Articles

The Element of Trust in Financial Markets Law

By Peter O. Mülbert and Alexander Sajnovits[*]

Abstract

Trust is an essential element for the functioning not only of ancient societies but also of modern societies. This article explores the different dimensions of trust in general and the different dimensions of the relationship between trust and the law, in particular. More specifically, we distinguish three different levels of interaction between trust and the law: (1) trust in the law; (2) trust through the operation of law, and (3) trust as defined by the law. Building on these categories, we finally turn to the "tsunami of regulation" ("*Regulierungstsunami*") in the area of EU financial market law that has occurred in the wake of the financial crisis of 2008. As will be shown, trust can serve as a legal concept for making sense of this flood of legislative acts and of shaping these into a coherent framework. A different question yet to be answered is whether the flood of legislation already resulted in providing for an excess level of trust.

[*] Prof. Dr. Peter O. Mülbert is the holder of the Chair of Civil Law, Commercial Law, Business Law and Banking Law and the Director of the Center for German and International Law of Financial Services at the University of Mainz, Germany. Alexander Sajnovits is a research assistant for the Chair of Civil Law, Commercial Law, Business Law and Banking Law at the University of Mainz, Germany.

This article is an abridged and updated version of a more German law-oriented article. *See* Peter O. Mülbert & Alexander Sajnovits, *Vertrauen und Finanzmarktrecht*, 2 ZEITSCHRIFT FÜR DIE GESAMTE PRIVATRECHTSWISSENSCHAFT (ZfPW) 1-51 (2016). The authors are deeply grateful to Ciara McGarry for her outstanding work in translating the German text. The usual caveat applies.

A. Introduction

Trust is of great importance, even in the commercial context. Kenneth Arrow in 1972 succinctly gave expression to this observation as follows: "Virtually every commercial transaction has within itself an element of trust, certainly any transaction conducted over a period of time."[1] This perception applies particularly to the financial markets as the repercussions of the collapse of the US investment bank *Lehman Brothers* in September 2008 emphatically demonstrate. The banking and financial crisis triggered by this event, which itself precipitated a general economic crisis, and the resulting ongoing European sovereign debt crisis are often attributed to a loss of trust on a grand scale. The financial markets crisis saw banks losing the trust of their peers and other market participants.[2] In the subsequent economic crisis it was the trust placed in the financial sector and the economy as a whole that could be seen to dwindle.[3] In the European sovereign debt crisis investors' ability to trust in the long-term solvency of certain EU Member States has, in turn, been severely undermined.[4]

This perceived crisis of confidence has prompted individual members of academic legal circles to demand trust-building reforms in financial markets law.[5] It has also, and above all, prompted corresponding action in the political sphere.[6] Reinforcing trust in the

---

[1] Kenneth Arrow, *Gifts and Exchanges*, 1 PHILOSOPHY AND PUBLIC AFFAIRS 343, 357 (1972).

[2] Roman Tomasic & Folarin Akinbami, *The Role of Trust in Maintaining the Resilience of Financial Markets*, 11 JOURNAL OF CORPORATE LAW STUDIES 369 (2011); ALEXANDER THIELE, FINANZAUFSICHT: DER STAAT UND DIE FINANZMÄRKTE 79 (fn. 93) (2014); Frens Kroeger, *The Development, Escalation and Collapse of System Trust: From the financial Crisis to Society at Large*, 33 EUROPEAN MANAGEMENT JOURNAL 431 (2015); Joan Loughrey, *Smoke and Mirrors? Disqualification, Accountability and Market Trust*, 9 LAW AND FINANCIAL MARKETS REVIEW 50, 52 (2015); Raymond H. Brescia, *Trust in the Shadows: Law, Behavior, and Financial Re-Regulation*, 57 BUFFALO LAW REVIEW 1361, 1372 (2009); Ronald J. Colombo, *The Role of Trust in Financial Regulation*, 55 VILLANOVA LAW REVIEW 577-602 (2010); Fran Tonkiss, *Trust, Confidence and Economic Crisis*, 44 INTERECONOMICS 196, 200 (2009); Timothy C. Earle, *Trust, Confidence, and the 2008 Global Financial Crisis*, 29 RISK ANALYSIS 785-792 (2009).

[3] *See* Paolo Sapienza & Luigi Zingales*, A Trust Crisis*, 12 INTERNATIONAL JOURNAL OF FINANCE 123, 130 (2012); Friedrich Sell & Marcus Wiens, *Warum Vertrauen wichtig ist – der ökonomische Blickwinkel*, 89 WIRTSCHAFTSDIENST 526-533 (2009). *See also* Holger Stelzner, *Der Kern der Krise – Vertrauen*, FRANKFURTER ALLGEMEINE ZEITUNG (Dec. 23, 2012), *abvailale at* http://www.faz.net/aktuell/wirtschaft/der-kern-der-krise-vertrauen-12004848.html.

[4] ANDREAS DOMBERT, EUROPÄISCHE STAATSSCHULDENKRISE - URSACHEN UND LÖSUNGSANSÄTZE 3, *available at* https://www.bundesbank.de/Redaktion/DE/Downloads/Presse/Reden/2011/2011_12_20_dombret_europaeische_staatsschuldenkrise.pdf?__blob=publicationFile; Adalbert Winkler, *Ordnung und Vertrauen – Zentralbank und Staat in der Eurokrise*, 14 PERSPEKTIVEN DER WIRTSCHAFTSPOLITIK 198, 202 (2013). Some commentators have posited an opposing theory as to the culprit responsible for the crisis: excessive and misplaced trust. *See* Brescia, *supra* note 2, at 1364. But Brescia also conceded that the loss of trust materially contributed towards the deepening of the crisis. *See id*. at 1373.

[5] Frank Partnoy, *Financial Systems, Crises, and Regulation*, *in* THE OXFORD HANDBOOK OF FINANCIAL REGULATION 68, 80 (Niamh Moloney *et al.* eds., 2015); Chris Brummer & Matt Smallcomb*, Institutional Design, The International Architecture, in* THE OXFORD HANDBOOK OF FINANCIAL REGULATION 129, 138, 151 (Moloney *et al.* eds., 2015); Tomasic & Akinbami, *supra* note 2, at 393. *See also* CAPITAL FAILURE – REBUILDING TRUST IN FINANCIAL SERVICES (Nicholas Morris & David Vines eds., 2014).

[6] Wolfgang Schäuble, *Mit einem neuen Ordnungsrahmen Vertrauen schaffen*, BÖRSEN-ZEITUNG (Feb. 27, 2009) ("The functioning of a financial centre is inextricably intertwined with the trust which it enjoys. We will

financial markets is the stated goal of a series of legislative acts adopted at the EU level since the outbreak of the financial markets crisis.[7]

At the same time, a legislative approach adopting a completely different line of attack has also been apparent. To begin with, credit ratings and credit rating agencies have been divested of some of their relevance. Even more notably is the attempt at providing an institutional framework allowing for the resolution of even systemically significant financial market actors in a manner that does not destabilise the financial markets or the economy as a whole, as a means of undermining the basis of actual trust in implicit government guarantees.[8] Moreover, in view of the rapid encroachment of the compliance-based approach, originally developed as a means of regulating providers of securities-related services, into ever more areas of social and economic life, the importance of trust as a mechanism may be described as having suffered quite a blow across the board. The expression "Trust, but verify," reputedly coined by Lenin, seems to neatly capture the mood in today's post-modern, fragmented, and (thus) increasingly juridified society.

With all of this in mind, this article takes up the question of trust in financial markets law. We begin with an introduction to the inter-disciplinary concept of trust as a mechanism for reducing complexity (B.). We then identify three manifestations of the correlation between trust and (financial markets) law: trust in the law; trust through the operation of law; and trust as defined by the law (C.). We then turn our attention to the impact of core elements of financial markets law in shaping attitudes of trust ("through the operation of law") (D.). The article ends with a few words by way of conclusion (D.).

---

reinforce the trust placed in Germany as one such financial centre by once more according greater significance to the fundamental principle of liability.)" (authors' translation). *See* Mark Carney, Governor of the Bank of England, Speech on 17 November, 2004, *available at* www.bankofengland.co.uk/publications/Pages/speeches/default.aspx; European Commission, Communication: Single Market Act Twelve Levers to Boost Growth and Strengthen Confidence, "Working together to create new growth," COM(2011) 206 final.

[7] Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds: Recital 3; Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds: Recital 1; Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive): Recital 1 and 7; Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU: Recital 4; Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies: Recital 20; Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010: Recitals 3, 31 and 35.

[8] Regulation (EU) No 462/2013 (*supra* fn. 7) and Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010.

B. Trust: An Inter-Disciplinary Concept

Trust is of crucial importance for the functioning of the economy and society. In the wake of the pioneering work of Georg Simmel[9] and, above all, Niklas Luhmann,[10] trust has become the focus of some interest. This is true for sociologists.[11] It is also true for psychology,[12] political science,[13] and jurisprudence.[14] Over the last 20 years the subject has even attracted the attention of a number of distinguished economists.[15]

I. Concept

Trust is defined as a "Firm belief in the reliability, truth, or ability of someone or something; confidence or faith in a person or thing, or in an attribute of a person or

---

[9] GEORG SIMMEL, THE PHILOSOPHY OF MONEY 1907 (Routledge 3rd edition 2004); GEORG SIMMEL, SOZIOLOGIE: UNTERSUCHUNGEN ÜBER DIE FORMEN DER VERGESELLSCHAFTUNG 346 (1st ed. 1908). Simmel was preceded by Thomas Hobbes, John Locke, and John Stuart Mill. *See* Brescia, *supra* note 2, at 1366; Annette Baier, *Trust and Antitrust*, 96 ETHICS 231-260 (1986).

[10] NIKLAS LUHMANN, TRUST AND POWER, PART 1 – TRUST (1979) (first published as VERTRAUEN – EIN MECHANISMUS DER REDUKTION SOZIALER KOMPLEXITÄT (1968)).

[11] *See, e.g.,* JAMES S. COLEMAN, FOUNDATIONS OF SOCIAL THEORY (1990); J.M. Barbalet, *Social Emotions: Confidence, Trust and Loyalty*, 16 INTERNATIONAL JOURNAL OF SOCIOLOGY AND SOCIAL POLICY 75-96 (1996).

[12] See, for example, Julian B. Rotter, *Generalized expectancies for interpersonal trust*, 26 AMERICAN PSYCHOLOGIST, 443-452 (1971).

[13] *See, e.g.,* Russell Hardin*, Do We Want Trust in Government?, in* DEMOCRACY AND TRUST 22 (Mark E. Warren ed., 1999); Russell Hardin, *Trustworthiness,* 107 ETHICS 26-42 (1996); Russell Hardin*, The Street-Level Epistemology of Trust,* 21 POLITICS AND SOCIETY 505-529 (1993); BARBARA MISZTAL, TRUST IN MODERN SOCIETIES – THE SEARCH FOR THE BASES OF SOCIAL ORDER (1996).

[14] Charles J. Goetz & Robert E. Scott*, Enforcing Promises: An Examination of the Basis of Contract,* 89 THE YALE LAW JOURNAL 1261 (1980); Thomas Wischmeyer, *Generating Trust Through Law? Judicial Cooperation in the European Union and the "Principal of Mutual Trust"*, 17 GERMAN LAW JOURNAL 339-382 (2016); Lawrence E. Mitchell, *Fairness and Trust in Corporate Law*, 43 DUKE LAW JOURNAL 425-491 (1993); Lawrence E. Mitchell, *Trust and Team Production in Post-Capitalist Society,* 24 JOURNAL OF CORPORATION LAW 869 (1999); Bruce Ian Carlin *et al.*, *Public Trust, the Law, and Financial Investment*, 92 JOURNAL OF FINANCIAL ECONOMICS 321-341 (2009); Larry E. Ribstein, *Law v. Trust*, 81 BOSTON UNIVERSITY LAW REVIEW 553-590 (2001); KARL LARENZ, ALLGEMEINER TEIL DES DEUTSCHEN BÜRGERLICHEN RECHTS § 2 IV. (43 et seq.) (7th ed. 1989); CLAUS-WILHELM CANARIS, VERTRAUENSHAFTUNG IM DEUTSCHEN PRIVATRECHT (1971); HANS CHRISTOPH GRIGOLEIT, VORVERTRAGLICHE INFORMATIONSHAFTUNG 21 (1997); CHRISTIAN KERSTING, DIE DRITTHAFTUNG FÜR INFORMATIONEN IM BÜRGERLICHEN RECHT 167 (2007).

[15] *See, e.g.,* George J. Stigler, *The Economics of Information*, 3 JOURNAL OF POLITICAL ECONOMY 213-225 (1961); Oliver E. Williamson, *Calculativeness, Trust, and Economic Organization*, 36 JOURNAL OF LAW AND ECONOMICS 453-486 (1993); Louis B. Barnes, *Managing the Paradox of Organizational Trust*, 59 HARVARD BUSINESS REVIEW 107-116 (1981); TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS (Diego Gambetta ed., 1988); Larue Tone Hosmer, *Trust: The Connecting Link between Organizational Theory and Philosophical Ethics*, 20 ACADEMY OF MANAGEMENT REVIEW, 379-403 (1995); Ernst Fehr, *On the Economics and Biology of Trust*, 7 JOURNAL OF THE EUROPEAN ECONOMIC ASSOCIATION 235-266 (2009); Ernst Fehr & John A. List, *The Hidden Costs and Returns of Incentives – Trust and Trustworthiness among CEOs*, 2 JOURNAL OF THE EUROPEAN ECONOMIC ASSOCIATION 743-771 (2004); TANJA RIPPERGER, ÖKONOMIK DES VERTRAUENS (2nd ed. 2003); Marek Korczynski, *The Political Economy of Trust*, 37 JOURNAL OF MANAGEMENT STUDIES 1-21 (2000); Paul S. Adler, *Market, Hierarchy, and Trust: The Knowledge Economy and the Future of Capitalism*, 12 ORGANIZATION SCIENCE 215 (2001); Horst Albach, *Vertrauen in der ökonomischen Theorie*, 136 JOURNAL OF INSTITUTIONAL AND THEORETICAL ECONOMICS 2-11 (1980).

thing."[16] Confidence is defined as "the mental attitude of trusting in or relying on a person or thing,"[17] and reliance as "dependence on or trust in someone or something."[18] The concept of trust—in our everyday use of the term as an expression of belief in the dependability and reliability of a person or thing—encompasses a range of complex and diverse manifestations of trust. For example, we speak of trust that is well-founded, justified, blind, irrational, etc. It is therefore in need of a precise definition that reflects the different knowledge objects, interests, and objectives of the various disciplines in the (social) sciences.

