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** I

REPORT

drawn up on behalf of the Committee on Legal Affairs
and Citizens' Rights

on the proposal from the Commission of the European
Communities to the Council (COM/87/111 final - C2-86/87)
for a directive coordinating regulations on insider
trading.

Rapporteur : Mr Geoffrey W. HOON

PE 121.114/fin.

Or. EN

On 3 July 1987 the President of the Council of the European Communities requested the European Parliament to deliver an opinion on the Commission proposal for a Council directive coordinating regulations on insider trading.

At its sitting of 9 July 1987, the President of the European Parliament referred this proposal to the Committee on Legal Affairs and Citizens' Rights as the committee responsible and to the Committee on Economic and Monetary Affairs and Industrial Policy for an opinion.

At its meeting of 23 September 1987, the Committee on Legal Affairs and Citizens' Rights appointed Mr HOON rapporteur.

The Committee examined a working document submitted by the rapporteur at its meeting of 17 and 18 February 1988, and examined a draft report on the Commission's proposal at its meetings of 14 and 15 March and 19 and 20 April 1988.

At this last meeting the Committee approved the Commission's proposal subject to the amendments it had adopted with 15 votes in favour and 1 abstention.

The Committee then adopted the draft legislative resolution as amended unanimously.

The following were present for the votes: Lady ELLES, Chairman; Mr SARIDAKIS and Mr VERDE I ALDEA; Mr HOON, Rapporteur; Mr BARZANTI, Mr CASINI, Mr DE WINTER, Mr GARCIA AMIGO, Mr HERMANN, Mr JANSSEN VAN RAAY, Mr KOLOKOTRONIS, Mr LAFUENTE LOPEZ, Mr LALOR (deputizing for Mr de la Malene), Mr MEGAHY, Mr PRICE, Mr ROTHLEY, Mr VETTER and Mr WIJSENBEEK.

The opinion of the Committee on Economic and Monetary Affairs and Industrial Policy is attached.

The deadline for tabling amendments to this report will be indicated in the draft agenda for the part-session at which it will be debated.

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The report was tabled on 26 April 1988.

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The Committee on Legal Affairs and Citizens' Rights hereby submits to the European Parliament the following amendments to the Commission's proposal and draft legislative resolution together with explanatory statement:

Proposal from the Commission for a Council directive coordinating regulations on insider trading

Commission text

Amendments proposed by the
Committee on Legal Affairs and
Citizens' Rights

First Recital

First recital

Amendment No. 1

Having regard to the Treaty establishing the European Economic Community, and in particular Article 54 thereof;

Having regard to the Treaty establishing the European Economic Community, and in particular Article 100(a) thereof;

Second, Third and Fourth recital unchanged

Fifth recital

Fifth recital

Amendment No. 2

Whereas Article 54(3)(g) provides that the Council shall coordinate to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 58 with a view to making such safeguards equivalent throughout the Community;

Whereas Article 100(a)(i) states that the Council shall adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market;

Remainder of the recitals unchanged

ARTICLE 1

ARTICLE 1

Amendment No. 3

1. Member States shall prohibit any person who, in the exercise of his profession or duties, acquires inside information as defined in Article 6 from taking advantage of that information to

1. Member States shall prohibit any person who, in the exercise of his employment, profession or duties, acquires inside information as defined in Article 6 from taking advantage of that information

buy or sell on their territory, either directly or through another person, transferable securities admitted to trading on their stock exchange markets.

to buy or sell on their territory, either directly or indirectly, transferable securities admitted to trading on their stock exchange markets.

Where the purchase or sale of transferable securities is carried out on a stock exchange market, it shall be deemed to be carried out on the territory of the Member State in which the stock exchange in question is situated or operates.

Where the purchase or sale of transferable securities is carried out on a stock exchange market, it shall be deemed to be carried out on the territory of the Member State in which the stock exchange in question is situated or operates.

