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CONGRATULATIONS FROM YOUR CONTINENTAL COUSINS, 10b-5: SECURITIES FRAUD REGULATION FROM THE EUROPEAN PERSPECTIVE*

*DR. GERHARD WEGEN***

INTRODUCTION

CONGRATULATIONS, Rule 10b-5, from your European cousins. Upon this historic occasion, I wish to offer my formal congratulations to Rule 10b-5, then look at 10b-5 from the European branch of the securities law family, and briefly tell you where “we” stand in Europe with respect to securities fraud law. I will then discuss the German relatives of Rule 10b-5—the distant relatives as well as some closer cousins—and draw some analogies. Additionally, I will consider other Western European analogues and conclude with a question for you, 10b-5.

Cousin, you come from a very well established family with a large, rich, and continuous history and tradition. In the fifty years of your existence, you have branched out into an impressive family tree of securities fraud regulation. But, 10b-5, you never lost your importance as an all-encompassing general clause supplemented by your own decisional case law in the United States. You are still competing with, or at least complementing, the other family members, including a host of other special sections of the securities acts, rules, and regulations which were not able to obviate you from existence. From a Continental perspective, your distinct character lies in your all-encompassing, sweeping language which we Europeans are accustomed to finding in our civil law system. Upon this type of sweeping language, we would build a whole range of decisional law. From our view, the anomaly is that this sweeping language is found in the very specific Rule 10b-5, in a highly regulated environment, and in a common law country. Normally, in a common law system, the statutes are very precise, very plain-meaning oriented, and would not contain such sweeping language. Rather, they would be precise in their circumscription of the original individual circumstances of what was regulated. This is something which we find a bit surprising.

Rule 10b-5 arose from a simple argument: “We are against fraud,

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aren't we?" In Europe, we are also against fraud and securities fraud, but we regulate fraud in a totally different manner.

We are, as measured against the bulk of what has evolved from Rule 10b-5 over the last fifty years, very poor cousins indeed, if any cousins at all. We are poor in history because we lack 10b-5's fifty years of uninterrupted history. We are poor in case law because we do not have established decisional law. We are poor in refined theory because the theory of capital markets and the securities laws that have developed over the years in the United States do not yet exist in Europe. On a practical level, we are also poor because our banking system and capital markets differ greatly from those of the United States and do not easily allow for enactment of 10b-5 analogues. Moreover, we are also poor in the volume of books written on the subject.

But still, I want to address you as a German, a related cousin; to a certain degree, I also speak for the other Continental cousins. Some distant derivations of Rule 10b-5 are found in Europe. These, however, in theory, are not direct off-springs of Rule 10b-5. They are cousins, I would say, of second degree or third degree. Elements of Rule 10b-5 crossed the Atlantic over to Europe not so much by direct need or inheritance but by *de facto* development arising from the fact that the United States is our most important trade partner. The United States has a refined securities regulatory system and a highly refined regulatory body, the Securities and Exchange Commission (the "SEC"). We do not have such a regulatory body in Europe. The United States also provides massive amounts of capital and has major banks and investment intermediaries in Europe. Trained in the 10b-5 environment, investment bankers in Europe act accordingly.

Last night I had a discussion with an investment banker, who practices in New York and Europe. He was commenting that there was no legal culture of 10b-5 in Europe, rightly so. I explained to him the theme of this lecture, the relationship between Rule 10b-5 and European securities fraud laws, and the fact that the United States plays a major role in international organizations dealing with securities regulation (e.g., IOSCO). The United States has contacts with the EC Commission, with the international banking community, and on the professional level. So, we do have many *de facto* links.

Consequently, on the Continent, we are aware of many of the shortcomings of our system—in particular, our universal banking system—and we are becoming more oriented towards a capital market economy. We will continue to follow your evolution and look forward to a review of European developments within the next fifty years. Happy Birthday Rule 10b-5.

I. RULE 10b-5 FROM THE CONTINENTAL FAMILY PERSPECTIVE

A. *As We Perceive You: The U.S. Regulations and Rules*

The general nature of Rule 10b-5 makes it a unique clause for American law. In the Continental civil law system, we have systematically built whole theories and whole libraries of law books on one sentence. This is not customary, however, in the American common law system. Because of 10b-5's sweeping language and scope, it would be easy to envision a similar clause somewhere in German securities law, but it does not exist.

It is fortunate that Rule 10b-5 is preceded by a definitional section. For instance, in your Securities Act, you have a definition of "securities," "exchanges," and "purchase" and "sale" of securities. We do not have this.

An aspect of your securities laws that Germans find confusing is that there are a whole host of other particular statutes, rules, and regulations dealing with the same subject matter that is already covered by 10b-5. For instance, section 9 of the '34 Act on the manipulation of securities prices, section 16 on the liabilities of officers, directors, and principal shareholders, section 18 on misleading statements, section 12, section 17, and, in particular, section 15 on broker/dealers all deal with aspects of 10b-5. This redundancy is difficult for us to understand. As I understand, Rule 10b-5 also allows for an implied private right of action which furthers the enforcement of SEC rules and regulations. It also deals with deceit and includes common law actions of deception, so it involves a great number of issues.

One of these particular issues is insider trading, a problem with which we are grappling in Germany. We have taken note of many other issues in the development of 10b-5, such as market insiders—primary insiders as well as secondary insiders—the scope of investment protection, the scope of market protection, and the fraud on the market theory. Like the efficient market hypothesis, all of these things developed within 10b-5's sphere of influence. Remedies also developed: the rescission of contracts, damages, waiver, estoppel, loss of bargain, benefit of the bargain, and disgorgement of profits. I understand that punitive damages are unavailable, but I have seen incidences of treble damages. Moreover, you can use class actions; we cannot because class actions do not exist in our system. We also have a problem with the statute of limitations, although there is not a uniform set of limitations in the United States either. We partly have the same problems. From my view, this is how we perceive 10b-5.

B. *Where We Stand: The Continental Difference*

Now, where does the Continental branch of the 10b-5 family tree stand? You must remember that in Europe, if you look at the European Community (the "EC"), we do not have a commission like the SEC, a

joint regulator, or a legislative body dealing with the securities regulations. We do not even have fifty years of joint or common experience in capital markets and securities purchases. In the EC, we do not have a single legal system, but rather we have twelve separate legal systems and twelve distinct financial and capital markets.¹ There is a degree of fragmentation in the EC; the EC acts only by way of directive in the securities field. Accordingly, if a directive is issued, we always require national implementation. The EC directives serve as somewhat of a framework, a rather artificial construction, which only come to life through a member state's implementation. The United States' securities laws provide a jurisdictional link between the various states when a crime is perpetrated involving the mails, interstate commerce, or a risk to national security. The EC does not have such a link between its member states. We do not have a single EC stock exchange; we must regulate the common market in Western Europe on the national levels rather than on an international EC level. Furthermore, it is doubtful that an EC regulator will come to be in the near future.

II. 10b-5 AND ITS GERMAN RELATIVES

Let us turn now to the German side of the family and look at Rule 10b-5's German relatives. In order to approach the German relatives, however, I think it is important to first understand our system. The facts and figures that I will give you are based on the German system, but the description holds true, to a certain degree for Belgium, the Netherlands, Spain, Italy, and France and the other EC member states, and, to a more limited degree, for the United Kingdom.

A. *Our Difference: Structure of the Capital Market*

In Germany, which is a federal state, we do not have a central authority like the SEC. We have no federal law dealing with securities fraud and capital markets regulation. To the contrary, we still have a mainly state-run self-regulatory system. The theory is that the stock exchanges and corporate bodies will take care of themselves and no state intervention beyond that is necessary except for extreme circumstances of actual deceit or fraud.

One of the main differences between the U.S. and Germany is that the majority of German companies are mainly organized as private, limited liability companies ("GmbHs"), the shares of which are non-transferable securities, not embodied in certificates, not quoted on any exchange, and not providing a liquid market. Public or stock corporations differ from GmbHs in that the stock certificates of such corporations are transferable

1. I would like to allude here to a presentation I made last year which was reprinted in the *Fordham Law Review*, where I tried to outline some of the fragmentation within the EC. See Gerhard Wegen, *Transnational Financial Services—Current Challenges for an Integrated Europe*, 60 *Fordham L. Rev.* S91 (1992).

securities. In Germany, we have approximately 2500 stock corporations, and approximately 500,000 GmbHs. Naturally, most of German industrial activity is conducted by the 500,000 GmbHs, whose shares require notarial recording to be transferred; in contrast, stock corporation may be listed on a stock exchange. We also have some 30,000 general partnerships and approximately 130,000 limited partnerships—a type of corporate structure with which you are familiar in the United States.

If you look at the German stock exchanges you will note that in the end of 1991 only 799 classes of shares of German corporations were actually traded and quoted on these exchanges. Together with the 639 classes of shares of non-German companies, there are a total of 1438 classes of shares.² Out of the approximately 2500 stock corporation, only 665 are actually listed on one of the German stock exchanges. That is a number to keep in mind. If you look at the current American markets, you will see very different numbers for the New York Stock Exchange, the American Stock Exchange, NASDAQ, and all of the other regional and national markets that you have developed over the years.

The future development of the German markets is quite clear for several reasons. The bulk of enterprises are medium size companies that are not organized as stock corporations. In our system, there is a conspicuous lack of institutional investors and, in particular, a dearth of pension funds. We do not have such funds because our pension and retirement systems work differently from those in the United States. Hostile and public takeovers are unheard of, not only in Germany but also on most of the Continent; the United Kingdom is an exception to this rule.

The German banks have a tight grip on the financing of these companies. The banks take seats on companies' supervisory boards, if a company has one. They also trade shares both on and off the stock exchanges for their own account. They can deal in their own shares, even if they are stock corporations. They solicit proxies for voting in the companies' general assemblies.

The universal banks in our system have also developed close ties with the preeminent companies through interlocking directorates and equity participations. In Germany industry, we have a significant amount of what we call "ringwise accumulated equity participation." It is our traditional belief that a self-regulatory system with the self-disciplining force of one big, inside capital market group is the best way to handle capital markets, as opposed to the Glass-Steagall type of fractioning of the banking functions and the different types of intermediate functions.

