The Regulation of Insider Trading in Germany: Who's Afraid of Self-Restraint

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The Regulation of Insider Trading in Germany: Who's Afraid of Self-Restraint?

*Joseph Blum*

I. INTRODUCTION

From near total destruction forty-one years ago, the Federal Republic of Germany has emerged as the fourth wealthiest industrialized nation. Germany's gross national product exceeds $655.5 billion, economic expansion continues at a rate of almost 3% per annum, and world leaders now look to Germany as the European economic locomotive. Yet despite this wealth, the German capital markets remain minuscule in comparison to those of other industrialized nations. In terms of market capitalization, for example, the Frankfurt Exchange is only a fraction as large as those of New York, Tokyo, Montreal, and London.

This development has had a significantly adverse effect on the ability of German companies to raise equity capital. The average Eigenkapitalquote (stockholder equity rate) in German stock corporations has fallen

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1 INFORMATION PLEASE ALAMANAC 195 (39th ed. 1986).

2 The Economist, June 7, 1986, at 123.

3 There are eight German stock exchanges: Frankfurt, Dusseldorf, Berlin, Hamburg, Munich, Hanover, Stuttgart, and Bremen. Of these, Frankfurt is the most important (accounting for 44% of the total turnover in domestic shares, 84% of the domestic bonds, 57% of foreign shares, and 87% of foreign fixed-interest securities) followed by Dusseldorf and Hamburg. Wegen, Federal Republic of Germany, in INTERNATIONAL SECURITIES LAW AND PRACTICE 5 (J. Robinson ed. 1985).

4 In 1980, the market capitalization of the New York Stock Exchange amounting to $1.2 trillion greatly exceeded the capitalization of the exchanges in Tokyo ($341 billion), London ($133 billion), Montreal ($113 billion), Frankfurt ($72 billion), Toronto ($67 billion), and Paris ($45 billion). INSTITUTIONAL INVESTOR, Nov. 1980, at 197.
from 35.8% in 1964, to 27.5% in 1977, to a dangerously low 18.5% in 1985. Moreover, the total number of stock corporations is extremely small and continues to decline: from 2,541 in 1964, to 2,149 in 1977, to 2,141 as of December 31, 1980. This trend is also reflected in the relatively small number of German companies turning to the equity markets to raise capital. In 1983, a mere dozen firms went public and a few of these never made it further than the unregulated market. In 1984, twenty corporations were added to the stock exchange listing while, in 1985, only a dozen corporations went public. Although the amount of capital raised by these public offerings has increased in recent years, it remains far below the amounts raised in other industrialized markets.

One explanation for the relatively weak development of the German equity markets lies in the reluctance of Gesellschaften mit beschränkter Haftung (“GmbHs”) (limited companies) to convert to Aktiengesellschaften (“AGs”) (stock corporations). In 1980, for example, there were 255,940 GmbHs (up from 39,000 in 1961) compared to 2,141 AGs (down from 2,541 in 1964). This reluctance is based in part on the historical desire of German businesses to retain as much control as possible over their operations—the so-called Herr im eigenen Haus (masters in their own home) philosophy. The much more burdensome disclosure and reporting requirements placed on stock corporations also serve as a deterrent to adopting the AG structure. As a result, the vast majority

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8 Capital raised through public offerings has increased from DM319 million in 1983, to DM1,7226 billion in 1984, and to DM1.8125 billion in 1985. Pohl, supra note 7.

9 For example, the gross proceeds from equity issues floated on the United States markets in 1983 were $51.579 billion. Securities Industry Yearbook 1984-85, supra note 7, at 591. Professor Hopt sums up the current situation as follows: “[i]n Germany, the stock market is weak, the number of new stock corporations is virtually nil, and there is little incentive to go public and to have the shares of the company traded on the stock exchange.” Hopt, Insider Trading on the Continent, 4 J. COMP. CORP. L. & SEC. REG. 379, 383 (1982).

10 See Aktiengesetz [AktG] § 177, Bundesgesetzblatt [BGBl.] I 1089 (1965)(W.,
Insider Trading in Germany
7:507(1986)

of German businesses remain as limited companies, never distributing their shares to the public at large.

Another reason for the arrested development of the German stock exchanges lies in the failure of the markets to attract and retain the small German investor. In 1974, for example, only 0.7% of individual savings were invested in stocks as compared to an average of 5.1% during the period 1960 to 1969.\(^1\) It is estimated that, at most, 3.5 million Germans own stock, while in the United States, a country four times the population of Germany, the number is fifteen times as great. According to the most recent figures, a remarkably small 200 German firms have more than 1,000 stockholders, and only seventeen corporations have more than 100,000 owners.\(^2\) In fact, in 1980 there were only 224 domestic stock corporations listed on the Frankfurt Stock Exchange, the country's largest.\(^3\) The wide distribution of production capital which had been hoped for simply has not come to pass in the Federal Republic.

The aversion of individual Germans to invest in equity securities can be explained on a number of levels. First, many investors find that fixed-rate bonds and similar securities provide equal if not better yields than stocks, without the concomitant risk. Germans are also more risk averse than, for example, their United States counterparts. Second, tax laws and enforcement practices, particularly those allowing investors to retain interest on bank and savings accounts de facto tax-free, make investing in stocks less attractive. Finally, taxes on the purchase and sale of stock, relatively high (fixed) broker commission fees, and the automatic withholding of a portion of the distributed dividends, combine to repel the small investor from the stock market.

Another significant reason that many small investors in Germany shy away from stock investments is the widely-held belief that the markets are, to some extent, "fixed," in particular, that insiders and speculators retain a significant advantage over the common investor.\(^4\) This perception is enhanced by the numerous incidences of insider trading re-

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\(^1\) J. JENKEL, supra note 5, at 18.
\(^2\) Pohl, supra note 7.
\(^3\) Id. In 1983, there were 442 (450 in 1982) domestic corporations quoted officially and semiofficially on German stock exchanges, of which approximately 80 domestic shares were quoted semiofficially. In 1983, 181 (182 in 1982) foreign shares were officially quoted on German stock exchanges. Wegen, supra note 3, at 85.
ported in the daily press.\textsuperscript{15} Der \textit{Spiegel} noted in October 1985, with respect to the takeover by Daimler-Benz of AEG, that: “In fact, there are already several other cases [in addition to the Daimler-Benz—AEG affair] in which insiders have speculated with their information on the stock exchange. The Board of Inquiry would be overwhelmed if it pursued every clear suspicion.”\textsuperscript{16}

The purpose of this Article is to explore the German approach to the regulation of insider trading. The Article begins with a discussion of the structure and regulation of the German capital markets. Insider trading is then defined, followed by a short history of the German attitude toward such trading. The Article examines next the possibility of regulating insider trading through actions under German civil and common law, followed by an in-depth analysis and criticism of the current voluntary insider trading code. A short survey of the effectiveness of the rules governing insider trading is then presented through two case studies. The Article concludes with an evaluation of current efforts to reform the insider trading rules, in particular through the harmonization program of the European Economic Community ("EEC" or "Community").

