Tulsa Journal of Comparative and International Law

Volume 3 | Issue 1 Article 3

9-1-1995

In Search of a Giant Leap: Curtailing Insider Trading in International Securities Markets by the Reform of Insider Trading Laws under European Union Council Directive 89/592

Stephen J. Leacock

Follow this and additional works at: http://digitalcommons.law.utulsa.edu/tjcil

Part of the Law Commons

Recommended Citation

Stephen J. Leacock, *In Search of a Giant Leap: Curtailing Insider Trading in International Securities Markets by the Reform of Insider Trading Laws under European Union Council Directive 89/592*, 3 Tulsa J. Comp. & Int'l L. 51 (1995).

Available at: http://digitalcommons.law.utulsa.edu/tjcil/vol3/iss1/3

This Article is brought to you for free and open access by TU Law Digital Commons. It has been accepted for inclusion in Tulsa Journal of Comparative and International Law by an authorized administrator of TU Law Digital Commons. For more information, please contact daniel-bell@utulsa.edu.

IN SEARCH OF A GIANT LEAP: CURTAILING INSIDER TRADING IN INTERNATIONAL SECURITIES MARKETS BY THE REFORM OF INSIDER TRADING LAWS UNDER EUROPEAN UNION COUNCIL DIRECTIVE 89/592

Stephen J. Leacock[*]

I. INTRODUCTION

In a robust effort to attain more effectively the goals of the Treaty of Rome[1] and more efficiently promote the free movement of capital within a genuine common market,[2] the European Union (EU) has recently taken significant steps to ensure a truly barrier-free, pan-European securities market. The goal of eliminating all market barriers arose from the continuing drive toward an economically integrated

---

* Professor of Law, DePaul University College of Law. Barrister (Hons.) 1972, Middle Temple, London; LL.M. 1971, London University, King's College; M.A.(Bus. Law) 1971, City of London Polytechnic (London Guildhall University), London; Grad. Cert. Ed. (Distinction) 1971, Garnett College, London; B.A.(Bus. Law)(Hons.) 1970, City of London Polytechnic (London Guildhall University), London. The author gratefully acknowledges the valuable research assistance provided by Mazyar M. Hedayat and Tim J. Ehinger in the preparation of this Article.

1. Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11 [hereinafter Treaty of Rome]. The Treaty envisioned a single market "without internal frontiers in which the free movement of goods, persons, services and capital is ensured." *Id.* art. 8(a). Art. 8(a) was added by art. 13 of the Single European Act of 1986. 1987 O.J. (L 169) 1, 7 [hereinafter Single European Act]. At present, fifteen nations are signatories to the Treaty of Rome: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain, Sweden, and the United Kingdom. *See generally* Roger J. Goebel, *The European Union Grows: The Constitutional Impact of the Accession of Austria, Finland and Sweden*, 18 FORDHAM INT'L L.J. 1092, 1093 (1995).

2. *See* Treaty of Rome, *supra* note 1, arts. 67-73, 298 U.N.T.S. at 42-44.

Europe, which gave rise to the Single European Act of 1987.[3] In addition, the more persistently adverse effects of these barriers have been exacerbated by the increasing number of international securities transactions.[4]

Another effect of market barriers in the EU is the varying degrees of regulatory measures that have tended to create disincentives for investment in some member states[5] while simultaneously increasing the flow of capital into others.[6] These disparities have also contributed to varying degrees of investor confidence in the securities markets of the individual member states and have tended to undermine integrity in the operation of these markets.[7]

---

3. The Single European Act amended the Treaty of Rome and vested greater central authority in the governing institutions of the EC. *See* Hans-Joachim Glaesner, *The Single European Act: Attempt at an Appraisal*, 10 FORDHAM INT'L L.J. 446, 453 (1987). The Act also set the goal of achieving complete regulatory harmony and economic unity by December 31, 1992. Single European Act, *supra* note 1, art. 13; Manning G. Warren III, *The Regulation of Insider Trading in the European Community*, 48 WASH. & LEE L. REV. 1037, 1037 n.2 (1991).

4. *See Financial Capitals: Can the Centre Hold?*, ECONOMIST, June 27, 1992, at 62. In a cost/benefit analysis of EC regulations on insider trading, it was concluded that consumers, as well as intermediaries, are willing to bear higher compliance costs for the sake of well-policed financial centers. *Id.*

5. Italy is one of the most visible examples of a stock market dominated by insiders; thus, it provides strong disincentives to foreign investment. *See Making the Borsa Fit for Investors*, INSTITUTIONAL INVESTOR, July 31, 1991, at 61. *See also Into a Murky Future*, EUROMONEY, July 1, 1991, at 65; *Reshaping The Italian Bourse*, ECONOMIST, July 6, 1991, at 85; Richard Waddington, *Reform on the Way for Scandal-Hit Italian Share Market*, REUTER NEWSWIRE—REUTER GEN. NEWS, Sept. 2, 1991; *Another Big Bang—New Legislation and Screen Trading Transforms Italy's Stockmarket*, BANKING TECH., Oct. 10, 1991, at 32; Haig Simonian, *Bourse Reform—Counting The Cost Of Technological Change*, FIN. TIMES, Oct. 9, 1991, at 26.

6. For example, London and Paris have two of the largest stock exchanges in Europe. *See* David J. Berger, *A Comparative Analysis of Takeover Regulation in the European Community*, 55 LAW & CONTEMP. PROBS. 53, 62 (1992) (noting that the market capitalization of the Paris stock market has risen from less than $120 billion in 1987 to more than $200 billion in 1990); *8.0 Equity Financing-8.1 General*, FINANCING FOREIGN OPERATIONS, Aug. 1, 1993, *available in* LEXIS, World Library, EIUFFO File (noting that the London Stock Exchange executed £763 billion in transactions in 1992). The London and Paris stock exchanges were also the first to adopt significant market regulation. Amy E. Stutz, *A New Look at the European Economic Community Directive on Insider Trading*, 23 VAND. J. TRANSNAT'L L. 135, 155-61 (1990).

7. "Adoption of the Insider Trading Directive [89/592 adopted on November 13, 1989] indicates the Community's awareness that confidence in the integrity of the market is essential to the development of a major securities market." Laraine L. Laudati, *Report of the Delegation to the European Community: Key Issues in the 1992 Unification Program*, 1 Ilex Briefing Monograph Series 12 (1990); *see also* Warren, *supra* note 3, at 1039. The EC's efforts to harmonize securities regulations are intended "to level the playing field for market participants and to promote investor confidence" in the securities markets of the member states. *Id.* Efforts to outlaw insider trading throughout the EC, just as in the United States, are based upon the

As of September 30, 1990, France, the United Kingdom, Germany, the Netherlands, and Denmark had all introduced a number of measures against insider trading,[8] varying in stringency. Ireland and Italy were in the process of introducing such legislation.[9] Stock markets in the other EU countries had been either dominated by policies that promoted a no-questions-asked posture,[10] or had been less affected by the ravages of insider trading.[11] These countries, therefore, lacked the necessary justification for the relatively heavy expenditure required to properly administer a full set of sophisticated, regulatory insider-trading laws.

More recently, however, the ever-increasing flow of capital across national boundaries, which picked up speed in the 1980s,[12] exposed both larger and smaller exchanges — in EU, as well as in non-EU countries — to the vagaries of insider-trading tactics. Switzerland, long a destination for off-shore capital, serves as an example.[13]

---

realization that a "widespread fear of pervasive unfairness" among investors has a "corrosive impact" on securities markets. ABA Comm'n on Fed. Regulation of Sec., *Report of the Task Force on Regulation of Insider Trading, Part I: Regulation Under the Antifraud Provisions of the Securities Exchange Act of 1934*, 41 BUS. LAW. 223, 225 (1985). *See also* Thomas Lee Hazen, *Defining Illegal Insider Trading-Lessons from the European Community Directive*, 55 LAW & CONTEMP. PROBS. 231, 236-37 (1992) (characterizing the directive as largely successful in defining insider trading, in contrast to the reluctance of United States regulatory authorities to make the effort to arrive at a similarly effective definition).

