Information in the Context of Financial Markets and of Private Placements in Particular

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Abstract

There is no doubt about the decisive role that information plays in the market system. Markets need a constant flow of information, and that's why jurists have wondered whether the State should intervene or not in order to satisfy this need.

The debate on mandatory disclosure has actually been one most controversial in the field of financial markets, but it may have come to an end, because now it seems necessary to accept the opinion of those who consider indispensable a binding law.

Also, there is the need for an accurate evaluation of information, since the disclosure mechanism seems to be effective only if the operators are able to fully understand the information, but behavioral finance research shows that investors' decisions are often marked by moments of irrationality, wich lead them to inefficient choices.

There is currently no way to completely prevent such irrational tendencies, and that's why research on this issue would seem today to be sufficiently justified if it's aimed at ascertaining how this background disorder can be takled.

Meanwhile the European Union has been working on Capital Market Union, which is an ambitious project to unite the European capital markets and part of this project is dedicated to information.

EU also wants to innovate the market of private placement, ie the technique of selling financial products without going public and favoring individual negotiations with a limited number of investors. Usually small and low trust companies use private placements, whilst banks show little interest in them, so that the need to limit bank financing constitutes a sufficient reason to attempt to strengthen the private placements.

This way of financing has been increasing over time and its development is really important, also due to the undisputed centrality in the European economic system of small and medium-sized enterprises, but, if we want to achieve this goal, we need a greater harmonization of the markets active in the EU countries.

I. Information and Financial Markets

There is no doubt about the decisive role that information plays in market systems and it is also not disputed that a particularly intense debate has taken place on this issue, especially in the US; actually, as is well known, the United States have always had the most advanced financial markets, and this has allowed, in the US, the most relevant development of the doctrinal studies in

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that field. The concepts referred to below are therefore, for the most part, well known to any legal expert, so that we can certainly proceed briefly regarding these concepts. In doing so, we must first stress that the most important public need is obviously that of having an efficient market, wich is able to best allocate the resources of high trust companies, ie to the benefit of the productive structures that best enhance them. On the other hand, the market is more efficient the more it allows – and at the highest possible speed – to arrive at a correct price for the securities that are sold in it, and this result is achievable when investors have all the necessary information regarding the offered products – given that only with the right information we can make more or less accurate estimates on the value of these products – so that we can conclude that the price generated by the market expresses, ultimately, all the information available in it or, rather, the sum of opinions and choices made on the basis of this information. More specifically, those choices derive from the discrepancy between the market price and the estimated value of the specific financial instrument, and they are therefore pursued as long as the aforementioned discrepancy is not eliminated. At this point, however, two problems arise: that of ensuring the availability of all the information on the single instrument and that of being sure that such information is correctly assessed. The first objective, however, is clearly an utopia and just makes the aim of achieving the *correct price* unrealistic, with the consequent need to step back towards the achievement of a sufficiently correct price. In other words, the information given to investors will never be complete and, moreover, if this does not happen, it would be even more dangerous for two reasons. Firstly, we actually need to consider the phenomenon known as 'overload', which can also be explained by highlighting that 'more information is not better than less'.[1] In other words, it is common knowledge that a person can process only a finite amount of information at a given time; moreover, the knowledge of an excessive amount of information easily generates – and this even in the most experienced investors – overconfidence, that is to say an excessive confidence in the data available, with the result that a constant increase in the gained information is linked, before or after, with a progressive decrease in the quality of decisions made. The second problem deriving from a hypothetical situation of complete information consists, instead, in the fact that this would surely involve an absence of risk, and it is useless to underline how risk constitutes, at the end of the day, a positive element for investors, because in its absence investors should certainly renounce the advantages related to the investment,[2] that is to the profit that they hope will come from the instruments purchased. It's well known that the investor tries to 'beat the market' by focusing on its inefficiencies,[3] but if all the prices

[1] T.A. Paredes, 'Blinded by the Light: Information Overload and Its Consequences for Securities Regulation' 81 *Washington University Law Review*, 417-486, 451-452 (2003).

[2] C. Gulinello, 'Regulating Private Placements in China: A Principled Approach', 125, avalible at https://tinyurl.com/y5gmkg3n (last visited 28 May 2019).