II. Structure of the German Capital Markets

There are three types of securities markets in Germany: the German stock exchanges for officially listed securities; the \textit{geregelter Freiverkehr} (semiofficial market for the regulated trading of unlisted securities); and the \textit{ungeregelter Telefonverkehr} (market for nonregulated, unlisted transactions, i.e., those securities traded off the stock exchange by telephone and not included in the other markets).

Only securities officially traded on the German stock exchanges are subject to the rules of the Stock Exchange Act.\textsuperscript{17} The regulated trading of unlisted securities, despite the considerable market which exists, is governed by no specific law, but is subject to the self-regulation of market.

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\textsuperscript{16} Pohl, \textit{supra} note 7. Dr. Ralf Wojtek notes that empirical evaluations of the frequency of insider trading are almost nonexistent. He concludes, however, that in light of the suspicions constantly reported in the daily press, one can draw the conclusion that the abuse of nonpublic information in securities transactions is not a rare occurrence. R. \textit{WOJTEK}, \textit{INSIDER TRADING IM DEUTSCHEN UND AMERIKANischen RECHT} 15-16 (1978).
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\textsuperscript{17} \textit{Börsengesetz [BörsG]} (1908), \textit{REICHSGESETZBLATT [RGBl.] 215, amended by BGBl.I 1013} (1975).
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participants. Similarly, trading in nonregulated, unlisted securities is subject only to limited control and supervision by market participants. Examination of the quality of securities before they are included on the dealers' price list is little more than rudimentary. Prices in this market are posted in daily private newsletters.

The Stock Exchange Act, which was last revised in April 1975, governs the licensing of persons admitted to the exchanges, the organization of the exchanges, the admission of securities and commodities for trade, the settlement of exchange transactions, trading in futures, and the responsibilities of market participants. The stock exchanges also promulgate their own trading rules, including nonbinding recommendations made by informal committees and working groups. The Stock Exchange Act contains absolutely no reference to or regulation of insider trading.

Under the Exchange Act, the stock exchanges are established as institutions of public law administered by bodies of the exchanges themselves. The admission of securities for trading is subject to the approval of the Zulassungsstelle (Admissions Board), at least half of whose members may not be professionally engaged in securities brokerage. Quotations are fixed by Kursmaklers (publicly-appointed exchange specialists). Exchange activities are subject only to the supervision of the Länder (states) and specially appointed state commissioners. There is no agency in Germany, either at the federal or Länder level, which is at all comparable in authority or resources to the United States Securities and Exchange Commission ("SEC").

Although there is no law requiring the registration of securities in connection with a public offering, the Stock Exchange Act does require the filing of a prospectus for officially listed stocks. The prospectus must be published at least three days prior to the admittance of the issue for trade on the exchange. The Admissions Board, although required to ensure that the prospectus is complete, is not called upon to attest to the

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18 The listing of a security on the semiofficial market is decided by a panel comprised of market participants. Trading is conducted within the stock exchanges in accordance with rules established by the Federal Association of German Banks. The regulation of these unlisted transactions is therefore completely in the hands of the securities dealers. This market is not covered by the safeguards of the Stock Exchange Act. Publication of a prospectus is not compulsory, and there is no statutory liability for the correctness and completeness of a prospectus, should one be issued. Prices are not fixed by independent, government-supervised persons. In short, trade in the semiofficial regulated market lacks any genuine statutory or outside control. See Schwark, Regulation of the German Capital Markets, 1 J. COMP. CORP. L. & SEC. REG. 299, 309-10 (1978).

19 Kraus, supra note 6, at 111 (citing BörsG §§ 17, 36(3)(c), & 38). For a detailed description of prospectus and other issuing requirements, see Notification of Admission of Securities (Zulassungsbekanntmachung) for Official Quotation of July 4, 1910, translated in Wegen, supra note 3, at 104-06.
accuracy of the prospectus with regard to the financial and narrative information. Consequently, disclosure in connection with a public offering usually occurs only when the issuer is concurrently seeking to list the security on an official stock exchange. Unlisted securities traded on the regulated and unregulated markets, which constitute the bulk of German stocks, are most often issued without the publication of a prospectus.

Corporations issuing unlisted securities which do not fall under the purview of the Stock Exchange Act are subject only to the Aktiengesetz (Stock Corporation Act), which governs all corporations. The Corporation Act, however, was not designed to regulate the issuance and trading of securities, but to outline the responsibilities of corporate officers and directors and to establish the rights of shareholders. It offers only very limited protection to a securities investor.

In short, the Stock Exchange Act provides only limited regulation for the issuance and trading of German securities, and then only for those several hundred stocks officially listed on the stock exchanges. It is within this regulatory framework that the German approach to insider trading is considered.

III. INSIDER TRADING DEFINED

Insider trading occurs when an individual who has access to material, nonpublic information—an "insider"—trades or causes the trade of securities based on that information. It is through the subsequent public disclosure of this information, which typically has a significant effect on the value of the securities, that the insider is able to make a profit or avoid a loss either personally or for a third party. Insider trading is considered today to be undesirable by most legislators, courts, and commentators because it undermines the equality of opportunity among investors. This, in turn, erodes investor confidence, thereby threatening the proper functioning of the stock markets.

