Towards a General Framework for a Common Definition of "Securities": Financial Markets Regulation in Multilingual Contexts

Giuliano G. Castellano *

This article aims at providing a linguistic and comparative perspective on financial markets governance by investigating the meanings and legal categories underlying the term "securities" in a multilingual society. It first illustrates how the term "securities" is not a straightforward legal concept and requires clear definition – both at the national and transnational levels – to limit regulatory arbitrage and forum shopping phenomena that might endanger investor protection and financial stability. Subsequently, moving from the economic function of securities, the article analyses the legal techniques adopted to define the term "securities" in the United States and in selected European countries, with particular attention to France, Italy and the United Kingdom. The legal and linguistic comparison reveals hidden similarities, converging towards a common a set of shared components related to the concepts of investment, negotiability and value. Notwithstanding this common core, several discrepancies emerge when finally the study focuses on the application of EU securities law and on the legal standardisation efforts carried out by the International Organization of Securities Commissions (IOSCO). The article shows that in a globalised and multilingual society, the meanings attributed to the term "securities" have a direct impact on the overall soundness of the financial system and that any legal definition of the term must consider the implicit cognitive processes, embedded in language, that are necessary to interpret and apply securities law.

I. – INTRODUCTION

Scholars from different disciplines of the social sciences have approached the various ways in which multilingualism impacts in a globalised society. Economists and linguists in particular have assessed the costs of different policies

* Fellow in Law, London School of Economics and Political Science, Law and Financial Markets Project (United Kingdom); Research Associate, École polytechnique, PREG/CRG (France).

aimed at preserving multilingualism or pursuing linguistic standardisation within given societies.[1] Balancing multilingualism with the need to foster communication implies taking into account different aspects that might generate unforeseen costs. This extends beyond economic costs – such as the cost of translation into multiple languages or the cost of learning a new language – and includes social costs, typically related to national cohesion and group identity. In exploring the issue of legal multilingualism, other considerations surface and the critical question of legal certainty must be addressed. The adoption of a single common language might undermine the uniform understanding of international legal provisions. Similarly, the adoption of multilingual policies *per se* does not guarantee a uniform understanding of common legal standards, as international norms might rely on concepts and meanings linked only to a single, specific notion not commonly understood in different legal systems and cultures. Comparative lawyers have investigated, from different angles, the interaction between linguistic diversity and legal certainty in globalised trade law and international financial transactions.[2] Studies provide a starting point to understand the complex interplay between language and governance by offering useful insights, allowing a more in-depth survey of the relationships between legal multilingualism and financial markets governance in the field of securities regulation.

Language policies in a multilingual society aim at balancing the need to protect multilingualism – and therefore social diversity – with the need to facilitate communication and access to information among different groups within that society. As pointed out above, such policies have direct costs. In the European Union, for instance, at the end of 2006 – by which time the 2004 enlargement had been fully implemented –, the cost of translation borne by all European institutions was estimated at over 800 million euros

1 For a thorough analysis of the multifaceted and cross-disciplinary issues related to linguistic policies in general, see V. GINSBURGH / S. WEBER, *How Many Languages Do We Need? The Economics of Linguistic Diversity*, Princeton, Princeton University Press (2011). For a perspective on the different challenges posed by multilingualism in the globalisation process, see J. Maurais / M.A. Morris (Eds.), *Languages in a Globalising World*, Cambridge, University of Cambridge Press (2003).

2 For an overview of the major practical problems posed by linguistic diversities in international transactions, see P.L. DEL DUCA, *Choosing Language of Transnational Deals. Practicalities, Policies and Law Reform*, Chicago, ABA Publishing (2010). For a thorough account of the relationship between language and law in the European Union, see B. Pozzo / V. Jacometti (Eds.), *Multilingualism and the Harmonisation of European Law*, The Netherlands, Kluwer Law International (2006).

per year.[3] Following the 2007 enlargement, that cost had risen starkly.[4] Although the cost of multilingualism might suggest that a trend towards linguistic standardisation could have significant economic advantages, an excessively narrow approach reducing linguistic diversity might generate unintended consequences. Noting that language is an intimate part of both individual and group identity, the introduction of monolingual policies for the sake of cost minimisation in a multilingual society might lead to greater social disenfranchisement,[5] weakening political unity, social cohesion and cooperation, and ultimately undermine legal certainty in international economic relationships. This is why the European Union has adopted different approaches in an attempt to balance the reduction of costs, strengthen legal certainty and protect diversity. At present, with twenty-three official languages,[6] the European Commission has established a set of strategies to reduce these costs, including: limiting the scope of translation services,[7]

3 EUROPEAN COMMISSION, "Translation in the Commission: where do we stand two years after Enlargement?", press release, MEMO/06/173, Brussels, 27 April 2006, available at <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/06/173&format=HTML&aged=0&language=EN&guiLanguage=en>.

4 The actual costs of translation may be even higher, as the addition of new languages implies a greater number of combined translations that grows exponentially. Thus, in Europe, 9 official languages had 72 linguistic combinations, then 11 and 17 languages had respectively 110 and 272 combinations. Finally, the adoption of 23 languages results in 506 combinations.

5 The exclusion of one or more native languages may cause considerable economic and social costs, as the costs of linguistic barriers rise enormously for those people that do not speak the official language; see J. POOL, "The Official Language Problem", (85) *American Political Science* Review (1991), 495.

6 For a complete overview of the legal approaches adopted by European institutions to preserve linguistic diversity as a way of sustaining European integration and political identity, see P. ATHANASSIOU, "The Application of Multilingualism in the European Union Context", *European Central Bank Legal Working Papers*, No. 2, March 2006.

7 The Directorate-General for Translation, which runs the European Commission's in-house translation service, specifies that it follows a selective translation policy. Twenty-three versions are produced only for legislative texts and policy documents of major importance. Other official documents are translated only into those languages needed in each case, while German, French, and English are adopted as internal languages. See <http://ec.europa.eu/dgs/translation/index_en.htm>.

condensing the length of documents,[8] and adopting "pivot languages" [9] to reduce the number of translators required.

Notwithstanding such attempts to preserve multilingualism, it is imperative to acknowledge that, for practical purposes, only a few languages are used on a daily basis. Within the EU administration, internal communication is conducted mainly in English, French, and German. Furthermore, English is the language commonly used to define international transactions, draft legal provisions and foster communication, also outside the Union. Indeed, the English language leads the globalisation process,[10] as is also reflected in the language and legal concepts embedded in the rules governing economic integration. Yet these rules do try to take into account that however all-pervasive English might be as a language spoken almost everywhere,[11] it is nevertheless not spoken by everyone.[12] Legal multilingualism is, therefore, a fact that has to be carefully analysed as being intertwined with the process and success of legal harmonisation within the EU, and with legal standardisation at the international level.

The very concepts of legal harmonisation and standardisation, as well as the different techniques adopted, have evolved over time and involve a complex interaction between national, supranational, international, and private players [13] embodying a diverse range of legal traditions and languages. A wide array of legal devices, ranging from binding international norms to soft laws, have been developed in order to formulate and implement common

8 As reported in an interview with Mr Karl-Johan Lönnroth, former Director General for Translation: A. BRANCHADELL, "The language of Europe is translation. An interview with Karl-Johan Lönnroth", (14) *Quaderns. Revista de Traducción* (2007), 207, at 208.

9 Pivot languages, sometimes also known as "bridge languages", are adopted as intermediaries for translation among many different languages. Pivot languages serve the purpose of limiting the expansion of linguistic combinations and therefore translations costs. However, the adoption of pivot languages, by creating a chain of translations, increases the risk of mistakes and ambiguities.

10 See, in general, A. DE SWAAN, *Words of the World: The Global Language System*, Cambridge, Polity Press and Blackwell Publishing (2001).

11 It has been estimated that English is spoken by some one and a half billion people, including four hundred million mother tongue speakers: D. CRYSTAL, *A Dictionary of Language*, Chicago: University of Chicago Press (1999), at 105.

12 In the EU, more than half of the population does not speak English. See GINSBURG / WEBER, *supra* note 1, at 152.

13 J.A. ESTRELLA FARIA, "Future Directions of Legal Harmonisation and Law Reform: Stormy Seas or Prosperous Voyage ?", *Unif. L. Rev. / Rev. dr. unif.* (2009), 5.

rules (or shared principles) with a view to enhancing legal certainty in international economic transactions and stability in financial markets.[14] A multilingual approach reveals two crucial, interrelated aspects of such international efforts.

