aspects are not further examined in this thesis.
Securities regulations have assigned different disclosure duties to the above parties in a reasonable manner. While issuers determine a product’s characteristics and implement respective amendments, intermediaries are in close contact with investors. As a result, issuers are generally required to provide investors with prospectuses and continuous product-specific information, whereas legislators commit intermediaries to inform investors about product risks on an individual basis. However, the three jurisdictions have not yet tapped the full potential of non-issuing parties in relation to their abilities to enhance continuous disclosure in securities markets. The below sections will examine how Canadian, Swiss and German securities regulations could enhance third party information without overly jeopardizing market efficiency and existing procedures in securities markets. As disclosure of information at the point of sale is closely intertwined with suitability duties of intermediaries, information duties of these parties will be examined in the context of further point of sale duties in chapter six below.

2. Securityholders

2.1 Early Warning Disclosure

All three jurisdictions require that investors of equity securities disclose their ownership positions once they reach a significant threshold. While Swiss and German regulations obligate investors to report ownership positions as from three percent of the total of securities onwards, Canadian securities regulation has so far established the relevant threshold at ten percent. Further, unlike the two other jurisdictions, Swiss securities regulation has introduced an early warning duty for cash-settlement derivatives relating to reportable securities. Hedging practices of derivative issuers suggest that this requirement should also be introduced in Canadian and German securities regulations. However, Swiss early warning requirements are still confined to listed securities. In view of the globally spreading hedge fund industry, timely disclosure of interests in publicly held corporations appears to be of paramount importance. As speculative activities and takeover operations are not confined to listed

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1006 S. 20 (1) SEsta and § 21 (1) WpHG.
1007 S. 15 SESTO-FINMA.
1008 Although option trades without physical settlement do not provide the holder of a call option with the right to a physical delivery of the underlying assets, counterparties typically buy the underlying shares in order to hedge their risks. Upon maturity of the options, the option writer is looking for a potential buyer for its stock of the hedge and, should the former option holder be interested in the physical acquisition of the shares, a purchase agreement on the underlying shares will follow the ‘cash settled’ option trade. As the parties are aware of these implications, an option trade with cash settlement might lead, from an economic point of view, to virtually the same results as if a physical settlement had been agreed between the buyer and the seller.
1009 S. 20 (1) Sesta.
corporations, the Swiss limitation of its early warning rule to exchange-traded securities can no longer be justified by cost-benefit arguments or local peculiarities but should be replaced by a provision including non-listed public companies.

2.2 Insider Disclosure

Canadian, Swiss and German securities regulations contain disclosure requirements in relation to insider dealings. Whereas the three jurisdictions agree on the general concept of insider disclosure, the finer details of their regulations vary considerably. To begin with, definitions of the term ‘insider’ in Canadian, Swiss and German regulations do not fully correspond. While the Canadian understanding of an insider includes significant shareholders, management companies providing significant services to an issuer and directors or officers of an issuer, German and Swiss disclosure regulations are largely confined to the latter group of market participants. In addition, the scope of the two jurisdictions’ insider reporting duties is confined to transactions in equity securities or related financial instruments, whereas Canadian reporting requirements apply to equity and debt securities. Further, Canadian insider provisions require that insiders file their reports on an electronic platform. German and Swiss insider regulations, on the other hand, impose the publication of relevant transactions on affected issuers. Moreover, in order to enhance transparency of issuers with regard to insiders of their company, paragraph 15b WpHG requires that German issuers keep a register of all insiders and inform the listed persons about their reporting duties. Similar measures have so far not been introduced into Canadian or Swiss legal frameworks. Finally, Swiss and German insider provisions apply only in relation to listed issuers.

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1010 See s. 1.1, ‘significant shareholder’ of NI 55-104.
1011 s. 1.2 (b) of NI 55-104.
1012 See, for example, s. 1.1 BCSA, ‘insider’.
1013 § 15a WpHG, BUCK-HEEB (fn. 193), p. 132; s. 56 (1) SIX Listing Rules.
1014 For Germany, see BUCK-HEEB (fn. 193), p. 132, 133. For Switzerland see s. 5 (2) SIX Directive on Disclosure of Management Transactions. “Debt securities without reference to shares are not subject to reporting.”
1015 NI 55-104, s. 3.3. See below, section (c).
1016 s. 3.1 of NI 55-104. See also <www.sedi.ca>, and GILLEN (fn. 40), p. 209, 210.
1017 Insiders are required to report their transactions to the respective issuer which, in turn, is obliged to disclose relevant transactions to the public (§ 15 WpHG) or to the competent stock exchange which then “make the notifications it receives (...) available to be called up by the public” (s. 56 (5) SIX Listing Rules).
1018 See, however, FINMA Circular 2008/38 on market behaviour rules for the securities market, November 20, 2008, which states in n. 54 that securities dealers must keep watchlists in relation to price-sensitive information about certain issuers.
1019 Insider reporting duties are contained in s. 56 SIX Listing Rules; the rules’ scope applies to listed securities only.
1020 § 15a WpHG; BUCK-HEEB (fn. 193), p. 132, 133.
Insider reporting requirements have been introduced in order to “deter (...) improper insider trading”.\footnote{GILLEN (fn. 40), p. 375.} As insiders may have more information about the issuer’s business prospects than other market participants, they may be tempted to purchase or sell their securities based on this additional knowledge. Securities regulation strives to prevent such disruptive market behaviour by prohibiting “trading on the basis of material information concerning an issuer, or any of the securities of an issuer, that has not been generally disclosed”.\footnote{GILLEN (fn. 40), p. 375.} In order to further deter insiders from entering into such prohibited transactions, legislators have introduced the above reporting duties for insiders.\footnote{BUCK-HEEB (fn. 193), p. 132, or GILLEN (fn. 40), p. 375.}

Considering this legislative reasoning, the scope of reporting duties should not be limited to directors or managers of relevant issuers. Rather, all persons that are in a close relation to issuers should be obligated to disclose any transactions in related securities. Therefore, German and Swiss disclosure regimes for insiders should adopt the Canadian scope rather than maintaining their narrow concept of mandatory insider disclosure. However, the filing and publication duties of issuers of Swiss and German regulations should be retained unchanged. By channelling insider reports through the relevant issuer, regulators can focus on another responsible entity to ensure disclosure of insider transactions. Further, German issuers’ duty to keep a register of people with insider status may prompt an increase in insiders’ awareness of their duties and enhance monitoring capacities of issuers. Finally, Swiss and German laws should abandon their current limitation of reporting duties to insiders of listed issuers and, instead, adopt the more appropriate scope of Canadian law.

2.3 Disclosure Duties and Debt Securities

The above early warning requirements apply exclusively to transactions in equity securities or debt instruments that are closely related to equity securities.\footnote{See, for example, MI 62-104, s. 5.2 (1).} Swiss and German disclosure frameworks have chosen an identical perspective for the regulation of insider disclosure. Canadian insider provisions, however, require disclosure of insider transactions irrespective of whether the traded securities are equity or debt securities. Should Swiss and German insider regulations pass on to a more comprehensive approach? Should early warning requirements of all jurisdictions extend to the disclosure of debt positions?

Debt securities have significant similarities to equity securities. Issuers are provided with capital and securityholders, in turn, take advantage of monetary or participatory rights that have been conveyed to
them in exchange for their investment. However, the decisive difference between these two kinds of securities is the fact that owners of debt securities do not “share in the distributions of profits of the company” \(^\text{1025}\) and never have “the right to vote at shareholder meetings”. \(^\text{1026}\) Further, their position is less vulnerable than shareholders’ standing in case of the issuer’s bankruptcy. \(^\text{1027}\) Considering the fact that shareholders generally benefit from dividend payments following an upturn of their company, the value of equity securities is more susceptible to material changes in the issuer’s business and other relevant shifts in securities markets. The focus of Swiss and German insider regulation on equity-related transactions may therefore be justified. However, owners of debt securities are not always excluded from active influence on the issuer’s fate. In particular, they are essential players in constellations of financial need of the company. \(^\text{1028}\) Further, major debtholders may act as indicators of the financial condition of an issuer and, therefore, attract smaller securityholders with fewer capacities for a thorough assessment of the relevant company. \(^\text{1029}\) Balancing these factors, Canadian insider provisions appear to be preferable to their Swiss and German counterparts. Although debt and equity securities can be clearly distinguished in theory, their economic roles may not always be that far apart from each other. As a result, insider transactions relating to the issuer’s debt securities should be included in reporting obligations of Swiss and German laws.