[3] C. Angelici, 'La società per azioni - I - Principi e problemi', in A. Cicu et al eds, *Trattato*

were perfectly correct, then every speculative activity would be impracticable: as was said, 'when everyone knows the truth, no one can speculate on it',[4] even though it would also seem essential to avoid any extremes: the system, in order to work, still needs a constant and significant flow of information, and it is therefore normal that sometimes jurists have questioned whether the State should intervene or not, at the legislative level, in order to satisfy this need of information in the context of financial markets and of private placements in particular.

II. The Mandatory Disclosure

Briefly, the evoked theme is that of mandatory disclosure, that is to say one of the most controversial topics in the field of financial markets, even if more than one reason leads us to wonder if this traditional quarrel still has, today, reason to exist, or if the debate can be considered now exhausted or, at least, no more interesting. It's well known that this long-standing debate is linked to the fact that legislating in the financial sector means imposing costs relating to the production and dissemination of information. Therefore, many scholars have denied for long time the usefulness of a law that obliges companies to release information on their own structure and activity, arguing that this law would be pleonastic, since companies produce the necessary information even if not forced to do so. More precisely, in the hypothetical absence of any rules, releasing information about themselves would still be functional to the activity of high trust companies and vice versa negative for badly managed companies, so that markets would be in any case informed about the first ones but also, at the same time, warned about the dysfunctions of the others because of the lack of data on them; therefore, even if it is an expensive commodity, information would not be underproduced and this should also be proven by the fact that companies already release more information than that asked by the legislator.[5] However, this approach is questioned by those who think that mandatory disclosure is necessary. In spite of the costs borne to produce it, information is actually, by its nature, a public good, whose usefulness decreases very quickly: companies wich sustain the costs of information do not manage to fully capitalize its value, and this is paradoxically more true when the market is more efficient.[6] Recently, therefore, some scholars have argued that if there were no mandatory rules, because of the mentioned interests of broadcasters to disclose only positive information, companies would release news only as long as benefits related to the cost of the loan would not

di diritto civile e commerciale (Milano: Giuffrè, 2012), 537, fn 58.

[4] F.H. Easterbrook and D. Fischel, 'Mandatory Disclosure and the Protection of Investors' 70 *Virginia Law Review*, 682 (1984).

[5] R. Romano, 'Empowering Investors: A Market Approach to Securities Regulation' 107 *Yale Law Journal*, 237 (1997-1998).

[6] E. Macrì, *Informazioni privilegiate e disclosure* (Torino: Giappichelli, 2010), 9, fn 33.

become less significant than the costs related to the damage in terms market ranking, and that implies that in a voluntary scenario the release of information would be in suboptimal amount.[7] If we add to this that even some theoreticians of voluntarism recognize the potential benefits linked with mandatory disclosure, it seems necessary to accept the opinion of those who consider indispensable a binding law, and that is even more true in the case of the Italian system, where the market is notoriously inefficient. On the other hand, if the purpose of financial market regulation is to make markets as functional as possible, we can see that this aim is also achieved by mandatory disclosure, because through disclosure we aim to release the greatest amount of information, being aware that this increases both the liquidity of the securities and the attitude of prices to become a point of reference.[8] Furthermore, the imposition of disclosure requirements seems to satisfy the Kaldor-Hicks criterion, by reducing the overall cost of information, when the burden of production is borne by the companies, that is to say by the subjects for whom this cost is minor, since the retrieval of the data to be disclosed is obviously easier for the *intranei* than for the *extranei*. Finally, even if nothing prevents the release of information on a voluntary basis to a greater extent than asked by law, in any case this has not happened during the recent, international crisis, that is during an event related, in its genesis, to an information deficit towards institutional investors. Of course, through the legal rules it's very difficult to arrive at the aimed amount of information, since it is more probable that there will be an overproduction or an underproduction of information; but as we have said, this would also be the effect of an information regime left to the will of the issuers. After explaining this, we can also add that the proposed thoughts are channeled into a doctrinal polemic whose usefulness is now very little, because the different points of view are – and not from today – absolutely clear, and it seems that jurists should now take more care of the function – proper to legal sciences – of expressing *de iure condendo* models. Actually, this function is correctly performed only if the aforementioned models have at least a remote chance to be put into legal system in a not too wide period of time, otherwise we would create a mere intellectual theory. If this is correct, then we can not understand the *raison d'être* of pushing on the opportunity of a radical deregulation in the field of information to the markets, essentially for two reasons. The first one is that it's very difficult not to consider paradoxical a situation in which a listed company could give rise to an information blackout against investors and supervisors. The second – perhaps more significant – consists instead in the fact that the current context sees in all important legal systems the presence of a mandatory rule,[9] and above all nothing let us believe

[7] L. Enriques and S. Gilotta, 'Disclosure and Financial Market Regulation' *ECGI Working Paper Series in Law*, 18, avalaible at https://tinyurl.com/y6o897wj (last visited 28 May 2019).