It is thus entirely in line with our everyday use of this term to talk of trusting in the occurrence of a random event. Nevertheless, the expectation that share prices will develop in a certain manner in the future[19] – in any case to the extent that their development may be likened to a "random walk down wall street", a metaphor made popular by the 1973 book of the same name – does not, from an economic perspective, have anything to do with trust, nor could such an expectation ever, from a legal perspective, be accorded the status of one warranting protection. Rather, it is, from a legal and economic standpoint, more akin to a mere "hope" or "aspiration."[20] Random events in the narrower sense are indeed rare occurrences, at least outside of the context of radioactive decay. But expectations as to the (non-)occurrence of highly improbable events—whether these involve winning the lottery or exposure to risk of loss in the form of what have most recently come to be known as "black swan"[21] or "tail risk" events—will not, from a legal and economic standpoint, be a matter of "trust." The rationality of trusting in the occurrence or non-occurrence of a certain event will also depend on the extent of the loss that the party acting on trust would be likely to incur should his or her trust have been misplaced.

Trust may therefore be understood, in the context under consideration here, as an expectation as to the future conduct of a person or an organisation or as to the functionality of a system, whereby the trustee or the system in question must fundamentally be capable of acting or functioning in fulfilment of said expectation.

II. Function

In these modern times the individual necessarily finds himself or herself in situations that he or she is unable to fully grasp, faced with a degree of complexity that must be

[16] Oxford English Dictionary.

[17] Oxford English Dictionary.

[18] Oxford English Dictionary.

[19] BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET (10th ed. 2012).

[20] Ripperger also refers to hope as the antonym of trust. RIPPERGER, *supra* note 15, at 38.

[21] *See* NASSIM NICHOLAS TALEB, THE BLACK SWAN (2nd ed. 2010).

overcome.[22] The more complex a social system is, then the more difficult it is for the individual to function autonomously within its bounds. Deciding upon one of a number of available options is a process that is rife with uncertainty. There are a number of possible means, most of which can be cumulatively deployed, for overcoming this uncertainty and thus reducing the complexity faced by the individual, at least according to his own perception. First, one can increase his or her ability to assimilate, process and interpret information. Second, one can conclude explicit contracts.[23] Third, one can choose to trust in a given outcome.

Trust therefore constitutes an essential mechanism for reducing complexity.[24] It is not only of relevance in cases in which an explicit contractual agreement is lacking.[25] Rather, trust generally serves as a "functional equivalent"[26] of rational predictive ability and information.[27] Instead of coming to terms with the existing complexity, the trusting party deliberately forgoes the possibility of unlimited predictive ability and thus of command of and control over a given situation. This allows the trusting actor to actually participate in the system.[28] Such deliberate forbearance may result in a reduction in transaction costs, and it is not least for this reason that the mechanism of trust has piqued the interest of proponents of New Institutional Economics.[29]

---

[22] See LUHMANN, *supra* note 10.

[23] Explicit contracts might serve as a means of reducing complexity. *See* RIPPERGER, *supra* note 15, at 27; Horst Eidenmüller, Vertrauensmechanismus und Vertrauenshaftung, ARCHIVES FOR PHILOSOPHY OF LAW AND SOCIAL PHILOSOPHY (Beiheft 74) 117, 121 (2000).

[24] *See* LUHMANN, *supra* note 10. *See also* PAUL MILGROM & JOHN ROBERT, ECONOMICS, ORGANIZATION AND MANAGEMENT 139 (1991) ("In a world of costly and incomplete contracting, trust is crucial to realizing many transactions."); JAMES S. *COLEMAN*, 1 FOUNDATIONS OF SOCIAL THEORY 91 (1990); HOLGER FLEISCHER, INFORMATIONSASYMMETRIE IM VERTRAGSRECHT 106 (2001); Christoph Engel, *Das schwindende Vertrauen in die Marktwirtschaft und die Folgen für das Recht*, *in* FESTSCHRIFT HOPT 2733, 2742 (2010).

[25] *See* KERSTING, *supra* note 14, at 176. Ackermann addresses the possibility of an express "promise," i.e. trusting in conduct being in compliance with one's contract. THOMAS ACKERMANN, DER SCHUTZ DES NEGATIVEN INTERESSES 141 (2007).

[26] Dirk U. Gilbert, *Vertrauen als Gegenstand der ökonomischen Theorie: Ausgewählte theoretische Perspektiven, empirische Einsichten und neue Erkenntnisse*, 2 ZEITSCHRIFT FÜR MANAGEMENT (ZfM) 60, 71 (2007).

[27] *See, also,* Wischmeyer, *supra* note 14, at 347; HANS-BERND SCHÄFER & CLAUS OTT, LEHRBUCH DER ÖKONOMISCHEN ANALYSE DES ZIVILRECHTS 5 (5th ed. 2012).

[28] Gilbert, *supra* note 26, at 71; Katharina Beckemper, *"Das Rechtsgut Vertrauen in die Funktionsfähigkeit der Märkte"*, 6 ZEITSCHRIFT FÜR INTERNATIONALE STRAFRECHTSDOGMATIK 318, 319 (2011); LUHMANN, *supra* note 10, at 50.

[29] Stephen Knack & Philip Keefer, *Does Social Capital Have an Economic Payoff? A Cross-Country Investigation*, 112 THE QUARTERLY JOURNAL OF ECONOMICS, 1251, 1252 (1997); T.K. Das & Bing-Sheng Teng, *Trust, Control, and Risk in Strategic Alliances: An Integrated Framework*, 23 THE ACADEMY OF MANAGEMENT REVIEW 491-512 (1998); Beckemper, *supra* note 28, at 320. Blair and Stout have considered this from a corporate law perspective. Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 UNIVERSITY OF PENNSYLVANIA LAW REVIEW 1735, 1753 (2001).

III. Object

The object in which trust is placed is the past, present, or future conduct of persons or organisations. Or, in the case of a (technical) system, trust is placed in the functionality of that system. The object of trust may therefore be a recommendation given by an individual, the future actions of the legislature (e.g. dealing with tax matters), or the proper processing of transactions via securities trading systems in addition to the clearing and settlement of those transactions.[30]

This also applies in principle to the context in which one places trust in information that, at least from an economic and legal perspective, involves trust being placed not in an abstract piece of information but in information ascribed to a certain author or source, i.e. also in the latter's conduct in providing that information. Rationally speaking, one will only be able to rely on information to the effect that the annual profits of a certain listed company are set to increase by 200% if one is familiar with the source of that information.

The position with regard to the market price on organised markets is a singular one, namely, there is no way of ascribing such information to any particular person or organisation. Information relating to the market price is rather more the result of pricing activity, i.e. the product of a pricing mechanism comprising numerous individual elements or, in systemic terms, the output of the pricing system in place.

IV. Basis

The key phrase "basis for trust" raises the question as to why trust is placed in persons or organisations conducting themselves, or in systems functioning, in a certain way. In the case of the provision of information, for example, the object of trust is information ascribable to a certain person/organisation. The reason for placing trust in the information relates to the person/organisation, or to the legal norms regulating their conduct. Consequently, the basis for trust may be provided by individuals (trust in persons), organisations (trust in organisations), and also systems (trust in systems). An example of the latter would be the trust extended to particular trading systems governed by rules.[31] The issue of the basis for trust is often discussed, particularly in Anglo-American texts, in conjunction with the concept of trustworthiness, with the focus turning to the trustee and the identification of those attributes that are particularly conducive to a finding of trustworthiness.[32]

---

[30] In this regard, see *infra* D.II.2.2.

[31] Other have taken a somewhat similar approach. *See* Adler, *supra* note 15, at 218; Korczynski, *supra* note 15, at 4; Friederike Welter, *Vertrauen und Unternehmertum im Ost- West- Vergleich*, *in* VERTRAUEN UND MARKTWIRTSCHAFT 7, 8 (J. Maier ed., 2004); HANS-DIETER HAAS & SIMON MARTIN NEUMAIR, INTERNATIONALE WIRTSCHAFT 780 (2006); JEANETTE HEDWIG MÜLLER, VERTRAUEN UND KREATIVITÄT 161 (2009).

[32] *See* Loughrey, *supra* note 2, at 51; Brescia, *supra* note 2, at 1378; Avner Ben-Ner & Freyr Halldorsson, *Trusting and Trustworthiness: What are They, How to Measure Them, and What Affects Them*, 31 JOURNAL OF ECONOMIC PSYCHOLOGY 64 (2010).

1. Trust in Persons

1.1 Personal Attributes and Experience

A well-founded decision to place trust in one particular person on personal grounds, will be sufficient to do away with complexity in in less complex systems. But in the financial markets context, outside of the bank adviser-customer relationship,[33] personal trust will only be of minor importance.[34] To the degree that it matters in this context, personal trust will usually be based on experience gathered and evaluations carried out at an interpersonal level.[35] Therefore, personal reputation will be a particularly important factor from the perspective of a trustor forming expectations as to the future conduct of a trustee in accordance with the principle of extrapolation, i.e. on the basis of the latter's past conduct.[36]

1.2 Transference of Trust in Systems

In addition to an individual's personal attributes, which are then reflected in the trustor's experience and evaluations at the interpersonal level, his or her role within an organisation or a system will often also have a role to play in building trust. But the trust placed in an individual as a result of his or her position will be derived directly from the trust placed in the system in question.[37] The trustee profits from his or her role/position within the system, but that position is not the true point of reference for the trust placed in him or her by the trustor. It is his position that enables him or her to come into contact with the trustor in the first place. This contact then enables the trustee to also build a personal relationship of trust with the trustor on the basis of the trust inspired by his position (trust in systems).[38] The transference of the trust in the system to the trustee's position will thus often be the factor that enables the latter to develop personal relationships of trust in the first place, and may therefore be taken to be a condition for the establishment of such trust. This can be seen in practice in the context of the provision of investment advisory services, which is characterised by the phenomenon of personal investment advisers leaving one bank to work at another and taking their existing customers with them. This is a testament to the fact that once a personal

[33] Susan P. Shapiro, *The Social Control of Impersonal Trust*, 83 AMERICAN JOURNAL OF SOCIOLOGY 623, 632 (1987).

[34] Luigi Guiso *et al.*, *Trusting the Stock Market*, 63 JOURNAL OF FINANCE 2557, 2586 (2008).

[35] Luhmann and Adler have addressed aspects of personal trust. *See* LUHMANN, *supra* note 10, at 39; Adler, *supra* note 15, at 217. Kosfeld has written regarding the biochemical aspects of reputation and trust in the context of personal contact. *See* Michael Kosfeld *et al.*, Oxytocin Increases Trust in Humans, NATURE 673, 674 (2005).

[36] *See* SCHÄFER & OTT, *supra* note 27, at 546.

[37] Roderick M. Kramer, *Trust and Distrust in Organizations: Emerging Perspectives, Enduring Questions*, 50 REVIEW OF PSYCHOLOGY 569, 575 (1999). *See, e.g.,* Adler, *supra* note 15, at 218; Nancy Kurland, *Trust, Accountability, and Sales Agents' Dueling Loyalties*, 6 BUSINESS ETHICS QUARTERLY 289, 295 (1996).

[38] BART NOOTEBOOM, TRUST: FORMS, FOUNDATIONS, FUNCTIONS, FAILURES AND FIGURES 8 (2002).

relationship of trust has been established, then it may come to override the trust placed in the system.

The link between the trust placed in a particular position and that placed in the system as a whole becomes particularly evident in the case of the application of rules of professional conduct, such as prerequisites for admission to a profession or substantive requirements relating to the practice of a profession. National legislation in the form of prerequisites for admission to a profession or substantive requirements relating to the practice of a profession have the effect of increasing the extent to which that individual is prepared to trust in the reliability of his counterpart without having any actual knowledge of the latter's personal attributes. This is true as a matter of fact and according to the individual's own perception. These regimes foster the establishment of interpersonal relationships of trust. Sanctioning mechanisms, whether these involve rules providing for civil/criminal liability or the imposition of other penalties, additionally serve to increase the probability of compliance with rules and regulations, which also indirectly supports the reinforcement of trust at the personal level. A regime of sanctions will further remove the focus of the trust being placed in a person from the actual person concerned, transferring the point of reference for that trust to the effectiveness of the law enforcement mechanism in place, such that it is again the trust placed in the system that is of material relevance here.