Where the purchase or sale of transferable securities is carried out outside a stock exchange market, it shall be deemed to be carried out on the territory of the Member State in which the counterpart of the person referred to in the first subparagraph is resident.

Where the purchase or sale of transferable securities is carried out outside a stock exchange market, it shall be deemed to be carried out on the territory of the Member State in which the counterpart of the person referred to in the first subparagraph is resident.

2. The prohibition laid down in paragraph 1 shall not apply to transferable securities bought or sold outside a stock exchange market without the involvement of a professional intermediary.

Amendment No.4

2. Unless Member States specifically waive the prohibition laid down in paragraph 1, it shall ~~(one word deleted)~~ apply to transferable securities bought or sold outside a stock exchange market without the involvement of a professional intermediary.

ARTICLE 2

Member States shall prohibit any person who is resident on their territory and who acquires inside information in the exercise of his profession or duties from:

ARTICLE 2

Amendment No.5

Member States shall prohibit any person who is resident on their territory and who acquires inside information in the exercise of his employment, profession or duties from:

Commission text

Amendments proposed by the
Committee on Legal Affairs and
Citizens' Rights

- disclosing that inside information to a third party unless such disclosure is made in the normal course of exercising his profession or duties;

- using that inside information to recommend a third party to buy or sell transferable securities admitted to trading on their stock exchange markets.

ARTICLE 3

1. Member States shall impose the prohibition provided for in Article 1 in accordance with the terms referred to therein also on any person who has knowingly obtained inside information from a person who has acquired that information in the exercise of his profession or duties.

2. Member States shall prohibit any person referred to in paragraph 1:

- from disclosing the inside information to a third party;
- using that inside information to recommend a third party to buy or sell transferable securities admitted to trading on their stock exchange markets.

(a) disclosing that inside information to a third party... unless such disclosure is authorized as part of the normal course of exercising his employment, profession or duties

(b) using that inside information to recommend a third party to buy or sell transferable securities admitted to trading on their stock exchange markets.

ARTICLE 3

1. Unchanged

Amendment No. 6

2. Member States shall prohibit any person referred to in paragraph one from:

- (a) (delete 'from') disclosing the inside information to a third party,
- (b) (delete 'from') using that inside information to recommend a third party to buy or sell transferable securities admitted to trading on their stock exchange markets.

Articles 4 and 5 unchanged

ARTICLE 6

For the purposes of this Directive, inside information is information unknown to the public of a specific nature and relating to one or more issuers of transferable securities or to one or more transferable securities, which, if it were published, would be likely to have a material effect on the price of the transferable security or transferable securities in question.

ARTICLE 6

Amendment No. 7

1. For the purposes of this Directive, inside information is information inaccessible or not available to the public of a specific nature and relating to one or more issuers of transferable securities or to one or more transferable securities, which, if it were published, would (~~Delete 'be likely to'~~) have a material effect on the price of the transferable security or transferable securities in question.

Amendment No. 8

2. Publication for these purposes involves the effective disclosure of inside information in such a manner sufficient to ensure its availability to the investing public.

Article 7 unchanged

ARTICLE 8

1. Member States shall designate the authority or authorities competent to ensure that the provisions adopted pursuant to this Directive are applied. They shall inform the Commission accordingly, indicating, if appropriate, how duties have been allocated.

ARTICLE 8

1. Unchanged

Commission text

2. The competent authorities shall be given all such supervisory powers as may be necessary for the exercising of their duties.

3. The competent authorities in the Member States shall cooperate wherever necessary for the purpose of carrying out their duties and shall exchange any information required for that purpose.

ARTICLE 9(1)

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

Amendments proposed by the
Committee on Legal Affairs and
Citizens' Rights

Amendment No. 9

2. The competent authorities shall be given all such supervisory and investigatory powers as may be necessary for the exercising of their duties.

3. Unchanged

ARTICLE 9(1)

Amendment No. 10*

1. Unchanged

[*This amendment does not apply to the English text: in the French version, the words 'et réglementaires' are deleted.]

