INSIDER DEALING AND MARKET MANIPULATION UNDER EUROPEAN CAPITAL MARKETS LAW

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Archil Gabatashvili
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Supervisor 1: Prof. Dr. Jörn Axel Kämmerer
Supervisor 2: Prof. Dr. Zviad Gabisonia
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Introduction

European capital markets law has an important role in the market regulation process. Market regulation is a fundamental part of well functioning financial markets. The purpose of this thesis is to investigate why the European legislator decided to change four framework directives. This thesis explains the basics of Capital Markets legislation in Europe and provides information about the scope and effect of the legislative Acts on Capital Markets law. The paper analyses the current situation according to Market Abuse Regulation, the main difference between the new Market Abuse regulation and the old four frameworks in terms of insider dealing and market manipulation. The paper also addresses to the Criminal Sanctions for Market Abuse which is new for European members and which requested to implement criminal sanctions for market abuse into their national law. I will review also the current national sanctioning systems of Germany, Italy, France and Spain. This work emphasis on what the European legislator has to focus more in future perspective in terms of protecting investors and enhancing European market efficiency. As an outcome the paper must reveal what were the intentions of the European legislator by adopting new rules on insider dealing and market manipulation and give assessment whether the intended goal was achieved or not.

European capital markets law rapidly developed as an independent subject of Law in Europe. We have not a precise definition of this subject, but after analyzing legal literature we can say that it refers to the organization of capital markets, the trading of
securities and the behavior of the participants who operate on the market, e.g. issuers, investors, financial intermediaries.\(^1\)

The European legislature always tries to reach single European market for financial services. On this way the main goal of European Legislature is to protect investors and to guarantee the efficiency of the capital markets.\(^2\)

The European parliament has enacted Market Abuse Regulation (EU) No 596/2014 and additional at the same time the Directive 2014/57/EU on Criminal Sanctions for Market Abuse (Market Abuse Directive) on 16 April, 2014. The new Market Abuse regulation repealed the following directives:

- Directive 2003/6/EC
- Directive 2003/124/EC,
- Directive 2003/125/EC
- Directive 2004/72/EC

The new Market Abuse regulation provides us the common framework on insider dealing and on market manipulation. Its aim is to ensure the integrity of financial markets and to protect the investors on the market.\(^3\) The Market Abuse Regulation has desire to increase power of authorities, uniform minimum sanctions, to improve protection against market abuse through commodity derivatives and etc.\(^4\)

Due to the fact that the market, economy and also other market such as over the counter (OTC), multilateral trading facilities (MTFs), multilateral trading facilities (MTFs) and high frequency trading (HFT) develop every day, the legislature purposed to revise four framework and other legal documents to adapt EU rules to the new market situation\(^5\), to

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\(^1\) Rudiger Veil, European Capital Markets Law, 2013, p.17


\(^3\) Market Abuse Regulation 16.04.2014, Chapter 1, Article 1


respond to new market developments and new market developing strategy, to strength fighting against market abuse across related derivative markets, to give us precise legal definitions and to cover the areas which were out of above-mentioned old directives.

Today the current sanctions are lacking effectiveness and the result is that the current Directive does not enforce well in real life. On the other hand the Member States of Europe stipulate them self administrative and criminal sanctions for insider dealing and market manipulation and they define on the different way which forms of insider dealing or market manipulation shall be considering breach of capital market rules. There are some countries which have not criminal sanctions for the issues which can be a negative influence on the market. As I mentioned we already have the new directive on Criminal Sanctions for Market Abuse. The aim of European legislator according to this new directive and regulation is to establish minimum level of rules for criminal sanctions for insider dealing and for market manipulation in the Member States, to save financial markets in the Union and to protect investors.

In chapter one i will overview the evolution of the capitals market law in Europe. In second chapter I will write about an aim of the legislative Acts and their effect on Capital Markets law. In third chapter I will consider the insider dealing, I will provide its definition and role on the regulated market, also I will describe why is important disclosure information and notification obligation and how they prevent market and help investors in decision making process. In fourth chapter I will try to show what kind of behaviors can be considering as market manipulation under new Market Abuse regulation and what requirements stipulates the European legislator for market participants. In fifth chapter I will focus on the main distinguish between old Market Abuse directive and new Market Abuse regulation regarding to sanctions, especially I will pay attention on criminal sanctions. While the European legislator has offered us new concept, approach in this area I will explain the aim of criminal sanctions and their effective role in reality.

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Finally, in last chapter I will provide my own opinion on the insider dealing, market manipulation and sanctions, also I will try to analyze what we need more for protecting the market participant and for enhancing market efficient.

Due to the fact that in my country, in Georgia, there is lack of specialists in European Capital market law and there is a lack of books, publications and legal materials in this field, i hope this paper will be useful to students of legal faculty, but will also appeal for the researchers and practitioners in law and business.

CHAPTER 1: Capital Markets legislation in Europe

1.1 Evolution

The development of a European capital markets law started in 1966 when a group of experts made public a report about capital market. This report called Serge Report which consisted 350 pages and referred to the problems on the capital markets and provided us information how could be loose those problems. This report was important because it tried to harmonize the access to the European capital market. The main aim of this report was to disclose information and additional provide the idea about the three aspects of an „information policy“

In 1970 the European Community decided to create a programe to harmonize securities and corporate laws of the Member States. They divided this program into five phases.

During the first phase (1979-1982) the Serge Report included detailed proposal about the trading of securities on the national stock markets. This report was basis of firs following directives: Directive 79/279/EEC about the conditions for the admissions of securities to official stock exchange listing, Directive 80/390/EEC about the requirements for the drawing up , scrutiny and distribution of the listing and Directive 82/121/EEC on information to be

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8 Rudiger Veil, European Capital Markets Law 2013, p.2
published on a regular basis by companies the shares which have been admitted to
the official stock-exchange listing\textsuperscript{10}, were based on the EU Treaty and first step of
harmonization of the Member States provisions\textsuperscript{11}.

Next step of the development of European capital market law was in 1985 when the
Commission of European Council finished working on the paper „Completing the Internal
Market”. The Commission tried to liberalize capital movements in the EU Community and
tried to help financial integration process.

The second phase contained the period between 1988 and 1993 and focused on harmonization
88/627/EEC on transparency. The aim of this directive was to protect investors, to increase
investors confidence on the market and to guarantee the functioning system of securities
market\textsuperscript{12}.

On 17 of April 1989 was enacted Directive 89/298/EEC on prospectus. The directive regulated
the issues when the transferrable securities are offered for first time in a Member state\textsuperscript{13}.

Directive 89/592/EEC on insider dealing was next paper which enacted on 13 November
1989\textsuperscript{14}. It was communicated to the secondary market for securities and gave an order to
Member States to represent provisions prohibiting about insider dealings. Unfortunately, the
directive did not provide us information how compliance with those new rules should be
supervised\textsuperscript{15}.

\textsuperscript{12} See \url{http://www.esma.europa.eu/system/files/Dir_88_627.PDF}
\textsuperscript{13} See \url{http://www.esma.europa.eu/content/Directive-89298EEC-Council-Prospectus}
\textsuperscript{14} See \url{http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31989L0592:EN:HTML}
\textsuperscript{15} Rudiger Veil, European Capital Markets Law 2013, p.5
The developing process continued again and on 10 Mai 1993 we gain new Directive 93/22/EEC on investment services in the securities field. This directive was fundamental instrument to reach the goal of the White Paper (Completing the internal market). The main aim of this directive was protecting investor and improving the free movement of services\(^\text{16}\).

Financial Services Action Plan (FSAP) in 1999 was next developing area of European Capital markets law. This plan is an important paper in term of creation a single market for financial services\(^\text{17}\). The provisions of the plan covered securities and derivative instruments, improved a modern financial system and planed to decrease the costs of capital and intermediation\(^\text{18}\).

After the Financial Services Action Plan the Economic and Financial Affairs Council ordered Alexandre Lamfalussy who was a chairman of a committee to develop European capital market, to create new suggestions regarding the law of securities and to hasten implementation process of new rules. In November 2000 the committee made public their report. This report shown that on the way of develop European capital markets law the process of adopting legislation was quit slow and on the other hand the Member States interpreted different the provisions. In 2001 the committee published final report which proposed a procedure on four levels what called the Lamfalussy process. This process illustrated the regulation of capital markets. The firs level was developing of the framework directives. On the second level established a committee of European Securities Regulators (CESR) which main function was advising in legislative process\(^\text{19}\). Additionally, the CESR was responsible to develop the collaboration between the national supervisory authorities in term to work out disputes between the authorities and estimate the implementation of EU law\(^\text{20}\).

In 2001 the European legislator had desire to renew the directives which enacted between 1979 and 1982 and Directive 88/627/EEC, because all of them needed more transparency. In

\(^{16}\) See: http://www.esma.europa.eu/system/files/Dir_93_22.PDF

\(^{17}\) See: http://en.wikipedia.org/wiki/Financial_Services_Action_Plan

\(^{18}\) Rudiger Veil, European Capital Markets Law 2013, p.6

\(^{19}\) See: http://www.marketswiki.com/mwiki/Committee_of_European_Securities_Regulators

\(^{20}\) Rudiger Veil, European Capital Markets Law 2013, p.7
this result the EU enacted the new Directive EC/2001/34\textsuperscript{21}, but the directive did not make significant changes in the security markets law.