2. Trust in Organisations

The trust placed in organisations, i.e. in institutions whose (board) members are individuals, is a sort of hybrid of the trust placed in persons and that originating in the context of systems.[39] On the one hand, organisations (in particular corporate bodies and other legal entities) act as a single unit in their dealings with the world at large, much as an individual does. In this way they become the point of reference for attitudes of trust on the part of third parties. On the other hand, as a general rule trust in organisations is not founded on experience gathered and evaluations carried out at the interpersonal level.[40] Instead, for example, with regard to specific managers, trust is based on the fact that the prevailing legal system provides for more or less comprehensive monitoring and sanctioning mechanisms that ensure that each organisation as a whole acts in accordance with a particular body of rules and regulations. In this respect, the trust placed in organisations can be said to be akin to the trust placed in systems.

3. Trust in Systems

Where a multitude of participants interact with each other within complex systems without actually coming into close contact with one other, trust at the personal level will generally not be sufficient to overcome the complexity of a given situation. This is due to the fact that, overall, the market may be described as the most impersonal

[39] *See* GUSTAV SCHMOLLER, GRUNDRIß DER ALLGEMEINEN VOLKSWIRTSCHAFTSLEHRE 61 (1900); EIRIK FURUBOTN & RUDOLF RICHTER, INSTITUTIONS & ECONOMIC THEORY 10 (2nd ed. 2005).

[40] Nooteboom use similar terminology. *See* NOOTEBOOM, *supra* note 38, at 8.

relationship of a practical nature that people may establish with other people.[41] In the absence of any trust at the personal level, trust placed in systems will come into play.[42] For example, anyone who places trust in the stability of the value of money and the continued availability of a wide range of possible uses for his money does so solely on the basis of his trust in the functioning of this system, and without actually having any personal connection with someone within that system.[43] Here, it is immaterial whether the trust placed in the system is continually reflected onto a particular person and brought to the trustor's attention by that individual. In fact, it may be said, in line with our understanding of the concept of trust, that someone who is not constantly aware of the extent of his own reliance and vulnerability will tend to be particularly trusting.[44]

This welfare-fostering aspect of the placing of trust in systems is contingent upon the existence of institutions established to facilitate interactions between individuals in cases not involving any personal contact.[45] Thus, a structure of institutional arrangements must be in place that is recognized and complied with by the individuals participating in the system in question. These individuals are also able to anticipate its impact in terms of the regulation of their conduct,[46] thereby ensuring that any trust placed in the system does not prove to be misplaced, and ultimately fostering conduct on the part of all of the participants that justifies the trust placed in them. These institutions, which effectively govern the conduct of the actors within a system by means of regulatory requirements and incentive programmes, are established pursuant to legislative provisions, contractual regulations, but also customary business practice.[47] They stipulate the expectations that an individual may cultivate with regard to the conduct of other participants in the system, and the degree of trust that he will ultimately place in those participants.[48] An example of this is provided by the regulation of the banking sector, comprising as it does requirements as to the maintenance of equity capital, liquidity, risk management, and corporate governance mechanisms. The ultimate purpose of these requirements is to foster trust in the banking system as a whole by first fostering trust in its individual institutions.[49]

The regime of sanctions (including its enforcement mechanisms) that applies to a particular system will be of crucial importance for establishing trust in that system.

---

[41] MAX WEBER, ECONOMY AND SOCIETY 636 (1978).

[42] Shapiro has commented on the necessity of "impersonal trust." *See* Shapiro, *supra* note 33, at 634.

[43] *See* LUHMANN, *supra* 10, at 50.

[44] *See* CLAUS-WILHELM CANARIS, *supra* note 14, at 503.

[45] Shapiro, *supra* note 33, at 634.

[46] Gilbert, *supra* note 26, at 90; FURUBOTN & RICHTER, *supra* note 39, at 86.

[47] Guiso *et al.*, *supra* note 34, at 2559..

[48] Paola Sapienza, *Trust and Financial Markets*, *in* THE FIRST CREDIT MARKET TURMOIL OF THE 21ST CENTURY 29, 34 (Evanoff *et al.* eds., 2009); Sapienza & Zingales, *supra* note 3, at 124; Blair & Stout, *supra* note 29, at 1746.

[49] *Infra* D.III.1.

Effective regulations governing liability and other penalties are not only intended to ensure that the participants in the system conduct themselves in a manner that is consistent with the rules of that system. They are also a signal from the legislature that each market participant may expect the others to conduct themselves in a manner that is consistent with those rules.[50]

V. Motivation

1. Trustor

The trustor will necessarily be exposed to certain risks in relying upon his or her predictions as to the conduct of other individuals or of corporate bodies, or the expected development or functioning of certain systems. In this posture, the trustor will not be able to exert any influence on, much less any control over, the expected developments and thus the degree of personal benefit which he will derive from them (trust dilemma).[51] One speaks of the risk involved in the trustor unilaterally effecting performance as being the constitutive feature of a situation of trust and one that constitutes an expression of the trustor's freedom to choose to be either trusting or mistrustful.[52] Where no such risk exists, there will also be no need for any decision as to whether or not to adopt an attitude of trust and, conversely, placing one's trust in a certain expected conduct or functionality will always entail the risk of one has misplaced his or her trust. Still, trust is often the only means available for overcoming complex structures.[53] Thus, the trustor will decide in favour of trusting as a means – albeit a risky one – of enabling his own participation in a particular situation. An individual's willingness to trust is directly linked to his personal willingness to take risks.[54]

2. Trustee

One motivation for a particular trustee to conduct himself in a manner that earns others trust may lie in his or her personal sense of integrity, i.e. in his or her determination not to fall short of the trustor's expectations (intrinsic trustworthiness).[55] This is likely to be the material factor in many interpersonal relationships of trust, but less so in cases involving complex and anonymised systems such as the financial markets.[56]

---

[50] *See* Peter O. Mülbert & Steffen Steup, 59 ZEITSCHRIFT FÜR WIRTSCHAFTS UND BANKRECHT 1633, 1639 (2005). *See also* Blair& Stout, *supra* note 29, at 1746; Adler, *supra* note 15, at 217.

[51] Williamson, *supra* note 15, at 463; Guiso *et al.*, *supra* note 34, at 2558; COLEMAN, *supra* note 11, at 99.

[52] *See* LUHMANN, *supra* note 10, at 24, 35.

[53] RIPPERGER, *supra* note 15, at 5.

[54] *See* Guiso *et al.*, *supra* note 34, at 2558; Peter Smith Ring & Andrew H. van de Ven, *Structuring Cooperative Relationships between Organizations,* 13 STRATEGIC MANAGEMENT JOURNAL 483, 489 (1992).

[55] *See* Loughrey, *supra* note 2, at 53; Stout & Blair, *supra* note 29, at 772; Brescia, *supra* note 2, at 1370; Colombo, *supra* note 2, at 580. *See also* Carlin et al., *supra* note 14, at 321.

[56] See Williamson, supra note 15, at 482.

On the other hand, most trustees operating within complex anonymised systems will be able to anticipate the advantages of conducting themselves in a manner that justifies the trust placed in them, with those advantages being founded upon a desire to avoid the incurrence of penalties.[57] But the trustee also (perhaps even primarily) acts in a manner that inspires trust on the general expectation that all of the participants in the system will conduct themselves in this way (calculative trustworthiness).[58] An additional, financial, motivation for trustees is the prospect of a so-called "trust premium," which, in many cases, will take the form of a mark-up on prices, or the enhancement of one's reputation.[59] This particular aspect is likely to prove problematic in the context of the voluntary provision of information, a situation in which the amount of any trust premium typically will not be on the same scale.[60]

C. Trust and the Law

I. Trust: "In the Law," "Through the Operation of Law," and "As Defined by the Law"

There are a number of very different views of the relationship between trust and the law: Some commentators see the law as serving as a substitute for trust, and trust itself merely as a necessary mechanism for the reduction of complexity only in cases that are not governed by regulatory legislation (or contractual arrangements).[61] In contrast, another and broader interpretation of the concept of trust – also considered here – states that the adoption of regulatory legislation will not generally render trust obsolete, rather will itself constitute, on the one hand, the object of trust (trust in the law) and, on the other hand, an essential factor in establishing trust and thus the actual basis for

---

[57] *See* LUHMANN, *supra* note 10, at 35 ("trust cannot be reduced to trust in the law and in the sanctions which the law makes possible.").

[58] Colin Mayer, *Trust in Financial Markets*, 14 EUROPEAN FINANCIAL MANAGEMENT 617, 630 (2008); COLEMAN, *supra* note 11, at 104; Adler, *supra* note 15, at 217. *But see* Michael Baurmann, *Vertrauen und Anerkennung, in* Neuer Institutionalismus 107, 111 (Andrea Maurer & Michael Schmid eds., 2002).

[59] SCHÄFER & OTT, *supra* note 27, at 559; KERSTING, *supra* note 14, at 205.

[60] Bishop offered a similar assessment. *See* William Bishop, *Negligent Misrepresentation through the Economists' Eyes*, 96 LAW QUARTERLY REVIEW 360, 364 (1980).

[61] *See* Shu Yu *et al.*, *Trade, Trust and the Rule of Law*, 37 JOURNAL OF POLITICAL ECONOMY 102, 103 (2015) ("Trust and formal institutions are considered to be two different transaction cost reducing channels and as such serve as substitutes."); Beckemper, *supra* note 28, at 321. Luhmann had a more nuanced approach. *See* LUHMANN, *supra* note 10, at 34 ("Legal arrangements which lend special assurance to particular expectations, and make them sanctionable, are an indispensable basis for any long-term considerations of this nature; thus, they lessen the risk of conferring trust. This collated development is the only plausible meaning one can attach to the notion occasionally advanced that law is a *substitute* for trust."); *ID.* at 41 (note 5) ("In all more sharply differentiated, more complex social orders, on the contrary, it is inevitable for law and trust to become separate in this way."). Some scholars go so far as to suggest that legal regulation undermines, and prevents the establishment of, trust. *See* FRANCIS FUKUYAMA, TRUST: THE SOCIAL VIRTUES AND THE CREATION OF PROSPERITY 27 (1995); Ribstein, *supra* note 14 at 580; David T. Llewellyn, *Trust and Confidence in Financial Services: A Strategic Challenge*, 13 JOURNAL OF FINANCIAL REGULATION AND COMPLIANCE 333, 336, 341 (2005).

trust (trust through the operation of law).[62] A further area of overlap between the law and the concept of trust is the category of "trust as defined by the law," which relates to existing legal concepts of trust.

II. Trust in the law

1. Trust in the Legal System

Sanctioning a failure by trustees to conduct themselves in a manner that justifies the trust that has been placed in them is a way for the legislature to also ensure and foster the establishment of relationships of trust (including those of an interpersonal nature) because sanctions provide an additional incentive for those trustees to conduct themselves in the desired manner (general deterrence). Trust is then placed in both the individual person and the legal system, or more precisely: trust is placed in the quality of the substantive law in force, on the one hand, and in the effectiveness of the law enforcement mechanism, on the other hand.[63]

But the law's function in this regard is not only to foster trust. To a large extent the law might serve to replace trust as a mechanism for overcoming complexity. Contractual arrangements can be used as a means of addressing any uncertainty arising in the decision-making context as a result of inadequate procurement or processing of information, or even the risk of opportunistic conduct on the part of other market actors.[64] Of course, this will not always provide an ideal solution, given the impossibility of specifying contractual arrangements to cover every possible eventuality.[65]

One might well think that a perfect legal system – even if the notion is entirely Utopian[66] – in the form of an exhaustive body of dispositive and mandatory legal rules would go so far as to render the concept of trust, as a mechanism for overcoming complexity, entirely superfluous.

---

[62] Wischmeyer, *supra* note 14, at 344; Loughrey, *supra* note 2, at 53. This perception of the possible role of the law in fostering trust also forms the basis of those theories that identify a correlation between regulation and trust within a society. *See* Knack & Keefer, *supra* note 29, at 1251 (Attempting to gauge the prevailing level of trust by reference to the findings of the World Values Survey (WVS), in which participants are asked, among other things, the following question: "Generally speaking, would you say that most people can be trusted or that you need to be very careful in dealing with people?"). *See also Brescia*, *supra* note 2, at 1401. Others have pursued a more nuanced approach. *See* Carlin *et al.*, *supra* note 14, at 321; Philippe Aghion *et al.*, *Regulation and Distrust*, 125 THE QUARTERLY JOURNAL OF ECONOMICS 1015-1049 (2010) (Explaining that a "cross section of countries, government regulation is strongly negatively correlated with trust.").

[63] *Supra* B.IV.1.2. and B.IV.3.

[64] RIPPERGER, *supra* note 15, at 27.

[65] *See* Shapiro, *supra* note 33, at 633; Katharina Pistor, *Law in Finance*, 41 JOURNAL OF COMPARATIVE ECONOMICS 315, 326 (2013) (With further references to the "incomplete contract theory.").

[66] *See, generally*, Baurmann, *supra* note 58, at 109 (With further references.).

Such optimism with regard to the reach of the law must, upon closer consideration, be tempered. After all, even a perfect legal regime would only be able to bring about a shift in the object of trust, albeit a far-reaching one. For example, in the case of a legal transaction, the shift would be from the need to trust the other party to a contract and instead to trusting in the functioning of the legal regime in force. This is particularly apparent in the context of the law governing the formulation of general terms and conditions of business. Pursuant thereto, an individual is not required to judiciously take note of the T&Cs or even to trust in the user's stipulations taking his or her interests into account, but the consumer will – at least, as someone who is not a lawyer – have to place his or her trust in the relevant mandatory legislative provisions providing adequate protection, and also in the functioning of the state law enforcement mechanisms. The same will apply in the case of (other) consumer protection standards and investor protection legislation. While mandatory protective rules reduce the risk of exposure for consumers and investors, the latter must still rely on the functioning of the state legislative, supervisory, and law enforcement mechanisms.[67]

2. Trust in Persons as an Extension of Trust in the Legal System

In addition, the use of compulsory execution orders as a means of law enforcement by the state is subject to some limitations. While execution orders pertaining to the settlement of monetary claims should only prove ineffective in insolvency cases, the effectiveness of execution orders for performance will necessarily be limited in some cases. Where a creditor has an interest in the debtor taking certain action, and that interest cannot be entirely served by other means, then he or she will ultimately have to trust that the latter will remain able to effect performance – i.e. not falling victim to disability, dementia or death – and will remain willing to do so.[68]

Furthermore, even a perfect legal system will be unable to eliminate the risk of insolvency on the part of a counter-party. Where the latter does not have sufficient assets to satisfy creditors' monetary claims, even an optimally structured legal framework will prove ineffective. Thus, placing one's trust in the future solvency of a counter-party will be of fundamental importance. In these circumstances, a third party's promise of collateral merely serves to bring about a shift in the object of that trust.