[8] B. Jorgensen, J. Li and N. Melumad, 'The Economic Consequences of Selective Disclosure', 20, available at https://tinyurl.com/y6n3n5jq (last visited 28 May 2019).

[9] F. Denozza, 'La trasparenza garantita nei mercati finanziari: "prolegomeni" ad un'analisi

that this situation is going to change in the short or in the medium-long term; in other words, everything shows that the vision of those who consider indspensable the imposition of informative duties is definitively rooted at least on political level. It is then necessary to wonder whether going on feeding a debate on the need of an imperative disclosure does not represent, ultimately, an unnecessary waste of intellectual energies that would be more profitably employed if only we would agree that we can not get rid of the imposition of disclosure obligation on issuersand that we should focus our research on regulatory models that move from this assumption. One of the tasks that seems to weigh on the current generation of jurists seems to be to determine not whether, but to what extent, disclosure should be provided – as was written, '(t)he appropriate comparison is not regulation against market but one kind of regulation against another'[10] – by considering the need to protect the interest of broadcasters and therefore to create a regulatory apparatus endowed with the necessary flexibility. Furthermore, the pervasive diffusion of mandatory disclosure also shows a further meaning, which seems necessary to have in mind. As someone has pointed out, it is important to understand both the functions the financial markets can concretely carry out and what are the ideal methods of operating that should be transferred to those markets.[11] If it's therefore true that three different kinds of market are theoretically thinkable – weak, semi-strong and strong – it seems however also indisputable that the legislator prefigures, in most cases, a semi-strong environment.[12] It then becomes necessary to wonder if it's useful to propose legal theories aimed at an hypothetical market when the rules are thought to apply to a different context: elementary needs of economy and rational use of resources seem, actually, to suggest to limit ourselves to the identification of legal solutions that are characterized, basically, by the hypothesis of a semi-strong market.

III. Considerations About Behavioral Finance

Then there is the second issue – wich is the need for a correct evaluation of the released information – which is undoubtedly important, given that the disclosure mechanism would seem to be effective only if the operators are able to correctly understand the information received. Inevitably, even the debate concerning this problem has had the chance to fully develop and can now be ended without any worry: in other words, we have all the premises to take a step forward. The data from which to move, in particular, is in this case represented by the fact that the discoveries of behavioral finance can finally be considered a

costi/benefici' *Banca Impresa e Società*, 191 (2007).

[10] F.H. Easterbrook and D. Fischel, n 4 above, 673.

[11] F. Denozza, n 9 above, 182.

[12] C. Angelici, 'Su mercato finanziario, amministratori e responsabilità' *Rivista del diritto commerciale e del diritto generale delle obbligazioni*, I, 15-16 (2010).

common heritage, so that what we are waiting for are proposals that start from such discoveries and that integrate them into the traditional model, since in any case nobody denies the inestimable value of traditional models. The point is, in short, that even if it is excessive to argue that investors are almost always irrational, it is certain that they are marked by moments of irrationality;[13] on the other hand, it is sufficient to think of the *calendar anomalies*,[14] ie, how prices tend to grow on sunny days[15] and how people notoriously underestimate some information and overestimate other.[16] It seems to be clear that market actors are often irrational, and this irrationality is theoretically able to void the usefulness of the available data – given that disclosure may not be helpful to those suffering from bias[17] – to lead therefore to inefficient choices and, ultimately, to give rise to the failure of the market, given that the efficient market theory is based on rationality, ie on the premise that rational choices are made on the basis of a correct evaluation of the information released. The appropriate step would therefore consist simply in accepting that there is no way to completely fight such irrational drives. Several studies show that the market has antibodies to be activated against illogical behaviour;[18] but these reactions are most often insufficient in the short to medium term and above all so are, in most cases, the actions of information traders and, more specifically, the activities carried on by the arbitrageurs, whose work is notoriously often marked by the phenomenon of hearding. Actually, the arbitrageurs are also used to following the trend that they think is erroneous instead of facing the risk that the price does not readily coincide with what they consider as the correct value of the stock, thus putting in place a behavior that is not irrational,[19] since it's evident that it is often more convenient to follow the gregarious instinct and ride a speculative bubble rather than trying to counter it. If the foregoing conclusion is correct, then research on these issues would seem today to be sufficiently justified only if it aims to understand exactly to what extent each kind of investor gives rise to irrational behavior and also to ascertain how this *background disorder* can be fought, while the difficulty in fighting irrational elements through legal ways does not necessarily have to be seen as an insurmountable obstacle. There is no doubt about the fact that irrational investors are essentially retailers, and yet these people, especially if