First, the very drafting process of international or supranational provisions implies the adoption of specific legal language(s) more or less implicitly referring to categories related to one or more legal systems. Alternatively, international and supranational policy-makers might decide to detach new provisions from a specific legal system by implementing a set of definitions to embrace a variety of categories as they are adopted in different legal systems. In this scenario, a new linguistic code is created. Secondly, once those rules have been drafted, and possibly translated into several official languages, they have to be implemented in various legal systems. The success of this latter stage has pivotal relevance for the actual accomplishment of any legal harmonisation efforts and is intrinsically influenced by the legal language(s) and linguistic code adopted in the text(s). To this end, the conceptual frame of reference revealing the legal message contained in the legal text must be clearly and uniformly understood in a variety of legal and cultural contexts, as legal rules do not operate in a vacuum. On the contrary, they are interdependent since they refer to ideas and categories already embedded in national legal systems. Typically, the interpretation of national legal texts relies on a set of legal concepts expressed in different areas of the legal system and contained in the legal language. This implies that the implementation of international legal standards or supranational binding norms can only work when the provisions contained therein consistently fit in with the entire body of laws already in place.[15] With this in mind, the new, exogenously generated laws must adopt a terminology that is semantically and conceptually consistent within the receiving legal system, as for any law to be effective, *i.e.*, to influence behaviour, it has to be understood by law enforcers and citizens.

In the context of international financial markets governance, legal harmonisation and standardisation in a multilingual environment display a high

14 In particular, soft laws pose different problems, analysed under different angles in the literature. See C.M. CHINKIN, "The Challenge of Soft Law: Development and Change in International Law", *The International and Comparative Law Quarterly*, Vol. 38, No. 4 (1989), 850; A.E. BOYLE, "Some Reflections on the Relationship of Treaties and Soft Law", *The International and Comparative Law Quarterly*, Vol. 48, No. 4 (1999), 901.

15 K. PISTOR, "The Standardization of Law and Its Effect on Developing Economies", *The American Journal of Comparative Law*, Vol. 50 (2002), 97, at 107.

level of complexity. All the aforementioned considerations have to be paired with the need to ensure a sound financial system, both at the international and national levels, by minimising the impact of opportunistic behaviour (*e.g.,* forum shopping and regulatory arbitrage), the cost of which may ultimately have to be borne by citizens and, more generally, to ensure financial market stability. The adoption of one common language as a *lingua franca*, or the enactment of language policies aimed at preserving diversity, seems unlikely to provide *per se* definitive solutions for avoiding regulatory inconsistencies among different legal systems. The subject needs to be carefully addressed not only from a theoretical perspective, but also from a practical standpoint.

A comparative legal and linguistic approach will show up the grey areas that persist in the definition of what is a fundamental term of financial markets law and governance: the term "securities". Although its meaning has occasionally been investigated within national borders in order to understand what national legal regime should be applied to a given financial product or service, scant attention has been paid to the meaning attributed to the term in a multilingual, globalised economy. A comparative analysis of different national jurisdictions would appear to be the best way of verifying whether the different languages and jurisdictions have key elements in common, and of understanding the legal categories that underlie the English term as adopted by international and supranational organisations.

This article, in Section II, will illustrate that the term "securities" is not a straightforward legal concept and requires clear definitions both at the national and transnational levels. As will be shown, the lack of such a thoroughgoing definition endangers the basic aims of securities laws, *i.e.,* to ensure financial stability and protect investors. Section III will then shed some light on the meaning of the term and the definition adopted in different legal systems. Moving from the economic function of securities, the analysis goes on to focus, first, on the approach taken in the United States, where economic reality appears to be the touchstone for determining whether a given transaction falls into the category of securities, and second, on the legal techniques adopted in the United Kingdom to define "securities". The UK approach will immediately reveal that even where the same official language is used, notably English, diverse interpretative techniques may nevertheless be used. Conceptual similarities will be found in the study of definitions adopted in France and Italy as well as in some of the Baltic countries. A comparison between the US and selected European legal systems, using linguistic lenses, will help to reveal hidden similarities and differences to identify a set of shared, core characteristics. Section IV of the article addresses the definition of "securities" in a transnational context, by analysing the European directives constituting the body of EU securities law. This section shows that national idiosyncrasies are impacting on the harmonised understanding of the term "securities", leading to discrepancies in the application of harmonised laws; it concludes by considering whether, and to what extent, the international legal standardisation efforts carried out by the International Organization of Securities Commissions (IOSCO) may contribute to guide national and supranational policy-makers in establishing a clear definition of the term "securities".

II. – WHY THE DEFINITION OF "SECURITIES" IS A MATTER OF CONCERN

In the wake of the recent financial crisis, the need for a common set of rules and principles to govern financial markets has become a priority on both national and international political agendas. At the international level, a number of soft laws have been reinforced to ensure a sound international financial system. At the European level, different measures have been implemented to reinforce the existing body of laws and ensure their uniform application.[16] Financial misconduct in a domestic market has been shown to have a global impact, transcending national borders while triggering new, concerted transnational legal actions. Nevertheless, as studies on legal transplants show,[17] the need to harmonise certain areas of law within a multilingual society poses specific legal challenges and the benefit of legal harmonisation has to be balanced with national (legal and linguistic) idiosyncrasies.[18] Therefore, any meaningful process to establish a common set

16 The responses to the financial crisis adopted at the EU level encompassed a wide range of measures, reinforcing the already existing rules and creating a new European system of financial supervisors (ESFS), consisting of three European Supervisory Authorities. See, in particular on the latter reform, G.G. CASTELLANO / A. JEUNEMAÎTRE / B. LANGE, "Reforming European Union Financial Regulation: Thinking Through Governance Models", *European Business Law Review*, Vol. 23, No. 3 (2012), 409.

17 The study of legal transplants has grown into a well-developed branch of comparative law. Since the first elaboration of the concept attributed to Alan Watson, several methodologies have been developed and applied to different fields of law. See A. WATSON, *Legal Transplants, an Approach to Comparative Law*, Edinburgh, Scottish Academic Press, (1974). A complete outlook on the study of legal transplants is offered by M. GRAZIADEI, "Comparative Law as the Study of Transplants and Receptions", in: M. Reimann / R. Zimmermann, *Oxford Handbook of Comparative Law*, Oxford, Oxford University Press (2008).

18 On this point, a notable example of how the introduction of harmonised legal concepts might clash with existing national legal categories is provided by the introduction in British law of the concept of "good faith" in 1994 by way of EU consumer protection law. From this event, Gunther Teubner elaborated the famous idea of "legal irritants": G. TEUBNER, "Legal

of legal provisions must thoroughly study and compare a diverse range of legal-linguistic dimensions so as to avoid unintended consequences with far-reaching cost implications.[19]

In this regard, a comparative analysis of the term "securities" addresses one of the most crucial and multifaceted elements of the financial system. The term "securities" is undoubtedly the keystone around which the financial system revolves, and policy-makers spend time and effort to ensure the soundness of financial markets on a global scale. Nonetheless, the meaning of the term appears to be quite obscure *per se*, and is anything but self-explanatory.

The famous Italian adage "*traduttore, traditore*" ("translator, traitor") is perfectly fitting where odd attempts at translating the term "securities" are hazarded, as a literal translation would simply result in confusion.[20] It is for this very reason that securities regulation proves the point – as indeed do a number of other circumstances [21] – that a literal translation may be impossible, as it might lead to a misinterpretation of the legal provisions attached to the term. For example, in French, Italian and Spanish, securities may be correctly translated, respectively, as *valeurs mobilières* or *titres financiers*, *valori mobiliari* (movable values or financial titles), and *valores* (valuables). German, Estonian, and Lithuanian refer correspondingly to *Wertpapiere*, *väärtpaberite*, and *vertybiniai popieriai* (paper values). Latvian uses the expression *pārvedami vērtspapīri* (transferable paper values). This general overview of the possible (non-literal) translations immediately reveals that a variety of concepts are embedded in a term so widely used in financial jargon.

Although the different terminologies reveal some common characteristics, such as transferability and the ability to attribute a value to these financial

Irritants: Good Faith in British Law or How Unifying Law Ends up in New Divergences", Vol. 61, No. 1 *Modern Law Review* (1998), 11.

19 In the EU, when the process of harmonisation relies on legal multilingualism, interpretation requires a linguistic comparison to disclose the actual meaning of the law and ensure its uniform application: see A. GAMBARO, "Legislative Multilingualism and Comparative Law: a European Perspective", reproduced elsewhere in this issue of the *Uniform Law Review*.

20 Also for this reason, the process of legal harmonisation relies on the joint efforts of highly trained translators and legal experts: see S.V. BAZINAS, "Multilingualism in UNCITRAL's Work on Security Interests", reproduced elsewhere in this issue of the *Uniform Law Review*.