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20 See WORLD'S MAJOR STOCK EXCHANGES/LISTING REQUIREMENTS 13 (1984); Gesetz Über das Kreditwesen [KWG](Banking Act), revised by BGBL I 1121 (1976).
22 AktG § 177. The basic corporate information is contained in the Handelsregister (commercial register) which is maintained by each municipal court within the corporation’s jurisdiction. All forms of mercantile and industrial enterprises have to be registered in the Handelsregister and are required to disclose basic corporate facts such as share capital, shareholders, articles of association and by-laws, legal representatives of the firm, and members of the management and supervisory boards. The Handelsregister is open to the public and any interested person may ask for official certificates of entry and for certified copies of any document filed with it. Such registration constitutes constructive notice to the public. Wegen, supra note 3, at 87.
23 A small minority of commentators argue that insider trading serves a useful purpose by more
IV. ATTITUDES TOWARD INSIDER TRADING

In nineteenth-century Germany, investing money in stock was considered to be an affair for those educated in the ways of business and was not intended for the public at large. The public was advised to invest its savings in bonds and, in particular, government bonds. The law reflected this attitude. Under the Civil Code of 1896, a guardian was allowed to invest the money of a beneficiary in mortgages or government bonds, but was prohibited from buying stock. The same was true for insurance companies. Shares were considered to be a highly-speculative investment. As trading was considered to be only for sophisticated and well-informed individuals who could protect themselves against the attendant risks, regulation of insider trading was not an issue.24

After World War II, the United States introduced in Germany not only the Marshall Plan, but also a new attitude toward the free market economy. It was believed that by encouraging citizens to participate financially in the economic system, they would have an increased interest in supporting it. Such participation could be accomplished by widely distributing capital ownership to the public. Consequently, public participation in the German stock markets reached its peak in the mid-1960s.25

In order to guarantee a functioning market economy and orderly capital markets, it was also understood that certain legal structures had to be imposed. Most post-War legal commentators in Germany have come to realize that insider trading is harmful to the stock markets and that businesses and managers should not be allowed to use sensitive information obtained by virtue of their position for private gain. The attitude that insider trading is a perquisite of management is no longer endorsed. As part of the legal rules necessary to ensure orderly markets, German scholars and practitioners now generally accept the principle that insider trading should be prevented.

gradually moving the market price of a given stock toward a level reflecting its true value, and thus may be regarded as both a legitimate stimulant and reward for entrepreneurial ability. See, e.g., H. Manne, Insider Trading and the Stock Market (1966). However, the contention that insider trading is desirable has been widely discredited. See, e.g., Mendelson, The Economics of Insider Trading Reconsidered (Book Review), 117 U. PA. L. REV. 470 (1969); Ferber, The Case Against Insider Trading: A Response to Professor Manne, 23 VAND. L. REV. 621 (1970); Marsh, Book Review, 66 Mich. L. Rev. 1317 (1968)(reviewing H. Manne, Insider Trading and the Stock Market (1966)).

24 Address by Professor Coing of the University of Frankfurt, Second International Securities Law Conference (Apr. 3-4, 1975), reprinted in MULTINATIONAL APPROACHES-CORPORATE INSIDERS 55, 121-22 (L. Loss ed. 1976)[hereinafter Coing Address].

25 Stocks lost their appeal among the German public after the first significant downturn in the market. See J. Jenkel, supra note 5, at 18.
V. CIVIL AND COMMON LAW APPROACHES TO INSIDER TRADING

Before examining the current insider trading code, it is useful to examine briefly the possibility of applying German civil and common law theories to incidences of insider trading. It should be noted at the outset, however, that the German Civil and Criminal Codes contain no provisions specifically addressing the issue of insider trading.

A. An Action under Contract or Tort Law

One way of evaluating the legality of insider trading is to consider whether an insider is obligated under civil contract law to disclose information before engaging in a securities transaction. Although the German Civil Code\(^2\) has no specific rules in this respect, § 123 of the Code states that deceit makes a contract voidable. In applying this section, the courts have established the following principles: 1) a seller is not obligated to a buyer to disclose fully all material facts about the sale as the law recognizes that there is a conflict of interest between buyers and sellers; and 2) whether a particular material fact known only to a seller must be disclosed is to be determined in view of the circumstances of the case and under the standards of good faith and general business practices.\(^2\) Legal commentators have concluded that, based on these principles, insiders would most likely be obligated to disclose to outsiders the particular material facts known to them prior to making a trade.\(^2\)

These principles, however, have no practical application to insider trading. The law requires there be privity between the seller and buyer, a requirement which does not exist in most securities transactions. In other words, common law rules regarding deceit would only apply in the exceptional case where the buyer and seller conduct their business outside the stock exchange and not through the agency of banks or brokers. Legal scholars have also concluded that, because there is a lack of privity in most securities transactions, an action in tort by a buyer against a seller for failure to disclose inside information would most likely fail.\(^2\)

B. An Action for Breach of Fiduciary Duty

Article 93 of the Stock Corporation Act imposes civil liability on


\(^{27}\) See Coing Address, supra note 24, at 56 (citing ENTSCHEIDUNGEN DES REICHSGERICHTS IN ZIVILSACHEN [RGZ] 111, 233, at 234-35; RGZ 62, 149, at 150; and RGZ 111, 233, at 56).

\(^{28}\) Coing Address, supra note 24, at 57.

\(^{29}\) Id.
members of the Vorstand (Board of Management) for failure to comply with the requisite standard of care. Paragraph (1) states:

In managing the company, the members of the Board of Management shall act with the care of a diligent and prudent executive. They shall keep secret all confidential information and secrets of the company, especially business and trade secrets, which have become known to them in connection with their activities as members of the Board of Management.

Article 116 places members of the Aufsichtsrat (Supervisory Board) under the same standard of care. Board members are jointly and severally liable to the corporation for damages caused by breach of their fiduciary duty.

Because directors and managers are under a duty to keep secret confidential information, it may be possible to apply this section to insider trading cases, particularly if the insider has revealed confidential information to a third party (i.e., to a so-called “tippee”). It is not clear, however, whether this duty precludes an individual from using the information for personal gain, as is common in insider trading cases. Neither would it prevent individuals from trading in the stock of corporations for which they do not work and to which they owe no fiduciary obligation. While a company can sue its directors and managers for gains obtained from a breach of their fiduciary duty, it appears there has been no court decision addressing this issue with respect to insider trading. It is also important to note that German law allows no derivative shareholder actions.

In sum, German civil and common law remedies do not provide adequate tools for combating insider trading. Specific statutory-type rules are necessary.

VI. THE VOLUNTARY INSIDER TRADING CODE

After much public debate in the mid-1960s over the need to reform the stock exchange system to encourage wider distribution of shares among the general public, the Federal Minister of Economics established in 1968 the Commission of Stock Exchange Experts (“Commission”) to devise and implement necessary changes. In July 1969, the Commission appointed a subcommittee under the direction of Professor Doctor Wolf-

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30 AktG §§ 93, 116.
32 Coing Address, supra note 24, at 58.
33 The only provision allowing derivative-type actions is § 147 of the Stock Corporation Act, which permits 10% of the shareholders to demand a damage action be brought by and on behalf of the company against members of the Board of Managers and Supervisory Board whose acts have injured the company. AktG § 147.
gang Stutzel to look into the issue of insider trading. The regulation of insider trading had become a controversial topic in Germany, particularly in light of numerous reports of suspected insider trading abuses in preceding years.