The third phase of the development of European Capital Markets law was between 2003 and 2007 years when the four framework directives have improve the regulations process in the field of European capital markets law. The following directives were: the Market Abuse Directive (MAD,2003), the Prospectus Directive (PD,2003), the Markets in Financial Instruments Directive (MiFID, 2004) and the Transparency Directive (TD,2004)\textsuperscript{22}.

The Market Abuse Directive was the first directive which contained rules on market manipulation\textsuperscript{23}. According to this directive it was required the Member States to prohibit insider dealing, also disclosure of information was important to prevent market from manipulation\textsuperscript{24}.

Due to the fact that the provisions of the directives needed concretization, the European Commission enacted several Directives such as Directive 2003/124/EC\textsuperscript{25} on definitions of insider information and market manipulation, Directive 2003/125/EC\textsuperscript{26} on investment recommendations and the disclosure of conflicts of interest and also Directive 2004/72/EC\textsuperscript{27} about insider legislation. The Committee finished work on exemptions for buy back programmes and financial instruments stabilization.

The Prospectus Directive made significant changes and gave new possibilities for issuers of securities in the European Capital Markets\textsuperscript{28}. The aim of this Directive was always to ensure investor protection and market efficiency\textsuperscript{29}.

\textsuperscript{21} See: [http://www.esma.europa.eu/system/files/Dir_01_34.PDF](http://www.esma.europa.eu/system/files/Dir_01_34.PDF)

\textsuperscript{22} Rudiger Veil, European Capital Markets Law 2013, p.7-8


\textsuperscript{24} Rudiger Veil, European Capital Markets Law 2013, p.8


\textsuperscript{28} See: [http://cmlj.oxfordjournals.org/content/1/1/89.extract](http://cmlj.oxfordjournals.org/content/1/1/89.extract)

\textsuperscript{29} Recital 10 PD
The Directive 2004/39/EC on Markets in Financial Instruments (MiFID) referred to investment firms and aspects of market organization. The MiFID made competition between investment services and tried to create more choice and efficient prices for investors.

The fourth framework Directive was the Transparency Directive which required transparency for the issuers whose securities were traded on the market. The legislator thought that timely disclosure of information would be useful Business and ensured investor protection and market efficiency.

The European capital market continued law making process and in 2004 was enacted the Takeover Directive 2004/25/EC (TOD). The Directive contained provisions of company law and also covered main areas of capital markets law. Under this directive a person who offered securities to third person was obliged to make public his/her decision about a bid. Time to time this obligation transformed as a sphere/area of European capitals market law.

White Paper on Financial Services Policy (2005-2010) presented the European Commission's financial services policy activities from 2005 to 2010. In this document the Commission believed that the progress of the Financial Services Action Plan (FSAP) to be continued in the financial services sector of the EU. The basic principle of this plan was ,, better regulation”, but the commission did not wanted to change or added new rules according to rating agencies, for Takeover Directive and financial analysts.

After the global financial crisis in 2008 the European commission ordered group of experts to propose the recommendations what would be beneficial in future for European capital

31 See http://ec.europa.eu/internal_market/securities/isd/index_en.htm
33 Recital 1 Directive 2004/109/EC
36 See http://europa.eu/legislation_summaries/internal_market/single_market_services/financial_services_general_framework/l33225_en.htm
37 Rudiger Veil, European Capital Markets Law 2013, p.11
market38. The chairman of this group was Jaques de Larosier. He worked with his group very hard and at the beginning of 2009 published the report39 which analyzed market failures, monetary imbalances, weakness of supervisory authorities and the reinforcement of financial stability40.

Since 2009 began the fourth phase of European laws developing process which referred to a European Supervision. After Jaques de Larosier’s report the Commission collected all relevant legislative measures and considered systemic risks in European financial system and the measures how to make better the supervision of financial service providers and participants of capital market41. The Commission also decided to establish a European System of financial Supervisors (ESFS). This idea achieved in 2010 when European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA) were founded. Since 2009 the ESMA has started to take a part in the legislative process and is obliged control the securities markets with a coordination national authorities42.

Revision of the framework Directives and the regulation of credit rating agencies was the fifth phase (2009-2012). The Commission parallel was considering an issue according to credit agencies regulation. The Commission thought that credit agencies regulation should regulate themselves and being independent because it would be much effective43, but they changed this idea and believed that this system needed regulation for market stability, transparency after the world financial crisis (2008) while credit agencies were important elements on the regulated market which provided financial information what influenced on European

38 Rudiger Veil, European Capital Markets Law 2013, p.12
41 CF. Communication from the Commission on European financial supervision, 27 May 2009, COM (2009),252 Final
42 Rudiger Veil, European Capital Markets Law 2013, p.12
43 Rudiger Veil, Europäisches Kapitalmarktrecht 2. Auflage 2014, p.15
market. That is why the European Parliament and Council enacted regulation (EC) No 1060/2009 on credit agencies and one year later the Commission presented its amendments for preventing future financial crisis and caring for the financial system stability. In November 2011 the Commission created new amendment which contained civil liability for incorrect credit ratings and stricter disclosure obligations for rating agencies.

After some years the Commission started consultations with the CESR and with the European Securities Market Expert Group to make simpler and develop four frameworks. The Commission made proposals and in this result in 2010 the European parliament and the Counsel of the European Union enacted Directive 2010/73/EU on amendments to the PD and the TD. Those amendments were oriented on the protection of investors. The Commission proposed also administrative and criminal sanctions for market abuse and started working to replace the MAD 2003/6/EC by the regulation on insider dealing and market manipulation and the Directive on criminal sanctions for insider dealing and market manipulation. The Commission presented also a second proposal according to TD and would like to decrease of administrative burden for SME issuers and to improve the system for notification of holdings. The Commission planed to change the MiFID 2004/39/EC because financial instruments and technology developed rapidly and the rules in the MiFID were old.

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52 Rudiger Veil, European Capital Markets Law 2013, p.15
On 15 September 2010 the European Commission considered a proposal for a new Regulation on swaps on short sales and certain aspects of credit defaults which enacted later and entered into force in 2012\(^53\). The aim of the new regulations was to prevent systemic risks on the market.

The next step of developing of European capital markets law was the regulation on OTC derivatives (over-the-counter)\(^54\) which aimed to protect the European derivatives market and cared for its transparency which would be beneficial for investors.

In September 2013 the Commission presented a proposal\(^55\) for a regulation indices used as benchmarks in financial instruments and financial contracts. During the integration process of benchmarks was very difficult to control financial instruments, for example interest rate swaps, commercial and non-commercial contracts (mortgages and loans, also risk management). The manipulation of benchmarks may damage the reputation and confidence of the financial market, because this fact would influence on investors and the economy\(^56\). In this case EU regulation was necessary to ensure the functioning of benchmarks\(^57\).


The new Market Abuse regulation is the common framework on insider dealing and on market manipulation. Its aim is to ensure the integrity of financial markets and to protect the investors on the market.\(^58\) The MAR desires to increase power of authorities, uniform minimum

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\(^56\) See: http://ec.europa.eu/internal_market/securities/benchmarks/index_en.htm#maincontentSec1

\(^57\) Rudiger Veil, Europäisches Kapitalmarktrecht 2. Auflage 2014, p.21

\(^58\) Market Abuse Regulation 16.04.2014, Chapter 1, Article 1
sanctions, to improve protection against market abuse, to regulate other trade platforms and etc.

The evolution of the European capital markets law never ends and the European Commission with the European Parliament always tries to do the best for the security of the financial market, to protect an interest of investors and care for transparency and market integrity.

Chapter 2: Scope and Effect of the legislative Acts on Capital Markets law

2.1.1 Overview

Capital markets are financial markets were long-term debt or equity (security) are traded\(^{59}\) and were big corporations, regional or national governments\(^{60}\) can raise their capital and receive free money (cash).

Capital Market plays an important role in a national economy. Efficient capital market is a initial step for growth. In the last year the structure of capital markets changed because the technology developed rapidly, created new trading facilities, new trading systems, established new financial products and investment strategies. It is apparent that all of newness need modern legal regulation for preventing market from insider dealing and market manipulation, for ensuring investor confidence\(^{61}\) and increase the trust of market participants.

In general Capital markets divided into two parts: primary market and secondary market. Primary market is a market where stock and bond are issued and traded first time, and

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\(^{61}\) Sussanne Klass, International Review of Law and Economics, 2007, p. 70-71

secondary market is a market where are traded existing securities. The European capital markets law (legislative acts) regulates only regulated markets.

The Scope of the Prospectus Directive is „to harmonize the requirements for the drawing up, approval and distribution of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market situated or operating within a Member State“.

According to the Market Abuse Regulation (MAR) is requested from the Member States to set forth prohibitions for insider dealing and market manipulation and state the requirements of the disclosure of inside information which connected financial instruments that are admitted to trading on a regulated market. The MAR aims to determine the method to the right functioning of the market, also to prevent market from manipulation and to detect insider dealing. The purpose of this Regulation is „to protect the integrity of the financial market and to enhance investor confidence, which is based, in turn, on the assurance that investors will be placed on an equal footing and protected from the misuse of inside information“.