21 The problem is a well-known one in other fields. Notably, Vladimir Nabokov severely criticised Walter Arndt's English translation of Pushkin's poem "Eugene Onegin", considering it a profanation. More in general, on the problem of translation, one of the most complete studies, defining translation more as an "art" than a science, was conducted by E. NIDA, *Language Structure and Translation*, Stanford, Stanford University Press (1975).

transactions, a deeper analysis is required. The methods used to understand the meaning of a legal concept, such as "securities", involve adopting a set of cognitive tools that rely on a contextualised linguistic analysis that transforms legal texts into legal norms, *i.e.*, standards capable of influencing behaviour.[22] To this end, national legal systems provide for a definition. Even in English, the term "securities" is quite cryptic and may be confused with the concept of "security interests", which is related to secured transactions. From a methodological standpoint, as the analysis conducted in Section III will show, in order to uncover the characteristics underlying these expressions, it is essential to compare the various legal techniques adopted to define the meaning of the term "securities".

Here, it is important to note that the variety of semantic expressions so far presented refers to a set of intangible objects, whose nature is essentially contractual, although it also embraces relevant property law aspects.[23] As a category, however, it is anything but static. The group of transactions falling within the category of "securities" changes rapidly as new financial products and business practices are developed. The legal definition therefore has to keep pace with that mutating nature. To this end, any definition of "securities" should combine a degree of flexibility – to allow adjustment to mutating market conditions – with clarity – to ensure sufficient legal certainty. When financial transactions are considered as securities, a specific legal regime must be applied aimed at ensuring investor protection and the soundness of financial markets. If the obscurity of the term is not alleviated by a sufficiently clear definition, the rules regulating the issuing of and trade in certain financial products are simply not applicable.

This may seem obvious but, as the 2004 scandals involving Hungarian real estate investment cooperatives have shown,[24] an inadequate definition of the meaning of the term "securities" may have far-reaching consequences. What happened was that in 2004, a number of Hungarian cooperatives started selling "membership rights" or "membership shares" entitling investors to the

22 These cognitive tools have been defined by David Gerber as "authority heuristics" to explain the understanding (or the misunderstanding) of authoritative texts when foreign law is approached: see D. GERBER, "Authority Heuristics", *Chicago-Kent Law Review*, Vol. 79 (2004), 959.

23 For the property law implications see, for instance, the concept of securities based on equity as illustrated in Section III below, or the possibility of collateralising securities.

24 T. TAJTI, "Central European Contribution to the American Debate on the Definition of "Securities" or Why does the Definition of 'Security' Matter?", *Transnational Law & Contemporary Problems*, vol. 15 (2005), 109.

payment of interest. The agreement also provided that the cooperatives were held to repurchase the membership rights at a fixed future date and price, entitling investors to the return of the principal, *i.e.,* the capital initially invested. Under the relevant Hungarian laws, *i.e.,* the Hungarian Civil Code and the Capital Markets Act,[25] these investment schemes did not fall within the ambit of any of the instruments typically listed as "securities". As a result, the cooperatives were subject neither to securities law nor to the Hungarian Financial Supervisory Authority (HFSA), which would have required them to comply with specific conduct of business rules, disclosure of information through an investment prospectus, and to evidence sufficient liquidity to satisfy prudential regulatory standards. Over a period of approximately one year, the scheme lured many participants and became very popular – the formula being perceived as being as safe as regular saving deposits but more profitable. However, it collapsed after barely one year since it was based on a rudimentary Ponzi scheme that worked only as long as there was an exponential increase in new capital inflow. Worse, the fact that the "membership shares" were not considered as securities under Hungarian law had other legal consequences: participants were not considered as "investors" but as owners of the cooperatives which meant that, as typically occurs under any bankruptcy legal regime, they came last in the creditor ranking in liquidation proceedings.

The Hungarian case illustrates how, if the definition of "securities" is not sufficiently flexible, in that it adopts a *numerus clausus* approach, this facilitates the issuing of financial products expressly tailored to fall outside a legal regime that would in all probability reveal serious financial ambiguities in the investment scheme and possibly prevent its disruptive economic consequences. It follows that in establishing the meaning (and definition) of the term "securities", *regulatory arbitrage* is a matter of fundamental concern. Since financial products may be expressly designed to avoid securities laws and the associated costs of compliance, financial innovation may be used to define contractual arrangements that exploit the gap between the economic substance of a given transaction and its legal definition, thereby benefitting from a more favourable legal regime, usually at the investors' expense.[26]

25 *Ibidem*, at 148-151.

26 F. PARTNOY, "Financial Derivatives and the Costs of Regulatory Arbitrage", 22 *Journal of Corporations Law* (1997), 211, at 227. An example of the dramatic consequences of regulatory arbitrage is provided by the US sub-prime crisis, when bank-like institutions moved into a *shadow banking* system to avoid banking (more stringent) regulations. J. STIGLITZ, "Regulation and Failure", in: D. Moss / J. Cisternino (Eds.), *New Perspectives on Regulation*, The Tobin Project (2009), 21ff, at 25–61.

A second aspect that highlights the important role played by the definition of "securities" relates to the international legal dimension of financial transactions. Whether an international transaction is considered part of the securities family determines the applicability of specific choice-of-law conventions. From a private international law standpoint – unless choice-of law clauses are contained in the contract –, the legal nature of a given transaction is an essential step in determining which substantive law will regulate the contract and which will be the corresponding competent jurisdiction.[27] The *Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary* (also known as the Hague Securities Convention) was specifically drafted to ensure a higher level of legal certainty in cross-border securities transactions. Under the widely-adopted indirect holding system, one or more intermediaries, located in different jurisdictions, operate between investors and issuers. This common business practice impelled the Hague Conference on Private International Law to draft a Convention aimed at harmonising the principles used to determine the applicable law in the cross-border trade of securities. The Convention – ratified by two countries and signed by one at the time of writing – abandons the classic "look-through approach", based purely on the *lex rei sitae* principle, that investigates the chain of intermediaries by establishing the proprietary aspects of transactions to determine the competent jurisdiction.[28] The complexity of financial schemes, involving fungible accounts and various tiers of intermediaries, often meant that it was impossible in practice to define *ex ante* which jurisdiction was competent. Thus, the Hague Securities Convention, like the European Union,[29] adopted the "Place of the Relevant Intermediary Approach" (PRIMA), which focuses on the location of the intermediary immediately above the parties involved in the transaction. This suggests that, also from a choice-of-law rationale, the definition of the term is key to determining whether a given cross-border transaction (falling within the

27 For a complete analysis of the choice of law implications of financial instruments, see F.C. VILLATA, *Gli Strumenti Finanziari nel Diritto Internazionale Privato*, Padova, Cedam (2008).

28 For a thorough look at the conflict-of-law issues in international securities transactions, see C.S. BJERRE / S.M. ROCKS, "A transactional approach to the Hague Securities Convention", 3(2) *Capital Markets Law Journal* (2008), 109; and Ch. BERNASCONI / H.C. SIGMAN, "The Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary (Hague Securities Convention)", *Unif. L. Rev. / Rev. dr. unif.* (2005), 117.

29 The PRIMA approach was first introduced in Europe with Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on Settlement Finality in Payment and Securities Settlement Systems, *Official Journal* L. 166, 11.6.1998, (p.) 45.

securities category) follows the PRIMA approach. A different categorisation would follow the application of a different choice-of-law rule, leading to a different outcome. That is why the Hague Securities Convention provides a definition of securities in its Article 1(1)(a) worded as follows:

> [S]ecurities means any shares, bonds or other financial instruments or financial assets (other than cash), or any interest therein.

It appears from the above that the international dimension of securities trading poses yet another problem that calls for careful investigation of the definition of the term "securities". Financial products may be expressly crafted to choose more favourable jurisdictions, a phenomenon commonly referred to as *forum shopping*. As financial instruments circulate in different markets and economies, affecting investors located in different geographical areas, international and supranational action has been taken to limit forum shopping and regulatory arbitrage phenomena with a view to ensuring legal certainty, investor protection, and overall financial stability. These efforts have essentially taken two directions: one aims at defining internationally shared choice-of-law principles, the other seeks to harmonise substantive securities law. In both cases, a common understanding of what "securities" are and how the term is understood in different legal systems is a fundamental element to achieve the policy objectives of a harmonised securities law to govern global financial markets.

In order to create a minimum level of uniformity among substantive national laws, the International Organization of Securities Commissions (IOSCO) has produced a set of principles, known as the Objectives and Principles of Securities Regulation (hereinafter: IOSCO Principles) to establish the minimum requirements for any national securities law. The aim of the intended standardisation process is to equip financial markets around the world with a basic set of fundamental guidelines to reach three primary objectives: protection of investors; fairness and transparency in securities markets, and reduction of systemic risk. As will be seen below,[30] the IOSCO Principles do not provide for a definition of the term "securities". Even though this omission may reflect a specific policy choice, it would seem to weaken the core objectives of the document. In fact, in order to understand what securities are, the analysis cannot take the international setting as its point of departure. On the contrary, following a bottom-up method, a comparative legal and linguistic analysis of different national legal systems commends itself

30 See Section III below.

to reveal the meaning of the term "securities" and to understand whether there is a common set of shared features that characterise these financial devices.

