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INSIDER TRADING ON THE CONTINENT

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1. Introduction

Bob Mundheim has asked me to give you a 15 minute presentation on law and practice with respect to insider trading on the Continent. I must confess that I feel somewhat as if I were in Jules Verne's *Around the World in 80 Days* – but only somewhat, because Europe in 15 minutes corresponds to "Around the World in 80 Minutes". But, as this is the age of jets, I will try my best.

2. Three approaches to insider trading

I have prepared for you a short synoptic table [1] with condensed information on Germany, France, and the European Economic Community [2]. I have included *Germany* because of its very peculiar self-regulation system. As we will see, it is a contractual self-regulation system of the stock exchanges, banks, and industry – which is different from the admission rules, for example, of the New York Stock Exchange or the American Stock Exchange. *France* stands for a fully-fledged legal system. It is characterized by rather serious penalties, a central securities commission, and a slowly growing case law. A draft amendment to the French legislation on insider trading as of 1980 is supposed to redefine "inside information" and "insider securities" and would extend the scope of prohibition. The *European Economic Community* cannot be left out because of its harmonization efforts.

There have been three steps in the EEC endeavor. The first is an insider provision in the 1970/1975 draft regulation concerning a Statute for European Companies [3]. This would apply to a truly European company: mainly multinational enterprises and their joint ventures, somewhat similar to an American federal company. The draft regulation has run into political difficul-

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ties, however, primarily because of labor codetermination, which the Germans do not want to give up but which many of our neighbors do not want in its far-reaching German version. As for the proposed insider provision of the draft, one should not regret its sorry fate. It is shaped after the example of the American section 16 of the 1934 Act and it includes only company insiders.

The second step is the European Code of Conduct relating to transactions in transferable securities which the EC Commission recommended to the member states in 1977. This Code contains basic principles of fair trading in securities. One general principle is the equality of treatment for all holders of securities of the same type issued by the same company. Several supplementary principles are directed against the improper use of price-sensitive information.

In its explanatory memorandum to the European Code of Conduct, the EC Commission conceded that harmonization by legally binding directives is "the only [method] capable of attaining the objective of true European integration". Since July 1979, a Working Party, with delegates from the EC Commission and from the ministries, stock exchanges, and certain supervisory agencies of the various member states, has been making good progress in preparing such a directive on insider trading.

3. Other approaches in Europe

My choice of Germany, France, and the EEC is, of course, too narrow. Here, as on most occasions, Europe speaks with many voices. Quite often smaller countries, like Belgium or the Scandinavian countries, come up with very interesting legal experiments. At this point it is enough to state that there are many countries in Europe with a record of both insider trading and insider rules. In *Switzerland,* for example, 10 years ago profit from insider trading was not only considered to be quite all right, but it was sometimes openly justified as part of management remuneration (*i.e.* the Manne theory in practice). Recently, however, in Zurich there have been efforts to outlaw insider trading by more than mere self-regulation. *Denmark* has its insider rules in the Danish corporation law of 1973, with a company register solution that resembles the one in English company law. In *Belgium,* the specific institutional set-up and the established authority of the Banking Commission have helped to prevent insider trading for many years without any legal text. Nevertheless, in 1979 the government introduced a draft law on insider trading. It is a penalty-type solution and will be inserted into the company law. The draft law contains a most interesting international law provision, which I will mention later. *Italy*'s insider rules are contained in the law of 1974. Having lived and taught at the European University Institute in Florence for two years, I am somewhat sceptical about analyzing these rules word by word. Rather, the interesting problem is the intricate connection among private industry, public enterprise,

and party politics. These are the sources of Italian law in action, which is very difficult to grasp from the outside. The CONSOB, a kind of Italian mini-SEC created by the 1974 law, has been generally known for its inefficiency. Yet this may very well change under its newly appointed president, who is a well-known corporate lawyer from Milan with long experience and international exposure.

4. Four fundamental questions

Since the details of the German, French, and European solutions are in the synoptic table, I will not dwell on them here. I would rather raise four fundamental questions with respect to insider regulation from a European point of view.