As I stated earlier, we do not have a central regulatory agency like the SEC. We do, however, have the German Bundesbank. The Bundesbank promulgates guidelines on the issuance of deutsche mark denominated bonds and other securities. We also have the German Banking Agency in Berlin which is the supervisory authority for all banking activity in-

2. The figures for 1992 are not yet available, but they are not very different.

cluding the regulation of domestic and foreign investment companies. Investment companies fall within the Agency's authority because, under German law, trading—the sale and purchase on a commercial level of stocks and certificates—is as much a banking activity as any other securities-related activity.

We have eight stock exchanges on the single state level as well as our Futures Exchange. The German Stock Exchange in Frankfurt, formerly known as the Frankfurt Stock Exchange, is one of the eight stock exchanges. The regional exchanges in seven other cities have taken equity participations in this exchange, and it now also administers the Futures Exchange and the German clearing system. This, still today, is a self-regulatory system. It is now a stock corporation, but its operation is under the supervision of the state of Hessen and not under any kind of federal supervisory institution.

In short, comprehensive market supervision, like that in the United States, does not exist in Germany. There is no separation of the different banking functions to which you are accustomed. Although I do not want to dwell on this, this lack of market supervision will change with draft legislation to be introduced based on the so-called "Waigel Paper." The Waigel Paper was reproduced for the first time in the United States in the *Fordham Law Review* as an Annex to my address last year.³ Based on that paper, we will introduce market supervision by implementing some of the EC directives. A separate Federal Securities Agency, the *Bundesaufsichtamt für das Wertpapier Wesen*, will be domiciled in Frankfurt. There is also draft legislation, which is not yet public, that provides for supervision of the stock exchanges, off-the-exchange transactions, and securities dealings. In particular, this draft legislation includes notification requirements in connection with takeovers and administering prospectus requirements in public securities sales situations.

Now, having said all of this, I want to discuss a matter, which I will deal with in more detail in a moment, that we call "grey capital markets." As we do not have a liquid market for securities other than stocks in stock corporations or bonds and debentures, there was a need for a vehicle by which investors could invest capital in organizations such as limited partnerships. There were many German partnerships which were tax-driven, investment vehicles. We developed the grey capital markets to satisfy their capital needs. There was no supervision of the grey capital markets and, as a result, there was a great amount of fraud in these markets. So, the courts were called upon to develop case law dealing with these grey markets. This case law is the closest German analogue to Rule 10b-5.

3. See Gerhard Wegen, *Transnational Financial Services— Current Challenges for an Integrated Europe*, 60 *Fordham L. Rev.* S91, S107-S116 (1992).

B. *Individual Relatives: Securities Fraud Regulation in Germany*

Having now laid out the fundamentals, I want to describe briefly some of Rule 10b-5's relatives in our system. I will begin with something that may not be very obvious to you.

1. Unfair Competition Rules

One way of protecting market integrity is achieved by using unfair competition laws. Our standard unfair competition act has been used in the past to prohibit false or incomplete advertising for investment securities, limited partnerships shares, and the like. In particular, paragraph 3 of our unfair competition act penalizes misleading advertising. What is misleading or against public policy may then be developed by recourse to special rules, e.g., the existing special rules on prospectus liability, or certain non-binding guidelines issued by private institutions in connection with prospectus auditing.

The remedies under the unfair competition act are mainly cease and desist orders or judgments. They may, however, also provide for criminal liability in certain circumstances. If the individual investor sues, he may require or ask for a rescission of a contract that was concluded based on misleading advertising. Based on the general rules of the Civil Code, damages may be requested but are outside the scope of our unfair competition rules.

2. Investment Advice and Brokerage

The second area where we see a Rule 10b-5 relation is in investment advisory relationships and broker-dealer relationships. This is not a category *per se* because we do not have, with respect to securities, active dealers, investment advisors, or broker-dealers. A test for determining liability has been developed based on general rules in Germany and is analyzed on a case by case basis. Under the test, the claimant must prove that he or she built up a special confidence based on the defendant's conduct and that the claimant then relied on that advisor or broker or relied simply on the special expertise of a set person. The cause of action implied here is a particular claim for non-performance or partial, incomplete, or insufficient performance if there was actually a contract.

A second theory of liability, which in civil law is very important, is based on pre-contractual liability. We call it *culpa in contrahendo* or *c.i.c.* I do not know if you have this term here in the States, but it means that even if a contract is not actually concluded, one side may be liable to the other based on pre-contractual confidence and trust built up by action based on certain reliances or special expertise (similar to estoppel principles). For instance, the sales organization for securities or stocks is made up of so-called investment advisors. They hold themselves out to be advisors, but, in fact, they are a mere distribution organization. Such

distributors may be liable even if the contract has not actually been concluded.

3. Tort Liability

The third theory is tort liability which you also have in your system. Tort rules apply directly, for example, paragraph 823 of our Civil Code, or indirectly by way of reference to a rule not contained in our Civil Code which, however, is designated to protect an investor, such as criminal sanctions in our Criminal Code. Remedies available to an injured party in this area would be either rescission of the contract or what we call "negative interest." Negative interest means that the injured party is compensated to put him or her in the position he or she would have occupied had the contract not been concluded. It is not specific performance, which we call "positive interest." In all these cases, the claim may be based on mere negligence. Therefore, one does not have to prove intent or gross negligence.

4. General Prospectus Liability

Another German relative to Rule 10b-5 is prospectus liability. We have developed two different kinds of prospectus liability. General prospectus liability does not require a formal prospectus. As a prospectus, any form of market-related written information is sufficient—any piece of paper that might protect the investor. Of course, we then have the prohibition against furnishing false or incomplete material facts in connection with the investment decision. Not every false statement or inaccurate information would be sufficient; it would have to meet the materiality test. The prospectus information must be current, I think that is the same in your system; it might even require the disclosure of certain equity holdings or directorates and their relationship to the company whose limited partnership terms are offered.

I already have said that this type of liability was established through a wide range of case law for purposes of holding responsible the initiators, the founders, the controlling groups, the guarantors—those who professionally by their expertise guarantee the outer appearance of the prospectus—and the managing director and shareholders of the general partner. Often in these cases, one entity acts as a fiduciary limited partner who then distributes set portions to the reinvestors. These fiduciary limited partners may also be held liable.

Prospectus liability initially started by way of inclusion in our Stock Exchange Act of 1908 due to fraud incurred stemming from the incorporation of various stock corporations in the early 1900s. General prospectus liability, which still exists, is the core of a special prospectus liability that is based on special rules.

In contrast to this type of liability, we also have a prospectus liability that developed under our civil law standard. You would refer to this as a

common law action that is not based on a specific clause. This was developed as prospectus liability for the grey capital markets which I mentioned previously. This really started with Investors Overseas Services ("IOS") which by way of a new distribution scheme came prominently into Germany in the 1960s and then collapsed. This led to the introduction of specific prospectus requirements and prospectus liability for domestic and foreign investment companies. We even had in our federal legislature at that time, in 1969, a Draft Investment Protection Act which was never discussed again.

During this period in the 1960s, investment companies became regulated and much capital was available. Other areas of unregulated capital markets then developed, and this was the beginning of the grey capital markets, in particular with respect to tax driven limited partnerships, because limited partnerships in our system are tax-wise transparent. Tax losses of limited partnerships are attributed directly to each limited partner. This is a very favorable way of calculating tax losses and tax savings or tax haven schemes. One particular vehicle utilized was the GmbH & Co. KG, a limited partnership in which the general partner has limited liability. The general partner, however, in turn, is a limited liability company so that liability is limited further. What developed is what we call public limited partnerships. I believe you may call this a master limited partnership ("MLP"). You have developed, I understand, in some states even liquid markets for MLP limited partnerships which we did not. What happened is the courts started to develop a prospectus liability for the offering and selling of limited partnership shares.

The basis for this is the theory of pre-contractual information and disclosure requirements, *culpa in contrahendo*. If somebody offers shares in a limited partnership, he or she establishes pre-contractually a legal obligation to, first, furnish accurate information and, second, to restore any inaccuracies or not to omit any material facts. This basis for liability was available to claimants and it was construed around the "privity of contract," the pre-contractual relationship.

The real problem in our system is reaching the truly responsible parties behind such limited partnerships. We have a fairly strict rule in German corporate law that we only look at the legal form and do not pierce the corporate veil. It was a major step for our investment protection principles and for our courts to say, at a given moment, that they would not look to the legal form but they would look to those who really initiated, engineered, and controlled the limited partnership in question. This liability was later extended to the general partner and the directors of the general partner because, normally, they acted as a legal representative of the limited partnership.

By the same token, special expertise served as the basis for liability. Therefore, any lawyer, tax advisor, accountant, bank, investment advisor, evaluation expert, or other who held themselves out as experts in connection with the offer of such limited partnerships shares could be

held liable. That is one part of the prospectus liability I wanted to mention.

The privity of contract concept, the pre-contractual element that we have, allows only the first purchaser to bring a claim. The second purchaser who bought from the first limited partner could not go back and sue the initial controlling groups responsible for the fraud. The second problem is that in these circumstances causality must be shown; the claimant must prove that the misleading or omitted prospectus caused not only the purchase, as such, but also, the damage now claimed. This is a double causality requirement. The claimant, however, does not have to prove intent or even gross negligence, mere negligence suffices. Additionally, joint and several liability can be established for all those participating in the scheme. This is important because there may be only one deep pocket. The other defendants may have gone bankrupt or may have left the country. Therefore, one tries to establish a deep pocket through joint and several liability. The claimant can seek the negative interest; so, the investor would have to be put in the position that he or she would have occupied absent the purchase. The plaintiff cannot seek specific performance.

Finally, there is a major problem with the statute of limitations. The statute of limitations bars suits commenced later than six months from the knowledge of the fact of the fraud or, at the latest, three years since the purchase. If, however, there is a general contractual fiduciary relationship, as with banks for instance, then the statute of limitations applicable to contracts controls—a statute of limitations of 30 years. As you can see, in Germany, the issue often centers around the applicable statute of limitations which, in turn, determines the alleged cause of action.