III. – THE DEFINITION OF SECURITIES IN THE UNITED STATES AND IN SELECTED EUROPEAN LEGAL SYSTEMS

As noted above, the semantic signs used in different legal systems to label transactions as "securities" are not sufficient to disclose the meanings and the legal features inherent in each language. A plain juxtaposition of different terminologies shows that a literal translation of the term "securities", even though it is not possible, affords some insight into the legal features that must be present if transactions are to qualify as securities. Nonetheless, given the legal and economic implications of such a qualification, a comparative analysis of the meaning of securities involves focusing on the various techniques and concepts adopted to define the term "securities" in different legal systems. Bearing in mind the ultimate goals of securities laws, it is therefore necessary to focus on the tools that guide the linguistic and cognitive process of interpretation, resulting in the application of the appropriate legal regimes.

Securities represent a category of intangible concepts and abstract notions. The word is not linked *per se* to the image of a tangible object or to a specific physical manifestation of reality – which is precisely why different legal systems employ quite complex mechanisms to define and identify the characteristics of securities. In general, the term "securities" includes a series of business transactions whose nature, as explained and justified by the economic theory of corporate finance, aims at accomplishing specific economic functions. Seen through these lenses, securities appear to be instruments issued by a corporation, or by a government, as a way to finance business activities.[31] The economic theory and business practice distinguish two basic categories of securities to serve financing needs. The first consists of selling a position of ownership in a corporation, through "equity securities", typically common and preferred stocks (or shares) entitling investors to receive ownership interests, and to full or limited voting and dividend rights. The second category of securities is based on debt instruments to enable the borrowing of capital from investors. Investors are creditors entitled to the payment of interest and, at maturity, of the principal. Such debt securities are generally bonds, certificates of deposit, commercial papers, and debentures. Both equity

31 See J. TIROLE, *Theory of Corporate Finance*, Princeton, Princeton University Press (2006), at 80-94.

and debt securities are issued and sold to individuals or institutional investors as forms of investment.[32] In the securities market, the supply side is represented by companies or governments keen to access new capital, while the demand side is represented by investors purchasing securities in return for a profit (either in the form of interest on the capital put up, or dividends). Securities, furthermore, may be subsequently negotiated in the secondary market, thereby transferring the rights to new holders.

The economic function offers a conceptual understanding of "securities" and provides for an objective ground upon which the comparison among different legal languages and systems may be conducted. What securities law attempts to regulate – and what legal language attempts to capture – is, in fact, a series of transactions shaped to realise a specific economic function. However much an understanding of the legal categories attached to the diverse range of declinations of the term "securities" requires an analysis of the different definitions, an understanding of the legal definitions should also look at the economic function of a given transaction to categorise it as a form of securities. The relationship between the legal definition and the economic function will become more evident when we examine the United States federal securities laws and their interpretations, in the following paragraphs.

In the United States, the definition of securities is provided by the *Securities Act* of 1933 [33] and by the *Exchange Act* of 1934.[34] The two definitions are almost identical and the Supreme Court, by focusing on the economic reality, has treated them as functionally indistinguishable,[35] sufficiently broad to encompass virtually any financial instruments that constitute an investment,[36] and able to enact securities laws regardless of the name given.[37] Therefore, according to the 1933 Securities Act:

32 This basic distinction allowed economists to understand the capital structure and the economic incentives in market economies. For instance, the Nobel laureate, Franco Modigliani and Merton Miller, moving from the separation between equity and debt instruments, formulated their famous theorem on firms' financial structure. See F. MODIGLIANI / M. MILLER, "The Cost of Capital, Corporation Finance and the Theory of Investment", *American Economic Review*, Vol. 48(3) (1958), 261.

33 15 U.S.C. §77a *et seq.*

34 15 U.S.C. §78a *et seq.*

35 *See Reves v. Ernst & Young*, 494 U.S. 56, at 61 (1990) and *Tcherepnin v. Knight*, 389 U.S. 332, 335 (1967).

36 *SEC v. Infinity Group Co.*, 212 F.3d 180, 186, 241 (4th Cir. 1988).

37 *SEC v. Joiner*, 320 U.S. 344, 351 (1945).

> The term "security" means *any* note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on *any* security, certificate of deposit, or group or index of securities (including *any* interest therein or based on the value thereof), or *any* put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, *or, in general, any interest or instrument commonly known as a "security"*, or *any* certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.[38] *(emphasis added)*

The technique adopted to define "securities" enumerates a series of typical cases, referring to the broad economic distinction between equity and debt securities. This allows for flexibility in the application of federal securities laws, without always requiring a case-by-case analysis of the most common financial instruments – such as stocks, warrants, debentures, and bonds. As the repetition of the word "any" suggests, this approach does not provide for an exhaustive, *numerus clausus*, list of items. On the contrary, the economic function – not the label attached – determines whether a transaction should be qualified as an investment subject to securities laws. Even more significantly, in several instances US courts have noted the limited meaning of terms such as "stocks" and "notes".[39] Therefore, in order to determine the applicability of securities laws, the common features of those transactions have to be ascertained through the *economic realities test* elaborated by the courts. Using this process, it is possible to determine whether an investment should be included in the category of securities on the ground of its actual economic function.[40]

38 15 U.S.C. §77(b)(1).

39 Among the most relevant recent decisions, see *Robinson v. Glynn*, 349 F.3d 166, at 172 (2003).

40 See B. BLACK, "Is Stock a Security? A Criticism of the Sale of Business Doctrine in Securities Fraud Litigation", 16 *University of California Davis Law Review* (1982-1983), 325, and S. KAULBACH, "The Supreme Court and the Definition of 'Security': The 'Context' Clause, 'Investment Contract' Analysis, and Their Ramifications", 40 *Vanderbilt Law Review* (1987), 489.

The *Howey* case [41] clarifies that the definition adopted in the US was designed to cover the "countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." [42] The Supreme Court deployed a test based on three steps – subsequently fine-tuned over the decades through a series of notable decisions – to identify when transactions have to be considered as securities. The first requirement is that the investment be subject to the risk of monetary loss.[43] Secondly, the investment should take place as part of a common enterprise, where the success of an individual investor is tied to the success of the overall scheme.[44] Alternatively, it has been noted that the relationship between investor and promoter is sufficient to meet the common-enterprise criteria.[45] Thirdly, the profit generated – in the form of dividends, periodical payments, increased value of the original investment or even tax benefits [46] – should come from the efforts of others.[47]

Based upon the pillars established using the *Howey* test, a series of common features have been identified to determine whether an investment falls within the definition of "securities". The Supreme Court, in *United Housing Foundation* [48] and *Landreth Timber*,[49] established that the traditional common features characterising stocks or shares as securities are: (i) the right to receive dividends upon an apportionment of profit; (ii) the possibility to be negotiated; (iii) the ability to be used as collateral; (iv) the possibility to confer voting rights in proportion to the stock owned; and (v) the capacity for value appreciation.[50] In addition, the Supreme Court, by reaffirming the principles

41 *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

42 *Idem*, at 299.

43 *SEC v. Rubera*, 350 F.3d 1084, at 1090 (9th Cir. 2003).

44 See *Deckebach v. La Vida Charters, Inc. of Florida*, 867 F.2d 278 (6th Cir. 1989). For a slightly different understanding of the principle of communality, see *Majors v. S.C. Comm'n*, 644 S.E. 2d 710 (S.C. 2007).

45 Deckebach 867 F.2d, at 282. See also *SEC v. Pickney*, 923 F. Supp. 76 (E.D. N.C. 1996).

46 On the concept of profits, see *SEC v. Edwards*, 540 U.S. 389, 394 (2004). With explicit reference to tax benefits, see, among others, *Long v. Shultz Cattle Co., Inc.*, 881 F.2d 129, at 132 (5th Cir. 1989).

47 *Rubera*, 350 F.3d, at 1091-1092.

48 *United Housing Foundation v. Fo*rman, 421 U.S. 837 (1975).

49 *Landreth Timber Co. v. Landreth*, 471 U.S. 681 (1985), in which it was stated that various types of preferred stocks that usually do not carry voting rights have to be considered as securities.

50 *United Housing Foundation v. Forman*, 421, at 851.

stated in *Howey*, noted that the quintessential characteristic for any investment to be subject to federal securities laws is the ability to generate profits from the efforts of others. It follows that when the contractual arrangement reveals that the intention of the purchaser is not for profit – as in those cases where the ultimate intention is the use or consumption of a good [51] –, the transaction does not fall within the definition of securities.