The Transparency Directive (TD) stipulates disclosure of systematic information about issuers whose securities are traded on the regulated market.

The Member States are obliged to transpose and implement the requirements of European legislative acts (main frameworks) for their regulated market. Those requirements are not obliged for non-regulated market, but the Member States can use these provisions and extend on secondary market.

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63 See Rudiger Veil, European Capital Markets Law 2013, p.15
64 Art. 1(1) PD.
65 Art 2 (1) (a) MAR.
66 Recital 4, MAR
67 Recital 45, MAR
68 Article 16 (1), MAR
69 Recital 24, MAR
70 Art. 1(1) TD.
The TREATY OF ROME stipulates free movement of services and capital\textsuperscript{72}. Also the most directives on European capital markets law are intended to reduce the legal barriers and help the Member States to sell their services freely from one State in another States on the financial market. After those facts it is clear that an effect on the economy of the Member states is quit important. The European Community’s aim is to reach financial and monetary integration. The European legislator always tries that their legislative acts being effective in real live. We can remark that the main effects of the European legislative acts are\textsuperscript{73}:

1. Liberalization financial services sectors;
2. Increasing control on fiscal and monetary policy of the Member States;
3. Creation possibilities for the suppliers to get benefit;
4. Protecting Customers and etc;

The legislative acts are not fruitful if they are not implemented and if we cannot enforce the standards well. Countries with stricter implementation and enforcement practice have extensively larger capital-market effects. Moreover, stricter implementation of the new directives often has an incremental effect\textsuperscript{74}.

\textbf{CHAPTER 3: Insider Dealing}

3.1.1 Purpose and Requirements on Inside Information under European Law

Since 1961 the Securities and Exchange Commission (SEC) and the courts in USA tried to define the meaning of improper trading on nonpublic information. Unfortunately, the Congress and also the SEC had not a real will to create legal definition of insider dealing (trading). In contrast of the USA, the European Community (EC) always tried to work on the precise definition of insider dealing. The European Legislator used the concept which

\textsuperscript{72} The Treaty of Rome, 25 March 1957. See \url{http://www.eurotreaties.com/rometreaty.pdf}
\textsuperscript{74} See \url{http://area1.bwl.unimannheim.de/fileadmin/files/area1/files/research_seminar/fss2013/Christensen_Hail_Leuz_2013.pdf}
developed by the courts in the USA and promulgate the definition of above-mentioned subject in its Directives.\textsuperscript{75} The EC has achieved something what the U.S Congress could not accomplish. The Market Abuse Directive covered almost all areas of insider dealing (persons, transactions, prohibitions) what we could not find in the legislation of the United States.\textsuperscript{76}

The economic dissuasion around the need for an insider commercial prohibition was pushed with the basic Publication of the American Professor Manne from 1966, „Insiders Trading and floor Market”. In this publication Manne expressed the prohibition of the insider trade with juridical norms. In his opinion insider trade was necessary for the capitalistic economic system. He provided us two following central arguments:\textsuperscript{77}

1) Insider trade was desirable to creation of the institutional conditions for the effective management of the enterprise;
2) Insider trade was economically useful;

Between 1960 and 1970 was debating in the United States\textsuperscript{78} and in Europe\textsuperscript{79} about that the insider dealing had a positive effect or not and it should be legalize or not.\textsuperscript{80} It was argued that a investor who wanted to make a securities transaction with an insider did not carried for damages, because legislation of insider dealing assume regulated conflicts between principals and agent\textsuperscript{81} (agency cost). The issuer always has an interest in keeping the agency cost law.

Insider dealing is an achievement premium for management. The permission of insider dealing is a part of the incentive and reward system. The admissibility of this kind of remuneration was explained with the fact that contractual arrangements should be allowed between principal and agent about the utilization of insider information.\textsuperscript{82}

\textsuperscript{75} Thomas lee Hazen, Defining Illegal Insider Trading- Lessons from the European Community directive on insider Trading”, p.231-232 See http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=4167&context=lcp
\textsuperscript{76} Thomas lee Hazen, Defining Illegal Insider Trading- Lessons from the European Community directive on insider Trading”. p.239
\textsuperscript{77} Mennike Fuchs (ed), WpHg, 2009, Vorbemerkung zu den par. 12-14, Rn.100-101
\textsuperscript{78} H.G Manne, Insider trading and the Stock Market (1966), p.131
\textsuperscript{79} K.J Hopt and E.Wymeersch, European Insider dealing (1991)
\textsuperscript{80} Rudiger Veil, European Capital Markets Law 2013, p.135
\textsuperscript{81} Mennike Fuchs (ed), WpHg, 2009, Vorbemerkung zu den par. 12-14, Rn.108
Insider dealing looks at course-stabilization. It is obvious that Insider dealing has an effect from the spreading of the insider’s information in the market and with it an improvement of the efficiency of information. The legislator should secure the market participants from illegal activities, because the public news would raise the transaction costs.

The European legislator enacted Directive 89/592/EEC on insider dealing on 13 November 1989 which was something new for this time. The purpose of this Directive was to protect investor against the improper use of inside information. The legislator always tried to ensure the market and worked on changes in legal system. For the market efficiency the European legislator after Directive 89/592/EEC on insider dealing enacted Marked Abuse Directive (MAD) later which replaced the Insider Directive. The aim of Market Abuse Directive was to enhance investors’ confidence. On 16 April, 2014 the European parliament has enacted Market Abuse Regulation and additionally Criminal Sanctions for Market Abuse. The Market abuse regulation is effective because determines the meaning of insider dealing what needed an improvement. It stipulates that „insider dealing arises where a person possesses inside information and uses that information by acquiring or disposing of, for its own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates. The use of inside information by cancelling or amending an order concerning a financial instrument to which the information relates where the order was placed before the person concerned possessed the inside information, shall also be considered to be insider dealing”.

Insider dealing is a purchase and sale of securities under using of relevant information which is not publicly known, but only available to few people. It is necessary to determine the persons who have access to information or possessors of information for avoiding insider dealing. The people which have such information and can do the transactions

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83 Mennike Fuchs (ed), WpHg, 2009, Vorbemerkung zu den par. 12-14, Rn.110
84 Mennike Fuchs (ed), WpHg, 2009, Vorbemerkung zu den par. 12-14, Rn.111
86 Rudiger Veil, European Capital Markets Law 2013, p.136
87 Rudiger Veil, European Capital Markets Law 2013, p.136
88 Rudiger Veil, European Capital Markets Law 2013, p.136
91 Article 8 (1), MAR
are called insiders. Insiders might be the board of directors, supervisors and administrative staff of the issuer, also professional advisors and employees, stockholders and in general everyone who directly or indirectly gains insider information. If we need to prohibit insider dealing we can use a “Chinese Wall” which is a barrier for separating people, restrict the flow of information and which avoids the illegal use of inside information what could be influence the advice related to business transaction provided by a company for a client. The “Chinese Wall” prevents disclosure information and does not give a possibility persons who have access on information and using it when it is unknown for public and get a profit from an advantage of the facts.

Due to the fact that the Directives and Regulations on insider dealing in Europe periodically were changed, the concept of inside information was always interesting for the market participants and it related to the rules on market manipulation.

Article 7 (1) (a) of Market Abuse Regulation (MAD II) provides us the definition of inside information as, “information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments”. From this definition is obvious that inside information contains two basic elements:

a) That of information is never published;

b) The information influence on the prices of financial instruments.

Under Market Abuse Regulation we have a new definition of inside information in relation to derivatives on commodities, specifically: “information of a precise nature, which has not been made public, relating, directly or indirectly to one or more such derivatives or relating directly to the related spot commodity contract, and which, if it were made public, would be likely to have a significant effect on the prices of such derivatives or related spot commodity contracts,

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93 Bahaa Ali El-Dean, Privatization and the Creation of a Market-Based Legal System, 2002, p.68
and where this is information which is reasonably expected to be disclosed or is required to be disclosed in accordance with legal or regulatory provisions at the Union or national level, market rules, contract, practice or custom, on the relevant commodity derivatives markets or spot markets”.

Information is to be qualified as insider’s information before it being publicly known. The fact that an investor with positive information can influence on the sales, this would be negative for market efficiency.  

CESR outlines that the price nature of information have to evaluate on case-by-case which based on the context and the content of the information. Although, it is really complicated how we can determine the instant when an action is price-sensitive and when „the information has become precise“ . On the other hand it is very difficult to consider issues case-by-case because on the financial market we have thousands of transactions daily and to determining which one of them has price nature and influence direct or indirect, it needs long time and specific individual approach.