8. "Insider trading," as the term is used in this paper, involves the misuse of material information not available to the public in order to make profits or avoid losses in the purchase and sale of securities. *See* RICHARD W. JENNINGS & HAROLD MARSH, JR., SECURITIES REGULATION 42 (6th ed. 1987).

9. *The Coordination of Regulations on Insider Trading*, FIN. SERVICES, Sept. 30, 1990, *available in* WESTLAW, European Update, 1990 WL 262262.

10. Greece, Italy, and Portugal, for example, had previously considered insider trading to be acceptable. Douglas A. Nystrom, Note, *Securities—Insider Trading—The Effects of the New EEC Draft Insider Trading Directive*, 18 GA. J. INT'L & COMP. L. 119, 119 n.3 (1988) (citing BARRY ALEXANDER K. RIDER AND H. LEIGH FRENCH, THE REGULATION OF INSIDER TRADING 251-53, 263 (1979)).

11. *See generally* Harvey L. Pitt & David B. Hardison, *Games Without Frontiers: Trends in the International Response to Insider Trading*, 55 LAW. & CONTEMP. PROBS. 199, 199-203 (1992) (noting that countries with developing stock markets were beginning to recognize the significance of regulation).

12. *See* Christine A. McGuinness, Note, *Toward the Unification of European Capital Markets: The EEC's Proposed Directive on Insider Trading*, 11 FORDHAM INT'L L.J. 432, 434-35 (1988) (describing the globalization of securities trading).

13. In 1988, Switzerland (a non-EU country) acquiesced to demands, primarily by the United States, to increase market transparency in order to counter the growing number of insider-trading scandals resulting from the vaunted practice of Swiss banking secrecy. Part of the result was Switzerland's first insider-trading law. *See* Schweizerisches Strafgesetzbuch, Code penal suisse, Codice penale svizzero art. 161, ¶¶ 1, 3 (Switz.). *See also A Clockwork Future for Finanzplatz Schweiz?*, ECONOMIST, July 7, 1990, at 73 [hereinafter *Clockwork*

It is estimated that seventy percent of the funds under Swiss management are foreign owned, and that thirty to forty percent of the share capital of Swiss companies quoted on the stock market is held by overseas investors.[14] In light of the gentlemen's secrecy agreement among Swiss bankers, many observers have alleged that a culture of insider trading has been imported into Switzerland, with no history of disclosure or enforcement to counter its effects.[15] Moreover, those securities markets in which effective restrictions on insider trading were absent became significantly less competitive in the tightening race for foreign, as well as domestic, capital.[16] Investors are wary of receiving reduced profits or being saddled with losses caused by trading with insiders in possession of valuable nonpublic information about the securities being traded. Thus, they have preferred to channel their funds into those few markets that protect them from insider trading.[17]

As a consequence, Germany, for example, has finally recognized the need for some form of insider-trading legislation in order to build a competitive international financial sector, despite its formerly vigorous opposition to EU proposals for banning insider trading by legal means.[18] This recognition followed a relatively sharp decline in the German capital markets index. This accompanied a correspondingly significant decline in foreign investor confidence in the German market due to the highly publicized insider-trading scandal involving Germany's largest banking interest, Deutsche Bank.[19] Foreign perceptions of the German economy had become the "pivotal factor in the movement of share prices," and apprehension over insider trading and interest rates had lowered the stock market index.[20]

With respect to domestic investors in Germany, the ease with which securities could now be traded internationally made the transfer of capital to more highly regulated foreign markets more attractive and seductive.[21] Thus, the ability of domestic corporations to efficiently

---

Future].

14. *See Clockwork Future*, *supra* note 13, at 73.

15. *Id.*

16. *See supra* note 5 and accompanying text.

17. *See supra* note 6 and accompanying text.

18. *See Finance Ministry Releases Plan to Revamp Securities Laws; Exchanges Reach Agreement*, INT'L SEC. REG. REP., Jan. 27, 1992, *available in* LEXIS, World Library, ISRR File [hereinafter *Finance Ministry*].

19. *Stock and Bond Financing*, INVESTING LICENSING & TRADING, Sept. 1, 1991, *available in* LEXIS, World Library, EIUILT File.

20. *Id. See* Pitt & Hardison, *supra* note 11, at 202.

21. *See* Joseph Blum, *The Regulation of Insider Trading in Germany: Who's Afraid of Self-Restraint?*, 7 NW. J. INT'L L. & BUS. 507, 509-10 (1986) (stating that small investors in Germany "shy away" from domestic stock investments because of the widely held belief that the markets are "fixed" in favor of insiders).

raise equity capital was adversely affected, necessitating heavy reliance on banks or debt financing.[22]

Against this backdrop, EU Council Directive 89/592,[23] adopted in November, 1989, mandated member states to enact insider-trading legislation that met or exceeded certain identified minimum specifications, before June 1, 1992.[24] In anticipation of this Directive, some member states embarked upon drafting laws impacting insider trading as early as 1986.[25]

The language and requirements of EU Council Directive 89/592 have even led a number of nonmember countries to adopt similar measures or to increase the strictness of existing insider-trading enactments.[26] This is particularly true of the members of the European

---

22. *See id.* at 530 (describing the heavy debt financing among German corporations). *See also* NORMAN S. POSER, INTERNATIONAL SECURITIES REGULATION: LONDON'S "BIG BANG" AND THE EUROPEAN SECURITIES MARKETS 395 (1991) (noting the dependence of German companies on bank credit).

23. Council Directive 89/592 on Coordinating Regulations on Insider Dealing, 1989 O.J. (L 334) 30 [hereinafter Directive 89/592]. Directive 89/592 was first proposed, in a different form, in 1987, although the European Commission (Commission) had been examining alternatives for dealing with insider trading since 1976. These earlier studies produced the "Commission Recommendation Concerning a European Code of Conduct Relating to Transactions in Transferable Securities," which received only a lukewarm reception. Warren, *supra* note 3, at 1043-45.

24. Under the Treaty of Rome, directives are essentially orders to the member states, issued by the Council and the Commission, to enact a certain kind of legislation. Treaty of Rome, *supra* note 1, art. 189, 298 U.N.T.S. at 78. Except for regulations issued by the Council or the Commission, EC institutions do not generally have the authority to enact law for the Community as a whole. Instead, the Council and the Commission are vested with the power to demand that member states enact laws that further the goals of the Treaty of Rome. *Id. See* D. LASOK & J.W. BRIDGE, LAW AND INSTITUTIONS OF THE EUROPEAN COMMUNITIES 126-48 (5th ed. 1991) (examining the interaction of the Treaty of Rome articles with specific authority such as article 100 and article 235 with the general power granted in article 189 in regard to the ability of the Council or Commissioner to legislate); *see also* Christopher Cruickshank, *Insider Trading in the EEC*, 10 INT'L BUS. LAW. 345, 345 (1982) (explaining the drafting procedure for a Directive). Much of the Commission's power to shape the law of the EC is exercised through the initiation of legislative measures for adoption by the Council and the taking of legal measures under authority from the Council. ERIC STEIN ET AL., DOCUMENTS FOR EUROPEAN COMMUNITY LAW AND INSTITUTIONS IN PERSPECTIVE 40 (1976).