First, there is a striking difference between the German and the French solution. In a nutshell this is self-regulation versus regulation through law. Unlike Americans, many Europeans conceive this to be a true alternative: not just the question you have faced once more in your Securities Acts Amendments of 1975 – namely, where to draw the best line between self-regulation and regulation by the SEC and the courts. The German way of insider regulation is contractual self-regulation of the stock exchanges, banks, and industry. The insiders of the stock corporations and banks agree by contract to respect the Insider Trading Guidelines of 1976 [4] and to be subject to the jurisdiction of the Insider Trading Inquiries Commissions at the various stock exchanges. As a matter of practice, by 1980 nearly 100% of the German banks and around 95% of the stock corporations (counted on the basis of stated capital) are bound by these insider guidelines. Since the first version of the guidelines in 1970, many inquiries by the Inquiries Commissions have taken place. For example, in the Thyssen–Rheinstahl case, a friendly takeover in 1973, 172 single inquiry proceedings have been carried out – with negative results.

The evaluation of the German experience is quite controversial [5]. Since its very beginning, I have been an outspoken critic of the German solution for several reasons. First, an insider regulation should cover all insiders concerned. In Germany this is not the case. If counted not on the basis of stated capital, but on the basis of the number of companies at the stock exchange, only slightly above 50% of the stock corporations are bound. For free investment advisers (*i.e.* the non-banking sector), the percentage is even much smaller. Secondly, the guidelines do not go far enough. While this could be shown at several points (for example the definition of insider), it is most serious with respect to the securities covered. Only transactions in shares admitted to the official or semi-official stock exchanges are affected. This means that insider trading in the shares of more than three-quarters of the 2,000 odd German stock corporations remains permissible, since only the shares of some 470 stock

corporations are admitted to the stock exchange. Thirdly, the contractual sanctions are mild. The insider risks only bearing the costs of the proceedings and paying back his profit to the company. The risk of publicity is small. As a general principle, even a clear conviction may not be rendered public by the Inquiries Commission. Only in case of a gross violation and upon the unanimous decision of the Commission (and, in practice, after a proceeding before the courts) may there be an exception.

This is one side of the story. On the other side, practitioners involved in the self-regulatory process are convinced of the efficacy of the system. Judge Kissel, for example, who was presiding judge of the Inquiries Commission at the Frankfurt Stock Exchange and who is now presiding judge of the Bundesarbeitsgericht (the highest German labor court), has warned in a public statement of December 1980 not to turn the matter over to the courts. Currently, in case of inquiries everyone cooperates voluntarily. This is true even for Mr. Vetter and other trade union members on the boards of co-determined stock corporations, who, as a matter of principle, are against insider self-regulation. Judge Kissel fears that enforcement of an insider law by a state agency or by the courts would be utterly inefficient, just like prosecution of white-collar criminality in general. However that may be, of all inquiry proceedings under the German guidelines since 1970, none has ended with publicly known conviction – quite in contrast, for example, to France, where in the last seven years 26 people were accused, 16 were adjudged, and all but one found quilty, with actual fines imposed ranging from 5,000 to 50,000 francs and prison terms from two to ten months (although only on probation). Other cases are still pending.

The second key issue is timely disclosure. The inverted relationship between insider dealing and early disclosure is generally seen in Europe. But up to now there is no established body of rules making disclosure obligatory or even providing for liability in case of non-disclosure. The EEC directive on the conditions for admission of securities to official trading on a stock exchange has only very recently stated a very general principle in this respect:

> The company must inform the public without delay of major new developments in its sphere of activity which are not public knowledge and which may, by virtue of their effect on its assets and financial position or on the general progress of its business, lead to large movements in the prices of its shares [6].

Furthermore, it is still far from being settled under what circumstances inside information may be disclosed, or even must be disclosed, under overriding legal rights or duties. This is true for the labor union members on co-determined company boards. It is also true for banks giving investment advice. The rationale of *Cady, Roberts* is not necessarily valid for those European countries with mere self-regulation of insider trading and with a

universal banking system. These universal banks participate in the companies: they are represented on the company boards, they exercise a depository vote for shareholder–clients, and they do all kinds of banking business with the company. Of course, they use all their information for their own credit business. What if such a bank knows that the company will very soon become bankrupt, that company insider dealing is going on, or that the stock prices are manipulated? Can the bank still do business both with the company and with the small investor without warning the latter? There is a growing opinion in German legal literature that in such cases, legal duties of warning and investor protection cannot be done away with by mere self-regulation [7].

