**Babeș-Bolyai University, Cluj-Napoca**

**Faculty of Law**

# Crimes regarding the Capital Market
# Market Abuse
# - Ph. D. Thesis Abstract -

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**Keywords:** market abuse, Directive no. 6/2003/EC, Market Abuse Directive, Law No. 297/2004, Regulation No 596/2014 on market abuse and Directive 2014/57/EU on criminal sanctions for market abuse, regulated market, financial instrument, Multilateral Trading Facility (MTF), deal transaction, transactions on an order-driven market, primary market, Initial Public Offer, due dilligence report, inside information, primary insider, secondary insider (outsider), insider dealing, misappropriation theory, disclosing inside information (tipping), recommending any other person to acquire or dispose of financial instruments to which that information relates (tuyautage), market manipulation, transactions or orders to trade: (i) which give, or are likely to give, false or misleading signals as to the supply of, demand for or price of financial instruments, or (ii) which secure, by a person, or persons acting in collaboration, the price of one or several financial instruments at an abnormal or artificial level, transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance, dissemination of information through the media or by any other means which gives, or is likely to give, false or misleading signals as to financial instruments, wash sale, pump and dump, concealing ownership, abusive squeeze, scalping, ad-hoc publicity, chinese walls, dealing reports.

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## Abstract

This paper explores an area of criminal law in which not many have had the courage to engage. Until recently, market abuse has been an "exotic" topic in criminal business law (or *white collar* criminality), sporadically approached in the national legal literature.

Due to the vastness of this topic, the scope of this paper is not an exhaustive exposition of all relevant criminal behaviours that might occur on the capital markets but only of those that are truly specific, ie market abuse.

At the legislative level, the aspects regarding the functioning of capital markets are rigorously regulated not only nationally but also at a European level. In fact, one could say that this area is rather the prerogative of the European Union since, most often, the national regulatory framework represents the transposition of European legal provisions. This is also the case for market abuse, since this form of illicit is primarily regulated at the European level by Directive. 6/2003 /EC on market abuse (MAD) and the criminal conducts defined in the national norms represent a national "adaptation" of the EU rules. Consequently, throughout our analysis we took into account not only the law, doctrine and national jurisprudence but also that of other Member States.

Also as a preliminary finding, it must be observed that at European level market abuse was recently the subject of important reforms that resulted in a new regulatory framework: a regulation on administrative sanctions for market abuse directly applicable in the Member States - MAR ( EU Regulation no. 596/2014 on market abuse and repealing Directive 2003/6 / EC of the European Parliament and of the Council and Directives 2003/124 / EC, 2003/125 / EC and 2004/72 / EC of Commission) and the second directive on market abuse that, in opposition to the first, requires Member States to incriminate the serious and intentional forms of market abuse (Directive no. 2014/57 /EU on criminal sanctions for market abuse - MAD II).

According to national legislation, market abuse has a dual nature, being sanctioned not only criminally but also administratively in the "backbone" of the national regulatory framework on capital markets, namely Law no. 297/2004 (hereinafter the Law).

Thus, according to art. 279 sect. b in conjunction with art. 244-245 of the Law, market abuse comprises the following conducts:

**(1)** ***insider dealing*** (trading using inside information) that consists in using inside information by acquiring or disposing of, or by trying to acquire or dispose of, for his

own account or for the account of a third party, either directly or indirectly, financial instruments to which that information relates;

**(2)** ***the adjacent behaviours*** that consist either in disclosing inside information to any other person unless such disclosure is made by the author in the normal course of the exercise of his employment, profession or duties or recommending or inducing another person, on the basis of inside information, to acquire or dispose of financial instruments to which that information relates

and

**(3)** ***market manipulation*** that includes:

(a) transactions or orders to trade:

- which give, or are likely to give, false or misleading signals as to the supply of, demand for or price of financial instruments, or

- which secure, by a person, or persons acting in collaboration, the price of one or several financial instruments at an abnormal or artificial level,

(b) transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance;

(c) dissemination of information through the media, including the Internet, or by any other means, which gives, or is likely to give, false or misleading signals as to financial instruments, including the dissemination of rumours and false or misleading news, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading. In respect of journalists when they act in their professional capacity such dissemination of information is to be assessed, without prejudice to Article 11, taking into account the rules governing their profession, unless those persons derive, directly or indirectly, an advantage or profits from the dissemination of the information in question.