While a key reason for implementing early warning requirements is the intention to give “the target corporation an early warning of any potential takeover”, \(^\text{1030}\) another motivation for the introduction of these rules is the legislator’s objective to disclose those shareholders that may influence decisions in a public company. \(^\text{1031}\) Whereas the first rationale for the implementation of early warning requirements does not apply to ownership structures in relation to debt securities, the second aspect can be of similar importance with regard to debt instruments. As mentioned above, important creditors may exert a dominating influence in financing decisions and, therefore, be crucial factors if an issuer is in the process of refinancing its business or, even more importantly, if it is insolvent or has entered bankruptcy

\(^{1025}\) Gillen (fn. 40), p. 7.
\(^{1026}\) Gillen (fn. 40), p. 7.
\(^{1027}\) Valden/Paton/Davis/Sarra/Gillen/Condon (fn. 280), p. 1178.
\(^{1029}\) Sarra (fn. 614), p. 8.
\(^{1031}\) Bsk-Weber (fn. 1030), s. 20 Sesta n. 1.
proceedings.\textsuperscript{1032} As a result, debtholders could significantly benefit from the disclosure of significant holdings of debt securities. However, such disclosure is meaningful only if it reveals whether the owners of debt securities bear, at the same time, the economic risk inherent to the instruments.\textsuperscript{1033} As HU/BLACK mention in their paper on Debt, Equity and Hybrid Decoupling, debt “decoupling markets are often larger, relative to the size of the underlying market, than their equity counterparts”.\textsuperscript{1034} Further, the “rights held by shareholders are more uniform across firms than the rights held by creditors”.\textsuperscript{1035} Consequently, adequate disclosure is much more challenging than early warning transparency in relation to equity securities.\textsuperscript{1036}

Some of the above issues can be considerably reduced by implementing new regulatory standards for debt derivatives. In particular, drafts of new OTC Regulations\textsuperscript{1037} seek to introduce additional standardization measures and increase margin and capital requirements.\textsuperscript{1038} Although these regulatory innovations may significantly enhance investors’ positions,\textsuperscript{1039} it is rather unlikely that they will provide full transparency in relation to an issuer’s creditors. Even if the new regulations required disclosure of all relevant transactions, the different formats and standards of debt securities and their multiple transfers and segmentations among various market participants would presumably render disclosure efforts a painstaking exercise rather than valuable help for investors. What is more, large creditors are not necessarily securityholders but may have entered into conventional loan agreements with the relevant issuer; the introduction of an early warning requirement for debt securities would not disclose these positions to investors and, as a result, disclosure of related derivative transactions might create confusion instead of transparency.

In view of the above, the inclusion of debt securities into the scope of current early warning requirements does not appear a viable measure to increase transparency in relation to debt markets. Rather, more modest regulatory amendments should focus on the following three aspects. First,
debtholders’ influence is most pronounced in the case of the issuer’s bankruptcy.\textsuperscript{1040} As creditors with no or even negative economic exposure are far less interested in successful restructuring proceedings of a financially distressed company than creditors whose risks are not hedged,\textsuperscript{1041} the latter’s positions should be disclosed to involved parties. Further, their influence in related procedures should be clearly confined so as not to compromise “the potential for a viable business restructuring plan”.\textsuperscript{1042} Second, transparency of derivative transactions should be increased for the contractual parties involved in a specific trade.\textsuperscript{1043} Although such ‘internal’ disclosure requirements would not create transparency in public securities markets, they would result in an enhanced quality of transactions and increased risk awareness of the parties involved and, therefore, may result in more risk-sensitive behaviour of market participants. Third, major creditors of public companies should be required to disclose their positions and, in addition, indicate whether they have passed on their credit risk to third parties.\textsuperscript{1044} Although this measure would not inform market participants about the ultimate risk bearers,\textsuperscript{1045} it could at least eliminate the positive signalling effect of large creditors to smaller, less experienced market participants. Finally, it remains to be noted that transparency measures may not be sufficient to tackle the issues arising from the hedging of credit risks.\textsuperscript{1046} However, an in-depth consideration of comprehensive solutions would clearly go beyond the scope of this thesis and will not be further pursued.

3. Analysts and Product Raters

Retail investors often lack the knowledge, time and funds to assess the value and prospects of securities available in capital markets. Professional analysts and product raters can considerably facilitate investment decisions by analyzing and rating financial instruments offered in public markets. However, past events\textsuperscript{1047} have shown that information mediaries do not qualify as additional information sources

\textsuperscript{1040} See Hu/Black (fn. 1028), p. 680.
\textsuperscript{1041} SARRA (fn. 614), p. 13.
\textsuperscript{1042} SARRA (fn. 614), p. 15.
\textsuperscript{1043} SARRA (fn. 614), p. 11, n. 1 and 2.
\textsuperscript{1045} In relation to credit derivatives, see also SARRA (fn. 614), p. 15. “While these innovations [i.e. CDS protocols and industry auctions] are important, they address only one aspect of the settlement process. There continues to be a lack of transparency as to who is bearing the ultimate costs of the deficiencies in value when all the CDS settlements are completed.”
\textsuperscript{1046} See also SARRA (fn. 614), p. 16, who suggests several measures to ensure better insolvency proceedings in relation to credit derivatives. Similar Hu/Black (fn. 1044), p. 735.
\textsuperscript{1047} For a brief summary of abusive ratings in the U.S. after the internet bubble see Ulrich L. Gores, Interessenkonflikte von Wertpapierdienstleistern und -analysten (Berlin. De Gruyter Rechtswissenschaften Verlags-
for retail investors unless their assessments are highly credible and not misunderstood by investors or other market participants. These preconditions cannot be established by ready-made regulatory measures. Instead, comprehensive approaches to the regulation of analysts, rating agencies and other information mediaries in financial markets require a careful analysis of recent failures of these entities. While current Canadian, Swiss and German securities laws have acknowledged the need for regulation of analysts and rating agencies, none of the three jurisdictions features a comprehensive framework defining the tasks, standards and requirements for these intermediaries. However, current national and international regulatory initiatives recognize that the following aspects must be considered in order to re-establish investors’ trust in the soundness of financial analyses or ratings of investment instruments. First, the data used by analysts and rating agencies must be of high quality in order to produce any meaningful results. Second, structured finance ratings differ from traditional corporate debt ratings in various ways. These differences should be disclosed to investors by the implementation of customized rating categories for structured and non-structured financial instruments. Third, investors, analysts and regulators have increasingly embraced product ratings as decisive factors in the assessment of investment products. Although high or low ratings can give valuable advice on the products’ loss characteristics, they are not able to give an overall assessment of all relevant risk factors. For further details, see the referenced sources.

1050 SCHWARZ (fn. 1049), p. 222.
1052 FSF (fn. 1051), p. 36.
1053 FSF (fn. 1051), p. 34.
1054 IOSCO, The Role Credit Rating Agencies (fn. 1051), p. 8.
factors of a specific product.\textsuperscript{1055} Fourth, the integrity of ratings can be seriously compromised by conflicts of interests arising from “the issuer-pays model”.\textsuperscript{1056} Although these agency problems may not have been the main cause of the overly positive credit ratings of structured investment instruments prior to the financial crisis,\textsuperscript{1057} a mitigation of agency-cost conflicts\textsuperscript{1058} could considerably enhance investors’ trust in the integrity of ratings.

Even a comprehensive implementation of the above suggestions cannot guarantee that retail investors are always adequately protected against misinformation or misinterpretation. To begin with, national jurisdictions may not always be able to introduce regulatory measures that, from their perspective, would be most suitable for investors but must comply with international standards. Due to the significant impact of rating agencies’ inadequacies in relation to complex structured instruments, current international regulatory activities largely focus on rating procedures and aim less to mitigate conflicts of interests of financial analysts.\textsuperscript{1059} Further, current efforts to regulate credit rating agencies are far from covering all relevant rating procedures that are applied in capital markets.\textsuperscript{1060} Finally, the above observations have shown that ratings can never provide investors with a comprehensive assessment of all risks related to a product. Although credit ratings or other risk-based ratings may be valuable indicators of whether a specific product is suitable for interested investors, they cannot be substitutes for investors’ overall understanding of the product characteristics and risks.\textsuperscript{1061} If retail investors are not sufficiently knowledgeable to assess the suitability of a particular product, they may be dependent on professional advice. The following chapter will analyze to what extent suitability assessments should be implemented in point of sale regulation and to what extent this assistance should be a mandatory step in the acquisition of investment products by retail investors.

\textsuperscript{1055}FSF (fn. 1051), p. 37, SCHWARZ (fn. 10491047), p. 263.
\textsuperscript{1056}ROUSSEAU (fn. 1051), p. 25.
\textsuperscript{1057}SCHWARZ (fn. 1047), p. 402.
\textsuperscript{1058}SCHWARZ (fn. 1047), p. 381.
\textsuperscript{1059}See, however, INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (IOSCO). “Report on Analyst Conflict of Interest” (September 2003).
\textsuperscript{1060}See, for instance, the risk ratings for Swiss and German structured notes which are conducted by other companies than those qualifying as credit rating agencies (\langle http://www.svsp-verband.ch/download/risikokennzahl/100201_svsp_var_informationen_en.pdf\rangle).
\textsuperscript{1061}FSF (fn. 1051), p. 37 et seq.
IV Conclusion

The above examinations have shown that the current allocation of continuous disclosure duties to different market participants accords with the parties’ activities and knowledge. The continuous disclosure framework of all the examined jurisdictions could be considerably enhanced by filling the following gaps. First, the value and risk exposure of structured securities is closely related to the prices of the product’s components and structure. In order to assess the current value of a specific product, investors are therefore dependent on updated product prospectuses and periodic publication of the product’s net asset value. Second, disclosure in relation to economic ownerships of debt securities lags significantly behind disclosure requirements for equity securities. While the implementation of an early warning system for debt securities might not be feasible in the same way that it exists for equity securities, the present deficit could be considerably mitigated by introducing disclosure duties that require transparency in crucial constellations. In particular, disclosure requirements should obligate creditors to reveal their economic exposure in the issuer’s bankruptcy and provide that contracting parties enhance pre-contractual transparency vis-à-vis their counterparts. Third, rating agencies and analysts are important factors in investors’ abilities to assess product risks and prospects. Nevertheless, investors must be made aware of the fact that products cannot be assessed in a comprehensive manner by exclusively relying on product ratings. Further, product analyses must be considered in the context of the investor’s entire portfolio and financial position. As a result, retail investors are likely to depend on the assistance of advisors or portfolio managers in order to properly understand and use complex financial investments.
Chapter six  
Code of Conduct at the Point of Sale

I. Introduction

Issuers of publicly distributed securities are suitable parties to provide investors with initial and continuous information about the characteristics, risks and performance of their products. However, as securities are generally not distributed by their issuers but by appointed intermediaries, issuers may not be able to put the disclosed facts into investors’ contexts and assess whether a specific investor is adequately knowledgeable so as to understand and handle the risks involved with the purchase of a certain instrument. As a result, Canadian, Swiss and German securities regulators have imposed additional risk information duties on intermediaries. In addition, intermediaries may provide important assistance to less sophisticated investors. In particular, they can draw investors’ attention to aspects which issuers would rather not disclose to market participants, or advise them on the composition of their entire portfolio.

