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# FINANZPLATZ DEUTSCHLAND: GERMANY ENACTS INSIDER TRADING LEGISLATION

Ursula C. Pfeil\*

## INTRODUCTION

On August 1, 1994, Germany's financial markets took a leap into the world of Anglo-Saxon financial culture<sup>1</sup> as the Second Financial Markets Promotion Act (*Zweites Finanzmarktförderungsgesetz*),<sup>2</sup> legislation restructuring German financial markets and outlawing insider trading,<sup>3</sup> became effective.<sup>4</sup> After years of harboring an insider corporate culture, regulated only by a voluntary code of conduct on corporate behavior and insider dealings,<sup>5</sup> Germany, in the face of internal and external pressures, became the last major financial center to adopt legislation prohibiting insider trading.<sup>6</sup> The new insider trading prohibition in Ger-

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1. John Eisenhammer, *View from Frankfurt: Learning How To Be Held To Account; John Eisenhammer Watches German Companies Try to Cope With Sharp Changes to Share Trading Laws*, THE INDEPENDENT, Aug. 15, 1994, at 26 (describing the change to the new restrictions as a "sudden jump into hostile Anglo-Saxon terrain" and a "leap across the cultural divide").

2. *Zweites Finanzmarktförderungsgesetz* [Second Financial Markets Promotion Act], 1994 Bundesgesetzblatt, Teil I [BGBl. I] 1749 (F.R.G.) [hereinafter *FmFG*].

3. *Wertpapierhandelsgesetz* [Law on Securities Trading], in *FmFG*, *supra* note 2, at 1750-60 [hereinafter *WpHG*].

4. See *Insider Trading Law Takes Effect*, FACTS ON FILE WORLD NEWS DIG., Aug. 25, 1994, at 607 [hereinafter *FACTS ON FILE*] (reporting that the Second Financial Markets Promotion Act was passed on June 17, 1994, by the Bundestag, the lower house of the German Parliament, and by the Bundesrat, the upper house of the German Parliament, on July 8, 1994).

5. See *infra* notes 16-44 and accompanying text (describing prior voluntary system of insider trading regulation in Germany).

6. See Michael D. Mann et al., *Developments in International Securities Law Enforcement and Regulation*, in INT'L SEC. MARKETS 1994, at 298-321 (PLI Corporate

many represents the first of several steps towards establishing a fairer and more attractive investment environment in Germany and, ultimate of promoting the growth and stature of the German financial market place (Finanzplatz Deutschland). To ensure utmost compliance with the insider trading prohibition and, thus, the promotion of the Finanzplatz Deutschland, the new law mandates the creation of a Federal Supervisory Office for Securities Trading (Bundesaufsichtsamt für den Wertpapierhandel) with extensive compulsory powers.<sup>7</sup> The new law also provides for stiff criminal penalties<sup>8</sup> and fines.<sup>9</sup> Although a comprehensive insider trading law is an essential ingredient in combatting insider trading violations, German authorities still face both statutory and structural hurdles in attaining an effective enforcement structure: an insider trading law with some bite.<sup>10</sup>

This Comment first reviews the developments leading up to Germany's adoption of insider trading legislation by focusing on the reasons why German legislators decided to implement insider trading legislation after years of opposing such change and why Germany's system of voluntary compliance no longer sufficed. Second, it embarks on an in-depth analysis of Germany's new insider trading legislation from both a statutory and practical vantage point, concentrating on prospects for its successful enforcement. Third, this Comment provides an overview of potential obstacles to the successful implementation of Germany's insider trading prohibition and the intended promotion of German capital markets that are rooted in German corporate culture, the federalized German system, and Germany's, heretofore, decentralized financial market structure. Finally, this Comment concludes with several recommendations for ensuring effective insider trading enforcement and encouraging greater investment in the Finanzplatz Deutschland.

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Law and Practice Course Handbook Series No. B4-7057, 1994) (describing insider trading laws enacted by The Netherlands, Japan, Italy, Switzerland, Germany, The European Union, United Kingdom, Austria, France, Hong Kong, and Finland); see also FACTS ON FILE, *supra* note 4, at 607 (noting that Germany was the last major financial center to prohibit insider trading).

7. FmFG, *supra* note 2, §§ 3-11 at 1750-53.

8. *Id.* § 38 at 1759 (criminal sanctions).

9. *Id.* § 39 at 1759-60 (fines).

10. Cf. Andreas Möller, *Das neue Insiderrecht—Eckpfeiler funktionsfähiger Wertpapiermärkte* [The New Insider Trading Law—Cornerstone of a Functional Securities Market], in 2 BETRIEBSWIRTSCHAFTLICHE FORSCHUNG UND PRAXIS 99, 99 (1994) (noting that the insider trading law must be believable to raise and maintain the needed level of investor confidence in the German securities markets).

## I. BACKGROUND ON INSIDER TRADING IN GERMANY

While securities regulators pursued insider trading violations in the United States as early as the 1930s,<sup>11</sup> trading on inside information remained a popular and unpunishable means of securing high profits in Germany through most of 1994.<sup>12</sup> For years, German business culture has thrived in a close-knit and familiar atmosphere among companies, banks, analysts, and journalists.<sup>13</sup> So-called "fireside chats," during which German journalists, financial analysts, and others heard inside information prior to its public announcement, were a common phenomena.<sup>14</sup> One foreign banker based in Frankfurt noted that it became a real "joke" to watch prices move first and then data being issued.<sup>15</sup>

## A. PRE-1994 INSIDER TRADING REGULATION

Prior to the enactment of the Second Financial Markets Promotion Act<sup>16</sup> and its Law on Securities Trading,<sup>17</sup> insider trading was not a crime in Germany.<sup>18</sup> Even though certain German laws were theoretic-

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11. See Securities Exchange Act of 1934, § 404, 15 U.S.C. § 8a-7811 (1988 & Supp. I 1989) (setting out regulations prohibiting insider trading). See generally NASSAR ARSHADI & THOMAS H. EYSELL, *THE LAW AND FINANCE OF CORPORATE INSIDER TRADING: THEORY AND EVIDENCE* 43-57 (1993) (discussing the law of insider trading as it developed in the United States after the passage of the Securities Exchange Act in 1934); C. EDWARD FLETCHER, *MATERIALS ON THE LAW OF INSIDER TRADING* 13-333, 439-524 (1991) (discussing history of insider trading regulation in the United States).

12. See Nina Magin, *Krumme Wertpapier-Geschäfte sind nun strafbar [Crooked Securities Transactions are Now Punishable]*, SÜDDEUTSCHE ZEITUNG [SZ], Aug. 1, 1994 (referring to study of Kiel scientists Reinhard Schmidt and Soenke Wulf, which concluded that insiders take advantage of corporate inside information in every fifth incidence of trading); see also Anthony Williams, *Five Probed in Alleged German Insider Scandal*, REUTER W. EUR., July 25, 1994 (describing one of Germany's largest insider trading scandals, uncovered a week before Germany's new law banning insider trading went into effect, in which a ring of traders and brokers were suspected of pocketing nearly \$63 million through a front-running scheme).

13. John Eisenhammer, *Germany Introduces Insider Trading Law*, THE INDEPENDENT, July 9, 1994, at 12.

14. John Templeman & Bill Javetski, *Achtung! Insider Trading Is a Crime*, BUS. WK., Dec. 5, 1994, at 54.

15. *Id.*

16. FmFG, *supra* note 2.

17. WpHG, *supra* note 3, at 1750-60.

18. See HAROLD S. BLOOMENTHAL & EBERHARD ROHM, *INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION* § 8C.11 (Clark Boardman Callaghan ed.,

cally applicable to insider trading, such as the Stock Corporation Act,<sup>19</sup> criminal laws prohibiting fraud,<sup>20</sup> or general principles of civil tort or contract law,<sup>21</sup> prosecutors and plaintiffs did not invoke these laws for that purpose.<sup>22</sup>

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1992) (analyzing introduction and history of insider trading rules in Germany); Heinz-Dieter Assmann, *Das künftige deutsche Insiderrecht (I)* [The Future German Insider Trading Law], DIE AKTIENGESSELLSCHAFT, May 1994, at 196 [hereinafter *Das Künftige*] (providing detailed analysis of developments leading up to insider trading legislation in Germany); Joseph Blum, *The Regulation of Insider Trading in Germany: Who's Afraid of Self-Restraint?*, 7 J. INT'L L. BUS. 507, 512-30 (1986) (giving a detailed analysis of the history of regulation of insider trading in Germany); Andreas J. Roquette, *New Developments Relating to the Internationalization of the Capital Markets: A Comparison of Legislative Reforms in the United States, the European Community, and Germany*, 14 U. PA. J. INT'L BUS. L. 565, 599-615 (1994) (describing deregulated German securities exchanges, developments leading up to insider trading rules, and the then anticipated legislative reforms in Germany); Hans-Bernd Schafer & Claus Ott, *Economic Effects of EEC Insider Trading Regulation Applied to Germany*, 12 INT'L REV. L. & ECON. 357, 357-62 (1992) (explaining development of insider trading regulation in Germany).

19. Aktiengesetz [AktG], 1965 BGBl. I 1089, at 177 (W. Ger.), amended by 1994 BGBl. I 48, at 1777 (F.R.G.); see, e.g., Blum, *supra* note 18, at 514-15 (finding that Article 93 of the Stock Corporation Act theoretically could be used to impose civil liability on corporate insiders, such as directors and managers, for breaching their fiduciary duty to the corporation by releasing confidential company information to third parties); Schafer & Ott, *supra* note 18, at 359 (stating that since corporations must make "an application for prosecution" for breach of fiduciary duty under the Stock Corporation, no insider trading prosecutions have been brought under this provision); David L. Hoeflmayr, *The Developing German Insider Trading Regulation*, 4 GERMAN AM. L. J. 31 (1994) (noting that, with respect to suits under the Insider Trading Guidelines, corporations probably have little incentive to sue their own management).

20. Schafer & Ott, *supra* note 18, at 359 (stating that German criminal anti-fraud laws do not apply to insider trading activities occurring on the stock market because "a duty to disclose inside information to an outsider as a precondition of fraudulent deception can hardly be imposed for the benefit of an anonymous market").

21. Bürgerliches Gesetzbuch [Civil Code] [BGB], 1896 Reichsgesetzblatt [RGBl.] 195, amended by 1981 BGBl. 553 (F.R.G.); see Blum, *supra* note 18, at 514 (discussing the possibility of holding insiders liable for failing to disclose material, non-public information to outsiders prior to making a trade under § 123 of the German Civil Code, under which contracts entered into by deceit, such as buyer's failure to disclose certain material facts to seller, are voidable).

22. See Blum, *supra* note 18, at 514-15 (noting, first, that German courts have not addressed the issue of whether corporations can sue their directors and managers under the Stock Corporation Act for alleged insider trading violations; second, that derivative shareholder actions are not permitted under German law; and third, the high likelihood that a civil law action by a buyer against a seller for failure to disclose

German legislators first devised Insider Trading Guidelines (Guidelines)<sup>23</sup> in 1970, and later revised and amended them in 1976 and 1988.<sup>24</sup> These Guidelines are comparable to a so-called gentleman's agreement<sup>25</sup> or a moral code<sup>26</sup> in that they were binding only on those persons who voluntarily submitted to them by private contract.<sup>27</sup> Thus, by means of individual contracts between a corporation or bank and its corporate insiders, such insiders could commit themselves to abstain from insider trading<sup>28</sup> and to submit to an investigation if suspicions of insider trading arose.<sup>29</sup> The sole remedy authorized by the regulations was the disgorgement of trading profits to the corporation,<sup>30</sup> or in the event of refusal, an action in court for breach of contract.<sup>31</sup> The Guidelines provided for no criminal sanctions.<sup>32</sup>

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inside information would fail since the necessary element of privity between buyer and seller is not met in most securities actions).

23. Insiderhandels-Richtlinien [Insider Trading Rules], reprinted in R. BRUNS, WERTPAPIER UND BOERSE 436 (1976), translated in Gerhard Wegen, *Congratulations From Your Continental Cousins, 10B-5: Securities Fraud Regulation From the European Perspective*, 61 FORDHAM L. REV. 557, S81-S84 (1993) [hereinafter Guidelines]; see BLOOMENTHAL & ROHM, *supra* note 18, § 8C.11 (providing a history of insider trading guidelines); Blum, *supra* note 18, at 515-28 (giving a detailed description and critique of the Guidelines and presenting two case studies involving application of Guidelines to the Thyssen takeover of Reinstahl and the Daimler-Benz purchase of AEG); Harvey L. Pitt & David B. Hardison, *Games Without Frontiers: Trends in the International Response to Insider Trading*, 55 LAW & CONTEMP. PROBS. 199, 213-16 (1992) (providing cursory description of background, content, and enforcement of the Guidelines); Schafer & Ott, *supra* note 18, at 358-60 (describing history, scope, and enforcement of the Guidelines); Daniel J. Standen, *Insider Trading Reforms Sweep Across Germany: Bracing for the Cold Winds of Change*, 36 HARVARD INT'L L. J. 177, 195-201 (1995) (discussing voluntary insider trading guidelines and problems with "German system of self-restraint"); Hoeflmayr, *supra* note 19, at 31 (providing short discussion of the Guidelines).

24. BLOOMENTHAL & ROHM, *supra* note 18, § 8C.11.

25. *Id.*

26. Schafer & Ott, *supra* note 18, at 360.

27. See Guidelines, *supra* note 23, § 5 at S83 (stating that the corporation shall persuade insiders in its employment to submit themselves to the Guidelines). See also Blum, *supra* note 18, at 517 (stating that insiders may contractually bind themselves to comply with the Guidelines); Schafer & Ott, *supra* note 18, at 359 (declaring Guidelines are only binding if insiders enter private contracts).

28. Schafer & Ott, *supra* note 18, at 359; Blum, *supra* note 18, at 517.

29. Schafer & Ott, *supra* note 18, at 359.

30. Guidelines, *supra* note 23, § 4(1) at S83.

31. *Id.* § 4(2) at S83 (providing for contract remedies).

32. Blum, *supra* note 18, at 524.

Even though the majority of corporate Germany had accepted this voluntary code of conduct by 1992,<sup>33</sup> investigations under the Guidelines remained scarce<sup>34</sup> and conclusive findings of insider trading were practically nonexistent.<sup>35</sup> While the Guidelines provided that a five-member Board of Inquiry be established at each of the regional exchanges to investigate alleged insider violations,<sup>36</sup> a Board of Inquiry generally was not permitted to initiate an investigation absent the submission of a complaint.<sup>37</sup> Because this procedure effectively required corporations to bring an action against their own management, the corporations rarely submitted such complaints.<sup>38</sup> In practical terms, the old procedure left the enforcement of the Guidelines completely at the discretion of leading federal trade and industry associations and the bank-

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33. BLOOMENTHAL & ROHM, *supra* note 18, § 8C.11 (noting that 70% of all corporations quoted on the listed or unlisted markets have agreed to abide by the Insider Rules and pointing out that these corporations represent 90% of the actual transactions in securities in German corporations).

34. See *Sweeping Out the Stables*, ECONOMIST, Aug. 31, 1991, at 15 (finding that the Frankfurt Stock Exchange on the average conducted five to 10 insider trading investigations annually). From 1964 to 1993, there were approximately 32 cases of suspected insider trading in Germany involving the companies: Boswau Et. Knaur AG (1964), DEA (1966), Sarotti AG (1967), Langenbrahm AG (1968), Maschinenfabrik Fahr (1968), Geraer Strickgarnfabrik Gebr. Feistkorn AG (1968), Julius Berger AG (1969), Glanzstoff AG (1969), Daimler Benz AG (1969), Ilseder Hütte AG/Salzgitter AG (1969), Nordzement AG (1969), Preussag (1969), Elikraft AG (1970), RWE (1970), Audi-NSU AG (1971), Bayer AG (1972), Thyssen/Rheinstahl (1973), Adca AG (1973), Kämmerei Döhren (1973), AGIV/Triton-Belco AG (1973), BuM/WestLB (1980), Neckermann AG (1980), Bremer Vulkan (1982), AEG (1985), Klöckner (1988), Springer AG (1988), Berthold AG (1989), Daimler Benz/Mercedes Holding (1993), Moksel (1993), Technocell (1993), Quante AG (1993), and Wünsche AG (1993). Matthias Magnus, *Insidergeschäfte und Reglungsbedarf aus ökonomischer Sicht [Insider transactions and Need for Regulation from an Economic Viewpoint]*, 11 ZEITSCHRIFT FÜR DAS GESAMTE KREDITWESEN 543, 544 (1994) [hereinafter Magnus].

35. See Silvia Ascarelli, *Insider Trade is Now a Crime in Germany*, WALL ST. J. EUR., Aug. 1, 1994, at 9 (reporting that "[n]o one in Germany has been found guilty of violating the rules."). But see Blum, *supra* note 18, at 525-28 (discussing Daimler-Benz's takeover bid of AEG, a large electronics firm, in 1985, where AEG stock went up by 28% just 10 days prior to the takeover and the Board of Inquiry reluctantly found only the Chairman of Supervisory Board of AEG, Dr. Klaus Kuhn, liable for a "minor" violation requiring him to disgorge his profits).

36. Blum, *supra* note 18, at 523; Hoeflmayr, *supra* note 19, at 31.

37. Blum, *supra* note 18, at 523.

38. See Hoeflmayr, *supra* note 19, at 31 (remarking about a company's lack of incentive to sue its own management).

ing sector.<sup>39</sup> In the end, resources were too scarce and enforcement efforts too disparate to have any effect on insider trading in Germany.<sup>40</sup> Commentators have speculated that the reason why the Guidelines were so widely accepted by the financial community despite their ineffectiveness in combatting insider trading is that they were merely "part of a strategy to avoid more effective and restrictive statutory law."<sup>41</sup>

Due to the ineffectiveness of the insider trading regulations, insider trading in Germany continued to flourish.<sup>42</sup> The investing community in Germany and the world-at-large were aware of the widespread insider trading practice in Germany and acted accordingly: investors generally played the German equity market if they were insiders and invested elsewhere if they were not.<sup>43</sup> As confidence in the German equity market began to erode, however, the favorable times for insiders in Germany began to change.<sup>44</sup>

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39. BLOOMENTHAL & ROHM, *supra* note 18, § 8C.11.

40. See Ascarelli, *supra* note 35, at 9 (noting that while all traders at the stock exchanges submitted to the insider-trading Guidelines, insider trading continued in Germany because too few regulators with too few resources were in place to regulate trading activities on Germany's eight regional exchanges).

41. Schafer & Ott, *supra* note 18, at 3; see Magnus, *supra* note 34, at 543-45 (summarizing traditional economic arguments raised by advocates of the prior system of voluntary insider compliance; explaining that insider trading actually benefits financial markets and market participants; and criticizing assumptions on which those arguments are based).

42. See Magnus, *supra* note 34, at 544 (providing a table illustrating alleged insider trading scandals in Germany from 1964 through 1993 and listing the corresponding newspaper source for each case). From 1980 through 1993, for example, German newspapers covered suspected cases of insider trading involving the companies BuM/WestLB, Neckermann AG, Bremer Vulkan, AEG, Klöckner, Springer AG, Berthold AG, Daimler Benz/Mercedes Holding, Moxsel, Technocell, Quante AG, and Wünsche AG. *Id.*; see also Ascarelli, *supra* note 35, at 9 (noting that insider-trading Guidelines did little to prevent insider trading scandals from occurring at regular intervals); *infra* note 53 (describing several well-known recent insider trading scandals in Germany).