**I. The first Title** contains a short presentation of all the normative elements (or, in other words, the technical aspects) that are essential for understanding stock markets' mechanisms and the rationale for sanctioning market abuse.

All these have previously been "placed" in a historical context, through a short presentation of the financial markets' evolution and the role they occupy in the national and world economy.

**1.** Consequently, **in the first chapter**, we tried to present the importance of the capital markets in the national and international macroeconomic context, revealing the reasons why stock markets represent and indispensable element for the sound functioning of a capitalist economy. The main role of capital markets is to facilitate a shift of resources from those who have a surplus (the investors) towards those who need them (the issuers) - mechanism specific for primary markets. On the other hand, in order for the investors not to remain "stuck" in their previous investments, secondary markets were created, ie markets that provide the "interchangeability" of the financial instruments held by the investor.

**2. In Chapter II of the first title**, we analysed several technical aspects regarding the functioning of capital markets, since their understanding is essential for the identification of the rationale for market abuse and for the "decryption" of the objective content of the interdiction.

In brief, the trading activity on an order-driven stock market has the following timeline: a brokerage contract between the investor and a brokerage firm (SSIF), issuing the trading order by the investor and its transmission to the broker, the registration of the order in the market's order book and the transaction (the sale contract specific for capital markets).

In this context, taking into consideration the problems it raised in the national jurisprudence, we've examined the peculiarities of transactions that refer to a significant volume of financial instruments, their main feature (essential for their exclusion under certain aspects from the scope of market abuse) being that they may be closed not only through negotiation carried out on the stock exchange but also through a process of direct negotiation between buyer and seller.

**3.** In **Chapter III** we've provided some "preliminary" landmarks regarding the reasons behind the decision to incriminate market abuse.

The conclusion we've reached at this point was that, even if, at first, the abusive market conduct was perceived as "natural", firstly because of its "speculative" character, the US Great Crash (1929) provoked a "re-qualification" of market abuse from a tolerated conduct to a "blamed" one.

The US Securities Exchange Act of 1934 was the first to introduce penalties for this type of behaviour. Subsequently (even if a few decades away) the most important European countries (starting with France and Great Britain) adopted a similar approach. This "combative" approach was then unified and "finalised" when the European Directive on insider dealing was adopted in 1989, afterwards through the adoption of MAD and recently through the adoption of MAD II and MAR.

**4.** In the last chapter of the introductory title (**Chapter IV**), we extensively analysed how much European law can influence national law, taking into consideration the strong European influence exerted not only on the national incrimination norms but also on the corresponding norms from other European legal systems.

The conclusion we've reached, also valid for other situations within the same paradigm (the national incrimination norm represents the transposition of a norm enclosed in a directive), was that the alignment of the national norm to the European one may be accepted only if the national norm grants us this possibility, more precisely when the national legislator did not have the intention to derogate from the European norm. Only in this case the norm has the necessary elasticity and allows its alignment to the European norm, without any risks of infringing the principle of legality. Therefore, in this context, given the present form of the national incrimination norms (a loyal copy of the corresponding European texts), the national incrimination norms can significantly be shaped by European law and its interpretation by ECJ.

**II.** In the **second title** (title that represents the centre of gravity of this paper) we proceeded to the actual analysis of the incrimination norms.

A first challenge was to identify the "borders" of the incrimination norms and to identify if they present any common areas with the administrative norm that sanctions market abuse. Even if, as a result of the inconsistency of the national supervisory authority (ASF), the topic can generate a series of debates, we concluded that, at the moment, the delimitation between the scope of the criminal norms and that of the administrative ones is to be made by reference to the *mens rea* (in the case of intentional market abuse the criminal rules are activated, the administrative norm being incident only in cases of negligent market abuse).

In this context, we formulated some *de lege ferenda* proposals. In this respect, we have shown that, in our view, a system of normative coexistence of the two types of sanctioning norms, with the exclusion of one in favour of the other, as a result of an *in concreto* evaluation based on well individualized and stable criteria established by an authority with mixed competences (authority competent in the administrative sanctioning of market abuse and with competences for prosecuting such conducts), would be more likely to increase the efficiency of the sanctioning norms for this type of abusive behaviour (a sanctioning system functional nowadays in states like Great Britain or USA).