While the key role of intermediaries in the distribution of securities has not been adequately acknowledged by legislators for some time, recent regulatory initiatives have tightened legal standards for intermediaries and their risk disclosure obligations. In particular, advisors, asset managers and securities dealers are subject to registration and authorization requirements. Further, they are obligated to disclose relevant risks to their customers. However, the above legislatory measures have not yet fully managed to establish consistent and comprehensive risk disclosure mechanisms at the so-called point of sale. In particular, Canadian and Swiss regulations are still focused on institutional rather than functional regulation. As a result, issuers distributing their securities without the assistance of intermediaries do not necessarily fall under the scope of NI 31-103 and its information and suitability obligations. Further, Swiss regulations lack detailed information requirements for advisors.

Rather than assessing current regulations of intermediaries in Canadian, Swiss and German laws, the below observations will be confined to outlining the key features of German point of sales regulations as

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1062 See, for example, NI 31-103, which requires that advisors and asset managers must register at the competent securities commission (part 7), or the authorization requirements for securities dealers set forth in s. 10 SESTA.
1063 See, for example, NI 31-103, s. 14.2 (2)(c), and s. 11 SESTA.
1064 See INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (IOSCO), “Principles on Point of Sale Disclosure”, Consultation Report of the Technical Committee of IOSCO (November 2009), p. 1, fn. 3. “For purposes of this report, point of sale refers to the moment at which a customer requests that a product be purchased.” The term will be used accordingly in this thesis.
the most comprehensive set of rules for intermediaries out of the three jurisdictions examined. Drawing from these regulations, section III will highlight the core aspects that should be considered when regulating intermediaries. In particular, the below analysis will focus on the relationship between disclosure duties of issuers and transparency requirements imposed on intermediaries. Further, it will determine the content and personal scope of point of sale regulation. Finally, section III.5 will examine to what extent investors should be allowed to waive disclosure and suitability duties of intermediaries.

The chapter will not further examine the question of how intermediaries should be supervised in order to guarantee an adequate implementation of disclosure requirements by these parties. However, current regulations and developments strongly suggest that continuous supervision of point of sale entities may be as important for transparent markets as the constant monitoring of product issuers themselves.

II German Point of Sale Regulation

German provisions are based on the *European Directive 2004/39/EC on markets in financial instruments (MiFID Directive)*. They require that investment firms provide their services in the interest of their customers and avoid conflicts of interest. Further, paragraph 31 (2) and (3) *WpHG* establishes that investors must be provided with information about the characteristics and risks of the financial instruments distributed by investment firms. Unlike prospectuses, risk information at the point of sale needs not disclose the risks that are inherent to a specific investment instrument. Instead, investment firms are required to draw investors’ attention to risks that typically occur in relation to certain kinds of investment instruments. Information can be produced in a standardized form. If investment firms provide “investment advice or portfolio management”, they must not only provide investors with the above information, but also “obtain the necessary information regarding the client’s or potential client’s

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1066 Canadian and Swiss disclosure duties at the point of sale have been briefly outlined in chapter three, section III above.
1068 See s. 4 (1) *MiFID Directive* for a definition of the term ‘investment firm’. “‘investment firm’ means any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis”.
1070 BUCK-HEEB (fn. 193), p. 194. Similar risk disclosure techniques are required by s. 11 SESTA (see also ROLF WATTER/URS KÄGI, *Basler Kommentar zum Börsengesetz* (Basel. Helbing Lichtenhahn, 2007), s. 5 SESTA.n. 30 - 47).
1071 BUCK-HEEB (fn. 193), p. 194.
1072 S. 19 (4) *MiFID Directive*. 167
knowledge and experience (...), his financial situation and his investment objectives so as to enable the firm to recommend to the client or potential client the investment services and financial instruments that are suitable for him* 1073. If investment firms do not offer investment advice or portfolio management, they are not required to assess the suitability of a specific transaction; instead, they must establish whether the transaction is appropriate in view of the client’s knowledge and experience. 1074. If investment firms are approached by their clients in relation to a non-complex transaction, 1075 they are not obligated to obtain information or assess whether the envisaged transaction is appropriate for the client. 1076

Should investment advisors or portfolio managers not manage to obtain the information which would be necessary to assess the suitability of a transaction, they are not allowed to perform their advisory or managerial services. 1077. If investment firms must assess the appropriateness of a transaction, they can perform their services even if they do not obtain the relevant information. However, they must inform the particular client that - due to their lack of information - they are not able to conduct any assessment.

III. Core Aspects of Point of Sale Regulation

1. Relationship between Point of Sale Disclosure and Disclosure by Issuers

The term ‘point of sale disclosure’ is used in different contexts. In a broad sense, point of sale disclosure includes all written or oral communication at the point of sale - i.e. before a particular trade is executed 1078 - regardless of whether this information has been prepared by the product issuer or its intermediary. In a narrower sense, however, point of sale disclosure includes information only that is provided by the entity which is in contact with the interested investor at the time of the product purchase. As this chapter focuses on professional obligations of intermediaries, the term will refer to its second meaning. Nevertheless, it should be kept in mind that intermediaries’ duties are not confined to

1073 § 19 (4) MiFID Directive, emphasis added.
1074 § 31 (5) WpHG. The provision requires that investment firms obtain information on the client’s knowledge and experience in relation the envisaged kind of investment transaction. However, firms are not obligated to investigate their clients investment objectives and financial position.
1075 Non-complex investment transactions are listed in § 31 (7)(1) WpHG.
1076 § 31 (7) WpHG
1077 § 31 (4) WpHG.
making their own information available to investors, but also require that point of sale entities provide investors with relevant documentation supplied by the product issuer.\textsuperscript{1079}

As mentioned in chapter five, section III.1 above, issuers’ involvement in the creation of products makes them the most knowledgeable and appropriate parties to provide investors with product-related information. Consequently, point of sale disclosure should not interfere or overlap with this concept but step in only if investors require additional information that cannot be provided by issuers.\textsuperscript{1080} In particular, intermediaries can enhance investors’ level of information by disclosing their own position and interests.\textsuperscript{1081} Further, they may specify “the full range of charges associated with purchasing and owning the product”.\textsuperscript{1082} In addition, intermediaries are - unlike product issuers\textsuperscript{1083} - in direct contact with investors. As a result, they are able to assess investors’ skills and experience and provide detailed information on the products’ characteristics in a customized manner.\textsuperscript{1084} Finally, intermediaries can point out an investment instrument’s risk degree in comparison to other product types and assess whether a particular investment is appropriate and suitable for a particular investor.

2. Personal Scope of Point of Sale Regulation

The above observations have shown that prospectus disclosure by issuers does not necessarily cover investors’ information needs in a comprehensive manner. In particular, issuers often do not establish any personal contact with investors and, consequently, are not able to assess investors’ knowledge and risk awareness. Further, prospectuses address themselves to securities markets as a whole and may not adequately consider information needs of all market participants.\textsuperscript{1085} However, regulating intermediaries does not necessarily take account of these insights. As risk disclosure at the point of sales constitutes an additional step towards comprehensive investor protection, it should not be confined to those constellations where securities are bought from intermediaries rather than from the issuer itself. Instead, point of sales regulation should apply to any entity selling the product to investors, irrespective of their relationship with the products’ issuer.\textsuperscript{1086}

\textsuperscript{1079} IOSCO (fn. 1064), p. 21.
\textsuperscript{1080} See IOSCO (fn. 1064), p. 27. “In deciding what key information disclosure to impose on intermediaries and product producers, regulators should consider who has control over the information that is to be disclosed”.
\textsuperscript{1081} IOSCO (fn. 1064), p. 4, 25.
\textsuperscript{1082} IOSCO (fn. 1064), p. 28.
\textsuperscript{1083} Unless the products are distributed by the issuer itself, see below, section III.2.
\textsuperscript{1084} IOSCO (fn. 1064), p. 20, 31.
\textsuperscript{1085} CONTRATTO (fn. 129), p. 355.
\textsuperscript{1086} See also COMMISSION OF THE EUROPEAN COMMUNITIES, “Packaged Retail Investment Products”, Communication from the Commission to the European Parliament and the Council (April 30, 2009), p. 11. “Consistent conduct of
In order to act as credible gatekeepers of investors’ interests, entities conducting point of sales activities must be largely independent of the products’ issuers. Independence of intermediaries that are not affiliated with issuers can be achieved by either regulating and disclosing referral agreements\textsuperscript{1087} or placing a ban on advisor charges.\textsuperscript{1088} If issuers distribute their products through affiliated intermediaries or are even in direct contact with investors, independence of point of sale entities may not be viable on a corporate level. However, issuers and affiliated intermediaries should be required to separate the sales forces and advisory staff from the structuring or trading entities of the issuer. Such organizational segregation is not a new concept for financial institutions. In particular, regulations generally require that banks establish Chinese walls between analysts and traders. Similar models may also be appropriate in relation to the issuers’ product structurers and their sales forces.