25. *See* Stutz, *supra* note 6, at 164-65 (noting that Belgium and Denmark had insider trading laws pre-dating Directive 89/592). These states, however, did not know the specifics that the upcoming directive would adopt and, therefore, had to reexamine the express language of their own statutes in order to ensure that the provisions thereof conform to the directive's mandate. *See EC: Insider Dealing; EC Member States Prepare Rules for 1992*, FIN. TIMES, Feb. 7, 1990, at 8.

26. *See, e.g., Austria-Overseas Business Report,* NAT'L TRADE DATA BANK MARKET REP., Sept. 3, 1991, *available in* LEXIS, World Library, ALLWLD File (noting that Austria passed new legislation covering several areas of securities law, including insider trading, in order to harmonize Austrian law with EC law); *Swiss Insider Trading Bill Passes Final Parlia-*

Free Trade Association (EFTA).[27] Indisputably, the influence of the United States' experience of highly regulated securities markets under the supervision of the Securities and Exchange Commission (SEC)[28] has contributed to the sense of immediacy fueling adoption of insider-trading regulations among both EU and EFTA nations.[29]

II. ESSENTIALS OF EU COUNCIL DIRECTIVE 89/592

A. *Basics*

The Single European Act of 1987 strived to sustain momentum toward complete European economic integration by designating December 31, 1992, as the deadline for establishing common, barrier-free markets in goods, employment, services, and capital.[30] Substantial progress had already been made in the first three categories, through decades of directives and court decisions.[31] Now, establishing a common market for capital presented the greatest challenge to the twelve member states.[32] The unenviable task confronting the member states,

---

mentary Hurdle, REUTER LIBR. REP., Dec. 16, 1987, *available in* LEXIS, World Library, REUWLD File (examining Switzerland's new insider-trading law).

27. Three members of the European Free Trade Association (EFTA) (*viz.* Iceland, Liechtenstein and Norway) have become parties to the European Economic Area (EEA) Agreement. See Goebel, *supra* note 1, at 1103-08. Switzerland, the fourth member of EFTA, did not become a member of the EEA because of a Swiss referendum in 1992 against membership. *Id.* at 1105. For a brief historical discussion of EFTA see Friedl Weiss, *The European Free Trade Association after Twenty-five Years*, 5 Y.B. EUR. LAW 287 (1985).

28. The SEC was instituted by the Securities Exchange Act of 1934, 15 U.S.C. § 78j (1982).

29. Various joint statements and memoranda of understanding (MOU) have been signed between the SEC and European nations. Cooperating states include the United Kingdom, France, and The Netherlands. *See SEC, EC Sign Joint Statement Regarding Exchange of Information*, INT'L FIN. DAILY, Sept. 24, 1991, *available in* LEXIS, World Library, BNAIBF File.

30. Single European Act, *supra* note 1, art. 13.

31. *See, e.g.,* Case 249/81, Commission v. Ireland, 1982 E.C.R. 4005, 2 C.M.L.R. 104 (1983) (broadly defining the ban on quantitative restrictions on goods so as to find that a "Buy Irish" campaign sponsored by the government impeded the free movement of goods); Case 53/81, Levin v. Staatssecretaris van Justitie, 1982 E.C.R. 1035, 2 C.M.L.R. 454 (1982) (broadly defining the term "worker" so as to extend the freedom of movement to persons seeking part-time work); Case 115/78, Knoors v. Secretary of State for Economic Affairs, 1979 E.C.R. 399, 2 C.M.L.R. 357 (1979) (recognizing the right of family members to accompany a national who exercises the freedom of establishment); Council Directive 64/221, 1968 O.J. (L 257) 13 (harmonizing the laws of the various countries invoking exceptions to the free movement of workers); Council Directive 77/249, 1977 O.J. (L 78) 17 (establishing rules more liberal than those in the United States for the licensing of lawyers in the various jurisdictions of the EC).

32. WILLIAM RAWLISON & MALACHY CORNWELL-KELLY, EUROPEAN COMMUNITY LAW § 12.20 (1990). *See also Presentation of Interim Report on Completion of Internal Market*, AGENCE EUROPE, Jan. 9, 1992, *available in* LEXIS, World Library, TXTLNE File (noting that Germany, Italy, and Luxembourg have produced the most vigorous resistance to reforms

therefore, was to craft a reasonable and logical investor protection system for the EU that would endure into the twenty-first century and beyond.

Council Directive 89/592, the result of this formidable task, represented an ambitious step toward economic integration in EU securities markets. Of the twelve member states, only the United Kingdom[33] and France[34] had any history of meaningful governmental intervention and regulation of their securities markets in general, or insider trading in particular.[35] This Directive, requiring all twelve member states to adopt or improve insider-trading legislation before December 31, 1992, constituted more than merely the harmonization of their existing laws. With respect to eight member states, the Directive required, for the first time, the adoption of substantive restrictions on securities exchanges, in addition to the creation of genuinely viable administrative institutions to effectively enforce those restrictions.[36] Regarding the United Kingdom and France, the fundamental effect of Directive 89/592 was to modify even their comparatively strict insider-trading laws.[37]

The Directive's philosophy more closely resembled that of the United States' federal regulatory scheme rather than any European

designed to create a common European market).

33. *See Maxwell Pension Fund Scandal Leads to U.K. Review of Financial Regulation*, INT'L FIN. DAILY, Aug. 13, 1992, *available in* LEXIS, World Library, ALLWLD File. The United Kingdom's current two-tiered system of securities regulation was created by the Financial Services Act of 1986, ch. 60. Under this self-regulatory structure, the Treasury and Securities and Investment Board (SIB) jointly oversee four industry funded Self-Regulatory Organizations (SRO's); the Securities and Futures Authority (SFA); the Financial Intermediaries Managers and Brokers Regulatory Association (FIMBRA); the Life Assurance and Unit Trust Regulatory Organization (LAUTRO); and the Investment Management Regulatory Organization (IMRO). *Id.* Despite a study commissioned in 1992 by the Chancellor of the Exchequer, Norman Lamont, to examine the system's apparent failure in light of the Robert Maxwell affair and other insider-trading scandals, Mr. Andrew Large, Chairman of the SIB, has rejected the notion of developing a British regulatory body resembling the American SEC. *Id. See also London's Regulatory Mess*, ECONOMIST, May 29, 1993, at 15.

34. *See* George Graham, *European Finance and Investment—The New Powers of the COB*, FIN. TIMES, Oct. 22, 1990, at VIII; William Dawkins, *France Defines Insider Trading*, FIN. TIMES, May 8, 1990, at 26. Despite a history of intervention in the financial markets, the chief regulatory authority in France, the Commission des Operations de Bourse (COB), was forced by insider-trading scandals such as those involving Societé Génerale, Pechiney-Triangle, and Perriér, to promulgate a comprehensive code of conduct in 1990, including the introduction of insider trading into French law. The measure articulates a definition of insider trading that is essentially identical to that in Council Directive 89/592. *Id.*

35. *See supra* notes 33-34.

36. Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, and Spain did not have substantive insider-trading regulation. *See* Stutz, *supra* note 6, at 154-67.