**2**. In the **second chapter** we've examined the material scope of market abuse. According to the relevant legal provisions, market abuse applies to any financial instruments admitted to trading on a regulated market or for which a request for admission to trading on a

regulated market has been made and emission allowances or any other not traded financial instrument whose value depends on a financial instrument from the first category.

The notion of ***financial instrument*** has a legal definition, found in art. 2 of the Law. Among the most familiar financial instruments are shares, bonds and derivatives such as futures and options.

Similarly, the notion of ***regulated market***, an essential normative element of the incrimination norm, is defined by the Law. Even so, regarding this aspect, some “false problems” of interpretation were created in the national jurisprudence.

Thus, although the legal provisions are clear, establishing that the interdiction is applicable only to financial instruments admitted to trading or for which a request for admission to trading on a regulated market has been made, in practice a plea for expanding the regulatory concept of regulated market used by the legislator has been made, in the sense that, actually, there should be no correlation between the concept of regulated market comprised by the incrimination norm and the concept defined by the Law and that, in this context, the concept is to be understood in a “non-juridical” manner, respectively every market that is subject to a set of rules.

This expansion of the scope of the criminal interdiction was blocked, including with the “help” of ECJ that established that only a regulated market in the sense assigned by MiFID (and nationally, by the Law) is a regulated market (sic!) within the meaning of market abuse sanctioning norms. Such trenchant conclusion of the ECJ that was afterwards confirmed by the national Supreme Court clarifies beyond any doubt that trading on trading platforms that have not taken the form of a regulated market (such as RASDAQ market or multilateral trading systems) are not *de lege lata* within the scope of market abuse interdictions.

We couldn’t have concluded our analysis without mentioning the crucial aspect that, with the entry into force of the new European regulatory framework on market abuse, this "discrimination" will be eliminated and the sanctioning norms will become applicable to any financial instrument traded on any trading platform that is subject to the control and supervision of the supervisory authority (regulated market, MTF and any other trading venue) - one of the most important changes brought by the new European regulatory framework.

**2.** In **Chapter II of Title II** he have proceeded to the analysis of the "core" of this paper, namely of the components of market abuse, beginning with insider dealing and its adjacent behaviours.

At this point, our analysis starts with the most controversial aspect of this criminal offence, namely its rationale. In this battle of the pros (brought mostly by representatives of the

Chicago School) and arguments against sanctioning market abuse, we've chosen to position ourselves "on the side" of those who plea for sanctioning market abuse, understanding why bypassing the rules of the "game" played on the stock market, through the unfair exploitation of inside information, could harm the market's informational efficiency and could produce an unwanted effect of investors' "flee" (especially in the case of non-professional investors).

Consequently, we have chosen to concur with the opinion expressed in foreign doctrine and jurisprudence, and concluded that the incrimination norms protect the existence of a theoretical equality between investors and that property's protection is a simple reflex effect of these rules.

In relation to insider dealing and its adjacent conducts, inside information is the notion around which the incrimination norms revolve. For this reason, the notion is subject to an ample analysis, in which, for the first time in the national literature, we try to offer clear benchmarks for the meaning of the concept, especially regarding the problematic types of inside information (such as inside information in case of an evolving process).

According to the "general" legal definition (we refer to it as the general definition since the Law also offers definitions for particular forms of inside information), ***inside information*** is an information of precise nature which has not been made public, relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.

The ***precise nature*** of the information does not presupposes an absolute accuracy and "tolerates" an incomplete information, as far as the information can be exploited on the market.

Regarding the ***aptitude of the information to have a significant effect on the prices*** of the financial instruments, this characteristic was defined by using the alternative criteria offered by the national and the European legislator, respectively that of the reasonable investor.

Similarly, in respect of the ***(non) public character*** of the information, we concluded that this condition rather involves a lack of accessibility *in abstracto* and does not necessarily require an effective publicity, namely that the information is effectively known by an undetermined number of people.