The focus on investors' motivation is also the yardstick of the test elaborated in the *Reves* case,[52] dealing with debt securities. Here again, the investor's intention to earn a profit, deriving from the effort of others, has to meet the seller's financing needs.[53] Negotiability and general distribution to the public are also two main indicators, under the *Reves* test, for a debt-based instrument to meet the definition of "securities" as provided by the 1933 Securities Act.

From the above, it emerges that an investigation of the economic function ultimately determines whether a transaction comes within the definition of securities. The key components of the term "securities" that satisfy its economic function may be summarised as follows: first, it must be an *investment*, aimed at satisfying both the financing needs of issuers and the profit requirements of investors; secondly, the investment should be *negotiable* so that it may be traded in a market; thirdly, the concept of negotiability also embraces the possibility of a monetary appreciation to determine the *value* of the investment. Although European countries adopt a variety of legal techniques not based on the economic reality test, similar components appear to characterise securities.

A certain level of uniformity may be found among European legal systems, since the definition of the term "securities" has been influenced by the recent efforts of EU policy-makers to harmonise securities law. Nevertheless, before looking at the definitions provided at the EU level, it is worth

51 In the *United Housing Foundation* case, shares purchased by low-income tenants within a cooperative-run housing scheme entitled them to rent state-subsidised apartments were not considered as securities. The main purpose of the transaction was the satisfaction of purchasers' housing needs. Stocks were not transferable – even if they could have been passed by inheritance to a surviving spouse. They did not entitle the purchaser to receive interests and, upon termination of occupancy, tenants were obliged to sell back the stocks, at the initial price, to the cooperative. Furthermore, no voting or divided rights were attached. The Supreme Court stressed in particular that the intention of purchasers was to participate in a state-subsidised housing scheme and surely not participate in an investment. *See idem*, at 851.

52 *Reves v. Ernst & Young*, 494 U.S. 56 (1990).

53 *Idem*.

taking a look at the legal and linguistic approaches adopted domestically to define the term.

Partially reinforcing the famous quote attributed to Oscar Wilde according to which the British and Americans have "everything in common except, of course, the language", in the United Kingdom, the terminology as adopted in the *Financial Services and Markets Act* 2000 (FSMA) refers to "transferable securities". This wording appears to be in line with both the continental European legal tradition(s) and the EU approach, all of which highlight the transferability of the investment (to some degree equalling the idea of "negotiability" used in the US legal system).[54] Transferable securities are considered as forms of investment the issuing and trading of which, as "regulated activities", must be conducted by an authorised person or by an exempted person.[55] The UK approach to the regulation of financial markets services appears to be structurally different from that of the US. The governance of financial markets in the UK is primarily conducted through a regulatory agency,[56] whose powers are established in the FSMA. Section 102A of the FSMA provides a relatively simple wording, which mainly refers to the provisions contained in European directives – in particular, the Markets in Financial Instruments Directive (MiFID).[57] A more detailed elaboration of the investments considered as securities is provided in a statutory instrument, the *Financial Services and Markets Act 2000 (Regulated Activities) Order* 2001,[58] which enumerates a series of securities, notably shares, debentures and

54 The concepts of negotiability and transferability are per se diverse, however, as it will be explained at the end of this section transferability of investment in practical terms mirrors the idea of negotiability, as in both circumstance it is necessary to attribute a value.

55 The provision is known as the general prohibition to conduct regulated activities, *Financial Services and Markets Act (FSMA)* 2000, s 19(1).

56 The FSMA established the Financial Service Authority (FSA) and equipped it with an impressive set of rulemaking and supervisory powers over all the main branches of financial markets (banking, insurance and pension funds, and securities market). Nonetheless, the FSA is in the process of being transformed re-organising the regulatory structure for financial market regulation. For a thorough account of the new structure, see E. FERRAN, "The Break-up of the Financial Services Authority" 31 *Oxford Journal of Legal Studies* (2011), 455 and J. BLACK / M. HOPPER, "Breaking Up is Hard to do: the Future of UK Financial Regulation?" Law and Financial Markets Project, London School of Economics and Political Science, Herbert Smith (January 2011), <http://www.lse.ac.uk/collections/law/staff%20publications%20full%20text/black/breakingup.pdf>, accessed 20 August 2012.

57 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments, *Official Journal* L. 145, 30.4.2004.

58 SI 2001 n. 544.

alternative debentures, government and public securities, warrants, certificate representing certain securities, units, stakeholder pension schemes, personal pension schemes, rights to or interests in investments in shares and in stakeholders pension schemes. Moreover, Section 74(2) of the FSMA establishes that the regulatory authority, as part of its power to maintain an official list, may admit "other things as it considers appropriate" in that list.

The style adopted in the UK appears to follow the listing technique to define the variety of investments that fall within the definition of the term "securities". Allowing a regulatory agency to expand the official list ensures flexibility and avoids the rigidity that generally accompanies the *numerus clausus* technique, whilst legal certainty is, in principle, ensured by means of general provisions contained in primary legislation and further explained in statutory regulations.

In France, the *Code du Commerce* (Commercial Code)[59] and the *Code Monetaire et Financier* (Monetary and Financial Code)[60] are the primary sources shaping the legal regime for securities. Both codes are composed of a legislative part (*partie législative*), whose articles are preceded by the letter "L" as enacted through primary legislations, and a regulatory part (*partie réglementaire*), whose articles are preceded by the letter "R" as enacted through statutory instruments. Additionally, the financial market authority (*Autorité des Marchés Financiers* AMF)[61] has the power further to regulate and supervise financial markets. In other words, the French legal system combines primary legislation with statutory provisions and administrative acts to govern financial markets. Article L228-1 *Code du Commerce* refers to the concept of *valeurs mobilières*, which are considered as *titres financiers* (financial titles) and belong to the general category of *instruments financiers* (financial instruments) as laid down in Article L221-1 of the French Monetary and Financial Code, which in the second paragraph establishes that:

> *II. Les titres financiers sont:*
>
> *1. Les titres de capital émis par les sociétés par actions;*
>
> *2. Les titres de créance, à l'exclusion des effets de commerce et des bons de caisse;*

59 As of 20 August 2012.

60 As of 20 August 2012.

61 The AMF also works in collaboration with the newly established Prudential Supervisory Authority (*Autorité de Contrôle Prudentiel*, ACP), which is a body partially controlled by the French national central bank (*Banque de France*).

3. Les parts ou actions d'organismes de placement collectif.[62]

The use of the term *"titres financiers"* in the French Monetary and Financial Code, as opposed to the term *"valeurs mobilières"* adopted in the Commercial Code, reflects a decade-old dispute over the expression *"valeurs mobilières"* and the need to provide for a more thorough definition and categorisation. In 1996, during the parliamentary discussions leading to the enactment of the *Code Monétaire et Financier*, it was noted that the term lacked a clear description.[63] At first, the Parliament elected to discard the listing technique to define the term, as proposed by the Government, in favour of a definition reflecting its main legal characteristics.[64] As a result, the definition in force until 2009 was based on the distinction between equity and debt securities whose primary characteristic of transferability was explicitly mentioned in the text.[65] The new definition comes across as more concise and the statutory parts of both codes identify the elements that determine when investments and transactions are subject to the securities law regime. The combined reading of Article L211-1 *Code Monétaire et Financier* and Article L228-1 *Code du Commerce* produces a general definition where *titres financiers* is a synonym for *valeurs mobilières*, with the concept of transferability being implicitly contained in the adjective *mobilières* (movable).

A similar approach may also be observed in the Italian expression *valori mobiliari*, used to qualify securities under Italian law. In the Consolidated Law on Financial Intermediation (*Testo Unico della Finanza*, TUF),[66] securities are referred to as a sub-category of financial instruments, and Article 1*bis* states:

62 "II. – Financial securities include: (1) Equity securities issued by joint-stock companies; (2) Debt securities, with the exception of bills of exchange and interest-bearing notes; (3) Units or shares in undertakings for collective investment." Translation provided by Legifrance, see <http://www.legifrance.gouv.fr>.

63 Rapport n° 326 (1995-1996) de M. Philippe MARINI, Commission des finances, 24 April 1996, at Section 1, para. 2.

64 *Ibidem*, at Section 1, para. 1.

65 The previous version of Art. L211-1 of the Monetary and Financial Code stated that: "*Constituent des* valeurs mobilières*, les titres émis par des personnes morales, publiques ou privées,* transmissibles *par inscription en compte ou tradition, qui confèrent des droits identiques par catégorie et donnent accès, directement ou indirectement, à une* quotité du capital *de la personne morale émettrice ou à un* droit de créance *général sur son patrimoine.*" (emphasis added).