This is what we call the civil law/grey capital market oriented general prospectus liability.

5. Prospectus Liability Under the German Stock Exchange

In addition to general prospectus liability, we have prospectus liability contained in specific rules. The most prominent of these rules is the German Stock Exchange Act; I will cite from its text in a moment. This prospectus liability attaches only in circumstances of prospectuses which were issued for admission to official quotation in Germany. That is a very narrow area which you can see from the numbers that I gave you in the beginning of my speech.

If a prospectus, on the basis of which securities have been listed for official quotation, contains information material to the evaluation of such securities which is incorrect, the persons who published the prospectus and the persons who ordered its publication shall assume joint and several liability towards any owner of such security in the amount of the damage suffered by such holder arising from the factual position being different from the information given, if those persons were aware that the information was incorrect, or if they should, without gross

negligence, have been aware that it was incorrect. The same shall apply if the prospectus is incomplete as a consequence of the omission of relevant facts and this incompleteness is the consequence of malicious concealment or of malicious failure by those who published the prospectus or those who ordered its publication to conduct an adequate examination.⁴

That is a fairly specific statement for our civil law system, yet it is limited in scope; official quotation is addressed only in the admission procedure, not in capital formation. Possible defendants include the issuers, the initiators of the issues, the bank which signs the prospectus, and all other persons mentioned and somewhat attached to the prospectus. These may include chartered accountants and perhaps lawyers if they appear in the prospectus. If one reads the language carefully, one will see that claims made under this rule could only be based upon purchases of shares within Germany that were actually admitted for official quotation, if that claim is causally connected to the misleading prospectus. This is outdated; nonetheless, in Germany, we have never tried a case concerning a purchase of securities effected outside Germany.

The second problem with this prospectus liability lies in the two different standards of negligence. If you reread the clause above you will notice that there are two different standards of negligence—thus, it is significant whether or not a claim is based upon inaccurate facts that were known, or by virtue of gross negligence that was not known. In the case of incompleteness of facts, a claimant would have to show malicious concealment. Malice is a stricter standard than gross negligence or malicious failure to disclose.

In addition, the liable party may satisfy its remedial obligations by repurchasing the securities in question in exchange for reimbursement of the purchase price actually paid by the holder of these securities or the official price of the securities at the time of the introduction. Thus, the liable party has the right to either pay damages or to simply repay the purchase price. The statute of limitations precludes any claims filed five years after admission to listing. In relation to other claims, it is clear that normal civil law claims, like your common law actions, are not excluded.

An interesting question arises that I pose to Rule 10b-5. In Germany, a person can bring an action against the State or State officials if they do not perform their functions based on a theory of liability of the State. The question is whether regulatory commissions or stock exchanges themselves could be held liable on the theory of non-performance of their duties as state officials in the case of the admission of securities based on an improper prospectus. As far as I am aware, in Germany, this has never been litigated, but I wonder if this could be done in the United States.

4. BörsG § 45 (Stock Exchange Act). For translated text, see *infra* Annex.

6. Prospectus Liability Under Paragraph 77 of the Stock Exchange Act

The aforementioned Stock Exchange Act rules are extended to what we call semi-official listing on the regulated markets. A market segment on the Stock Exchanges requires stocks certificates and is consequently very minimal in its reach. According to paragraph 77 of the Stock Exchange Act, this prospectus liability extends also to business reports which are required for listing on the regulated market.

7. Prospectus Liability Under Section 13 of the Selling Prospectus Act

There is an extension of these Stock Exchange Act rules in a new act concerning the public offering and selling of securities that are not listed on a stock exchange. This new act, the Selling Prospectus Act, became law in 1989 and was based on an EC directive. Until 1990, we had no rules dealing with prospectus requirements for securities not listed in the official market or the regulated market. This Act introduces the requirements for publishing such a prospectus. A few of the requirements read as follows:

For securities which are offered to the public for the first time within the Federal Republic of Germany and which are not admitted to trading on a German stock exchange, a prospectus shall be published by the person making the offer, unless otherwise provided in [sections] 2 through 4.⁵

This mandate was new to us in Germany and introduces some way for capital market regulation.

This statute outlines the required contents of the prospectus as follows:

If in respect of the securities offered to the public an application for admission to official listing on a German stock exchange has not been made, the prospectus shall contain the information which is necessary to enable the public to make a proper assessment of the issuer and the securities being offered.⁶

These are our basic principles for prospectuses. Paragraph 13 of the Selling Prospectus Act makes reference to the Stock Exchange Act rules in the case of inaccurate or incomplete prospectuses.⁷

8. Prospectus Liability for Domestic and Foreign Investment Funds

We have two further instances of technical prospectus liability, as I mentioned earlier, embodied in our Domestic Investment Companies Act and the Foreign Investment Companies Act. Under both acts, investment companies, whether domestic or foreign, have to issue a prospectus.

5. Selling Prospectus Act § 1. For translated text, *see infra* Annex.

6. Selling Prospectus Act § 7. For translated text, *see infra* Annex.

7. *See* Selling Prospectus Act § 13. For translated text, *see infra* Annex.

It is their duty to issue a prospectus if they want to distribute the investment shares in Germany. In the case of false or incomplete representations or information in the prospectus, the possible defendants include the investment company, all sellers or distributors, and all brokers and dealers. Therefore, not only is the issuer of the prospectus liable, but also all parties comprising the entire distribution chain are liable. This type of liability, however, requires negligence.

As for the remedies, the claimant is entitled to the repayment of the purchase price plus costs incurred in exchange for the investment shares. If the claimant has resold the investment shares, the claimant is only entitled to the difference between the original purchase price and the resale price, if any. As you can see, the remedies are not very elaborate under this theory.

9. Criminal Liability

Additionally, we have criminal liability in certain circumstances for investment fraud. Our Criminal Code has only explicitly penalized investment fraud since 1986. This provision, paragraph 264a of the Criminal Code,⁸ has not been largely used. I will not recite this clause which is included in the Annex. It deals with securities, subscription rights, and shares that grant participation in the outcome of an enterprise—this, in our parlance, means not only stock certificates but any kind of equity participation which grants participation rights in profits; thus, all kinds of investment vehicles are covered. Furthermore, certain criminal offenses, embodied in our Stock Exchange Act, relate mostly to manipulation of stock prices.

10. Bank Liability in Particular

Another aspect of our securities fraud laws that I would like to stress is bank liability, which must be viewed in the light of our universal banking system. Rule 10b-5 analogues, of course, are found in our universal banking system. These analogues are embodied in a mixture of information and disclosure duties of a bank based on its contractual relation with its customer, insider dealing notions, and trader and advisor rules.

a. *Contractual Relationships Between Banks and Clients*

First, there is an ongoing banking relationship whenever there is a bank contract. These contracts are based partly on the standard terms and conditions for banks which were just reformulated in Germany in the beginning of 1993. Scholars have widely debated the reach of the contractual obligations on information, advice, and disclosure incumbent upon banks in relation to their clients. One thing is certain, namely, that positively inaccurate information by a bank renders that bank liable. The

8. StGb § 264a (Penal Code). For translated text, see *infra* Annex.

standard for this type of liability is based on the level of sophistication of the bank customer and the sophistication of the transaction in question.

The bank is liable in accordance with general rules for its bank employees and directors. The question remains whether there is a requirement of special diligence for banks. This is unclear in German case law.

b. *Conflicts of Interests Within the Universal Banking System*

Secondly, we come to the more important field of conflicts of interests within our universal banking system. Our banks may act as underwriters, issuers, agents, or distributors within or without the stock exchanges. They act as dealers and traders on and off the stock exchanges. They act as custodians; they have their own deposit accounts for stock. They solicit proxies for representation in general assemblies of the corporations whose stocks they hold on their own account or in custody. They are allowed to trade on their own account. They can trade as agents for their customers. If the bank itself is a stock corporation, it may also deal in its own shares both on behalf of itself and its customers.

c. *Price Development of Securities by Banks*

In addition, if it is participating in the issuance of equity, traditionally, a bank will take care of the price development of a security on the stock exchange. This is not forbidden; it is not a manipulation. We call it *Kurspflege*. So, now you can envision the potential for conflicts of interest in our banking system. If a customer comes into a bank and wants to sell some shares at price X , and the bank itself is active in price stabilization, or the bank is about to sell a block of those shares on the stock market, or the bank is considering disposing of these stocks or just developing these stocks, whose interest will the bank put first? Moreover, banks in our system, if they act for customers, may execute the order either as an agent on the stock exchange, or they may act as a principal and turn around as the other party. This is a fairly conflict laden situation for which we do not yet have definite answers in Germany, and it is an area which is particularly alluded to here.

The investment banker with whom I spoke last night said that because Germany does not have a Rule 10b-5, there is a potential for conflict. I responded that we do not have any inside problems or conflicts of interests because we tend to define ourselves in total as one big (inside) group.

German doctrine recommends that one weigh the different interests in each case. Ideally, however, one would want to separate the different functions of the banks. This is not yet accepted. In practice, a combination of weighing of interests in particular cases occurs, such as the conflict between a bank and its customer or conflicts which arise for the bank because different customers give different orders.

We have three principles that are then put together: (1) the priority principle, (2) the parity principle, and (3) the equity principle. One

should distribute scarce resources evenly based on a combination of these principles. This is certainly a difficult area.

The same types of conflict arise in a situation where banks give investment advice. If they themselves intend to sell a block of shares on the stock exchange, should they tell the customer who wants to order a sale or purchase of such shares? The bank has to act in the best interest of the customer. But, can you force the bank to disclose to its customer its business policy? Traditionally, we say no; there is no duty to disclose such policies.