[13] L.E. Ribstein, 'Fraud on a Noisy Market' *University of Illinois Law & Economics Research Paper no LE05-022*, 138, available at https://tinyurl.com/y4g2dfh6 (last visited 28 May 2019).

[14] E. Marchisio and U. Morera, 'Finanza, mercati, clienti e regole… ma soprattutto persone' *Analisi Giuridica dell'Economia*, 21, fn 8 (2012).

[15] S. Choi and A.C. Pritchard, 'Behavioral Economics and the SEC' 56 *Stanford Law Review*, 77 (2003).

[16] T. Odean, 'Volume, Volatility, Price, and Profit When All Traders Are Above Average' 53 *Journal of Finance*, 1883, 1888 (1998).

[17] S. Choi and A.C. Pritchard, n 15 above, 83.

[18] S.M. Bainbridge, 'Mandatory Disclosure: a Behavioral Analysis' 68 *University of Cincinnati Law Review*, 1023 (2000).

[19] E. Macrì, n 6 above, 3, fn 12.

they suffer from overconfidence, are prone to hyper-activity,[20] which has a positive effect on the liquidity (and therefore on the efficiency) of systems, making the realigment of prices easier. Therefore, also for this reason, one of the problems to be solved is that of understanding what percentage of the negative effects of irrational action are offset by positive ones, in order to figure out, when the gap between the two values looks unsustainable, if we need to accept proposals such as temporarily inhibiting retail activities[21] and therefore the action of many informed investors.

IV. Retail Investment, Institutional Investment and Their Actual and Hypothetical Protection

The proposed questions must be addressed not only on the basis of the consideration that the inefficient choices of irrational operators show their influence only in the short term –[22] because in the long run, as predicted by classical theory, prices always tend to reach the correct value – but also privileging, once more, realistic research. With regard to these issues it is therefore important to refer to experience accrued in trying to eliminate frauds. This result is today regarded as unattainable, and that's why the fact that frauds occur should not be considered an unequivocal index of the ineffectiveness of law,[23] as it's unnecessary 'to pursue the mirage of impossible, absolute guarantees'.[24] Likewise, it would seem desirable to consider that the studies concerning the irrationality of operators take into great consideration that retail investors are opposed to institutional operators, in order to give the right weight also to the work of institutional operators. Also on this point, on the other hand, we have now come to some explanations that can be considered definitive. Actually, it is no longer in doubt that even institutional subjects suffer from bias[25] – including overconfidence[26] – even though these biases are less significant than those of which retailer suffer from,[27] because organizations can in any case make themselves able to reduce the impact of these disfunctions.[28] On the other hand, this is not – and here we

[20] L. Guiso and T. Jappelli, 'Information Acquisition and Portfolio Performance' *CSEF Working Papers no 167, Centre for Studies in Economics and Finance (CSEF), University of Naples, Italy, 7-8*, available at https://tinyurl.com/y48lg3rq (last visited 28 May 2019).

[21] A. Dalmartello, *Private placement e circolazione di strumenti finanziari* (Milano: Giuffrè, 2013), 44.

[22] L.E. Ribstein, n 13 above, 142.

[23] F.H. Easterbrook and D. Fischel, n 4 above, 679.

[24] F. Denozza, n 9 above, 194.

[25] A. Dalmartello, n 21 above, 45.

[26] G. Strampelli, 'L'informazione societaria: profili evolutivi e problemi', in F. Annunziata ed, *Il Testo Unico della Finanza. Un Bilancio dopo 15 anni* (Milano: EGEA, 2015), 328.