ARTICLE 10

The Contact Committee set up by Article 20 of Council Directive 79/279/EEC of 5 March 1979 coordinating the conditions for the admission of securities to official stock exchange listing shall also have as its function:

(a) to facilitate the harmonized implementation of this Directive through regular consultations on any practical problems which arise from its application and on which exchanges of view are deemed useful;

(b) to advise the Commission on any amendments to be made to this Directive.

ARTICLE 11

Member States shall determine the penalties to be applied for infringement of the measures taken pursuant to this Directive.

ARTICLE 10

Amendment No.10

The Contact Committee set up by Article 20 of Council Directive 79/279/EEC of 5 March 1979 coordinating the conditions for the admission of securities to official stock exchange listing shall also have as its function:

(a) to facilitate the harmonized implementation of this Directive especially as regards penalties, through regular consultations on any practical problems which arise from its application and on which exchanges of view are deemed useful;

(b) to advise the Commission on any amendments to be made to this Directive.

ARTICLE 11

Amendment No.12

1. The prohibition laid down in Article 1 shall involve a breach of the criminal law as well as giving rise to appropriate civil remedies.

2. Member States shall determine the penalties to be applied for infringement of the measures taken pursuant to this Directive.

Amendment No. 13

3. Appropriate civil remedies for the purpose of this article shall involve the payment of an indemnity by those profiting by the use of inside information to those who can show that they have thereby suffered a loss.

Articles 12 and 13 unchanged

DRAFT LEGISLATIVE RESOLUTION
(COOPERATION PROCEDURE: first reading)

embodying the opinion of the European Parliament on the proposal from the Commission to the Council for a directive coordinating regulations on insider trading.

The European Parliament,

- having regard to the proposal from the Commission to the Council⁽¹⁾,
 - having been consulted by the Council pursuant to Article 54 of the EEC Treaty (Doc. C 2-86/87)
 - considering Article 100A of the EEC Treaty to be the appropriate legal basis for the proposal,
 - having regard to the report of the Committee on Legal Affairs and Citizens' Rights and the opinion of the Committee on Economic and Monetary Affairs and Industrial Policy (Doc. A 2-55/88).
1. Approves the Commission's proposal subject to Parliament's amendments and in accordance with the vote thereon;
 2. Calls on the Commission to alter its proposal pursuant to Article 149(3) of the EEC Treaty by including in it the amendments adopted by Parliament, and to inform Parliament of any further change it makes to the proposal;
 3. Calls on the Council to incorporate Parliament's amendments into the common position that will be adopted pursuant to Article 149(2)(a) of the Treaty;

(1) OJ No. C 153, 11 June 1987, page 8

4. Calls on the Council to notify Parliament if it intends to depart from the text adopted by it;
5. Calls on the Council to consult Parliament again if it intends to make substantial changes to the Commission's proposal;
6. Instructs its President to forward to the Council and Commission, as Parliament's opinion, the Commission's proposal as amended by Parliament, together with this legislative resolution.

B

EXPLANATORY STATEMENT

Introduction

It is now generally accepted that insider trading is wrong. It has been compared to theft in that those who, for example, sell shares without the benefit of inside information lose the financial advantage which accrues to those trading with inside information.

The true insider, such as the director of a company trading in the company's shares with the benefit of inside information about the company's changed position, does so in breach of confidence. A greater problem in the increasingly sophisticated financial world is the leaking of inside information to third parties who then either use the inside information themselves or pass it on to others who are able to do so.

Inside information thereby damages the confidence of investors in the fair and efficient functioning of the market. It divides potential investors into those 'in the know' and those on the outside. Potential investors are discouraged in case they are not party to information which is available to others.

As the international market in securities grows in size and sophistication the problems are compounded. Insider traders can operate in the stock market with the weakest safeguards and regulations, thereby breaking into the chain of international dealing.

It is therefore clearly necessary for the control of insider trading to be consistent from one country to the next, particularly within the European Community. Indeed, it has been argued that as a result of the European Community's legislative powers, it has a particularly important role to play in the provision of a uniform regulation of the securities markets within its jurisdiction.