The third key issue, which I can mention only briefly, is the problem of costs. In the stiff economic environment that we face in Europe today, there is not sympathy for big, new regulatory agencies. Quite the contrary, distrust of state administration and the plea for deregulation are becoming strong. For this reason alone, aside from several others, today in Germany a Securities and Exchange Commission is politically just not feasible; and this is even more true on the EEC level. At least as important is the question of priorities in corporate and capital market law reforms. In Germany the stock market is weak, the number of new stock corporations is virtually nil, and there is little incentive to go public and to have the shares of the company traded on the stock exchange. This problem of revitalizing the stock market is, of course, much more urgent and more fundamental than insider trading and a new commission. Furthermore, there are the possible side-effects of fully-fledged insider regulation. Even under the mild German version, since the introduction of the insider regulation the share ownership of board members in their own companies has clearly decreased. While there is no proof of a general causal relationship, the fact itself is unwelcome and even alarming.

Finally, there is the problem of the internationalization of securities transactions and also of insider trading. The French, English, and Belgian securities commissions have been confronted with this problem repeatedly. Since national law ends at the state frontiers – which unlike in the U.S. are very close – the commissions have tried to solve the problem on practical terms, but without too much success. One road to take in this dilemma is the harmonization of insider regulation as planned in the European Communities. Then, at least all over the ten member states, the problem would lose much of its acuteness. However, even then there would still be the problem of Swiss bank accounts (our Swiss friend Alain Hirsch is asked to forgive).

Another answer may be the expansion of national insider rules to their utmost extent. Belgium is about to try this. In the new draft law of 1979 there is a provision that obliges the Belgain intermediary acting for a person established abroad to disclose the identity of the latter in case of presumptive evidence of insider trading. In the event of a refusal, the court may prohibit, for a period of between one and ten years, execution in Belgium of any order

conveyed to the intermediary acting for the person established abroad. Such a conviction would be made public in the *Official Gazette* and in at least two daily newspapers. The effect of such publication would be that everyone in the Belgian securities business would be forbidden from taking part in the execution of such orders. This opens up interesting international perspectives, even though there are quite serious doubts as to the effectiveness of the Belgian solution.

Notes

[1] See Appendix.

[2] As an introductory bibliography cf. the following books:
- Arbeitskreis Gesellschaftsrecht, Verbot des Insiderhandelns, Heidelberg, 1976;
- P. Forstmoser, Effektenhandel durch Insider, Zurich, 1974;
- A. Georges, L'utilisation en bourse d'informations privilégiées dans le droit des Etats-Unis, Paris, 1976;
- K.J. Hopt & M.R. Will, Europäisches Insiderrecht, Stuttgart, 1973;
- J.H. Jenkel, Das Insiderproblem im Schnittpunkt von Gesellschafts-und Kapitalmarktrecht in materiell- und kollisionsrechtlicher Sicht, Frankfurt 1980;
- O. Kramis, Insiderhandel in Effekten (Eine schweizerische Lösung), Zürich, 1978;
- L. Loss, ed., Multinational Approaches – Corporate Insiders: Second International Securities Law Conference, London, April 3–4, 1975, New York, 1976;
- L. Loss, ed., New Trends in Company Law Disclosure, 1980;
- B. Rider and H.L. Ffrench, The Regulation of Insider Trading, London, 1979;
- R.J. Wojtek, Insider Trading im deutschen und amerikanischen Recht, Berlin, 1978;
- E. Wymeersch and J. Van Dijck, eds., Het misbruik van voorwetenschap inzake effectenhandel, Referaten en discussieverslagen van de studiedag gehouden te Antwerpen op 28 april 1977.

[3] Statute for European Companies, Bulletin of the European Communities, Annex 4/75. The proposed Art. 82, which contains the insider provision, has been discussed and criticized by K.J. Hopt and M.R. Will, Europäisches Insiderrecht 140–176 (1973).