III. Trust Through the Operation of Law

Legislative acts might reinforce trust. They would do this by helping to optimize the aim of trust by imposing requirements on market actors, providing for the establishment of institutions, and establishing incentive programmes and sanctioning mechanisms. This would stabilize expectations that have no basis in certainty.[69]

---

[67] KERSTING, *supra* note 14, at 187.

[68] Bartels and Sajnovits have commented on the position under German law. *See* Klaus Bartels & Alexander Sajnovits, *Die Rolle der Beschaffung beim Gattungskauf*, 69 JURISTEN ZEITUNG 322, 328 (2014).

[69] Wischmeyer, *supra* note 14, at 348.

Achieving this result does not depend on whether it is an explicitly stated goal of the legislature to reinforce trust, or whether this effect is merely a by-product of the application of the legislative act in question. It is equally irrelevant whether the legislature is striving to foster trust in the system or trust at the interpersonal level.

But it is clear that not every legislative act will be capable of attaining the status of a trust-building measure. This caveat applies not only in the case of far-reaching tax legislation but also to many other areas of the law: legislative intervention in the sphere of property rights; changes to all manner of government measures designed to subsidize certain activities (a case in point: solar energy); and long-term decisions relating to issues of infrastructure (an example that comes to mind here is the acceleration of the phasing-out of nuclear power in Germany in response to the disaster in Fukushima). Rather, it is those regulations that result in improvements in the protection afforded a contractual party or in the functionality of systems (whether this is the stated goal or a by-product of the legislation in question) that will have a positive, trust-building impact at the substantive law level.

1. Fostering Trust as an Objective of Legal Policy in the Financial Markets Context

While fostering trust by means of legislative acts is not an end in itself,[70] it certainly constitutes a legitimate objective in the case of financial markets law. Trust plays a particularly important role in this field[71] because of the need to improve efficiency in this context.[72] Improvement may result from an increased willingness on the part of market participants to supply the market with liquidity, a lowering of transaction costs or the prevention of market failures.

1.1 Trust in the Financial Markets

In the financial markets, trust constitutes a major factor affecting the willingness of investors to provide necessary equity or external financing to individuals or entities in need of funds in the primary market, and to supply liquidity as participants in the secondary market.[73] The likelihood of a financing relationship actually coming into being will largely depend on the relationship of trust that exists between the financing party and the would-be recipient of the funds.[74]

---

[70] *See supra* note 7; *supra* note 8.

[71] Julia *Black*, *Reconceiving Financial Markets—From the Economic to the Social*, 13 JOURNAL OF CORPORATE LAW STUDIES 401-442 (2013); Llewellyn, *supra* note 61, at 336, 341 *et seqq*.

[72] *See also* Eidenmüller, *supra* note 23, 117, 123.

[73] *See* Tomasic & Akinbami, *supra* note 2, at 374; *infra* D.1.

[74] *See* Sapienza, *supra* note 48, at 30.

Moreover, the existence of greater trust in the market, one's market counterparts, and the quality of the legal infrastructure in place will help to lower the costs incurred by individual market participants in connection with the procurement and processing of information, in part by encouraging them to dispense with certain safeguards.[75] Governmental regulation as a means of further fostering trust may therefore also result in a reduction in *transaction costs* – costs incurred for searches and the procurement of information, the negotiation and decision-making contexts, and in connection with monitoring and enforcement activities. This kind of regulation can be justified from an economic perspective on the grounds that markets in general, and the financial markets in particular, tend to benefit from maintaining minimal transaction costs.[76]

As regards the secondary market, the capital market theory supports the prohibition against insider trading in spite of its adverse effects on the efficiency of the capital markets on the grounds that increased liquidity will be a side effect of market participants trusting in the fairness of the market,[77] and similar concerns were raised in connection with (other) issues of liability affecting the secondary market.[78] In more general terms, investors' mistrust of the stock market is viewed as one of the reasons why, in times of economic prosperity, the liquidity and degree of capitalisation of stock markets does not increase in proportion to the growth experienced by the economy as a whole.[79]

1.2 Trust In and Between Financial Institutions

The trust placed by the investing public (savers) in financial institutions,[80] or (more precisely) in the latter's solvency, and especially the trust placed by banks in each other, is of particular importance. During the financial markets crisis, the run on banks that many feared did not in fact materialise, partially because politicians made statements that aimed to re-establish trust. These statements were bolstered by the prompt creation in Europe and the US of instruments designed to stabilise the position of

[75] FURUBOTN & RICHTER, *supra* note 39, at 57; RIPPERGER, *supra* note 15, at 34.

[76] Mayer, *supra* note 58, at 630.

[77] *Infra* D.II.3.

[78] Peter O. Mülbert, *Finanzmarktregulierung – Welche Regelungen empfehlen sich für den deutschen und europäischen Finanzsektor?*, 65 Juristen Zeitung 834, 842 (2010).

[79] Sapienza, *supra* note 48, at 30; Guiso *et al.*, *supra* note 34, at 2557 (with regard to the degree of capitalization); Tomasic & Akinbami, *supra* note 2, at 379 (with regard to the connection between trust and liquidity). *See also* Adam Ng *et al.*, *Does Trust Contribute to Stock Market Development?*, 52 ECONOMIC MODELLING 239-250 (2016).

[80] *See* David-Jan Jansen *et al.*, When Does the General Public Lose Trust in Banks?, De Nederlandsche Bank NV, Working Paper No. 402 (2013); Markus Knell & Helmut Stix, *Trust in Banks during Normal and Crisis Times—Evidence from Survey Data*, 82 ECONOMICA 995 (2015). Filipiak provided a comprehensive overview of current economic research. *See* Ute Filipiak, *Trusting Financial Institutions: Out of Reach, Out of Trust?*, 59 QUARTERLY REVIEW OF ECONOMICS AND FINANCE 200-214 (2016).

vulnerable institutions (SoFFIn[81] and TARP[82] for example).[83] Thus, the emphatic announcement made in 2008 by the German Chancellor and the German Finance Minister insisting that the savings of the German public were safe succeeded in nipping the public's rising doubts as to the stability of the German banking system in the bud.[84] Mario Draghi's subsequent assurance, in the context of a speech given in London in 2012, had a similar effect. Draghi famously declared: "Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough."[85] This succeeded, at least temporarily, in dispelling the prevailing doubts as to the survival of the Eurosystem, thereby halting the stark rise in interest rates for government bonds issued by the PIIGS countries as well as the growing mistrust of banks in the Eurozone, with their extensive portfolios of securities issued by their own national governments.

2. Undermining Trust as an Objective of Legal Policy

In addition to prompting the implementation of trust-building measures, the lessons learned as a result of the financial markets crisis have also provoked quite contrary reactions in the legal policy sphere. The corresponding changes to the existing legal framework are intended to further reinforce the pre-eminence of personal responsibility on the part of market participants, rather than placing the focus on conduct based on trust. At the same time, a legislative approach adopting a completely different line of attack has also been apparent. To begin with, credit ratings and credit rating agencies have been divested of some of their relevance. Even more notably is the attempt at providing an institutional framework allowing for the resolution of even systemically significant financial market actors in a manner that does not destabilise the financial markets or the economy as a whole, as a means of undermining the basis of actual trust in implicit government guarantees.[86] Similar endeavours – to some extent, of a legal policy nature – relate to the illiquidity of individual countries within the

[81] Special Financial Market Stabilization Funds (Sonderfonds Finanzmarktstabilisierung). *See* Section 1 of the German Act Establishing a Financial Market Stabilization Fund (*Gesetz zur Errichtung eines Finanzmarktstabilisierungsfonds* – FMStFG), BGBl I 2008, 1982.

[82] Troubled Asset Relief Program.

[83] Goddard *et al*. provided a comprehensive overview. *See* John Goddard *et al.*, *The Financial Crisis in Europe: Evolution, Policy Responses and Lessons for the Future*, 17 JOURNAL OF FINANCIAL REGULATION AND COMPLIANCE 362-380 (2009); Pistor, *supra* note 65, at 319.

[84] Available at: http://www.spiegel.de/wirtschaft/merkel-und-steinbrueck-im-wortlaut-die-spareinlagen-sind-sicher-a-582305.html (as of: October 2015).

[85] Available at: https://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html (as of: October 2015).

[86] Regulation (EU) No 462/2013 (*supra* fn. 7) and Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010.

Eurozone and the reinforcement or revival of the no bail-out principle enshrined in the EC/EU treaties.[87]

IV. Trust as Defined by the Law

An issue that must be kept distinct from the trust-building objective of legal policy and the placing of trust in the functioning of the legal system is that of the meaning attributed to the concept of trust pursuant to established law. In this connection, reference is repeatedly made – mostly in a critical sense – to the ubiquitous nature of the definition of trust pursuant to the law.[88] But this fact in itself does not preclude the possibility of the concept of trust being amenable to sufficiently precise definition in particular contexts in which it is used. This, after all, is a requirement of the rule of law.[89] Quite the opposite is the case. Neither the courts nor legal theorists may now decline to undertake this task because the concept of trust has now grown beyond its original function. It is no longer merely a notion of legal dogma having an explanatory and organisational purpose. Trust has become a constituent element of numerous legal provisions.

The concept of trust (in the sense of confidence or reliance) is a recognised legal concept in many European legal systems, as well as in EU law. In civil law, not only has it been adopted as a constituent element of legislative provisions,[90] it also makes an appearance in numerous other contexts.[91] Building on the groundwork laid by Claus Wilhelm Canaris

[87] Rodi commented on the management of the crisis at the EU level. *See* Michael Rodi, *Machtverschiebungen in der Europäischen Union im Rahmen der Finanzkrise und Fragen der demokratischen Legitimation*, 70 Juristen Zeitung 737 (2015). Heun and Thiele have commented on the limits of Art. 125 TFEU. *See* Werner Heun & Alexander Thiele, *Verfassungs- und europarechtliche Zulässigkeit von Eurobonds*, 67 JURISTEN ZEITUNG 973, 978 (2012).

[88] Johannes Köndgen, Selbstbindung ohne Vertrag 114 (1981) ("One should dispense with the application of a legal concept once it ceases to adequately function as a classification tool and tends to result in the making of erroneous inferences in day-to-day practice.") (authors' translation). Several other commentators have also been critical of the ubiquitous nature of trust if defined pursuant to the law. *See* Christian von Bar, *Vertrauenshaftung ohne Vertrauen. — Zur Prospekthaftung bei der Publikums-KG in der Rechtsprechung des BGH*, 12 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT 476, 490 (1983); Klaus J. Hopt, *Nichtvertragliche Haftung außerhalb von Schadens- und Bereicherungsausgleich - Zur Theorie und Dogmatik des Berufsrechts und der Berufshaftung*, 183 ARCHIV FÜR CIVILISTISCHE PRAXIS 608, 639 (1983); Eduard Picker, *Positive Forderungsverletzung und culpa in contrahendo — Zur Problematik der Haftungen „zwischen" Vertrag und Delikt*, 183 ARCHIV FÜR CIVILISTISCHE PRAXIS 369, 418 (1983); FLEISCHER, *supra* note 24, at 420.

[89] Canaris responded to the criticism. *See* Claus-Wilhelm Canaris, *Schutzgesetze - Verkehrspflichten – Schutzpflichten, in* FESTSCHRIFT LARENZ 27, 105 (Gotthard Paulus *et al*. eds., 1983); Claus-Wilhelm Canaris, *Die Schadensersatzpflicht der Kreditinstitute für eine unrichtige Finanzierungsbestätigung als Fall der Vertrauenshaftung*, FESTSCHRIFT SCHIMANSKY 43, 53 (Norbert Horn *et al.* eds., 1999); Claus-Wilhelm Canaris, *Die Vertrauenshaftung im Lichte der Rechtsprechung des Bundesgerichtshofs*, *in* 50 JAHRE BUNDESGERICHTSHOF – FESTGABE AUS DER WISSENSCHAFT 129, 191 (Canaris *et al*. eds., 2000).

[90] In Section 122(1), Section 179(2) and the second clause of Section 311(3) of the German Civil Code (*Bürgerliches Gesetzbuch* – BGB).