43. See Aline Sullivan, *Need for Foreign Capital Prods European Reforms*, INT'L HERALD TRIB., Oct. 1, 1994 (quoting a fund manager at a major United States firm in London that investors refuse to tolerate not being on the inside track by not buying shares on the German exchange if they suspect insider trading).

44. See *infra* notes 49-58 and accompanying text (describing how decreased investor confidence in German securities markets attributed to enactment of legislation criminalizing insider trading).



## B. REASONS FOR CHANGING PAST PRACTICE

The enactment of the Second Financial Markets Promotion Act<sup>45</sup> falls in line with a number of recent trends in Germany heralding a new era for Germany's capital markets.<sup>46</sup> Several influences have contributed to the recent legislative drive to improve the Finanzplatz Deutschland,<sup>47</sup> including increased pressures to compete internationally, harmonize European capital markets, assist international enforcement efforts, and adapt to technological developments.<sup>48</sup>

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45. FmFG, *supra* note 2.

46. See *The Deutschmark Capital Markets—"Equity? Was Ist Das?,"* EUROMONEY, July 19, 1994, at 82 [hereinafter *Equity*] (listing the following trends to support the notion that the German financial market is changing: (i) German companies are more frequently shifting production to other countries (e.g., Daimler-Benz recently built a new manufacturing plant in the United States); (ii) German banks are encountering increased pressure "to reduce their large holdings in the shares of leading industrial companies;" and (iii) the government is privatizing huge public concerns such as Lufthansa and Deutsche Telekom).

47. See, e.g., Dieter Gamedinger, *Finanzplatz Deutschland*, 15 ZEITSCHRIFT FÜR DAS GESAMTE KREDITWESEN 717-18 (1994) (discussing general impetus behind recent initiative to improve the "Finanzplatz Deutschland", and expressing concern that legislators strike proper balance between state regulation and market forces according to the motto of "So viel Markt wie möglich, so viel Aufsicht wie nötig" ["As much market as possible, as much regulation as necessary"]); Möller, *supra* note 10, at 99-101 (noting that the concept of the "Finanzplatz Deutschland", which the Federal Ministry of Finance devised in 1992, is based on the following central premises: (i) establishment of an efficient securities and exchange supervision comparable to international standards, especially in the area of insider trading surveillance; (ii) improvement of investor access to information and market transparency; (iii) creation of a code of conduct for market participants to ensure greater investor protection; (iv) establishment of similar competitive conditions for floor and on-line trading; and (v) promotion of market liquidity and attractiveness of securities; Ulrich Stache, *Der Finanzplatz Deutschland wird attraktiver [The Financial Marketplace of Germany Becomes More Attractive]*, BANK MAGAZIN, Feb. 1994, at 50-54 (describing German federal government's goal of improving the "Finanzplatz Deutschland" through the Financial Market Promotion Act (*Finanzmarktförderungsgesetz*)).

48. See EBERHARD SCHWARK, BÖRSEGESETZ: KOMMENTAR ZUM BÖRSEGESETZ UND ZU DEN BÖRSENRECHTLICHEN NEBENBESTIMMUNGEN [STOCK EXCHANGE LAW: COMMENTARY TO THE STOCK EXCHANGE LAW AND TO RELATED INCIDENTAL PROVISIONS] 54-57 (1994) (noting that harmonization of European capital markets, increased self-financing of corporations through capital markets, and sharper international competition has caused innovation of German stock market); see also Pitt & Hardison, *supra* note 23, at 2-4 (discussing competitive pressures, international enforcement efforts, and technological development as primary factors that encourage most countries to prohibit insider trading).

## 1. International Competition

German legislators adopted insider trading legislation primarily as a means of strengthening Frankfurt's position as a leading financial market center of continental Europe in a time of growing international competition.<sup>49</sup> Germany realized that it would be unable to set the European standard for financial markets<sup>50</sup> and make inroads in its continuing competition with Europe's financial powerhouse London<sup>51</sup> unless Germany enacted insider trading laws.<sup>52</sup> Numerous highly-publicized insider trading scandals in recent German history contributed to an erosion of domestic and foreign investor confidence in Germany's security markets<sup>53</sup> and, in turn, resulted in increased political pressure to level the

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49. The Federal Ministry of Finance, Bonn, F.R.G., *Towards a German Financial Center* (Jan. 1992), translated in Gerhard Wegen, *Transnational Financial Services—Current Challenges for an Integrated Europe*, 60 FORDHAM L. REV. S91, S110 (1992) [hereinafter *Towards a German Financial Center*] (discussing German government's goal of actively developing an internationally competitive financial center in Germany by implementing widespread market reform including an insider trading law); see *Deutsche Börse AG and Ministry Welcome Passage of Markets Act*, WALL ST. J. EUROPE, July 11, 1994 (quoting Germany's Finance Minister Theo Waigel as heralding the law's passage as a "sustained strengthening of the position of Germany as a financial markets center against international competitors"); see also Andrew Fisher, *Frankfurt Brushes Up its Act: Germany's Financial Capital Is Improving its Appeal as a Regional Center*, FIN. TIMES, Dec. 9, 1994, at 16 [hereinafter *Frankfurt Brushes Up*] (finding that of the \$68 billion invested in foreign equities by United States investors last year, only \$2.7 billion went to Germany).

50. Germany's desire to set the European standard for financial markets is implicitly required by its status as the future home for the European Monetary Institute, a precursor of the planned European Central Bank EMI. Cf. Andrew Fisher, *Survey of Germany*, FIN. TIMES, Nov. 21, 1994, at V [hereinafter *Survey of Germany*] (noting that Frankfurt, home of the Bundesbank and the new European Monetary Institute, has a central place in the restructuring of Germany's financial markets).

51. Cf. Karen Heemann et al., *Geld und Größenwahn [Money and Pursuit for Greatness]*, FOCUS MAG., Mar. 6, 1995, at 272-74 (noting that German bankers witnessed the Barings crash with "one laughing and one crying eye" because of Frankfurt's continuing battle against the previously overpowering and often arrogant city of London, on one side, and the incentive the obvious failure of English supervisory practices will give German banking hardliners for greater regulatory control in Germany).

52. Baie Netzer, *New Legislation Fuels Up German Regulatory Arsenal*, INT'L HERALD TRIB., Oct. 1, 1994; see Rupert Bruce, U.S., *Britain Spur Asia Toward Reform*, INT'L HERALD TRIB., Oct. 1, 1994 (referring to Barry Rider's, Dean of Jesus College at Cambridge University and an authority on insider trading, opinion that the presence of insider trading laws make a securities market respectable).

53. See, e.g., *Germany Laments Loss of the Prussian Virtues*, TIMES, Aug. 16,

inherently unfair playing field in German securities.<sup>54</sup> Accordingly, the German financial world came to view the enactment of insider trading legislation as a key strategy for fostering the competitiveness of German capital markets and rectifying Frankfurt's historically weak image in the eyes of the international financial community.<sup>55</sup> The new insider dealing law is expected to attract new domestic and foreign investors<sup>56</sup> and thereby raise much needed equity capital, an essential ingredient for in-

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1994 (noting that Germany "suffered an unprecedented outbreak of fraudulent bankruptcies and corporate criminality during the past couple of years" with a 30% increase in white collar crimes last year alone); Ascarelli, *supra* note 35, at 9 (describing first how German attitude towards insider trading became more skeptical after "charges of widespread abuses led the Frankfurt prosecutor's office in 1991 to investigate at least 270 people for allegedly evading taxes on income related to insider trading" and, second, attributing growing public outrage over inside trading to the affair of Franz Steinkuhler, former head of the powerful IG Metall metalworkers union and a member of Daimler-Benz AG's supervisory board, who reaped considerable profits by investing nearly one million marks in Daimler shares shortly before Daimler announced market-moving information); Williams, *supra* note 12 (describing Germany's biggest stock exchange scandal, exposed only a week before Germany's insider trading law went into effect, in which a ring of over twenty traders and brokers were suspected of making over 100 million marks in profits in a scheme called "front-running" in which dealers buy stock in a company they know is about to be traded heavily); David Gow, *Insider Dealing "Mafia" Danger*, GUARDIAN, July 26, 1994, at 15 (reporting that financial authorities tried to dispel rumours of a "stock-exchange mafia" to prevent damage to Frankfurt's international standing); John Willcock, *Barclays Offshoot in German Tax Evasion Inquiry*, THE INDEPENDENT, July 26, 1994, at 23 (announcing what may be Germany's most serious stock exchange trading scandal).

54. See Ascarelli, *supra* note 35, at 9 (stating that numerous recent insider-trading scandals "raised doubts about the old system of self regulation").

55. *Frankfurt Brushes Up*, *supra* note 49, at 16 (commenting that Frankfurt's appeal as a financial center is improving considerably from its prior uninspired image as a place in which to live or do business, whereby "[s]everal years ago, foreign bankers posted there often saw it as something less than an enhancement of their career prospects"); cf. Andrew Fisher, *Tally-Ho Sounds for Elusive German Breed—Insider Dealers Are Hard to Track Down—But the Hunt Is On*, FIN. TIMES, Dec. 23, 1994, at 24 [hereinafter *Tally-Ho*] (noting that even though foreign investors favored the London over the Frankfurt financial market, even for their Deutsch Mark transactions in domestic securities, greater investor confidence in an improved regulatory system in Germany will strengthen Frankfurt's competitiveness).

56. See Netzer, INT'L HERALD TRIB., *supra* note 52 (noting that new law will improve fairness of German markets and hopefully attract both international and German investors, while also quoting Rolf Passow, Chief Executive at the mutual fund subsidiary of the Dresdner Bank, as stating that the new law is too restrictive to attract many additional investors).

dustrial growth and effective international competition,<sup>57</sup> for a market in which an equity culture has long been lacking.<sup>58</sup>

## 2. Harmonization of European Capital Markets

The second reason, if not the primary driving force, why legislators decided to proscribe insider trading in Germany was to ensure harmonization of European capital markets.<sup>59</sup> On November 13, 1989, the Council of European Communities issued a European Community Direc-

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57. See, e.g., *Towards a German Financial Center*, *supra* note 49, at 108 (noting that the German industry and state have increased capital requirements in order to manage structural change; and that this need for equity capital is a reason for strengthening Germany as a financial center); Magnus, *supra* note 34, at 545 (finding that investors' failure to participate in German equity markets will jeopardize corporate financing and thereby harm total economic growth); Glenn Whitney, *Leveling Charges: Top 3 German Banks Draw Fire for Choking Capital Market Growth*, WALL ST. J. EUROPE, May 11, 1994, at 1 (noting that German companies may incur higher debt financing and stock issuance costs than their foreign counterparts because of Germany's noncompetitive equity market, which, as a result, may hurt Germany's industrial base and hinder development of the "Finanzplatz Deutschland").

58. See, e.g., Blum, *supra* note 18, at 507-11 (providing thorough analysis of reasons for weak development of German equity markets); Magnus, *supra* note 34, at 545 (providing the following statistics: (i) Germany has four times fewer publicly-financed corporations than Japan or Great Britain and 10 times fewer than the United States, and (ii) from 1970 through 1989, stock issuance provided only up to 1.6% of financing for West-German corporations); Guidelines, *supra* note 23, at S60-61 (noting that the majority of German companies are closely held—500,000 Limited Liability Companies, 30,000 General Partnerships, and 130,000 Limited Partnerships—and of the 2500 stock corporations, only 665 are listed on German stock exchanges); *Equity*, *supra* note 46, at 82 (analyzing why Germany lacks an equity culture and quoting a principal at Morgan Stanley who argues that Germany now needs equity to ensure growth).

59. See, e.g., *Towards a German Financial Center*, *supra* note 49, at S107 (stating that "intra-EC integration" is a condition for an evolving German financial marketing); SCHWARK, *supra* note 48, at 54-57 (referring to harmonization of European capital markets as reason for new German law); *Das Künftige*, *supra* note 18, at 196-200 (stating that EC measures for the creation of a common market, which culminated in the EC Directive on insider trading, stand in the spotlight of many other factors contributing towards the implementation of insider trading legislation in Germany); Charles V. Baltic, III, *The Next Step in Insider Trading Regulation: International Cooperative Efforts in the Global Securities Market*, 23 LAW & POL'Y INT'L BUS. 167, 192-96 (1991/1992) (noting that European Economic Community Directive on Insider Trading was a means of harmonizing regulatory regimes of member states and served more as a statement of EEC policy on investor protection rather than a measure for integrating such capital markets).

tive (EC Directive)<sup>60</sup> requiring Member States to incorporate regulations on insider trading into their national legislations by June 1, 1992.<sup>61</sup> In short, the EC Directive provided a minimum standard for defining "inside information"<sup>62</sup> and an "insider"<sup>63</sup> to which Member States must adhere,<sup>64</sup> but left imposition of the method of enforcement<sup>65</sup> and the extent of penalties<sup>66</sup> largely to the discretion of the Member States.<sup>67</sup>

60. Council Directive Coordinating Regulations on Insider Dealing 89/592, 1989 O.J. (L 334) 30 [hereinafter EC Directive]. See generally HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, INT'L CAPITAL MARKETS AND SEC. REG. § 9A.05 (1992) (providing general overview of EC Directive); Baltic, *supra* note 59, at 192-96 (discussing uniform and discretionary aspects of EC Directive); Dariusz M. Budzen & Ania M. Frankowska, *Prohibitions Against Insider Trading in the United States and the European Community: Providing Guidance for Legislatures of Eastern Europe*, 12 B.U. INT'L L.J. 91, 115-22 (1994) (providing general overview of EC Directive); Thomas L. Hazen, *Defining Illegal Insider Trading—Lessons From the European Community Directive on Insider Trading*, 55 LAW & CONTEMP. PROBS. 231, 236 (1992) (describing EC Directive as a praiseworthy attempt to balance the need for a clear and straightforward rule against the fear of creating gaps in its coverage); Schafer & Ott, *supra* note 18, at 357 (presenting an economic analysis of the EC Directive as it concerns Germany).

61. EC Directive, *supra* note 60, art. 14.

62. *Id.* art. 1 (defining "inside information" as any information "which has not been made public . . . which, if it were made public, would be likely to have a significant effect on the price of the . . . security . . .").

63. *Id.* art. 2 (defining a primary insider as "any person who . . . possesses inside information [and takes] advantage of that information with full knowledge of the facts by acquiring or disposing of for his own account or for the account of a third party, either directly or indirectly . . ."); *id.* (noting that Member States have the option of exempting transactions effected without the assistance of a professional intermediary in a non-recognized market); *id.* art. 4 (defining a secondary insider as "any person other than [a primary insider] who with full knowledge of the facts possess inside information . . .").

64. *Id.* art. 6 (noting that Member States may adopt measures more stringent than those required by Articles 2 and 4 of the directive).

65. *Id.* art. 8 (requiring only that Member States designate administrative authorities with competence "to ensure that the provisions . . . [of] this Directive are applied" and that such authorities be "given all supervisory and investigatory powers that are necessary for the exercise of their functions . . .").

66. *Id.* art. 13 (failing to specify whether criminal, administrative, or civil measures shall be adopted and requiring only that penalties "shall be sufficient to promote compliance with those measures").

67. See Amy E. Stutz, Note, *A New Look at the European Community Directive on Insider Trading*, 23 VAND. J. TRANSNAT'L L. 135, 169-72 (1990) (criticizing EC Directive for failing to harmonize implementation of penalty and enforcement provisions by Member States).

After Germany failed to succumb to the EC Directive by the original date of compliance, the European Commission instituted infringement proceedings against Germany in October 1992.<sup>68</sup> Two years later, on July 8, 1994, Germany finally passed the required insider trading law, thereby becoming the last European Community Member State to prohibit insider trading.<sup>69</sup> While absolute reliance on the EC Directive as the basis of the changed laws in Germany, particularly considering the two year delay in compliance, is misplaced,<sup>70</sup> the EC Directive clearly forced German legislators to re-conceptualize their view of the insider trading phenomena in Germany.<sup>71</sup> Supporters of the old system of non-supervision came to realize that insider trading is not a victimless crime,<sup>72</sup> for, at a minimum, insider trading in Germany did harm the Finanzplatz Deutschland.<sup>73</sup>

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68. European Parliament Question on the Insider Dealing Directive 89/592/EEC, 1994 O.J. (C 226) 35.

69. Heinz-Dieter Assmann, *Kein Papiertiger, aber Auslegungsprobleme [No Papertiger, but Interpretation Problems]*, SZ, Aug. 5, 1994 [hereinafter *Kein Papiertiger*].

70. See Hoeflmayr, *supra* note 19, at 31 (stating that the German bill was formulated under the EC Directive). While the EC Directive clearly was not the only factor contributing to implementation of insider trading legislation in Germany, its importance should not necessarily be diminished solely on the basis of Germany's delayed compliance with its measures. After all, the insider regulation was only a part, albeit a central part, of much broader measures to modernize Germany's financial marketplace. *Das Künftige*, *supra* note 18, at 199. The Federal Minister of Finance released the first draft of the proposal to make over Germany's capital markets in August, 1992, and it inevitably took some time to finalize this proposal in the form of the Second Financial Markets Promotion Act. *Id.* In fact, the fourth draft of the Act was the first to reach the Federal Cabinet. *Id.* at 200.

71. *Das Künftige*, *supra* note 18 (noting that the EC Directive first compelled German legislators to change their way of thinking about their current system of self-regulation, which had been in place for the past 30 years, and speculating that Germany may not have complied with the EC Directive had the reputation of the Finanzplatz Deutschland not been at issue).

72. See Magnus, *supra* note 34, at 543-45 (concluding that the potential costs of insider trading for the efficient functioning of Germany's capital market far outweigh any potential usefulness of such trading activity; and that past insider trading activity in Germany may have jeopardized the equity financing of investments and, thereby, impaired Germany's economic growth); cf. *Dealing with Insider Trading*, ECONOMIST, July 16, 1994 [hereinafter *Dealing*] (discussing argument that insider trading generally is a victimless crime that makes the stockmarket run more efficiently and often leads to more winners than losers).

73. See Sullivan, *supra* note 43 (noting how foreign investors refused to invest in Germany's capital markets due to widespread insider trading in Germany).

### 3. International Enforcement Efforts

The third reason the German legislature passed insider trading legislation was the growing need to provide mutual assistance in the international enforcement of insider trading violations.<sup>74</sup> The globalization of securities markets has expedited investment in international securities markets and, consequently, has created better opportunities for insider traders to escape prosecution<sup>75</sup> and shield their illicit profits from detection.<sup>76</sup> In the past, Germany has been unable to assist enforcement authorities in the United States or elsewhere in the investigation and prosecution of insider trading violations because German bank secrecy prohibits the release of banking account information except for criminal proceedings under German law.<sup>77</sup> As a result, the continued application of insider trading laws to securities transactions based in Germany by for-

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74. *Dealing*, *supra* note 72 (stating that the criminalization of insider trading is necessary to ensure "international collaboration, subject to the principle of reciprocity and due respect for bank confidentiality").