66 *Decreto legislativo* 24 February 1998, n. 58: "Testo unico delle disposizioni in materia di intermediazione finanziaria, ai sensi degli articoli 8 e 21 della legge 6 febbraio 1996, n. 52", as last modified by *Decreto legislativo* 2 July 2010, n. 104.

> *Per "valori mobiliari" si intendono categorie di valori che possono essere negoziati nel mercato dei capitali, quali ad esempio:*
>
> *a) le azioni di società e altri titoli equivalenti ad azioni di società, di partnership o di altri soggetti e certificati di deposito azionario;*
>
> *b) obbligazioni e altri titoli di debito, compresi i certificati di deposito relativi a tali titoli;*
>
> *c) qualsiasi altro titolo normalmente negoziato che permette di acquisire o di vendere I valori mobiliari indicati alle precedenti lettere;*
>
> *d) qualsiasi altro titolo che comporta un regolamento in contanti determinato con riferimento ai valori mobiliari indicati alle precedenti lettere, a valute, a tassi di interesse, a rendimenti, a merci, a indici o a misure.*[67]

Apart from the obvious linguistic similarity between the French and Italian terms used to qualify securities, the definition adopted in Italy would appear to be less concise as it follows the open-listing technique based on the classic distinction between equity (*azioni*, *i.e.,* shares) and debt securities (*obbligazioni*, *i.e.,* bonds). The list opens with an exemplification using the expression "*ad esempio*" (literally: "for instance") and continues by using words like "*qualsiasi*" (any) and "*altri*" (other) to stress that the enumeration is not exhaustive. The style shows significant similarities with the technique adopted in the US Securities Act of 1933. The term "*valori mobiliari*" also encompasses the concept of transferability; nonetheless, the TUF explicitly refers to the idea of negotiability, which has also been stressed in US Supreme Court decisions.

A mere glance suffices to bring to light the relevant differences between the legal systems here presented. In attempting to conduct a meaningful comparative analysis of the term "securities" as used in different legal languages, these differences should be carefully handled. Beneath the surface of the various techniques used to regulate financial markets, lawyers

67 "Securities" shall mean categories of securities for trading on the capital market, *such as*: (a) company *shares* and *other shares equivalent* to shares of companies, partnerships or other persons and share deposit certificates; (b) *bonds* and *other debt securities*, including certificates of deposit relating to such securities; (c) any other security *normally negotiated* which permits the purchase or sale of securities indicated in the preceding paragraphs; (d) *any other security* usually involving cash settlement determined with reference to securities indicated in the preceding paragraphs, to currency, interest rates, returns, commodities, indices or measures." (emphasis added) Translation provided by the Italian Financial Markets Authority, Consob, see <http://www.consob.it>.

operating in the respective legal systems are required to deploy various interpretative paths. The economic reality test elaborated by the US Supreme Court is not a reasoning that explicitly characterises the hierarchical governance structure through which the UK "regulatory State" governs the financial markets. Similarly, the role of the regulatory authorities in clarifying the definitions found in primary legislation varies considerably in accordance with the constitutional principles that characterise national legal systems. Therefore, even when the same official language is used (as in the case of the UK and the US), the cognitive process to disclose the legal nature of the term "securities" appears to diverge significantly. Nonetheless, a functionally-oriented comparative analysis reveals a convergent understanding of the concepts underlying the legal terminologies and languages in use. A common core composed of a set of shared characteristics in a multilingual society surfaces.

The basic distinction between equity and debt securities is, without doubt, one such shared ground upon which different definitions have been constructed to accommodate common financing needs. In addition, a closer look also reveals that the concepts of value, investment, and transferability lie at the core of every definition of securities. In particular, the concepts of transferability and negotiability are critical elements. The former simply implies the possibility that the securities might circulate. Negotiability on the contrary also requires the securities to be marketable and therefore to have a value. The primary characteristic of a negotiable instrument, as a substitute for money, is that it may pass freely into the hands of a third party which purchases it in good faith and may enforce the underlying obligation.[68] The characteristic of negotiability denotes the idea of transferability and fungibility. Nonetheless, transferability is not necessarily a feature characteristic of securities, as other contracts might be transferable without being classified as securities.[69] This is the case of "documents of title" (*e.g.*, a bill of lading), which allow the transfer of property interests (for instance, in goods) by transferring a document of title.[70] However, in UK securities law, the concept

68 D. McClean / K. Beevers (Eds.), *Morris on the Conflict of Laws*, London, Sweet & Maxwell (2005), at 326.

69 The historical evolution of financial instruments shows a general suspicion over the possibility that contracts, determining personal obligations between the parties involved, could have been transferred as an item of property, see H. Collins, *Regulating Contracts*, Oxford, Oxford University Press (1998), at 204 and ff.

70 The ambiguous relationship between transferability and negotiability in documents of title has been also extensively discussed in the United Kingdom. For an overview of the issue see

of "transferable securities" as contained in the FSMA is linked to the idea of investment, which implies the possibility of value appreciation. In this sense, the transferability of the investment might be considered as functionally equivalent to the idea of negotiability developed in US common law to characterise securities. Similarly, the concept of value is embedded in the legal language used in France and Italy, where securities are "movable *values*" (respectively, *valeurs mobilières* and *valori mobiliari*). The need to distinguish between documents of title and securities is even more manifest if we examine the provisions contained in the Lithuanian Civil Code. Article 1.101 of the Lithuanian Civil Code adopts the terminology *"vertybiniai popieriai"* (literally: "paper values"). Although this terminology is commonly translated as "securities", its meaning would appear to be broader than the Anglo-Saxon term, since it also includes documents of title. *Vertybinis popierius* (in its singular form) is a general legal category describing a document certifying the obligation of the issuer towards the holder. However, a subsequent clarification in the Civil Code states that where the documents are purchased as a form of investment – *i.e.*, not for the enjoyment of goods –, they are subject to a separate legal regime that in English would be understood as securities law. The comparative approach reveals that negotiability is the keystone underlying the terminology adopted in the different languages. Negotiability implies the possibility of attributing a monetary value to the instruments, which may be considered as an investment meeting the needs of market participants. This economic rationale moves securities markets and distinguishes such products from other instruments, such as documents of title.

Although a common core of shared characteristics can be isolated, the linguistic and conceptual divergences between national legal systems are at the root of a series of problems that focus attention on the role of legal harmonisation and standardisation, fostered respectively by EU policy-makers and IOSCO standard-setters. To understand the supranational and international approaches discussed below, the definitions provided by EU policy-makers will be analysed first, followed by an examination of the IOSCO Principles.

M. BRIDGE, *Sales of Goods*, Oxford, Oxford University Press (2009) at 235 and ff. See, generally, D. RICHARDSON, *Guide to Negotiable Instruments and the Bills of Exchange Acts*, London, Butterworths (1983). On this matter it has to be noted that the landmark case *Lickbarrow v. Mason* has been construed to make bills landing transferable and negotiable, see *Lickbarrow v. Mason* (1787) 2 T. R. 63, 69 (King's Bench decision).

IV. – THE DEFINITION OF SECURITIES IN THE EU DIRECTIVES AND IN THE IOSCO PRINCIPLES

This section illustrates the meanings attributed to the term "securities" at the supranational and international levels. To this end, the different definitions employed in the most relevant EU directives enacted with the *Financial Service Action Plan* (FSAP) 1999-2004 are presented. Definitions of securities pre-dating the FSAP may be found in several other Acts. One of the first definitions of securities elaborated by European policy-makers is contained in Commission Recommendation 77/534/EEC concerning a European code of conduct relating to transactions in transferable securities.[71] The recommended code of conduct – which might be considered as the first attempt to develop a common set of EC rules for securities and investment services – employs the expression "transferable securities" to describe "all securities which are or may be the subject of dealings on an organized market." [72]

Nonetheless, the bulk of directives in the FSAP show the way to an understanding of whether, at the time of writing, efforts to harmonise European securities laws sufficiently clarify the concept of securities. It is worth remembering in that regard that the forty-two measures implemented through the FSAP do not make up a "European financial services code", but instead represent a series of legal texts concentrating on specific aspects of financial markets, with the common aim of creating a single market for financial services.[73] In the post-FSAP era, *i.e.*, from 2005 onward, a series of amendments have been made to the measures adopted [74] which have not, however, affected the core policy of the FSAP nor indeed the definitions provided for securities. Apart from the benefits of providing a series of sector-specific harmonised provisions, the approach adopted by EU policy-makers has determined a diverse range of definitions reflecting the policy aims pursued by each individual directive. Therefore, to understand the term

71 77/534/EEC: Commission Recommendation of 25 July 1977 concerning a European code of conduct relating to transactions in transferable securities, *Official Journal* L 212, 20.8.1977, (p.) 37.

72 *Idem*, in the Annex Code of Conduct Relating to Transactions in Transferable Securities.