The second problem is bank secrecy which, in Germany, is not based on statutes, but on contract. Can the banks really go to a customer and inform him or her that other customers have just dumped their securities? No, this would be a violation of the bank secrecy. A bank is, of course, free to engage concurrently in different contractual situations. The conflict must then be resolved by the bank that has conflicting contracts with different customers. In practice, however, this is a problem that is unresolved.

d. *Execution of Orders*

The position of banks in the execution of orders must also be examined. Assume there are colliding orders of customers—one customer wants to sell, the other wants to buy. What does the bank do? Does it execute in time priority? Does it match these two? Does it wait and see the rate and prices development? There are, as you can see, a variety of conflicts in the execution stage. One thing again is clear; if a customer gives special instructions, then, of course, the bank is to follow these instructions. Otherwise it may act as an agent or it may match the order itself.

e. *Codes of Conduct*

We have tried to cope with these potential conflicts in Germany, until today, with voluntary, non-binding codes of conducts, the *Rules for Traders and Advisors*. These codes were established by a committee of experts at the Federal Ministry of Finance consisting of members of trade associations and professional associations, and in particular, the German Association of Banks. These rules are binding only to the extent they are explicitly acknowledged in writing by the individual. These rules do not really carry any sanctions except for deletion from the list of traders. The *Rules for Traders and Advisors* reads as follows:

Banks trading securities which are admitted for official quotation on a domestic stock exchange or for trading on the regulated market, or which are publicly offered with reference to the intended introduction to a domestic stock exchange, may a) not recommend transactions for reasons which are not in the interest of the customer; in particular they may not make recommendations for the purpose of reducing or increasing the own holdings of the bank, the bank's managers or the

employees working and trading or advisory departments . . . , or for the purpose of influencing the quotation of securities for the benefit of dealings of such person on their own behalf, b) not effect transactions on their own behalf based on a customer's order for the purchase or sale of securities which result in quotations which are disadvantageous for the customer.⁹

f. *Protection of Bank Customers Post Execution*

The final problem in this area is the protection of bank customers after the execution of orders. The issue is this: if a bank executes orders of customers at a certain price, can it then immediately thereafter dump its own stock in the market so that the prices go down significantly? Or, can a bank, that has given a customer specific advice to sell, continue to buy if the stocks go up? If prices increase for a while, the bank reaps profits. This is what we call a "post execution problem."

I thought I would dwell on this type of bank liability a bit longer because this seems to be an area where Rule 10b-5 practices in the United States might be particularly relevant to us. But, again, the German banker would partly answer this by noting that we do have, in fact, compliance officers and compliance procedures which try to erect, if not Chinese walls, then, at least, mechanisms which make the advisory functions separable from the execution functions and from the bank's own dealings. This is, however, as I said earlier, not really controllable.

11. Insider Trading

One important area in which there is a relation between Rule 10b-5 and German analogues is insider trading. I understand that Rule 10b-5 is still the most important mechanism in the area of insider trading in the United States despite the existence of other specific insider trading rules. To reiterate, at the present time in Germany, we only have had a voluntary system of insider trading rules which are not binding except for explicit written acknowledgement with virtually no sanctions attaching. We do have some new developments, though, and insider trading is a very good field in which one can trace a direct legal parentage to the United States and to Rule 10b-5.

In the early 1970s, we Continentals became aware of the United States' insider trading laws. In particular, France did away with the self regulatory non-binding system at a very early stage.

Presently, we do have a statutory instrument that is largely forgotten or maybe not really acknowledged. The *Convention on Insider Trading* was formulated under the auspices of the Council of Europe and then opened for signature. It actually entered into force some months ago. This Convention defines the terms "insider," "insider information," and "inside security." Moreover, it stipulates the cooperation between the

9. Rules for Traders and Advisors § 1. For translated text, see *infra* Annex.

countries ratifying the Convention. The Convention is open not only to all members of the Council of Europe, which includes the twelve members of the EC, but also to the other Western European states, as well as the Eastern European states, which are in the process of ratifying it. Thus, the Council of Europe's Insider Convention will have a definite significance, particularly with respect to the Eastern and Central European States.

The second matter in the area of insider trading that I would like to mention, is the EC Insider Directive in its final form of 1989. Some member states have partly implemented this directive. Although, it was due to be implemented by June 1992, a few states are delinquent, including Germany.

Again, included in the Draft Act establishing our Federal Securities Agencies is a part on insider trading which has not yet been publicly discussed. Thus, we will have insider trading rules and sanctions in a short time. These rules and sanctions will closely follow the EC Insider Directive. In particular, we will have primary and secondary insider liability. Additionally, the scope of inside information will be fairly large. I will leave this for further discussion.

Let me just reiterate, as a final conclusion, that the grey capital markets that we have in Germany will most likely remain unregulated, and will be governed by case law. I can not foresee whether these grey capital markets will also be under the market supervision of the Federal Securities Agency. It appears as if we will have a large area which remains outside federal supervision.

Where will we go in Germany? It will be up to the Federal Securities Agency that will still have to grapple with the demarcation of the supervision of banking activity, under the auspices of the Federal Banking Agencies, from the new securities market supervision.

CONCLUSION

Of course, there are other Western European relatives to Rule 10b-5 that are too numerous to mention. You can proceed on the assumption that basically all of the Western European states in the meantime do have some kind of central regulatory authority. In France, Spain, and Italy, there are stock exchange committees; in Belgium, there is the Banking Commission; in contrast, in Holland, the Amsterdam Stock Exchange is in charge of supervision; in the United Kingdom, under the Financial Services Act, a variety of self-governing bodies supervise activities on and off the stock exchanges.

With regard to the EC Commission, I want to reiterate that there is no legislative or regulatory power of the EC Commission, as such. The EC Commission issued recommendations for securities transactions and a code of conduct relating to securities transactions in 1975. The Code of Conduct is very explicit and very smooth, but, again, it is not binding. It

is a voluntary set of rules. What we have also seen, and what may also be important, is that the EC entered into several cooperation agreements with other enforcement agencies, such as the SEC. You may be aware of the fact that in September 1991, EC Commissioner Sir Leon Brittain and SEC Chairman Richard Breeden signed a Cooperation Memorandum on cooperation in the field of securities, in particular, with respect to market transparency and mutual help in detecting market insufficiencies.

The EC Commission will deal in the future with global custody, with investment services, and with clearing systems. It is my view that it will not deal with comprehensive securities acts or other undertakings at this time. So, on that level, you can proceed on the assumption that we will continue to have 12 separate legal systems, all with a common minimum standard being introduced by way of EC directives.

Now having made this little survey of the German and European relatives, my final question would be to Rule 10b-5: "When do you come over to visit us, and in particular, when do you come over to visit your more distant cousins in the East?" In this perspective, all that has been developed here in the United States might find its way not only into Western Europe but also into Eastern Europe. These developments may find their way to the East for two reasons. One, the Eastern European countries look for guidance to the West in establishing their own capital markets. They look in the first place to the EC, because they have aspirations to become members at a given time or to be associated closely with the EC. They try to anticipate or try to correspondingly implement, without being members, the EC legislation in the securities and banking fields. Second, they have very good relations with the United States. The U.S. has sent over hosts of advisors, including private practice lawyers, SEC personnel, and professionals of other backgrounds, such as investment bankers. They all try to bring their ideas of capital markets and securities fraud to these states and emerging markets. Soon a visit might be warranted, dear cousin.

ANNEX

This Annex includes German law provisions in English translation as well as the Insider Convention and the Insider Directive referenced in the address.*

Act Against Unfair Competition ("UWG")

§ 1. [General clause] A claim for negligence or for damages may be made against any person who, for the purposes of competition, indulges in activities which offend against common decency/public policy.

§ 3. [Misleading information] A claim for omission of information may be made against any person who, in commercial activities, for the purposes of competition, provides misleading information on business conditions, in particular on the quality, the origin, the manufacture and the pricing of individual goods or of commercial services or of the entire range, on price lists, on the form of purchase or on the source from which goods are purchased, on the possession of awards, on the reason or on the purpose of the sale or on the quantity of stock.

§ 13a [Right to termination in the event of false and misleading promotional information]

(1) Any purchaser who was encouraged to make its purchase by false promotional information, which information is likely to be misleading within the terms of § 4, and which is, for that public for which it is intended, material to the conclusion of contracts, shall be entitled to terminate the contract. If the promotional material which contains this information was issued by a third party, the purchaser shall have the right to terminate the contract only if the other party to the contract was aware, or should have been aware, that the information was false and was likely to be misleading or has itself taken action to associate itself with the promotional material which contains this information.

(2) Notice of termination shall be submitted to the other party to the contract immediately after the purchaser has gained knowledge of those circumstances upon which its termination is based. The right to termination shall lapse, if it is not exercised within a period of six months from the conclusion of the contract. It is not possible to contract out of this right in advance.

(3) For movables, the consequences of the termination are governed by § 3, paras. 1, 3 and 4 and by § 5, para. 3, sentence I of the Act for the Revocation of Door-to-Door Sales and of similar Transactions. The assertion of further claims for damages is not excluded. If the promotional

* The English translations of the German law provisions were prepared by Dr. Gerhard Wegen and Glyn Haggatt, Gleiss, Lutz, Hootz, Hirsch & Partners, Stuttgart. The European Council Insider Convention and the EC Insider Directive have been reproduced from the official English text. The Insider Trading Guidelines and the Rules for Traders and Advisers are reprinted from a version published by the Federation of German Stock Exchanges.

material was issued by a third party, the third party shall, within the relationship between the other party to the contract and itself, assume sole liability for the damages, unless the other party to the contract was aware of the contravention.

German Civil Code ("BGB")

§ 823. [Liability to compensate for damages]

(1) Any person who, wilfully or negligently, unlawfully injures the life, body, health, freedom, property or other right of another, shall be obliged to compensate it for any damage arising therefrom.

(2) The same obligation shall be imposed upon any person who contravenes a law which is intended to provide protection for others. If the content of that law is such as to permit its contravention without fault, the obligation to make compensation shall arise only in the event of fault.

Stock Exchange Act ("BörsG")

§ 45 [Liability for false prospectuses]

(1) If a prospectus, on the basis of which securities have been listed for official quotation, contains information material to the evaluation of such securities which is incorrect, the persons who published the prospectus and the persons who ordered its publication shall assume joint and several liability towards any owner of such a security in the amount of the damage suffered by such holder arising from the factual position being different from the information given, if those persons were aware that the information was incorrect, or if they should, without gross negligence, have been aware that it was incorrect. The same shall apply if the prospectus is incomplete as a consequence of the omission of relevant facts and this incompleteness is the consequence of malicious concealment or of malicious failure by those who published the prospectus or those who ordered its publication to conduct an adequate examination.