[27] H.K. Baker, G. Filbeck and V. Ricciardi, 'How Behavioural Biases Affect Finance Professionals' *The European Financial Review*, 27 (2014).

[28] S. Choi and A.C. Pritchard, n 15 above, 39.

refer to well-known concepts – the only positive element related to the presence, in the system, of institutional investors. Indeed, we have to consider that the collection of information carries, from time to time, some costs and that the value of data obtained is linked to the amount of the related investment, so that people able to invest more are also the ones who are more dedicated to finding information;[29] and that's why while retail investors usually buy few securities and therefore are not interested in obtaining a huge amount of information,[30] institutional investors do the opposite, as they typically obtain a significant amount of data in the awareness of a greater ability to process them. The latter category is, in other words, composed by information traders, that is to say by subjects that historically are the most skilled to avoid both frauds and incompetent entrepreneurs, who are characterised by a stronger diversification attitude,[31] and generally are more able to sustain market efficiency[32] – because the more investors in the market are able to process and verify the available information in an efficient way, the more information tends to be reflected in the prices of financial instruments – so that it is quite natural that they become a reference for activity of other investors. If it is true that short-term investors are usually more careful in predicting the behaviour of other market players than conducting fundamental analysis,[33] it is also true that this *flock effect* tends to identify, in institutional investors, the *alpha subject* to be taken as a model; and similarly, it can not be ignored that a constantly growing number of small investors go to professional operators, when deciding to inject their savings into the financial market. It is then also from these elements that the legislator should draw its conclusions as to the course of action that has to be carefully followed, even at the cost of making unpopular decisions. The point is, first of all, the need to avoid protecting the retail investors just because they are such. On the one hand, actually, the logical corollary of the freedom of this type of investors to dispose of their goods consists in the tolerance of any consequences – hence also the negative ones – deriving from decisions taken; on the other hand, it is easy to see that any rule in favor of these investors would inevitably be associated with serious systemic effects, such as, for example, those consisting in hazards and in the greater chance that those investors make choices even less rational than those usually performed. Rather, the goal of protecting informed investors should be pursued with even greater effort, in order to increase liquidity and efficiency of the market, with the consequential, beneficial effects on other

[29] J. Peress, 'Wealth, Information Acquisition, and Portfolio Choice' 17 *Review of Financial Studies*, 879, 880 (2004).

[30] V. Maksimovic and P. Pichler, 'Private versus Public Offerings: Optimal Selling Mechanisms with Adverse Selection', 32, available at https://tinyurl.com/y64edwem (last visited 28 May 2019).

[31] C. Gulinello, n 2 above, 162-163.

[32] Z. Goshen and G. Parchomovsky, 'The Essential Role of Securities Regulation' 55 *Duke Law Journal*, 770 (2006).

[33] F. Denozza, n 9 above, 193.

investors. That does not mean, however, that rules that would objectively harm the retail category would be acceptable, because we have to remember the significant percentage of informed investors included in this category.

V. The Capital Market Union

It is now appropriate to draw attention to the European continent, so as to remember that the European Union has for some time been working on the Capital Market Union, wich is an ambitious project to unite the European capital markets – initially proposed to the European Parliament, in July 2014, by the President of the European Commission Junker – which essentially focuses on the Action Plan published on 30th September 2015. The European institutions called it a 'fundamental' project; however, it's not perfectly clear what a Capital Market Union really is,[34] as this expression has been defined misleading and 'more symbolic than real'.[35] Therefore, we must prudentially identify a set of reforms functional to the creation of a real union of the capital markets between all the twenty-eight EU Member States. The premise for such a great reform seems clear: if we want to sum up, the European economy is substantially similar to that of the US, but the capital markets of our continent correspond to less than half of the North American ones, while the debt markets are even less than a third. The project of the Capital Market Union is therefore characterised by a purpose that can actually be appreciated, even if it's not easy to identify the real aims that are pursued. The EU bureaucracy argues that this reform has, ultimately, three aims: that of widening the sources of financing the companies, that of strengthening the Single Market, and finally that of promoting financial growth and stability. A reconstruction in these terms appears, however, excessively generic and of limited value. More interesting is the one proposed by Confindustria in the Action Plan for the Union of Capital Markets, which highlighted how the Action Plan will bring into force twenty legal and non-legal measures, intended to be progressively implemented by 2019. Several of these measures are dedicated to information and one has already been implemented: EU Regulation no 1129/2017, has indeed realized a reform of the law concerning prospectus.