Based upon the recommendations of this subcommittee, the Commission and the Minister of Economics unanimously adopted on November 13, 1970, a document entitled “Recommendations for the Solution of the So-Called Insider Problems” (“Recommendations”).34 In late 1971, the Commission also adopted Rules of Procedure for the Boards of Inquiry of the stock exchanges.

Faced with the need to provide greater flexibility and practicality, the 1970 Recommendations were subsequently modified and extended by the Insider Trading Guidelines of July 1, 1976 (“Guidelines”).35 These new Guidelines were based on the recommendations of the so-called Committee of Stock Exchanges and the Federal Ministry of Finance.36 The Rules of Procedure were also modified in July 1976.37

In adopting rules proscribing insider trading, the Commission members clearly recognized the economic harm caused by such trading. The Preamble of the Guidelines states:

The stock exchanges play an important role in the raising of financial capital for investment in the economy. The greater the confidence in the orderly transaction of stock exchange business, the more they are able to fulfil this role. To this end, preventing the abuse of insider information plays a significant role.38

Despite the recognition that insider trading can cause long-term damage to capital markets, the Commission of Stock Exchange Experts and the federal government declined to make insider trading illegal, or even subject to civil sanctions. Instead, the German authorities opted for a unique system mixing voluntary compliance with self-regulation. Consequently, the Guidelines and Rules of Procedure are characterized as

35 Insiderhandels-Richtlinien, reprinted in R. Bruns, supra note 34, § 436 [hereinafter Guidelines].
36 Participating organizations were the Federation of German Stock Exchanges, Federation of German Industry, Federation of German National Banks and Natural Resource Banks, Federation of German Wholesalers and Exporters, Federation of German Banks, German Federation of Savings Banks, Federation of Insurance Companies, Federation of German Retailers, the Federation of Federated Business Banks, and the Federation of Public Banks.
38 Guidelines, supra note 35, at 1.
By adopting a voluntary code designed to educate corporate executives and others to the harms and immorality of insider trading, the Germans believed that they could more effectively control abusive insider trading than by adopting a state-enforced system of statutory proscription. This philosophy is summarized in the following Comment to the Recommendations:

Because the Insider Recommendations employ private law means to enforce a certain code of conduct, they and the Insider Rules of Procedure contain, relative to general standards, no meaningful sanctions for violations.

In my opinion, this particular defect is compensated to a large extent by the fact that the Rules are recognized voluntarily and approved by the professional community. Legal regulation would only be accepted reluctantly and circumvented to the extent possible. Such regulation can certainly theoretically, but not practicably, be as effective as a rule by which the behavior of the affected individuals is observed by professional colleagues as opposed to the more or less distant state authority.

Efforts in other countries to solve insider problems by legal means has led, as far as can be seen, to only partial success. This was also to be expected because it is practicably not possible to supervise carefully individuals for all violations of the relevant regulations.

The German approach relies on corporations and banks to obligate contractually their top employees to abstain from insider trading and to ensure that these prohibitions are not violated. Only when insiders have bound themselves contractually to comply with the Guidelines are they prohibited from engaging in insider trading.

Section 1 of the Guidelines establishes a blanket prohibition against insiders trading on inside information. Specifically, insiders may “not engage in dealings of ‘inside securities’ with the use of inside information (which they obtained by virtue of their position), at any time, or under any circumstances, for their own benefit or the benefit of a third party.” Third parties can include companies and other legal persons. There are a number of exceptions to this general prohibition, including: 1) transactions executed at the instruction of others (e.g., a broker’s execution of an order from a customer); 2) transactions involving the safeguarding of clients’ interests and other transactions conducted in the normal course of the bank’s securities business; and 3) certain dealings based on long-term business planning.
Under the formulation in the 1970 Recommendations, insiders include members and legal representatives of the management and supervisory boards and those employees who routinely have access to certain classes of sensitive information. The corporation itself decides whether an individual has such access to be classified as an insider. The 1976 Guidelines expanded the concept of insider to include domestic shareholders holding more than 25% of a company's stock. (If the 25% shareholder is a company, then its directors and legal representatives are considered insiders.) Directors and employees of affiliated enterprises, under certain circumstances, may also fall within the definition of insider. Although persons outside the corporation with inside information were not initially covered under the 1970 Recommendations, the 1976 Guidelines were drafted to prohibit, in certain instances, insider trading by banks and credit institutions and their directors, managers, and employees. Tippees are not covered by the Recommendations or the Guidelines.

"Inside securities" encompass stocks, Genusscheine (participating certificates), Wandel- und Gewinnchuldverschreibungen (convertible and participating bonds), stock options, and Bezugsrechte (preemptive subscription) stock rights. However, the Insider Trading Regulations only apply to those securities which are either officially listed on the stock exchanges or traded on the semiofficial regulated market. Corporations whose shares are traded off the stock exchange on the market for nonregulated, unlisted transactions are not covered by the Regulations.

The scope of this general prohibition on insider trading is circumscribed, in large part, by the categories of information defined as inside information. Section 2(3) of the Guidelines broadly defines insider information as "knowledge about known and unknown circumstances which can influence the valuation of insider securities." Specifically included in the definition of insider information is knowledge of the following:

a) changes in dividend rates;

b) substantial changes in earnings or facts which may influence such earnings;

c) actions taken to reduce or raise capital, including the raising of capital from corporate resources;

d) conclusion of a direct-control contract or profit-sharing agreement;

e) takeover and settlement offers;

f) planned mergers, amalgamations, transfers of assets, and reorganizations; and

43 Id.
44 Id. § 2(2), at 3.
45 Id. § 2(3), at 4.
g) dissolution of the company.

It is not important that the information be of a confidential nature. The
decisive element is whether the information was available to the public at
the time it was acted upon by the insider.

The Official Comment of the Guidelines reiterates the principle that
adherence to the insider trading rules is based on voluntary agreement
between an insider and the company. "[The Guidelines] are applicable
only when the individuals concerned have expressly recognized them. . . ."\(^46\) This is usually effected by corporations inserting a specific
prohibitionary clause in the individual employee contracts of corporate
insiders. Where there is no employment contract, as for example with
members of an Aufsichtsrat, adherence to the Guidelines can be made a
term of appointment. Nonetheless, there is no legal requirement that a
company request its key employees to accept such an agreement. In fact,
a number of well-known German corporations have not adopted the in-
sider trading rules at all.\(^47\) As a result, employees in these companies,
like those whose shares are not traded on the official or semiofficial ex-
changes, are not prohibited from engaging in insider trading.