Disclosure provisions must also consider the relationship between the entity at the point of sale and investors. If the latter rely on advice of an experienced market participant, intermediaries’ duties should be more pronounced that in execution-only scenarios.\textsuperscript{1089} In addition, it may be essential that regulators confine the scope of transactions in which inexperienced investors can be left to their own resources. As discussed in chapter three, section V.3, prospectuses of complexly structured products may not reveal relevant risks in an adequate manner to interested investors. Consequently, risk disclosure at the point of sale is an essential element of investor protection in relation to these types of instruments. Whether investors should be allowed to waive respective disclosure measures will be further examined in section 5 below.

3. Content of Point of Sale Disclosure

3.1 Conflicts of Interest and Referral Agreements

Section 1 above has pointed out that point of sale disclosure should complement rather than duplicate information that is generally contained in prospectus disclosure. As securities are usually distributed through several channels, issuers may not be able to refer to all distributors’ services and potential conflicts of interest. Consequently, point of sale disclosure must inform investors about “the potential business, inducements and conflict of interest provisions, with MiFID as the benchmark, would be applied to all those selling packaged retail investment products, irrespective of whether the entity is an intermediary or the product manufacturer themselves. Detailed requirements might need to take account of the service being offered (advice, transmission of orders).”\textsuperscript{1087}

\textsuperscript{1087} See, for example, \textit{NI 31-103}, part 13, division 3.
\textsuperscript{1088} \textit{FINANCIAL SERVICES AUTHORITY} (fn. 3), p. 29 et seq.
\textsuperscript{1089} See, for example, the above description of German suitability duties in relation to investment advisors and portfolio managers. These duties cannot be waived by investors or intermediaries.
for the intermediary to suffer from a conflict of interest” and “the nature of the services being offered” by intermediaries.

Investors should be made aware of the financial benefits of intermediaries upon conclusion of a transaction and their relations to the product issuer or related parties. Both Canadian and German disclosure provisions have largely implemented requirements to disclose remuneration structures. Paragraph 31d WpHG bars intermediaries from accepting any benefits from third parties that are related to their investment services. The interdiction does not apply if remuneration results in improved quality of investment services or if they are disclosed to investors. Canadian NI 31-103, s. 13.8 (c), has chosen a similar approach by requiring intermediaries to ensure “that the information prescribed by subsection 13.10(1) [disclosing referral arrangements to clients] is provided to the client in writing before the earlier of the opening of the client’s account, or any services are provided to the client, by the person or company receiving the referral”. Swiss securities regulation so far features no comprehensive regulation of remuneration structures. However, based on general contractual duties, Swiss intermediaries usually disclose third party remuneration to their clients and do not retain these funds unless the latter have agreed in advance.

Although investors may not be overly interested in whether intermediaries benefit from product purchases, disclosure of any ties between the product issuer and intermediaries is vital if investors depend on professional advice. As a result, remuneration agreements of all kinds should be disclosed by point of sale entities. In order to establish investors’ clear understanding of potential conflicts of interest that may arise from referral agreements, a brief reference to these circumstances should be included in the documentation of remuneration. Moreover, investors should be made aware of remuneration in relation to each investment instrument they consider purchasing. General reference to potential remuneration agreements may not be an adequate signal for investors to realize that intermediaries do

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1090 IOSCO (fn. 1064), p. 17.
1091 IOSCO (fn. 1064), p. 17.
1094 See FINMA Circular 2009/1, n. 27 et seq., on remuneration disclosure of asset managers; further, see the decision of the Swiss Supreme Court 4C.432/2005 of March 22, 2006, on kickbacks, stating that asset managers must transfer third party funds to their clients unless other agreements have been made in advance. [ALEX GEISSBÜHLER/STEFAN STULZ/JEAN-LUC EPARS, Legal Update, Neues aus dem Bundesgericht (August 2006), online. <http://www.kpmg.ch/docs/Legal_Update_Neues_aus dem_Bundesgericht-250906.pdf>].
1095 In particular, of s. 398 and 400 SCO, imposing a duty of care and fiduciary duties on agents.
1096 GEISSBÜHLER/STULZ/EPARS (fn. 1094), p. 4.
1097 See IOSCO (fn. 1064), p. 17.
not act in their best interest. Finally, disclosure of referral agreements and the consent of clients should be made in writing.

3.2 Specifications

While issuers are, as a rule, the most suitable parties to disclose product-related information to investors, they may not be able to disclose all details when issuing their prospectuses. In particular, “the full range of charges associated with purchasing and owning the product will often vary according to the method of distribution”. Therefore, point of sale entities often have more accurate or detailed information about the costs incurring in relation to a specific product purchase than the issuer of the particular product and, consequently, should be required to disclose related specifications.

3.3 Explanations

Prospectuses generally contain relevant product-related information. However, investors may not always be sufficiently skilled to read these documents or draw appropriate conclusions. Point of sale disclosure can be adjusted to the knowledge and experience of investors and clarify uncertainties or misunderstandings. Sophisticated investors do not need the same kind of information as retail investors and are generally more risk-aware than their inexperienced counterparts. Consequently, point of sale disclosure should adopt its level of information to the knowledge and skills of investors and, in relation to retail investors, should particularly highlight the risks that are typically involved when purchasing a certain type of security.

All the examined jurisdictions have implemented general risk disclosure requirements. However, only the German legal framework has established disclosure duties that apply at the point of sale irrespective of the person who sells the securities to investors. As mentioned in section II above, paragraph 31 (3) WpHG obligates investment firms to inform investors about the relevant risks that are inherent to

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1098 In relation to asset managers, such disclosure could not be feasible in advance of the actual investment decisions. However, clients should be informed periodically about the investments made by their manager and, if applicable, about referral agreements between the latter and product issuers.
1099 IOSCO (fn. 1064), p. 28.
1100 See also IOSCO (fn. 1064), p. 28.
1101 See Swiss Banking Association (fn. 438), or, in relation to Canadian exchange contracts, risk disclosure statements as, for example, BC Form 91-903F, Instructions, and NI 31-103, s. 14.2. “a description of the types of risks that a client should consider when making an investment decision”. Although risk disclosure requirements of Canadian and Swiss securities regulation are similar to those of German regulation, they apply only to Swiss securities dealers or Canadian advisors or portfolio managers. As mentioned above, a comprehensive point of sale regulation should not be based on an institutional but on a functional approach.
certain types of investments. Information can be generic but should match the knowledge and skills of investors.\footnote{1102}

Specific risk disclosure in relation to the product itself is provided to investors by the issuers’ prospectuses. Consequently, entities at the point of sale are not responsible for the assembly of related information. However, risks in relation to specific investments not only depend on the type of investment, but also on the experience, knowledge and investment portfolio of the individual investor. This customized risk disclosure can be provided only by parties that are in direct contact with potential investors and have a basic knowledge of the client’s financial situation and investment experience. As a result, individual risk appraisals are generally imposed on point of sale entities and not on product issuers. Assessments of an investment’s appropriateness or suitability may not always be received favourably by investors. Therefore, entities at the point of sale should be required to assess the suitability of a transaction only if (i) such clarification is a precondition of the specific service provided by the intermediary\footnote{1103} or (ii) the client is deemed unable to gauge the implications of a complex transaction.\footnote{1104} The latter threshold is arguably crossed if retail investors consider investing into structured investments other than tightly regulated mutual funds.\footnote{1105} Section 4 below will specify in more detail the circumstances under which suitability obligations should apply.