37. *See supra* notes 33-34 and accompanying text.

model. Similar to the United States' federal securities law approach, the philosophy behind the Directive's blueprint for securities regulation was the adoption of public disclosure of market-sensitive information.[38] For example, in the United Kingdom, insider trading had traditionally been perceived as falling primarily under the bailiwick of "pure company law."[39] Thus, the crime of insider trading was defined in terms of the fiduciary duties owed by the officers and directors (i.e., the insiders) of a corporation.[40] So that the company, rather than the shareholders, was perceived as the person victimized by insider trading.[41]

The Directive essentially changed the legal conceptualization of insider-trading regulation. It shifted the focus from the bilateral (company versus insiders) approach of "pure company law" to the more dynamic multilateral approach of securities-market regulation.[42] Furthermore, in light of the definitions of "inside information,"[43] "insid-

---

38. *"[D]isclosure still remains the principal safeguard on which the [United Kingdom] Companies Acts pin their faith, and every succeeding Act since* 1862 has added to the extent of the publicity required . . . ." L.C.B. GOWER, PRINCIPLES OF MODERN COMPANY LAW 497 (4th ed. 1979) (emphasis added). United Kingdom adoption of the disclosure philosophy predates the United States's adoption of this safeguard in the federal securities regulation statutory scheme. However, creation of a single regulatory body (i.e. the SEC) was an American innovation. *See also* JENNINGS & MARSH, *supra* note 8, at 37. *See* Stutz, *supra* note 6, at 139. *See* Warren, *supra* note 3, at 1052 (stating that the Council adopted a philosophy of disclosure in enacting the directive); Lisa A. Hedges, Note, *Insider Trading and the EEC: Harmonization of the Insider Trading Laws of the Member States,* VIII B.C. INT'L & COMP. L. REV. 151, 155 (1985). *See also* P.L. Davies, *The European Community's Directive on Insider Dealing: From Company Law to Securities Market Regulation?,* 11 OXFORD J. LEGAL STUDIES 92, 94-101 (1991) (describing the philosophical bases for Directive 89/592). The EC's emphasis on disclosure is reflected in several of the ten directives comprising the Community's program on company law harmonization. *See* Hedges, *supra,* at 166.

39. GOWER, *supra* note 38, at 631. *See also* Davies, *supra* note 38, at 92-93.

40. *See* Davies, *supra* note 38, at 95.

41. The courts attempted to ameliorate this unjust construct and allow shareholder recovery in some instances. *See* GOWER, *supra* note 38, at 573, 631. *See also* Davies, *supra* note 38, at 93-95.

42. This shift is reflected in the legal basis for the Directive. The initial proposal for Directive 89/592 invoked Article 54(3)(g) of the Treaty of Rome as the basis for the Directive. Treaty of Rome, *supra* note 1, art. 54, 298 U.N.T.S. at 38-39. Article 54 focuses on the standards of fair behavior toward investors and creditors of member states' firms who do business with firms and brokerages in other member states. *Id.* However, upon the recommendation of the European Parliament, the Council used Article 100a of the Single European Act as the legal basis for the Directive. *See* Single European Act, *supra* note 1. Article 100a is aimed at ensuring the smooth functioning of the European economy as a unified market. *Id. See also* Warren, *supra* note 3, at 1048.

43. The Directive defines "inside information" as information that: (i) relates to one or several issuers of transferable securities or to one or several transferable securities; (ii) is of a precise nature; (iii) has not been made public; and (iv) if made public, would be likely to have

er,"[44] and other critical elements of insider-trading violations, the Directive has opted for an extended sphere of coverage.[45] The Directive, therefore, regulates the activities of a cadre of personnel, encompassing more than just a few persons closely associated with a company.[46] Arguably, the scope of the Directive extends to "tippees," as these persons are known in United States securities markets.[47] Unfortunately, however, the Directive does not expressly prohibit tippees from simply passing the inside information on to subsequent tippees.[48]

Additionally, Directive 89/592 mandates that all member states regulate insiders, as defined in the Directive,[49] and punish them for violations that they commit within the territorial boundaries of the member states.[50] This includes securities transactions effectuated outside those boundaries that have been carried out on securities markets within the territory of any member state.[51] Administratively, therefore, the most onerous aspect of the Directive is not so much the man-

---

a significant effect on the price of the security or securities in question. Directive 89/592, *supra* note 23, art. 1(1). The class of "transferable securities," to which the Directive's restrictions on insider trading apply, includes shares and debt securities and their equivalents, in addition to, contracts or rights to subscribe for, acquire, or dispose of such securities, futures contracts, options, financial futures, and index contracts in respect of such securities. *Id.* art. 1(2).

44. "Insider" is defined as someone who: (A) takes advantage of inside information; (i) with full knowledge of the facts; (ii) by acquiring or disposing, directly or indirectly, transferable securities of the issuing company to which the information relates; (iii) for his own account or for the account of a third party; and (B) possesses such inside information because of his (i) membership in administrative, management, or supervisory bodies of the issuing company; (ii) holding in the capital of the issuing company; or (iii) access to such inside information in the exercise of his employment, profession, or duties. Directive 89/592, *supra* note 23, art. 2(1). Additionally, where the insider is a legal person, responsibility for insider trading attaches to anyone who takes part in the decision to carry out the illegal transaction. *See id.* art. 2(2).

45. Primary insiders are prohibited from disclosing information or making recommendations. Directive 89/592, *supra* note 23, art. 3. Secondary insiders who have full knowledge of inside information, which could only have come from a primary insider, are also subject to regulation. *Id.* art. 4.

46. *See* Directive 89/592, *supra* note 23, art. 3. Thus, persons who are not explicitly within the definition of "insider," but who nevertheless possess inside information that only an insider could have provided, are also subject to restrictions on trading. *See id.* art. 4.

47. *See, e.g.*, Ross v. Licht, 263 F. Supp. 395, 410 (S.D.N.Y. 1967) (defining "tippees" as "persons given information by insiders in breach of trust").

48. *See* definition of "secondary insiders." Directive 89/592, *supra* note 23, art. 4. Therefore, a secondary insider (under the Directive's definition) would be the equivalent of a tippee (under the U.S. federal securities law definition), but would *not* be a subsequent tippee (under the U.S. federal securities law definition).

49. *See* Directive 89/592, *supra* note 23, arts. 2-4.

50. *See* Directive 89/592, *supra* note 23, art. 5.

51. *Id.*

date to enact the insider-trading legislation, but rather establishing the fundamental structure to enforce the Directive's mandate.[52] The designation of pertinent authorities and the formation of administrative organizations to ensure enforcement of the regulations will prove costly to the individual member states.[53] Furthermore, the Directive requires member states to imbue such authorities with all supervisory and investigatory powers necessary to effectively and efficiently carry out their statutory functions.[54]

B. *Penalties*

With respect to the imposition of penalties for insider-trading violations, the Directive leaves specific choices to the member states individually.[55] Penalties need not be criminal.[56] In fact, they may take any form, provided that they are sufficiently coercive to deter conduct violative of the insider-trading enactments.[57] In light of past unsuccessful enforcement of regulations by some member states, this grant of discretion by the Directive does not ensure the curbing of insider trading.[58]

III. THE GERMAN RESPONSE

Traditionally, Germany has been reluctant to play a leadership role in the EU.[59] The country's unwillingness to assume command is typ-

---

52. Directive 89/592, *supra* note 23, art. 8.

53. Recently, for example, Italy has taken steps to regularize disclosure, inhibit insider trading, and inject greater competition into the stock market by introducing a new form of business organization, the *Societa di Intermediazione Mobiliare* (SIM), to compete with brokers formerly enjoying a monopoly. *Into a Murky Future*, *supra* note 5, at 65; *Another Big Bang—New Legislation and Screen Trading Transforms Italy's Stockmarket*, *supra* note 5, at 32. These steps, intended to bring the Italian market into line with EC requirements, were taken concurrently with the allocation of expanded powers and additional staff to Consob, the Italian stock market watchdog. *Id.*

54. Directive 89/592, *supra* note 23, art. 8. Progress in empowering the authorities has been inconsistent as EC member states proceed to harmonize the requirements of Directive 89/592 with their respective domestic financial cultures. *See Clockwork Future*, *supra* note 13, at 73; Alex Brummer, *Sweeping Away an Insidious Culture of Self-Regulation*, GUARDIAN, May 8, 1993, at 36.