As the insider trading prohibition is based on a voluntary contrac-
tual agreement between an insider and the company, no legal or discipli-
nary action may be taken against an offender by any outside agency.
Section 4 specifically states that the Guidelines provide no sanctions for
breaches by insiders; they only provide a mechanism for establishing
whether a violation has occurred. Any action against insider trading
must be brought by the company against its employee (or board member)
for breach of contract (or term of appointment). Section 4, note 1 states:

Such violations [of the Guidelines] represent at the same time, a breach of
the contracts, which exist between the insider and the company. The action
a company takes based on this type of contractual violation is for [the com-
pany] to decide; the Insider Trading Guidelines contain no provisions in
this regard. . . .\(^48\)

In the case of an insider trading violation, the company to which the
person was contractually bound by the Guidelines may recover the prof-
its made from the trade. In the case of a bank or credit institution (or
their directors, employees, or managers), profits must be forfeited to the
company whose securities were the subject of the insider transaction.
Profits from avoided losses are similarly subject to these rules.\(^49\) The

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\(^{46}\) Id. at 7.

\(^{47}\) See text accompanying notes 60-61.

\(^{48}\) Guidelines, supra note 35, § 4 n.1, at 6.

\(^{49}\) Id. § 4 n.2.
violator must also pay for the cost of the proceedings.\textsuperscript{50} Finally, should the insider refuse to disgorge the ill-gotten profits to the harmed company, the Guidelines provide that the company may enforce its claim in court. There are exceptions, however, if there are financial or other important mitigating circumstances relative to the insider.\textsuperscript{51}

The Guidelines provide for the establishment of a \textit{Prüfungskommis-

sion} (Board of Inquiry) for each stock exchange to ensure that the insider trading rules are carried out and to investigate allegations of abusive trading.\textsuperscript{52} The jurisdiction and functioning of these boards (there are currently eight) is prescribed in the Rules of Procedure.\textsuperscript{53}

The Boards of Inquiry have five members each. The President must be a judge experienced in commercial matters. The judge is nominated by the President of the \textit{Oberlandesgericht} (Supreme Court) and is then elected by representatives of the leading federations associated with the stock exchanges. The other four members are elected from federation representatives, and at least two must be professionally involved with a stock exchange. All appointments are for three years.

The board may open an inquiry on the basis of a complaint filed by any individual, including one of self-accusation. The complaint must be in writing and signed by the complainant and it must state facts that clearly imply a violation of the rules. The name of the person who is suspected of having committed the violation must also be given, as well as the date on which the complainant discovered the violation. The board is authorized to act only where the Guidelines may be applied to the accused or the accused explicitly accepts them. Further, matters of form must be strictly followed or the complaint will be rejected.\textsuperscript{54}

The board (which may act through a committee comprised of the President and two other members) may conduct a preliminary inquiry to decide if the available facts warrant a full investigation. During the preliminary inquiry, documents and information may be collected from the persons concerned and compelled from institutions. If a decision is made to close a case, the board has the discretion to reopen it based on newly-discovered evidence. The accused will be notified of an investigation, and

\textsuperscript{50} Rules of Procedure, supra note 37, § 5(2), at 7.

\textsuperscript{51} Guidelines, supra note 35, § 4(2), at 6. Pursuant to § 88(3) of the Stock Corporation Act, a corporation must assert a claim against an insider for ill-gotten profits within three months of management's learning of the insider's obligation to pay. AktG § 88(3). The statute of limitations is five years when there is no knowledge on the part of corporate management that such obligation exists. Guidelines, supra note 35, § 4 n.2, at 6.

\textsuperscript{52} Id. § 3, at 5.

\textsuperscript{53} See generally Rules of Procedure, supra note 37.

\textsuperscript{54} B. Rider & H. Ffrench, supra note 31, at 246.
a copy of the complaint will be furnished. Corporate representatives will also be notified and required to assist in writing or through personal testimony.

The Guidelines provide that, prior to the board issuing its formal written findings, the accused must be shown the results of the investigation and allowed to present a defense either verbally or in writing. To this end, the accused may collect and submit evidence as part of a defense.

The board will conclude in its formal findings as to whether there has been a breach of the Insider Trading Guidelines. If such a violation is found, the board will automatically charge the cost of the proceedings to the violator. The board reports its findings only to the Federal Minister of Economics and to the relevant corporation together with the evidence and the reasons for its findings. The decision is not published unless the violator consents. However, if the violation is considered extreme, publication may be made without the violator's consent.55

A. Criticism of the Insider Trading Guidelines

The German approach to combating insider trading has been the subject of extensive criticism by legal scholars and practitioners.56 The purpose of this section is to examine some of the important limitations inherent in the current voluntary system. This examination will be followed by a brief discussion of two cases in which the Guidelines have been applied.

One of the major shortcomings of the Guidelines is that the definition of insider does not include a number of groups with access to inside information. Under United States law, for example, corporate insiders and tippees privy to material, nonpublic information are generally prohibited from buying or selling securities based on that information prior to its disclosure.57 (The class of insiders for the purpose of this prohibi-

55 Rules of Procedure, supra note 37, § 5(3), at 7-8. Even in an extreme case, strict conditions must be met before publication is allowed. The violator must be given a hearing, and the board’s decision must be unanimous and verified in writing. Publication must be shown to be in the public interest. The board must also wait six weeks after notice has been given to the violator. Should the violator file suit during this six-week period, the board must await the suit’s final adjudication before it can publish its findings. Id. § 5(7), at 8.

56 See, e.g., Hopt, supra note 9; R. Wojtek, supra note 16; Arbeitskreis Gesellschaftsrecht, Verbot des Insiderhandelns (1976); U. Pfisterer, Machtmisbrauch im Wertpapierhandel durch Insider: Implikationen für die Bundesrepublik Deutschland aus Erfahrungen in der USA (1976); Zahn, Regulation of Insider Trading in the Federal Republic of Germany, 2 Int’l Bus. Law. 92 (1974).

tion includes not only directors, officers, and majority or controlling shareholders, but also employees of the corporation who possess inside information by virtue of their position.) Moreover, United States insider trading rules apply to those outsiders standing in a fiduciary or agency relationship to the sellers or purchasers of a company's securities.58

The German Guidelines, on the other hand, contain absolutely no prohibition on trading by individuals who have insider knowledge but fall outside the limited definition of insider. As a result, auditors, lawyers, family members, customers, suppliers, and all other tippees with access to inside information may engage in trading based on that information. Similarly, employees who are not classified by the corporation as insiders because they do not have routine access to inside information are not prohibited from trading should confidential, nonpublic information come across their desks. In addition, because insiders (except those working for banks or credit institutions) are prohibited from engaging in insider trading only in the stock of the corporation with which they have contracted, they are free to trade in the securities of totally unrelated companies.59 This apparently would include, for example, stock in a company subject to a takeover attempt by the corporation for which the insider works. In short, the restricted and inflexible definition of insider under the German Guidelines allows a large number of individuals with access to inside information to escape the reach of the trading prohibition.