VI. Proposals for Reform and New Regulation of Prospectus

The desire to revise the law concerning prospectus was first of all based on

[34] P. Schammo, 'Capital Markets Union and Small and Medium-sized Enterprises (SMEs): a Preliminary Assesment', in F. Allen, E. Carletti and J. Gray eds, *The New Financial Architecture of the Eurozone (European University Institute, RSCAS, Florence School of Banking and Finance* (2015), 13-14, available at https://tinyurl.com/y3swyzxn (last visited 28 May 2019).

[35] W. Ringe, 'Capital Markets Union for Europe – A Political Message to the UK' 9 *Law and Financial Markets Review*, 5 (2015).

the feeling that this source of information was the real gateway to the EU capital markets, and that therefore this document should be easy to draft, clear for investors and quickly approved. Actually, jurists used to complain about how it was written in a very technical language – and that's why it was asked to make it 'simpler',[36] making it easier to process the information received –[37] and about how it usually highlighted so many risk factors that it was impossible to understand which of these were really relevant.[38] More generally, everybody asked for a less lenghty prospectus,[39] which was therefore less expensive to create. Finally, many jurists have denied the utility of the prospectus emphasising, on the one hand, that unsophisticated investors are not able to understand its content and, on the other hand, that sophisticated investors are still used to requesting additional information from the issuer. This usually leads to the conclusion that investment decisions are not made in the light of the prospectus, especially in the event of secondary issues, that is when the value of the prospectus decreases. These last set of considerations are not, however, fully persuasive. It is actually true that in general the retail investor is not inclined to dwell on the prospectus,[40] and that's why Italian SEC requests the delivery of a prospectus only upon request (see Art 9 of the Issuers Regulation); however, the retail category includes a significant number of informed investors, who use the prospectus – and are to be considered informed also because of this – and are unable to demand further data from the issuer. Precisely for this reason, it's very difficult to appreciate the great discretion which from now on the issuers will have when determining the content of the prospectus summary; and at the same time it is surprising that the legislator has underestimated that strengthening the flow of information is crucial for the financing of SMEs, as highlighted by the introduction of the *EU growth prospectus*,[41] which is extremely simplified (see Art 15). Beyond this, however, the decision to introduce new types of prospectus looks convincing. Moreover, the power of varying the content according to specific needs seems to be functional to a more orderly data exposure and therefore also able to mitigate the risk of information overload[42] on which we have previously focused. Similarly, we have to appreciate that from now on no more than fifteen risk factors can be underscored in the prospectus summary (see Art 7, para 10) and that a simplified prospectus will be provided for any secondary issues (see Art 14).

[36] G. Strampelli, n 26 above, 331.

[37] T.A. Paredes, n 1 above, 485.

[38] D. Busch, 'A Capital Markets Union for a Divided Europe', 13, available at https://tinyurl.com/y3vjnx7m (last visited 28 May 2019).

[39] L. Burn, 'KISS, but Tell All: Short-form Disclosure for Retail Investors' 5 *Capital Markets Law Journal*, 141 (2010).

[40] A. Dalmartello, n 21 above, 338.

[41] P. Maume, 'Initial Coin Offerings and EU Prospectus Disclosure' *MIT Sloan Research Paper No. 5347-18*, 26-27, available at https://tinyurl.com/yxekymwg (last visited 28 May 2019).

[42] T.A. Paredes, n 1 above, 474-475.