The CESR provide us criteria how to verify the information has significant effect or not. According to first criteria we have to consider issue when the information has the same effect on prices as in past time. The second criteria is connected to the analyst who’s report or opinions might be indicate price-sensitive information. Third criteria addressed to the company which never has taken care for own performance as inside information. In this context, it’s interesting when such kind of information can be qualified as relevant information and which has significant effect for investors. On this question even the European Court of Justice (ECJ) does not provide a clear answer. In the case of Geltl vs. Daimler, the court

94 Julia Bedorf, Das Merkmal der Vervendung von Insiderinformation, Schriftlichen zum deutschen, europaeishen und internationalen Wirtschaftsrecht, Band 14, 1 Auflage 2011, p.49
95 CESR, Level 3, second set of CESR guidance and information on the common operation of the Directive to the market, CESR/06-562b, July 2007
96 Rudiger Veil, Europaisches Kapitalmarktrecht 2. Auflage 2014, p.147
97 Rudiger Veil, European Capital Markets Law 2013, p.149
did not consider which events could be have a „significant effect” on the market and on the price of the issuer’s securities.

The Market Abuse Regulation consist the disposition norms for the Member State, especially prohibitions for insider dealing. The Regulation gives us the definition of insider information as we looked over and determines which action actions/activities the Member States have to prohibit, namely 1)\(^{100}\), acquiring and disposing of shares to which the information relates, 2) „disclosing inside information to any other person” and 3) recommending or inducing another person of the basis of this information, to acquire or dispose of the respective shares”. In that matter the Member States must foresee those prohibitions which apply to primary insiders, the persons who have the possibility to access to the information directly.

The Market Abuse Regulation provides general rules for the Member States which are directed applicable, but the Member States have an opportunity to initiate a high level of security. Under this Regulation „the Member States, should have the adequate and effective safeguards against any abuse”\(^{101}\). Also the Regulation contains provisions which strength the power of the national supervisory authorities\(^{102}\). This fact is very positive because the supervisory authorities play important role according to national economical stability and strength their power will influence also on trans-border transactions. The Regulation oriented on administrative measures and sanctions, additionally the Member state are obliged to prohibit certain forms of activities by criminal law sanctions what was not requested under Market Abuse Directive (MAD)\(^{103}\).

The aim of The European legislators is to give a guarantee for all investors that they will have a chance to get the price-sensitive information in a short time and what avoid illegal dealings. The rules related to insider dealing and ad hoc disclosure have the same concept. Also under the Transparency Directive (TD) the obligation to make public director’s dealing and an

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99 See: ECJ of 28.06.2012, C-19/11, Geltl/Daimler AG
100 Rudiger Veil, European Capital Markets Law 2013, p.137
101 Recital 66, MAR
102 Recital 70, MAR
103 Recital 71, MAR
obligation of notification about the changes in major stockholders intend to prevent illegal using of inside information. The MiFID contains the provisions which purpose is to secure the market during the insider dealing by requesting compliance institutes (Chinese Walls) in the legal enterprises.

3.1.2 Disclosure of Information

Disclosure of information was discovered in Continental Europe for banking law about 1970 and then developed for European capital markets law in the 1990’s 104. In legislation disclosure mainly grounds on the different users such as consumers and others. Common law does not differentiate between the classes, because it considers cases individual and checks the necessity of information. The duty of disclosure comes from transaction and it does not exist without information 105. The evaluation of a disclosure system in Europe started in 1979 when was enacted Securities Admission Directive. At the beginning the disclosure provisions in different Directives regulated only the issues for issuers whose securities were traded on the stock exchange market 106. Later the legislator decided to regulate activity on the primary and secondary market and this process continues till today.

The European capital markets law has desire ensuring disclosure for economical reasons (reduction of transaction cost and risk of market failure). Market Failure may result from an asymmetrical distribution of information 107 between market participants which can be reduces by legal provisions 108. The Theory of the social value of public information by Farma/Laffer 109.

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104 Stefan Grundmann, Wolfgang Kerben, Stephen Weatherill, Party Autonomy and The Role of information in the internal Market, 2001, p.259
105 Stefan Grundmann, Wolfgang Kerben, Stephen Weatherill, Party Autonomy and The Role of information in the internal Market, 2001, p.261
106 Rudiger Veil, European Capital Markets Law 2013, p.218
107 H.Fleischer, Informationsasymmetrie im Vertragsrecht. Eine rechtsvergleichende und interdisziplinäre Abhandlung zu Reichweite und Grenzen vertragsschlußbezogener Aufklärungspflichten, 2001, p.121
and Hirshleifer\textsuperscript{110} shows that if the information is privately it could be disadvantageous mechanism of the efficient market. The cost of information can be used by market participant without any advantage. „An excessive amount of information is produced as market participants generate the same information parallel to one another“\textsuperscript{111}. It is clear why we need disclosure of information which holds the economical advantage and reduce the loss of recourse combined with the information surplus\textsuperscript{112}. The signal theory provides us an overview how the better information gives someone an economic advantage\textsuperscript{113}. Market failure can also result from the monopoly. Corporate information related to the monopoly of the issuer wants to be a leader on the market and who is oriented on lowest costs. In these situations the obligation of disclosure can avoid monopoly on the regulated market\textsuperscript{114}. In many theories is discussing that disclosure might be voluntarily or necessary. According to the transaction cost theory disclosure provisions are not maximal effectively but disclosure has to regulate by the law which contribute reduction of transaction cost on the financial market. The legislative provisions which develop the concept of disclosure hold many significant advantages on the market process. It improves the opportunities to reduce processing costs\textsuperscript{115}.

The European legislator intends to implement economic theories in law which helps functioning of capital market. The provisions are obligatory for ensuring investor protection\textsuperscript{116}.

The obligation of disclose information in European capital markets law divides mainly into two parts: 1. Periodic Disclosure and 2. Ongoing Disclosure, we can also subdivide it as ad-hoc disclosure and disclosure of major holdings.

The obligation of disclose information is like a prevention of insider dealing, because the permanent, periodical or systematically publishing special financial forms of the enterprise,

\textsuperscript{110} J.Hirschleifer, 61 Am. Econ. Rev. (1971), p.561
\textsuperscript{112} R.U. Fuelbier, Regulierung der Ad-hoc-Publizitaet, p.177-178
\textsuperscript{113} Rudiger Veil, European Capital Markets Law 2013, p.215
\textsuperscript{114} R.U. Fuelbier, Regulierung der Ad-hoc-Publizitaet, p.181
\textsuperscript{115} Rudiger Veil, European Capital Markets Law 2013, p.216-217
ensure the market efficiency and helps investor he/her wants to make a transaction on the market and considers all official published statements before decision.

Periodic disclosure is a supply of the capital market which consist information about issuer. It is requested for the companies whose shares and debt securities are traded on the stock exchange market and which annual report is public and everyone can look at. According to The Transparency Directive (TD) we have four reporting formats: the annual financial report, the half-yearly financial report, the quarterly financial report and the interim management statement. All financial reports except interim management statement related to the capital markets law which states disclosure obligation and the requirements are the same for those reports. Periodic disclosure of information helps investors in decision making process. All investors need such as information to run their business well, looking at market development and foresee prognosis regarding to the securities which are traded on the regulated market.

The financial accounting information gives us an overview for a risk and chance for future activities. The financial information is very sensitive which influence on the market and do to the fact the European legislator aim to protect investor and to avoid speculations, manipulations related to the share prices on the market.

The European capital markets law aims to ensure disclosure. When the investors consider different financial project at this time they want to know about price sensitive information, because this information will help them in decision making process. The aim of European legislator base on economical consideration: „Information asymmetries can result in failure”.

For example, when the market offers high quality product, but after we buy an item and it seems that it is under average quality good which would be offered on market, in this case we meet market failure. The European capital markets law does not give the market participants

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119 Rudiger Veil, European Capital Markets Law 2013, p.246-247
120 J.Ronen, The Dual Role of Accounting, p.415, 1979
121 Akerlof,84 Q.J.Econ (1970), p.488
the right to provide information voluntarily. It states duties of disclosure for the issuers. The investors always wait for the precise and relevant information from the issuers. The purpose of the obligation of disclosure is related to investor’s protection.

The effect of disclosure information is that the insider loses trading benefit when inside information published. An Obligation of Disclosure is important because it restrain insider dealing. The disclosure of price-sensitive information gives a same right and chance for people who participate on the market and on the other hand it develops the concept of transparency. Ad hoc disclosure consist two dual functions: a) a disclosure measure and b) a preventive measure\textsuperscript{122}. Both functions have the same purpose to accomplish the efficiency on the regulated market. According to opinion of legal society, the disclosure obligation for inside information must primarily be classified as rules on transparency for systemic reasons, requiring their incorporation in the further rules on transparency and disclosure\textsuperscript{123}.

The function of disclosure has a significant role in practice. The quantity of public disclosure information in some Member States increase every year and opposite in some Member States decrease, for example the number of disclosures in Spain was 11,033 in 2010 and in 2011 the number raised till 11,501\textsuperscript{124} but in Germany in 2011 the number was 2,207 when in 2010 it was 2,657\textsuperscript{125}.

The Prospectus Directive, the Transparency Directive and MAD do not identify the persons who have a chance to appeal when financial report or ad hoc disclosure are not precise\textsuperscript{126}. Periodic disclosure of inside information has an important role in practice, because if the financial report is price sensitive also have to be made public. In reality not all financial report includes inside information.