A second shortcoming of the Guidelines is that the optional nature of the trading code has allowed a number of stock corporations to reject adoption of the Guidelines for their insider employees and board members. Although by 1980 nearly 100% of the German banks had accepted the insider rules, only slightly more than 50% of the stock corporations had done so. (If counted on the basis of stated capital, stock corporations holding 95% of the total stated capital of all German corporations had declared by 1980 that they would adhere to the Guidelines.60) Der Spiegel recently reported that 107 major German firms, including Hochteif and Hussel, have still not adopted the Guidelines.61 Of course, corporations which have accepted the Guidelines may later decide to reject them.

Third, the securities covered by the Guidelines comprise only a

59 However, banks and credit institutions (including their directors, managers, and employees) are prohibited from using their inside knowledge to trade in securities of corporations involved in takeover and compensation bids. See Guidelines, supra note 35, § 2(1), at 3.
60 Hopt, supra note 9, at 381.
small fraction of those issued by stock corporations. Only transactions in shares admitted to the official stock exchanges or traded on the semi官

62 This means that insider trading is permissible in the shares of more than three-quarters of the 2,000-plus German stock corporations. 63 This figure does not take into consideration those stock corporations which could be subject to, but have refused to adopt, the Guidelines. Further, trading in bonds (excluding convertible and participating bonds), limited partnership interests, and other forms of securities are not covered by the insider trading rules.

A fourth major shortcoming to the Guidelines is that the procedures established for conducting an investigation of alleged trading abuse are inadequate. Under the Guidelines, a Board of Inquiry may only open an investigation when a signed complaint is submitted naming a particular suspect and providing the date on which the alleged insider trade took place. A Board of Inquiry is not authorized to initiate an investigation on its own, even when there has been an unusual change in the price of a given stock or a significant fluctuation in trading volume. 64 Perhaps more important to the effectiveness of any probe is the fact that it is customary in Germany for shares to be purchased in bearer form. (Bearer securities are usually deposited in banks for safekeeping, thereby giving the banks the voting rights of the stock. 65) This system, combined with strict German bank secrecy laws, makes it very difficult, if not impossible, to determine who has purchased what stock. 66 Der Speigel summarized the current situation as follows:

Even when the stock exchange examiners make a serious effort to uncover violations against the Guidelines, the chances [of catching the insiders] are virtually nil. When an insider uses his informational advantage on the stock market, he has almost nothing to fear. The reason is that his transac-

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62 See Guidelines, supra note 35, § 2(2), at 3.
63 Hopt, supra note 9, at 381-82.
64 The Board of Inquiry made an exception to this rule in the Thyssen-Rheinstahl case when it initiated an inquiry despite the fact that no formal complaint had been filed. See infra text accompanying notes 71-72.
65 Banks are now obligated under the Public Companies Law to pass on information to shareholders that has been supplied by the corporation. Moreover, a bank must disclose to shareholders its intention regarding voting of the shares, and solicit the shareholders for their voting instructions. If a shareholder does not respond, the bank may vote the shares as it sees fit. See B. RIDER & H. FFRENCH, supra note 31, at 245. In light of the fact that many shareholders are not interested in how their shares are voted and therefore do not respond to voting inquiries, the banks have been able to retain tremendous influence over corporate boards. It is very common in Germany for nominees of banks to sit on the boards of corporations (particularly the Aufsichtsrat (supervisory board)). Because there is no law prohibiting interlocking directorates, these nominees are often directors and officers of the banks at the same time.
66 B. RIDER & H. FFRENCH, supra note 31, at 245.
tion orders go from bank to bank, and quite often institutions in Basel and Zurich are used in between. The German purchasers remain anonymous; thanks to bank secrecy, the inquiry remains in the dark.67

As a result, the chances of an insider being caught for prohibited trading are very small. In fact, the Boards of Inquiry have never found a significant violation of the Insider Trading Guidelines since their inception, despite repeated allegations and reports of extensive insider trading.68

Finally, even if it were easy to uncover insider trading, the sanctions are so mild that they have little or no deterrent effect. The Guidelines require only that a violator disgorge to the injured company all profits earned from the prohibited transaction and pay the cost of the inquiry proceedings. No fines may be imposed and there are absolutely no criminal sanctions. Further, the decision to enforce any board finding is left entirely to the discretion of the corporation; the Boards of Inquiry have no enforcement powers.

Perhaps the greatest failing of the Guidelines, however, is the strict limitation on the publication of any investigatory findings or decision of the Boards of Inquiry, except in the most extreme cases, and then only after numerous procedural requirements have been met. This procedure almost ensures that violators will not be personally subject to professional or public disapproval of their actions, an important element in establishing an effective deterrent. Consequently, the maximum risk an insider faces for engaging in prohibited trading is paying the cost of the proceedings plus the attendant inconvenience. Any profits which must be returned to the corporation represent nothing more than unjust enrichment.

In sum, the German Insider Trading Guidelines can be characterized, in the words of University of Munich Professor Doctor Michael Will, as a "toothless device."69 It is therefore not at all surprising that there have been only a handful of investigations conducted under the Guidelines and that, with one minor recent exception, no one has ever been held liable for insider trading even in the face of fairly strong prima facie evidence that such trading had occurred.70

68 See text accompanying note 15, supra. In its investigation of the takeover bid of Daimler-Benz for AEG, the Frankfurt Board of Inquiry found that a member of AEG’s Supervisory Board had committed a "minor insider trading violation." Insiderregeln, Handelsblatt, June 27-28, 1986.
70 See, e.g., Thyssen-Rhein steel and Daimler-Benz—AEG investigations discussed infra at text accompanying notes 71-80. The insider in the Daimler-Benz inquiry was asked to return to AEG his profit of DM15,957 on the trade of 700 shares of AEG stock. Insiderregeln, Handelsblatt, July 1986. See generally text accompanying notes 78-80.
B. Application of the Guidelines: Two Case Studies

This section will briefly consider two cases—the Thyssen takeover of Rheinstahl and the Daimler-Benz purchase of AEG—which exemplify the difficulties in applying the Insider Trading Guidelines.