75. See Michael D. Mann & Lise A. Lustgarten, *Internationalization of Insider Trading Enforcement—A Guide to Regulation and Cooperation*, in INT'L SEC. MARKETS 1993, at 2 (PLI Corporate Law and Practice Course Handbook Series No. B4-7024, 1993) (noting that United States insiders often take advantage of global securities markets since foreign bank secrecy and difficulty in obtaining foreign-based evidence shield them from detection by United States enforcement authorities); see also Pitt & Hardison, *supra* note 23, at 203-04 (noting that unprincipled traders often prevent disclosure of account information to foreign authorities by trading in jurisdictions with secrecy and blocking laws).

76. *Global Recognition of Legal Judgments Next Big Enforcement Issue*, Mann Advises, 21 SEC. REG. & L. REP. (BNA) No. 44, at 1665 (Nov. 10, 1989) (interview of Michael Mann, Director, Office of International Affairs, SEC) (noting that cooperation is necessary to ensure detection and seizure of fruits of illegal insider trading activities that have been deposited in foreign accounts).

77. See Otto Sandrock & Ellen Klausning, *Germany*, in EUROPEAN BANKING LAW: THE BANKER-CUSTOMER RELATIONSHIP 61, 92 (Ross Cranston ed., 1993) (explaining that bank secrecy in Germany is derived from the contractual relationship between the financial institution and customer and the general fiduciary duty arising therefrom). Furthermore, the German Federal Constitution establishes the basic premises underlying German bank secrecy. GRUNDGESETZ [Federal Constitution] [GG] art. 1 (containing citizen's fundamental right to decide about diffusion of personal data); *id.* art. 2(1) (containing citizen's fundamental right to personal integrity and privacy); *id.* art. 12(1) (containing fundamental right of freedom in exercise of professional duties). See generally Sandrock & Klausning, *supra*, at 92-108 (discussing the legal basis and confines of exceptions to bank secrecy in Germany); Peter Q. Noack, Comment, *West German Bank Secrecy: A Barrier to SEC Insider-Trading Investigations*, 20 U.C. DAVIS L. REV. 609, 619-23 (1987) (describing German bank secrecy).

eign authorities, particularly the United States Securities and Exchange Commission (SEC), has directed greater attention to Germany's inability to cooperate in these enforcement efforts and, in turn, served as an additional incentive for Germany to enact insider trading legislation.<sup>78</sup>

#### 4. Technological Developments

Technological developments represent a fourth factor influencing German authorities to adopt insider trading legislation.<sup>79</sup> As technological advances in Germany facilitate the sale and purchase of securities, such as its electronic trading system (IBIS),<sup>80</sup> opportunities for insider trad-

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78. See *SEC v. Marcour*, No. CIV.A.90-1390, 1990 SEC LEXIS 1213 (D.D.C. June 14, 1990) (alleging that Marcour, employee of Apollo Computer Inc.'s German subsidiary, violated United States securities laws by trading on inside information concerning decline in Apollo's sales and revenues obtained through his position as international sales manager); see also Pitt & Hardison, *supra* note 23, at 204 (referring to pressure the SEC has placed on foreign countries to enact legislation proscribing insider trading and assist the SEC in insider cases). Barry Rider, Dean of Jesus College of Cambridge University and an authority on insider trading, has also expressed the opinion that the SEC strongly influenced Germany, Switzerland, and Japan to implement insider trading legislation. Bruce, *supra* note 52. Nevertheless, Michael Mann, Director of the Office of International Affairs, U.S. Securities and Exchange Commission, characterizes the SEC's approach in promoting foreign insider trading laws as "mutual respect for law" not "lex americana." *Id.*

79. See *Towards a German Financial Center*, *supra* note 49, at S109-10 (noting that linking of market economy and technology is necessary for ensuring competitiveness of Germany as a financial center); Pitt & Hardison, *supra* note 23, at 206-07 (discussing technological developments as a principal factor motivating most countries to prohibit insider trading).

80. See *Equity*, *supra* note 46, at 82 (describing that in December 1989, Frankfurt launched a nationwide computerized trading system, the "Integrierten Boersenhandels- und Informations Systems" (IBIS), which now accounts for 40% of trading volume in the 30 stocks listed on the Deutscher Aktienindex (DAX)). Many traders on the Frankfurt Exchange predict that IBIS soon will dominate trading of German shares. *Id.* In late 1995, Frankfurt was eager to pursue implementation of a successor to IBIS, the "Elektronisches Handelssystem" (EHS), a computerized auction exchange, but then delayed further development of EHS due to opposition from Germany's regional exchanges and broker-dealers. *World Equity Markets—Germany*, EUROMONEY SUPPLEMENTS, June 29, 1994, at 11 [hereinafter *World Equity Markets*] (noting opposition of regional exchanges to EHS system); *Weichen für die Computerbörsen gestellt. Aufsichtsrat der Deutsche Börse AG segnet neue Strategie unter dem Stichwort Zeus ab* [Advances for the Computer Exchanges are Made. The Board of Directors for Deutsche Börse AG promotes a New Strategy Under the Pseudonym Zeus, SZ, May 26, 1995 [hereinafter *Computerbörsen*] (noting opposition of German broker-dealers to EHS); see also *infra* note 269 and accompanying text



ing invariably grow as well.<sup>81</sup> As previously discussed, increased incidence of insider trading in Germany erodes investor confidence in German equity markets and, as a result, jeopardizes Germany's position as a financial center.<sup>82</sup> Thus, Germany's ability to compete internationally is inextricably interwoven with its ability to improve the transparency and liquidity of its stockmarkets and the accuracy and fairness of stock transactions while maintaining competitive transaction costs.<sup>83</sup> Germany can only attain these goals and ensure its international competitiveness if, according to the German Ministry of Finance, its financial markets have access to "modern microelectronics and communications technology to develop the stock exchange system and optimize its organizational structure."<sup>84</sup>

## II. GERMANY'S NEW LAW ON INSIDER TRADING

After twenty-five years of harboring an ineffective system of voluntary insider trading compliance,<sup>85</sup> Germany finally enacted its first law criminalizing insider trading in August 1994.<sup>86</sup> This section focuses,

(discussing the Deutsche Börse AG's newest proposal (ZEUS) to implement gradually a complete electronic trading system in Germany in the place of floor trading within the next three to five years).

81. See Pitt & Hardison, *supra* note 23, at 206-07 (stating that rapid technological advances facilitating telecommunications, multiple listing of securities, and 24 hour trading increase opportunities for insider trading, while also creating new opportunities for more effective surveillance); see also *Politische Skepsis*, *supra* note 269, at 31 (citing the Bavarian President of the Landeszentralbank, Franz-Christoph Zeitler, as stating that actual people could better evaluate the risks of the trading activity on the exchanges than computer programs).

82. See *supra* notes 12-44 and accompanying text (describing the past insider trading climate in Germany and the detrimental effects this widespread practice had on investment in German capital markets).

83. See *Towards a German Financial Center*, *supra* note 49, at S110 (noting Finance Ministry's belief that a "prime objective" in improving the Finanzplatz Deutschland and ensuring its international competitiveness is maintaining competitive costs for securities transactions while simultaneously enhancing the safety of transactions and the market's transparency and liquidity).

84. *Towards a German Financial Center*, *supra* note 49, at S110.

85. See *supra* notes 16-44 and accompanying text (discussing previous system of voluntary insider regulation in Germany).

86. WpHG, *supra* note 3, at 1750-60; see SCHWARK, *supra* note 48, at 1, 47-54 (analyzing Germany's Insider Trading Law); *Das Künftige*, *supra* note 18, at 196, 196-206 (discussing Germany's new insider trading prohibition); Herbert Jütten, *Das Zweite Finanzmarktförderungsgesetz aus Sicht der Kreditwirtschaft [The Second Financial Markets Promotion Act from the Viewpoint of the Financial Institutions]*, DIE

first, on the basic structure of the new law and its central provisions; second, on the scope of the law's insider trading prohibition; third, on the three-tiered level of market supervision proposed and the respective investigatory and remedial powers accorded to each tier; and, lastly, on potential barriers to the successful enforcement of the new law.

#### A. BASIC STRUCTURE AND CENTRAL PROVISIONS

The German Parliament passed its new Law on Securities Trading (Insider Trading Law),<sup>87</sup> together with several other amended laws, as part of the Second Financial Markets Promotion Act,<sup>88</sup> a so-called "Artikelgesetz."<sup>89</sup> Overall, the Second Financial Markets Promotion Act contains seventeen amended laws designed to restructure German

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BANK, Oct. 1993, at 601, 601-03 (analyzing Germany's Insider Trading Law from perspective of the German banking industry); Möller, *supra* note 10, at 99, 101-11 (analyzing Germany's Insider Trading Law and its role in restructuring Germany's financial markets); Stefan Riepe, *Das Zweite Finanzmarktförderungsgesetz-Verbesserung der internationalen Wettbewerbfähigkeit des Finanzplatzes Deutschland [The Second Financial Markets Promotion Act—Improvement of the International Competitiveness of the Financial Marketplace of Germany]*, 34 DEUTSCHES STEUERRECHT 1236, 1236-39 (1994) (analyzing Germany's Financial Markets Promotion Act); Wolfgang Scharrenberg, *Neue Aufsichtsstrukturen für das Wertpapiergeschäft [New Supervisory Structures for the Securities Business]*, SPARKASSE, Feb. 1994, at 90, 90-93 (analyzing Germany's Insider Trading Law and pointing out problem areas); Stache, *supra* note 47, at 50 (summarizing main elements of Germany's Insider Trading Law); Standen, *supra* note 23, at 201-05 (analyzing Germany's Second Financial Markets Promotion Act with an emphasis on the Insider Trading Law).

87. WpHG, *supra* note 3, at 1750-60.

88. FmFG, *supra* note 2, at 1749-85.

89. An "Artikelgesetz" (articles of law or article-law) enacts and amends several laws on a related subject matter. *See id.* (containing a total of 17 amended laws dealing with the restructuring of the German financial marketplace).

financial markets,<sup>90</sup> of which the new Insider Trading Law<sup>91</sup> is the centerpiece.

The Insider Trading Law<sup>92</sup> itself consists of seven sections (*Abschnitte*). The first section contains a statement on the scope of the legislation<sup>93</sup> and definitions of key terms.<sup>94</sup> The second section mandates the establishment of a Federal Supervisory Authority for Securities Trading<sup>95</sup> and defines its organization,<sup>96</sup> duties,<sup>97</sup> and compulsory powers.<sup>98</sup> The third section sets forth the scope of insider trading surveillance by, among other things, defining primary and secondary insiders,<sup>99</sup> prohibiting insider trading,<sup>100</sup> and requiring the disclosure of market-moving information (ad hoc publicity).<sup>101</sup> The fourth section lowers the requirement for disclosure of acquisition or sale of share holdings from twenty-five to five percent.<sup>102</sup> The fifth section establishes a code of conduct for securities service firms (i.e., investment or brokerage firms) by prohibiting such practices as front-running.<sup>103</sup>

90. For example, the Act contains (1) the amended Stock Exchange Act (*Börsengesetz*) (Article 2), (2) the amended Investment Company Act (*Gesetz über Kapitalanlagegesellschaften*) (Article 3), (3) the amended Foreign Investment Act (*Auslandinvestmentgesetz*) (Article 4), (4) the amended Stock Corporation Act (*Aktiengesetz*) (Article 5); and (5) the amended Associate Company Act (*Gesetz über Unternehmensbeteiligungsgesellschaften*) (Article 9). See Jütten, *supra* note 86, at 601-07 (providing an overview of the central features of the amendments to the Stock Exchange Act, the Investment Company Act, and the Stock Corporation Act, among others); see also Riepe, *supra* note 86, at 1236, 1239-40 (analyzing the amended Investment Company Act and the amended Stock Corporation Act).

91. WpHG, *supra* note 3, at 1750-60.

92. *Id.* at 1750-60.

93. *Id.* § 1, at 1750 (describing scope of application).

94. *Id.* § 2 at 1750 (providing definitions).

95. *Id.* § 3 at 1750 (establishing the Federal Supervisory Office).

96. *Id.* §§ 3 and 5 at 1750 (setting forth organization of the Federal Supervisory Office).

97. *Id.* §§ 4-7, 9, and 15-16 at 1750-54 (containing duties and powers of Federal Supervisory Office, such as investigation of insider trading violations, cooperation with state authorities, cooperation with international authorities, surveillance of disclosure duty, surveillance of ad-hoc publicity requirement, and continuous surveillance).

98. *Id.* § 10 and 16 at 1752, 1754 (containing compulsory powers to enforce regulations and request information, documents, or search of business premises).

99. *Id.* § 13 at 1753 (defining primary insiders).

100. *Id.* § 14 at 1753 (containing insider trading prohibition).

101. *Id.* § 15 at 1753-54 (providing for ad hoc disclosure).

102. *Id.* § 21 at 1755 (containing corporate shareholder disclosure duties).

103. *Id.* § 32 at 1758 (setting forth rules of conduct for investment firms and broker-dealers); see Magin, *supra* note 12 (discussing frequent practice of frontrunning,

The sixth section prescribes appropriate criminal penalties<sup>104</sup> and fines.<sup>105</sup> The seventh section contains transitional provisions which primarily concern disclosure requirements under section four.<sup>106</sup>

### B. INSIDER TRADING PROHIBITION

Section three of the Insider Trading Law<sup>107</sup> implements the mandatory requirements of the EC Directive in prohibiting insiders from trading insider securities on insider information.<sup>108</sup> This insider trading prohibition consists of four key concepts: (1) insider,<sup>109</sup> (2) insider information,<sup>110</sup> (3) insider securities,<sup>111</sup> and (4) insider transactions.<sup>112</sup> It is important to analyze these elements individually to better understand the scope of Germany's insider trading prohibition. Further study of the

whereby German broker-dealers or investment advisors would purchase securities for their own accounts prior to executing larger purchase orders for the same securities on behalf of their clients, which would drive the price of the securities up and allow the brokers to make large profits upon resale of their securities).

104. WpHG, *supra* note 3, § 38 at 1759 (providing for criminal sanctions).

105. *Id.* § 39 at 1759-60 (providing for fines).

106. *Id.* § 41 at 1760 (providing transitional provisions).

107. *Id.* at 1753-55. Section 3 of the Insider Trading Law consists of sub-sections 12 through 20, which have the following headings: § 12 Insider Securities (Insiderpapiere), § 13 Insider (Insider), § 14 Prohibition on Insider Trading (Verbot von Insidergeschäften), § 15 Publication and Communication of course-relevant information (Veröffentlichung und Mitteilung kursbeeinflussender Tatsachen), § 16 Continuous Surveillance (Laufende Überwachung), § 17 Analysis and Use of Personal Information (Verarbeitung und Nutzung personenbezogener Daten), § 18 Criminal Proceedings for Insider Trading Violations (Strafverfahren bei Insidervergehen), § 19 International Cooperation (Internationale Zusammenarbeit), and § 20 Exceptions (Ausnahmen).

108. See EC Directive, *supra* note 60, art. 5 at 31 (providing that articles 2, 3, and 4 of the EC Directive contain mandatory provisions which Member States must apply in the drafting of their internal insider trading legislation). These articles establish minimum standards for the definition of key concepts, such as an insider, inside information, and transferable securities. Article 2 of the EC Directive contains the definition of a primary insider and incorporates by reference the definitions of inside information and transferable securities provided in Article 1. *Id.* at 31. Article 3 sets forth the insider trading prohibition. *Id.* Article 4 defines a secondary insider. *Id.*

109. See WpHG, *supra* note 3, § 13(1) at 1753 (defining primary insider); see also *id.* § 14(2) at 1753 (defining secondary insider).

110. *Id.* § 13(1) at 1753 (defining insider information).

111. *Id.* § 12 at 1753 (defining insider securities).

112. *Id.* § 14 at 1753 (providing prohibition of insider transactions for primary and secondary insiders).

interplay between the sanctions and the enforcement provisions which the new law proposes, the imposition of which the EC Directive has largely left to the discretion of the Member States,<sup>113</sup> however, is truly determinative in judging the effectiveness and strength of the new law.<sup>114</sup> Before proceeding with this study, a succinct overview of the *prima facie* elements of Germany's insider trading prohibition follows.

## 1. Insiders

Germany's Insider Trading Law follows the lead of the EC Directive by exempting from its coverage transactions in the interest of monetary, exchange rate, or deficit management policy.<sup>115</sup> Specifically, the insider trading prohibition does not cover securities transactions by the federal government, a private trust for the federal government, a state (Land), the German Central Bank, a foreign state, a foreign state's central bank, other delegated organizations, or any of their representatives.<sup>116</sup>

As mandated by the EC Directive, Germany's insider trading prohibition extends to both primary<sup>117</sup> and secondary insiders.<sup>118</sup> In short,

113. See *supra* notes 65-66 (citing relevant language of enforcement and penalty provisions of EC Directive that provide Member States the ability to determine the proper method of enforcement and the penalties to be applied). The only provisions which must be adopted in full address the insider trading prohibition. See *supra* note 108 (describing mandatory measures of EC Directive).

114. See *Das Künftige*, *supra* note 18, at 204 (noting that a restrictive definition of insider information or insider securities can limit the scope of an otherwise expansive insider trading prohibition and that the effectiveness and strength of an insider trading regulation is truly a function of its sanctions and surveillance apparatus).

115. WpHG, *supra* note 3, § 20 at 1755. Section 20 contains the following exception to the insider trading prohibition:

*Die Vorschriften dieses Abschnitts sind nicht auf Geschäfte anzuwenden, die aus geld- oder währungspolitischen Gründen oder im Rahmen der öffentlichen Schuldverwaltung vom Bund, einem seiner Sondervermögen, einem Land, der Deutschen Bundesbank, einem ausländischen Staat oder dessen Zentralbank oder einer anderen mit diesen Geschäften beauftragten Organisation oder mit für deren Rechnung handelnden Personen getätigt werden.*

*Id.* The key concepts of this section are translated in the main body of this text. Section 20 emulates the language contained in Article 2(4) of the EC Directive which states, "[t]his Directive shall not apply to transactions carried out in pursuit of monetary, exchange-rate or public debt-management policies by a sovereign State, by its central bank or any other body designated to that effect by the State, or by any person acting on their behalf . . . ." EC Directive, *supra* note 60, at 31.