73 For further details on the provisions regulating securities market through the FSAP see E. FERRAN, *Building an EU Securities Market*, Cambridge, Cambridge University Press (2004).

74 For a comprehensive look at the different aspects of securities regulation in the EC context, see N. MOLONEY, *EC Securities Regulation*, Oxford, Oxford University Press (2008).

"securities" in a EU context, we need to analyse the key directives that regulate multiple aspects of the securities markets.

Directive 2004/39/EC,[75] also known as MiFID, and its subsequent amendments [76] are the cornerstone of the FSAP. Annex 1, Section C of the Directive specifies that transferable securities are part of the broader category of financial instruments, which also encompasses derivative contracts. Specifically, Article 4(18) establishes that:

> "Transferable securities" means those classes of securities which are *negotiable* on the capital market, with the exception of instruments of payment, such as:
>
> (a) *shares* in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares;
>
> (b) *bonds* or other forms of securitised debt, including depositary receipts in respect of such securities;
>
> (c) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures. (*emphasis added*)

Again, the term "transferable securities", reflecting the classic economic features illustrated above, is subsumed in the definition adopted by the directive. The French version of the directive uses the term "*valeurs mobilières*", not "*titres financiers*" as in the French Financial Monetary Code. The Italian version adopts the terminology "*valori mobiliari*" and does not translate the adjective "transferable" which is implicitly contained in the word *"mobiliari"* (movable). The Spanish version emphasises the element of negotiability in the terminology itself by referring to "*valores negociables*", which are then redundantly defined as "*las categorías de valores que son* negociables *en el mercado de capitales* […]."

75 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments, *Official Journal* L 145, 30.4.2004.

76 A series of amendments have been made, among which the latest incorporates the new European Supervisory System in the MiFID structure. Furthermore, on October 2011 the European Commission adopted a MiFID revision proposal. The proposal is composed of a revised directive and a new regulation, together commonly referred to as "MiFID II". See EUROPEAN COMMISSION, "New rules for more efficient, resilient and transparent financial markets in Europe", press release 20 October 2011, IP/11/1219.

The strong emphasis on negotiability is also underlined in Directive 2003/6/EC,[77] also known as the "Market Abuse Directive". As in the directive amended by the MiFID, specific reference is made to the definition of the term "transferable security".[78] The expressions "*valeurs mobilières*" and "*valori mobiliari*" are maintained in the French and Italian versions, respectively, while the Spanish version refers to both "*valores negociables*" and "*valores mobiliarios*". Nonetheless – given the directives' aim of guaranteeing the integrity of European financial markets and increasing investor confidence by combatting market manipulation practices –, negotiability is the primary identifying feature, as it is the key element to justify the protection afforded by the Market Abuse Directive.

Directive 2009/44/EC,[79] which also modifies Directive 2002/47/EC [80] on financial collateral arrangements, refers to the definition provided in the MiFID for financial instruments – of which, as noted, transferable securities are a sub-category.[81] The aim of the directive is to provide a legal framework for the use of financial instruments, among which securities, as collaterals. Hence its focus is on the value appreciation characteristic contained in the term "securities", which allows them to be used as collateral.

77 Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), *Official Journal* L. 96, 12.4.2003, (p.) 16.

78 Notably Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field, *Official Journal* L. 141, 11/06/1993, (p.) 27.

79 Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems, and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims, *Official Journal* L. 146, 10.6.2009, (p.) 37.

80 Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements, *Official Journal* L. 168, 27.6.2002, (p.) 43.

81 However, in order to understand the contribution of the European regime for financial collateral arrangements in defining the characteristics of the term "securities" in Europe, it is useful to recall the definition of financial instruments provided in Directive 2002/47/EC, according to which, at Art. 2(e), financial instruments are: "shares in companies and other securities equivalent to shares in companies and bonds and other forms of debt instruments if these are negotiable on the capital market, and any other securities which are normally dealt in and which give the right to acquire any such shares, bonds or other securities by subscription, purchase or exchange or which give rise to a cash settlement (excluding instruments of payment), including units in collective investment undertakings, money market instruments and claims relating to or rights in or in respect of any of the foregoing."

In a multilingual context, the definitions provided in the different official languages seem to suggest that the term "transferable" is interpreted as being synonymous with the term "negotiable". Furthermore, the possibility of attributing a value in order to negotiate and use such financial instruments as collateral emerges as another fundamental characteristic requiring special protection. The multilingual approach to these core directives reveals a point of convergence with the doctrine expressed by the US Supreme Court, as in *Landreth Timber*.[82]

Nonetheless, the European definition appears susceptible of creating divergent interpretations among member States, leaving a grey zone in the uniform application of one of the most important directives on securities, *i.e.,* Directive 2003/71/EC,[83] as amended by Directive 2010/73/EU [84] and also known as the "Prospectus Directive". Directive 2003/71/EC introduced a "single passport rule" for issuers, allowing securities to be made available to the public either through a public offer procedure or by admitting their shares to trading. Once a prospectus, *i.e.,* a document of disclosure of information, is approved by the competent authority of a member State, it must be accepted everywhere else in the EU. In order to ensure a uniform level of investor protection, the prospectus must meet common European standards as to the type of information that should be disclosed and whether disclosure is required. In pursuing this goal, the Directive classifies securities as *equity* and *non-equity*. Equity securities are defined as shares or securities that may be converted into shares of the issuer,[85] while non-equity securities are all those securities that are not considered as equity.[86]

82 See *supra* note 49.

83 Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC in *Official Journal* L. 345, 31/12/2003, (p.) 64.

84 Directive 2010/73/EU of the European Parliament and of the Council of 24 November 2010 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 Text with EEA relevance, *Official Journal* L. 327, 11/12/2010, (p.) 1.

85 Art. 2(1)(b) of Directive 2003/71/EC states:

"[E]quity securities" means shares and other transferable securities equivalent to shares in companies, as well as any other type of transferable securities giving the right to acquire any of the aforementioned securities as a consequence of their being converted or the rights conferred by them being exercised, provided that securities of the latter type are issued by the issuer of the underlying shares or by an entity belonging to the group of the said issuer."

86 *Idem*, at Art. 2(1)(c).

This distinction and the definition adopted raise a crucial problem concerning the applicability of the Directive. Convertible debt securities, which are hybrid instruments generally purchased as bonds with the possibility subsequently to convert them into shares would, on the basis of the definition contained in Article 2(1)(b), appear to be considered as equity security. However, Recital 12 of the same directive establishes that "[...] securities convertible at the option of the investor, fall within the definition of non-equity securities set out in this Directive." This contradiction indicates an open issue related to the definition of the term "securities", which impacts on the applicability of information disclosure requirements. The problem has meanwhile been resolved by a communication from the Committee of European Securities Regulators (CESR), now the European Securities and Market Authority (ESMA). Member States' regulatory authorities have agreed that Recital 12 should be read as referring to convertible securities, which fall outside the scope of the definition provided in Article 2(1)(b). Therefore, convertible bonds would be considered as equity securities – and therefore be subject to the prospectus requirement – when they are issued by the issuer of the underlying shares or by an entity belonging to said issuer's group.[87]

A similar problem concerns the non-transferable options in relation to employee share schemes. Since such schemes imply the issuing of non-transferable securities that might only be converted at a later stage, the regulatory authorities of most member States have agreed that such schemes should not fall under the Prospectus Directive since that directive only applies to *transferable securities*. However, German and Polish regulators took a different view, stressing, respectively, that employee share schemes also have a public offering element and that, if the employee subsequently exercises its option to convert, the instruments indeed become "transferable". In addition, until 2007 the Italian regulatory authorities considered non-transferable options in relation to employee share schemes as securities subject to prospectus requirements, whose transferability was simply postponed to a future date.[88]

A comparative analysis of national approaches and an investigation of the supranational dimension provide clear insight into the issues underlying the definition of the term "securities". To complete this study by putting it into a

87 EUROPEAN SECURITIES AND MARKET AUTHORITY, Questions and Answers Prospectuses, 16th updated version, 23 July 2012, ESMA/2012/468.

88 *Idem*, at 11. The documents also suggests that in specific circumstances a short-form disclosure for offers to the employees is allowed, see *idem*, at 57.

globalised financial markets context, we must also mention the international initiatives that have been deployed to establish a common set of standards for financial markets governance. In this area, the work of the International Organization of Securities Commissions (IOSCO) has profoundly influenced the legal regimes of different legal systems as well as European policy-makers.[89] Since their creation in 1998, the IOSCO Principles have been amended on several occasions, culminating in the 2010 version which clarifies the three core objectives of any securities law regime, namely: to protect investors; to ensure that markets are fair, efficient and transparent; and to reduce systemic risk. Thirty-eight principles have been constructed upon these core objectives to guide national and supranational regulatory authorities in their regulatory and supervisory activities. A number of recommendations to market participants and intermediaries are also included.