LIST OF AMENDMENTS WHICH WERE REJECTED IN THE COMMITTEE RESPONSIBLE,
THOUGH HAVING OBTAINED AT LEAST 5 VOTES

(see Rule 36(6) of the Rules of Procedure)

- second part of the Rapporteur's Amendment No. 1 (refraining from buying or selling - see PE 121.114),
- second part of the Rapporteur's Amendment No. 9 (list of investigatory powers - see PE 121.114).

OPINION

(Rule 120 of the Rules of Procedure)

of the Committee on Economic and Monetary Affairs and Industrial Policy

At its meeting of 30 September-2 October 1987 the Committee on Economic and Monetary Affairs and Industrial Policy appointed Sir Fred CATHERWOOD draftsman of the opinion.

The committee considered the draft opinion at its meetings of 16-17 February 1988 and 24-25 March 1988. During that latter meeting the committee adopted it unanimously.

The following took part in the vote: BEUMER (chairman), Peter BEAZLEY (vice-chairman), Sir Fred CATHERWOOD (draftsman), BONACCINI, Ingo FRIEDRICH, HERMAN, LINKOHR (deputizing for MIHR), METTEN, MÜHLEN, PATTERSON, PETRONIO, ROGALLA

The Community economy, which is continually changing, will require more and more investment. The role of securities markets is bound, therefore, to increase in importance. As the capital market becomes more international, the formation of an international securities market cannot occur without consistent regulation designed to ensure the continued integrity of the market system and the protection of all investors. Rules dealing with the generally condemned practice of insider trading will have to be consistent from one Member State to the next in order to protect all investors.

Insider trading occurs when certain individuals ('insiders') after obtaining non-public information that relates to the value of companies, and publicly held securities, trade on that information to profit when the information is eventually disclosed.

There is no specific legislation in this area at present in nine out of twelve Member States, as only Denmark, France and the United Kingdom have introduced legislation penalizing the exploitation of inside information. In other Member States either voluntary rules or codes of conduct have been established or no rules exist at all.

It has been argued that 'insider trading' is a victimless crime, that the insider who uses his information to buy or sell is only alerting the market to the true value of the security. Had he not used the information, those who sold or bought would have done so in any case, so they are not victims. And those who did not buy or sell are now holding their shares at a price nearer to its true value, so they are not victims either.

We do not accept this argument. The 'insiders' have used their knowledge to enrich themselves at the expense of others. What the argument does show is that it is extremely difficult for any individual to prove a specific loss to the courts. This is why some countries with large capital markets have made 'insider trading' a criminal offence, on which the state takes action on behalf of the public at large.

'Insider trading' legislation is consistent with the European Communities' current work in the company law area. Company law harmonization is an attempt by the Community to protect employees, shareholders and the public against certain kinds of business misconduct. The 'insider trading' proposal for a directive fits within the framework of company law harmonization, in that it is designed to ensure that people who deal with the business community in different Community Member States receive consistent treatment and enjoy essentially the same safeguards. Because 'insider trading' legislation is designed to support investor confidence in the stock markets, investors may be discouraged from trading in those markets which are unregulated or poorly regulated. Such discouragement will in turn inhibit the growth of companies in those countries and slow down the progress towards internationalizing the market. In other words the proper operation of the security markets depends on the degree of confidence they give investors.

An essential element in the freedom of movement of capital is the right of establishment. Implementing this right will enable companies established in one Member State to be able to conduct business in another Member State and enjoy the privileges that a local company would enjoy. The creation of a common capital market for the Community is a prerequisite to the attainment of the free movement of capital. The recent proposals from the Commission for the creation of a European financial area (COM(87) 550), in order to bring about an internal market in capital, is to be seen as a further attempt to achieve this aim. These proposals should eventually allow for the full liberalization of capital movements as a follow-up to the recent strengthening of the European Monetary System.