116. WpHG, *supra* note 3, § 20 at 1755.

117. A primary insider is defined as follows:

primary insiders are defined as those persons who have access to and knowledge of insider information.<sup>119</sup> Instead of relying on abstract analyses or criteria of what constitutes access to insider information, German legislators provided a clearly-enumerated categorization of parties deemed to have access to insider information.<sup>120</sup> The law divides insiders with access to insider information into three groups: first, parties directly affiliated with the source of insider information, namely members of the management- or supervisory-committees or general partners of the issuer or its affiliates;<sup>121</sup> second, parties with access to insider information due to their position as stockholders of the issuing company

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*Insider ist, wer—(1) als Mitglied des Geschäftsführungs- oder Aufsichtsorgans oder als persönlich haftender Gesellschafter des Emittenten oder eines mit dem Emittenten verbundenen Unternehmens, (2) aufgrund seiner Beteiligung am Kapital des Emittenten oder eines mit dem Emittenten verbundenen Unternehmens oder (3) aufgrund seines Berufs oder seiner Tätigkeit oder seiner Aufgabe bestimmungsgemäß—Kenntnis von einer nicht öffentlich bekannten Tatsache hat . . . .*

*Id.* § 13(1) at 1753. The key concepts of this section are described and translated in the main body of this text. The language of § 13(1) of the German Insider Trading Law closely resembles the definition of a primary insider under Article 2(1) of the EC Directive, which states the following:

Each Member State shall prohibit any person who: (1) by virtue of his membership of the administrative, management, or supervisory bodies of the issuer, (2) by virtue of his holding in the capital of the issuer, or (3) because he has access to such information by virtue of the exercise of his employment, profession, or duties, possesses inside information . . . .

EC Directive, *supra* note 60, at 31. The only real distinction between the definition of a primary insider under the EC Directive and the German Insider Trading Law is that the latter does not include persons who are members of administrative bodies of the issuer. WpHG, *supra* note 3, § 13(1) at 1753. The German Insider Trading Law, however, exceeds the scope of the EC directive by including persons who are members of the administrative and management bodies or stockholders of companies affiliated with the issuer. *Id.*; see *infra* notes 137-40 and accompanying text (discussing further limitations on primary insiders under German law).

118. WpHG, *supra* note 3, § 14(2) at 1753. Under § 14(2), a secondary insider is defined as “*einem Dritten, der Kenntnis von einer Insider Tatsache hat . . .*” or, in English, “a third party, who has knowledge of insider information . . .” *Id.*; see *infra* notes 124, 141-43 and accompanying text (discussing definition of and further limitations on secondary insiders).

119. WpHG, *supra* note 3, § 13(1) at 1753.

120. See *Das Künftige*, *supra* note 18, at 204 (noting that the German Insider Trading Law provides a concrete definition of primary insiders).

121. WpHG, *supra* note 3, § 13(1)(1) at 1753.

or its affiliates;<sup>122</sup> and third, parties with access to insider information due to their occupation, position, or assignment.<sup>123</sup> Secondary insiders, on the other hand, are simply defined as all other third parties who have knowledge of insider information.<sup>124</sup>

## 2. Insider Information (*Insidertatsache*)

As the EC Directive further mandates, Germany's insider trading prohibition applies only to those primary and secondary insiders trading on "insider information."<sup>125</sup> For information to constitute "insider infor-

122. *Id.* § 13(1)(2) at 1753.

123. *Id.* § 13(1)(3) at 1753.

124. *Id.* § 14(2) at 1753; *see also supra* note 118 (providing German language text of § 14(2) and English translation). The definition of secondary insiders under German law is less precise than the definition of a secondary insider under the EC Directive, which defines such insiders as "any person other than those referred to in . . . Article [2] who with full knowledge of the facts possesses inside information . . ." EC Directive, *supra* note 60, art. 4 at 31. The main distinction between the two definitions is that the EC Directive requires "full knowledge" that the information possessed constitutes inside information, while the German Insider Trading Law only requires "knowledge." *Id.* The distinction between the more general definition of a secondary insider under German law as compared to the EC Directive may be purely semantic without any true practical implications. While the German statutory language arguably suggests that secondary insiders with mere knowledge of insider information will be held strictly liable, German authorities likely will require some showing of culpability. Commentators have speculated that the German legislators may have found the "source specification" superfluous in defining secondary insiders since "inside information is by definition derived from insiders." Standen, *supra* note 23, at 202 n.153. The statutory language of the actual insider trading prohibition imposed on secondary insiders under § 14(2), however, clarifies this matter by suggesting that secondary insiders must knowingly utilize insider information in order to succumb to liability. *See infra* notes 142-44 and accompanying text (noting that only the first of three prohibited insider trading prohibitions applies to secondary insiders, under which only those secondary insiders with knowledge of insider information are prohibited from taking advantage of such knowledge to acquire or sell insider securities for themselves or others); *see also supra* note 48 (stating that taking advantage of one's knowledge of insider information means that one must consciously or knowingly utilize such information).

With respect to the scope of secondary insiders covered by the German Insider Trading Law, it is interesting to note that German legislators discarded an initial proposal to extend secondary insider liability to "third parties who have no direct access to privileged information" as too controversial. J. Terence Gallagher, *Germany Falls Into Line on Securities Regulation*, REUTER W. EUR., June 15, 1994.

125. WpHG, *supra* note 3, § 13(1) at 1753. Insider information is referred to as an "Insidertatsache" under § 13(1) and is defined as "[E]ine[] nicht öffentlich

mation," it must meet three requirements. First, insider information must be non-public information.<sup>126</sup> The information, however, need not be material or contain any indicia of trustworthiness.<sup>127</sup> Second, the information must pertain either to one or several issuers of insider securities or to the insider securities themselves.<sup>128</sup> Third, the non-public information must be capable of considerably influencing the value of an insider security if it were publicized.<sup>129</sup> The Insider Trading Law, in contrast to the EC Directive, specifically exempts information in the form of an assessment based exclusively on public information from the

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*bekannte[] Tatsache . . . , die sich auf einen oder mehrere Ermittelten von Insiderpapieren oder auf Insiderpapiere bezieht und die geeignet ist, im Falle ihres öffentlichen Bekanntwerdens, den Kurs der Insiderpapiere erheblich zu beeinflussen (Insidertatsache)."* *Id.* Section 13(1) WpHG closely follows the text of the EC Directive which states:

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

EC Directive, *supra* note 60, art. 1(1) at 31. The only distinction between the two definitions is that the EC Directive refers to information of a "precise nature" and extends the group of securities whose prices may be affected by the release of insider information to the "securities in question." *Id.* Since these terms are fairly ambiguous and arguably superfluous, German legislators may have decided to omit them from their concise definition of insider information. On the other hand, too much statutory precision may provide an escape route for scrupulous traders. *See* Standen, *supra* note 23, at 203 (noting that the precisely-worded definition of insider information under German law would create an escape hatch by allowing accused insider traders to claim their inside information was not factual in nature).

126. WpHG, *supra* note 3, § 13(1) at 1753.

127. *Id.*; *see* SCHWARK, *supra* note 48, at 48 (noting that the law limits the type of information that may constitute insider information by requiring only that the information pertain to an issuer of the security regardless of its degree of trustworthiness).

128. WpHG, *supra* note 3, § 13(1) at 1753. Information arising from within the corporate-context easily meets this requirement, while information arising outside of the corporate-context, which nevertheless affects securities markets and consequently securities prices, is less easily classified as insider information. SCHWARK, *supra* note 3, at 48. Clearly, information relating to political developments that ultimately affects the price of a security should not constitute issuer-related insider information. *Id.* Information relating to capital markets (i.e., fiscal policy information) that influences the prices of securities, however, should not be as readily excluded from the law's coverage. *Id.* Since such information is generally released to the public on regular intervals, it is much easier for insiders to anticipate when securities price fluctuations will occur and how to profit from such fluctuations. *Id.*

129. WpHG, *supra* note 3, § 13(1) at 1753.



category of "insider information," even if such assessment is capable of influencing the value of an insider security.<sup>130</sup>

### 3. Insider Securities (*Insiderpapiere*)

Germany's insider trading prohibition further falls in line with the EC Directive by covering only insider information pertaining to "insider securities" or issuers of "insider securities."<sup>131</sup> While section 12 of the

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130. *Id.* Section 13(2) provides that "*Eine Bewertung, die ausschliesslich aufgrund öffentlich bekannter Tatsachen erstellt wird, ist keine Insider Tatsache, selbst wenn sie den Kurs von Insiderpapieren erheblich beeinflussen kann.*" *Id.* The main text accompanying this note summarizes the content of this section. While the EC Directive contains no comparable provision to limit the scope of insider information under Article 1(1), assessments based exclusively on publicly-known information, nevertheless, would fall outside of the scope of insider information under Article 1(1) because they do not contain non-public information.

131. WpHG, *supra* note 3, § 12 at 1753. Section 12 defines insider securities (*Insiderpapiere*) as follows:

(1) *Insiderpapiere sind Wertpapiere, die 1. an einer inländischen Börse zum Handel zugelassen oder in den Freiverkehr einbezogen sind, oder 2. in einem anderen Mitgliedstaat der Europäischen Gemeinschaften oder einem anderen Vertragsstaat des Abkommens über den Europäischen Wirtschaftsraum zum Handel an einem Markt im Sinne des § 2 Abs. 1 zugelassen sind. Der Zulassung zum Handel an einem Markt im Sinne von § 2 Abs. 1 oder der Einbeziehung in den Freiverkehr steht gleich, wenn der Antrag auf Zulassung oder Einbeziehung gestellt oder öffentlich angekündigt ist.*

(2) *Als Insiderpapiere gelten auch 1. Rechte auf Zeichnung, Erwerb oder Veräußerung von Wertpapieren, 2. Rechte auf Zahlung eines Differenzbetrages, der sich an der Wertentwicklung von Wertpapieren bemisst, 3. Terminkontrakte auf einen Aktien- oder Rentenindex oder Zinsterminkontrakte (Finanzterminkontrakte) so wie Rechte auf Zeichnung, Erwerb oder Veräußerung von Finanzterminkontrakten, sofern die Finanzterminkontrakte Wertpapiere zum Gegenstand haben oder sich auf einen Index beziehen, in den Wertpapiere einbezogen sind, 4. sonstige Terminkontrakte, die zum Erwerb oder zur Veräußerung von Wertpapieren verpflichten . . . .*

*Id;* see *infra* notes 132-35 and accompanying text (explaining the concept of "insider securities" under German law). Section 12 is comparable to Article 1(2) of the EC Directive which labels "insider securities" as "transferable securities":

"[T]ransferable securities" shall mean: (a) shares and debt securities, as well as securities equivalent to shares and debt securities; (b) contracts or rights to subscribe for, acquire or dispose of securities referred to in (a); (c) futures contracts, options and financial futures in respect of securities referred to in (a); (d) index contracts in respect of securities referred to in (a), when admitted to trading on a market which is regulated and supervised by authorities recognized by public bodies, operates regularly and is accessible directly or indirectly to

German Insider Trading Law provides a fairly complex, and arguably cumbersome, definition of insider securities,<sup>132</sup> the insider trading prohibition basically extends to all securities traded on an exchange or through a transaction otherwise covered by the Insider Trading Law.<sup>133</sup> Specifically, securities listed either on the official or a regulated market in Germany, traded on the over-the-counter market in Germany, or listed on an exchange of a European Union Member State, constitute insider securities.<sup>134</sup> Furthermore, insider securities include stocks, certificates representing stocks, bonds, notes, debt instruments, stock options, and other securities comparable to stocks or bonds.<sup>135</sup> Moreover, parties cannot circumvent the insider trading prohibition by investing in derivatives since derivative instruments come within the scope of insider securities under section 12(2).<sup>136</sup>

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the public.

EC Directive, *supra* note 60, at 31. The definition of insider securities under German law encompasses the measures mandated by the EC Directive. *Id.* In fact, the scope of an "insider security" under § 12 appears to exceed the scope of a "transferable security" under Article 2 of the EC Directive in two respects. First, the German Insider Trading Law covers securities traded on the over-the-counter (OTC) market (*Freiverkehr*) even though OTC trade does not take place on a "market which is regulated and supervised" by competent regulatory authorities, as envisioned by the EC Directive. *See Das Künfiige*, *supra* note 18, at 205 (making this point); *see also* Möller, *supra* note 10, at 102 (noting that the inclusion of securities traded OTC in the insider trading prohibition is important because investors do not distinguish whether insider trading violations occur in the trade of listed securities or OTC securities and repeated occurrences of insider trading violations on the OTC trade, therefore, could jeopardize all regulated trade). Second, the EC Directive does not expressly cover derivative instruments as does § 12(2). *See infra* note 136 and accompanying text (discussing WpHG's coverage of derivative instruments).

132. *See Das Künfiige*, *supra* note 18, at 205 (noting that § 12 offers a fairly complex definition of what constitutes insider securities).

133. WpHG, *supra* note 3, § 12(1) at 1753.

134. *Id.*; *see* SCHWARK, *supra* note 48, at 48 (noting that the determinative criteria in deciding what constitutes an insider security is whether such security is listed for trade on a market, not whether the security transaction in question actually took place through such market); *see also Das Künfiige*, *supra* note 18, at 205 (stating that the definition of insider securities extends to the gambit of securities admitted to trade on a German exchange or traded over-the-counter, as well as those traded on a securities market of an European Union Member State that is regulated by a competent state authority).

135. WpHG, *supra* note 3, § 12(2) at 1753.

136. *Id.* § 12(2) at 1753; *see* Möller, *supra* note 10, at 102 (noting that parties will not be able to circumvent the insider trading prohibition by investing in derivatives since § 12(2) clearly states that so-called derivative instruments constitute insider

#### 4. Insider Transactions

As the EC Directive requires, the German Insider Trading Law places a three-part prohibition on primary insiders in their use of insider information.<sup>137</sup> First, the law prohibits primary insiders from taking advantage of their knowledge of insider information<sup>138</sup> to acquire or dispose

securities).

137. WpHG, *supra* note 3, § 14 at 1753. Section 14 proscribes three types of insider transactions by primary insiders:

*(1) Einem Insider ist es verboten, 1. unter Ausnutzung seiner Kenntnis von einer Insideratsache Insiderpapiere für eigene oder fremde Rechnung oder für einen anderen zu erwerben oder zu veräußern, 2. einem anderen eine Insideratsache unbefugt mitzuteilen oder zugänglich zu machen, 3. einem anderen auf der Grundlage seiner Kenntnis von einer Insideratsache den Erwerb oder die Veräußerung von Insiderpapieren zu empfehlen.*

*Id.*; see *infra* notes 138-41 and accompanying text (explaining three-part prohibition on primary insiders under § 14). Section 14 is modeled after Articles 2 and 3 of the EC Directive. The only exception is that the first use prohibition leave included in Article 2, and the second and third prohibitions on communications and recommendations, respectively, are included in Article 3 of the EC Directive. EC Directive, *supra* note 60, at 31. Article 2 provides that:

1. Each Member State shall prohibit any person who: . . . possesses inside information from taking advantage of that information with full knowledge of the facts by acquiring or disposing of for his own account or for the account of a third party, either directly or indirectly, transferable securities of the issuer or issuers to which that information relates.

*Id.* While Article 2 of EC Directive refers to the "direct[] or indirect[]" acquisition or disposal of securities, *id.* § 14(1)(1), refers only to the acquisition or disposal of securities "for ones own or a foreign account or for someone else." WpHG, *supra* note 3, § 14 at 1753. Article 3 of the EC Directive provides that:

Each Member State shall prohibit any person subject to the prohibition laid down in Article 2 who possesses inside information from: (a) disclosing that inside information to any third party unless such disclosure is made in the normal course of the exercise of his employment, profession or duties; (b) recommending or procuring a third party, on the basis of that inside information, to acquire or dispose of transferable securities admitted to trading on its securities markets as referred to in Article 1(2) *in fine*.

EC Directive, *supra* note 60, at 31. While § 14(1)(2) limits the primary insider's communication of insider information to authorized uses, Article 3(a) of the EC Directive clearly delineates situations in which such communications are authorized (i.e., in the normal course of employment, etc.). Section 14(1)(3) contains language largely identical to Article 3(b) of the EC Directive.

138. See SCHWARK, *supra* note 48, at 50 (noting the requirement that insiders "take advantage of their knowledge" of insider information means that they must knowingly utilize insider information).

of insider securities for themselves or others.<sup>139</sup> Second, it prohibits primary insiders from informing or providing others with access to the insider information without authorization.<sup>140</sup> Third, the law prohibits primary insiders from using their knowledge of insider information to recommend to others the acquisition or sale of insider securities.<sup>141</sup>

Reflecting the scope of the EC Directive, secondary insiders are decisively less restricted in their use of insider information than primary insiders because only the first of the three aforementioned prohibitions applies to secondary insiders.<sup>142</sup> Secondary insiders are simply prohibited from using insider information to acquire or sell insider securities for themselves or others.<sup>143</sup> They are not prohibited from furnishing others with insider information, or from making recommendations to others on the purchase or sale of insider securities based on such insider information.<sup>144</sup>

Overall, the German insider trading prohibition is expansive in its coverage of insiders, insider information, insider securities, and insider transactions.<sup>145</sup> It contains few, if any, apparent gaps.<sup>146</sup> Furthermore,

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139. WpHG, *supra* note 3, § 14(1)(1) at 1753.

140. *Id.* § 14(1)(2) at 1753; see SCHWARK, *supra* note 48, at 51 (noting that the concept of authorization is problematic and finding that communications of insider information are not "unauthorized" when parties are acting strictly within the scope of their employment and, arguably, are "unauthorized" when parties are acting only in the interest of the corporation).

141. WpHG, *supra* note 3, § 14(1)(3) at 1753.

142. *Id.* § 14(2) at 1753. Section 14(2) prescribes transactions by secondary insiders as "(2) Einem Dritten, der Kenntnis von einer Insider Tatsache hat, ist es verboten, unter Ausnutzung dieser Kenntnis Insiderpapiere für eigene oder fremde Rechnung oder für einen anderen zu erwerben oder zu veräußern." *Id.*; see *supra* notes 118, 124 and accompanying text (translating prohibition on secondary insider transactions contained in § 14(2)). The prohibition on transactions by secondary insiders contained in § 14(2) of the German Insider Trading Law closely resembles the use prohibition under Articles 2, 3 and 4 of the EC Directive, which applies to secondary insiders. EC Directive, *supra* note 60, at 31.

143. WpHG, *supra* note 3, § 14(2) at 1753.

144. *Id.*; see Scharrenberg, *supra* note 86, at 92 (noting that German legislators were considering whether to extend the recommendation prohibition to secondary insiders and speculating that they probably would drop this proposal as too expansive).

145. See *supra* notes 114-44 and accompanying text (discussing four elements of insider trading prohibition).

146. See *infra* notes 220-22 and accompanying text (discussing the applicability of laws to government insiders leaking economic data capable of influencing entire financial markets); see also *infra* notes 221-23 and accompanying text (addressing difficulty

the prohibition unequivocally complies with the measures mandated by the EC Directive and arguably expands beyond the scope of insider liability under United States law, particularly with respect to the formulation of tippee or secondary insider liability.<sup>147</sup>

### C. THREE-TIERED ENFORCEMENT STRUCTURE

The new Insider Trading Law envisions a three-tiered surveillance structure on the federal, state (Länder), and exchange level.<sup>148</sup> The law's coverage extends to both unlisted or over-the-counter trade (Freiverkehr), and listed trade<sup>149</sup> on Germany's eight regional stock exchanges.<sup>150</sup>

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in determining whether information arising in the non-corporate context, such as the interest rate policy of the Central Bank, which is released at regular intervals and directly affects the securities markets, falls within the scope of insider information).

147. See Donald C. Langevoort, *Defining Insider Trading: The Experience in Other Countries*, 6 INSIGHTS 7 (1992) (concluding that the scope of insider trading prohibition in EC Directive, as well as in Japan, Great Britain, and Australia, is broader than the United States version, particularly with respect to secondary insiders).