[91] Mülbert and Sajnovits have commented on aspects of German law. *See* Peter O. Mülbert & Alexander Sajnovits, *Vertrauen und Finanzmarktrecht*, 2 ZEITSCHRIFT FÜR DIE GESAMTE PRIVATRECHTSWISSENSCHAFT (ZfPW) 1, 16 (2016). Atiyah have commented on the common law principle of "reliance" in this context. *See* Patrick S.

the discrete legal concept of "liability based on the principle of reliance" has become established in German law.[92] Subject to some qualification and various shifts in emphasis, it has also found its way into Swiss,[93] Austrian,[94] and Portuguese law.[95] Trust is a material factor in establishing pre-contractual liability in all Continental European legal systems, quite irrespective of whether these recognise a discrete legal concept of liability based on the principle of reliance.[96]

The fundamental public law principle that enforces reliance or, more concisely, the principle of reliance, is also an established general principle of EU law, although it is considered by the CJEU to be a by-product of the application of the principle of legal certainty.[97] In substantive terms, this principle stipulates that citizens must be able to rely on the continued application of the governmental regulations that govern their conduct. By virtue of the developments in EU law in this regard, the public law principle of reliance has also had an influence on legal developments in Member States that previously did not recognise the application of any such principle.[98]

The importance of the concept of trust with regard to the rules governing liability for securities prospectuses and non-disclosure of capital markets information is of particular interest in the present context. Numerous EU Member States have introduced specific legislation defining constituent elements of liability for securities prospectuses,[99] while in others the issue of liability in connection with inaccurate

---

Atiyah, *Promises, Obligations, and the Law of Contract*, 94 THE LAW QUARTERLY REVIEW 193 (1978). Lindsay has written about the implied term of trust and confidence. *See* HMJ Lindsay, *The Implied Term of Trust and Confidence*, 30 INDUSTRIAL LAW JOURNAL 1-16 (2001). Goetz and Scott have commented on the relevant US contract law. *See* Goetz & Scott, *supra* note 14, at 1261. *See also* Williamson, *supra* note 15, at 453. MacNeil has written in regard to relational contract theory. *See* Ian Roderick MacNeil, *Whither Contracts?*, 21 JOURNAL OF LEGAL EDUCATION 403 (1969). *See* Jürgen Oechsler, *9. Wille und Vertrauen im privaten Austauschvertrag - Die Rezeption der Theorie des Relational Contract im deutschen Vertragsrecht in rechtsvergleichender Kritik*, 60 RABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALS PRIVATRECHT 91, 93 (1996).

[92] *See* Mülbert & Sajnovits, *supra* note 91, at 20.

[93] Wolfgang Wiegand, *Die Canaris-Rezeption in der Schweiz - Vertrauenshaftung und „einheitliches gesetzliches Schuldverhältnis" im Schweizer Recht, in* 2 FESTSCHRIFT CANARIS 881-896 (2007); PETER LOSER, DIE VERTRAUENSHAFTUNG IM SCHWEIZERISCHEN SCHULDRECHT (2006).

[94] Higher Commercial Court (*Oberhandelsgericht* – OHG) of Vienna, judgment of 16 December 2014, file no. 4 Ob 155/14v.

[95] *See* Manuel A. Carneiro da Frade, *Die Zukunft der Vertrauenshaftung oder Plädoyer für eine „reine" Vertrauenshaftung, in* 1 FESTSCHRIFT CANARIS 99 (2007) (with further references).

[96] HEIN KÖTZ, EUROPÄISCHES VERTRAGSRECHT 10 (1st ed. 1996).

[97] Fundamental Westzucker, Case 1/73, [1973] ECR 723. Wischmeyer has written about the concept of trust in EU law. *See* Wischmeyer, *supra* note 14, at 350.

[98] This is true particularly in the UK and to some extent in France. *See* Gunnar Folke Schuppert, *Public Law: Towards a Post-National Model, in* GERMANY, EUROPE AND THE POLITICS OF CONSTRAINT 109, 123 (Kenneth Dyson & Klaus Goetz eds., 2003).

[99] For example, Germany, the U K, Greece, Ireland, Austria and Portugal. In addition, also the US and Switzerland. *See* ESMA, Comparison of Liability Regimes in Member States in Relation to the Prospectus

disclosure in securities prospectuses is governed by general instruments of civil law.[100] In many legal systems, claims for damages are limited to the damage or loss incurred by the claimant *in reliance upon* the correctness/completeness of the information contained in the securities prospectus in question, although the precise extent of the damage or loss that is eligible for compensation (expectation damages or reliance damages) may vary greatly.[101] Liability for non-disclosure of capital markets information in the form of the publication of inaccurate ad hoc notifications or the failure to publish such notifications has become established in numerous Member States, despite the fact that Directive 2003/6/EC on insider dealing and market manipulation (the Market Abuse Directive) and now Regulation (EU) No 596/2014 on market abuse (the Market Abuse Regulation – the MAR) neither provide for the imposition of penalties for breaches of the ad hoc disclosure obligation under civil law, nor (explicitly[102]) require the establishment of corresponding rules governing liability by the Member States.[103] The crucial element in establishing causation and, thus, liability, as well the extent of the damage or loss that is eligible for compensation, is once more reliance on the part of the individual claimant. In the English legal system, for example, Section 90a of the Financial Services and Markets Act 2000 (the FSMA), in conjunction with Paragraphs 3(1) and 4(a) of Schedule 10A thereto, recognises liability claims only where the investor suffering loss effects the disposals resulting in that loss "in reliance on the information in question."[104]

Directive, 2013, ESMA/2013/619, *available at* https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-619_report_liability_regimes_under_the_prospectus_directive_published_on_website.pdf. *See also* KLAUS J. HOPT & HANS-CHRISTOPH VOIGT, PROSPEKT- UND KAPITALMARKTINFORMATIONSHAFTUNG 44 (2005).

[100] Belgium, France, Luxembourg, Italy, the Netherlands and Spain. *See* ESMA, Comparison of Liability Regimes in Member States in Relation to the Prospectus Directive, 2013, ESMA/2013/619, *available at* https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-619_report_liability_regimes_under_the_prospectus_directive_published_on_website.pdf. *See also* HOPT & VOIGT, *supra* note 99, at 44; NIAMH MOLONEY, EU SECURITIES AND FINANCIAL REGULATION 121 (3rd ed. 2014).

[101] *See* ESMA, Comparison of Liability Regimes in Member States in Relation to the Prospectus Directive, 2013, ESMA/2013/619, p. 12, *available at* https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-619_report_liability_regimes_under_the_prospectus_directive_published_on_website.pdf. *See also* HOPT & VOIGT, *supra* note 99, at 87.

[102] Tountopoulos has commented on the "principle of effectiveness" under EU law and the duty of Member States to provide private enforcement mechanisms pursuant to that principle. *See* Vassilios Tountopoulos, *Market Abuse and Private Enforcement*, 11 EUROPEAN COMPANY AND FINANCIAL LAW REVIEW 297, 315 (2014). *See also* Iain MacNeil, *Enforcement and Sanctioning*, *in* THE OXFORD HANDBOOK OF FINANCIAL REGULATION 280-306 (Niamh Moloney *et al*. ed., 2015); Dörte Poelzig, *Private enforcement im deutschen und europäischen Kapitalmarktrecht*, 44 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT 801-848 (2015); Christoph H. Seibt, *Europäische Finanzmarktregulierung zu Insiderrecht und Ad hoc-Publizität*, 177 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 388, 424 (2013); Klaus Ulrich Schmolke, *Private Enforcement und institutionelle Balance*, 19 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT 721, 723 (2016).

[103] Belgium, Germany, the UK, France, Greece, Italy, Luxembourg, the Netherlands, Austria, Portugal and Spain. In addition, also Switzerland and the US. *See* HOPT & VOIGT, *supra* note 99, at 114.

[104] *See* Dirk A. Verse, *Zur Reform der Kapitalmarktinformationshaftung im Vereinigten Königreich*, 76 RABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALS PRIVATRECHT 893, 916 (2012).

D. Shaping Trust with Financial Markets Law

I. Dependency on Trust in the Financial Markets Context

The great significance of trust for the functioning of the various markets comprising the financial markets –capital markets, money markets, and the foreign exchange market – is a consequence of the singular features of the goods and market structures involved.

In the financial markets context *legal interests* taking the form of promises of future cash flows are issued (primary market) and traded (secondary market).[105] The present value of those interests will depend, on the one hand, on the future ability and willingness of the issuer of the financial security in question to meet its obligations and, on the other hand, on the evaluation of the promised cash flows. Unlike real assets, which are routinely amenable to physical testing for quality assurance purposes, both of these factors can only be determined by means of a – prognostic – evaluation of all of the relevant information. Therefore, all of the factors that are of material importance for setting the price of a financial product are contingent upon future developments and as such they are rife with uncertainty. Trading legal interests on the financial markets involves a substantial element of trust.[106]

In addition, the ability of financial products (as products of the operation of law) to achieve to foundational functions of markets is contingent upon the existence of special trading, depository, and clearing and settlement mechanisms. The first of these foundational functions is that the market must facilitate the realisation of high turnover rates. This is a key requirement for the attainment of the desired market depth. The second of these foundational functions is that the market must generate liquidity, as an essential sign of quality, on the relevant secondary markets. These are provided, by virtue of the *anonymity* of trading activities, by multilateral market structures such as stock markets and multilateral trading facilities (MTFs), which facilitate business dealings between large numbers of participants. In addition, all market segments require clearing and settlement mechanisms that strive to ensure that all liabilities of the (anonymous) market participants are discharged within the shortest possible period of time and with the highest possible levels of security in place. These structures require market participants to place considerable trust in several elements: (1) the financial soundness; (2) the professionalism and fairness of the other (anonymous) participants; (3) the technical infrastructure for trading, clearing, and settlement activities; and (4) the appropriateness of the institutional (legal) framework governing the establishment of these markets.

---

[105] Sapienza, *supra* note 48, at 30 ("Financing is nothing but the exchange of a sum of money today for a promise to return more money in the future."); Guiso *et al.*, *supra* note 34, at 2558; Loughrey, *supra* note 2, at 52; Natalie Gold*, Trustworthiness and Motivations, in* THE OXFORD HANDBOOK OF FINANCIAL REGULATION, *supra* note 5, at 141.

[106] Sapienza, *supra* note 48, at 30 ("trust-intensive contracts"); Shapiro, *supra* note 33, at 628; Llewellyn, *supra* note 61, at 336.

II. Object of Trust

1. Financial Soundness of Market Actors

Investors' ability to trust in the financial soundness, i.e. the (future) solvency, of banks is of fundamental importance for the functioning of the financial markets. Investors also must be able to trust in the financial soundness of insurance companies, investment funds, central counterparties, central securities depositories, and operators of regulated markets. Finally, investors also must be able to trust in other major and even systemically significant financial market actors.

2. Professionalism of Market Actors in Upholding the Interests of Third Parties

The professionalism, i.e. expertise and integrity, of market actors constitutes a highly significant object of trust, to some extent in conjunction with their financial soundness and to some extent quite independent thereof. To the extent that the activities of market actors also serve the interests of third parties – customers, other market actors or even the capital markets community – the trust placed in their professionalism will no longer be of relevance solely from the perspective of their own economic success, rather it will also be of interest from a macroeconomic standpoint. This will particularly apply to the activities of groupings of market actors.

2.1 Financial Intermediaries

The professionalism of financial intermediaries constitutes a fundamental object of trust in the context of the provision of investment advisory services, particularly in the retail customers segment. Private investors who are unable to place such trust in their personal investment advisers and the latter's underlying sales organisations – banks, providers of securities-related services – will find it considerably more difficult, if not impossible, to gain access to many financial products.[107]

2.2 Market Infrastructure Managers

In the case of organised trading venues as a central component of developed financial markets, the professionalism of the market operators constitutes a major object of trust for the use of the services of those trading venues. It is incumbent upon operators to create an institutional framework in the form of a system that combines technical and legal aspects, and that is structured in accordance with statutory and/or contractual requirements. This should enable the individual to place trust in the functioning of that system without necessarily grasping the details of its mode of operation and certainly without having any more extensive control mechanisms at his or her disposal.[108] This

[107] Peter O. Mülbert, *Anlegerschutz und Finanzmarktregulierung – Grundlagen*, 177 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 160, 172 (2013); JOHN ARMOUR *ET AL.*, PRINCIPLES OF FINANCIAL REGULATION 226 (2016).

[108] *See* Sapienza & Zingales, *supra* note 3, at 124.

involves the establishment of an IT structure as well as a body of rules and regulations that, for example, permits measures to be taken to absorb the impact of any market turbulence (interruption of trading) and precludes the use, for example in the high-frequency trading context, of trading techniques that pose a threat to the system ("flash crashes"). In addition, the rules governing the organisation of the market intended to facilitate the creation of highly liquid markets provide for the possibility of business dealings on an anonymous basis. This explains the necessary shifting of the object of trust in this context from the personal sphere, i.e. the individual counterparty, to the appropriateness of the bodies of rules and regulations created by professional market operators.

The prompt and secure clearing and settlement of business dealings is likewise of great importance for market participants. This is manifestly the case for trades conducted on an anonymous basis. Clearing and settlement systems that reduce the risk of any losses increase investors' ability to place their trust in the settlement of the transactions in question by shifting the focus of that trust from the individual counterparty to the clearing and settlement system itself. This is demonstrated particularly vividly in cases involving a central counterparty (CCP) who assumes the role of "middleman" between the two parties and provides a special guarantee for the settlement of the transaction in question. Here, the object of trust is the professionalism and financial soundness of the central counterparty.

2.3 Producers of Information and Systems for the Dissemination of Information

Information will only constitute an object of trust where it can be ascribed to a specific producer of information. It will therefore be the latter's professionalism, i.e. the appropriateness and correctness of the process of information production implemented, that will constitute the actual object of trust. The position with regard to systems for the supply of information prescribed by legislation or voluntarily established by private stakeholders (media) is very similar, with market participants being required to place their trust in the integrity of operators of systems for the dissemination of information. This, for example, would promote trust that the information fed into such systems will then be disseminated in a proper manner.