[4] For the complete text of the Insider Trading Guidelines *see* Baumbach-Duden-Hopt, Handelgesetzbuch (mit Nebengesetzen ohne Seerecht) (25th ed. 1982), Nebengesetze No. 16; E. Schwark, Börsengesetz, Annex II at 481 (1976).

[5] For critical appraisals *see,* for example, Arbeitskreis Gesellschaftsrecht, Verbot des Insiderhandelns (1976); E. Schwark, Börsengesetz 497 (1976); K.J. Hopt, Rivista delle Società XIX at 1046–1065 (1974).

[6] Council Directive, March 5, 1979, O.J. Eur. Comm. No. L 66/21 March 16, 1979, Form C, No. 5a and Form D, No. A 4a.

[7] F. Kübler in a report given at the Banking Law Symposium January 23–24, 1981, at Kronberg, published in 145 Zeitschrift für das Gesamte Handelsrecht und Wirtschaftsrecht 204–221 (1981). *See also* K.J. Hopt, Der Kapitalanlegerschutz im Recht der Banken 448–478 (1975).

Appendix: Insider regulations on the Continent

	Germany	France	European Economic Community
I. *Characteristics*			
1. Source	Insider Trading Guidelines as of 1976	Ordinance of 1967 as changed by Law of 1970 (draft amendment as of 1980)	European Code of Conduct of 1977 (Code) Project of Directive (Project)
2. Self-regulation v. law	contractual self-regulation of the stock exchanges, banks, and industry	legal regulation	combination of voluntary code and legal directive (to be incorporated into the national laws of the member states)
3. Type	prohibition of insider trading, no registration required	prohibition of insider trading, no registration required	prohibition of insider trading, no registration required
II. *Content*			
1. Insider	-members of the board of directors -includes affiliated enterprises -shareholders with more than a 25% holding -employees who, as such, typically acquire inside information -banks and their personnel as above (but cf. II 4)	-members of the board of directors -includes affiliated enterprises	-members of the board of directors (Project) -includes affiliated enterprises -shareholders able to exercise a determining influence on the management -employees with regular access to inside information -financial intermediaries and their personnel as above -auditors, persons with professional or business links, certain others -public officials with regular access to inside information -journalists -spouses or relatives in direct line

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	Germany	France	European Economic Community
		–any other persons who, during the course of the exercise of their business activity or their functions, come into possession of inside information	–any persons who come into possession of inside information in exercising their profession or carrying out their duties (Code)
2. Inside information	information on not-yet-published or not-yet-known circumstances which may have influence on the evaluation of the securities (certain examples given)	privileged information on the technical, commercial, and financial functioning of a company (privileged information regarding the prospects or situation of a security or facts having a potential bearing on the operation or situation of the securities market, or on the performance of a security)	unpublished price-sensitive information = significant confidential information relating to an undertaking which, if it were published, would be likely materially to affect the price of the security (Project) information which is not public and which relates to a company or to the market in its securities or any event of general interest to the market, which is price-sensitive (Code)
3. Securities	stock, stock options, bonds which are issued by the company or an affiliated company and are admitted to official or quasi-offical stock exchange trading (exception for execut-	stock (securities of any kind)	securities which are admitted to trading on an offical stock exchange or on another regulated market (Project) Transferable securities = all securities which are or may be the subject

		ing orders on behalf of customers and other transactions in the normal securities business of the banks)		of dealings on an organized market (Code)
	4. Prohibition	transactions of insiders in securities in which inside information is used for their own profit or the profit of third parties	transaction on the securities market on the basis of inside information before it has been made public (or enabling such transactions to be carried out)	transactions in which inside information is used, and giving the information to another person so that he may profit from it before the information becomes public (Code)
	5. Sanctions	–profit to be claimed by the company –costs of the inquiries proceeding –notification to the board of the company –publication in case of gross violation	imprisonment from 2 months to 2 years and/or fine from 5,000 to 5 million francs or higher, up to four times any profit obtained (with the fine in no case to be less than such profit)	(to be left to the member states)
III.	*Enforcement*			
	1. Self-regulatory body	Inquiries Commissions at the various stock exchanges (one judge and four assessors from industry)		(to be left to the member states)
	2. Courts		penal courts	
	3. SEC-type commission	no	yes	