148. See Netzer, *supra* note 52 (discussing three-tiered level of market supervision and the respective functions of each); *Börsenaufsicht mit Biss erwünscht—Im Jahre 1995 soll Frankfurt internationalen Anschluss bekommen* [Securities Supervisory Authority with Bite Sought—In the Year 1995, Frankfurt Will Gain International Acceptance], SZ, Sept. 27, 1994 [hereinafter *Börsenaufsicht*] (describing three-tiers of market surveillance); *Bei Insidergeschäft bis zu fünf Jahre Gefängnis—Bonn legt Gesetzentwurf zur Finanzmarktförderung vor—Neues Aufsichtsamt geplant* [Up to Five Years Prison Term for Insider Trading—Bonn Presents Proposed Law For Promoting the Financial Marketplace—New Supervisory Office is Planned], SZ, July 13, 1993 (discussing three levels of market supervision from planning perspective).

149. WpHG, *supra* note 3, § 16 at 1754 (providing that Federal Supervisory Office conducts continuous surveillance over listed and unlisted securities businesses); cf. Blum, *supra* note 18, at 510-11 (indicating that under Germany's prior voluntary compliance system only listed securities, officially traded on the exchanges, fell under the jurisdiction of the Stock Exchange Act, while the trading of regulated, unlisted or non-regulated, unlisted securities was subject only to limited self-regulation).

150. See Blum, *supra* note 18, at 507 n.3 (identifying Germany's eight regional exchanges as Frankfurt, Düsseldorf, Munich, Hamburg, Berlin, Hanover, Stuttgart, and Bremen). Of the eight exchanges, Frankfurt is the largest and most active, clearing over 73% of the total of DM 7,486 billion in trading activity in Germany last year. *Die Börsen in Frankfurt, Düsseldorf und München planen eine enge Kooperation* [The Exchanges in Frankfurt, Düsseldorf and Munich plan tight cooperation], SZ, May 9, 1995. The Düsseldorf Exchange comes in second place, engaging in approximately DM 732 billion in trading activity last year. *Id.* The Bavarian Exchange in Munich is in third place with approximately DM 371 billion. *Id.* The remaining market share of around 12% is spread among the other five exchanges in 1994. *Id.*

## 1. Federal Supervisory Office

The German Parliament delegated the principal power for enforcing Germany's Insider Trading Law to the newly-created Federal Supervisory Office for Securities Trading (Federal Supervisory Office).<sup>151</sup> The Federal Supervisory Office is a self-funding,<sup>152</sup> independent government agency within the jurisdiction of the Federal Ministry of Finance.<sup>153</sup> The federal government has the power to appoint the agency's President with the advice of the state governments.<sup>154</sup> The Federal Supervisory Office officially began operating on January 1, 1995,<sup>155</sup> in Frankfurt<sup>156</sup> with a limited staff and budget.<sup>157</sup>

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151. WpHG, *supra* note 3, §§ 3-11 at 1750-53 (setting forth the organisation, functions, and funding of the Federal Supervisory Office).

152. *Id.* § 11(1) at 1752 (distributing cost coverage for expenses relating to the Federal Supervisory Office as follows: 75% to credit institutes located in Germany; 5% to exchange brokers, independent brokers, and other companies listed on the exchange; 10% to issuers located in Germany whose securities are listed on a German exchange).

153. *Id.* § 3(1) at 1750 (stating that the Federal Supervisory Office shall be established under the jurisdiction of the Federal Ministry of Finance).

154. *Id.* § 3(2) at 1750 (stating that the President of the Federal Republic of Germany shall appoint the head of the Federal Supervisory Office on behalf of the federal government with the advice of the competent state ministries). In October 1994, German authorities appointed Georg Wittich, a former Finance Ministry official responsible for the supervision of international securities matters, to head the Federal Supervisory Office. *Ministerialrat Wittich zum Chef des Börsen-Aufsichtsamtes ernannt [Minister Wittich Appointed to Head the Federal Supervisory Office]*, SZ, Oct. 14, 1994; see Ascarelli, *supra* note 35, at 9 (noting that Georg Wittich is the Finance Ministry's connection to the International Organization of Securities Commissions and is thought to be well-suited to promote Germany's new hard-line approach against insider trading to foreign investors); Tally-Ho, *supra* note 55, at 24 (citing Mr. Wittich's view that tough legal penalties and a new enforcement authority with broad investigatory powers are a sufficient deterrent to insider dealings and just as important as actual punishment); Equity, *supra* note 46, at 82 (stating that the possibility of appointing Rudiger von Rosen, former Chairman of the Deutsche Börse AG, to the head of the agency was quickly discarded because von Rosen is "too closely associated with the German banks and . . . the authorities wish to portray the stock exchange as an institution which has grown beyond the control of a handful of German bankers").

155. FmFG, *supra* note 2, art. 20 at 1784 (stating that § 3 (organisation of Federal Supervisory Office), § 9(3) and (4) (select powers of Federal Ministry of Finance concerning disclosure duty), § 11 (costs), and other select provisions not applicable to the Federal Supervisory Office shall become effective on August, 1, 1994, while all other provisions shall take effect on January 1, 1995).

156. See, e.g., *Börsenpolizei und Strukturreform stärken den Finanzplatz Frankfurt*

a. *Enforcement Powers*

The Federal Supervisory Office has extensive investigatory and surveillance powers to ensure compliance with the Insider Trading Law and, as a result, the proper functioning of Germany's securities markets.<sup>158</sup> To help the Federal Supervisory Office meet its broad enforcement mandate,<sup>159</sup> German legislators took a dual approach. They provided the agency with expansive investigatory powers, on one hand, imposed expansive disclosure requirements on market participants, on the other hand.<sup>160</sup> The agency has four central surveillance and compulsory duties under the Insider Trading Law.

(1) *Insider Trading Investigations*

The Federal Supervisory Office is primarily responsible for the investigation of insider trading violations.<sup>161</sup> To assist the agency with its

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[*Securities Regulators and Structural Reform Strengthen the Financial Marketplace Frankfurt*], SZ, Dec. 11, 1993 (noting that Frankfurt, future home of the European Monetary Institute, a precursor of the planned European Central Bank, was unanimously chosen as the site of the Federal Supervisory Authority by a commission composed of the federation and the states in the face of competition from other cities such as Bremen and Leipzig); *Die Börsen in Frankfurt*, *supra* note 150 (noting that the Frankfurt Exchange is Germany's largest exchange, conducting 74% of Germany's total stock exchange business in 1994); *Tally-Ho*, *supra* note 55, at 24 (noting that the Frankfurt Exchange is the world's fourth largest exchange).

157. *See Tally-Ho*, *supra* note 55, at 24 (explaining that the Agency began operating with a core staff of 30 to 40 people in November 1994, and an annual budget of DM 12 million (\$7.6 million)).

158. WpHG, *supra* note 3, § 4 at 1750 (defining broad duties of the Federal Supervisory Office in the enforcement of the Insider Trading Law, i.e., preventing problems from arising that may impair an orderly securities trade and cause considerable disadvantages for the securities markets).

159. *Id.*

160. *Id.* § 16 at 1754 (covering primary investigatory powers of the Federal Supervisory Office); *see id.* §§ 9 and 15 at 1751-54 (containing Insider Trading Law's key provisions mandating disclosure of information to the Federal Supervisory Office, namely the disclosure or reporting duty (Meldepflicht) and the Ad Hoc Publicity duty (Veröffentlichung und Mitteilung kursbeeinflussender Tatsachen) respectively).

161. *Id.* § 4 at 1750 (granting primary enforcement powers under the Insider Trading Law to the Federal Supervisory Office); *see id.* § 16(1) at 1754 (stating that the Federal Supervisory Office supervises the listed and unlisted trade in insider securities in order to enforce the insider trading prohibition under § 14); *see supra* note 137 and accompanying text (providing information on the scope of the insider trading prohibition under § 14).

investigatory role, the Insider Trading Law imposes an expansive and, arguably, unwieldy mandatory disclosure requirement on all credit institutes with headquarters in Germany, their foreign-located branch offices, and other market participants.<sup>162</sup> These entities must disclose their transactions in securities and derivative instruments on markets within the scope of the Insider Trading Law to the Federal Supervisory Office on a daily basis.<sup>163</sup> The federal agency must verify whether these entities have complied with this disclosure requirement every year.<sup>164</sup> The Insider Trading Law imposes substantial fines on entities that intentionally or recklessly fail to comply with the disclosure requirement.<sup>165</sup>

If the Federal Supervisory Office has a valid suspicion of an insider trading violation, the agency, under its continuous surveillance function, may make further inquiries into the securities transactions giving rise to the suspicion.<sup>166</sup> For example, the agency may request disclosure of the principal's identity.<sup>167</sup> In this context, the agency may demand the production of documentation from the suspected parties or access to their business premises.<sup>168</sup> Furthermore, the Federal Supervisory Office, under a valid suspicion of an insider trading violation, may make inquiries of issuers of insider securities and their affiliates, who are located in Germany or whose securities are listed on German exchanges, as well as

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162. *Id.* § 9(1) at 1751-52 (containing disclosure duty (Meldepflichten)); see Scharrenberg, *supra* note 86, at 91 (noting that the authorities will carry a large technical and administrative task in evaluating the large amount of information with which the respective credit institutes and other entities will supply them on a daily basis and noting that the credit institutes alone engage in 60,000 to 70,000 securities transactions daily).

163. WpHG, *supra* note 3, § 9(1) at 1751-52.

164. *Id.* § 36(1) at 1759.

165. *Id.* §§ 39(1)(1.) (a), 39(3) at 1759-60 (imposing fine not in excess of DM 100,000 on entities that intentionally or recklessly fail to make a disclosure as mandated under § 9 or make such a disclosure in an incorrect, incomplete, improperly formatted, or untimely manner).

166. *Id.* § 16(2) at 1754 (granting continuous surveillance powers to the Federal Supervisory Office which are triggered only if the Federal Supervisory Office has a "substantiated suspicion" of an insider trading violation under § 14 (Anhaltspunkte für einen Verstoß)).

167. *Id.* (stating that the Federal Supervisory Office may request the identity of the principal as long as the agency's inquiries address insider securities which give rise to the suspicion of an insider violation or whose prices are dependent on such securities).

168. *Id.* § 16(3) at 1754 (granting power to Federal Supervisory office to demand production of documents and access to the business premises of the entities who are subject to the disclosure duty under § 9).



other persons with knowledge of insider information.<sup>169</sup> Under its continuous surveillance function, the Insider Trading Law imposes substantial fines on parties who intentionally or negligently fail to comply with the federal agency's requests for information, documentation, or access to business premises.<sup>170</sup>

If the Federal Supervisory Office ascertains facts confirming the suspicion that an insider trading violation has occurred, the agency must refer the matter to the competent state attorney's office for prosecution.<sup>171</sup> The Insider Trading Law imposes extensive criminal sanctions and fines on primary and secondary insiders convicted of violating the insider trading prohibition.<sup>172</sup>

## (2) *Surveillance of Ad Hoc Publicity*

The Federal Supervisory Office is also responsible for supervision of the ad hoc publicity requirement. Under this requirement, issuers, absent a waiver, must disclose all potentially market-moving information to the investing public via exchange newspapers and electronic information systems.<sup>173</sup> The Federal Supervisory Office may make inquiries of, demand documentation from, and enter business premises of issuers to

169. *Id.* § 16(4) at 1754 (stating conditions under which Federal Supervisory Office may question issuers or persons with knowledge of insider information about insider information or about other persons who have knowledge of such information).

170. *Id.* §§ 39(2), 39(3) at 1760 (imposing fines up to DM 100,000 for intentionally or negligently not complying with Federal Supervisory Office's request for information, documentation, or access to business premises under § 16).

171. *Id.* § 18(1) at 1754 (setting forth the standard for criminal referral).

172. *Id.* § 38 at 1759 (mandating the imposition of a five year prison term or the disgorgement of profits on primary and secondary insiders and noting that a comparable foreign criminal sanction may be substituted for such sanction).

173. *Id.* § 15(1) at 1753 (stating ad hoc publicity requirement and noting that the Federal Supervisory Office may exempt an issuer from this requirement if the information to be disclosed may harm the issuer); *see id.* § 15(2) at 1753-54 (providing that the issuer, prior to making the mandated public disclosure, must provide the potentially-market moving information to the exchanges on which the issuer's securities or derivatives based on such securities are listed and to the Federal Supervisory Office so that these authorities may determine whether the trading of such securities should be halted); *see id.* § 15(3) at 1754 (describing means of disclosure); *see also* Bernhard Pellens & Rolf Uwe Fülbiel, *Publizitätspflichten nach dem Wertpapierhandelsgesetz [Publication Duties under the Insider Trading Law]*, 28 DER BETRIEB 1381 (1994) (providing an extensive evaluation of the ad hoc publicity requirement under § 15 and making a comparative analysis to disclosure requirements in Great Britain and the United States).

determine if the requirements of ad hoc disclosure have been met.<sup>174</sup> If issuers fail to publicize relevant information in the manner and time frame required by the Insider Trading Law, the exchanges may halt the trading of the issuer's stock for a short period until the relevant information has been properly disseminated to the public.<sup>175</sup> The Insider Trading Law imposes large fines on parties who fail to comply with either the ad hoc publicity requirement or the federal agency's requests for information, documentation, or searches.<sup>176</sup>

Commentators have noted that the concept of ad hoc publicity is by far one of the most important provisions contained in the Insider Trading Law.<sup>177</sup> Its purpose is to provide the public with immediate access to potentially market-moving information, and thereby serve as a preventive measure against insider trading.<sup>178</sup> While the rationale underlying

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174. WpHG, *supra* note 3, § 15(5) at 1754.

175. Börsengesetz [Stock Exchange Act], in FmFG, *supra* note 2, § 43 at 1760, 1761 [hereinafter BörsG] (permitting trading halts for the protection of investors even despite the publication of market-relevant information); *Deutschland: FWB—Aussetzungsregeln an Ad-Hoc-Regeln Anpassen* [Germany: Financial Market News—Adapting Trading Halt Rules to Ad-Hoc Rules], REUTER GERMAN NEWS, Apr. 27, 1995 (citing department head of the Deutsche Börse AG, Arno Thielemann, as stating that since legislators failed to consider the trading halt requirements under BörsG's § 43 when enacting WpHG's § 15, one should take the ad hoc provision into account when contemplating trading halts; therefore, German exchanges may not be required to stop the trading of securities under § 43 if companies release their market-moving information over electronic media as required by § 15).

176. WpHG, *supra* note 3, §§ 39(2), 39(3) at 1760 (imposing a fine not in excess of DM 100,000 for intentionally or recklessly not complying with the federal agency's information, document, or search request, or for doing so in an incorrect, incomplete, improperly formatted, or untimely manner); *see id.* §§ 39(1)(2)(a), 39(3) at 1759-60 (imposing a fine not in excess of DM 3 million for intentionally or recklessly not complying with ad hoc publicity requirement or for doing so in an incorrect, incomplete, improperly formatted, or untimely manner); *see id.* §§ 39(1)(3), 39(3) at 1760 (imposing a fine not in excess of DM 3 million for intentionally or recklessly not disclosing potentially-market moving information to the public through an electronic information service or for doing so in an incorrect, incomplete, improperly formatted, or untimely manner).

177. SCHWARK, *supra* note 48, at 52 (noting that the ad hoc publicity requirement is the most important measure of the insider trading prohibition since it attempts to make insider transactions obsolete).

178. *See Das Künftige*, *supra* note 18, at 206 (noting that ad hoc publicity is based on the rationale that the quickest possible public disclosure of non-public material information erodes the basis for insider transactions); Möller, *supra* note 10, at 108 (finding that ad hoc publicity is a measure intended to prevent the misuse of insider information).

the ad hoc publicity requirement is sound, the practical implementation of ad hoc disclosure has been troublesome.<sup>179</sup> The requirement has caused much confusion within the business community,<sup>180</sup> has resulted in several trading halts to date,<sup>181</sup> and arguably, may be evaded by clever insiders.<sup>182</sup> As of April 1994, the Federal Supervisory Office has demonstrated its uncertainty over the requirement of ad hoc publicity by abstaining from imposing any fines on German companies for non-compliance, despite inconsistent adherence to the new requirement.<sup>183</sup>

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179. See SCHWARK, *supra* note 48, at 52 (stating that experts have questioned the effectiveness of the ad hoc publicity requirement as a preventive measure against insider trading).

180. See *Deutschland: Wenig Licht im Paragraphen-Dschungel* [Germany: Little Light in the Jungle of Paragraphs], NEUE ZUERCHER ZEITUNG [NZZ], Nov. 1, 1994 (noting that Deutsche Börse AG's recently released pamphlet (Leitfaden) assisting companies on which information to publicize under the ad hoc publicity requirement demonstrates how hard it is to understand this disclosure requirement); see also *In Deutschland herrscht grosse Unsicherheit* [In Germany, Great Uncertainty Abounds], SZ, Aug. 3, 1994 (noting that many companies do not exactly know what information they must provide or to whom, before they inform the exchanges, the Federal Supervisory Office, and the effected public).

181. See *Deutschland: Börse Ab Neu Jahr Mit Neuer Aussetzungspraxis* [Germany: Exchange After New Year with Trade-Halting Practice], REUTERS, Dec. 15, 1994 (noting that until the end of 1994, the exchanges will halt trading of a stock if the public, including private investors, is not informed of market-moving information through a stock exchange newspaper (Börsenpflichtblatt), but after January 1, 1995, the Frankfurt Exchange will only require that the affected public (Bereichsöffentlichkeit) be informed of potentially market-moving information); *Aussetzungen verstören die Anleger* [Trading Halts Disturb Investors], SZ, Dec. 16, 1994 (stating that the Frankfurt exchange halted the trading of Schaerf AG and Roder Zeltsysteme AG for failing to meet the timeliness requirement of the ad hoc publicity and thereby caused much confusion in the business community about their publicity duties).

182. See SCHWARK, *supra* note 48, at 52 (noting that insiders may circumvent ad hoc publicity measures by moving their insider activities ahead to an earlier time-frame, at which the course-relevant circumstance has not yet become a fact).

183. See Margit Thomann, *Deutschland: Schwieriger Umgang mit Ad-Hoc-Publizität* [Germany: Difficult Dealings with Ad-Hoc-Publicity], REUTERS GERMAN NEWS, Apr. 30, 1995 (citing official of the Federal Supervisory Office, Jürgen Oberfrank, stating that the office has dealt generously with possible violations of the ad hoc publicity requirement. It further noted that heavily-traded companies, such as the Commerzbank and Siemens, purposely disregarded ad hoc publicity with respect to marginally course-relevant information on prior occasions, while instead publishing the news through their established press connections).