3. Fairness of Market Participants

The ability of investors to place their trust in the fairness of the other market participants is generally considered to constitute an essential condition for willingness on their part to supply the financial markets with liquidity.[109] The object of trust with regard to fair market conduct is the expectation that the other market participants will not exert improper influence over the functioning of the financial markets (market manipulation) or abuse their position in order to secure particular advantages for themselves (insider trading).

[109] *See* Mülbert, *supra* note 107, at 184 (with further references).

4. Price-setting in Organised Markets

In the case of legal interests, the market price will play a central role for information purposes in that it may be presumed, on the basis of the (semi-strong version of the) efficient capital market hypothesis (ECMH), to reflect all of the publicly available information at a given time.[110] Subject to this requirement, individual trading participants may, in reliance upon the proper ascertainment of the market price, save themselves the expense of procuring and processing their own information and, as rational (retail) investors, should even be able to dispense with considering and evaluating individual pieces of information.[111]

The object of trust with regard to the market price is a special case insofar as the information concerned cannot be ascribed to a particular person or organisation. Instead, it constitutes the product of a price-setting system that only lends itself to being neatly reduced to an interplay of supply and demand at a very superficial level. Rather, the object of trust relates to the proper functioning of a complex price-setting system that is contingent on all of the market actors involved in the setting of prices conducting themselves in a manner that complies with the applicable rules and regulations, on the proper functioning of all technical systems, and on those actors having an influence on supply and/or demand also conducting themselves appropriately.

III. Improvements in the Basis for Trust: Overview

1. Financial Soundness of Market Participants

The regulation of the banking sector – capital adequacy, liquidity, and leverage ratio requirements (prudential supervision) supplemented by increasingly detailed requirements as to the institutions' risk management and corporate governance procedures – is intended to increase the willingness of market participants, in particular other banks acting in the capacity of participants in the inter-bank markets, to place their trust in the financial soundness and stability of banks and thus the banking system as a whole.[112] Currently, the key documents at the international level are Basel I-III,[113]

---

[110] Fama contributed Groundbreaking work on the subject. *See* Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 JOURNAL OF FINANCE 383-417 (1970). Gilson and Kraakman have addressed this from a legal perspective. *See* Ronald J. Gilson & Reinier Kraakman*, The Mechanisms of Market Efficiency*, 70 VIRGINIA LAW REVIEW 549-643 (1984). The same authors have provided arguments in defense of the efficient capital markets hypothesis (ECMH) in light of the doubts cast upon its validity in the wake of the financial markets crisis and insights from the sphere of behavioral finance. *See* Ronald J. Gilson & Reinier Kraakman, *Market Efficiency after the Financial Crisis: It´s still a Matter of Information Costs*, 100 VIRGINIA LAW REVIEW 313-375 (2014). *See* Burton G. Malkiel, *The Efficient-Market Hypothesis and the Financial Crisis*, *in* RETHINKING THE FINANCIAL CRISIS 75-98 (Alan Blinder *et al*. eds., 2012).

[111] Lars Klöhn, *Marktbetrug*, 178 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 671, 675 (2014) (with further references).

[112] *See* Recital 12 of the CRR: "This Regulation would entail that all institutions follow the same rules in all the Union, which would also boost confidence in the stability of institutions, especially in times of stress."

[113] Moloney has written about Bassel III. *See* MOLONEY, *supra* note 100, at 379; Armour *et al., supra* note 107, at 305. Currently, the Basel Committee on Banking Supervision is in the process of finalizing further revisions

while at the EU level the CRR[114] and the CRD IV[115] transpose these international agreements into EU law.[116] With respect to the insurance sector, the pursuit of largely similar objectives at the EU level has resulted in the adoption of the Solvency II Directive,[117] which contains provisions with regard to risk management and corporate governance that are substantively similar to those contained in the aforementioned legislation regulating the banking sector.[118] In addition, very similar considerations and a similar regulatory approach with regard to risk management and corporate

---

of the Basel agreements (Basel IV) which, in part, are highly controversial between European and US regulators and supervisors. *See, e.g.,* Caroline Binham *et al.*, *Bank reform talks fail to agree loan risk measures - Basel Committee likely to miss year-end deadline for securing agreement on rules*, FINANCIAL TIMES (Nov. 30, 2016), *available at* https://www.ft.com/content/7d2fdaca-b71d-11e6-ba85-95d1533d9a62.

[114] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012. *See* MOLONEY, *supra* note 100, at 381; EUROPEAN BANKING REGULATION (Horst Eidenmüller *et al.* eds., 2016). Very recently, the European Commission presented plans for further amendments and revisions of the CRR, in particular implementing the Basel III framework. *See* Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012, COM(2016) 850 final and Annex to the Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012, COM(2016) 850 final.

[115] Directive 2013/36/EU (fn. 93). Very recently, the European Commission presented plans for further amendments and revisions of the CRR, in particular implementing the Basel III framework. *See* Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures, COM(2016) 854 final.

[116] Several commentators have discussed the qualitative requirements as to risk management and corporate governance forming part of Pillar I of Basel III. *See* Peter O. Mülbert, *Managing Risk in Financial System*, *in* THE OXFORD HANDBOOK OF FINANCIAL REGULATION, *supra* note 5, at 364, 372; Kern Alexander, *The Role of Capital in Supporting Banking Stability*, *in* THE OXFORD HANDBOOK OF FINANCIAL REGULATION, *supra* note 5, at 334, 349. Gurlit and others have written about macro-prudential banking supervision. *See* Elke Gurlit, *Instrumente makroprudenzieller Bankenaufsicht - unter besonderer Berücksichtigung zusätzlicher Kapitalanforderungen*, 69 ZEITSCHRIFT FÜR WIRTSCHAFTS UND BANKRECHT 1217, 1257 (2015; Elke Gurlit & Isabel Schnabel, *The New Actors of Macroprudential Supervision in Germany and Europe - A Critical Evaluation*, 27 JOURNAL OF BANKING LAW AND BANKING 349-362 (2015); Ester Faia & Isabel Schnabel, *The Road from Micro-prudential to Macro-prudential Regulation*, *in* Financial Regulation – A Transatlantic Perspective 3 (Faia *et al.* eds., 2015); Brigitte Haar, *Organizing Regonal Systems, The EU Example*, *in* THE OXFORD HANDBOOK OF FINANCIAL REGULATION, *supra* note 5, 157, 174, 177; Rosa M. Lastra, *Systemic Risk and Macro-Prudential Supervision*, *in* THE OXFORD HANDBOOK OF FINANCIAL REGULATION, *supra* note 5, at 309; Armour *et al., supra* note 107, at 409.

[117] Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II). *See* Michelle Everson, *Regulating the Insurance Sector*, *in* THE OXFORD HANDBOOK OF FINANCIAL REGULATION, *supra* note 5, at 409, 432; MEINRAD DREHER, II TREATISES ON SOLVENCY (2015).

[118] Meinrad Dreher, *Die ordnungsgemäße Geschäftsorganisation der Versicherungsgruppe nach Solvency II und VAG 2016*, 69 ZEITSCHRIFT FÜR WIRTSCHAFTS UND BANKRECHT 649, 655 (2015).

governance[119] mean that certain investment funds known as undertakings for collective investment in transferable securities (UCITS),[120] alternative investment fund managers (AIFMs),[121] CCPs,[122] central securities depositories,[123] and operators of regulated markets[124] are now also subject to regulation, again at the EU level.

Counter to this trend are the trust-fostering correlative effects of statutorily prescribed collective safeguarding mechanisms, such as and in particular the deposit guarantee schemes in place in the banking industry, which have been used as a means[125] of stabilising the banking system[126] since the Great Depression. The long-term solvency of the individual institution will be supplemented by the functionality of the deposit guarantee scheme in question as the object of trust, given that a greater degree of financial soundness can be attributed to the latter as compared to a single institution due to its broader financial base. In this regard it is irrelevant whether a deposit guarantee scheme merely covers the value of deposits up to certain amount in line with the provisions of the Deposit Guarantee Schemes Directive[127] or, similar to the institutional protection schemes for the cooperative banking sector as well as savings and state banks in Germany, accord protection to the institution per se.[128] The current – and highly controversial – Commission proposal for a Regulation establishing a European Deposit Insurance Scheme aspires to the creation of an overarching guarantee scheme for the EU as a whole.[129]

---

[119] *See* Mülbert, *supra* note 116, at 374 (with further references).

[120] Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions. *See* MOLONEY, *supra* note 100, at 200.

[121] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

[122] *See, e.g.,* Art. 26 to Art. 28 of Regulation (EU) No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR).

[123] Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012.

[124] Art. 45 *et seq*. of the MiFID.

[125] Several commentators have written about deposit guarantee schemes. *See* MOLONEY, *supra* note 100, at 835; Mülbert, *supra* note 116, at 390.

[126] *See also* Mülbert, *supra* note 116, at 390.

[127] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes, in particular Recitals 3 and 7. *See* Patricia Sarah Stöbener de Mora, *Bankrecht: Neuer Kommissionsvorschlag für ein Einlagensicherungssystem*, 26 EUROPÄISCHE ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT 931 (2015). Moloney has commented on the proposal. *See* MOLONEY, *supra* note 100, at 843.

[128] *See* Mülbert, *supra* note 116, at 390.

[129] Proposal of the European Commission for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme, COM(2015)

2. Professionalism of Market Actors

2.1 Financial Intermediaries

Reinforcing trust in the conduct of financial intermediaries in the context of the provision of investment advice that is tailored to customers' individual requirements – investment advisory services, execution-only services, and also of late product issuance services – was already a central objective of the EU legislature with regard to the area of financial markets law prior to the financial market crisis. It has attracted even more attention since the crisis. The first Directive 2004/39/EC on markets in financial instruments (the MiFID I) was a cornerstone of the package of measures comprised in the Financial Services Action Plan[130] (the FSAP). It entered into force in 2004 and was expected to mark the start of a certain interval in the process of consolidation.[131] But, in the wake of the financial markets crisis, it mutated into a comprehensive programme of legislation intended to do two things. First, it would improve the protection afforded to investors. Second, according to the explicitly worded objectives of the legislation, it would also reinforce the attitude of trust on the part of investors.[132] At the EU level, the fundamental aspects of the new environment of trust-building investor protection measures have become clearly delineated in the wake of the adoption of several legislative acts, including: Directive 2014/65/EU on markets in financial instruments (the MiFID II); an associated legislative act in the form of Regulation (EU) No. 600/2014 on markets in financial instruments (the MiFIR) and the Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs). At the national level, the necessary legislation for the implementation of the MiFID II is still incomplete. The most notable change brought about by these developments may well be the extension of the scope of application of trust-building

586 final. With regard to the further development thereof, see European Economic and Social Committee, Opinion of the European Economic and Social Committee on the Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme COM(2015) 586 final – 2015/0270 (COD), ECO/393, 18 May 2016 Official Journal of the European Union C 177/21; ECB, Opinion of the European Central Bank of 20 April 2016 on a proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 806/2014 in order to establish a European Deposit Insurance Scheme (CON/2016/26), 12 July 2016, Official Journal of the European Union C 252/1. Very recently, the European Commission presented a proposal for amending the Regulation, see Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 806/2014 as regards loss-absorbing and Recapitalisation Capacity for credit institutions and investment firms, COM(2016) 851 final (*supra* notes 114 and 115).

[130] European Commission, Financial Services: Implementing the framework for financial markets: Action Plan, COM(1999)232, 11 May 1999, available at: http://ec.europa.eu/internal_market/finances/docs/actionplan/index/action_en.pdf.

[131] European Commission, Green Paper on Financial Services Policy (2005-2010) /* COM/2005/0177 final, p. 4 *et seqq.*, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52005DC0177&from=DE.

[132] Recitals 4, 5 and 39 of the Directive 2014/65/EU (*supra* note 7); Recital 2 of the Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs).

regulations. To date, the protection of investors' interests and the fostering of trust on their part has been the purview of rules governing marketing activities. In the future issuers will be called upon by law to take account of investors' interests in designing their products.

(a) Marketing: Institutions ("The bank you can trust") are subject to extensive requirements with regard to their marketing activities, in terms of both the provision of information and advisory services to customers and the execution of customer orders. General rules of conduct[133], the obligation to maintain an organisational structure aimed at preventing conflicts of interest[134] and the general prohibition against the accepting of gifts or benefits[135], in particular, are intended to ensure that such information and advisory services are provided in a professional manner. Article 19 and Article 21 of the MiFID and Articles 44 to 46 of the MiFID Implementing Directive also require the best possible execution of customer orders and contain detailed specifications to this end.

With a view to preventing the sounding of the death knell for the model of commission-based investment advisory services that has been the custom to date, Article 26 of the Commission's Delegated Directive on the MiFID imposes certain stringent requirements of form upon the acceptance of gifts or benefits. Increasing unease in the face of the conflicts of interest that arise in the context of the acceptance by financial institutions of such gifts or benefits has resulted in the emergence of an alternative in the form of so-called fee-based advisory services. The German legislature has attempted to enhance the attractiveness of this model by imposing strict requirements on the provision of "independent" investment advisory services[136] – which is also an option for institutions with suitable "Chinese wall" structures in place – and, in particular, has prohibited the receipt or retention of gifts or benefits[137]. Thus, applying these principles in the context of financial markets regulation, one would expect that the elimination of conflicts of interests inherent in the provision of commission-based investment advisory services would result in greater trust being placed in the provision of fee-based investment advisory services.

The MiFID II will introduce a number of more stringent provisions. The future of commission-based investment advice remains a hotly debated subject in the political sphere.[138] Apart from this aspect, distributors of financial products will be called upon

[133] Art. 11, Art. 17 and Art. 18 of the MiFID and Art. 27 et seqq. of the Commission's Delegated Directive on the MiFID.