(2) The liability cannot be excluded by an indication in the prospectus to the effect that the information was supplied by a third party.

§ 46 [Extent of the liability to indemnify]

(1) The liability to indemnify covers only those securities which were listed on the basis of the prospectus and which were acquired by the holder in a domestic transaction.

(2) The person liable to indemnify can fulfill his liability by acquiring the security from the holder either against payment of the price which the holder can prove it paid, or against payment of the market price of the security at the time of listing.

(3) The liability to indemnify is excluded if the holder of the securities knew, at the time of acquisition, that the information in the prospectus was incorrect or incomplete. The same shall apply if the holder of the securities should have realized, by exercising, at the time of the acquisition, the diligence usually employed in its own affairs, that the informa-

tion in the prospectus was incorrect, unless the liability to indemnify is based upon malicious conduct.

§ 47 [Limitation of claims to indemnification]

Any claims to indemnification shall become barred five years after the securities are listed.

§ 48 [Invalidity of agreements concerning exclusion of liability]

(1) Any agreement by which liability pursuant to §§ 45 through 47 is restricted or excluded shall be null and void.

(2) Further claims which may be asserted under a contract pursuant to the provisions of civil law shall remain unaffected.

§ 77 [Incomplete information]

If the information in the business report is incorrect or incomplete, the provisions of §§ 45 through 49 shall apply *mutatis mutandis*.

§ 88 [Fraudulent manipulation of the exchange or market price]

A prison term of up to three years or a fine shall be imposed on a person who, in order to manipulate the exchange or market price of securities, subscription rights, commodities or interests which shall grant a participation in the results of an enterprise,

1. makes false statements on circumstances material for appraisal of the securities, subscription rights, goods or interests, or conceals such facts in violation of existing regulations, or

2. otherwise employs fraudulent means.

§ 89 [Usurious inducement to exchange speculation]

(1) A prison term of up to three years or a fine shall be imposed on a person who commercially induces others, by taking advantage of their inexperience in speculative exchange transactions, to such transactions or to direct or indirect participation in such transactions.

(2) Speculative exchange transactions within the meaning of subparagraph (1) are in particular

1. purchasing or selling transactions with deferred delivery date, also when concluded outside a domestic or foreign exchange,

2. options on such transactions, which are directed at a realization of a profit on the difference between the price agreed for delivery and the actual exchange or market price at the time of delivery.

Stock Exchange Admission Regulation ("BörsZulVO")

§ 14 Information about Persons or Companies which assume Liability for the Contents of the Prospectus

The prospectus shall state the names and the position, in the case of legal entities and companies the name and domicile, of those persons or companies which shall assume liability for the contents of the prospectus; it shall contain a statement to the effect that, to their knowledge, the

information given is correct and no material information has been omitted.

Selling Prospectus Act

§ 1 Principle Rule.

For securities which are offered to the public for the first time within the Federal Republic of Germany and which are not admitted to trading on a German stock exchange, a prospectus shall be published by the person making the offer, unless otherwise provided for in §§ 2 through 4.

§ 7 Contents of Prospectus.

(1) If in respect of securities offered to the public an application for admission to official listing on a German stock exchange has not been made, the prospectus shall contain the information which is necessary to enable the public to make a proper assessment of the issuer and the securities being offered.

(2) The Federal Government shall be authorized to issue by regulation, which shall require the consent of the Federal Council, such provisions as are necessary for the protection of the public on the required contents of the prospectus, in particular in respect of:

1. the persons or companies assuming responsibility for the contents of the prospectus;
2. the securities being offered; and
3. the issuer of the securities and its capital, activities, assets and liabilities, financial position, profits and losses, management and supervisory bodies, and prospects of business.

(3) The regulation pursuant to subsection (2) may include provisions regarding exemptions permitting the omission from the prospectus of certain information:

1. if special circumstances exist with respect to the issuer, the securities being offered, their issuance, or the circle of investors at which the issue is directed, and the interests of the public are sufficiently safeguarded by other means of information; or
2. in view of the minor relevance of that information or if disclosure of that information would result in substantial damage to the issuer.

§ 13 Inaccurate Prospectus.

If information contained within a prospectus is inaccurate or incomplete, the provisions of §§ 45 through 48 of the Stock Exchange Act shall apply analogously, except that a claim for compensation of damages shall be barred upon the expiration of five years following the publication of the prospectus.

Investment Company Act ("KAGG")

§ 20 [Statements in prospectuses; inaccuracy of prospectuses]

(1) If a sales prospectus (§ 19) contains information material to the evaluation of share certificates which is inaccurate or incomplete, any person who has based its decision to purchase such share certificates upon that sales prospectus shall be entitled to request the investment company and those who sold those share certificates commercially on their own behalf to re-purchase, as joint and several debtors, those share certificates at the price which it paid. If, at the time the purchaser becomes aware that the information in the sales prospectus is inaccurate or incomplete, that purchaser is no longer in possession of the share certificate, it shall be entitled to request payment of that sum by which the price it paid for the share exceeds the redemption price of the share at the time at which it sold that share.

(2) Those documents required to be attached to the prospectus, pursuant to § 19, para. 1, sentence 2, shall be deemed to constitute information material to evaluation within the terms of paragraph 1.

(3) A claim cannot be made against an investment company or an enterprise which sold the share certificates on its own behalf commercially if that investment company or that enterprise is able to prove that it was not aware that the information in the sales prospectus was inaccurate or incomplete, and if the lack of knowledge does not result from gross negligence. A claim cannot be made on the basis of paragraph 1, if the purchaser of the share certificates was aware, when it made the purchase, of the fact that the information in the sales prospectus was inaccurate or incomplete.

(4) Any person who, in full knowledge of the fact that the information in the sales prospectus is inaccurate or incomplete, acts as a commercial agent for the sale of share certificates or sells those share certificates on behalf of a third party, shall be subject to that obligation to repurchase the share certificates which is contained within paragraph 1. A claim cannot be made on the basis of paragraph 1, if the purchaser of the share certificates was also aware, when it made the purchase, that the information in the sales prospectus was inaccurate or incomplete.

(5) The claim shall become barred six months after that time at which the purchaser becomes aware of the fact that the sales prospectus is inaccurate or incomplete, and at the latest three years after the purchase contract is concluded.

Foreign Investment Companies Act ("AIG"):

§ 12

(1) If a sales prospectus (§ 3) contains information material to the evaluation of foreign investments which is inaccurate or incomplete, any person who has based its decision to purchase investment shares upon that sales prospectus shall be entitled to request the foreign investment

company, the management company and the distribution company to repurchase, as joint and several debtors, those investment shares at the price which it paid. If, at the time the purchaser becomes aware that the information in the sales prospectus is inaccurate or incomplete, that purchaser is no longer in possession of the shares, it shall be entitled to request payment of that sum by which the price it paid for the shares exceeds the redemption price of the shares at the time at which it sold those shares.

(2) That information in prospectuses required by § 3, para. 2, sentences 2 and 3, shall be deemed to constitute information material to evaluation within the terms of paragraph 1.

(3) A claim cannot be made against a company pursuant to paragraph I if that company is able to prove that it was not aware that the information in the sales prospectus was inaccurate or incomplete, and if the lack of knowledge does not result from gross negligence. A claim cannot be made on the basis of paragraph 1, if the purchaser of the investment shares was aware, when it made the purchase, of the fact that the information in the sales prospectus was inaccurate or incomplete.

(4) Any person who, in full knowledge of the fact that the information in the sales prospectus is inaccurate or incomplete, acts as a commercial agent for the sale of shares or sells those shares on behalf of a third party, shall be subject to that obligation to repurchase the shares which is contained within paragraph 1. A claim cannot be made on the basis of paragraph 1, if the purchaser of the shares was also aware, when it made the purchase, that the information in the sales prospectus was inaccurate or incomplete.

(5) The claim shall become barred six months after that time at which the purchaser becomes aware of the fact that the sales prospectus is inaccurate or incomplete, and at the latest three years after the purchase contract is concluded.

German Penal Code ("StGB")

§ 264a Fraud in Capital Investments

(1) Any person who, in conjunction with

1. The sale of securities, subscription rights, or shares which grant a participation in the profits of an enterprise, or

2. An offer to increase investments in the aforementioned shares provides to a larger group of people incorrect, positive information or withholds detrimental facts in prospectuses, or in fact sheets or in statements on the assets, which information and facts relate to circumstances material to the decision on acquisition of shares, or to that on the increase of investments in shares, shall be subject to a prison sentence of up to three years or to a fine.

(2) The foregoing paragraph shall also apply if the crime is related to

shares in assets which an enterprise is administrating in its own name but for the account of another.

(3) Any person who wilfully prevents the performance of that service which is dependent upon the acquisition of, or upon the increase of investments in shares, shall not be subject to punishment pursuant to paras. 1 and 2. If the service is not performed without the assistance of the offender, the offender shall be exempt from punishment if it makes a wilful and genuine attempt to prevent the performance of the service.

Insider Trading Guidelines

§ 1

(1) Insiders are not permitted at any time or in any manner to enter into, or to cause others to enter into, transactions in Insider Securities based on the use of Insider Information obtained by reason of his/her professional position for his/her own benefit or for the benefit of any third person. They are also prohibited from passing on Insider Information to persons who are not Insiders unless such Insider Information is passed on pursuant to a provision of law or in order to preserve justified interests.

(2) The following shall not be subject (1):

- a) Transactions executed as a result of instructions. The responsibility of the person giving such instructions shall not be affected hereby;
- b) Transactions within the scope of the objects of the enterprise specified in the articles of incorporation for the purposes of corporate planning of such enterprise or any of the enterprises specified in § 2(2);
- c) Transactions entered into in compliance with customers' interests or within the scope of the otherwise customary securities trading business of the bank.