### (3) *Mutual Cooperation*

The Federal Supervisory Office is responsible for cooperating with competent European Community and foreign securities enforcement authorities in the enforcement of insider trading violations under the German Insider Trading Law or foreign laws.<sup>184</sup> Specifically, the Federal Supervisory Office is in charge of obtaining information requested by other enforcement authorities and transmitting such information to them.<sup>185</sup> The agency may use its compulsory powers to secure the requested information.<sup>186</sup> The agency also has the authority to deny mutual assistance on two grounds: if the release of information could jeopardize the sovereignty, security, and public order of the Federal Republic of Germany, and if German authorities have already initiated a judicial proceeding into the subject matter of the request or have issued a final decision on the matter.<sup>187</sup>

### (4) *Administrative Law Making Power*

The Federal Supervisory Office has the express authority to issue regulations for the purpose of remedying abuses that impair the orderly trading of securities or that may significantly disadvantage the stock market.<sup>188</sup> While the Insider Trading Law offers no real guidance on the potential content of such regulations, the law does provide that the regulations may broaden the scope of the Federal Supervisory Office's duties and powers,<sup>189</sup> but only to the extent that they do not interfere

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184. See WpHG, *supra* note 3, § 19 at 1755 (providing for international cooperation); see also *id.* § 19(5) at 1755 (stating that Federal Supervisory Office may cooperate with other enforcement agencies in the enforcement of insider trading prohibitions under German or foreign law).

185. *Id.* § 19(1) at 1755 (stating that Federal Supervisory Authority may transmit requested information to other competent enforcement authorities and that the agency may utilize its compulsory powers under § 16(2) in order to execute the foreign request for assistance).

186. *Id.*

187. *Id.* § 19(3) at 1755 (setting forth reasons under which The Federal Supervisory Office may refuse to execute a foreign request for assistance).

188. *Id.* § 4(1) at 1750 (stating that the Federal Supervisory Office may issue regulations to remedy "abuses . . . which jeopardize the orderly performance of the securities trade or could bring about considerable disadvantages for the securities market").

189. See WpHG, *supra* note 3, § 16(1) at 1754 (providing the Federal Supervisory Office with practically unlimited jurisdiction over the enforcement of insider trading violations). Furthermore, the law gives the Federal Supervisory Office free reign to

with areas of competence explicitly reserved to either the states<sup>190</sup> or the exchanges under the Second Financial Markets Promotion Act.<sup>191</sup> The Federal Supervisory Office may use the compulsory measures available under German administrative law to compel compliance with the regulations that the agency promulgates and may impose extensive fines for non-compliance.<sup>192</sup>

*b. Securities Council*

The Insider Trading Law mandates the creation of a Securities Council (*Wertpapierrat*) within the Federal Supervisory Office, consisting of representatives from each state.<sup>193</sup> The Council primarily has an advisory role focusing particularly on newly-issued regulations, enforcement decisions affecting exchange and market structures, and questions concerning the respective areas of competence of the Federal Supervisory Office and the state supervisory authorities.<sup>194</sup> The Securities Council must meet at least once a year.<sup>195</sup> Overall, the Securities Council

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seek the assistance of other persons and offices in meeting its expansive enforcement task. *Id.* § 6(1) at 1751. Under the Insider Trading Law, and absent any constitutional considerations, the insider trading enforcement powers of the Federal Supervisory Office supersede the limited enforcement duties delegated to the regional and exchange authorities. *Compare supra* notes 158-87 and accompanying text (describing broad enforcement and rule-making powers of the FSA) *with infra* notes 196-206 (describing lesser powers of regional and exchange authorities).

190. *See* FmFG, *supra* note 2, art. 2, § 1 at 1760-61 (listing Regional Authority's powers under the amended Stock Exchange Act).

191. *Id.* art. 2, § 1b at 1761 (containing functions and powers of Exchange Authorities under the amended Stock Exchange Act).

192. WpHG, *supra* note 3, § 10 at 1752 (describing compulsory powers that the Federal Supervisory Authority may employ in enforcing agency regulations and noting that the federal agency may impose fines up to DM 50,000 for non-compliance).

193. *Id.* § 5(1) at 1750.

194. *Id.* § 5(2) at 1750 (stating that the Securities Council will assist in the enforcement of the Insider Trading Law and describing particular areas in which Council will have an advisory role).

195. *Id.* § 5(3) at 1750. The President of the Federal Supervisory Office must call the meetings of the Securities Council at least once a year and at other times upon the request of a third of its members. *Id.* The Insider Trading Law authorizes representatives of the Federal Ministries of Finance, Justice, and Economics, the German Central Bank (Deutsche Bundesbank), and the Federal Supervisory Office for Banking Regulation to attend such meetings. *Id.* § 5(1) at 1750. In addition, leading industry exports may testify at meetings of the Securities Council. *Id.*

serves as a state government check on the expansive powers of the Federal Supervisory Office.

## 2. States (*Länder*)

The Federal Supervisory Office may seek the assistance of the Regional Exchange Supervisory Authorities (Regional Authorities) at the state level, which previously oversaw Germany's eight stock exchanges in carrying out the agency's duties under the Insider Trading Law.<sup>196</sup> Specifically, the Regional Authorities must assist the Federal Supervisory Office in urgent matters involving the enforcement of Germany's insider trading prohibition.<sup>197</sup> Individual agreements between the Federal Supervisory Office and the respective Regional Authorities shall govern mutual cooperation between such state and federal authorities in the enforcement of insider trading violations.<sup>198</sup>

The Regional Authorities have other duties and powers with respect to general market surveillance under the amended Stock Exchange Act.<sup>199</sup> For example, the Regional Authorities are responsible for supervising the exchanges,<sup>200</sup> the corporations listed on the exchanges, and the broker-dealers.<sup>201</sup> They must enforce exchange rules and maintain orderly trading practices on the exchanges.<sup>202</sup> To carry out these duties, Regional Authorities have extensive powers to initiate inspections, make inquiries, and request documents.<sup>203</sup> In furtherance of their surveillance duty, they may conduct searches of the business premises of the exchange and its participants during regular business hours and, at other times, only to prevent immediate danger to public safety.<sup>204</sup> Finally, Regional Author-

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196. *Id.* § 6(2) at 1751 (stating that the Regional Authorities (Börsenaufsichtsbehörden) must assist the Federal Supervisory Office in urgent matters involving the enforcement of insider trading violations at their respective exchanges).

197. *Id.*

198. *Id.*

199. BörsG, *supra* note 175, at 1760-70.

200. *Id.* § 1(2) at 1760 (stating that the Regional Authority carries out the surveillance over the exchange, which includes ensuring that the exchange rules and regulations are complied with and that an orderly trade is maintained).

201. *Id.* § 1a(1) at 1761 (stating that the Regional Authority may request documents from or search business premises of various market participants, such as companies listed at the exchange and broker-dealers).

202. *Id.* § 1(2) at 1760 (explaining the Regional Authority's surveillance duties).

203. *Id.*, § 1a(1) at 1761 (setting forth powers of the Regional Authorities to request documents from and search business premises of exchange participants).

204. *Id.* (stating conditions under which Regional Authorities may search the busi-

ities have a rulemaking power of their own.<sup>205</sup> They may impose regulations on the exchanges and their participants in order to enforce compliance with exchange rules, or to prevent or remedy other abuses.<sup>206</sup>

### 3. Exchanges

On the exchange level, the amended Stock Exchange Act mandates self-regulation. Each regional stock exchange must establish a Trading Supervision Authority (Exchange Authority) to supervise trading on the exchange.<sup>207</sup> The Exchange Authorities must compile data on the trading activity in their respective exchanges in a systematic manner, assess such data, and then conduct further investigations if necessary.<sup>208</sup>

Self-regulation on the exchange level, nevertheless, falls completely under the immediate supervision of the competent Regional Authority. The Regional Authority may issue warnings to its subordinate Exchange Authority and take over the exchange's internal investigations.<sup>209</sup> If an Exchange Authority, on the basis of its investigations, ascertains facts supporting the assumption of an exchange rule violation, it must immediately notify the appropriate Regional Authority.<sup>210</sup> The standard for criminal referral imposed on the Federal Supervisory Office, i.e., facts confirming the suspicion,<sup>211</sup> is much higher than the standard for investigative referral imposed on the Exchange Authorities, i.e., facts supporting the assumption.<sup>212</sup> As a result, more investigations are likely to be funnelled from the exchanges to the regional level than from the federal

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ness premises of specified exchange participants and the scope of such searches).

205. *Id.* § 1a(2) at 1761 (stating that the Regional Authority may implement regulations on the exchange and its participants in order to prevent violations of the rules or to prevent other abuses that may jeopardize the orderly securities trade at the exchange and the completion or surveillance of securities businesses).

206. *Id.*

207. *Id.* § 1b at 1761 (creating the Trading Supervision Authority (Handelsüberwachungsstelle als Börsenorgan), subject to the supervision of the competent Regional Authority).

208. *Id.*

209. *Id.*

210. *Id.* § 1b(5) at 1761 (providing for immediate referral of investigations from Exchange to Regional Authority if latter authority determines that rules or regulations have been violated that affect the orderly operation of securities trade).

211. *See supra* note 171 and accompanying text (describing standard for criminal referral from Federal Supervisory Office to prosecutor's office under § 18(1)).

212. *See supra* notes 208, 210 and accompanying text (describing the standard for investigatory referral from the Exchange to the Regional Authority under § 1b(5)).

level to criminal prosecution. The significance of this distinction is two-fold: first, this differentiation signifies the large extent of control that the *Länder* possess over the Regional Authorities; and second, this distinction demonstrates the extremely high burden of proof placed on criminal referrals in Germany's new three-tiered securities enforcement structure.

#### D. BARRIERS TO EFFECTIVE ENFORCEMENT

Initial reactions to the new Insider Trading Law range from positive acceptance<sup>213</sup> to general uncertainty.<sup>214</sup> Because the new law represents a significant change from one financial culture to a disparate other,<sup>215</sup> such a mixed response is certainly not unusual. The financial community is concerned over potentially increased bureaucracy and technocracy.<sup>216</sup> German financial specialists have also voiced trepida-

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213. See *Deutschland: Bankverband Unterstützt Finanzmarktgesetz [Germany: Bankers Support the Financial Market Promotion Law]*, REUTER GERMAN NEWS, June 23, 1994 [hereinafter *Bankverband*] (indicating that the Bankers Association welcomes the Second Financial Markets Promotion Act since the Act will make the Finanzplatz Deutschland more attractive and strengthen investor confidence).

214. See Templeman & Javetski, *supra* note 14, at 54 (noting that the "dramatic cultural shift" called for by the new law will not occur "overnight," and quoting Sabine Kruger of the Frankfurt-based financial publicist Charles Barker as stating that the new law will cause a lot of initial confusion).

215. See Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States*, 102 YALE L.J. 1927, 1936-37 (1993) [hereinafter *Some Differences*] (providing comparative analysis of German and American corporate culture and pointing out that a small group of institutional voting blocks at many German companies control nearly half of the stock voted, while institutional control in the United States does not exceed 5% blocks). For example, the Deutsche Bank holds large aggregate voting blocks in the following German companies: (i) 17.64% in Siemens, (ii) 41.80% in Daimler-Benz, (iii) 30.82% in Bayer, (iv) 28.07% in BASF, (v) 14.79% in Hoechst, and (vi) 19.99% in VEBA. *Id.* Other illustrative examples of the large amount of control German banks hold in German publicly-held corporations, a phenomena that could not arise under United States banking regulations, are statistics relating to the top five institutional voting blocks in Daimler-Benz: the Deutsche Bank, Dresdner bank, Commerzbank, Sonst. Kredit, and the Bayerische L-Bank hold 41.80%, 18.78%, 12.24%, 4.41%, and 1.16%, respectively, or a cumulative total of 78.39%, in Daimler stock. *Id.*; see also *Germany Wakes Up to Equities*, ECONOMIST, Oct. 1, 1994 [hereinafter *Germany Wakes Up*] (describing Germany's slow financial revolution and noting that an equity culture is finally taking root in Germany).

216. See *Dresdner's Eberstadt Says New Stock Exchange Laws May Increase Bureaucracy*, AFX NEWS, Dec. 30, 1994 [hereinafter *Dresdner's Eberstadt*] (expressing the concerns of Dresdner Bank board member Gerhard Eberstadt over the new Insider



tion over the evolution of a new class of overly-cautious equity advisors<sup>217</sup> and the development of a conservative information policy generally disadvantageous to stock traders.<sup>218</sup> While these problems and fears are by no means insignificant, they nevertheless should be categorized as short-term problems that will gradually become less relevant as German financial culture adapts to a new era of market transparency and financial regulation.<sup>219</sup>

Aside from problems resulting directly from an initial period of adjustment to a new regulatory structure,<sup>220</sup> Germany's new insider trading legislation has given rise to more substantial barriers to effective enforcement and the eventual creation of a highly capitalized equity market. These barriers may require legislative solutions. Problem areas include possible statutory gaps in the definition of insider trading; conflicts between Frankfurt and the other regional exchanges due to Frankfurt's new federal control over Germany's financial markets; and the limited ability of non-commercial, domestic investors to invest in the German equity market due to high banking and brokerage fees, and high stock prices.

#### 1. Legislative Gaps: Definition of an Insider

Even though the Insider Trading Law offers a fairly expansive definition of insider trading,<sup>221</sup> finance ministry officials have begun to question the law's applicability to government insiders leaking economic data

Trading Law); *Durch Umsetzung neuer Börsengesetze droht eine Zunahme an Bürokratie. Dresdner-Bank-Vorstand Eberstadt: Firmen sollen mehr für die eignen Aktionäre tun* [Passage of New Stock Exchange Laws Threaten an Increase in Bureaucracy. Dresdner-Bank-Head Eberstadt: Companies Should Do More for Their Own Shareholders], .SZ, Dec. 30, 1994 [hereinafter *Bank-Vorstand Eberstadt*] (providing full text of interview).

217. See *Dresdner's Eberstadt*, *supra* note 216 (warning that "[i]f everyone has a lawyer sitting behind them, no one will dare do anything").

218. See *id.* (stating that while company news was susceptible to varied interpretations in the past, in the future corporate news will focus on "a sober information policy, largely based on earnings and performance figures"); see also *Bank-Vorstand Eberstadt*, *supra* note 216 (adding that diversity of opinion generally helps trade in securities).

219. See *Dresdner's Eberstadt*, *supra* note 216 (claiming that a long period of uncertainty caused by the new law will "normalize only slowly").

220. See *supra* notes 213-19 and accompanying text (describing initial reactions to the new Insider Trading Law).

221. See *supra* notes 117-24 and accompanying text (providing definitions of both primary and secondary insiders under the Insider Trading Law).

capable of influencing the financial markets.<sup>222</sup> While the Insider Trading Law expressly covers primary or secondary insiders trading on insider information arising in the corporate context, it is not clear whether the law extends to non-corporate parties possessing insider information, such as macroeconomic data, that nevertheless, could affect entire industries or manufacturing sectors.<sup>223</sup> This concern surfaced only recently as the German Ministry of Economics initiated an investigation into leaks of sensitive ministry financial information on economic indicators for industrial production to Frankfurt-based investors.<sup>224</sup>

## 2. High Cost of Regionalism

The passage of the Second Financial Markets Promotion Act has been a lengthy and, at times, caustic state-federal battle over the creation of a central supervisory body in a strong federal system.<sup>225</sup> While Frankfurt itself is not currently a powerful global financial center,<sup>226</sup> and continues even today to suffer because of its limited role in world financial markets,<sup>227</sup> Frankfurt has attained a financial stronghold in

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222. See *German Economics Ministry*, AFX NEWS, Nov. 15, 1994 (noting that it remains unclear whether government leaks of economic data are covered under the new insider trading law).

223. *Id.*; see *supra* note 128 and accompanying text (noting uncertainty in whether insider information that arises in a non-corporate context, but nevertheless, is capable of affecting securities markets and consequently securities prices, constitutes "insider information" under § 13(1); and, arguing that such information should fall within the law's coverage).

224. See *Ministry Investigating Leaks to Market Speculators*, AGENCE FRANCE PRESSE, Nov. 4, 1994 (discussing how millions of dollars can be made through leaking sensitive financial information to stock exchange investors and noting that economic ministry officials still have no solid evidence regarding the involvement of any particular German government ministry).

225. Eisenhammer, *supra* note 13, at 12.

226. See Templeman & Javetski, *supra* note 14, at 54 (noting that the Frankfurt exchange was a sideshow in 1980, with an annual turnover of just over \$25 million); see also *supra* notes 55, 80, 156 and accompanying text (providing additional information concerning Frankfurt's status as an international financial center).

227. See *Frankfurt Brushes Up*, *supra* note 49, at 16 (noting that Frankfurt's self-esteem recently took a beating when the Deutsche Bank decided to place its international investment banking activities in London, home of the bank's UK merchant banking subsidiary Morgan Grenfell, rather than in Frankfurt); see also Tony Roddam, *Dresdner Bid For Kleinwort is Blow to Frankfurt*, REUTER EUROPEAN BUS. REP., June 15, 1995 (noting that the recent decision of Dresdner Bank, Germany's second largest bank, to buy British investment bank Kleinwort Benson constitutes "another slap in the face of Frankfurt's ambitions to usurp London's financial supremacy" and

Germany.<sup>228</sup> As a result, German legislators recognized that in order to meet their goal of fostering the growth and international competitiveness of the Finanzplatz Deutschland, Frankfurt was the logical place for expansion.<sup>229</sup> The growth of the Frankfurt exchange, however, has run up against the strong tradition of competition between Germany's eight regional exchanges.<sup>230</sup> This battle for financial control among the exchanges, culminating in the fight over Frankfurt's rise to central control, has had detrimental effects on Germany's financial industry as a whole<sup>231</sup> and potentially may prove to be an impediment to the effective enforcement of Germany's new insider trading prohibition.

In October 1992, two years prior to the creation of the Frankfurt-based Federal Supervisory Office, the development of the Finanzplatz Frankfurt took a great leap forward with the creation of the Deutsche Börse AG.<sup>232</sup> The Deutsche Börse AG is a Frankfurt-based holding company that operates the Frankfurt exchange together with Germany's other regional exchanges under a "single financial roof."<sup>233</sup> The Deutsche Börse AG has been instrumental in the centralization of Germany's financial markets by overcoming opposition to change from regional exchanges such as Hamburg, Munich, and Stuttgart.<sup>234</sup> The Deutsche Börse AG, due in part to its strong backing by Germany's largest banks, has been successful in promoting greater centralization of Germany's financial markets at the expense of regional exchanges,<sup>235</sup> which have

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"a damning vote of no-confidence in Germany's banking capital—home of the Bundesbank and future European central bank").

228. *See supra* notes 55, 80, 156 and accompanying text (providing information on Frankfurt's status as a financial center).

229. *See supra* notes 55, 80, 156 and accompanying text (alluding to Frankfurt's central role in making the Finanzplatz Deutschland more attractive to foreign investors).

230. *World Equity Markets*, *supra* note 80, at 11 (noting that Germany's financial services industry has been fragmented because eight regional exchanges have traditionally competed against each other in the German market).

231. *Id.* (noting that for years the structure of German capital markets has prevented the development of a central market and that the traditional competition between Germany's eight regional exchanges has been detrimental to the industry as a whole).

232. *Id.*

233. *See Whitney*, *supra* note 57, at 1 (applauding the new structure for its efficiency and technological sophistication. Recognizing critics' claims that banks have created an exchange that only heavily capitalized players can afford to use. Furthermore, noting that smaller brokerage firms find telecommunications technology, electronic record-keeping, and transaction fees too costly).