55. Directive 89/592, *supra* note 23, art. 13.

56. *Id.*

57. *Id.*

58. The history of prior enforcement by EC member states has been inconsistent. For example, there has been a relative lack of enforcement in Italy; marginal enforcement in Germany, where compliance with insider-trading laws has heretofore been voluntary and any "penalties" previously imposed for insider infractions have been civil restitution; and the most significant enforcement in the United Kingdom and France, where a mixture of civil and criminal penalties have traditionally been available to regulators. *See* Stutz, *supra* note 6, at 155-67.

59. *German President Richard von Weizsacker Addresses Members*, COUNCIL CHRON.

ified by the following remarks of President Richard von Weizsacker:

> Germany is not the leading power in the European Community. It is not the senior partner and is not first among equals either. Germany would not want such a position, could not hold such a position and, what is more, should not be pushed into such a position either from within or without.[60]

Of course, these views may be perceived in the political context of the EU, but they unavoidably resonate in the legal context as well. As President von Weizsacker readily conceded: "It is true, [that] Germany-together with France-not only constitutes the center of Europe, [but] *Germany also serves on that continent as an engine for European unification.*"[61] It is therefore the obligation of "the engine" to push, or pull, the EU into the sophisticated securities-market regulatory era of the twenty-first century, in general; and to be at the forefront of modern investor-protective insider-trading measures within the EU in particular.

Germany presented a special problem in the implementation of the insider trading Directive. Unlike the other two economic and financial heavyweights in the EU, the United Kingdom and France, Germany had not previously established a set of mandatory procedures for regulating insider trading.[62] Thus, implementing the Directive in Germany required more than merely fine-tuning or amending existing legislation. Rather, the creation of an entirely new regulatory system for insider trading was necessary. This provided a challenge for German legislators.

First, the banking industry had strongly opposed legal measures against insider trading.[63] Second, and more important, the German government, at first, vigorously opposed the substantive thrust of Directive 89/592 during its formative stages, which emphasized legally binding regulations.[64] Instead, Germany preferred self-regulatory measures, relying on voluntary guidelines on insider trading[65] drafted in 1970, and amended in 1976, and again in 1988, by the German Stock Exchange Commission of Experts.[66] The rationale for creating these

---

(Chicago), Sept. 1993, at 1 [hereinafter *German President*].

60. *Id.* at 1, 3.

61. *Id.* at 1 (emphasis added).

62. Stutz, *supra* note 6, at 161; Blum, *supra* note 21, at 516-17.

63. Blum, *supra* note 21, at 528.

64. Warren, *supra* note 3, at 1045.

65. Insider Trading: Insider Trade Directives as of July 1976, *reprinted in* INTERNATIONAL SECURITIES LAW AND PRACTICE 85, app. 4 at 108-10 (J. Michael Robinson ed. & Gerhard Wegen trans., 1985) [hereinafter INSIDER TRADING GUIDELINES]. *See also* Pitt & Hardison, *supra* note 11, at 216 (noting that the Guidelines, as adopted in 1970, and amended in 1976 and 1988, indicate a gradual shift in the German position towards greater harmony with Directive 89/592).

66. Marjory A. Appel & Gerhard Wegen, *The EEC Directive on Insider Trading*, 22 REV.

voluntary guidelines was the contention that to be caught engaging in insider trading, and subsequently shunned by the business community at large, would be sufficient punishment to deter insider trading.[67]

The financial and economic weight of opinions expressed by German financial institutions was another obstacle to enacting the Directive into law in Germany. These institutions consistently resisted governmental intervention to solve the problem, vehemently supporting self-regulation as the most viable alternative.[68] For Germany, Directive 89/592 meant considerably more than simply establishing a novel regulatory system where none previously existed. Rather, the Directive required the radical transformation of deeply entrenched attitudes strongly favoring a privately regulated system.

Replacing this system with intrusive governmental intervention has been a formidable step. This has been particularly true since the attitude of the German government toward implementing the Directive significantly reflected the attitudes of the country's major financial institutions.[69] As a result, although the Directive was adopted in 1989, the German government did not initiate any viable plans for enactment of conforming insider-trading laws until 1992.[70] It did not actually

---

SEC. & COMMODITIES REG. 137, 140 (1989) (stating that the Stock Exchange Commission of Experts was primarily responsible for drafting the guidelines); *Insider Trading in West Germany: Impeccable Complacency*, ECONOMIST, Mar. 11, 1989, at 83 (stating that the guidelines were drafted and amended in 1970, 1976, and 1988).

67. *German Insider Trading: Behind the Times*, Economist, July 13, 1991, at 86. The rules of procedure for investigating an insider-trading violation provide that the investigatory board may not publish its findings unless the violation is extreme or the violator consents. Blum, *supra* note 21, at 521. Furthermore, insider-trading regulations are currently voluntary and only those who agree to be bound may be punished for their violation. *Insider Commission Powerless in Steinkuehler Case*, REUTER FIN. REP., May 28, 1993, *available in* LEXIS, World Library, FINRPT File. The likely deterrent effect of such feeble "enforcement" provisions remains indeterminate at best, and nugatory at worst, although public humiliation in the wake of recent insider-trading scandals has precipitated relatively harsh social sanctions such as the loss of position, power, and livelihood. *Germany: Daimler Shareholders Snub Disgraced Union Chief*, REUTER EUR. BUS. REP., May 26, 1993, *available in* LEXIS, World Library, BUSRPT File; *Germany: Deutsche Bank Will Not Bless Steinkuehler's Work*, REUTER FIN. REP., May 26, 1993, *available in* LEXIS, World Library, FINRPT File.

68. Stutz, *supra* note 6, at 163.

69. *See supra* note 63.

70. *Finance Ministry*, *supra* note 18. *See also Tighter Insider Trading Rules Have Little Practical Impact*, FINANCING FOREIGN OPERATIONS, Mar. 1, 1991, *available in* LEXIS, World Library, FINFOR File (noting that the Finance Ministry had, at that time, "not even begun to grapple with the issue"); O.W. Breydha, *German Equity Markets*, *in* GLOBAL EQUITY MARKETS 117, 133 (Jess Lederman & Keith Park eds., 1991) (predicting that Germany would not succeed in meeting the deadline for implementing the directive on insider trading). Undoubtedly, the issuance by the Commission of an Art. 169 letter (under Treaty of Rome, *supra* note 1, art. 169, 298 U.N.T.S. at 75) to Germany in 1992, must have prodded enactment of conforming legislation. *See* Tenth Annual Report on the Monitoring of the Application of

enact the Directive into law in Germany until 1994.[71]

Essentially, Directive 89/592 mandated that Germany, arguably the most economically powerful member state,[72] eschew a firmly held belief system with respect to its securities markets and fundamentally amend its investor protection laws. The issuance of the Directive reflected the shift in jurisdictional forces within the EU, which ushered in a new era of enhanced juridical authority of the Council, authorizing it to act by qualified majority under a "co-operation procedure"[73] involving the European Parliament.[74] The new arrangement enabled the Council to exercise unprecedented powers to order fundamental reform of the securities markets of the member states.[75] This historical shift in the correlation of intrinsic legal forces in the EU is the legacy of the Single European Act, which replaced the rigid requirement of unanimity in the Council decision-making process, when amending a Commission proposal,[76] with the greater flexibility of qualified majority rule.[77]

Although Germany had argued forcefully against the adoption of these fundamental changes in insider-trading laws, it was forced to succumb to the will of the other member states. These States ranged from the United Kingdom, where insider trading was already quite tightly regulated,[78] to Spain,[79] which had "reportedly rampant" insid-

---

Community Law: Report on the Application of Directives, COM(93)320 final at 356. "At the beginning of 1993 the Federal Government [of Germany] decided to implement the EC Directives on insider dealing and takeovers by means of a new Securities Trading Act." Bruckhaus W. Stegemann, *Regional Development: Germany*, 28 INT'L LAW. 155, 161 (1994) (footnote omitted).