[134] Art. 13 and Art. 18 of the MiFID.

[135] Art. 18 and Art. 19 of the MiFID and Art. 26 of Directive 2006/73/EC implementing Directive 2004/39/EC (the MiFID Implementing Directive).

[136] Section 31(4b) and (4c) and Section 33(3a) of the German Securities Trading Act (*Wertpapierhandelsgesetz* – the WpHG).

[137] Section 31(4c)(2) of the WpHG.

[138] The European Parliament overturned the prohibition against the provision of commission-based investment advisory services originally contained in the Proposal put forward by the Commission. Some

to subject each of their products to a specific testing and approval process, as well as continuous monitoring[139] with a view to ensuring its suitability for the target market as stipulated by the issuer and for the target customer group.[140] These duties will be in addition to their existing and largely unchanged obligations.

(b) Issues: Pursuant to the MiFID II, as a means of safeguarding the interests of investors, issuers will now be subjected to extensive obligations of a largely procedural nature under the banner of "product governance." This new legislative approach is a reflection of two factors: on the one hand, the partial misfiring of the – to date – purely marketing-based investor protection legislation and, on the other hand, the difficulties involved in substantive product regulation measures.[141] It is for this reason that the allocation of the risk of any errors of judgment to the issuer, as an intrinsic part of this approach, is proving highly attractive to the supervisory authorities.[142] Pursuant to this product governance regime, issuers are required to implement specific processes for product testing and approval, and are additionally subject to ongoing product monitoring obligations.[143] They must identify, for each individual product, a target market

members of the Parliament called this move "a catastrophe." *See EU-Parlament kippt Provisionsverbot für Finanzprodukte*, REUTERS (Sept. 27, 2012), *available at* http://www.handelsblatt.com/politik/international/mifid-ii-eu-parlament-kippt-provisionsverbot-fuer-finanzprodukte/7188012.html). After this there was some discussion as to whether the European Securities and Markets Authority (ESMA) would, in its proposals with regard to delegated (Level II) acts, introduce a "de facto prohibition against commissions", provoking a strong response on the part of the European Parliament and a number of Member States. *See* Angela Wefers, *Bundestag bindet die Finanzaufsicht; "Wir konkretisieren das Mandat der BaFin" - EU-Behörden sollen sich auf gesetzlicher Basis bewegen*, BÖRSEN-ZEITUNG (May 6, 2015), at 5.

[139] Art. 16(3)(4) of the MiFID II. *See* EBA, Final Report – Guidelines on product oversight and governance arrangements for retail banking products, EBA/GL/2015/18, Guideline 9, p. 20.

[140] Art.16(3)(5) and Art. 24(2)(2) of the MiFID II. *See* EBA, Guidelines on product oversight and governance arrangements for retail banking products, EBA/GL/2015/18, 20, *available at* https://www.eba.europa.eu/documents/10180/1141044/EBA-GL-2015-18+Guidelines+on+product+oversight+and+governance.pdf; MOLONEY, *supra* note 100, at 796; Niamh Moloney, *Regulating the Retail Markets*, in The Oxford Handbook of Financial Regulation, *supra* note 5, at 736, 761; Petra Buck-Heeb, *Der Product-Governance-Prozess*, 179 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 782, 804 (2015).

[141] Mülbert has noted that more extensive regulation of products was rare outside of the fund context. *See* Mülbert, *supra* note 107, at 198; Buck-Heeb, *supra* note 140, at 789.

[142] The European Banking Authority (EBA) has accordingly stipulated, citing the fostering of trust as one of the grounds for this stipulation, that, with regard to the retail banking products falling within its area of responsibility, the competent bank supervisory authorities, i.e. including the ECB, must ensure that each of the institutions which are subject to their supervision has a product governance regime in place. *See* EBA, *supra* note 140) (This report does not address the question as to the legal grounds for the imposition of such obligations on the institutions in question.).

[143] *See* Art. 16(3) and Art. 24(2) of the MiFID II; see, furthermore, EBA (fn. 140) Guideline 5, p. 16 *et seqq*. *See* Emilios Avgouleas*, Regulating Financial Innovation,* in The Oxford Handbook of Financial Regulation, supra note 5, at 659, 681; MOLONEY, *supra* note 100, at 825; Armour *et al., supra* note 107, at 261; Niamh Moloney*, Financial market governance and consumer protection in the EU, in* Financial Regulation – A Transatlantic Perspective 221, 237 (Ester Faia *et al.* eds., 2015); Buck-Heeb, *supra* note 140, at 782; Katja Langenbucher,

comprising a target customer group whose requirements, singular features and conceptions correlate with the attributes of the product in question, as well as carrying out scenario analyses and stress tests. Issuers must also tailor their marketing strategies to their target markets.

With regard to the highly diverse manifestations of the securitisation of receivables (ABSs) and stocks, which are considered to have been one of the main causes of the financial markets crisis,[144] the EU has applied one of the lessons learned from the crisis. Some years ago it began to impose stringent requirements on the financial institutions involved in such securitisation activities in the capacity of originators or sponsors. This was meant to encourage investors to place their trust in such instruments.[145] Institutions participating in such transactions must themselves retain at least 5 % of the issued securities and must at all times be aware of all of the relevant, material data pertaining to the creditworthiness and performance of the individual underlying receivables (the look-through approach). Given that the hopes for a revival of the securitisation market have to date remained unfulfilled, the creation of the European Capital Markets Union (CMU) is intended to improve the framework conditions for (CMU) securitisation transactions by means of the implementation of higher standards. The new standards would particularly apply to the transparency and coherence of securitisation transactions. The European Commission, in its recently released Action Plan on Building a Capital Markets Union, explicitly placed this objective in context as a measure for fostering trust.[146]

Anlegerschutz - Ein Bericht zu theoretischen Prämissen und legislativen Instrumenten, 177 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 679, 698 (2013).

[144] *See* Rob Nijskens & Rolf Wagner, *Credit Risk Transfer Activities and Systemic Risk: How Banks Became Less Risky Individually but Posed Greater Risks to the Financial System at the Same Time*, 35 JOURNAL OF BANKING & FINANCE 1391-1398 (2011); Wolf Wagner & Ian W. Marsch, CREDIT RISK TRANSFER AND FINANCIAL SECTOR STABILITY, 2 JOURNAL OF FINANCIAL STABILITY 173-193 (2006).

[145] Recital 27 of (repealed) Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management. The relevant provisions are now contained in Art. 406 *et seq*. of the CRR. *See* Mülbert*, supra* note 116, at 394.

[146] See European Commission, Action Plan on Building a Capital Markets Union, COM(2015) 468 final, available at: http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf, p. 6: "[…] to build a single market for capital from the bottom up, identifying barriers and knocking them down one by one, creating a sense of momentum, and sparking a growing confidence for investing in Europe's future." See the Proposal for a Regulation of the European Parliament and of the Council laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation and amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012, COM(2015) 472 final, available at: https://ec.europa.eu/transparency/regdoc/rep/1/2015/EN/1-2015-472-EN-F1-1.PDF; Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms, COM(2015) 473 final, available at: https://ec.europa.eu/transparency/regdoc/rep/1/2015/EN/1-2015-473-EN-F1-1.PDF. See, also, European Commission, press release from 25 April 2016: Capital Markets Union: Taking stock of the progress made so far, available at: http://europa.eu/rapid/press-release_IP-16-1562_en.htm.

(c) Granting of Loans: The position will be somewhat different to the extent that banks are subjected, under the banner of "responsible lending practices,"[147] to ever more obligations in the context of the granting of loans. This will apply, for example, to the creditworthiness checks that, in the case of consumer loan agreements, must now be subject to penalty measures under liability law in accordance with the requirements of EU law[148] and, similarly, to the imposition of new obligations on mortgage lenders, commensurate with those incumbent on providers of investment advice, to provide comprehensive advice to consumers looking to take out a mortgage loan (implementation of the Mortgage Credit Directive).[149] The primary objective here is to take out of the hands of the consumer the decision as to whether to take out a loan that is actually unsuitable for his or her requirements or would even place him or her under an excessive financial burden. The fact that this is likely to reinforce consumers' willingness to trust that the loans offered to them will actually "suit" them will be a side effect of lesser importance to individuals looking to take out a loan, as their primary goal will be to secure the granting of that loan.

2.2 Market Infrastructure Managers

The system of rules and regulations capable of building trust in the stock markets is the body of securities legislation. The business processes of stock exchanges are governed by several regimes, including the German Stock Exchange Act (*Börsengesetz* – the BörsG) – or the comparable national legislation in force in other countries – and the accompanying rules and regulations of the individual stock exchange in question. They are also monitored by the commercial and securities supervisory authorities. This serves to establish sufficient confidence on the part of the investing community to persuade its members to open themselves up to the risks involved in anonymous securities trading. As compared to its predecessor, the MiFID II imposes more stringent requirements on regulated markets (stock exchanges) in Articles 48 to 52 with regard to the body of rules and regulations governing their business processes. This aims to reinforce trust on the part of investors.[150] Articles 18 to 20 contain more detailed, and in some cases more

---

[147] MARCUS ZAHN, ÜBERSCHULDUNGSPRÄVENTION DURCH VERANTWORTLICHE KREDITVERGABE (2011); Petra Buck-Heeb, *Ausklärungs- und Beratungspflichten bei Kreditverträgen - Verschärfungen durch die EuGH-Rechtsprechung und die Wohnimmobilienkredit-Richtlinie*, 15 ZEITSCHRIFT FÜR BANK- UND KAPITALMARKTRECHT 177-186 (2015); Wolfgang Servatius, *Aufklärungspflichten und verantwortungsvolle Kreditvergabe*, xx ZEITSCHRIFT FÜR IMMOBILIENRECHT 178 (2015).

[148] *But see* CJEU, judgment of 27 March 2014 – C-565/12 (LCL Le Crédit Lyonnais SA/Fesih Kalhan), NJW 2014, 1941 (regarding the application of the Consumer Credit Directive (Directive 2008/48/EC on credit agreements for consumers)). Herresthal offered an opposing view. *See* Carsten Herresthal, *Unionsrechtliche Vorgaben zur Sanktionierung eines Verstoßes gegen die Kreditwürdigkeitsprüfung*, 25 EUROPÄISCHE ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT 497-500 (2014) (denying the existence of any duty in this regard).

[149] Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010. *See, e.g.,* Section 511 of the BGB, as amended by the German Act Implementing the Mortgage Credit Directive (*Gesetz zur Umsetzung der Wohnimmobilienkreditrichtlinie*). *See* Buck-Heeb, *supra* note 147, at 184.

[150] See Recitals 4 and 133 of the MiFID II.

extensive, stipulations applicable to the operators of MTFs and organised trading facilities (OTFs) within the meaning of Article 4(1)(22) thereof.

Some light has been shed on the extent to which organised marketplaces will be deemed to bring about the stabilisation and establishment of an attitude of trust on the part of investors by a provision newly included in the MiFIR in implementation of the lessons learned from the financial markets crisis. Article 28 thereof stipulates that certain derivatives must be traded on regulated markets, MTFs or OTFs as a means of preventing the occurrence of market distortions in the case of over-the-counter (OTC) trading in derivatives in the future.

The institutionalisation of clearing activities at the EU level pursuant to regulatory requirements enshrined in Regulation on OTC derivatives, central counterparties and trade repositories (the EMIR)[151] requires market participants to use the services of a central counterparty (CCP) in the context of the settlement and clearance of certain derivatives contracts, as EMIR uses a three-prong approach. This results in a shifting of the object of trust from the individual market counterpart to numerous new and – in view of the volume of derivatives in question – even systemically relevant actors. The EMIR attempts to counterbalance this development by imposing particularly stringent requirements as to the professionalism and organisational structures of the CCPs involved.[152]

2.3 Information Producers and Systems for the Dissemination of Information

Ensuring the quality of information provided is of particular concern to the legislature in the context of capital markets legislation.

In the primary market, issuers enjoy a natural monopoly and have considerable information at their disposal.[153] But other market participants have few means of verifying the correctness of information disclosed to them. The legislature has thus established a basis for the standardised production and dissemination of information, in the form of the various constituent elements of the obligation to publish a securities prospectus,[154] with explicit rules governing the production of information in terms of

[151] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories. *See* Mülbert, *supra* note 116, at 391; Guido Ferrarini & Paolo Saguato*, Regulating Financial Market Infrastructures, in* THE OXFORD HANDBOOK OF FINANCIAL REGULATION, *supra* note 5, at 568, 584.

[152] *Supra* D.III.1.

[153] *See* Johannes Köndgen*, Effizienzorientierung im Kapitalmarktrecht?, in* EFFIZIENZ ALS REGELUNGSZIEL IM HANDELS- UND WIRTSCHAFTSRECHT 100, 129 (Holger Fleischer & Daniel Zimmer eds., 2008) ("a clear case of information asymmetry") (authors' translation). *See also* Holger Fleischer, Empfiehlt es sich, im Interesse des Anlegerschutzes und zur Förderung des Finanzplatzes Deutschland das Kapitalmarkt- und Börsenrecht neu zu regeln?, Gutachten F zum 64. DJT 2002, F 23.