The Community will need to be able to mobilise its savings to create investment and jobs wherever there are opportunities; so, increasingly, savings will be invested outside the traditional areas covered by local capital markets and so outside the immediate knowledge of the investor. It is absolutely essential that investors are able to trust in the integrity of those who run the enterprises, large and small, in which their savings are invested.

The wider the market, the more easily securities can be bought and sold on narrow margins between the buying and selling price. The investor knows that in a wide market it will be easy to sell with little loss and the enterprise can raise money more easily and at cheaper rates.

Especially in the present situation characterized by uncertainty on the international stock exchanges and involving drastic drops in security rates the promotion of a European/international legislative framework is extremely important.

As shown above the different aspects of European economic integration are closely linked. Community legislation on 'insider trading' is thus necessary and desirable. The directive does not attempt to make national legislation identical, but rather to achieve an acceptable minimum standard of investor protection throughout the Community. Tougher rules may be introduced or maintained in Member States as long as they are non-discriminatory.

To sum up the free movement of capital will only be obtained through the emergence of a common capital market. The 'insider trading' proposal will move the Community one step closer to this goal by encouraging investors to trade, and issuers to list their shares on foreign exchanges. In the internal market context the movement of capital will provide Member States with a more efficient and rational flow of capital to meet their needs. The fact that companies may now be listed on stock exchanges in many different countries (also extra-Community countries) means that 'insider traders' have more opportunities to use their price-sensitive inside information in fraudulent ways. The more that markets are opened up the more the reason for establishing international provisions on 'insider trading'.

SPECIFIC REMARKS

The proposal is a natural supplement to directives already adopted or being considered by the institutions in the securities field (see the Commission proposal, explanatory statement item I, paragraph 3).

It could be argued that the directive also covers the public sector securities and knowledge of monetary policy decisions. However, as the directive is based on Article 54 of the EEC-Treaty it only applies to "companies and firms constituted under civil or commercial law governed by public or private law", cf. Article 54, paragraph 3, litra g) and Article 58, paragraph 2. Activities connected with the exercise of official authority is excluded from the provision in the Treaty-Chapter on right of establishment.

The definition of 'insiders' is rather broad and the interpretation and incorporation into national law could therefore be less uniform than desired. In the recitals or in the explanatory statement the Commission could give examples of 'inside information' in order to avoid this risk.

The scope of the proposal is limited to securities admitted to trading on Member States' stock exchange markets. It would improve the protection of the investors if securities that are traded on the secondary markets were also to be included in the directive.

The work of the investment analyst, which is very important for the proper working of a capital market must be protected. Article 6 defines 'inside information' as 'information which is unknown to the public'. But the results of investment analysis are also unknown to the public and the information is used to buy and sell shares.

In order to make the Community legislation more efficient and to carry out the follow-up that is needed the European Community should conclude agreements with other important financial powers in order to ensure a common approach towards such legislation at international level.

CONCLUSIONS

The Committee on Economic and Monetary Affairs and Industrial Policy requests the responsible Committee on Legal Affairs and Citizens' Rights to incorporate the following amendments to the proposal for a Council directive coordinating regulations on insider trading (COM(87) 111 final - doc. C2-86/87):

Text proposed by the Commission of
the European Communities

Text proposed by the Committee on
Economic and Monetary Affairs and
Industrial Policy

First recital

Having regard to the Treaty
establishing the European Economic
Community, and in particular
Article 54 thereof;

Amendment No. 1

First recital

Having regard to the Treaty
establishing the European Economic
Community, and in particular
Article 100 (a) thereof;

Recitals 2-4 unchanged

Fifth recital

Whereas Article 54 (3) (g) provides
that the Council shall coordinate to
the necessary extent the safeguards
which, for the protection of the
interests of members and others, are
required by Member States of
companies or firms within the meaning
of the second paragraph of Article 58
with a view to making such safeguards
equivalent throughout the Community;

Amendment No. 2

Fifth recital

Whereas Article 100 (a) (1) states
that the Council shall adopt the
measures for the approximation of the
provisions laid down by law,
regulation or administrative action
in Member States which have as their
object the establishment and
functioning of the internal market;

Recitals 6-14 unchanged

Article 1. (1)

1. Member States shall prohibit any person who, in the exercise of his profession or duties, acquires inside information as defined in Article 6 from taking advantage of that information to buy or sell on their territory, either directly or through another person, transferable securities admitted to trading on their stock exchange markets.