71. Gesetz uber den Wertpapierhandel und zur Anderung borsenrechtlicher und wertpapierrechtlicher Vorschriften (Zweites Finanzmarktforderungsgesetz), 1994 BGBl. I 1749 [hereinafter German Statute].

72. *See supra* text accompanying note 61.

73. *See* LASOK & BRIDGE, *supra* note 24, at 230.

74. *See* Single European Act of 1986, *supra* note 1, art. 7, which amends Article 149 of the Treaty of Rome (replacing the *universal* requirement of unanimity with respect to an EC Council vote to amend an EC Commission proposal).

75. See Directive 89/592, *supra* note 23, Preamble.

76. *See* RAWLISON & CORNWELL-KELLY, *supra* note 32, § 12.20.

77. "Qualified majority rule" is explained in Article 148 of the Treaty of Rome. Treaty of Rome, *supra* note 1, art. 148, 298 U.N.T.S. at 70. Article 148 weighs the voting power of the member states differently, creating a total of seventy-six possible votes among the twelve member states. *Id.* To adopt a proposal from the Commission (e.g., a proposed directive), fifty-four votes are required; in all other cases, fifty-four votes from eight member states are required. *Id.*

78. *See supra* text accompanying note 33.

79. *See Insider Trading in Europe: A Daft Draft*, ECONOMIST, May 20, 1989, at 86 [hereinafter *Daft Draft*] (noting that Spain was quite willing to adopt the proposed insider trading directive by June 1989).

er trading.[80]

Furthermore, in light of Germany's lack of hostility in the past toward even egregious insider-trading practices, it is not surprising that subsequent to the issuance of Directive 89/592, the integrity of the German securities market was further called into question. In the recent past, the number of insider trading scandals in Germany increased, providing ammunition for those who favored reform of its investor protection laws regulating insider trading.[81] First, a scandal arose in late June, 1991, involving Deutsche Bank, Germany's largest banking institution. This prompted Germany's then Finance Minister, Theo Waigel, to introduce a comprehensive plan for restructuring German securities markets, including a call for insider-trading legislation consistent with Directive 89/592.[82] More recently, a major scandal involving Mr. Steinkuehler, a supervisory board member of Daimler Benz,[83] further raised national awareness of insider-trading abuses. As a result of this consciousness-raising, governmental officials and securities traders, sensitive to Germany's role in the EU, evinced the willingness to support federal securities law reform that ultimately led to enactment of the German legislation.[84]

---

80. *Financing*, BUS. INT'L FORECASTING, June 13, 1989, *available in* LEXIS, World Library, EIUCF File. In fact, financially less-developed member states, such as Spain, may have supported the Directive because they reasoned that these reforms would substantially improve foreign investors' confidence in the integrity of their own securities markets.

81. *See British Bankers Association*, THOMSON'S FIN. COMPLIANCE WATCH81., Oct. 11, 1991, *available in* LEXIS, World Library, ARCNWS File. *See also* Michael Shields, *Insider Trading Becoming Less Acceptable in Europe*, REUTER LIBR. REP., Dec. 2, 1989, *available in* LEXIS, World Library, REUWLD File.

82. *See Finance Ministry, supra* note 18.

83. The most notable recent insider-trading scandal in Germany, and the one that challenged the German system on the most fundamental level, is the case of Franz Steinkuehler, leader of Germany's most powerful union, IG Metall, and until recently, a board member of Daimler Benz. Mr. Steinkuehler's alleged purchase of shares of Mercedes Automobile Holding (M.A.H.) and Dutch aerospace company Fokker, in advance of share swaps by Daimler, severely undermined the credibility of the hallowed German practice of *Mitbestimmung*, which imposes worker directors on every enterprise. The scandal simultaneously exposed (a) the shortcomings of the practice of *Mitbestimmung*, (b) the inadequacies of the German system of voluntary restraint in matters of insider dealing, and most importantly, (c) the distinct lack of power of the German regulatory authorities. *See European Business-Union Man's Daimler Dealing Downfall Fuels German Woes*, DAILY TELEGRAPH, May 31, 1993, at 22; *Insider Commission Powerless in Steinkuehler Case*, REUTER NEWSWIRE-ECON. NEWS, May 28, 1993; *Steinkuehler Offers to Resign Over Insider Issue*, REUTER NEWSWIRE-ECON. NEWS, May 24, 1993; *Germany: Capitalism's Limits*, ECONOMIST, May 29, 1993, at 58; *Insider Dealing: Balancing Act*, ECONOMIST, May 22, 1993, at 84; and finally, "Franz Steinkuhler, chief of IG Metall, [Germany's] biggest union . . . [o]n May 25[, 1993,] . . . resigned after admitting that he had speculated in the shares of companies associated with Daimler-Benz while sitting on its supervisory board." *Germany: Capitalism's Limits*, ECONOMIST, May 29, 1993, at 58.

84. *See* German Statute, *supra* note 71.

IV. The German Statute Contrasted With Germany's Voluntary Guidelines On Insider Trading

A. *The Guidelines*

The voluntary guidelines on insider trading in Germany were in desperate need of reform. Adoption by German corporations of the voluntary guidelines, unfortunately, left a serious gap in the protective net for securities investors. Therefore, sweeping changes were therefore necessary in order to ensure conformance with requirements of the Directive. Even though the definition of "insider" in the guidelines was expanded (as part of the 1988 amendments) to include advisors and lenders privy to inside information,[85] it was still more narrowly drawn than the definition in the Directive.[86] It included only persons in specifically listed positions, which typically encompassed those persons who had a very close relationship with the company, enabling them to obtain inside information in the ordinary course of their business activities.[87] The guideline definition unfortunately omitted "tippees" altogether.[88]

Furthermore, the scope of "inside information" regulated by the guidelines was particularly constrained. Although "inside information" included "knowledge of circumstances not yet disclosed or publicly known that could affect the valuation of insider securities,"[89] in reality, this apparently broad definition was interpreted restrictively.[90] Moreover, any restrictions imposed upon insiders did not apply to transactions in securities not listed on a German stock exchange, thereby leaving unregulated a significant subseries of securities transactions that could be conducted through private intermediaries.[91] Nor

85. *See West Germany Broadens Rules on Insider Trading*, WALL ST. J., Apr. 8, 1988, at A28. *See also supra* note 66 and accompanying text.

86. *West Germany Broadens Rules on Insider Trading*, *supra* note 85, at A28.

87. The definition of "insider" in §2 of the Insider Trading Guidelines listed legal representatives and members of the supervisory board of a company or an affiliated domestic enterprise; shareholders holding less than twenty-five percent of the company shares and their legal representatives; members of the board of directors holding less than twenty-five percent of the company shares; employees obtaining inside information in the ordinary course of their business; agents of the company obtaining inside information in the ordinary course of their business with the company; banks and members of their supervisory boards; and other general managers, employees, and agents retained by the corporation and privy to inside information in the ordinary course of their business. *See* Appel & Wegen, *supra* note 66, at 141 n.37. *See also* Thomas J. Ramsdell, *The EEC Directive on Insider Trading: Will There Be a Cure by 1992?*, 6 AMER. U.J. INT'L L. & POL'Y 637, 669-71 (1991) (discussing the limited definition of insider in the German guidelines compared to the EC Directive).

88. Appel & Wegen, *supra* note 66, at 141.

89. *Id.* (citing INSIDER TRADING GUIDELINES, *supra* note 65, § 2(3), at 109).