Surpassing this "Gordian knot", we continued our analysis with the active subject. In this respect, we have shown that the "misleading" notion of insider has nothing to do with the current form of the incrimination norms, being a mere reminiscence of the initial rationale identified in USA for the sanctioning of insider dealing (breach of a fiduciary duty by persons

who can regularly access inside information - "the insider") and that, currently, the norms apply regardless of the concrete identity (insider or non-insider) of the person who commits such acts. However, given the "stubbornness" with which the classification primary insider - secondary insider is adopted in most European legal systems (in the law, doctrine and practice), we tried to identify the "stake" of such classification: differences regarding the type of liability (criminal or administrative), the rules for the burden of proof, an important criterion for the sanction's individualization, etc.

As regards the central figure of the interdiction, namely ***insider dealing***, we tried a "defragmentation" of the incrimination norm, noticing that trading on the basis of inside information involves knowing the information and then using it on the market (knowing and using the information cannot be considered equivalent).

We have also capitalized the aid provided by the ECJ in this matter that held that, at least in the case of the European corresponding norm from MAD, using inside information may be presumed from the related fact of knowing the inside information. To the question if such a "finding" can be translated into national law, we concluded that this approach could be accepted, since it actually represents a "natural" inference and can be contradicted by the evidence presented by the defence.

In relation to the new European regulatory framework, we observed that even if the interpretation of the ECJ refers only to primary insiders, MAR seems to promote the expansion of this presumption for secondary insiders, being therefore very likely that even in this cases the use of information will be presumed from the related fact of knowing the information.

Another problematic issue that we've examined in detail is that of the objective content and limits of insider dealing.

Thus, we examined the extent to which insider dealing can exist in the hypothesis of directly negotiated transactions or when we are confronted with inside information obtained during the takeover proceedings or the acquisition of a significant volume of shares. In both cases, since these operations represent are indispensable for the sound functioning of the market, we concluded that these two hypothesis may exceptionally be included within the scope of insider dealing, namely when the operations based on inside information are diverted from their natural scope and end up being nothing more than an exploitation of inside information.

Another important problem, ignored so far has in the national legal literature, is the relation between insider dealing and market manipulation (especially in the form of scalping). The conclusion we reached is that, in principle, when trading in shares on the basis of information regarding the existence of market manipulation and the aforementioned

transactions are part of the manipulative scheme, the conduct will only represent market manipulation (the act of insider dealing being in fact ”only” a part of the manipulative conduct).

Regarding *mens rea*, one aspect that deserved a special attention was that of the effects that an error could produce on the *mens rea*, given the highly technical nature of the incrimination norm. We insisted in identifying those elements that could be capitalized by the judicial authority in order to conclude to what extent such error can reasonably be retained and to determine what will be the effect of such error. Such circumstances may be: the investor type or if the investor, before the trading activity, received professional counselling regarding the lawfulness of his conduct. Surely, in the presence of a completely atypical investment behaviour (element that, most often, is the primary circumstantial evidence in terms of insider dealing), such defence will become more and more inacceptable.

Finally, we insisted on the relationship between the act of insider dealing and other offences. The most "challenging" problem in this context was identifying the boundary between insider dealing and fraud, since, at least at first glance, they present a multitude of common elements.

As shown, in fact, the two incrimination norms are addressed to different "economic orders", the first being specific to impersonal and anonymous transactions on the stock markets, the second having to intervene in “classical” economic relations. For these reasons, any superposition between the norms in a particular case becomes unlikely. But, if such overlap were to exist, given the heterogeneity of the social values protected, the two offences will be concurrent.

As regards the latter sub-components, namely the ***disclosure of inside information*** and the ***recommendation to trade*** made on the basis of inside information, we ‘ve firstly qualify them as an “obstacle” offence in relation to insider dealing.

In the case of ***disclosing inside information***, the *actus reus* has basically the same meaning as in the case of other more “classical” offences. However, the objective content does not presuppose the full disclosure of information and it “accepts” the solely disclosure of those elements that make the information exploitable on the market.

In this context, some interesting hypotheses have prompted a more detailed analysis, namely the situation in which the author discloses the information to a person who already knew that information or when the disclosure is made to an undetermined number of persons. In the first case, considering the rational of the incrimination (more precisely to avoid the "spreading” of the information), such act could be qualified only as an attempted offence. For the same reasons, we’ve concluded that the *actus reus* targets only the cases when the disclosure is made

to a determined number of people and not when the information was made public in an abusive manner. In this latter case, we are facing a public disclosure, that results in transforming the inside information in a “common” and public information that exists on the market.