§ 2

(1) Insider means:

- a) legal representatives and members of the supervisory board of such corporation;
- b) legal representatives and members of the supervisory board of affiliated domestic enterprises, unless they would in the ordinary course of business not as such obtain knowledge of Insider Information;
- c) shareholders, including their legal representatives and members of their board of directors, provided they hold more than 25% of the shares of such corporation; § 16(4) of the German Stock Corporation Act shall apply *mutatis mutandis*;
- d) employees of the corporation, of domestic enterprises affiliated with such corporation, and the shareholders of such corporation holding more than 25% of such corporation, provided that such

employees as such in the ordinary course of business obtain knowledge of Insider Information;

- e) agents of a corporation who in connection with their agency function in the ordinary course of business obtain knowledge of Insider Information;
- f) banks and the members of their supervisory boards, general managers, employees and agents, which or who have been retained in connection with any of the actions referred to in sentence 3 of (3) or in connection with lending business and, in connection therewith, in the ordinary course of business obtain knowledge of Insider Information.

(2) Insider Securities shall mean:

shares of stock, participation rights, convertible bonds, bonds with warrants, profit participation certificates, warrants, and subscription rights which are issued

- a) by the corporation,
- b) by a domestic enterprise affiliated with the corporation pursuant to §§ 17, 18 or 291 of the German Stock Corporation Act,
- c) by a domestic enterprise, or a domestic enterprise affiliated with such domestic enterprise, associated with the corporation by way of a domination agreement or profit and loss transfer agreement (Beherrschungs- oder Gewinnabführungsvertrag), by way of a tender or buyout offer (Übernahme- oder Abfindungsangebot), by consolidation, merger, transfer of assets or change of corporate status,

and which are admitted for official quotation or for trading on the regulated market (geregelter Markt) at a domestic stock exchange. A public offer of securities together with a statement to the effect that such securities are intended to be admitted to a domestic stock exchange shall be deemed equivalent to the admission to a domestic stock exchange. Subscription rights for Insider Securities shall also be deemed to be Insider Securities.

(3) Insider Information is knowledge of circumstances not yet disclosed or publicly known which could affect the valuation of the Insider Securities. Such information shall include knowledge of a change of dividend payments, of substantial changes in earnings or liquidity or of material circumstances which have or could have an effect thereon. Insider Information shall furthermore include knowledge of the following proposed actions:

- a) capital decrease or raising of capital including a capital increase out of corporate funds;
- b) entering into a domination or profit and loss transfer agreement;
- c) tender offer or buyout offer;
- d) consolidation, merger, transfer of assets, change of corporate form;
- e) dissolution.

§ 3

Violations of § 1 shall be investigated pursuant to the "Rules of Procedure of the Investigation Commissions Established at the Stock Exchanges pursuant to the Insider Trading Guidelines and the Rules for Traders and Advisers of July 1, 1976" by the relevant investigation commission. The person subject to an investigation shall provide all information required by the person commissioned with such investigations by the investigation commission. He shall also specify all banks at which Insider Securities are on deposit for his benefit or which have traded or kept on deposit for him any Insider Securities during the time period to which such investigation relates; furthermore, such banks shall be released by him from their obligation to maintain confidentiality as to all transactions which occurred in connection with Insider Securities of the person subject to such investigation, in connection with the providing of information pursuant to sentence 2.

§ 4

(1) Any further civil law consequences notwithstanding, Insiders and the enterprises for whose benefit they have acted shall transfer to the corporation any benefits derived from violations of § 1; § 88(3) of the German Stock Corporation Act shall apply *mutatis mutandis*. In the case of Insiders pursuant to § 2(1)(f), the corporation whose Insider Securities were subject to an insider transaction in violation of § 1 shall be entitled to any such benefits (§ 328 of the German Civil Code).

(2) If such obligation to transfer is not complied with, then the corporation entitled pursuant to (1) shall assert such claim in court unless under the circumstances the assets of the person who is liable are insufficient or any other material reason to the contrary exists.

(3) The enterprise shall take reasonable measures against such Insider independent of the transfer obligation pursuant to (1).

§ 5

(1) The corporations shall cause the Insiders within their sphere to submit themselves to the Insider Trading Guidelines and the Rules of Procedure referred to in § 3, sentence 1, as well as the respective comments.

(2) The banks referred to in § 2(1)(f) submit themselves *vis-a-vis* their respective associations to the Insider Trading Guidelines and the Rules of Procedure referred to in § 3, sentence 1, as well as to the respective comments as binding for themselves. Unless already done so pursuant to (1), they shall cause the members of the supervisory boards, general managers, employees and agents referred to in § 2(1)(f) to recognize the Insider Trading Guidelines and the Rules of Procedure referred to in § 3, sentence 1.

Rules for Traders and Advisers

§ 1

Banks trading securities which are admitted to official quotation on a domestic stock exchange or for trading on the regulated market, or which are publicly offered with reference to the intended introduction to a domestic stock exchange, may

- a) not recommend transactions for reasons which are not in the interest of the customer; in particular they may not make recommendations for the purpose of reducing or increasing the own holdings of the bank, the bank's managers or the employees working in trading or advisory departments (hereinafter the "employees"), or for the purpose of influencing the quotation of securities for the benefit of dealings of such persons on their own behalf;
- b) not effect transactions on their own behalf based on a customer's order for the purchase or sale of securities which result in quotations which are disadvantageous for the customer.

The same applies to bank managers or employees of banks.

§ 2

Violations of § 1 are investigated by the competent review commission in accordance with the "Rules of Procedure of the Investigation Commissions at the Stock Exchanges pursuant to the Insider Trading Guidelines and the Rules for Traders and Advisers of July 1, 1976." The entity or person whose conduct is investigated has to give all required information to those who have been invested with the mandate by the Investigation Commission to conduct the investigations. They also have to name all banks with which they have deposited securities, or which, during the time investigated, have traded securities for them, or which have kept securities in deposit for them; furthermore, they have to exempt such banks from the obligation of complying with the banking secrecy requirements in connection with the release of information referred to in the second sentence of this § 2 with respect to business transactions which relate to securities with the person involved in the investigation.

§ 3

The banks will cause the bank managers and employees to recognize contractually the Rules for Traders and Advisers and the Rules of Procedure referred to in § 2, sentence 1, and the relevant comments.

§ 4

Business enterprises and persons who, without being a bank, are involved in investment advice on a commercial basis (hereinafter "investment advisers") may by written declaration to the Federation of German Stock Exchanges submit themselves to the regulations set forth in §§ 1 through 3. The Federation will inform the stock exchanges about the statements submitted to it. The stock exchanges shall publish such declarations in

the official quotation gazettes and will maintain a list of the respective investment advisers.

§ 5

If investment advisers who are on the list willfully violate the Rules, the Federation of German Stock Exchanges may cause their deletion from the list. The stock exchanges will publish such deletion in the official quotation gazettes.

§ 6

Possible civil or criminal consequences of violations of these regulations are not affected. Willful violations of bank managers and employees of § 1 of these regulations constitute actions which, with respect to stock exchange regulations, are not compatible with the honor of a merchant or the claim based on merchant's faith.

II. COUNCIL OF EUROPE

- A. *Convention on Insider Trading Opened for Signature on April 20, 1989 (Parliamentary Assembly 27 January 1989, Doc. 5993 Addendum).*

PREAMBLE

The member states of the Council of Europe, signatories hereto,

Considering that the aim of the Council is to achieve a greater unity between its members;

Considering that certain financial transactions in securities traded on stock exchanges are carried out by persons seeking to avoid losses or to make profits by using the privileged information available to them, thus undermining equality of opportunity as between investors and the credibility of the market;

Considering that such behavior is also proving dangerous for the economies of the member states concerned and in particular for the proper functioning of the stock markets;

Considering that, because of the internationalization of markets and the ease of present-day communications, operations of this nature are carried out sometimes on the market of a state by persons not resident in that State or acting through persons not resident there;

Considering that efforts to counter such practices which are already being made on the domestic level in many member states make it essential to set up specific machinery to deal with these situations and coordinate endeavors at international level;

HAVE AGREED AS FOLLOWS:

Chapter I—Definitions

ARTICLE 1

1. For the purposes of this Convention an irregular operation of insider trading means an irregular operation carried out by a person:

- (a) who is the president or chairman, or a member of a board of directors or other administrative or supervisory organ, or is the authorized agent or in the employment of an issuer of securities, and has effected or caused to be effected an operation on an organized stock market knowingly using information not yet disclosed to the public, the possession of which he obtained by reason of his occupation and the disclosure of which was likely to have a significant influence on the market, with a view to securing an advantage for himself or a third party;
- (b) who has entered into the transactions described above knowingly using not yet disclosed information which he obtained in the performance of his duties or in the course of his occupation;
- (c) who has entered into the transactions described above knowingly using not yet disclosed information communicated to him by one of the persons mentioned in (a) or (b) above.

2. For the purposes of applying this Convention:

- (a) the expression 'organized stock market' signifies stock markets subject to regulations established by authorities recognized by the government for the purpose;
- (b) the term 'stock' signifies transferable securities issued according to the national legislation of each Party by business firms or companies or other issuers, where such securities may be bought and sold on a market organized in accordance with the provisions of paragraph (a) above, as well as other transferable securities admitted on that market in conformity with the national rules applicable to it;
- (c) the expression 'operation' signifies any act on an organized stock market which gives or may give entitlement to stock as provided for in paragraph (b) above.

Chapter II—Exchange of Information

ARTICLE 2

The Parties undertake, in accordance with the provisions of this chapter, to provide each other with the greatest possible measure of mutual assistance in the exchange of information relating to matters establishing or giving rise to the belief that irregular operations of insider trading have been carried out.

ARTICLE 3

Each Party may, by a declaration to the Secretary General of the Council

of Europe, undertake to provide other Parties, subject to reciprocity, with the greatest possible measure of mutual assistance in the exchange of information necessary for the surveillance of operations carried out in the organized stock markets which could adversely affect equal access to information for all users of the stock market or the quality of the information supplied to investors in order to ensure honest dealing.