90. INSIDER TRADING GUIDELINES, *supra* note 65, § 2, at 108-09.

91. Appel & Wegen, *supra* note 66, at 141; Stutz, *supra* note 6, at 163; 10C INTERNA-

did the restrictions apply to "secondary insiders," such as tippees.[92]

Finally, enforcement mechanisms were ineffective. Very few formal investigations resulted from adoption of the voluntary guidelines,[93] and the most recent finding of guilt under the guidelines occurred in 1986, when Daimler-Benz AG made a tender offer for the shares of *Allgemeine Elektriziteits Gezellschaft* (AEG).[94] Even then, the wrongdoer, a board member of AEG, was required only to return to AEG DM 16,000, the ill-gotten gains reaped from the use of inside information.[95] The violating board member was not disciplined, however, since the insider-trading rules had required voluntary consent by the insider in order to become binding.[96]

Only private review boards of the various stock exchanges were empowered to initiate investigations into suspicious trading activities.[97] Furthermore, this authority only arose upon the filing of an essentially private complaint that alleged a violation of the guidelines.[98] No central enforcement agency existed in Germany. In fact, the German securities market-place is still quite fragmented,[99] being spread among a number of stock exchanges with the Frankfurt *bourse* generating the most business.[100] This configuration, a result of Germany's pattern of fragmentation and local autonomy,[101] has tend-

---

TIONAL CAPITAL MARKETS AND SECURITIES REGULATION § 8C.11[2] (Harold S. Bloomenthal & Samuel Wolff eds., 1995).

92. Appel & Wegen, *supra* note 66, at 141.

93. *The Finanzplatz Fairytale — How Insider-trading Scandals Finally Awaken the Banks*, INSTITUTIONAL INVESTOR, May 31, 1992, *available in* Lexis, World Library, CURNWS File.

94. Blum, *supra* note 21, 526-28.

95. *Sweeping out the Stables*, ECONOMIST, Aug. 31, 1991, at 15. Restitution was then the standard remedy for insider-trading violations in Germany. *Id. See* Nystrom, *supra* note 10, at 129.

96. Stutz, *supra* note 6, at 163 (citing Elsing & Shook-Wiercinok, *New German Insider Trading Regulations*, 1988 INT'L FIN. L. REV. 30, 31 (1988)).

> The Frankfurt bourse's insider commission said it would not be able to take action against former German union leader Franz Steinkuehler *even if it could be proved that he used insider information in share deals*. The commission's chairman Friedrich-Carl zur Megede [indicated that] the insider commission could only take action against people who had signed insider guidelines at a firm where they had access to privileged information. . . . Steinkuehler — unlike other members of Daimler's supervisory board — had *not* signed the insider rules.

Insider Commission Powerless in Steinkuehler Case, REUTER FIN. REP., May 28, 1993, *available in* LEXIS, World Library, FINRPT File (emphasis added). For discussion of Franz Steinkuehler *see supra* note 83.

97. Blum, *supra* note 21, at 520-21.

98. *Id.* at 523.

99. Germany has exchanges in Berlin, Bremen, Dusseldorf, Frankfurt, Hamburg, Hanover, Munich, and Stuttgart. Appel & Wegen, *supra* note 66, at 141.

100. POSER, *supra* note 22, at 314.

101. *See generally* DONALD S. DETWILER, GERMANY: A SHORT HISTORY (2d ed. 1989).

ed to frustrate efforts to harness the economic and financial power of Germany's disparate stock exchanges and has hindered efforts to convert those exchanges into a centralized securities market.[102]

Above all, the nonbinding status of the guidelines had been the greatest obstacle to their enforcement. Only in those instances where insiders had contractually undertaken obligations to their employers to comply with the guidelines were they legally precluded from engaging in insider trading.[103] Moreover, companies could choose not to adopt insider-trading guidelines altogether.[104]

B. *The German Statute*

The limited scope and stringency of the voluntary guidelines provided an insufficient framework for the drafting of any new German legislation implementing Directive 89/592. However, the task confronting Germany's legislators was not insuperable and opponents of investor-protection law reform in Germany were in the end defeated. The Directive's main thrust in trying to counter insider trading is in the wide-ranging, yet precise, definitions of critical terms in its investor-protection mechanisms and their application to such a wide spectrum of securities transactions.

The definition of "insider" in the statute contains both primary *and* secondary insiders, including "tippees."[105] The statute definition of "inside information" includes similar requirements to the three specifics in the guidelines.[106] However, the fourth specific in the guidelines mandated by the Directive definition, requiring that the information be precise, is not specifically included,[107] and this may pose a problem.

The provisions for enforcement and penalties mandated by the Directive are probably too flexible. They have allowed the German legislature, as well as the legislatures of the other member states, too much leeway in designing a system for viable securities regulation. Whereas the provisions defining the scope of the Directive and the meaning of fundamental terms are reasonably precise and make manip-

102. *Another Unification Problem*, ECONOMIST, Aug. 31, 1991, at 61 (noting that smaller exchanges in Germany view centralization of the German stock markets as a threat to their existence and that local politicians view local exchanges as a symbol of success for their regions).

103. Blum, *supra* note 21, at 517.

104. *Id.* at 519.

105. Nystrom, *supra* note 10, at 135.

106. The guideline definition is that the information: (i) be nonpublic, (ii) relates to the securities being traded, and (iii) has potentially a material effect on the price of the securities. *See* INSIDER TRADING GUIDELINES, *supra* note 65, § 2(3), at 109.

107. German Statute, *supra* note 71, § 13(1)3.

ulation by member states more difficult,[108] the enforcement and punishment provisions essentially abdicate responsibility to mandate similar specifics.[109] When the European Parliament first reviewed the proposed Directive, it urged the adoption of harmonized penalties. However, the Council failed to embrace and mandate more rigorous and coercive enforcement requirements in addition to more harmonized punitive measures for violations.[110] This failure has led to criticism of the enforcement and penalty provisions in the Directive by a number of commentators.[111]

Furthermore, with regard to enforcement, the Directive has not mandated a central, supranational securities regulation agency for the EU.[112] Instead, it requires that each member state designate a competent authority, or set of authorities, to ensure compliance with the mandatory insider-trading regulations.[113] Under the German statute, enforcement of the new law through criminal proceedings is attained by Federal Supervisory Authority notification to the competent state prosecutor's office when information suggesting criminal violation of the insider trading law comes to light.[114] This structural arrangement leaves the actual prosecution up to the state prosecutor's office and allocates to the Federal Supervisory Authority essentially a monitoring role.[115]

In Germany, with its small, regional exchanges deeply rooted in a long tradition of local autonomy,[116] the statute's assignment of enforcement responsibility to state prosecutor's offices is not certain to attain significant enforcement. In fact, this state prosecution solution was adopted apparently because, although an increasing number of German securities traders had stopped criticizing national insider-trading laws,[117] they did not prefer a central enforcement agency akin to the United States' SEC and its extensive enforcement machinery.[118]

108. Stutz, *supra* note 6, at 168.

109. *Id.* at 171-72.

110. *See* Warren, *supra* note 3, at 1047-49.

111. *Id.* at 1074; Ramsdell, *supra* note 87, at 674; Nystrom, *supra* note 10, at 139-40; McGuinness, *supra* note 12, at 449; Appel & Wegen, *supra* note 66, at 140; Stutz, *supra* note 6, at 172.

112. Such an agency would be the functional equivalent to the SEC in the United States.

113. Directive 89/592, *supra* note 23, arts. 8, 13. *See* Warren, *supra* note 3, at 1075.

114. German Statute, *supra* note 71, § 18(1).

115. *Id.* § 18(2).

116. *See supra* text accompanying note 101.

117. *See Insider Trading Becoming Less Acceptable in Europe*, *supra* note 81.