VII. The Private Placements

The data wich have emerged so far, however, must now be placed into the context of a specific market such as that of private placements – or *reserved placements* – ie the technique of selling financial products without going public (thus the solicitation of an undetermined public) but favouring individual negotiations with a limited number of usually sophisticated investors.[43] In general, companies that privilege private placements usually have two features. The first one is that they do not have a significant size.[44] Of course, even the reserved placement can be too expensive for many small enterprises,[45] and therefore the fact that European companies are almost always micro-enterprises[46] is an obstacle to it becoming widespread; however, in most cases, the cost of reserved placement does not appear excessive when compared to that of the bank loans, which are caratherised by the fact of allowing access to smaller loans when compared to the reserved placements. The second one is that we are talking about relatively non-transparent companies.[47] This characteristic – which is probably the most distinguishing feature of private placement transactions[48] – is an element strictly connected to the size of the business organization involved: the cost of disclosure, being mostly fixed, is a burden on structures with lower capitalisation,[49] so it is not surprising that lack of transparency usually marks companies that are not particularly developed. On the other hand, it is also true that a situation of information asymmetry is not always related to poor capitalization or poor management, while it has long been known that too much transparency can sometimes decrease the private incentive to innovate, because some new products are profitable only if made secretly;[50] there are situations in which disclosure of information affects the interests of companies,[51] given that through disclosure a substantial advantage is very often given to competitors, workers or customers.[52] Beyond this, however, private placements show the attitude to reducing information asymmetry, because the investors who participate in it know what information they need and are able to obtain it; moreover, they

[43] Y. Wu, 'The Choice of Equity-selling Mechanisms' 74 *Journal of Financial Economics*, 93-119, 93-94 (2004).

[44] D.W. Blackwell and D.S. Kidwell, 'An Investigation on Cost Differences Between Public Sales and Private Placements of Debt' 22 *Journal of Financial Economics*, 259 (1988).

[45] N. Branzoli and G. Guazzarotti, 'Il mercato dei private placement per il finanziamento delle imprese', 19, available at https://tinyurl.com/patrg74 (last visited 28 May 2019).

[46] C.E. Pupo, 'Lo «Small Business Act» e il work in progress della sua attuazione' *Analisi Giuridica dell'Economia*, 135 (2014).

[47] E. Maynes and J.A. Pandes, 'The Wealth Effects of Reducing Private Placement Resale Restrictions' 17 *European Financial Management*, 500-531, 501 (2011).

[48] Y. Wu, n 43 above, 93-94.

[49] L. Enriques and S. Gilotta, n 7 above, 23.

[50] F.H. Easterbrook and D. Fischel, n 4 above, 708.

[51] J.R. Macey and G.P. Miller, 'Good Finance, Bad Economics: An Analysis of the Fraud on the Market Theory' 42 *Stanford Law Review*, 1059-1092, 1091 (1990).

[52] L. Enriques and S. Gilotta, n 7 above, 14-15.

often formally guarantee the issuer that they will not make public the data transmitted to them, so that companies that prefer not to fully disclose their operational plans can also resort to this way of financing. Furthermore, in this type of financing the companies can better model the issue of shares,[53] which is often smaller[54] and also faster than the ones realized in organized markets[55] (but not faster than bank financing). Finally, this kind of placement is usually governed by the principle according to wich every cost borne by investors while fixing the value of a company ultimately ends up falling on the company itself.[56] Indeed, informationis what private placements that take place in Europe are lacking.[57] Furthermore, the need to carry out both due diligence and monitoring activities produces a further consequence. The point is the fact that the demand for private placement usually comes only from institutional investors and in particular from the bigger and/or qualified ones; this is a phenomenon which is perfectly understandable if we only think that often the small size of the issue cannot justify the cost of information. In this context there is actually profit for investors only starting from issues for a value of at least twenty million euros. If this is added to the aforementioned illiquidity of the securities and to the problem consisting in often dealing with a company in the start-up phase, it is clear why one of the frequent characteristics of people investing in this specific market is the power to engage in the long term.[58] The logical consequence of these premises has therefore been the modest interest of banks towards the reserved placement,[59] so that it would seem evident that the difficulties of growth of private placements are above all due – and this is absolutely true for Italy – to the small size of non-bank intermediaries. In addition, the long-term perspective has historically made a selection that has allowed insurance companies and pension funds to excel in the reserved placement system,[60] so that it is correct to say that the future development of private placement is linked to the solution – which is notoriously very difficult – of the problem of expanding the category of long-term investors. On the other hand, after the last global recession, it seemed obvious to many

[53] N. Tilli and A. Novarese, 'Il collocamento privato negli Stati Uniti d'America nell'ambito delle privatizzazioni' *Diritto ed economia dell'assicurazione*, 876 (1995).

[54] R. Varma and S.H. Szewczyk, 'The Private Placement of Bank Equity' 17 *Journal of Banking Finance*, 1111-1131, 1112 (1993).

[55] C.A. Morss, 'Tapping the Private Placement Market' 79 *Management Review*, 39, 41 (1990).