\textsuperscript{122} Rudiger Veil, European Capital Markets Law 2013, p.272
\textsuperscript{123} Rudiger Veil, Europäisches Kapitalmarktrecht 2. Auflage 2014, p.381
\textsuperscript{124} CF.FMA, Jahresbericht 2011 (annual report), p.112
\textsuperscript{125} CF.BaFin, Jahresbericht 2011 (annual report), p.211
\textsuperscript{126} The EU Issuer-disclosure Regime: Objectives and Proposals for Reform, p.253
The Market Abuse Regulation provides us general information about public disclosure of inside information. According to article 17 (1) the issuer has obligation to give notice on inside information related to the issuer. Under this article the issuer shall ensure that the inside information provided to public is correct. These requirements are applied to issuers who have permission to trade their financial instruments on a regulated market in a Member State on an MTF or on an OTF. The term „inside information” is determined in Article 7 (1), this definition related to the rules which prohibit insider dealing and also to the disclosure of inside information. Article 17 (4) MAR permits an issuer to delay the disclosure of inside information at his own responsibility, presented that the disclosure will prejudice his legitimate interests, the omission is not likely to mislead to public and the issuer is able to ensure the confidentiality of that information. When confidential information discloses to a third party without confidentiality obligation, Article 17 (8) gives an order the Member States to require „an issuer or a person acting on his behalf or on his account, to make a complete and effective public disclosure of that information”.

The European capital markets law regulates disclosure to another person. According to Market Abuse Regulation the Member States of EU should prohibit inside information for disclosing „inside information to any other person unless disclosure is made in the normal course of the exercise of a person's employment, profession or duties”\(^{127}\). Under the decision of the ECJ on Grongaard/Bang this provision is not relevant when the insider passes information in a normal course of the exercise of his/her employment, profession or duties. According to the ECJ „this clause must be treated restrictively and can only be justified if there is a close link between the disclosure and the employment, profession or duties and disclosure of such a information is strictly necessary for the exercise thereof”\(^{128}\). Under the article 14 (b) (c) of the MAR a person should not give a recommendation to another person about the insider dealing or arrange another person to deal with insider’s trade or to announce unlawfully inside information.

The Market Abuse Regulation’s aim is to ensure the integrity of financial market in the Member States and to enhance investor confidence by prohibiting insider dealing and market

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\(^{127}\) Article 10 (1), MAR

\(^{128}\) ECJ of 22 November 2005, Case C-384/02 (2005), ECR I-9939
manipulation. It is considerable which influence on the issuer’s financial condition might be have the disclosure obligation related to the information, because we don’t know precise it changes the dividend payments and market segment or the legal form of enterprise does not influence on the financial circumstance of the company but might be based on disclosure obligation.

3.1.3 Insider’s List

Insider lists are an important instrument for regulators. The requirement to create and update insider lists imposes administrative burdens. For the competent authorities it is difficult to supervise without insider lists available at all times and care for the effective market. The issuers should present an insider list to the competent authorities upon request.

According to the Market Abuse Regulation the Member States have to ensure issuers or any person acting on their behalf or on their account, draw up a list of all persons who are working for them under a contract of employment or otherwise, who have access to inside information. The issuer has to update an insider list if the competent authority requests it, they have an obligation to send new updated version. Under the CESR Guidance these persons are directors, member of the management, also persons whom are hired for advice (for example: Auditors, Lawyers, Economist).

The European Legislator stipulates the minimal requirements what information shall include in the insider least. There are: personal information about the person who has access to inside information, answer on the question why the person is in the list, time when the person had access to inside information and when the insider list is created.

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129 Article 1, MAR
130 Rudiger Veil, European Capital Markets Law 2013, p.283
131 Recital 56, MAR
132 Article 18 (1) (a) (b) (c), MAR
134 Article 18 (3), MAR
3.1.4 Notification Obligation

One of the central elements of the insider’s supervision is a notification obligation. The Member States shall request any person a notification according to financial instruments transactions which might be constitute insider dealing or market manipulation to notify the competent authority without delay\textsuperscript{135}. The notification is an obligation of managers or a person closely associated with transaction without prejudice to the prohibitions laid down in this Market Abuse Regulation\textsuperscript{136}. Persons discharging managerial responsibilities, as well as persons closely associated with them, shall notify the issuer no later than three business days after the date of the transaction\textsuperscript{137}. Additionally market operators of regulated market, market operators operating an MTF or an OTF and investment firms have the notification obligation to the competent authority when the financial instruments are traded first time on the market. The European legislator set forth what kind of information shall include the notification\textsuperscript{138}, there are:

\begin{itemize}
  \item[a)] The names and identifiers of the financial instruments;
  \item[b)] The date and time of the request for admission to trading;
  \item[c)] Admission to trading and the date and time of the first trade.
\end{itemize}

The CESR provides a guidelines in which is explained what kind of proceedings are subjected to the notification\textsuperscript{139}. If we consider why the notification is important and requested by the European Legislator, it is apparent that the supervisor authorities need it to examine cases of Market Abuse, give the market participants’ relevant, precise information and pay attention to the well functioning of capital market\textsuperscript{140}.

\textsuperscript{135} Article 16 (2), MAR\\
\textsuperscript{136} Recital 59, MAR\\
\textsuperscript{137} Article 19 (1), MAR\\
\textsuperscript{138} Article 4 (1), MAR\\
\textsuperscript{139} CESR Level 3-Third Set of CESR Guidance and Information on the Common Operation of the Directive to the Market, CESR/09-219, May 2009\\
\textsuperscript{140} Rudiger Veil, Europäisches Kapitalmarktrecht 2. Auflage 2014, p.231
CHAPTER 4: Market Manipulation

4.1.1 Purpose and Requirements of Market Manipulation under European Law

Market manipulation is very important subject of European capital markets law. „Market manipulation involves deliberate acts and statements intended to create false or misleading impressions about a particular issuer of securities or to engage in behavior that would distort functioning of the market that could lead to unusual sharp price swings in securities and related volatility, which can undermine investor confidence and financial stability”\textsuperscript{141}. One of the main advantages of global trading is that it develops market efficiency and liquidity, also aims to reduce the cost of transaction. On the other hand we meet the facts of manipulation what causes destabilization on the market\textsuperscript{142}.

Manipulations usually take place when the market is not strict regulated, when the Principle of transparency is not as high as on the regulated markets. At this time the manipulators have an opportunity to use information and manipulate on the price. It is clear that the price influence the functioning of the market.

In 1930 the United States represented mechanism, prohibitions against market manipulation. In the European Union the common legislative concept has adopted only in 2003. After few years the Commission announced two proposals regarding to market abuse. The aim of the Commission was that the new rules should be directly applicable for the Member States\textsuperscript{143}. On the 27.7.2012 the Commission presented the changed proposal in which was incorporated the manipulation of Benchmarks as a result of the disclosure of the LIBOR/EURIBOR scandal. Such direct manipulations of Benchmarks (LIBOR and EURIBOR) did not fall in the range of

\textsuperscript{141} Handbook of Safeguarding Global Financial Stability: Political, Social, Cultural and Economic Theories and Models, edited by Gerard Caprio 2013, p.382
\textsuperscript{142} Handbook of Safeguarding Global Financial Stability: Political, Social, Cultural and Economic Theories and Models, edited by Gerard Caprio 2013, p.388
\textsuperscript{143} Rudiger Veil, European Capital Markets Law 2013, p.175
application of the original proposals and due to this fact the Commission created new text for the MAR\textsuperscript{144}. The European parliament has enacted new Market Abuse Regulation and additionally Criminal Sanctions for the Market Abuse on 16 April, 2014\textsuperscript{145}.

The Purpose of the Market Abuse Regulation is to ensure market from illegal activity, to prevent market transparency, which is obligatory requirement for all economic actors in the financial markets\textsuperscript{146}. The aim of the European legislator is to avoid potential regulatory arbitrage\textsuperscript{147}, to protect investor, preserve the integrity of markets and prohibit all instruments which will have negative influence on the market\textsuperscript{148}.

The scope of the Regulation divided into two parts: Personal Scope and Material Scope\textsuperscript{149}. Personal Scope covers all participants on the market. We have one exemption according to journalists when they are acting in own professional capacity. According to Market Abuse Regulation, Article 21 with regarding to journalists ,, the dissemination information is to be assessed taking account the rules governing their profession, unless those persons derive, directly or indirectly, an advantage or profits from the dissemination of the information in question or the disclosure or the dissemination is made with the intention of misleading the market as to the supply of, demand for, or price of financial instruments”.

The Material scope of the Market Abuse Regulation covers all types of market manipulation relating to financial instruments which are given in Article 2 (2). Under this article it’s clear that the scope is not limited and the new MAR covers all financial instruments traded on regulated market. The regulation broadens the area and it applies also to financial instruments which are traded on OTFs and MTFs\textsuperscript{150}.