[154] Article 3(1) of the Prospectus Directive.

the reasons therefor and the subject matter, volume, and extent thereof.[155] In November 2015 the Commission submitted a corresponding Proposal for a Prospectus Regulation,[156] which in the future will also ensure the maximum degree of harmonisation by means of directly applicable legislation in this context. These norms do not provide any guarantee as to the reliability of specific pieces of information. After all, national supervisory authorities are not under any obligation to verify the content of securities prospectuses. In fact, they will limit themselves to checking their completeness from a technical standpoint and their coherence in substantive terms. Nevertheless, the norms do provide an initial foundation for generating trust in the issuers of such prospectuses.[157]

In the secondary market, investors interact with other investors who will ideally be able to rely on historical market price data in deciding whether to invest or divest. Obligations on issuers to disclose information to the market in the form of so-called periodic reporting – annual financial reports[158] and half-yearly financial reports[159] –, as well as the related ad hoc disclosure obligation[160], supplement the informational value of market price data and enable it to be adjusted in line with current information.[161] Statutory requirements as to the content of disclosure apply not only in the financial reporting context[162] but also to the content of *ad hoc* notifications: The national supervisory authorities monitor compliance with these requirements; any non-compliant conduct will be subject to extensive (administrative and even) civil law penalties.

Marketing to retail customers is subject to extremely detailed requirements as to form and content, with key information documents for packaged retail and insurance-based investment products coming into play here.[163]

Finally, even information that has been produced on a voluntary basis will, as an object of trust, be subject to legal regulation. This is particularly the case with regard to the regulation of rating agencies at the EU level pursuant to the Credit Rating Agencies

---

[155] *See* Shapiro, *supra* note 33, at 637.

[156] Proposal for a Prospectus Regulation on the prospectus to be published when securities are offered to the public or admitted to trading (COM(2015) 583 final.

[157] Shapiro, *supra* note 33, at 637). In addition, the reputation of individual issuers, which bears no relation to the statutory requirements imposed by the law governing securities prospectuses, will play a decisive role in establishing trust, particularly in the primary market.

[158] *Article 4 of the Transparency Directive*.

[159] *Article 5 of the Transparency Directive*.

[160] *Article 17 of the MAR*.

[161] Efficient capital market hypothesis; *supra* fn. 112.

[162] *Articles 4(2) and Art. 5(2) of the Transparency Directive*.

[163] Articles 5 to 12 of the PRIIPs Regulation.

Regulation.[164] The Credit Rating Agencies Regulation provides for the application of quality standards to rating agencies, their internal structures, the production of information by such entities, the monitoring of compliance with these stipulations by the ESMA at the centralised EU level, and the imposition of penalties for non-compliance at the Member State level.

3. Fairness of Market Participants

With a view to encouraging market participants to place trust in the fairness of other market participants – and thus in the fairness of the market environment per se – Article 15 of the MAR essentially prohibits all forms of market manipulation while permitting only the implementation of share price stabilisation and market management measures to a limited extent.[165] This is supplemented by the prohibition against insider trading pursuant to Article 14 of the MAR, which extends to activities other than insider trading. This differs from the approach taken in the US. In the EU such activities will be disallowed even where the contractual party in possession of the insider information discloses it to the other contractual party.[166] Doubts are occasionally voiced with regard to whether such a harsh prohibition against insider trading is in fact justified, on the grounds that it undermines the efficiency of the dissemination of market price data because such information only becomes available to market participants after a considerable delay.[167] Were investors in fact to express a preference for true fairness in the markets,[168] they would also place greater trust in the functioning of those markets. Not only considerations of equity argue in favour of trust-building institutional mechanisms for upholding fairness; this approach also makes good economic sense.[169]

4. Price-setting in Organised Markets

Placing trust in the functioning of price-setting processes in organised markets is a process that is based on highly complex considerations. The establishment and reinforcement of such a basis for trust by means of legislation/regulation thus calls for

---

[164] Regulation (EU) No 462/2013, *supra* note 7. *See* MOLONEY, *supra* note 100, at 637. Schroeter has commented on ratings in general. *See* ULRICH G. SCHROETER, RATINGS – BONITÄTSBEURTEILUNGEN DURCH DRITTE IM SYSTEM DES FINANZMARKT-, GESELLSCHAFTS- UND VERTRAGSRECHTS (2014). Black has written about the role of gatekeepers. *See* Julia Black, *The Role of Gatekeepers*, *in* THE OXFORD HANDBOOK OF FINANCIAL REGULATION, *supra* note 5, at 254.

[165] Art. 5 of Regulation (EU) No 596/2014 (fn. 7).

[166] Art. 8 of Regulation (EU) No 596/2014 (fn. 7).

[167] *See* Klaus J. Hopt, *Grundsatz- und Praxisprobleme nach dem Wertpapierhandelsgesetz*, 159 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 135, 142 (1995); Klaus J. Hopt*, Europäisches und deutsches Insiderrecht,* 20 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT 17-73 (1991); Fleischer*, supra* note 153, F28; Harry McVea*, Supporting Market Integrity, in* THE OXFORD HANDBOOK OF FINANCIAL REGULATION, *supra* note 5, at 631, 639; HENRY G. MANNE, INSIDERTRADING AND THE STOCKMARKET (1966).

[168] *See* Mülbert, *supra* note 107, at 184 (with further references).

[169] *See id*. at 172; PETER O. MÜLBERT, AKTIENGESELLSCHAFT, UNTERNEHMENSGRUPPE UND KAPITALMARKT 119 (2nd ed. 1996).

a brief analysis of a number of precepts and prohibitions. Three factors, in particular, are of material importance: quality of the price-setting procedures; transparency; and freedom from manipulation.

4.1 Quality of Price-Setting Procedures

A prerequisite for (efficient) market price setting procedures is an effective institutional framework[170] that ensures/facilitates the brokerage of business dealings. The primary means of ensuring the quality of the price-setting system within this institutional framework, which will be characterised by the lowest possible spreads and an adequate rendering of the order situation, is the establishment of rules governing the quoted stock exchange price. This quoted stock exchange price will additionally serve as a reference point from a legal perspective for the monitoring and supervision of price-setting activities in the securities trading context.[171] The goal of the legal stipulations in this regard will be the maintenance of formally realistic market and share prices.[172]

4.2 Transparency

Furthermore, capital markets law strives, for example by means of the imposition of transparency and notification obligations (e.g. Articles 17 and 19 of the MAR) as well as other provisions regulating conduct (e.g. Articles 9 et seqq., 17 and 18 of the Transparency Directive[173]), to ensure the provision of as much as possible, if not all, of the information that is of relevance for price-setting purposes.[174] This fuller-spectrum of information can then be taken into account as publicly available information in the price-setting context.

4.3 Freedom from Manipulation

Finally, the prohibition against manipulation of the market (price) pursuant to Article 15 of the MAR aims to ensure the freedom from manipulation of the market environment and thus also the freedom from outside influences of the market price-setting procedures. It is therefore not surprising to find the MAR also advocating in favour of reinforcing trust in the market,[175] an approach that counters not only indirect manipulation of market prices but also the vulnerability to manipulation of the market

---

[170] Mülbert, *supra* note 107,at 183; Köndgen, *supra* note 153, at 105.

[171] Beck has written about the German law. *See* Heiko Beck, *Section 24 BörsG*, *in* KAPITALMARKTRECHTS-KOMMENTAR para. 1 (Eberhard Schwark & Daniel Zimmer eds., 4th ed. 2010).

[172] *See id.*

[173] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (consolidated text).

[174] Mülbert has commented on transparency and risk management. *See* Mülbert, *supra* note 116, at 386.

[175] Recital 2 of the MAR: "Market abuse harms the integrity of financial markets and public confidence in securities and derivatives."

environment as a whole and that is illustrated by the case of the manipulation of the LIBOR/EURIBOR reference rates.[176]

In addition to the quoted stock exchange price, prices in general also function in the financial markets context as public goods, with at best only rudimentary legal requirements as to the corresponding price-setting mechanism existing to date. This applies, for example, to the determination of the LIBOR and EURIBOR rates, which serve as reference values for numerous financial instruments and also mortgage loans,[177] as well as the calculation of foreign exchange rates. The cases of manipulation involving (very) small groups of individuals from major investment banks ("rogue traders") that have come to light in recent years have prompted the EU to introduce strict rules to regulate the procedures for the determination of prices and the supervision of such procedures,[178] and to place these in context as measures aimed at reinforcing trust in the financial markets.[179]

E. Conclusion

Trust appears to be a central concept in the context of financial markets law and in the legal system as a whole. By drawing a distinction between trust in the law, trust through the operation of law, and trust as defined by the law, we hope we have shed light on the numerous manifestations of this concept, as well as the diverse contexts in which it applies.

Trust in the law references the fact that even a perfect legal system would not render trust entirely superfluous and, above all, that trust in the legal system, and thus in the appropriateness and fairness of its legal rules, constitutes a central mechanism for reducing the complexity of life in modern societies.

Trust through the operation of law refers to the effect of legal rules in shaping attitudes of trust and, thus, the fact that this function (such as reinforcing or undermining trust that is placed in institutions and systems) is an important objective of legal policy

[176] The manipulation of benchmarks was subsequently included as a constituent element of the prohibitions against market manipulation. See Art. 12(1)(d) of the MAR.

[177] *See* MOLONEY, *supra* note 100, at 744-745 (VIII.8.2.3).

[178] Regulation (EU) No 1066/2016 of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts. *See* Malte Wundenberg*, Regulierung von Benchmarks, in* EUROPÄISCHES KAPITALMARKTRECHT sections 30 and 31 (Rüdiger Veil ed., 2nd ed. 2014); Gerald Spindler, *Der Vorschlag einer EU-Verordnung zu Indizes bei Finanzinstrumenten (Benchmark-VO)*, 27 JOURNAL FOR BANKING LAW AND BANKING 165-176 (2015).

[179] Recital 1 of Regulation (EU) No 1066/2016 of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts: "Failures in, or doubts about, the accuracy and integrity of indices used as benchmarks can undermine market confidence, cause losses to consumers and investors and distort the real economy. It is therefore necessary to ensure the accuracy, robustness and integrity of benchmarks and of the benchmark determination process."

measures, most particularly in the context of financial markets law but also in other areas.

Finally, *trust as defined by the law* takes account of the numerous challenges of legal dogma associated with the position that established law accords the subject. A particularly illustrative example is provided by the rules governing liability for non-disclosure of capital markets information.

The enhancing of trust by means of the operation of financial markets law, in particular, has evolved into a pivotal justification for the "tsunami of regulation" ("*Regulierungstsunami*"[180]) that has occurred in the wake of the financial markets crisis. As this article shows, trust can serve as a legal concept for making sense of this flood of legislative acts and of shaping these into a coherent framework.[181] Enhancing trust by means of legislative acts[182] constitutes a legitimate objective in financial markets law due to the potential for improvements in efficiency which may be realised as a result.[183] Yet, it is by no means certain that this will also improve the stability and efficiency of the financial markets as a whole. Rather, this calls for carrying out cost-benefit analyses,[184] not only for each individual legislative act (as is the approach currently taken at the EU level[185]) but also, more comprehensively, for the entire regulatory regime governing the operation of the financial markets.[186]

---

[180] *See* Peter O. Mülbert, *Regulierungstsunami im europäischen Kapitalmarktrecht*, 176 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT 369-379 (2012).

[181] *Supra* D.

[182] *See supra* notes 7 and 8.

[183] *See supra* C.III.1.

[184] *See, e.g.,* John H. Cochrane, *Challenges for Cost-Benefit Analysis of Financial Regulation*, 43 JOURNAL OF LEGAL STUDIES 64-105 (2014); Jeffrey N. Gordon, *The Empty Call for Benefit-Cost Analysis in Financial Regulation*, 43 JOURNAL OF LEGAL STUDIES 351-378 (2014); Edward Sherwin, *The Cost-Benefit Analysis of Financial Regulation: Lessons from the SEC's Stalled Mutual Fund Reform Effort*, 12 STANFORD JOURNAL OF LAW, BUSINESS & FINANCE 1-60 (2006); Robert W. Hahn & Cass R. Sunstein*, A New Executive Order for Improving Federal Regulation? Deeper and Wider Cost-Benefit Analysis*, 150 UNIVERSITY OF PENNSYLVANIA LAW REVIEW 1482 (2002).

[185] See the impact assessments carried out by the European Commission Staff, for example Commission Staff Working Paper – Impact Assessment on CRD IV, SEC(2011) 949 final, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52011SC0949&from=EN; Commission Staff Working Paper – Impact Assessment on BRRD, SWD(2012) 166 final, available at: http://ec.europa.eu/internal_market/bank/docs/crisis-management/2012_eu_framework/impact_assessment_final_en.pdf. The Joint Research Centre of the European Commission provides statistical analyses, computation tools, and modelling support to the Commission bodies in charge of financial markets regulation, which have been used for several impact assessments carried out in the context of financial markets regulation. Binder has been critical of the use of impact assessments in the context of EU legislation. *See* Jens-Hinrich Binder*, Ring-Fencing: An Integrated Approach with Many Unknowns,* 16 EUROPEAN BUSINESS ORGANIZATION LAW REVIEW 97, 116 (2015); Jens-Hinrich Binder, *"Alternativen: Keine"? Gesetzesfolgenabschätzung in der Finanzmarktregulierung, in* FESTSCHRIFT KÖNDGEN 65, 74 (Matthias Casper *et al.* eds., 2016).

[186] *See* Douglas Elliott *et al.*, IMF Working Paper: Assessing the Cost of Financial Regulation, 2012, WP/12/233, available at: https://www.imf.org/external/pubs/ft/wp/2012/wp12233.pdf. Coates has written with regard to cost-benefit analyses in the context of US financial markets law. *See* John C. Coates, *Cost-Benefit Analysis*

of Financial Regulation: A Reply, 124 YALE LAW JOURNAL 882-1011 (2015); Eric A. Posner & E. Glen Weyl, 124 YALE LAW JOURNAL FORUM 246-262 (2015); Cass R. Sunstein, *Financial Regulation and Cost-Benefit Analysis*, 124 YALE LAW JOURNAL FORUM 263-279 (2015).