118. The German Statute provides for the establishment of the German Federal Supervisory Authority to supervise the securities markets. *See* German Statute, *supra* note 71, § 16(1). As part of its supervisory functions, the Authority is empowered to demand production of information and documents in order to detect irregularities. *Id.* § 16(2),(3). The Authority may also

Therefore, the statute has struck a compromise, by splitting the functions between a federal supervisory authority and the state prosecutor's offices of the individual states on the following basis.

The German Statute provides for the establishment of the German Federal Supervisory Authority (Authority) to supervise the securities markets.[119] As part of its supervisory functions, the Authority is empowered to demand production of information and documents in order to detect irregularities[120] and to determine whether or not violations have occurred.[121] On suspicion, based upon the information collected that violations have occurred, the Authority must notify the appropriate state prosecutor's office so that criminal proceedings can be brought against the perpetrators if appropriate.[122] The state prosecutor's offices are required to keep the Authority informed of the progress of each case.[123]

Unfortunately, adoption of this compromise solution may very well inevitably perpetuate the current fragmentation in German securities regulation. Whereas the federal legislature has enacted statutory provisions for implementing the Directive, local state prosecution agencies have been allowed to retain important powers that inevitably allocate to them significant discretion in determining the manner in which the new laws will be enforced.

Of course, in the interest of promoting consistency, the Directive requires that regulatory agencies in the member states cooperate with each other in enforcing their insider-trading laws.[124] As a practical matter, this has been accomplished in the German statute, for the most part, by requiring the sharing of information procured in the course of individual investigations.[125] Hopefully, if German enforcement efforts turn out to be less effective than those of other member states, such as France or the United Kingdom, the example of more vigorous implementation by its counterparts may prod Germany into more energetic action in this regard. Admittedly, however, the external stimulus of other member states' practices may tend to play a more noticeable role

---

determine whether or not violations have occurred. *Id.* § 16(4). Based upon the information collected, and on suspicion that violations have occurred, the Authority must notify the appropriate state prosecutor's office so that criminal proceedings can be brought against the perpetrators. *Id.* § 18(1). The state prosecutor's offices are required to keep the Authority informed of the progress of each case. *Id.* § 18(2).

119. *See* German Statute, *supra* note 71, § 16(1).

120. *Id.* § 16(2), (3).

121. *Id.* § 16(4).

122. *Id.* § 18(1).

123. *Id.* § 18(2).

124. Directive 89/592, *supra* note 23, art. 10(1).

125. German Statute, *supra* note 71, § 19.

in international rather than local investigations, since the EU has not provided a centralized securities regulation enforcement agency. Moreover, other than the Frankfurt stock market, German exchanges are relatively small. As a result, it is less likely that Germany's state enforcement agencies will have many opportunities to participate in international investigations requiring cooperation with more aggressive member state counterparts.

With regard to retribution, the provisions of the Directive are weaker and use less assertive language[126] than in the enforcement provisions.[127] Member states are accorded substantial discretion in their selection of penalties "sufficient . . . to *promote* compliance" with the insider trading laws that they enact pursuant to the Directive's mandate.[128] Although administrative authorities in each member state must "ensure" that insider trading laws are properly applied,[129] the penalties enacted need only "promote," rather than *coerce,* compliance.[130] By enacting a criminal framework, the German statute seems to take enforcement seriously. Relegating enforcement to criminal proceedings by state prosecutor's offices — rather than creating a more powerful federal supervisory authority akin to the U.S. SEC — has seriously weakened prospective enforcement as a practical matter.

In criminalizing violations of the insider-trading law, the German statute has attempted to stigmatize insider trading and hopefully, this will help to reverse "decades of European regulatory indifference" to these harmful practices.[131] In a country where insider trading is viewed "simply as a lucky tip,"[132] the Directive would be unlikely to provide a sufficient impetus for weakening the temptation to engage in insider trading or to reverse the firmly established attitudes of indiffer-

126. Directive 89/592, *supra* note 23, art. 13.

127. Directive 89/592, *supra* note 23, art. 8.

128. Directive 89/592, *supra* note 23, art. 13 (emphasis added).

129. Directive 89/592, *supra* note 23, art. 8.

130. Directive 89/592, *supra* note 23, art. 13 (emphasis added). Conceivably, the shortcomings of the Directive in this regard are due, in large part, to the EC institutions' tradition of refraining from specifying sanctions in any detailed way, leaving them to the discretion of the member states. *See* Warren, *supra* note 3, at 1074 n.242 (arguing that this tradition must be abandoned in order to achieve regulatory harmony).

131. *See* Warren, *supra* note 3, at 1074. The Directive does not mandate that member states criminalize insider trading, but the United Kingdom has criminalized insider trading in implementing the provisions of Directive 89/592 in the Criminal Justice Act 1993. *See Balancing Act*, ECONOMIST, May 22, 1993, at 86. Presumably, the issuance by the Commission of an Art. 169 letter, (*see* Treaty of Rome, *supra* note 1, art. 169, 298 U.N.T.S. at 75) to the United Kingdom in 1992, must have prodded the passage of the Criminal Justice Act 1993. *See* Tenth Annual Report on the Monitoring of the Application of Community Law: Report on the Application of Directives, COM(93)320 final at 356.

132. *See* Warren, *supra* note 3, at 1041.

ence toward such practice.[133]

Germany, however, must be wary of its potential leadership role in the EU, and in Europe generally. "Germany's central position, the result of geography and politics, culture and economics . . . with all the advantages and drawbacks which history has proven are so hard [to bring] into balance[,]"[134] cannot be ignored. One commentator has expressed the belief that, although Germany has statutorily prohibited insider trading out of a sense of obligation mandated by the Directive, and perhaps even out of fear of losing investor confidence, the new regulations are probably not the result of a fundamental change of heart by the regulated, the regulators, and the courts.[135] If accurate, this would be a profound tragedy. Germany owes it not only to the EU, but also to itself, to adopt a more enlightened posture towards this pernicious activity.

VI. CONCLUSION

Admittedly, Council Directive 89/592 on Insider Trading has introduced and harmonized sophisticated insider-trading laws throughout the EU. Some specific provisions, as highlighted, create uncertainties with regard to prohibiting countries, such as Germany, from continuing a course of conduct substantially similar to past practices of widespread indifference toward insider trading. In a nation where the financial sector is large and powerful, as it is in Germany, if insider trading continues to be perceived as simply immoral conduct in spite of the German statute's criminalization of the activity, the EU governing institutions will most likely expect from German state enforcement agencies less than vigorous pursuit of cases referred to them by the Federal Supervisory Authority.

The Directive's approach to enforcement and penalties of relegating coercion to the member states individually, may ultimately fail to provide the hoped for deterrence. Nonetheless, Germany may do well to heed the sentiments expressed by German President Richard von Weizsacker:

> To put it in [the] form of a parable: [Germany is] like [someone] in the middle of a boat surrounded by . . . friends sitting at the edge. He is the one who has to keep the boat evenly balanced. His weight and position give him influence and demand attention even when he does not particularly want it. They place on him a special burden of responsibility, restriction and even discrimination: he cannot jump up and down, swap seats with his neighbor

---

133. *Id.* at 1041.

134. *See German President*, *supra* note 59, at 3.

135. Warren, *supra* note 3, at 1041. *See also Daft Draft*, *supra* note 79, at 87 (suggesting that judges will continue to treat insider trading as a "gentlemanly misunderstanding rather than a crime").

> or even shift his weight lest he rock the boat and put everyone in danger. His movements have to be coordinated well in advance and carefully discussed with several if not all of his neighbors.[136]

Germany must energetically cooperate with the other EU member states to maintain honest, efficient, and policed securities markets that inspire investor confidence and promote the healthy, unrestricted flow of capital into German companies and its economy. Such action will reap permanent, rather than transient, benefits for Germany, as well as for all the other member states of the EU.

---

136. *See German President, supra* note 59, at 3.