Many financial instruments are subjected to benchmarks. The actual or attempted manipulation of benchmarks might have a serious contact on market confidence and in this

\textsuperscript{144} Robert Kert. 2013. Vorschläge für neue EU-Instrumente zur strafrechtlichen Bekämpfung von Insiderhandel und Markmanipulatin. Neue Zeitschrift für Wirtschafts-, Steuer- und Unternehmensstrafrecht (NZWiSt) 252
\textsuperscript{145} See: http://ec.europa.eu/internal_market/securities/abuse/index_en.htm
\textsuperscript{146} Recital 7, MAR
\textsuperscript{147} Recital 4, MAR
\textsuperscript{148} Recital 8, MAR
\textsuperscript{149} Rudiger Veil, Europäisches Kapitalmarktrecht 2. Auflage 2014, p.248
\textsuperscript{150} Article 2 (1), MAR
case investor loses money. Therefore, the European legislator constitutes strict rules for benchmarks and purposes preserve the integrity of the markets and ensure that competent authorities have a possibility to enforce a prohibition of the manipulation of benchmarks

Market Manipulation takes place when someone tries to manipulate prices of financial instruments, for example publishes incorrect information related to the instruments.

The European legislator intents establish relevant requirement for the Member States to secure the market from illegal activities. The Market Abuse Regulation requests the Member States to prohibit any person from engaging in market manipulation. The regulation provides a definition of market manipulation and details all possible activities. This Regulation includes the provisions which are necessary for detecting market manipulation and requests the Member States to work out the effective systems, scheme and regulation for preventing market manipulation. The Member States are also obliged to provide the notification obligations for all transactions because the national authorities will have a possibility to supervise the market. Under Recital 68 (MAR) the authorities are required to assist other Member States authorities in monitoring and detecting market manipulation on a cross-border basis. The Market Abuse Regulation provides measures regarding market manipulation that are capable of being adapted to new forms of trading or new strategies that may be abusive. To reflect the fact that trading in financial instruments is increasingly automated, it is desirable that the definition of market manipulation provide examples of specific abusive strategies that may be carried out by any available means of trading including algorithmic and high-frequency trading. The regulation states sanctions for market manipulation, for example

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151 Recital 44, MAR  
153 Article 15, MAR  
154 Article 12 (1) (2), MAR  
155 Article 16 (1), MAR  
156 Recital 64, Article 19 (2), MAR  
157 Recital 38, MAR
according to Article 38 (a) „all Member States shall provide administrative sanctions for insider dealing and market manipulation”.

The Committee of European securities regulators provide us guidelines based on the market practice and clarifies different manipulative activities like a details for the safe-harbor rules. Additionally the CESR publishes several documents in which we can find the current status of the application of the directive and/or regulation in the Member States\textsuperscript{158}.

4.1.2 Information and Transactions-based Manipulation

The Market Abuse regulation defines the market manipulation in a new manner. According to Article 12 (1) we can determine a behavior as market manipulation entering into a transaction, placing an order to trade or any other behavior which gives incorrect or misleading signals or which secure the price of arbitrary financial instrument. Also any behavior that stipulates “disseminating information through the media or benchmark, including the internet, or by any other means, which gives, or is likely to give, false or misleading signals as to financial instrument, including the dissemination of rumors and incorrect information, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading” is considering as information-based-manipulation.

The European legislator divides manipulation as information-based-manipulation and transaction-based-manipulation\textsuperscript{159}. Information-based-manipulation is important the dissemination of false or misleading information\textsuperscript{160}. Transaction-based-manipulation requires false or misleading signals as to the supply of, demand for, or price of, a financial instrument, a related to transaction\textsuperscript{161}.

Information-based-manipulation might be the financial statement or other financial paper which are officially published (in Media, in Press etc.) and includes incorrect information. In a

\textsuperscript{158} Rudiger Veil, Europäisches Kapitalmarktrecht 2. Auflage 2014, p.247
\textsuperscript{159} Rudiger Veil, European Capital Markets Law 2013, p.179
\textsuperscript{160} Annex I (B) sub. (a), Market Abuse Regulation
\textsuperscript{161} Article 12 (1), MAR
definition of Painting the Tape „presenting non existing orders on the price tape in order to feign strong demand” also considering as information-based-manipulation\(^\text{162}\). Information-based-manipulation intends to govern situation on the market. When the investor has not precise information and his/her decision is based on incorrect and misleading information, it is apparent that a manipulator has an advantage because he/her can earn money when the investor loses.

Information-based-manipulation consist „pump and dump and trash and cash” schemes. According to the pump and dump scheme the manipulator buys the shares and then spreads misleading or factual information. After this action the manipulator observes market and when he/her looks at investors how they react on his information and the demand on the shares increases time to time and the price of each shear reaches the level as a manipulator desired, he/her sells all or part of shares at inflated price. The „trash and cash” scheme is opposite to the pump and dump method. Regarding to second scheme an investor first sells all his/her shares and then spreads negative information. When the investors looks a price share goes down, decreases, at this matter as usually they sell their shares with low price. The manipulator uses this situation and buys back shares much cheaper. It is clear that the benefit from this transaction for manipulator is a difference between sell and buy prices\(^\text{163}\).

In the Market Abuse Regulation we meet the idea of reasonable investor who makes his investment decisions on already available information. The legislator recommends that before the decision all investor have to take into account that information is correct or not\(^\text{164}\). On the other hand what the reasonable investor can do when information is known for public and has a significant effect on the prices of financial instruments? If he/her uses information and

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\(^\text{163}\) Rewrence R.Klein, Victoria Dalko and Michael H.Wang, Regulating Competition in Stock Markets; Antitrust Measures to Promote Fairness and Transparency trough Investor Protection and Crisis Prevention (See Chapter:Information-Based Manipulation Schemes in Practice), 25 April 2012

\(^\text{164}\) Recital 14, MAR
his/her decision will base on it, it might be riskier because we don’t know information is true or someone manipulates on the market with creating positive information.

The Market Abuse regulation requires the Member States to take account transaction-based market manipulations and prohibit it. Furthermore, the Member states have an obligation to ensure non-exhaustive signals, which cannot not necessarily be deemed, in themselves, to constitute market manipulation, shall be taken into account when transactions or orders to trade are examined by market participants and competent authorities\(^\text{165}\). The MAR also provides us information which kind of action can be considered as signal\(^\text{166}\).

The Committee of European securities regulators guideline\(^\text{167}\) outlines the types of trade based market manipulation. According to this guideline when a investor sells own shares to a company were he/her is the main shareholder, owns and controls a business entity, it is apparent that under this transaction the ownership does not change and this case can be considered as trade-based manipulation. Additionally if we look at marking the close, we can understand very well why the investor makes transaction on the basis of the closing price and pays a higher price\(^\text{168}\).

Sometimes Market manipulation does not subject to information or transaction, but the European legislator considers an issue or behavior as market Manipulation such as the conduct by a person, or persons acting in collaboration, to secure a dominant position over the supply of or demand for a financial instrument, related spot commodity contracts or auctioned products based on emission allowances which has, or is likely to have, the effect of fixing, directly or indirectly, purchase or sale prices or creates, or is likely to create, other unfair trading conditions\(^\text{169}\). From this definition it is clear the European legislator looks at antitrust problems related to monopoly and dominant position on the market which decrease the

\(^{165}\text{Annex I (A), MAR}\)

\(^{166}\text{Annex I, MAR}\)


\(^{168}\text{Rudiger Veil, European Capital Markets Law 2013, p.183}\)

\(^{169}\text{Article 12 (2) (a), MAR}\)
investors trust and in this case we have one or some dominants on the capital market and other investors are out of game. Under the Article 12 (2) (b) the Market Abuse Regulation „the buying or selling of financial instruments, at the opening or closing of the market, which has or is likely to have the effect of misleading investors acting on the basis of the prices displayed, including the opening or closing prices” is considering also as market manipulation.

Another example of market manipulation submits to „the taking advantage of occasional or regular access to the traditional or electronic media by voicing an opinion about a financial instrument, related spot commodity contract or an auctioned product based on emission allowances (or indirectly about its issuer) while having previously taken positions on that financial instrument, a related spot commodity contract or an auctioned product based on emission allowances and profiting subsequently from the impact of the opinions voiced on the price of that instrument, related spot commodity contract or an auctioned product based on emission allowances, without having simultaneously disclosed that conflict of interest to the public in a proper and effective way”. This fact is known „scalping” in jurisprudence. The scalper has a possibility to influence the share price if he/her buys illiquid shares than sends spam E-mails which informs the market participants about increasing of share price of an issuer and when a demand will be high the scalper sells this shares in a higher price and gains profit from price movement.

4.1.3 Price Stabilization

The European Union as the United States provides a safe harbor rules which related to the capital market and aim to ensure market from manipulation and preserve price stabilization. A safe harbor is a provision of a regulation that determines that certain conduct will be deemed not to violate a given rule. The EU Data Protection Directive is one part of a safe harbor law. It constitutes strict privacy protections for EU citizens and prohibitions

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170 Rudiger Veil, European Capital Markets Law 2013, p.185-186
171 Article 12 (2) (d), MAR
172 Rudiger Veil, European Capital Markets Law 2013, p.187
for European firms from transferring personal data to other jurisdictions laws\(^{173}\). The safe-harbour rule does not concern to the situations when a decline of price comes from bad economical circumstance of issuer. Stabilization only aims to block unnatural increasing of price and to guarantee markets efficiency\(^{174}\).