3.4 Verification of Accuracy and Completeness?

Although intermediaries do not originate all information that is offered to investors at the point of sale, they are in most cases responsible for the delivery of all relevant documentation to interested investors. In view of this duty, one might argue that entities at the point of sale should be required to verify the accuracy and completeness of information provided to investors. Bearing in mind that dealers, advisors and portfolio managers offer a variety of instruments issued by different issuers, it would hardly be reasonable to demand that entities at the point of sale conduct a substantive assessment of the accuracy of all documentations.\footnote{1106} Rather, verification duties should depend on the role that point of

\footnote{1102} See BUCK-HEEB (fn. 193), p. 190, on the categorization of investors.
\footnote{1103} I.e. advisory services or portfolio management.
\footnote{1104} See above, section II.
\footnote{1105} See § 31 (7) WpHG and § 7 WpDVerOV. The provisions specify that non-complex financial instruments are money market instruments, debt securities without embedded derivatives, mutual fund units in accordance with the European UCITS Directive and all other non-derivative financial instruments that can be traded on a regular basis and do not impose charges other than those for the purchase of the instrument on investors.
\footnote{1106} See also IOSCO (fn. 1064), p. 11. “While a product producer is generally responsible for the content of a prospectus, the intermediary is, in most jurisdictions, responsible for explaining the features of the product to a client.”
sale entities assume vis-à-vis investors. If they provide advisory or managerial services to investors, their fiduciary duties could go so far as to require that they examine the credibility of disclosure documentations of a particular instrument. If, however, point of sale entities provide execution only services, their duties should not exceed current regulatory requirements that obligate them to provide investors with relevant prospectuses or information statements before a product sale is concluded.

4. Suitability Requirements

The above considerations have made evident that the mere disclosure of risks is not always sufficient to protect investors in an adequate manner from unfavourable investment decisions. While investors may understand the risk elaborations of issuers and point of sale entities, they might not be able to assess the instrument’s impact on their investment portfolio or their financial position. As a result, regulatory suitability requirements are essential elements of codes of conduct at the point of sale. As already seen in section II and chapter three, section III.2.2 above, Canadian and German point of sale regulations require that entities selling securities assess the suitability of an investment by considering the investor’s financial circumstances\footnote{See, for example, 31-103CP, p. 29.} and investment knowledge.\footnote{31-103CP, p. 29.} In both jurisdictions, the nature and extent of information that is required to assess the suitability of a product depends on the services that point of sale entities perform on behalf of the client in question.\footnote{For Canada, see 31-103CP, p. 29. German regulations require suitability assessments only in relation to advisory or managerial services. In relation to all other services, appropriateness tests are sufficient to fulfill the mentoring duties of point of sale entities. Both jurisdictions do not require suitability assessments in case of execution only services.\footnote{S. 13.3 (4) of; see s. 1.1 of NI 31-103 for a definition of the term ‘permitted client’.\footnote{If suitability assessments in relation to advisory or managerial services cannot be conducted, investment firms must not provide advice or other customized services (§ 31 (4) WpHG). All other services can be conducted even if an appropriateness test cannot be carried out due to lacking information (§ 31 (5) WpHG). The intensity of the professional obligations varies in relation to the knowledge and skills of investors (see § 31 (9) WpHG and Buck-Heeb (fn. 193), p. 194).}} While the Canadian distinction between professional or

\footnote{IOSCO (fn. 1064), p. 13.}
wealthy clients and less sophisticated or well-funded investors accords with general principles of disclosure-related regulation,\textsuperscript{1113} the German differentiation considers the fact that suitability duties can be set aside only if investment firms do not require the data in order to perform their services. As advisory activities or portfolio management can hardly be conducted in a meaningful manner without adequate knowledge of the client’s financial circumstances and investment objectives, related waivers of suitability assessments should not be permitted.

However, regulations must consider that the above two criteria for legitimate waivers of suitability assessments are closely interrelated. Just as waivers based on the client’s experience or wealth\textsuperscript{1114} are limited to services that do not require a thorough knowledge of the client’s financial position and investment goals,\textsuperscript{1115} waivers due to the type of service\textsuperscript{1116} must be confined by the skills of the respective customer. Chapter four has shown that transactions in complex financial instruments cannot always be sufficiently explained in prospectus documentation.\textsuperscript{1117} With respect to these transactions, retail investors may depend heavily on adequate explanations and assessments of the investment firm that sells them the products and, consequently, suitability considerations should not be an optional service. While investors must remain free in their final purchase decisions, they should not be allowed to waive full disclosure of the instrument’s risks and its possible impact on their investment portfolios at any time of their choosing. By imposing on investment firms the duty to assess the appropriateness of complex financial instruments,\textsuperscript{1118} German point of sale regulation takes an important step in this direction. However, paragraph 31 (5) and (7) \textit{WpHG} could arguably be further improved. In particular, delimitation between complex and non-complex instruments is not adequate to create sufficient legal certainty among investment firms.\textsuperscript{1119} Further, paragraph 31 (5) \textit{WpHG} allows investors to waive intermediaries’ adequacy assessments in relation to complex financial instruments by simply not

\begin{footnotes}
\footnotetext{1113}{See \textsc{Gillen} (fn. 40), p. 250 - 252.}
\footnotetext{1114}{As, for example, the waiver of Canadian securities regulation for ‘permitted clients’ (fn. 1110).}
\footnotetext{1115}{See, for example, s. 1.3. (4) of \textit{NI 31-103} which allows waivers of suitability assessments only if “the registrant does not act as an adviser in respect of a managed account of the permitted client”.}
\footnotetext{1116}{See § 31 (5) \textit{WpHG}.}
\footnotetext{1117}{See chapter four, section III.5.1.}
\footnotetext{1118}{§ 31 (7) \textit{WpHG} e contrario.}
\footnotetext{1119}{See § 7 \textit{Verordnung zur Konkretisierung der Verhaltensregeln und Organisationsanforderungen für Wertpapierdienstleistungsunternehmen} (\textit{Wertpapierdienstleistungs-Verhaltens- und Organisationsverordnung, WpDVerOV}), July 20, 2007. on the definition of complex financial instruments. See also \textsc{Tilman Weichert/Thomas Wenninger}, “Die Neuregelung der Erkundigungs- und Aufklärungspflichten von Wertpapierdienstleistungsunternehmen gem. Art. 19 Ril. 2004/39/EG (MiFID) und Finanzmarkt-Richtlinie-Umsetzungsgesetz”, WM 2007, p. 627, 632, who argue that the law lacks a clear distinction between these two kinds of instruments.}
\end{footnotes}
delivering requested information. Depending on intermediaries’ stance on the worthiness of assessing the adequacy of transactions in complex instruments, assessment duties of paragraph 31 (5) WpHG may degenerate into a complete farce.1120

Considering the above, the following conclusions can be drawn. Suitability assessments at the point of sale can be both valuable assistance for retail investors and necessary preconditions for intermediaries’ investment services. However, the extent of these assessments should be graded in accordance with the services performed, the knowledge and skills of investors and the complexity of envisaged investments. Further, waivers of suitability duties must follow the same principles and be confined to constellations where the investment firm neither (i) provides any extensive advisory services nor (ii) deals with a client who may not gauge the complexity of the transaction and its interplay with other products of its investment portfolio.

IV Conclusion

Issuers provide investors with relevant information about their products’ characteristics and risks. However, they are not necessarily in personal contact with interested investors and, therefore, might not be able to draw investors’ attention to a product’s risks in relation to their overall portfolio and investment strategy. Further, issuers are not always aware of intermediaries’ interests and services. As a result, investment firms at the point of sale must provide investors with related information that is not offered by prospectus disclosure. Point of sale disclosure and prospectus documentations should complement each other and, thus, enable investors to gain a thorough comprehension of a specific transaction and its implications.

However, risk disclosure may not always be an adequate means to protect retail investors when purchasing securities. Further, investment firms delivering advisory services or managing the portfolio of investors are not able to conduct their tasks without a thorough knowledge of their clients’ skills, objectives and financial circumstances. Consequently, the introduction of suitability assessments may be essential in order to establish satisfactory protection and professional treatment of retail investors. However, suitability duties should not be implemented in a rigid and undifferentiated manner. Rather, regulations must consider the type of service provided by point of sale entities and the client’s personal circumstances. These criteria must also be considered when defining the scope of exemptions or waivers in relation to suitability assessments or appropriateness tests.

1120 The drawback from implementing non-waivable adequacy assessments, on the other hand, consists of the fact that investors may feel patronized by mandatory adequacy assessments by intermediaries.
Chapter seven  Synthesis

I  Introduction

The above analysis of Canadian, Swiss and German disclosure regulations has revealed significant differences between the three jurisdictions. In particular, Canadian and German provisions feature a considerably more comprehensive disclosure framework than their Swiss counterparts. However, the study has also uncovered several issues that have arisen in all of the examined jurisdictions and constitute recurrent themes throughout the entire thesis. Arguably, the most far-reaching issue of disclosure regulation deals with the question of whether transparency obligations should follow a substantive or a formal approach. Section II below will examine this matter by reverting to related reasonings of chapters three and four.

Another topic that has emerged in all jurisdictions relates to the conceptual design of disclosure regimes for structured investment instruments. Chapter four has shown that Canadian and Swiss regulations lack comprehensive frameworks for structured derivatives. While German regulations feature a more consistent approach to disclosure of structured investments, they largely ignore issuers’ needs for the timely issue of securities and fail to consider that retail investors may not be sufficiently skilled to read the complex and detailed prospectus documentations. Section III will revert to these questions and consolidate related findings of chapters four, five and six.

Chapter six has shown that prospectus disclosure is not always an adequate means to inform investors about significant challenges they may meet in the course of their investment activities. Rather, issuers’ efforts to create transparency in securities markets should be facilitated by those entities that are in direct contact with investors, i.e. the entities at the point of sale. Section IV will briefly recapitulate the conclusions of chapters four and six and outline how point of sale regulations should be designed in order to perform the above task.