Since an indispensable premise for the normal functioning of capital markets is the existence and access to all relevant information, knowledge that enables the investor to forecast the evolution of the financial instrument, it is only natural that the legislature excluded from the scope of the offence the disclosure made in the normal course of the exercise of a person’s employment, profession or duties; (an extremely relevant scenario in the case of public offers).

***Recommending another person to trade on the basis of inside information***, to acquire or dispose of financial instruments to which that information relate implies trying to determine a person to trade in a certain way, “suggestion” made on the basis of inside information.

Besides a “classical” analysis of the offence, we have also highlighted some imperfections of the national incrimination norm in respect to that comprised by MAD. Thus, if the text of MAD or from other European systems refers to recommendation or inducing another person to trade on the basis of inside information, the national legislature has chosen to incriminate only the recommendation. Given that such limitation does not make sense, de *lege ferenda*, we proposed the "correction" of the incrimination norm, by also incriminating the act of inducing another person to trade on the basis of inside information.

**3.** The second component of market abuse, namely ***market manipulation***, was approached in **Chapter III of Title II**.

Regarding the rationale of the incrimination, we’ve observed that the debates in this respect was much less fervid, since market manipulation constitutes a much clearer and brutal intervention in the capital markets’ mechanisms.

In this case, the main controversy refers to the “limits" the offense should have, especially when market manipulation is committed through the “natural” conduct on stock markets, namely through transactions or orders to trade. Thus, an infallible definition for market manipulation seems to be almost "impossible", since it clearly has to capture the differences between a speculative behaviour, tolerated by the market, and a manipulative conduct.

From this point of view, we agreed that the best solution is to build the concept of manipulation around the perpetrator’s manipulative intent, noticing that "too" many times, this is the only practicable criterion for the delimitation between speculative and manipulative conduct.

Regarding the ***concrete modes of market manipulation***, respectively (a) transactions or orders to trade which give, or are likely to give, false or misleading signals as to the supply

of, demand for or price of financial instruments ot which secure, by a person, or persons acting in collaboration, the price of one or several financial instruments at an abnormal or artificial level, (b) transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance and (c) dissemination of false information, in addition to a presentation of their objective characteristics we've also examined the examples of manipulative conducts provided by the first Guide regarding market manipulation issued by ECSR (wash sales, pump and dump, scalping, concealing ownership, etc).

As a common "defect" of the incrimination, we've critically remarked that for all forms of market manipulation, the legislature did not introduce a quantitative "threshold" for the magnitude of the distortion of price formation mechanisms. So, theoretically, any conduct that at least has this aptitude (regardless its "size") would fall under the scope of the incrimination norm.

From our point of view, the intervention of criminal law is justified only in serious cases of market manipulation, ie in those in which the false signals generated in the market or such aptitude could influence the market behaviour of a reasonable investor. Therefore, our plea was for a praetorian limitation of the incrimination norm, as in the case of insider dealing where such condition already exists.

***Information-based manipulation*** is by far the most important sub-component of market manipulation. Regarding this type of manipulation we analysed the concrete content of the actus reus, reaching the conclusion that the act of dissemination involves creating accessibility of the information in the market. Only in this manner the dissemination of false information has the ability to "disturb" the informational efficiency. However, exceptionally, we have accepted that the offence could also exist in the event of a "bipersonal" disclosure, more precisely when the recipient of the information will adopt a market conduct on the basis of that information, conduct that will result in an indirect "publication" of the information.

The "'pure" omission to inform the market about a special event, relevant for a financial instrument (especially, in cases where the issuer, based on its obligation to inform the market about any sensitive information that concerns him directly) cannot be included in the actus reus of the offence. Such a notable "absence" from the norm must immediately be remedied through its incrimination.