1. Thyssen—Rheinstahl

The first major investigation under the Insider Trading Recommendations occurred in 1973 as a result of the purchase by August Thyssen Huette AG of Rheinstahl AG. The available evidence indicates that in early November 1972, managers from Thyssen and Rheinstahl met to discuss the possibility of greater cooperation between the companies. After several months of negotiation, the companies agreed that Thyssen would purchase 51% of Rheinstahl’s securities. Thyssen completed the takeover in February 1973. During this period of negotiation, the volume of trading in Rheinstahl securities increased significantly and the market price of the stock rose to almost exactly that of the intended offer price.

In response to considerable comment and speculation in the press, the Dusseldorf Stock Exchange solicited allegations of insider abuse. Although no complaint was ever filed with the Dusseldorf Exchange, even after six major banks conducted internal investigations, the Chairman of the Exchange and the banks, with the consent of Thyssen, requested the Board of Inquiry to initiate an investigation. The President of the Inquiries Board, Judge Hans Naeke, agreed to conduct an investigation despite the fact that he technically lacked jurisdiction to do so because no complaint had been filed. Apparently Judge Naeke was willing to proceed because the affected companies had agreed to the probe and pledged their support.

The Board of Inquiry commissioned an independent chartered accountant to conduct the fact-finding portion of the investigation and questioned corporate representatives and others on its own. A total of 160 inquiries were made. The Board publicly concluded that, although there had probably been instances of abusive dealing, there was no evidence that the limited provisions of the Insider Recommendations had been violated. One reason for this conclusion was that the rules did not cover trading by insiders in the securities of unrelated companies. Trading by Thyssen executives in the stock of Rheinstahl was, therefore, not

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71 See B. RIDER & H. FFRENCH, supra note 31, at 247; Coing Address, supra note 24, at 63; Zahn, supra note 56, at 95.

72 B. RIDER & H. FFRENCH, supra note 31, at 247.
prohibited. Although not required to do so, the Board subsequently published its decision relating to the proceedings against Thyssen and Dresdner Bank AG.\textsuperscript{73}

2. \textit{Daimler-Benz—AEG}

A much more recent example of apparent insider trading occurred in connection with the takeover bid by Daimler-Benz AG of AEG AG, a large electrical and electronics firm. According to press reports,\textsuperscript{74} on Monday, October 7, 1985, the Chairman of AEG’s Board of Directors called his nineteen colleagues and invited them to attend a special meeting on the following Sunday. The Board members were apparently told that the meeting concerned Daimler’s participation in AEG and that absolute secrecy was required. The next day, the price of AEG stock jumped from DM157 to DM174, an 11% increase. There was also a huge increase in trading volume. During the last week in September, daily volume of AEG stock traded in Frankfurt and Dusseldorf had ranged between 9,000 and 31,000 shares. On October 8, 170,871 shares of AEG changed hands on the Frankfurt Exchange and 176,539 in Dusseldorf. In short, AEG stock jumped 28% in the ten days prior to Daimler’s official takeover offer. (The Commerzbank Index rose just over 1\% during this same period.\textsuperscript{75}) Daimler completed its purchase of a 56\% stake in AEG in February 1986, after receiving approval from the Federal Cartel Office.

The unexplained jumps in the price and volume of AEG stock caused widespread concern. Hans Peter Schreib, head of the German Association for the Protection of Shareholders, wrote to the Board of Inquiry of the Frankfurt Stock Exchange demanding that an investigation be conducted. The President of the Frankfurt Exchange consented to an inquiry, noting skeptically that “abuse by insiders is always possible.”\textsuperscript{76}

After four months of investigation, the Frankfurt Board of Inquiry, headed by Friedrich-Carl zur Megede, reported its preliminary finding

\footnotesize{\textsuperscript{73} Zahn, supra note 56, at 95 n.8 (citing \textit{DER BETRIEB} 2288 & 2290 (1973)).
\textsuperscript{75} In fact, the price of AEG stock began to move upwards at the beginning of October after discussions had taken place between the Daimler Board and the Chairman of AEG. On October 2, the price of the stock jumped 9 points; daily trading volume on the Hamburg and Munich Exchanges increased ten fold, and trading of AEG stock on the Dusseldorf Exchange experienced a 300\% increase in volume. Trading in AEG was suspended on October 11, 1985, prior to Daimler’s official announcement of its takeover bid. The price of AEG stock continued to climb after the takeover bid was made public, reaching DM241 on October 25, 1985.
\textsuperscript{76} \textit{DER SPIEGEL}, Oct. 28, 1985, at 28 (quoting Frankfurt Stock Exchange President Karl-Oskar Koenigs).}
that "there were no pointers to infringements of insider trading rules." The Wall Street Journal concluded at the time that, "[t]he [Board's] decision comes as little surprise." \(^{77}\)

On June 26, 1986, the Board of Inquiry concluded its investigation of the Daimler-Benz—AEG case by finding, for the first time ever, that there had been a violation—albeit a "minor" one—of the Insider Guidelines. As it was bound to secrecy, the Board refused to divulge publicly any details about its findings, confirming only that it involved a single violation of insignificant magnitude. \(^{78}\)

According to press reports, \(^{79}\) Deutsche Bank AG, which sits on the supervisory boards of both AEG and Daimler-Benz, applied pressure on the boards to make a public statement about the findings after being embarrassed by a shareholder's question at Daimler-Benz's annual meeting. It was also hoped that such a statement would end the considerable speculation by the public as to who had committed the violation. A few days later, Dr. Klaus Kuhn acknowledged his responsibility for the insider trade. Dr. Kuhn was Chairman of the Supervisory Board of AEG at the time of the Daimler takeover. According to Dr. Kuhn, he had purchased a total of 700 shares of AEG stock on September 12 and 20, 1985. These purchases were reportedly made on the recommendation of Dr. Kuhn's bank based on technical chart evaluations. Dr. Kuhn sold the stock in October 1985 for a profit of DM15,957.

During the investigation, Dr. Kuhn informed the Board of Inquiry of his transactions. The Board found that the purchases constituted a "minor" violation of the Guidelines, noting that, as a member of AEG's Supervisory Board, Dr. Kuhn presumably had knowledge of the takeover discussions being held by AEG and Daimler. According to the Board, Dr. Kuhn should therefore not have followed the recommendation of his bank to buy the stock. He subsequently returned the profits he had made from the trade to AEG. No fine or other costs were imposed on Dr. Kuhn for this "minor" violation. \(^{80}\)

The incidences described above represent two of the more spectacular cases of apparent insider trading in the German markets. Both investigations were initiated based upon very strong prima facie evidence that

\(^{77}\) Wall St. J., Mar. 21, 1986.

\(^{78}\) Insiderregeh, Handelsblatt, June 27-28, 1986.