ARTICLE 4

1. Each Party shall designate one or more authorities actually responsible for submitting any request for assistance, and for receiving and taking action on requests for assistance from the corresponding authorities designated by each Party.
2. Each Party shall, in a declaration addressed to the Secretary General of the Council of Europe, indicate the name and address of the authority or authorities designated in accordance with the provisions of this article and any modification thereto.
3. The Secretary General shall notify these declarations to the other Parties.

ARTICLE 5

1. Reasons shall be given for making a request for assistance.
2. The request shall contain a description of the facts establishing or giving rise to the belief that irregular operations of insider trading have been carried out or, if assistance is requested according to the rules laid down by Parties under article 3, reference to the principles mentioned in that article which have been violated.
3. The request shall contain reference to the provisions by virtue of which the operations are irregular in the state of the requesting authority.
4. The request shall be in or translated into one of the official languages of the state of the requested authority, or in one of the official languages of the Council of Europe.
5. The request shall specify:
 - (a) the requesting authority and the requested authority;
 - (b) the information sought by the requesting authority, the persons or bodies which may be in possession of it, or the place where it may be available;
 - (c) the reasons for and the purpose of the requesting authority's application, and the use it will make of the information under its national law; and
 - (d) how soon a response is required and, in cases of urgency, the reasons therefor.

ARTICLE 6

1. The execution of requests for assistance by the requested authority is

carried out in accordance with the rules and procedures laid down by the law of the Party in which that authority operates.

2. When the search for information so requires, and in the absence of specific provisions, the rules laid down by national law for obtaining evidence shall be capable of being applied by the requested authority or on its behalf. Sanctions laid down for breaches of professional secrecy shall not apply in regard to the information provided compulsorily in the course of enquiries.

3. These provisions shall not prejudice the rights accorded to the defendant by national law.

4. Save to the extent strictly necessary to carry out the request, the requested authority and the persons seeking the information requested are bound to maintain secrecy about the request, the component parts of the request and the information so gathered.

5. However, at the time of the designation of the authority, provided for by article 4, each Party shall declare the derogations to the principle set forth in paragraph 4 of this article possibly imposed or permitted by national law:

- either to guarantee free access of citizens to the files of the administration;
- or when the designated authority is obliged to denounce to other administrative or judicial authorities information communicated or gathered within the framework of the request;
- or, provided the requesting authority has been informed, to investigate violations of the law of the requested Party or to secure compliance with such law.

ARTICLE 7

1. The requesting authority may not use the information supplied for purposes other than those set out in its request.

2. The requested authority may refuse to supply the requested information or subsequently oppose its use for purposes set out in the request or fix certain conditions unless:

- (a) the facts are within the scope of article 1 and
- (b) the purposes set out are in conformity with the aims defined in article 2 and
- (c) the facts constitute in each state an irregularity as regards the rules of both states.

3. When the requesting authority wishes to use the information supplied for purposes other than those set out in the initial request it must inform in advance the requested authority who may refuse to consent to such use unless the conditions in paragraph 2 above are fulfilled.

4. The information supplied may be used before a criminal court only in cases where it could have been obtained by application of Chapter III.

5. No authority of the requesting Party may use or transmit this information for tax, customs or currency purposes unless otherwise provided in a declaration by the requested Party.

ARTICLE 8

The requested authority may refuse to give effect to the request for assistance or to supply the information obtained, if:

- (a) the request is not in conformity with this Convention;
- (b) the communication of the information obtained might constitute an infringement of the sovereignty, security, essential interests or public policy (*ordre public*) of the requested Party;
- (c) the irregularities to which the requested information relates or the sanctions provided for such irregularities are time-barred under the law of the requesting or of the requested Party;
- (d) the requested information relates to matters which arose before the Convention entered into force for the requesting or the requested Party;
- (e) proceedings have already been commenced before the authorities in the requested Party in respect of the same matters and against the same persons, or if they have been finally adjudicated upon in respect of the same matters by the competent authorities of the requested Party;
- (f) the authorities of the requested Party have decided not to commence proceedings or to stop proceedings in respect of the same matters.

ARTICLE 9

The requested authority shall, in so far as it is able to do so, supply the information requested by the requesting authority in the form desired by that authority or in the form currently in use between them.

ARTICLE 10

1. Any Party which has ascertained that there has been a substantial breach by the requesting authority of the confidentiality of the information provided may suspend the application of chapter II of this Convention with respect to the Party which has failed to discharge its obligation and shall notify the Secretary General of the Council of Europe of its decision. The Party may lift the suspension at any time and shall notify the Secretary General accordingly.

2. Any Party which intends to make use of the procedure provided for in paragraph 1 must first give an opportunity to the Party concerned to make observations on the alleged breach of confidentiality.

3. The Secretary General of the Council of Europe shall inform the member States and the Parties to this Convention of any use made of the procedure provided for in paragraph 1.

ARTICLE 11

Parties may agree that, notwithstanding the provisions of Article 5.4, requests for assistance and replies thereto may be drawn up in the language of their choice and made according to simplified procedures or by employing means of communication other than the exchange of written correspondence.

Chapter III—Mutual Assistance in Criminal Matters

ARTICLE 12

1. The Parties undertake to afford each other the widest measure of mutual assistance in criminal matters relating to offenses involving insider trading.
2. Nothing in this Convention shall be construed as restricting or prejudicing the application of the European Convention on Mutual Assistance in Criminal Matters and the Additional Protocol thereto among states party to these instruments or of specific agreements or arrangements on mutual assistance in criminal matters in force between Parties.

Chapter IV—Final Provisions

ARTICLE 13

This Convention shall be open for signature by the member states of the Council of Europe. It shall be subject to ratification, acceptance or approval. Instruments of ratification, acceptance or approval shall be deposited with the Secretary General of the Council of Europe.

ARTICLE 14

1. This Convention shall enter into force on the first day of the month following the expiration of a period of three months after the date on which three member states of the Council of Europe have expressed their consent to be bound by the Convention in accordance with the provisions of article 13.
2. In respect of any member state which subsequently expresses its consent to be bound by it, the Convention shall enter into force on the first day of the month following the expiration of a period of three months after the date of the deposit of the instrument of ratification, acceptance or approval.

ARTICLE 15

1. After the entry into force of this Convention, the Committee of Ministers of the Council of Europe may invite any state not a member of the Council of Europe or any international intergovernmental organization to accede to this Convention, by a decision taken by the majority provided for in article 20(d) of the Statute of the Council of Europe and by

the unanimous vote of the representatives of the Contracting states entitled to sit on the Committee.

2. In respect of any acceding state or international intergovernmental organization, the Convention shall enter into force on the first day of the month following the expiration of a period of three months after the date of deposit of the instrument of accession with the Secretary General of the Council of Europe.

ARTICLE 16

1. Any state may at the time of signature or when depositing its instrument of ratification, acceptance, approval or accession, specify the territory or territories to which this Convention shall apply.

2. Any contracting state may at any later date, by a declaration addressed to the Secretary General of the Council of Europe, extend the application of this Convention to any other territory specified in the declaration. In respect of such territory the Convention shall enter into force on the first day of the month following the expiration of a period of three months after the date of receipt of such declaration by the Secretary General.

3. Any declaration made under the two preceding paragraphs may, in respect of any territory specified in such declaration, be withdrawn by a notification addressed to the Secretary General. The withdrawal shall become effective on the first day of the month following the expiration of a period of three months after the date of receipt of such notification by the Secretary General.

ARTICLE 17

Without prejudice to the application of article 6 no reservation may be made to the Convention.

ARTICLE 18

1. After the entry into force of the present Convention, a group of experts representing the Parties to the Convention and the member states of the Council of Europe not being Parties to the Convention shall be convened at the request of at least two parties or on the initiative of the Secretary General of the Council of Europe.

2. This group shall have the task of preparing an evaluation of the application of the Convention and making appropriate suggestions.

ARTICLE 19

Difficulties with regard to the interpretation and application of this Convention shall be settled by direct consultation between the competent administrative authorities and, if the need arises, through diplomatic channels.

ARTICLE 20

1. Any Party may at any time denounce this Convention by means of a notification addressed to the Secretary General of the Council of Europe.
2. Such denunciation shall become effective on the first day of the month following the expiration of a period of three months after the date of receipt of the notification by the Secretary General; denunciation shall not prejudice requests already in progress at the time of denunciation.

ARTICLE 21

The Secretary General of the Council of Europe shall notify the member States of the Council and any Party to this Convention, of:

- (a) any signature;
- (b) the deposit of any instrument of ratification, acceptance, approval or accession;
- (c) any date of entry into force of this Convention in accordance with Articles 14, 15 and 16;
- (d) any other Act, notification or communication relating to this Convention.

In witness whereof the undersigned, being duly authorized thereto, have signed this Convention.

Done at Strasbourg, the 20th April 1989, in English and French, both texts being equally authentic, in a single copy which shall be deposited in the archives of the Council of Europe. The Secretary General of the Council of Europe shall transmit certified copies to each member state of the Council of Europe and to any State and any international intergovernmental organisation invited to accede to this Convention.

*B. Protocol to the Convention on Insider Trading Opened for
Signature on 11 September 1989*

The member states of the Council of Europe signatories to the Convention on insider trading (hereafter called the 'Convention') and to this Protocol,

Having regard to the undertakings contained in chapters II and III of the Convention relating to the exchange of information and the mutual assistance in criminal matters respectively;

Considering that between states members of the European Economic Community, the application of Community rules should be reserved;

HAVE AGREED AS FOLLOWS:

ARTICLE I

The following provision shall be inserted in the Convention:

“Article 16bis

In their mutual relations, Parties which are members of the European Economic Community shall apply Community rules and shall therefore not apply the rules arising from this Convention except in so far as there is no Community rule governing the particular subject concerned.”

ARTICLE 2

This Protocol shall be open for signature by the member states of the Council of Europe signatories to the Convention. It shall be subject to ratification, acceptance or approval. Instruments of ratification, acceptance or approval shall be deposited with the Secretary General of the Council of Europe.