234. *Id.*

235. *See id.* at 1 (noting that the Deutsche Bank's board member responsible for

had much to gain from the expansion of the Frankfurt market.<sup>235</sup> Only a few years ago, the primary players on Germany's stock markets were small private bankers and brokerage firms.<sup>237</sup> As activity on the Frankfurt exchange increased and most of the lucrative players in the German capital market moved to Frankfurt,<sup>238</sup> these smaller players were effectively forced onto the sidelines.<sup>239</sup>

The continued growth of Frankfurt as Germany's financial center has caused the *Länder* and their respective exchanges to scramble for control in the new securities enforcement structure and, as a result, has ignited an entrenched debate about the future of Germany's eight regional exchanges.<sup>240</sup> If effective enforcement can only be achieved through greater centralization, it appears inevitable that the battle between expanding central control and traditional regional governance will not be short-lived. Maintaining eight regional exchanges and their respective regional supervisory authorities is a costly method of enforcing the insider trading ban.<sup>241</sup> Arguably, the high cost of maintaining

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securities sales and trading, Rolf E. Breuer, is also the chairman of the Deutsche Börse AG). His position is indicative of the strong hold German banks have over the Frankfurt exchange. Moreover, the composition of the supervisory council of the Deutsche Börse AG, the policy-setting organ for the Frankfurt Exchange, illustrates the essential role German banks play in directing the growth and development of Germany's financial markets. Primarily, Germany's big banks dominate the decision-making council of the Deutsche Börse AG and only a minority of the council's members represent the stock brokers and the regional exchanges. *Weichenstellung der Deutschen Börse; Zentralisierung und Elektronisierung des Handels* [The Position of the Deutsche Börse; Centralization and Electronization of Trading], NZZ, May 26, 1995 (noting that shareholders of the Deutsche Börse AG are the banks with 81%, the stockbrokers (Makler) with 9% and a pool of the regional exchanges with 10%).

236. See Whitney *supra* note 57, at 1 (noting that banks have had much to gain from expansion of the Frankfurt market).

237. See *id.* at 1 (stating that small banks and brokerage firms were active traders on Germany's stock markets).

238. See *id.* at 1 (noting that Frankfurt is the home base for Germany's three biggest banks: the Deutsche Bank, Dresdner Bank, and Commerzbank).

239. See *id.*

240. See Helga Einecke, *Förderung statt Föderalismus* [Promotion Not Federalism], SZ, Dec. 30, 1994 (discussing the embittered fight of Frankfurt's supremacy over the other seven regional exchanges. In the interest of development rather than federalism, Frankfurt should consider a mutually agreeable resolution).

241. See *Finanzplatz Deutschland hat gewonnene Börsenreform aber noch nicht am Ziel. Aufsichtsratsvorsitzender Breuer kritisiert teures Regionalprinzip und Zinsbesteuerung* [The Financial Marketplace Germany Has Not Yet Accomplished Successful Stock Exchange Reform. Board of Directors Head Breuer Criticises Expensive Concept of Regionalism and Taxation], SZ, Feb. 2, 1994 (summarizing the state-

Germany's eight regional exchanges outweighs the benefits attainable through the proposed complex and far-reaching structure.<sup>242</sup> As commentators have noted, the three-tiered enforcement structure is a victim to federalism depending on the cost factor.<sup>243</sup> As trading activity decreases on the smaller exchanges, the cost question comes more frequently into play.<sup>244</sup>

As the market in Germany begins to react to what investors view as the potentially dwindling power-base of the regional exchanges, the cost question becomes more acute. A large German chemical conglomerate, BASF AG, only recently publicized its decision to de-list its shares from all exchanges except the Frankfurt exchange.<sup>245</sup> If successful,<sup>246</sup> other publicly-held, listed corporations likely will follow this move.<sup>247</sup> Such

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ments made by Rolf E. Breuer, head of the Deutsche Börse AG, criticizing the expensive principle of regional supervision).

242. See *Bankverband*, *supra* note 213 (noting that a three-tiered surveillance structure is not an ideal solution in light of cost and efficiency factors).

243. See *Bank-Vorstand Eberstadt*, *supra* note 216 (stating that the ability of the three-tiered enforcement structure to function properly is largely a question of cost. It is likely that the centralized Frankfurt market may establish an electronic surveillance function over other exchanges in the future).

244. See *Einecke*, *supra* note 240 (noting that the costs for electronic equipment and personnel will be difficult for smaller exchanges with sinking trading volumes to meet).

245. See *Deutschland: BASF Spielt Börsenentscheidung Herunter [Germany: BASF Plays Down Exchange Decision]*, REUTER GERMAN NEWS, Dec. 1, 1994 (discussing BASF AG's decision and legal defenses); see also *Frankfurt Brushes Up*, *supra* note 49, at 16 (noting that BASF AG's decision was a surprise).

246. See *Deutschland: Breuer Kritisiert Börsen Wegen BASF [Germany: Breuer Criticizes Exchanges Because of BASF]*, REUTER GERMAN NEWS, Mar. 16, 1995 (stating that the regional exchanges have refused to permit BASF AG to withdraw its shares from listing on their exchanges and have threatened administrative court action against BASF AG on this matter); see also *id.* (noting that Rolf E. Breuer, board member of the Deutsche Bank and head of the Deutsche Börse AG, criticized regional exchanges' lack of cooperation as follows: "If the clients do not show up at the vegetable woman's stand at the weekly market, she goes home and not to court."). Despite the threat of administrative action, the Deutsche Börse AG's proposal to close half of the regional exchanges, if legislatively implemented, does not appear to run afoul of any legal prohibition or constitutional impediment. *Towards a German Financial Center*, *supra* note 49, at S112 (stating that under the Basic Law, the enactment of legislation amending the Stock Exchange Act is fully within the domain of the federal legislature, even though legislative procedure grants the Länder an opportunity to consult with the federal government in the legislative process).

247. See *Frankfurt Brushes Up*, *supra* note 49, at 16 (claiming that if the sale of shares is successful it could encourage others to do the same).

actions will erode the ability of smaller exchanges to raise the capital needed to implement the expansive supervisory mechanisms required under the new law<sup>248</sup> and, in the end, may cause regional trading structures to collapse.<sup>249</sup>

In late 1994, the Deutsche Börse AG released a draft thesis as a formal response to the growing concern over the cost effectiveness of maintaining an operational, three-tiered enforcement structure throughout the eight *Länder* and exchanges.<sup>250</sup> The thesis recommended distributing control over specified areas of trading to the Frankfurt, Berlin, Düsseldorf, and Munich exchanges and closing the remaining four exchanges in Stuttgart, Hannover, Hamburg, and Bremen.<sup>251</sup> Specifically, the thesis envisioned that Frankfurt would take full control over the trade in German standard stocks (*Standardaktien*), which primarily include DAX blue chip stocks; that Düsseldorf would become the new home for Germany's futures market; and that Munich and Berlin would gain sole responsibility for the southern and northern German regional securities markets respectively.<sup>252</sup>

The strong opposition to the proposed closure of half of Germany's regional exchanges from both the regional exchanges and the *Länder* governments<sup>253</sup> successfully impeded the implementation of the Deut-

248. See *supra* notes 239-44 and accompanying text (discussing problems resulting from the high cost of regionalism for regional exchanges).

249. See *Frankfurt Brushes Up*, *supra* note 49, at 16 (speculating that other regional exchanges soon may be serving advisory roles rather than a trading role).

250. See *McKinsey plädiert für die Schliessung von vier deutschen Regionalbörsen. Konzentration auf restliche Handelsplätze angeregt* [Strategy theses sorgen für Wirbel] [*McKinsey opts for the closing of four German regional exchanges. Concentration on Remaining Trading Places Recommended*] [Strategy Thesis Causes Commotion], *SZ*, Nov. 12, 1994 [hereinafter *McKinsey*] (discussing strategy thesis and the respective realms of competence it proposes to create); *Harsche Kritik an Börsenthesen. Bremen Befürchtet Schliessung Aller Regionalen Handelsplätze* [Harsh Criticism of Exchange Thesis. Bremen Fears Closure of All Regional Exchanges], *SZ*, Nov. 15, 1994 [hereinafter *Harsche Kritik*] (discussing the negative reaction of regional exchanges towards the thesis proposal).

251. *Harsche Kritik*, *supra* note 250.

252. *McKinsey*, *supra* note 250.

253. *Harsche Kritik*, *supra* note 250. Opponents of the thesis raised two basic arguments. First, they argued that the financial markets in Berlin, Düsseldorf, and Munich would receive an enormous advantage to the detriment of the markets in Stuttgart, Hannover, Hamburg, and Bremen. See *supra* notes 249-52 and accompanying text (describing proposal to allocate specialized functions to select regional exchanges and close remaining exchanges). Second, opponents feared that the proposal to close the specified exchanges would result primarily from political pressures, rather than

sche Börse AG's strategy thesis.<sup>254</sup> Nevertheless, it forced the strongest of Germany's regional exchanges to take matters into their own hands. In May 1995, the exchanges of Frankfurt, Munich, and Düsseldorf entered into an agreement for far-reaching cooperation in the securities trade with the intent of strengthening the liquidity and efficiency of the German securities market.<sup>255</sup> Even though the agreement does not require the merger of the three exchanges into a single entity, the agreement calls for extensive cooperation in the trading of DAX stocks and allows for greater development of the regional securities market's pricing policies by the regional exchanges.<sup>256</sup> While some of the remaining exchanges are considering entering a cooperation agreement amongst them-

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impartial financial analyses focusing, for example, on the exchanges' respective trading volume. See McKinsey, *supra* note 250 (citing Wolfgang Peterhoff, the head of the Düsseldorf exchange, as stating that he would not oppose economically rational innovations, but that it was not clear whether the plans for restructuring German financial markets were truly economical); see also Harsche Kritik, *supra* note 250 (charging Deutsche Börse AG of trying to manipulate securities trading in Frankfurt in order to transfer all trading to an electronic trading system); cf. Blum, *supra* note 18, at 507 n.3 (noting that Hamburg is the third most important regional exchange in Germany and basing this conclusion on data of turnover in domestic shares and percentage share of domestic bonds, foreign shares, and foreign fixed-interest securities markets).

254. See *Die Börsen in Frankfurt, Düsseldorf und München planen eine enge Kooperation. Absichtserklärung unterzeichnet/Einheitliche Preisfindung bei DAX-Werten vorgesehen* [The Exchanges in Frankfurt, Düsseldorf, and Munich Plan a Close Cooperation. Agreement of Intent is Signed/Conformity in Setting DAX Prices Intended], SZ, May 9, 1995 [hereinafter *Kooperation*] (noting that the competent Ministers for the Länder ruled against the non-market determined closure of the four regional exchanges since such closure would cause the number of market participants and the liquidity of the market as a whole to diminish).

255. *Id.*

256. *Id.* While sources have noted that the agreement mandates the implementation of a common exchange surveillance and admissions authority, *id.*, the creation of such common bodies apparently requires prior legislative approval. See Bernhard Wild, *Kurse der Regionalbörsen sinken. Die Zukunft der kleinen Finanzplätze ist ungewisser denn je* [Trading on the Regional Exchanges is Decreasing. The Future of the Small Financial Marketplaces is More Uncertain than Ever], SZ, May 13, 1995 (noting that such legislative approval may take the form of a third Financial Markets Promotion Act).

selves,<sup>257</sup> they appear to have missed the only train for ensured survival.<sup>258</sup>

Overall, Germany's current regional exchange structure poses a serious impediment for the successful implementation of the insider trading prohibition and the general policy behind the Second Financial Markets Promotion Act.<sup>259</sup> Both federal and state authorities in Germany have recognized the importance of ensuring continued international competitiveness of Germany's securities markets and thus, have forged a new path for greater centralization of Germany's exchanges.<sup>260</sup> While adherence to traditional, albeit antiquated, concepts of federalism are difficult to overcome for some German *Länder*,<sup>261</sup> greater centralization of

257. See, e.g., *Kleine Börsen suchen nach Gemeinsamkeiten* [Small Exchanges Search for Similarities], SZ, May 16, 1995 (citing comments of the President of the Hannover Exchange, Dirk Hoffman, on intended discussion among smaller exchanges to explore possibility for cooperation); *Deutschland: Hamburger Börse zu Kooperationen bereit* [Germany: Hamburg Exchange Is Willing to Cooperate], REUTER GERMAN NEWS, May 16, 1995 (noting willingness of Hamburg exchange to enter into a cooperation agreement with other exchanges, as long as such cooperation does not include a merger with other exchanges); *Deutschland: Bremer Börse Weiter Gegen Frankfurt Börsenplan* [Germany: Bremen Exchange Continues to Oppose the Frankfurt Exchange Strategy], REUTER GERMAN NEWS, May 22, 1995 (supporting mutual cooperation, but not fusion); *Börse Berlin bedingt kooperationswillig* [Berlin Exchange is Conditionally Willing to Cooperate], SZ, May 10, 1995 [hereinafter *Börse Berlin*] (noting willingness of Berlin Exchange to join cooperation agreement between Frankfurt, Düsseldorf, and Munich and stating that Stuttgart Exchange hopes to stay independent).

258. See Wild, *supra* note 256 (citing the Director of the Munich Exchange, Heinz W. Schmitt, as stating that "the train goes on towards Frankfurt and cannot be delayed any longer," and noting that Schmitt obviously decided to go right along with that train); see also *Börse Berlin*, *supra* 257 (noting that Frankfurt has rejected Berlin's offer to join the cooperation agreement with Frankfurt, Düsseldorf, and Munich).

259. See *supra* notes 225-58 and accompanying text (discussing the problems that Germany's regional and decentralized exchange structure pose for the successful enforcement of the insider trading prohibition and the effective promotion of Germany's financial markets to foreign and domestic investors).

260. See *supra* notes 232-58 and accompanying text (discussing initiatives to encourage greater centralization of Germany's financial markets, including the creation of the Deutsche Börse AG, the Deutsche Börse AG's strategy thesis, and the cooperation agreement between Frankfurt, Munich, and Düsseldorf).

261. Cf. *Martini plädiert für drei Börsenplätze* [Martini Argues for Three Exchanges], SZ, July 10, 1995 (citing Eberhard Martini of the Bayerischen Hypotheken- und Wechsel-Bank AG in Munich as stating that the current decentralized system of eight regional exchanges is an "anachronism" which foreign countries simply would not



Germany's financial markets will prove essential in ensuring effective and standardized enforcement of Germany's insider trading prohibition and, thus, in promoting the international competitiveness of the Finanzplatz Deutschland.

### 3. Market for Highly Capitalized Players

A third barrier to meeting the underlying goal of the insider trading prohibition of expanding the Finanzplatz Deutschland through the attraction of greater equity investment in German capital markets is rooted in the reality that<sup>262</sup> the German financial market remains a market for highly capitalized players. The banking and brokerage fees, as well as the prices of stocks listed on the German exchanges, remain too high to attract needed equity capital. These two areas will be considered in turn.

#### a. Banking and Brokerage Fees

While German legislators, in order to attract greater equity investment, have abolished elements of a previously disadvantageous tax structure,<sup>263</sup> the fees imposed on investors in the German stock market remain exorbitant.<sup>264</sup> Banks and brokers alike charge heavily for equity custody services through variable bank and high broker commissions, respectively.<sup>265</sup> While the new law does not create any incentives for

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understand).

262. See *supra* notes 44, 46-58 and accompanying text (describing measures taken to improve the Finanzplatz Deutschland).

263. See Blum, *supra* note 18, at 509 (listing taxes on the purchase and sale of stock as one reason why German markets failed to attract small German investors); see also *World Equity Markets*, *supra* note 80, at 11 (noting that the German exchange tax was abolished at the end of 1990).

264. See, e.g., Blum, *supra* note 18, at 509 (showing relatively high, fixed broker commissions as another reason why small German investors have no incentive to invest in equity securities); *World Equity Markets*, *supra* note 80, at 11 (noting that investors in Germany are liable to brokers for a commission of 0.06% and to bankers for a variable commission covering "liquidation, settlement, investment advice and analysis" which is "linked to the size of the transaction"); *Equity*, *supra* note 46, at 82 (explaining that by charging heavily for equity custody services, banks reduce the value of dividend income to smaller investors and, in turn, effectively discourage investors from buying shares).

265. See *supra* note 264 (discussing high bank and broker fees); see also Frank Elsner, *Immer mehr Firmen locken Kleinanleger mit Fünf-Markt-Aktien. Doch hohe Bankgebühren schrecken die Sparer ab* [Ever More Firms Attract Small Investors with Five-Mark-Stocks, High Banking Fees, However, Scare Investors Away], *DIE WOCHE*,

lowering such equity investment fees,<sup>266</sup> a few banks, on their own initiative, opened discount brokerage houses to make lower cost investment services available to smaller, non-institutional investors.<sup>267</sup> Nevertheless, despite such limited, market-driven attempts at lowering the market entry costs for smaller investors, the banks have not been overly active in promoting their discount houses. In addition, it does not appear that such houses will provide smaller investors with the degree of investment advice and guidance otherwise available through traditional investment services.<sup>268</sup>

Furthermore, it is likely that the exchanges will suffer considerably higher operation costs in the next few years as a result of the gradual transition from a floor to an electronic trading system<sup>269</sup> and the creation of an expensive exchange surveillance structure as mandated by the new law.<sup>270</sup> The exchanges, in turn, will not be interested in charg-

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May 5, 1995, at 14 (noting that the high fees, usually not below DM 50, charged by German banks both at the time of purchase and sale of stocks represents the largest barrier against investment in German securities for small investors and further noting that even "dream dividends" will not overcome such investment costs).

266. See FmFG, *supra* note 2, at 1749-85 (failing to provide mandatory or discretionary incentives to lower such fees).

267. See Elsner, *supra* note 265, at 14 (noting that numerous financial institutions have established subsidiaries specializing in the securities trade, called "Discount Brokers," which do not offer personal consultations and, thus, are able to provide services at half the usual cost. Furthermore, pursuant to a study by the foundation Warentest, such discount brokerage services are only advantageous to individuals investing over DM 5000 and engaging in active trading).

268. See *supra* note 267 (noting that discount houses do not offer personal consultations).

269. See *Computerbörsen*, *supra* note 80 (discussing the Deutsche Börse AG's new proposal, officially announced on May 30, 1995, under the project name "ZEUS," to implement a complete electronic trading system in Germany in the next three to five years and gradually phase out floor trading; noting that computerized auctions will soon determine the course of the most heavily traded securities while broker-dealers will retain control over the less popular securities; and, finally, commenting that the new electronic trading system will be enormously expensive). While the modernization of Germany's exchange trading system is essential in ensuring greater competitiveness of Germany's securities markets with the United States and Japan, technological improvements will undoubtedly raise the cost of investment in German securities. See *Politische Skepsis gegenüber dem "Zeus" Project* [Political Skepticism About "Zues" Project], NZZ, July 7, 1995, at 31 [hereinafter *Politische Skepsis*] (discussing impact of electronic trading system on Germany's international competitiveness).