The Market Abuse Regulation provides the definition of stabilization. Under Article 3 (2) (d) (MAR) „stabilization means a purchase or offer to purchase securities, or a transaction in associated instruments equivalent thereto, which is undertaken by a credit institution or an investment firm in the context of a significant distribution of such securities exclusively for supporting the market price of those securities for a predetermined period of time, due to a selling pressure in such securities”. According to this definition we can understand that the regulation aims to prevent unnatural price drops and for this reason stipulates disclosure information regarding the stabilization or buy-back programme\(^{175}\).

"buy-back programme" means buy or sell own shares. The conditions of buy-back programmes are subjected to „trading, time and volume restrictions, disclosure and reporting obligations and price conditions for the stabilization”\(^{176}\). The aim of this programme is „to reduce the capital of an issuer, to meet obligations arising from debt financial instruments that are exchangeable into equity instruments, also to meet obligations arising from share option programmes or other allocations of shares, to employees or to members of the administrative, management or supervisory bodies of the issuer or of an associate company\(^{177}\).

According to Market Abuse Regulation transactions are limited to a time period. The European legislator requests issuers, offerors to notify the competent authorities about the transaction no later than the end of the seventh daily market session following the date of execution of such transactions\(^{178}\). Market operators, investment firms which acting an MTF or

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\(^{174}\) Rudiger Veil, European Capital Markets Law 2013, p.192

\(^{175}\) Recital 11, MAR

\(^{176}\) Recital 84, MAR

\(^{177}\) Article 5 (2), MAR

\(^{178}\) Article 5 (5), MAR
an OTF shall notify the competent authority about the date and time of the first trade\textsuperscript{179}. Regarding to these requirements it is clear that all information and transactions provide by the market participants can be price sensitive and speculative on the regulated market that is why the market regulators aim to get relevant information in a short time. After informing competent authorities, they observe all details, react to the price stabilization and try to prevent market from manipulation and other illegal activities.

ESMA provides regulatory technical standards for regulated markets, MTFs and OTFs concerning the financial instruments and the conditions for buy-back programmes, also and the measures about stabilization in which included conditions for trading, time and volume restrictions, disclosure and reporting obligations and price conditions for the stabilization. The purpose of those standards is preventing and detecting market abuse\textsuperscript{180}.

\textbf{CHAPTER 5: Sanctions}

5.1.1 Introduction

Sanction is a one important subject of law. From legislator’s point sanction is a mechanism which aims at first to prevent the illegal activity, for example when we know that our action is against the law and for it the legislator prescribes the sanction what about the actor is informed, at this time he/her refrains to violate the requirements of law or on the other hand when we a real fact breach of legal rules the legislator purposes sanctioning an infringer and shows the public society that it is not legal action and everyone can be punished.

In general, according to legal definition „Sanctions are penalties or other means of enforcement used to provide incentives for obedience with the law, or with rules and regulations“\textsuperscript{181}. The law differentiates administrative, criminal and civil sanctions. The common administrative sanctions are fines, criminal sanctions includes fines, imprisonment

\textsuperscript{179} Article 4 (1), MAR
\textsuperscript{180} Recital 84, MAR
\textsuperscript{181} See: \url{http://en.wikipedia.org/wiki/Sanctions_(law)}
and „the disgorgement of profits the offender gained through the offence” 182. Criminal law is a suitable state Reaction on social undesirable behavior. Historically discussion about sense and the purpose of the punishment continued long time in the legal society and finally everyone agreed that Criminal law is an integral and legitimate part of our judicial system. Regarding a political theory, the subsidiary principle aims to reduce a state activity for individual person and create general security system to supporting everyone. The criminal punishment is the sharpest sanction 183. In civil law a person can claim damages.

The Member States of the European Union had different type of sanctions related to insider dealing and market manipulation, but the European legislator decided to create precise rules about sanctions for the Member States. The sanctions in the Member States were based on national concept and the most Members are considering that European capital markets law is a part of public law and it is under the supervision of national authorities 184, because the supervisory authorities have the power to determine administrative sanctions. In Several Member States are presented civil law sanctions based on US concept what shows private enforcement as important aspect of capital markets law. This concept related to comparative and empirical studies which provide us an idea about that private enforcement is more beneficial and reasonable resource of the regulation of capital market than a subject of public law 185.

According to European Court of Justice the sanctions must be effective, proportionate and dissuasive 186. Capital markets law is in many respects legally stamped and the sanction mechanisms needed reform, the European capital markets law gives the Member States an opportunity to impose the sanctions according to national concept 187.

The developing of European capital market showed the European legislator that it was still the appropriate time to work on new concept of sanctions, especially on criminal sanctions. The

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182 Rudiger Veil, European Capital Markets Law 2013, p.124
Commission decided to impose the criminal sanctions which would be direct applicable for the Member States and this fact the Commission in proposal explained that the reason was this that the punishment systems were weak in the Member States and it was necessary to set forth minimal common standard for the Member States subjected to criminal sanctions. Finally, on 16 April, 2014 the European parliament has enacted Market Abuse Regulation (This new regulation replaced the Directives according to Market Abuse) and additionally Criminal Sanctions for Market Abuse.

5.1.2 Criminal and administrative sanctions

The Market Abuse Directive 2003/6/EC consisted administrative sanctions on insiders dealing and market manipulation. The MAD determined minimal requirements of administrative sanctions but not criminal sanctions. According to Article 14 (MAD), „Without prejudice to the right of Member States to impose criminal sanctions, Member States shall ensure, in conformity with their national law, that the appropriate administrative measures can be taken or administrative sanctions be imposed against the persons responsible where the provisions adopted in the implementation of this Directive have not been complied with. Member States shall ensure that these measures are effective, proportionate and dissuasive”. From this article is clear that the Member States had a free choice to present the criminal sanctions. The Directive did not contain the provisions which governed minimum fines or specific sanctions.\(^\text{188}\).

During working on Market Abuse regulation the Commission purposed to grow the supervision of European capital markets and to strength the power of competent authorities (national authorities)\(^\text{189}\), to give them „sufficient power to act and should be able to rely on equal, strong and deterrent sanction regimes against all financial misconduct, and sanctions should be enforced effectively“\(^\text{190}\). According to Market Abuse Regulation the aim of administrative sanction is to ensure the common approach in EU and increase their deterrent

\(^{188}\) Rudiger Veil, European Capital Markets Law 2013, p.125  
\(^{189}\) Recital 62, MAR  
\(^{190}\) Recital 70, MAR
effect and the Regulation is not limited to administrative sanctions and measures, on the contrary it gives the Member States an opportunity to impose themselves higher administrative sanctions or other administrative measures. The European legislator with this new regulation does not request from Member States to impose both administrative and criminal sanctions for the same issue, but it’s possible to do this when the national law of Member States does not prohibit this system. Under the Regulation it is requested to competent authorities to take into account all facts (For example: the gravity and duration of the infringement, the financial strength of the person responsible for the infringement and etc.) before deciding which kind of administration sanctions is relevant for an legal issue.

According to Directive on Criminal Sanctions for Market Abuse (MARKET ABUSE DIRECTIVE) market integrity is necessary if we want to have an efficient financial market and stronger investor confidence. The scope of the Directive is establishing the minimum rules with regard to the definition of criminal offences which will be more effective and beneficial for Member States. The financial crisis and especially Libor Scandal showed how many money could be lose the investors on the market. Due to those reasons the European legislator believes that „The imposition of criminal sanctions for market abuse will have an increased deterrent effect on potential offenders“ Under the four framework or other European Directives there was not were obligatory for Member States to have the criminal sanctions for market abuse, but the Directive on Criminal Sanctions for Market Abuse request the Member States to constitute criminal sanctions on insider dealing, market manipulation and unlawful disclosure of inside information. The fact that the Directive stipulates minimum rules for Members of the EU it does not means that the Member States cannot

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191 Recital 71, MAR
192 Recital 72, MAR
193 Article 31 (1), MAR
195 Article 1, Recital 10, 14 DIRECTIVE on criminal sanctions for market abuse (market abuse directive) 16 April 2014
196 Recital 7, DIRECTIVE on criminal sanctions for market abuse (market abuse directive) 16 April 2014
197 Recital 10, 14 DIRECTIVE on criminal sanctions for market abuse (market abuse directive) 16 April 2014
consider and implement into national law more strict criminal sanctions for market abuse\textsuperscript{198}. The Directive\textsuperscript{199} on Criminal Sanctions for Market Abuse (MARKET ABUSE DIRECTIVE) applies almost all financial instruments except trading in own shares in buy-back programs, also transactions, orders or behaviors related monetary, exchange rate or public debt management policy\textsuperscript{200}. It defines a sanctioning measures for a natural and legal persons and the Member States gives directives what kind of fact have to take account when they determine sanction for a offence. The legislator in this Directive uses a word „serious case” when provides the information regarding market abuse, for example Recital 10 stipulates the following: „Member States should be required to provide at least for serious cases of insider dealing, market manipulation and unlawful disclosure of inside information to constitute criminal offences when committed with intent”. Unfortunately the Directive does not defines the content of the term „serious case”, it seems that is a vogue concept, because in the Member States this term might be considered into different meaning.