ARTICLE 3

This Protocol shall enter into force:

- either on the same date as the Convention, if on that date all contracting states to the Convention have expressed their consent to be bound by this Protocol, in accordance with the provisions of article 2,
- or subsequently, on the first day of the month after the date on which all contracting states to the Convention have expressed their consent to be bound by this Protocol in accordance with the provisions of article 2.

ARTICLE 4

The Secretary General of the Council of Europe shall notify the member states of the Council of Europe:

- (a) any signature;
- (b) the deposit of any instrument of ratification, acceptance or approval;
- (c) the date of entry into force of this Protocol in accordance with the provisions of article 3;
- (d) any other act, declaration, notification or communication relating to this Protocol.

In witness whereof the undersigned, being duly authorized thereto, have signed this Protocol.

Done at Strasbourg, the 11th day of September 1989, in English and French, both texts being equally authentic, in a single copy which shall be deposited in the archives of the Council of Europe. The Secretary General of the Council of Europe shall transmit certified copies to each member state of the Council of Europe.

I. EUROPEAN ECONOMIC COMMUNITY

A. Council Directive of 13 November 1989 Coordinating Regulations on Insider Dealing (89/592/EEC) (OJEC 18.11.89 No L 334/30)

THE COUNCIL OF THE EUROPEAN COMMUNITIES

Having regard to the Treaty establishing the European Economic Community, and in particular article 100a thereof,

Having regard to the proposal from the Commission,¹⁰

In cooperation with the European Parliament,¹¹

Having regard to the opinion of the Economic and Social Committee,¹²
Whereas, article 100a(1) of the Treaty states that the Council shall adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in member states which have as their object the establishment and functioning of the internal market;

Whereas, the secondary market in transferable securities plays an important role in the financing of economic agents;

Whereas, for that market to be able to play its role effectively, every measure should be taken to ensure that market operates smoothly;

Whereas, the smooth operation of that market depends to a large extent on the confidence it inspires in investors;

Whereas, the factors on which such confidence depends include the assurance afforded to investors that they are placed on an equal footing and that they will be protected against the improper use of inside information;

Whereas, by benefiting certain investors as compared with others, insider dealing is likely to undermine that confidence and may therefore prejudice the smooth operation of the market;

Whereas, the necessary measures should therefore be taken to combat insider dealing;

Whereas, in some member states there are no rules or regulations prohibiting insider dealing and whereas the rules or regulations that do exist differ considerably from one member state to another;

Whereas, it is therefore advisable to adopt coordinated rules at a Community level in this field;

Whereas, such coordinated rules also have the advantage of making it possible, through cooperation by the competent authorities, to combat transfrontier insider dealing more effectively;

10. 1987 O.J. (C 153) 8; 1988 O.J. (C 277) 13.

11. 1987 O.J. (C 187) 93; and Decision of 1 October 1989 (not yet published in the Official journal).

12. 1989 O.J. (C 35) 22.

Whereas, since the acquisition or disposal of transferable securities necessarily involves a prior decision to acquire or to dispose taken by the person who undertakes one or other of these operations, the carrying out of this acquisition or disposal does not constitute in itself the use of inside information;

Whereas, insider dealing involves taking advantage of insider information; whereas the mere fact that market-makers, bodies authorized to act as contra-party, or stockbrokers with inside information confine themselves, in the first two cases, to pursuing their normal business of buying or selling securities or, in the last, to carrying out an order should not in itself be deemed to constitute use of such inside information; whereas likewise the fact of carrying out transactions with the aim of stabilizing the price of new issues or secondary offers of transferable securities should not in itself be deemed to constitute use of inside information;

Whereas, estimates developed from publicly available data cannot be regarded as inside information and whereas, therefore, any transaction carried out on the basis of such estimates does not constitute insider dealing within the meaning of this Directive;

Whereas, communication of inside information to an authority, in order to enable it to ensure that the provisions of this Directive or other provisions in force are respected, obviously cannot be covered by the prohibitions laid down by this Directive,

HAS ADOPTED THIS DIRECTIVE:

ARTICLE I

For the purposes of this Directive:

1. 'inside information' shall mean information which has not been made public of a precise nature relating to one or several issuers of transferable securities or to one or several transferable securities, which, if it were made public, would be likely to have a significant effect on the price of the transferable security or securities in question;

2. 'transferable securities' shall mean:

(a) shares and debt securities, as well as securities equivalent to shares and debt securities;

(b) contracts or rights to subscribe for, acquire or dispose of securities, referred to in (a);

(c) futures contracts, options and financial futures in respect of securities referred to in (a);

(d) index contracts in respect of securities referred to in (a),

when admitted to trading on a market which is regulated and supervised by authorities recognized by public bodies, operates regularly and is accessible directly or indirectly to the public.

ARTICLE 2

1. Each member state shall prohibit any person who:

- by virtue of his membership of the administrative, management or supervisory bodies of the issuer,
- by virtue of his holding in the capital of the issuer, or
- because he has access to such information by virtue of the exercise of his employment, profession or duties,

possesses inside information from taking advantage of that information with full knowledge of the facts by acquiring or disposing of for his own account or for the account of a third party, either directly or indirectly, transferable securities of the issuer or issuers to which that information relates.

2. Where the person referred to in paragraph 1 is a company or other type of legal person, the prohibition laid down in that paragraph shall apply to the natural persons who take part in the decision to carry out the transaction for the account of the legal person concerned.

3. The prohibition laid down in paragraph 1 shall apply to any acquisition or disposal of transferable securities effected through a professional intermediary.

Each member state may provide that this prohibition shall not apply to acquisitions or disposals of transferable securities effected without the involvement of a professional intermediary outside a market as defined in Article 1(2) *in fine*.

4. This Directive shall not apply to transactions carried out in pursuit of monetary, exchange rate or public debt management policies by a sovereign state, by its central bank or any other body designated to that effect by the state, or by any person acting on their behalf. Member states may extend this exemption to their federated states or similar local authorities in respect of the management of their public debt.

ARTICLE 3

Each member state shall prohibit any person subject to the prohibition laid down in article 2 who possesses inside information from:

- (a) disclosing that inside information to any third party unless such disclosure is made in the normal course of the exercise of his employment, profession or duties;
- (b) recommending or procuring a third party, on the basis of that inside information, to acquire or dispose of transferable securities admitted to trading on its securities markets as referred to in article 1(2) *in fine*.

ARTICLE 4

Each member state shall also impose the prohibition provided for in article 2 on any person other than those referred to in that article who with full knowledge of the facts possesses inside information, the direct or indirect source of which could not be other than a person referred to in article 2.

ARTICLE 5

Each member state shall apply the prohibitions provided for in articles 2, 3, and 4, at least to actions undertaken within its territory to the extent that the transferable securities concerned are admitted to trading on a market of a member state. In any event, each member state shall regard a transaction as carried out within its territory if it is carried out on a market, as defined in article 1(2) *in fine*, situated or operating within that territory.

ARTICLE 6

Each member state may adopt provisions more stringent than those laid down by this Directive or additional provisions, provided that such provisions are applied generally. In particular it may extend the scope of the prohibition laid down in article 2 and impose on persons referred to in article 4 the prohibitions laid down in article 3.

ARTICLE 7

The provisions of Schedule C.5(a) of the Annex to Directive 79/279/EEC shall also apply to companies and undertakings the transferable securities of which, whatever their nature, are admitted to trading on a market as referred to in article 1(2) *in fine* of this Directive.

ARTICLE 8

1. Each member state shall designate the administrative authority or authorities competent, if necessary in collaboration with other authorities to ensure that the provisions adopted pursuant to this Directive are applied. It shall so inform the Commission which shall transmit that information to all member states.
2. The competent authorities must be given all supervisory and investigatory powers that are necessary for the exercise of their functions, where appropriate in collaboration with other authorities.

ARTICLE 9

Each member state shall provide that all persons employed or formerly employed by the competent authorities referred to in article 8 shall be bound by professional secrecy. Information covered by professional secrecy may not be divulged to any person or authority except by virtue of provisions laid down by law.

ARTICLE 10

1. The competent authorities in the member states shall cooperate with each other whenever necessary for the purpose of carrying out their duties, making use of the powers mentioned in article 8(2). To this end, and notwithstanding article 9, they shall exchange any information required for that purpose, including information relating to actions published, under the options given to member states by article 5 and by the second sentence of article 6, only by the member state requesting cooperation.

Information thus exchanged shall be covered by the obligation of professional secrecy to which the persons employed or formerly employed by the competent authorities receiving the information are subject.

2. The competent authorities may refuse to act on a request for information:

- (a) where communication of the information might adversely affect the sovereignty, security or public policy of the state addressed;
- (b) where judicial proceedings have already been initiated in respect of the same actions and against the same persons before the authorities of the state addressed or where final judgment has already been passed on such persons for the same actions by the competent authorities of the state addressed.

3. Without prejudice to the obligations to which they are subject in judicial proceedings under criminal law, the authorities which receive information pursuant to paragraph 1 may use it only for the exercise of their functions within the meaning of article 8(1) and in the context of administrative or judicial proceedings specifically relating to the exercise of those functions. However, where the competent authority communicating information consents thereto, the authority receiving the information may use it for other purposes or forward it to other states' competent authorities.

ARTICLE 11

The Community may, in conformity with the Treaty, conclude agreements with non-member countries on the matters governed by this Directive.

ARTICLE 12

The Contact Committee set up by article 20 of Directive 79/279/EEC shall also have as its function:

- (a) to permit regular consultation on any practical problems, which arise from the application of this Directive and on which exchanges of view are deemed useful;
- (b) to advise the Commission, if necessary, on any additions or amendments to be made to this Directive.

ARTICLE 13

Each member state shall determine the penalties to be applied for infringement of the measures taken pursuant to this Directive. The penalties shall be sufficient to promote compliance with those measures.

ARTICLE 14

1. Member states shall take the measures necessary to comply with this Directive before 1 June 1992. They shall forthwith inform the Commission thereof.

2. Member states shall communicate to the Commission the provisions of national law which they adopt in this field governed by this Directive.

ARTICLE 15

This Directive is addressed to the member states.