270. See *supra* notes 199-206 and accompanying text (describing regional surveillance structure); see also *supra* notes 207-10 and accompanying text (describing exchange surveillance structure).

ing its participants, brokers and credit institutes, lower fees. These players, as a result, will pass their higher costs, particularly those incurred in funding the Federal Supervisory Office and its subordinate surveillance structures, on to the investor.<sup>271</sup> As it becomes more difficult for smaller investors to meet these investment-related expenses, they likely will choose not to invest in German equity securities.

*b. Stock Prices*

The prices of stocks listed on the German exchanges are much higher than those of its foreign counterparts and have traditionally dissuaded the non-institutional investor from entering the German equity market.<sup>272</sup> The Second Financial Markets Promotion Act recognizes the problem that expensive stocks pose for the successful allure of equity capital and has initiated the useful reform of lowering the mandatory par value of German shares from DM 50 to DM 5.<sup>273</sup> Overall, legislators hope this reform will encourage more people to buy shares on the German stock market.<sup>274</sup>

While the reform of the German share price structure calls only for voluntary compliance, several of Germany's largest public corporations<sup>275</sup> and financial institutions, including Germany's third largest

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271. See *supra* note 152 (discussing distribution of funding for the Federal Supervisory Office).

272. See, e.g., *World Equity Markets*, *supra* note 80, at 11 (stating that the current value of German equity shares is too expensive for the average German non-institutional investor); *Equity*, *supra* note 46, at 82 (reporting that only 6% or 7% of the households in Germany own shares as compared to 20% in the UK and 30% in the United States); *Survey of Germany*, *supra* note 50, at V ("[T]he market capitalization of German shares is equivalent to some 30 per cent of GNP, again far lower than elsewhere.").

273. FmFG, *supra* note 2, art. 16 at 1783-84 (Changing the Exchange Listing Requirements); see *Equity*, *supra* note 46, at 82 (stating that lowering the nominal value of German shares is a useful reform since high nominal values have prevented investors from buying diversified portfolios).

274. Gallagher, *supra* note 124.

275. See, e.g., *Fielmann liebäugelt verstärkt mit dem Ausland. Börsengang verschafft Europas größten Optiker Kapital für weitere Expansion [Fielmann Flirts More Strongly With Foreign Countries. The Course of Trading Brings to Europe's Largest Optician Capital for Further Expansion]*, SZ, Sept. 6, 1994 (noting that Fielmann AG, Europe's biggest optician, is the first German company to issue preferred stock at a list price of 5 DM); Elsner, *supra* note 265, at 14 (reporting that numerous German companies, including Escom, Metallgesellschaft, and Schering, are following the lead of Fielmann in offering so-called baby stocks. In addition, commenting that

bank, Dresdner Bank,<sup>276</sup> have already begun to issue stock at a list price of DM 5, or plan to do so in the near future.<sup>277</sup> Nevertheless, the Deutsche Bank and the Commerzbank are currently refusing to follow in the footsteps of the Dresdner Bank and introduce a so-called "baby stock."<sup>278</sup> Moreover, critics remain skeptical about the ability of the DM 5 stocks to cause an increase in the investment of stock certificates because dividing a share into smaller units only means higher administrative costs.<sup>279</sup> In part to address higher administrative costs and to maintain the traditional investment climate in Germany, German banks have countered the lower stock prices by only selling such securities in

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Fielmann stocks have been extremely active over the last eight months due to Fielmann's decision to offer securities at a DM 5 par value, or DM 44.50 per share, as compared to an otherwise DM 445 value per share for a DM 50 par value); *Daimler profitiert vom China-Projekt. Favorit KHD / Bankaktien leichter / Schleppender Rentenhandel* [Daimler Profits from China Project. Favorite KHD/Bank Stocks are Lighter/Slow Annuity Trade], SZ, July 13, 1995 (announcing that the company KHD is profiting from adopting a DM 5 par value for its stocks by incurring a 7.7% increase in trading activity); *Veba stellt auf Fünf-DM-Aktien um* [Veba Adopts Five-DM-Stocks], SZ, July 17, 1995 (indicating that Veba AG adopted a par value of DM 5 in order to attract smaller investors).

276. *Deutschland: Dresdner Bank führt 5-DM-Aktie ein* [Germany: Dresdner Bank Introduces 5-DM-Stock], REUTER GERMAN NEWS, Dec. 6, 1994; *Dresdner Bank lockt mit 5-DM-Aktie* [Dresdner Bank Tempts Investors with 5-DM-Stock], SZ, Dec. 7, 1994; see Elsner, *supra* note 265, at 14 (noting that the Bayerische Vereinsbank and Allianz-Versicherung have also decided to offer stocks at the lower DM 5 par value).

277. See, e.g., *Daimler Greets Approval of Five Mark Share*, REUTER ECON. NEWS, July 8, 1994 (stating that Daimler will issue five mark shares "as soon as possible" and noting that one 50 DM Daimler shares currently costs about 725 DM); Ashley Seager, *Daimler Welcomes New Law on Five Mark Shares*, REUTER EUROPEAN BUS. REP., July 8, 1994 (noting that at the next annual shareholder meeting in May 1995, Daimler will seek the approval of its shareholders for a "10-for-one share split"); *Germany Wakes Up*, *supra* note 215 (describing that in the privatization of Deutsche Telekom, Germany's telecommunications monopoly, Telekom will issue "people's share[s]" at 5-DM-shares to reach the ordinary German investors).

278. See *Deutschland: Deutsche Bank Wartet Mit Fünf-DM-Aktie Ab* [Germany: Deutsche Bank Holds Off on 5-DM-Stock], REUTER GERMAN NEWS, Dec. 7, 1994 (referring to Deutsche bank's reluctance to follow lead of Dresdner Bank); see also *Commerzbank mischt im Poker um Holzmann Mist. Alles ist eine Frage des Preises / Kohlhaussen äußert sich skeptisch zu 5-DM-Aktien* [Commerzbank Makes Smoke for Holzmann. Everything is a Question of the Price. Kohlhaussen Makes Sceptical Remarks About 5-DM-Stock], SZ, Sept. 21, 1994 [hereinafter Kohlhaussen] (noting skepticism of Commerzbank to issue a 5-DM-stock).

279. Kohlhaussen, *supra* note 278.

big bundles or by calculating transaction fees to the disadvantage of purchasers of less-weighty stocks.<sup>280</sup>

In the end, the opening up of the German stock market to smaller, non-institutional investors depends primarily on the actions of the German banking community.<sup>281</sup> German banks, to a large extent, control the public corporations listed on the exchanges<sup>282</sup> and, thus, have considerable influence on the stock pricing policies of such corporations.<sup>283</sup> The banking world in Germany has much at stake in the regulation of German financial markets and hopefully will enact reforms liberalizing their conservative investing policies to date, if not on their own initiative, then as a result of mounting public and political pressures.<sup>284</sup>

### III. RECOMMENDATIONS

Relying on the previous discussion of barriers to the effective implementation of Germany's new insider trading legislation, this Comment proposes several recommendations for ensuring effective enforcement of the Insider Trading Law and successful implementation of the primary motivation behind its prohibitions, namely the promotion of the Finanzplatz Deutschland both in the domestic and international realm.

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280. See Elsner, *supra* note 265, at 14 (stating that the banks are creating new barriers to "keep small investors away" by only offering newly-issued DM 5 par value stocks in bundles and by calculating their banking transaction fees according to the number of stocks sold not, as previously determined, according to a percentage of the total value of the stocks sold).

281. See *Bankgebühren bedrohen leichte Aktie. Kleinaktionäre ziehen eine ernüchternde Dividenden-Bilanz* [Bank Fees Threaten Eight Stocks. Small Stockholders Carry a Sobering Divident Balance], SZ, Aug. 9, 1994 (noting that a trade association for small stockholders welcomes the new price reform, but does not trust German banks since they are likely to raise banking fees proportionally to the increase in stock splits. This would result in the creation of smaller nominal shares from larger shares). But see *Bank-Vorstand Eberstadt*, *supra* note 216 (arguing that the criticism directed against banks for only issuing shares in big blocks was unfair because the banks should not have to carry all of the costs).

282. See *Some Differences*, *supra* note 215, at 1955 (describing the powerful role German banks play in running German public corporations and noting that German banks substantially control the German securities market).

283. See Guidelines, *supra* note 23, at §70 (describing how a German bank participating in the issuance of equity traditionally "[w]ill take care of the price development of a security on the stock exchange" under the premise of "Kurspflege").

284. See Mark J. Roe, *German "Populism" and the Large Public Corporation*, 14 INT'L REV. L. & ECON. 187 (1994) (describing the effect of political pressure on German banks).

## A. CENTRALIZATION OF GERMANY'S REGIONAL EXCHANGE STRUCTURE

First, German legislators should take steps to minimize the high cost of regionalism arising from the currently-envisioned, three-tiered securities enforcement structure.<sup>285</sup> Specifically, the federal legislature should give great weight to the Deutsche Börse AG's proposal to close Germany's smaller regional exchanges. As the new agreement between the exchanges of Frankfurt, Düsseldorf, and Munich illustrates, the market clearly needs some measure of greater cooperation among the German exchanges. This could result in the more efficient operation of the exchange structure as a whole, possibly culminating in the merger of the Frankfurt, Munich, and Düsseldorf Exchange and the closure of Germany's remaining six regional exchanges.

Despite the cost and efficiency benefits of creating only one centralized trading center in Frankfurt, it would be disadvantageous for Germany to take all regional exchanges out of the securities playing field entirely. Maintaining the operation of a few of the strongest regional exchanges in Germany will help foster competition among the German financial markets and, thereby, help improve the Finanzplatz Deutschland's ability to compete internationally.<sup>286</sup> The regional exchanges also serve a useful role in providing market access to smaller and medium-sized companies in Germany, who would suffer if they were forced to enter Frankfurt's more competitive financial environment.<sup>287</sup> In addition, Germany's smaller regional exchanges may be better qualified, than the Frankfurt exchange, to provide specialized, customer-oriented services, particularly attractive to smaller, non-institutional investors. For example, they could extend their hours of operation, with-

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285. See *supra* notes 224-61 and accompanying text (discussing the cost-benefits of restructuring Germany's decentralized exchange structure).

286. See *Deutschland: LZB-Chef Krupp Gegen Börsen-Konzentration [Germany: LZB-Head Krupp Opposes Concentration of Exchanges]*, REUTER GERMAN NEWS, Jan. 11, 1995 (arguing that limiting the stock trade to Frankfurt alone would restrict competitiveness within Germany and would jeopardize Germany's ability to compete internationally); see also *Fischer will Regionalbörsen erhalten. Niedersachsens Minister kritisiert Thesenpapier [Fischer Wants to Maintain Regional Exchanges. Niedersachsen Minister Criticises Thesis Paper]*, SZ, Jan. 14, 1995 [hereinafter *Regionalbörsen*] (stating that the concentration of the securities business in one city would limit the number of participants and be detrimental for the entire Finanzplatz Deutschland).

287. See *Regionalbörsen*, *supra* note 286 (fearing that smaller companies would go under in the Finanzplatz Frankfurt because no one would pay any attention to them on the larger exchanges).

in the limitations of the German business law, and provide more personalized services.<sup>288</sup>

Nevertheless, it is inevitable that the Finanzplatz Deutschland will suffer, with respect to its international competitiveness, if all seven regional exchanges, aside from Frankfurt, remain operative for much longer. Although market forces probably will bring about the closure of Germany's smaller regional exchanges in the next few years, the earlier German authorities create a workable and efficient securities exchange structure, the sooner they will be successful in their attempts to optimize the competitiveness of the Finanzplatz Deutschland.

#### B. MODERNIZATION OF GERMANY'S EXCHANGE TRADING SYSTEM

Second, federal and state German legislators should recognize that the Deutsche Börse AG is encouraging the development of an innovative and sophisticated electronic trading system in Germany.<sup>289</sup> A state-of-the-art electronic trading system in Germany is essential for insider trading enforcement efforts by providing more precise record-keeping of securities trading and greater market transparency.<sup>290</sup> Such a system will also ensure Germany's position as a European financial center. In addition, it will help Germany establish a special niche in its struggle for global recognition in the international investing community.<sup>291</sup>

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288. See *Deutschland: Regionalbörsen Erwägen Längere Handelszeiten* [Germany: Regional Exchanges Consider Longer Trading Times], REUTER GERMAN NEWS, Feb. 6, 1995 (noting that the regional exchanges are considering extending their hours of operation); see also *Deutsche Börsen auf der Suche nach neuen Wegen; Entdrückende Vorherrschaft Frankfurts* [German Exchanges in Search of New Ways; Frankfurt's Envious Lead], NZZ, Jan. 17, 1995 (recognizing that regional exchanges must look for specialized tasks in order to survive. For example, the Hamburg exchange is interested in attracting small companies to their exchange that previously had difficulty gaining access).

289. See *supra* note 80 and accompanying text (describing the IBIS trading system and proposals to expand this system into a computerized auction exchange).

290. See Netzer, *supra* note 52 (noting that while tips, not irregularities in trading data, primarily led to the discovery of most insider trading cases in the past, tips will become less important "as more trades become visible through on-line trading"); see also *Abstimmung über das Zeus-Projekt. Deutsche Börse vor entscheidender Weichenstellung* [Consensus on the Zeus-Project. German Exchange Faces Decisive Turning Point], SZ, May 23, 1995 (noting that the ZEUS project will allow the public listing of all orders for the purchase and sale of securities (offenes Auftragsbuch), thereby contributing to greater market transparency).

291. See *supra* notes 80-84 and accompanying text (describing the importance of a state-of-the-art electronic trading system for competing internationally).

### C. PROVISION OF MARKET ACCESS FOR NON-INSTITUTIONAL INVESTORS AND SMALL AND MEDIUM-SIZED GERMAN FIRMS

While a more centralized exchange structure and an electronic trading system will help attract a greater number of institutional investors to Germany's capital markets and promote the international competitiveness of the Finanzplatz Deutschland, such innovations will be costly. German legislators must take steps to prevent the costs incurred in improving the financial investment structure in Germany from jeopardizing the ability of non-institutional investors from investing in Germany's securities markets, and smaller and mid-sized German companies from obtaining equity financing. German authorities may be able to decrease the financial burden of investing in German equity markets by enabling greater competition among the providers of investment services or by financing some of the costs for improving the Finanzplatz Deutschland with federal funds.

### D. CREATION OF CIVIL AND ADMINISTRATIVE REMEDIES

With respect to the effective enforcement of the Insider Trading Law, German legislators should recognize the limitations inherent in enabling only criminal prosecution of insider trading violations and enact measures allowing for both administrative and civil actions.<sup>292</sup> Establishing a wider variety of judicial measures for combatting insider trading will ensure, first, that fewer insider traders are able to avoid detection and punishment,<sup>293</sup> and second, that the limited enforcement resources of the Federal Supervisory Office are put to their best use.<sup>294</sup> In many

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292. See *Kein Papiertiger*, *supra* note 69 (stating that the Insider Trading Law's provisions are not accessible to private parties seeking compensation for damages. The law was issued for the purpose of improving Germany's capital markets not for the purpose of creating private rights of action).

293. See *Dealing*, *supra* note 72 (noting that Britain's tough criminal prohibitions on insider trading are less effective than the American approach, which are mostly civil cases that encourage insider defendants to settle without going to trial and criminal prosecutions are left for the serious cases); *Insider am Geldbeutel treffen [Hit Insiders at Their Wallets]*, SZ, Aug. 9, 1994 (finding that Americans solved problems involved in criminally prosecuting insider traders by requiring persons to disgorge illegally gained profits prior to imposing criminal liability).

294. Compare FLETCHER, *supra* note 11, at 6 n.22, 25 (noting that the SEC's fiscal 1989 budget was \$142.6 million, of which \$45 million were allocated to enforcement and that the Enforcement Division has a staff of 650 lawyers) with *supra* note 157 (noting that the Federal Supervisory Office has a current budget of \$7.6 million



other countries, like the United States, criminal prosecution of insider trading violations supplements an expansive civil and administrative enforcement scheme meant to catch the so-called big fish.<sup>295</sup> Furthermore, in criminal actions the burden of proof is generally higher than that for civil or administrative actions and the scope of available remedies is limited.<sup>296</sup>

#### E. PURSUIT OF STRONG AND SUCCESSFUL CASES EARLY ON

Finally, the new class of federal securities enforcement officials need some early convictions of individuals who violate the new Insider Trading Law. While attempts to prevent insider trading violations from occurring in the first place, through such requirements as ad hoc publicity,<sup>297</sup> are important, quick and effective enforcement efforts are essential to show the world-at-large that Germany is taking its new role in global securities regulation seriously.<sup>298</sup>

#### CONCLUSION

German legislators have made great strides toward improving the Finanzplatz Deutschland by enacting the Second Financial Markets Promotion Act with the Insider Trading Law as its centerpiece. Overall, the law provides for a comprehensive insider trading prohibition and an expansive three-tiered enforcement structure. The law grants the new Federal Supervisory Office a wide realm of enforcement authority pre-

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and expects to hire a staff of 97).

295. See FLETCHER, *supra* note 11, at 525 (describing areas of enforcement under United States securities laws, such as administrative and criminal sanctions and institutional liability).

296. Langevoort, *supra* note 147 (noting (i) that the burden of proof under criminal securities laws is only circumstantial which makes conviction extraordinarily difficult; and (ii) that the United States statutory basis for insider trading enforcement combines criminal penalties, civil injunctions, disgorgement and civil penalties, while other countries rely much more on simple criminal enforcement).

297. See *supra* notes 173-83 and accompanying text (describing ad hoc publicity requirement).

298. See *Erster Insiderfall beim Staatsanwalt [The First Insider Trading Case at the Prosecutor's Office]*, SZ, July 8, 1995 (reporting that as of July 1995, the Federal Supervisory Office has initiated investigations into 10 cases of alleged insider trading, half of which still remain open and one of which has been referred to the State Attorney's Office for Prosecution).

misled on a combination of far-reaching mandatory disclosure and comprehensive, continuous surveillance.

The strengths of the Insider Trading Law clearly lie in the daunting scope of its prohibitions and criminal sanctions and the arduous duties it places on all market participants. Coming from a culture of selectively-disseminated insider information and practically limitless opportunities for undetected insider trading, there surely will be a period of initial confusion and opposition among market participants. These sentiments likely will pass, but more substantial barriers will remain unless properly dealt with.

The primary weaknesses of the new law derive not from the law itself, but from the forces of change it has set in motion. By creating a central federal enforcement agency in a highly federalized structure, the law has effectively depleted the power base of the states and given free reign to a centralized market structure. By imposing the costs for the new agency on the financial community and other market participants, the law has substantially raised the costs for investor participation in Germany's equity markets. In sum, the law has created a market place for highly capitalized players.

The creation of a market for highly capitalized players runs afoul of the primary purpose of the Second Financial Markets Promotion Act. Legislators implemented the Act in order to open up Germany's capital markets to multiple domestic and foreign investors and to attract much needed equity capital. While the Finanzplatz Deutschland, or Finanzplatz Frankfurt as it is now being called, may not turn out to be truly open to unsophisticated investors and small issuers, Germany's new Insider Trading Law, nevertheless, is sufficiently comprehensive to raise investor confidence in German securities markets and attract many new, albeit wealthy, investors.