The rest of Article 1 (1) unchanged

Article 1. (2)

2. The prohibition laid down in paragraph 1 shall not apply to transferable securities bought or sold outside a stock exchange market without the involvement of a professional intermediary.

Article 2

Member States shall prohibit any person, who is resident on their territory and who acquires inside information in the exercise of his profession or duties from:

The rest of Article 2 unchanged

Amendment No. 3

Article 1. (1)

1. Member States shall prohibit any person who, by his profession or occupation is in a fiduciary relationship with or has a duty of confidentiality towards the company or companies whose shares are in question, and acquires inside information ... (the rest unchanged)

Amendment No. 4

Article 1. (2)

2. The prohibition laid down in paragraph 1 shall not apply to transferable securities bought or sold outside a stock exchange market without the involvement of a professional intermediary. This prohibition shall apply to any purchase or sale of transferable securities whether they are issued by the public authorities, institutions in the public sector or private companies.

Amendment No. 5

Article 2

Member States shall prohibit any person, who by his profession or occupation, is in a fiduciary relationship with or has a duty of confidentiality towards the company or companies whose shares are in question, who is resident on their territory and who acquires inside information from:

Article 3. (1)

1. Member States shall impose the prohibition provided for in Article 1 in accordance with the terms referred to therein also on any person who has knowingly obtained inside information from a person who has acquired that information in the exercise of his profession or duties.

Amendment No. 6

Article 3. (1)

1. Member States shall impose the prohibition provided for in Article 1 in accordance with the terms referred to therein also on any person who has knowingly obtained inside information from a person who by his profession or occupation, is in a fiduciary relationship with or has a duty of confidentiality towards the company or companies whose shares are in question, and who acquired that information in the exercise of his profession or duties.

Article 3 (2) unchanged

Articles 4-5 unchanged

Article 6

For the purposes of this Directive, inside information is information unknown to the public of a specific nature and relating to one or more transferable securities, which, if it were published, would be likely to have a material effect on the price of the transferable security or transferable securities in question.

Amendment No. 7

Article 6

For the purposes of this Directive, inside information is information inaccessible or not available to the public of a specific nature and ... (the rest unchanged)

Articles 7-13 unchanged

The Committee also submits the following general conclusions:

1. Coordinated rules on 'insider trading' at Community level are necessary in order to provide more uniform safeguards for investors, and thus to contribute to greater interpenetration of the securities markets; the creation of a genuine European securities market is a prerequisite for the attainment of a European capital market which is a top priority for the European Communities, in that it provides free flow of capital to all parts of the Community.
2. 'Insider trading' is a fraud and must be regulated because it destroys investor confidence in capital markets. This confidence and protection of investors are necessary in order to bring about more investment in the Community economy.
3. The Commission proposal for a directive can therefore be supported with the following comments and proposals:
 - a) we see no reason for excluding public sector securities, so the basis of the directive should be a more general Article of the Treaty which does not exclude public sector securities,
 - b) in order to provide for more uniform incorporation of the directive into national legislation and to provide clearer guidance as to the scope of the directive the Commission is urged to give examples of legal case law in those Member States where 'insider trading' has been illegal,
 - c) the text of Article 1, paragraph 1, of the directive should make it clear that it also includes securities that are traded on the secondary markets,
 - d) though the investment analysts reports are unknown to the public, the information on which the analyst works is accessible. In Article 6 the word "unknown" should be substituted by the word "inaccessible".
4. Finally we would suggest that the Legal Committee in considering the legal points should look to the law and practice of those countries which have experience in operating very large capital markets.