5.1.3 Civil law sanctions

In the European Directives it is difficult to find appropriate provisions on civil law sanctions. Even the four frameworks did not concentrate on civil law liability. The question why the legislator does not work determining the conditions of civil liability it is not clear. The new Market Abuse Regulation also does not define importantly this issue. The Member States with their national law system can determine what kind of illegal action requires the civil liability sanctions, an amount for damages and etc.

We can meet some provisions on civil law liability subjected to incorrect information in the Prospectus Directive: „Member States shall ensure that responsibility for the information given in a prospectus attaches at least to the issuer or its administrative, management or

\textsuperscript{198} Recital 20, DIRECTIVE on criminal sanctions for market abuse (market abuse directive) 16 April 2014
\textsuperscript{199} DIRECTIVE 2014/57/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 16 April 2014 on criminal sanctions for market abuse (market abuse directive)
\textsuperscript{200} Article 1 (3), DIRECTIVE on criminal sanctions for market abuse (market abuse directive) 16 April 2014
supervisory bodies, the offeror, the person asking for the admission to trading on a regulated market or the guarantor, as the case may be”\textsuperscript{201}. This article does not provide us information about conditions of liability, it is vogue the issuer is legally responsible for wrongful intent or for negligence\textsuperscript{202}.

In general, the civil law norms are ineffective if no contractual relations exist between investor and insider. The civil law norms have to protect not only an individual single investor also sufficient functioning of a market\textsuperscript{203}.

5.1.4 National Sanctioning System (Germany, Italy, France, Spain)

The CESR’s report regarding to administrative measures and criminal sanctions in the member States provides us information about the legal practice in the Member States, the report gives a suggestion what kind of fines are necessary to avoid an illegal action and ensure the market. The report does not include any information about the sanctions for civil liability\textsuperscript{204}.

The concept of National sanctioning system in the Member states is similar, but the amount of fines is different.

In Germany, the Federal Financial Supervisory Authority (BaFin) imposes fines, has the right to make public information related to sanctions on its webpage. Under securities law for breach of capital markets law is 1,000,000 what is a maximum fine and the minimum for fines is 5 Euro. The criminal courts are obliged to consider the level of the fine and/or a term of imprisonment\textsuperscript{205}.

\textsuperscript{201} DIRECTIVE 2003/71/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 4 November 2003
\textsuperscript{202} Rudiger Veil, European Capital Markets Law 2013, p.127
\textsuperscript{203} Tomas Dingeldey, Insider-Handel und Strafrecht, 1983, p.114
\textsuperscript{204} Rudiger Veil, Europäisches Kapitalmarktrecht 2. Auflage 2014, p.171
\textsuperscript{205} Rudiger Veil, European Capital Markets Law 2013, p.128
German law regulates also the issues subjected to civil liability, defines the situations when a investor has right to sue damages for incorrect ad hoc notification\textsuperscript{206}. The Capital investors Test Proceedings Act give the investors an opportunity to claim test proceedings. Additionally, German civil law stipulates sanctions for breaches of law which protects investor on the market\textsuperscript{207}.

Under Italian law for breaches against the rules on inside information and market manipulation are using penalties and administrative fines, what means the Italian law combines criminal and administrative sanctions. The maximum criminal and administrative fines can be reached 10,000,000 Euro, the minimum might be 20,000 Euro for market manipulation\textsuperscript{208}.

In France, the AMF (Autorité Des Marches Financiers) which so-called commission des sanctions impose administrative sanctions has a power to impose fines for breach of capital market provisions. The maximum fines can be reached 10,000,000 Euro as in Italy. The AMF officially informs us on its website about the sanctions and violations\textsuperscript{209}. Unfortunately, the legislature of France does not present specific provisions on damages when we have a fact of breach of capital markets law. In that case a person can use basic rules of tort law if hi/her wants to claim. Under the French civil law it is possible also to claim damages when the claim comes from criminal law proceedings. For preventing hostile takeovers the loss of voting rights for failure is very important especially when it requires the notification obligations in major shareholders. Do to this fact a lot of French companies determined in articles of association additional notification for investors process and breach which causes a loss of rights\textsuperscript{210}.

\textsuperscript{206} CF. par 37b, 37c WpHG
\textsuperscript{207} Rudiger Veil, European Capital Markets Law 2013, p.128-129
\textsuperscript{208} Rudiger Veil, Europäisches Kapitalmarktrecht 2. Auflage 2014, p.174
\textsuperscript{209} See: www.amf-france.org
\textsuperscript{210}
Spain legislator is oriented on administrative measures for breaches of capital markets law than criminal sanctions\textsuperscript{211}. The Comisión Nacional del Mercado de Valores (CNMV) and the Ministry for Economy and Finance have an obligation to impose sanctions for serious infringements. Under the Spanish law the sanctions and breaches of the capital markets law provisions have to publish officially. In Spanish law we cannot find special provisions regarding to ad hoc disclosure obligations, but civil law determines sanctions for prospectus liability and incorrect financial reports\textsuperscript{212}. According to general civil rules of Spanish civil law and tort law an investor can claim for damages.

After considering sanctions systems in the Members states we have to look at lack of sanctions under civil law. It would be beneficial if the European legislator harmonize civil law sanctions and determines a minimum level as we already have under the Market Abuse Regulation and DIRECTIVE on criminal sanctions for market abuse. It will be additional advantage for an investor because harmonizing of civil law sanctions reduce the transaction costs and improves the general knowledge of investors about market security and the liability of infringer.

CHAPTER 7: Conclusion

After above-mentioned information we can say that the European capitals markets law is already really an independent field of law. Do to the fact that capital markets growth, creates new trade facilities and platforms and the develop investment strategy changes time to time the European legislator have to work on new concepts to adapt EU rules to the new market situations. This process will be beneficial way to develop capitals market law and it is possible in the future perspective to codify all necessary rules for European Member States. In general harmonization and implementation process continues long time, but it is important that the market will be safe and the investors protected. The developing of European capital markets

\textsuperscript{211} E.Hernandez Sainz, El abuso de information privilegiada en los mercados de valores, p.617 ff, 2007
\textsuperscript{212} E.Hernandez Sainz, El abuso de information privilegiada en los mercados de valores, p.617
law has the advantages, especially it reduces the transaction cost and ensures institutional functioning of capital market.

After the LIBOR/EURIBOR scandal we know that if the market is not regulated, a risky of market manipulation and illegal actions increase immediately. In my opinion it is very effective and positive that the European legislator presented new Market Abuse Regulation and Criminal Sanctions on Market Abuse, also OTC, MTF, and HFT systems are already regulated by the law.

Additionally, under the Market Abuse Regulation definitions about insider dealing, insider information, market manipulation are already precise described what was a lack of Market Abuse Directive. As a result of the new precise definitions, the meaning of the terms won’t be interpreted in different ways and it will be helpful for lawyers and judges. Furthermore, the provisions of Market Abuse Regulation consists details such as what kind of behaviors can be considering as market manipulation and how to prohibit those actions, also describes the effect of disclosure information and it’s prohibitions. Unfortunately, those issues were not precise described in Market Abuse Directive 2003/6/EC and also courts decisions cannot provide full interpretations of the vogue provisions. I believe the Courts interpretations and European Securities Regulators gridlines related to insider dealing and market manipulation will be useful for future cases in the Member States.

This fact that the Market Abuse Regulation enhances power of the supervisory authorities it is very good approach because in all Member States the supervisory authorities have to play important role in the stability of national economy and their strength guarantees market efficiency. On the other hand when the supervisory authorities of the Member States have a possibility to change necessary information this influences on trans-border transactions (reduce transactions costs).

As I have written in my paper, under the Market Abuse Directive the Member States of Europe could impose them self administrative and criminal sanctions for insider dealing and market manipulation and they defined issues on the different way, for example which forms of
insider dealing or market manipulation should be considering breach of capital market rules. There were some countries which did not have criminal sanctions for the issues which had a negative influence on the market and for investors.

As I mentioned the European parliament has already enacted the new directive on Criminal Sanctions for Market Abuse. The aim of European legislator according to this new directive and regulation is to establish minimum level of rules for criminal sanctions for insider dealing and for market manipulation in the Member States, to save financial markets in the Union and to protect investors. In my opinion, this is a good decision because after Libor we realized that it was necessary to have strict rules, namely only administrative sanctions were not enough against market abuse. The European legislator did not limit the area of criminal sanctions and gave the Member States right to impose more strict rules fighting against insider dealing and market manipulation what is a effective concept and I hope the Member States during the implementation process of minimum standard requirements according to criminal sanctions, they constitute will orient on high level criminal sanctions.

After considering sanctions systems in the Members states we have to look at lack of sanctions under civil law. I would advise the European legislator to focus on civil law sanctions, to consider a harmonizing of civil law sanctions and determine a minimum level which will be direct applicable for the member States as we already have under the Market Abuse Regulation and Directive on criminal sanctions for market abuse. I think harmonizing of civil law sanctions will be additional advantage for an investor because this minimum level will reduce their transaction costs, it gives them right to claim damages.

Finally, after summarizing all information, I would remark that Market Abuse Regulation and additional Criminal Sanctions for Market Abuse consists the provisions and new regulations which are beneficial for the European capital markets, but what we need is the European legislator has to continue work on enforcement of the provisions in real life.
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