Drawing on the insights of all preceding chapters, section V will venture a glimpse into the potential shape of future regulatory initiatives and put the above results into the context of other regulatory developments.

II  Formal versus Substantive Approach to Product Regulation

Chapters three and four have dealt with the manner in which Canada, Switzerland and Germany approach product regulation. While the Canadian and German frameworks have chosen mainly substantive approaches, Swiss securities regulation has so far aspired to merge formal product
categories with substantive product characteristics. Chapter three, section II.3 has shown that these efforts create a variety of delimitation issues and fail to consider upcoming product designs in a timely manner. As a result, the Swiss regulator will have to abandon the current approach in favour of a predominantly formal or substantive model.

When weighing the advantages of a substantive approach against those of regulations that determine disclosure requirements in dependence on the product’s legal form, the objectives of product regulations must be taken into account. Chapter three, section II.2 has made evident that substantive approaches underpin a functional perspective\(^{1121}\) of product regulation and, therefore, protect investors against issuers’ circumvention of regulatory requirements by choosing non-regulated product structures. Further, formal approaches may not be adequately prepared for challenges that arise when issuers introduce new product types in securities markets. In particular, issuers might introduce products whose economic characteristics converge with those of tightly regulated securities without due explanations to retail investors. In addition, global regulatory developments have considered the above undesirable outcomes of formal product regulation and, consequently, generally tend toward substantive product frameworks. Moreover, chapter four, section III.5.1, has shown that excessive constraints of substantive approaches on issuers’ flexibility in the issue of innovative and timely products can be mitigated by concise concessions to formal regulatory measures.

The implementation of formal elements into a substantive-oriented disclosure framework has already proven successful in relation to mutual fund regulation and - at least to some extent - the introduction of disclosure provisions for structured notes. While Canadian and German laws acknowledge the need for a tight regulatory framework for mutual fund vehicles, Canadian regulations have introduced a counterpart of mutual fund regulation by implementing reduced disclosure requirements for certain types of structured notes. By providing different legal structures for economically similar products, regulators let issuers and investors choose between a format with severe restrictions and strict regulations and structures that allow the timely issue of innovative and topical products under a flexible regulatory framework. In contrast to a consistently formal approach to product regulation, however, these selective formal elements can be confined to narrowly defined cases and, consequently, do not run the risk of undermining protective measures in relation to other types of investment products. As a result, Canadian and German regulations are strongly recommended to further follow their substantive approaches to product regulation. In addition, specific concessions to formal product regulation should

\(^{1121}\) See above, fn. 813.
be maintained or introduced, in order to either additionally protect investors\textsuperscript{1122} or provide them with more flexible, less costly and timely investment opportunities. As chapter four, section III.5.1, has already suggested, Swiss disclosure provisions should also adopt a substantive approach to product regulation. While their current design entails that regulatory insecurities are borne by retail investors, the implementation of a substantive approach with selected formal elements would impose the burden of finding the proper balance between substantive rule and formal exemptions on product issuers rather than retail investors.

However, even if regulators follow an entirely unfettered substantive approach to disclosure regulation, they cannot be certain that market participants are always protected against delimitation issues or lacking disclosure in relation to new products. Rather, regulators are bound to observe market developments in a continuous and close manner and must be able to react rapidly to undesirable trends. Although this task may be even more challenging than it would be with a formal approach to product regulation, the outcome of a successfully implemented substantive disclosure regulation is likely to be far more beneficial for retail investors than the creation and enforcement of a limited number of formal product categories.

\section*{III Disclosure of Structured Investments}

\subsection*{1. General Remarks}

As seen in section II above, regulators are inclined to introduce formal approaches to product regulation in relation to structured investments. These types of products are particularly suitable for differing regulatory standards for the following reasons. First, their structural characteristics allow retail investors to access new markets or apply advanced investment strategies that would otherwise not be available for investors with limited funds or investment knowledge. At the same time, the complexity resulting from the elaborate design of structured investments renders full and clear disclosure of all material product features a challenging task. As timely issues of topical products and tight regulation and supervision of these investment vehicles are not always compatible, regulators tend to leave the choice between the two alternatives to issuers and investors. Second, chapter four, section II.5.1, has made evident that a truly functional approach to structured product disclosure is not always appropriate to point out relevant risks and product characteristics. As a result, regulators must look for alternative regulatory solutions which, in turn, are prone to follow more formal criteria.

\textsuperscript{1122} I.e. mutual fund regulation.
Although the above root causes of formal elements in structured product regulations explain the need for different regulatory forms in relation to these investments, they are not sufficient to justify an unexceptional realization of the formal approach to product regulation. In particular, issuers’ freedom in the legal structuring of products must be limited to constellations where investors are still able to gauge the products’ characteristics and key risk factors. As soon as investors’ benefits from lean product structures are outweighed by the risk that retail investors may not be able to adequately assess the product’s features, regulators must confine the scope of particular structures in order to re-establish an appropriate relationship between investor protection and efficient product structuring. Formal approaches are not only limited by investors’ grasp of specific products but also by regulators’ assessments of the risks that may result from specific product structures. If regulatory authorities are of the opinion that issuers are not adequately protected without continuous supervision of products and issuers’ related activities, additional supervisory measures - including increased disclosure of product characteristics and developments - must be implemented regardless of restraints resulting from such requirements.

2. Scope and Limits of Structured Notes Regulations

While the scope of mutual fund regulation is largely uncontested, regulations of structured notes feature notable differences in the three examined jurisdictions. German regulations have largely refrained from creating separate disclosure provisions for structured investments other than mutual funds.\footnote{1123} Swiss securities regulation, on the other hand, has implemented prospectus requirements for structured products in section 5 CISA. The scope of this provision comprises PPNs, PRNs and any other investment instruments that derive their value from underlying values and are structured by several components. The Canadian framework occupies the middle ground between German and Swiss regulations of structured investments. Its \textit{PPN Regulations} provide disclosure regulations that are significantly less cumbersome for issuers than the transparency requirements of \textit{NI 41-101} and \textit{NI 51-102}.

In view of the reasons that support the existence of different regulatory requirements for structured investments,\footnote{1124} the introduction of simplified disclosure procedures for structured notes appears to be in accordance with the general goals of securities regulation. With this positive assessment in mind, the

\footnote{1123} Specific disclosure requirements do not create alleviations for product issuers, but rather introduce disclosure requirements that are particularly appropriate to identify characteristic features of specific structured investments.

\footnote{1124} See above, section 1 and chapter three, section II.3.
scope of these rules must be determined in due consideration of investors' interests and skills. As
chapter four, section II.5.1, has shown, actively managed structured notes bear economic characteristics
that are nearly identical to those of mutual fund structures. Although the differing regulatory standards
of these two types of structured investments could be pointed out to investors by means of product and
risk labels,\textsuperscript{1125} it remains doubtful whether these labelling techniques could adequately clarify the
significant differences between these two kinds of investment vehicles. Further, actively managed
products require continuous supervision by regulatory authorities. Unlike their passively managed
counterparts, these products can be adapted to significant market developments at the discretion of
issuers or product managers. In order to assess and monitor these alterations, regulators must have
access to continuous information about products and their components. Further, the entities
responsible for changes in the product structure should be subject to supervisory measures of
regulatory authorities. Otherwise, regulators have no means to prevent inappropriate or purely self-
interested product amendments. As a result, structured notes with active management should not be
subject to simplified disclosure obligations of \textit{PPN Regulations} or prospectus requirements in section 5
\textit{CISA}. Instead, this product category should be banned from product structures other than those
determined by mutual fund regulations.

Similar reservations apply in relation to structured notes that are issued by separate legal entities and,
at the same time, backed by assets of any kind. Both regulators and investors must be able to assess on
a continuous basis how investments are protected by the products' collateral. Simplified disclosure
measures would not do justice to these requirements and, consequently, should not be introduced in
relation to collateralized structured notes. Instead, investments of this kind must be subject to general
disclosure requirements of securities regulation or, if issuers prefer to structure them as collective
investments, to the regulatory framework of mutual funds.

Taking into account the above considerations, the following conclusions can be drawn. First, Canadian
\textit{PPN Regulations} apply to products that are appropriate investments for simplified disclosure
requirements. Their scope could even be widened by applying the rules to PRNs that are neither (i)
actively managed, nor (ii) qualify as collateralized debt obligations. Second, the current scope of Swiss
section 5 \textit{CISA} does not fully conform to the above observations. In particular, actively managed and

\footnotesize{\textsuperscript{1125} See above, chapter three, section II.3.}
collateralized structured notes fall under the scope of the above regulations.\textsuperscript{1126} As a result, investors purchasing these complex instruments are confined to information of simplified prospectuses as defined in section 5 \textit{CISA}. Further, they have no access to continuous information about their products and related components. Third, German regulations have refrained from implementing facilitated disclosure measures that apply to certain types of structured investments. Instead, structured notes are generally accompanied by shelf-prospectuses and respective supplements.\textsuperscript{1127} While the form of shelf-prospectus disclosure is undoubtedly an adequate means to provide investors with comprehensive information without unduly delaying the product issue, the content of current disclosure information should be further adapted to the products' characteristics and risks.\textsuperscript{1128} Further, the brief structure of simplified prospectuses in accordance with section 5 \textit{CISA} has proven to be beneficial for retail investors. In particular, their understanding of the product is not hampered by drawn-out prospectus descriptions and an abundance of information that may not apply to the product in question. As a result, an adoption of specific disclosure requirements for structured notes might be an option worth pursuing in German securities regulation. However, considering the strict prospectus requirements of European prospectus regulations, it is rather unlikely that such developments will take place in the near future.