\(^{80}\) Insiderregeh, Handelsblatt, July 7, 1986. Dr. Kuhn asserted that he saw no reason not to follow his bank's recommendation given the very general nature and nonbinding character of the talks between Daimler-Benz and AEG at that time. Dr. Kuhn also contended that in light of the small size of his investment and the fact that the impetus for the purchase came from his bank, it was clear that he had no intention of violating the Insider Trading Guidelines. \(Id.\)
considerable insider trading had taken place. Nonetheless, the conclusions of the Boards of Inquiry that there had been no significant violations of the Guidelines were virtually preordained. Simply put, one can not expect to effectively detect, punish, and deter insider trading of German securities under a system which lacks investigatory tools and meaningful sanctions and which defines violations in extremely narrow terms.

VII. PROSPECTS FOR REFORM

A. Domestic Reform

Despite repeated press reports of insider trading and criticisms offered by legal scholars, there appears to be little movement within the German government or by the stock exchanges to institute significant structural reforms to the current Insider Trading Guidelines. In fact, a number of authorities believe the current self-regulatory system is superior to legal controls. Judge Kissel, former president of the Board of Inquiry of the Frankfurt Exchange, warned in a public statement in December 1980 that enforcement of an insider law by a state agency or by the courts would be completely inefficient, similar to the prosecution of white-collar crime in general.81 Supporters of the current system also contend that insider trading can only be effectively controlled by strengthening the moral code among corporate executives and not by state agencies.82

The German financial establishment has recently been put on the defensive as a result of pressure from the EEC and the United States to crack down on insider trading. Nevertheless, German business and government leaders still contend that the voluntary code is workable, and even preferable, to legal restraint. Werner Jentsch, a director of the West German Banking Association, responded to the foreign criticism by stating: "It's a high price to pay for international legal cooperation if we have to give up this system of self-regulation. . . . We would regret it."83 Another senior Frankfurt banker complained that "the international bureaucrats want to regulate everything. . . . We'd rather have free capital markets, even if it means tolerating a few peccadilloes."84 The results of the Daimler-Benz—AEG investigation appear to have reinforced the belief among many that the current voluntary code is adequate, despite the fact that the Board found only a minor violation involving 700 shares. Mr. zur Megede, who headed the investigation, maintains that the

81 Hopt, supra note 9, at 382 (citing comments of Judge Kissel).
82 See Coing Address, supra note 24, at 126-27.
84 Id.
Board's discovery "shows that the insider trading guidelines are quite serviceable." 85

Furthermore, there appears to be little political support today for establishing a German equivalent of the SEC, particularly in light of the current atmosphere of distrust of government bureaucracies and the general movement towards decentralization. Any changes to the German rules will, therefore, most likely come about as part of the current attempt by the EEC to harmonize insider trading legislation among the Member States.

B. EEC Harmonization Efforts

The 1957 Treaty of Rome, which sets forth the principles governing the EEC, establishes the movement of capital as one of the four basic freedoms within the Community. 86 To give meaning to this freedom, the Commission of the EEC has undertaken measures to facilitate the creation of a common capital market among the Member States. This has included promoting "interpenetration" of the various national capital markets by encouraging investors to trade in securities offered on the markets of other states. Interpenetration will not occur, however, if there is a wide divergence in the efficiency and fairness of national markets. The Community has come to recognize that insider trading undermines the integrity of securities markets and therefore has a deleterious effect on the creation of a common capital market. 87

Among the Member States, 88 legislation prohibiting insider trading currently exists only in France and the United Kingdom. Germany, as discussed previously, has adopted a voluntary code. (Belgium and The Netherlands are currently considering some form of insider trading legislation. 89) Consequently, the protection offered to investors against insider abuse varies widely among the stock markets throughout the EEC.

As part of its company law harmonization program, the Commission is currently considering whether it should impose some minimum degree of coordination to address this variance in insider trading standards among the Member States. 90 The Commission has convened a

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85 Id.
88 There are currently twelve Community members: Belgium, Italy, The Netherlands, Luxembourg, France, The Federal Republic of Germany, The United Kingdom, Ireland, Denmark, Greece, Spain, and Portugal.
89 See Cruickshank, supra note 87, at 346.
90 Since the mid-1960s, the EEC has been pursuing a harmonization of laws program in a com-
Working Group\textsuperscript{91} which met for the first time in June 1985 to draw up a preliminary convention on insider trading. The aim of any insider trading rule would be to provide a minimum level of protection for all investors throughout the Community.

It is still uncertain whether agreement can be reached in the Working Group and at the Commission level on the need for insider trading regulations in the Community and the form these requirements should take. The current mood among German authorities indicates that Germany will object to any broad prohibitory convention.

Should the Commission officially adopt a convention on insider trading as a formal proposal, the Council of Ministers would still have to approve it. Council approval would result in the issuance of a Directive which would be binding on all the Member States.\textsuperscript{92} The entire approval process, however, could take many years to complete.

\section*{VIII. CONCLUSION}

The development of the German capital markets has lagged far behind the industrialization of the country. This situation has adversely affected the ability of German corporations to finance their expansion through equity capital, forcing them to be overly dependent on banks and debt financing. One way of developing and strengthening the German capital markets is to increase their attractiveness to the individual outside investor. This is dependent, in part, on demonstrating that there is equal opportunity for all market participants. Effective control of insider trading would be an important step in this direction.

The purpose of this Article has been to examine the structure and effectiveness of the insider trading code currently in effect in the Federal Republic of Germany. Notwithstanding the well-meaning intentions of its authors, the current voluntary code apparently has not been and cannot be effective in deterring and punishing insider trading abuses. If the German authorities are serious in their desire to prevent insider trading, comprehensive effort to protect employees, shareholders, creditors, investors, and the public against certain types of corporate misconduct. A number of directives have already been issued by the Council addressing such issues as public disclosure of corporate information, the validity of corporate acts, activities and responsibilities of public stock companies, and rules regulating mergers. Several other directives are still under consideration. An effort to harmonize insider trading rules is also part of the program. See Note, \textit{Insider Trading and the EEC: Harmonization of the Insider Trading Laws of the Member States}, 8 B.C. INT'L & COMP. L. REV. 151, 166 (1985).

\textsuperscript{91} The group is known as The Working Party of the Committee of Experts on Insider Trading.

\textsuperscript{92} Directives, however, are fairly flexible because they only require that a certain result be obtained within a defined period (usually two years), thereby allowing national governments the freedom to choose how they will implement the Directives.
significant structural reforms will have to be instituted. To this end, serious consideration should be given to adopting a statutory scheme similar to those in force in France, the United Kingdom, Japan, and the United States. Failure to prevent insider abuses will only serve to injure the long-term interests of German industry and society.