[56] T.J. Chemmanur and P. Fulghieri, 'A Theory of the Going-Public Decision' 12 *The Review of Financial Studies*, 249-279, 251 (1999).

[57] D. Valiante, *Europe's Untapped Capital Market – Rethinking financial integration after the crisis*, 24, available at https://tinyurl.com/y3brk3er (last visited 28 May 2019).

[58] N. Branzoli and G. Guazzarotti, n 45 above, 8.

[59] M. Carey et al, 'The Economics of the Private Placement Market', 32, available at https://tinyurl.com/yxqsznes (last visited 28 May 2019).

[60] D. He, D.C. Yang and L. Guan, 'Earnings Management and Long-run Stock Underperformance of Private Placements' 15 *Academy of Accounting and Financial Studies Journal*, 31, 34 (2011).

observers that the US production apparatus was able to restart more easily because it was less tied to bank financing.[61] The undisputed centrality of banking operators in the European economy[62] has turned out to be extremely inappropriate, when suffering companies lacked the necessary help from banks. In short, the need to limit bank financing with respect to self-financing or other methods of corporate borrowing constitutes a sufficient reason to seek to strengthen private placement, which constitutes, in any case, a technique that is merely complementary to the bank loans or to the regulated markets.[63] Once this has been clarified, we can add that interest in this financing instrument has long been increasing in almost all markets;[64] currently, the reserved placement has enjoyed tremendous growth since the nineties until 2007,[65] when it was severely hit by the crisis of 2008. Certainly, its spreading within the European countries now looks rather constrained: in a nutshell, in 2014 private placement issues reached six point six billion against the fifty registered in the USA,[66] and the US data are still more significant if we take into account that in US private placements constitute only zero point three percent of GDP and in that specific market only under four percent of the total bonds were subscribed.[67]

VIII. *(Cont'd)* The Prospects for a Change at the Regulatory Level

Undoubtedly, at the European Union level, the development of the private placement market is really important because of the undoubted centrality, in the European economic system, of small and medium-sized enterprises. In fact, there are surveys showing that two out of three people are employed at European SMEs,[68] and surveys tell us that in Europe medium-sized companies get, from the capital market, a funding that is one fifth of that given in the United States. It seems then correct to say that any reform should not necessarily pursue unitary aims, but rather strive to respect the regional peculiarities. If it is in fact correct that in general the European capital market is strongly fragmented[69] also because of the enormous differences at the macroeconomic level, it is also true

[61] W. Ringe, n 35 above, 4.

[62] N. Anderson et al, 'A European Capital Markets Union: Implications for Growth and Stability', 18, available at https://tinyurl.com/yxcfpyyj (last visited 28 May 2019).

[63] N. Branzoli and G. Guazzarotti, n 45 above, 5.

[64] H. Liang and W. Jang, 'Information Asymmetry and Monitoring in Equity Private Placements' 53 *The Quarterly Review of Economic and Finance*, 460 (2013).

[65] K. Wruck and Y. Wu, 'Relationship, Corporate Governance, and Performance: Evidence from Private Placements of Common Stock' 15 *Journal of Corporate Finance*, 30 (2009).

[66] N. Branzoli and G. Guazzarotti, n 45 above, 11.

[67] ibid 16.

[68] N. Véron and G.B. Wolff, 'Capital Markets Union: A Vision for the Long Term' 2 *Journal of financial Regulation*, 130-153, 138 (2016).

[69] K. Lannoo, 'Which Union for Europe's Capital Markets?', 1, available at https://tinyurl.com/yxjrxs2t (last visited 28 May 2019).

that there is a similar lack of homogeneity in private placement transactions, considering that only the English, the German (which alone represents fifty percent of the European one) and finally the French markets (which is a quarter of the European one) look developed enough. Nevertheless, we actually need a greater harmonization of the markets active in the EU Member States: it is well known that the home bias that usually affects European investors[70] has so far led to a private placement market essentially articulated on a national basis. With this in mind, the right measures would be:

- a reform aimed at improving information on creditworthiness, perhaps through the creation of a European rating agency, as the US NAIC;
- a reform aimed at endorsing, as far as possible, national risk centers (or even at launching a European one);
- a reform aimed at standardising the access to information about the business system.

[70] N. Véron and G.B. Wolff, n 68 above, 140-141.