3. Continuous Disclosure of Structured Investments

Chapter five, section II.2 above has pointed out that continuous disclosure regulations for structured investments must consider the structural peculiarities of these types of securities. To begin with, prospectuses must be provided to investors on a continuous basis. Otherwise, interested parties have no opportunity to assess the current product characteristics in a comprehensive manner. Further, the value of structured investments largely depends on the value of its components. As a result, issuers should be required to publish the product’s net asset value at regular intervals. Finally, issuers should be obligated to refer investors to information sources where they can follow current developments of the product’s underlying values or components.

\textsuperscript{1126} Although the \textit{SBA Guidelines}, p. 4, set forth that “such as collateralized debt obligations, credit linked notes, asset backed securities” do not fall under the scope of section 5 \textit{CISA}, neither the statutory provision nor the \textit{SBA Guidelines} prohibit the introduction of collateralized structures. See above, chapter three, section II.2.2.b.

\textsuperscript{1127} See above, chapter four, section IV.3.2.

\textsuperscript{1128} See, in relation to Canadian securities regulation, chapter four, section II.5.1, specifying that extensive disclosure of the underlying instruments is appropriate only if investors have no access to product information provided by the issuer of these instruments. Instead, disclosure of structured products should focus on \textit{appropriate risk information} and refer to \textit{structural characteristics} that might lessen investors’ prospects.
4. Point of Sales Disclosure

Chapter six, section 4, has drawn attention to the benefits that retail investors can derive from suitability assessments by entities at the point of sale. Further, it pointed out that suitability requirements should not be waivable in the case of complex product structures or advisory services. Structured investments are complex products insofar as investors must understand a product’s design in order to assess its characteristics and value. As product developments need not necessarily accord with the positive or negative trend of the underlying values, the relationship between the two values may be counterintuitive for investors. Consequently, structured investments should be deemed sufficiently complex so as to require further assistance for retail investors at the point of sale. Minimum standards of such support can be found in the current appropriateness test of paragraph 31 (5) WpHG which requires that investment firms must assess whether investors possess appropriate knowledge and experience in order to assess the risks arising from the financial transaction in question.

Even better protection could be achieved if retail investors were confined to buying these products in the context of comprehensive advisory services provided by independent investment firms. As advisors cannot carry out their services without adequate knowledge of their clients’ investment goals and financial circumstances, this requirement would entail suitability assessments with regard to all transactions in structured investments. However, the introduction of such requirements might not be appropriate in all constellations. In particular, retail investors who tend to buy several products with similar characteristics arguably do not need extensive advisory support for each of these purchases. If the above appropriate test is conducted with due care, constellations that require additional assistance will be detected prior to the transaction and, consequently, customers may be made aware of their need for advisory services in good time.

IV Enhancement of Transparency at Point of Sales

The above explanations as well as the observations of chapter six have made evident that prospectus disclosure may not always be an adequate means to inform investors about all relevant aspects of securities transactions. Instead, certain information can be better provided by those entities that are in

1129 See, for example, Swiss Derivative Guide (fn. 999), p. 50, explaining the pay-off diagram of a twin-win-certificate.
1130 FOK KAM (fn. 392), p. 276. Prices calculations can be based, for example, on the average of prices during the product’s term instead of “the price of the underlying asset at maturity” (ibid.).
1132 See BUCK-HEEB (fn. 193), p. 195, who elaborates that suitability assessments require knowledge of clients’ investment objectives, financial circumstances and investment skills. See also 31-1O3CP, p. 29.
direct contact with customers. Whereas the relationship between point of sale disclosure and prospectus requirements has already been explained in chapter six, the manner in which entities at the point of sale best disclose all relevant information - i.e. their own and information provided by issuers - to investors will be briefly investigated below.

As a first step, point of sale entities must disclose their services and potential conflicts of interest to interested investors. If investors are not aware of the role of intermediaries, they cannot properly assess the benefits from their services and, consequently, do not know whether their trust in their advisors is justified.

Secondly, investment firms should be required to provide investors with all relevant information that has to be delivered to them prior to the actual transaction. As an unfiltered communication of all available data may be confusing rather than clarifying, international bodies are currently examining the introduction of a so called layered approach to information. In particular, the IOSCO report on Point of Sale Disclosure advises regulators to “consider what information should be given prior to or at the point of sale, what can be signposted as available elsewhere or available upon request, and what information can be delayed until after the conclusion or execution of the investment transaction”.

Layered approaches are already implemented in Swiss prospectus regulation of mutual funds. Section 76 CISA requires that simplified prospectuses are offered to interested investors prior to the purchase of a mutual fund unit, whereas investors need not be provided with long form prospectuses unless they explicitly require these documents. As seen in chapter four above, European and Canadian regulators are currently in the process of implementing simplified disclosure formats that are designed to provide investors with clear and concise information about the key characteristics of their structured investment. Another European legislative initiative goes even further by suggesting that all structured investments should be accompanied by brief documents pointing out “that the existing

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1133 See chapter six, section III.1.
1134 See IOSCO (fn. 1064), p. 8. “In relation to disclosure about intermediaries, such as their status and remuneration, the function of trust can be particularly significant. Evidence suggests investors can be more inclined to discount these disclosures because they place their trust in their advisor.”
1135 According to IOSCO (fn. 1064), p. 15, a “layered approach refers to supplementing key summary information with additional and more detailed information either upon request or through additional supplementary material attached or linked to the summary information”.
1136 IOSCO (fn. 1064), p. 15.
1137 See s. 75 CISA.
1138 Both jurisdictions attach importance to the fact that primary disclosure documents at the point of sale have to be short and simple. More detailed information can be gained from the more elaborate prospectuses.
sectoral patchwork must be replaced by a horizontal approach" \(^{1139}\) which means that the new rules will not depend on the legal form of the retail product. \(^{1140}\) The Commission’s communication up to date does not fully clarify the relationship between the envisaged framework and existing disclosure provisions. \(^{1141}\) However, its reference to “the key features of the UCITS 'Key Information Document' (KID)” \(^{1142}\) indicates that the new disclosure instrument would not replace current prospectus requirements but rather act as a supplement to these documents. \(^{1143}\)

Finally, investment firms at the point of sale are obligated to provide investors with all transaction-related information that prospectuses are not able to provide. \(^{1144}\) As these specifications are essential for investors in order to assess the security’s value and prospects, they must be conveyed to interested persons at the same time as the ‘first layer’ of disclosure information provided by issuers. While the above point of sale disclosure initiatives are certainly valuable means to disclose relevant information that has been provided by the products’ issuers, they do not take into account that this information is not necessarily complete but may be lacking the final details that only point of sale entities can provide. What conclusion can be drawn from this slight inconsistency? If issuers are not related to investment firms at the point of sale, a cooperation of these parties in the creation of key information statements is unlikely and - considering the multitude of distributive channels that issuers may choose - not a viable option. As a result, point of sale disclosure must arguably consist of no less than two documents. First, issuers should provide investors with core information about the product, its structure and related risks. If this information “is buried in the (...) prospectus” \(^{1145}\) for the respective product, layered disclosure may be an adequate means to guide investors towards relevant statements. Due to the inherent complexity of structured investments, layered documentation may be particularly useful in relation to these product types. Second, investment firms at the point of sale must render issuers’ information more precisely by adding the aspects mentioned in chapter six, section III.3.d. As issuers have few

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\(^{1140}\) COMMISSION Communication (fn. 1139), p. 9.


\(^{1143}\) See also IOSCO (fn. 1064), p. 23.

\(^{1144}\) See above, chapter six, section III.3.d.

means to control these statements, each point of sale entity “must be held responsible for any information it provides”.  

V  Outlook

In view of the numerous and sophisticated suggestions that are brought forward all over the world in order to enhance disclosure in securities markets, the above analysis and examinations are not sufficiently elaborate to form the foundations of a comprehensive proposal for disclosure regulation in Canadian, Swiss and German laws. Instead, the following outlook is a far more modest attempt to point out key aspects that may improve current regulations if pursued in a consistent and careful manner.

First, drawing on the overall observations of this thesis, the introductive assessment that disclosure regulations will remain important features of securities regulation can be sustained by a broad variety of examples in the preceding six chapters. In particular, disclosure of essential product characteristics and related risks are key means to turn retail investors into responsible market participants. However, the rampant increase of complexity in financial markets claims significant concessions from advocates of a purely disclosure-centered approach to market regulation. To begin with, the divide between retail investors and their sophisticated counterparts can no longer be ignored. Rather, regulations must consider these differences and provide retail investors with product information they can understand and put into context. Further, disclosure provisions are not always sufficient to protect investors against misinformation or even misguidance by more knowledgeable market participants. Additional measures such as tight supervision of issuers and intermediaries must be introduced to support the disclosure framework of securities regulation.