Finally, precisely by virtue of its importance in terms of delimitation between speculative and manipulative market conduct, we insisted on the specific mens rea of the offence. In relation to this aspect there are two approaches: *intent-based manipulation* (which insists on the intention of the author) and effect-based manipulation (which insists on the

conduct’s market effects). We concluded that even if the second approach is much more “generous”, such a construction is unrealistic, since in certain cases the manipulative intention is the only criterion that can be used for the delimitation between these two types of conduct.

4. In **Chapter IV of Title II** we analysed several “final” common elements of the incrimination norms, ie aspects regarding the quantum of criminal sanctions and the main criteria for individualizing such sanctions. In its current form, the two components of market abuse (although they actually represent different offenses), are dealt with by the legislature in a unified manner, inclusively as regards the applicable sanction. The main sanction for market abuse is imprisonment from 1 to 5 years.

**5.** As regards the possible unconstitutionality of the incrimination norm, from different angles, the matter was approached in **Chapter IV of Title II**.

Regarding the possible unconstitutionality of the norm in terms of its sinuous construction we concluded that this kind of “waterfall” regulatory technique, even if flawed, can still be tolerated in relation to the principle of legality.

However, since nothing prevents a structural reform of the incrimination norm, we considered that a "unification" of all the relevant elements of the norms is highly desirable. In this sense, we suggested bringing all the relevant normative elements in the same article, on the one hand, and the separation of the two main incriminations (insider dealing and market manipulation) in two separate articles, on the other hand (separation that would capture more clearly the relation that exists between the two types of abusive behaviour).

We also considered unfounded the alleged breach of the principle of legality, in terms of the norms’ lack of predictability, generated by the use of terms which may be criticized for their ambiguity. We appreciated that this type of incrimination can be legitimized mainly by the dynamism of this area of law, by the variety of concrete modes for manipulating the market or by the variety of information that could be qualified as inside information. For all these reasons, a more precise definition of the actus reus would transform the incrimination norm in a casuistically one, thus jeopardizing its efficiency.

**III.** In the last title of our paper (**Title III**), we analysed the problems that the incrimination norms pose in respect to the prevention, detection, control and effective sanctioning (including from a procedural perspective).

Regarding the fight against market abuse and its sanctioning procedure, we addressed the issue in reference to two somewhat parallel plans: in the foreground, we analysed the physiognomy of current criminal proceedings in market abuse cases and in the second, as a *lege ferenda* proposal, we described what could be the main characteristics of such proceedings,

thus providing guidelines for such "construction", with a special attention to the fundamental rights of the person accused.

The respect for the fundamental rights of the accused in the administrative or criminal proceedings seems to be the "Achilles heel" in this matter.

In most cases, the competent national authority, ASF, will detect a behaviour that can be qualified as market abuse and, as a result, will make the first steps to review whether that particular conduct should be qualified as criminal.

Consequently, as a rule, if after preliminary investigations conducted by ASF, the authority concludes that the conduct may be qualified as criminal, ASF will notify the prosecuting authority.

The problem is that ASF has no strict rules for such preliminary investigations, rules that would be necessary for the protection of the fundamental rights of the accused. As such, regardless of the qualification received by a specific conduct, problems appear in the respect to the rights of the accused.

Criticism subsists also for the situation when only an administrative sanction is applied, because even in such cases, the procedural rights of the accused cannot be ignored given that, based on the qualifying criteria outlined in the jurisprudence of the ECHR, such accusation is to be qualified as criminal, qualification that triggers the application of art. 6 of the Convention. In addition, such a gap is even more serious, taking into consideration that the results of such preliminary administrative investigation can become evidence in criminal proceedings.

In this regard, we have proposed a reform of the procedural framework in which ASF can accomplish its investigative activities, by clearly providing the rights of the person subject to the investigation and the steps of the proceedings itself.

Then, for reasons of efficiency, we proposed the creation of a new authority with mixed competences (to investigate both criminal and administrative market abuse), that will lead to a more coherent sanctioning system, inclusively by eliminating the prospect of possible contradictions between authorities (the ASF and the current prosecuting authority).

In our final remarks we've presented the main contributions brought by our paper in this domain (an ample presentation of the features of inside information, the analysis of the relation that exists between insider dealing and market manipulation, the "criminal" definition of the regulated market, an analysis regarding the relation between insider dealing and market manipulation on the one side and fraud on the other side, etc, new proceedings for investigating market abuse, etc.).