As pointed out in Section II above, if we look at the IOSCO Principles to understand which transactions fall into the category of "securities", we are in for a disappointment as the Principles do not give a clear definition of "securities". They simply state that securities "should be understood to include derivatives where the context permits." [90] One of the goals of the document is to provide for a mechanism to assess the implementation of the Principles in different legal systems.[91] Accordingly, it might be argued that a definition of the term "securities" was purposely omitted to allow different legal systems to define the object of the regulation in accordance with their national legal terminology. In other words, given that the purpose is to guide national regulatory authorities, IOSCO leaves room for a certain degree of flexibility in order to foster the Principles' broad application.

A more in-depth analysis of the document, however, reveals that it does contain an implicit definition of "securities", aligned with the concept of "financial instruments" as adopted in the EU and in different European legal

89 For instance the IOSCO, *Statement of Principles for Addressing Sell-Side Securities Analyst Conflict of Interest* (2003), have profoundly influenced the European regime on gatekeepers, notably by shaping the core provisions on the subject of the MiFID and the Market Abuse Directive. See EUROPEAN COMMISSION, Communication on Investment Research and Financial Analysts (2006), COM/2006/789. On the influence of international standards on EU securities law, see MOLONEY, *supra* note 74, at 212 and ff.

90 IOSCO, Objectives and Principles of Securities Regulation (2010 version), in fn 3, (p.) 1.

91 The International Monetary Fund and the World Bank, in the Financial Sector Assessment Program, adopt the IOSCO Principles to evaluate the soundness of the financial system and the regulatory regime for each country.

traditions. In fact, derivatives are expressly considered as "securities", whereas the legal systems analysed so far tend to consider derivatives and securities as two distinct sub-categories of financial instruments. This understanding is not consistent throughout the document and the classic features of securities that have emerged so far may be found implicitly in the text.

In one set of Principles, a distinction is made between equity and debt securities, referring to the classic understanding of securities as a sub-category of financial instruments. For instance, the fundamental rights of "equity shareholders" are enumerated in the explanation of Principle 15 stating that "holders of securities in a company should be treated in a fair and equitable manner." [92] Then, the expression "equity and debt securities" is used to specify that the IOSCO Principles deal with "publicly traded" securities in primary and secondary markets – including stock exchanges and other "regulated forms of off-exchange".[93] Similarly, negotiability and transferability are central elements around which the Principles revolve, precisely because they deal with the regulatory and supervisory framework for "publicly traded" securities.[94] Finally, the concept of "investment" also permeates the Principles. The commentary on Principle 14 dealing with investor protection and disclosure of information states:

> The disclosure of current and reliable information necessary to make *informed investment decisions* is directly related to *investor* protection and to fair, efficient and transparent markets.

The concept of investment is considered as the economic rationale underlying the functioning of securities markets. Therefore, the need for "informed investment decisions" becomes pivotal for the smooth functioning of the market. Furthermore, Principles 17 to 22 deal with collective investment schemes which, according to the commentary to the Principles, appear to cover a wide range of operations involving different investors. For this reason, the concept of "investment" as an element of "securities" shows close resemblances with the concept that has evolved in US case law, in particular the idea of common enterprise, highlighted in the *Howey* case, where the success of an individual investor depends on the success of the overall

92 IOSCO Principles, at 72.

93 IOSCO Principles, at 64.

94 The document uses expressions such as "trade", "traded", and "tradable". Those expressions appear to be used in place of the most commonly adopted terms "negotiable" and "transferable".

scheme, *i.e.,* on the ability of the investment to generate profit from the efforts of others.

It appears from the above that an understanding of what the IOSCO Principles deem securities to be must be extracted from a series of elements. The inductive process aimed at identifying the implicit meaning attributed to the term "securities" results in the isolation of a series of elements that echo components of definitions used in the different legal systems contemplated in this article. For instance, the idea of negotiability permeates the IOSCO Principles, as the European national and supranational approaches do. Furthermore, the implicit meaning of the term "securities" in the IOSCO Principles meets the criteria of the *Howey* test. Nonetheless, given the international relevance of the IOSCO Principles in shaping securities law in different legal, linguistic and cultural contexts, a more explicit clarification defining the target of securities laws would have helped towards achieving the three basic objectives stated in the document: investor protection; fairness, efficiency and transparency of markets; and mitigation of systemic risk. It follows that simply to adopt the term "tradable" without clarifying (or even mentioning) the concepts of transferability and negotiability is unlikely to enhance investor protection. In this regard, the IOSCO Principles shed no light on the scenarios referred to earlier in this article where there is doubt whether non-transferable convertible securities should be subject to disclosure requirements.

Even more significantly, if the decision not to define the term "securities" was taken with intent in order to allow a broader application of the IOSCO Principles in different jurisdictions around the globe, the implicit understanding of the term would not ensure effective and uniform implementation of the Principles. Given the ambitious scope of application of the IOSCO Principles, a definition of the term "securities" inherently constructed upon the legal categories of a set of specific legal traditions might clash with the national idiosyncrasies of different legal systems. More precisely, the notion of "investment" underlying the Principles appears to be based on the potential to generate profit from the efforts of others. Such a feature might, for instance, clash with legal systems outside the Western legal tradition, such as Islamic law, which prohibits *riba* (interest). Although it is not within the purview of this article to address the compatibility of IOSCO Principles with Islamic finance, this consideration shows that a process of legal standardisation in a multilingual and multicultural society should carefully consider the far-reaching consequences related to the definition and common understanding of the term "securities".

V. – CONCLUSIONS

The governance of financial markets is a complex matter, both because of the market dynamics properties, which are in constant mutation, and because of the high level of interconnectedness among the economies and sectors involved. That complexity also transpires from the cognitive processes in which national lawyers engage to interpret financial laws. The interpretative effort implies recourse to an array of tools involving the simultaneous analysis of a diverse range of sources of law, *i.e.*, primary laws, statutory regulations, administrative acts, case law, and principles established at the EU level. A comparative legal and linguistic analysis of the regulatory techniques adopted in different legal systems makes it possible to identify a common set of components characterising those transactions that fall into the category of "securities" and, therefore, require a special legal regime. The key components that implicitly or explicitly surface relate to the economic function of securities, as eloquently expressed by the economic theory of corporate finance. Accordingly, in all the legal traditions examined in this article, the term "securities" and its different linguistic declinations encompass three fundamental features: *(i)* securities are *investments*, made to satisfy financing needs and return profits, in the form of either equity or debt; *(ii)* such investments are *negotiable*, both in the primary and the secondary market; *(iii)* they are *valuable*, meaning that monetary appreciation is always possible.

The directives (and their translations) that make up the body of EU securities law also reveal that these core components are subsumed in the definitions provided by EU policy-makers in different legal texts. Nonetheless, some divergent applications and non-harmonised interpretations of common EU laws still occur, leaving some unclear areas and thus endangering the policy goal of a single market with common rules.

A first reason for such discrepancies is probably related to the idiosyncratic interpretative processes that must be followed by national authorities and lawyers within their respective legal systems to understand the legal definition and apply the required legal regime. Therefore, the European regulatory approach, to be effective, must be constantly measured against these cognitive interpretative processes (which are also reflected in the language). Such a confrontation, in fact, reveals the reasons for and the scope of national divergences and their impact on the application of EU securities law. In this context, a clear terminology to define the term "securities" provides solid ground to ensure legal certainty and sufficient flexibility to minimise the impact of regulatory loopholes that fuel phenomena such as regulatory arbitrage and forum shopping, as illustrated earlier in this article.

It follows that a further reason for these discrepancies among member States may be traced to the fact that each directive is drafted to target a specific policy area by harmonising some distinct aspects of securities law in the EU and EEA member States. In other words, the definition provided in each directive – although the MiFID establishes common ground – tends to stress different elements, *e.g.,* the distinction between equity and non-equity for disclosure purposes, or the concept of value to allow the collateralisation of certain securities. As a result, the cognitive process followed in each member States to interpret a particular directive may suffer from the lack of a broader scope in the EU legal definitions.

One possible way forward would be for EU policy-makers and international standard-setters to establish a general framework for a common legal definition of "securities", based on the notions and concepts developed in different member States, leaving the fine-tuning to the national regulatory authorities.[95] The elaboration of such a general framework in a multilingual, transnational context would require broad agreement on the key substantive building blocks of the legal concept of "securities", as implicitly or explicitly defined in different jurisdictions, based on a thorough comparative and linguistic analysis of the rules and principles currently in force in the various national legal systems, along the lines traced in this article.

95 This scenario would probably require a different institutional organisation of the EU governance apparatus for financial markets. On this matter see CASTELLANO / JEUNEMAÎTRE / LANGE, *supra* note 16, at 429.