Second, recent experiences provide clear evidence that issuer-related disclosure regulations should be complemented by behavioural requirements for investment firms at the point of sale. While issuers are generally the most suitable parties to describe relevant product characteristics and risks inherent to such investments, point of sale entities are in direct contact with potential investors and, therefore, have more immediate impact on investment decisions than the product structurers themselves.

Third, complexity in securities markets not only requires additional measures to sustain comprehensive and fair disclosure of product characteristics and risks, but may also affect issuers’ freedom to choose the legal forms of their products at their discretion. Although the economic structure of products should

1146  IOSCO (fn. 1064), p. 11, with regard to responsibility of intermediaries set forth by the European MiFID Directive.
not be constrained by regulatory intervention, legal product designs must be confined to those forms that allow investors and supervisory authorities a continuous oversight of relevant developments and related risks. As seen in section III above, these precautionary measures may be particularly required in relation to structured investments.

Fourth, a functional approach to product regulation is typically the most suitable strategy to create fair and transparent markets. However, functional disclosure requirements may be limited by the complexity of structured investments. As the purchase of a structured product may yield economic outcomes different to the acquisition of its underlying values or components, disclosure measures of structured investments cannot always be in accordance with their underlying products. Further, section II above has shown that the implementation of narrow formal elements into product regulation may provide benefits for both issuers and investors.

Fifth, the analysis of Canadian, Swiss and German laws that has been conducted in this thesis has shown that comparative studies can be illuminative for regulators and scholars. Although national peculiarities should only be transplanted to other jurisdictions with utmost care, the reasoning behind these rules may give valuable advice for regulatory improvement in another national framework.
Chapter eight Conclusion

The above analysis has shown that transparency requirements of Canadian, Swiss and German securities regulations feature multiple parallels. In particular, the three jurisdictions aim at establishing transparent markets in order to achieve their main objectives of securities regulation - investor protection and the efficient functioning of capital markets. Further, all three frameworks acknowledge that transparent capital markets can be established only if the characteristics and risks of financial instruments are outlined in a clear and precise manner and investors are able to delimit the different product types from each other. In addition, they strive to provide investors with key information in a timely manner and try to enhance comparability between different investments. Moreover, their key means to implement these four preconditions of transparent capital markets consist of prospectus documentation at the issue of a product and continuous information on the product and its issuer during the whole life cycle of the investment.

A closer assessment of the above national transparency requirements has established that the three jurisdictions have chosen different approaches to product regulation. While the Canadian and German prospectus frameworks follow a substantive approach, the Swiss disclosure framework for securities still struggles to harmonize its formal legal typology of investment products with the products’ distinctive substantive features. Substantive approaches to product regulation focus on the economic characteristics of investment products. Their formal counterparts, on the other hand, are guided by the legal form an issuer has chosen for its product. As substantive product regulation generally adheres to the functional principle “same business, same risks, same rules”\(^{1147}\) and, therefore, does not create misdirected incentives to circumvent rules by alternative product structuring, it is generally preferable to a formal approach to securities regulation. Excessive constraints of substantive approaches on issuers’ flexibility in the issue of innovative and timely products can be mitigated by concise concessions to formal regulatory measures. The implementation of formal elements into a substantive-oriented disclosure framework seems to be particularly promising in relation to mutual funds and passively-managed structured notes. As the Swiss legislator’s efforts to converge substantive and formal characteristics create a variety of delimitation issues and fail to consider upcoming product designs in a timely manner, it is strongly recommended to abandon its current approach in favour of a predominantly substantive model.

\(^{1147}\) CONTRATTO (fn. 129), p. 405.
The three jurisdictions’ disclosure frameworks feature different degrees of comprehensiveness. While the Swiss framework approaches disclosure regulation in a fragmentary manner and lacks an adequate disclosure framework for non-listed shares, bonds and derivatives other than structured products in the sense of section 5 CISA, the Canadian framework provides disclosure rules for most investment products except certain derivatives. The most comprehensive prospectus provisions are found in German prospectus regulation. In particular, this framework provides comprehensive disclosure obligations for issuers of all kinds of derivative instruments.

The overview of continuous disclosure regulations of the three jurisdictions has shown that respective requirements of Canadian securities regulation provide investors with relevant information about their investments. The framework could be further improved by obligating issuers to update prospectuses of structured products. The Swiss framework for continuous disclosure is highly fragmentary. In particular, a need for improvement has been established in relation to non-listed shares, bonds and structured notes. Investors of all types of securities lack a central electronic platform where they can retrieve continuous information about securities that are distributed in Swiss securities markets. While German continuous disclosure regulations generally provide investors with adequate information about publicly offered investment products, they have not yet adopted adequate disclosure requirements in relation to structured notes. Further, the German regulatory framework has so far not established a central electronic platform where all relevant information of primary and secondary market disclosure can be retrieved by investors. Finally, Canadian, Swiss and German continuous disclosure frameworks of debt securities lag significantly behind disclosure requirements for equity securities. While the implementation of an early warning system for debt securities might not be feasible in the same way that it exists for equity securities, the present deficit could be considerably mitigated by introducing disclosure duties that require transparency in crucial constellations. In particular, disclosure requirements should obligate creditors to reveal their economic exposure in the issuer’s bankruptcy and provide that contracting parties enhance pre-contractual transparency vis-à-vis their counterparts.

Chapter six has established the need for additional disclosure and suitability assessments at the point of sale. Issuers are not always aware of intermediaries’ interests and services. As a result, investment firms at the point of sale must provide investors with related information that is not offered by prospectus disclosure. Further, point of sale entities often have more accurate or detailed information about the costs incurring in relation to a specific product purchase than the issuer of the particular product and, consequently, should be required to disclose related specifications. Moreover, risk disclosure is not always a sufficient means to protect retail investors when purchasing securities. In particular,
investment firms delivering advisory services or managing the portfolio of investors are not able to conduct their tasks without a thorough knowledge of their clients’ skills, objectives and financial circumstances. Consequently, the introduction of suitability assessments may be essential in order to establish satisfactory protection and professional treatment of retail investors. Suitability duties should not be implemented in a rigid and undifferentiated manner. Rather, regulations must consider (i) the type of service provided by point of sale entities, (ii) the client’s personal circumstances, and (iii) the complexity of the investment instruments in question. These criteria must also be considered when defining the scope of exemptions or waivers in relation to suitability assessments or appropriateness tests.

Chapter seven has revisited several topics that have come up repeatedly throughout the whole thesis. In particular, section III proposes key principles that should be taken into account in the regulation of structured investments. First, regulators should not entirely quell issuers’ endeavours to create products with similar economic structures under different regulatory forms. Considering the costs and time that issuers must spend in order to create a tightly regulated mutual fund vehicle, the legislatory permission to introduce similar, but less tightly regulated investment instruments such as PPNs can be beneficial for issuers and investors. Second, however, this acknowledged need for different regulatory forms in relation to structured investments should not allow investors to make use of different regulatory forms in relation to all kinds of product structures. In particular, issuers’ freedom in the legal structuring of products must be limited to constellations where investors are still able to gauge the products’ characteristics and key risk factors. The examination of Canadian PPN Regulations and Swiss requirements for structured products suggests that passively managed structured notes need not necessarily be subject to extensive prospectus. Rather, simpler prospectus structures as applied for Swiss structured products or Canadian PPNs could be introduced into the German prospectus framework. However, if structured notes are actively managed by their issuer, regulatory authorities must be able to supervise and monitor these products in an appropriate and continuous manner. As a result, structured notes with active management should not be subject to simplified disclosure obligations similar to Canadian PPN Regulations or section 5 of the Swiss CISA. Third, continuous disclosure obligations for structured investments must consider the structural peculiarities of these securities. In particular, prospectuses should be provided to investors on a continuous basis and the product’s net asset value should be published at regular intervals. Fourth, suitability duties at the point

1148 See also FOK KAM (fn. 571), p. 281. “Perhaps the greatest benefit to the investor relates to the flexibility of structured notes.”
of sale must consider the complexity of structured investments. Consequently, suitability assessments should not be fully waivable. An adequate minimum standard may be found in the appropriateness test of German point of sale regulation.

Based on the above results, the following conclusion can be drawn. Although transparency may not be the panacea it was once thought to be,\textsuperscript{1149} it is still an effective and comparatively gentle means to create fair conditions for all market participants. In fact, the numerous loopholes in present disclosure provisions have considerably hampered a timely detection of the unhealthy market techniques that have led to the disastrous effects mentioned above. Further, regulatory intervention beyond disclosure is given to cause unanticipated outcomes and, as a result, might produce more harm than benefit. In particular, the complexity of today’s financial markets requires regulators to exercise utmost care when prohibiting certain types of financial transactions so as not to inhibit harmless investment techniques along with the objectionable ones. As a consequence, the role of transparency in the protection of financial markets should not be underrated or easily discarded. Further measures should be taken only if market power or sophistication of a party prevents other market participants from acting sensibly and at their own discretion.

\textsuperscript{1149} See ROLF WATTER, \textit{Basler Kommentar zum Börsengesetz} (Basel. Helbing Lichtenhahn, 2007), s. 1 n. 10, referring to the origins of the idea of disclosure as a remedy for fraudulent market behaviour in the early 20\textsuperscript{th} century.
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