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THE DIRECTIVE ON CRIMINAL SANCTIONS FOR MARKET ABUSE: A MOVE TOWARDS HARMONIZING INSIDER TRADING CRIMINAL LAW AT THE EU LEVEL?

Michael G. Faure and Claire Leger***

INTRODUCTION

For a long time, it was generally held that the European Union (EU) had no competence in the area of criminal law. The EU issued directives, but Member States individually determined methods of implementing the directives in their States. As such, the directive's consequence, rather than a State's chosen instrument, was binding.

However, the European Commission has forced Member States to penalize violations of national legislation derived from EU directives with criminal sanctions, beginning with issues of environmental law. Indeed, in a September 2005 landmark decision, the European Court of Justice ruled that when the application of effective, proportionate, and dissuasive criminal penalties by national authorities are essential for combating serious environmental offenses, criminal law may be prescribed to ensure that national laws on environmental protection are fully effective.¹ The European Commission has exercised these powers through the so-called Environmental Crime Directive of 19 November 2008² and Directive 2009/123 on Ship Source Pollution of 21 October 2009.³ The powers of the EU to force Member States to use criminal law have now also been laid down in the Lisbon Treaty.⁴

Although initially limited to the domain of environmental criminal law, the Commission apparently intends to extend the application of EU criminal

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1. See Case C-176/03, *The Comm'n of the European Cmty. v. Council*, 2005 E.C.R. I-7907.

2. Council Directive 2008/99, *On the Protection of the Environment Through Criminal Law*, 2008 O.J. (L 328) 28. Member states were required to implement this Directive by December 26, 2010.

3. Council Directive 2009/123, *Amending Directive 2005/35 on the Ship-Source Pollution and on the Introduction of Penalties for Infringements*, 2009 O.J. (L 280) 52. It had to be transposed by November 16, 2010.

4. Treaty of Lisbon Amending the Treaty on European Union and the Treaty Establishing the European Communities, Dec. 13, 2007, O.J. (C 306) 1, art. 69 B(2) [hereinafter *Treaty of Lisbon*].

law to the area of economic law, particularly insider trading. The Directive on criminal sanctions for market abuse 2014/57/EU (the Directive), entered into force on April 16, 2014,⁵ introduced minimum rules on criminal offences to be transposed into national criminal law and applied by the criminal justice systems of the Member States. This Directive aligns with the Commission's policy to increasingly introduce EU minimum criminal law standards into other areas of law, on the grounds that only criminal law can demonstrate social disapproval of a qualitatively different nature than civil law's administrative sanctions or compensation mechanisms under civil law.⁶ As Member States' enforcement practices significantly diverge, the Commission argues that this may provide incentives for people to carry out market abuse in the Member States that do not provide for criminal sanctions for these offences or that provide weak enforcement.

This Article critically analyzes the Directive criminalizing insider trading at the EU level from a legal and an economic perspective. In that respect, this Article considers the following question: even if criminal laws may be necessary in particular circumstances, should such laws should be introduced at the EU level? The economic theory of federalism, which analyzes the division of labor between the Member States and the EU, can be used to analyze whether criminalization should be implemented at the EU level.⁷ The study further analyzes whether this Directive is consistent with the fundamental principles of European criminal law. An alternative would obviously be to respect the subsidiarity principle and to allow Member States to decide on the necessity of criminalization in particular circumstances.

This Article will contribute both to the economic theory of criminalization and to the economic theory of federalism by (1) studying which economic criteria criminalization of insider trading are necessary, (2) discussing whether such criminalization should be imposed on the EU or alternatively, on the Member State level, and (3) determining the appropriate guiding legal principles. Further, this discussion will have practice and policy implications as it sheds a critical light, under an economic analysis, on the Directive on criminal sanctions for market abuse.

This Article will be structured as follows: (I) an introduction to the legal background of harmonization of criminal and insider trading laws in the EU and the contents of the Directive on criminal sanctions for market abuse are outlined; (II) a consideration of whether insider trading should be

5. Council Directive 2014/57, On Criminal Sanctions for Market Abuse, 2014 O.J. (L 173) 179.

6. This motivation was expressed throughout the directive, but is stated explicitly in the preamble to Council Directive 2008/99. On the Protection of the Environment through Criminal Law, *supra* note 2, pmb1.

7. For an overview of the economics of federalism, see Roger Van den Bergh, *Towards an Institutional Legal Framework for Regulatory Competition in Europe*, 53 KYKLOS 435 (2000).

criminalized is considered; and then, (III) a discussion of whether such criminalization should be realized at the EU level or (IV) whether criminalization should be implemented at the Member State level.

I. LEGAL AND POLICY BACKGROUND: CONTEXT OF THE DIRECTIVE ON CRIMINAL SANCTIONS FOR MARKET ABUSE

A. HARMONIZATION OF CRIMINAL LAW IN THE EU

1. Criminal law is traditionally a State sovereignty matter

Criminal law is one of the fundamental expressions of State sovereignty: the right to punish. Criminal law intrinsically expresses society's fundamental values by determining its censurable behaviors, and criminal procedure provides the process through which criminally sanctioned conduct is made an offence. Criminal law results in the confrontation of the State's right to punish and the guarantee of citizens' civil liberties. For these reasons, the rules relating to criminal law fall within the competence of the legislature, and parliamentary democratic oversight is strongly involved in its elaboration.

Criminal law embodies other fundamental societal values such as culture, religion, and history. Within the EU, criminal law differs from one country to another. Consequently, as presented in a European Securities and Markets Authority (ESMA) report, Member States may unequally punish the same behavior, procedures may not correspond to the same demands, and the nature of sanctions may diverge significantly.⁸

2. EU criminal law

Historically, it has been held that the EU had no competence in the area of criminal law. Indeed, EU criminal law is a contested field of EU action because it presents a challenge to State sovereignty in this potentially tougher domain of law. Consequently, EU's authority in criminal law is limited because it can only address criminal sanctions through the issuance of Directives.

Behind the use of criminal law, there is the will of the Commission to "demonstrate a stronger form of social disapproval compared to administrative penalties" and to "send a message to the public and to potential offenders that competent authorities take such behaviour very seriously."⁹

8. See ESMA, REPORT: ACTUAL USE OF SANCTIONING POWERS UNDER MAD (2012), available at <http://www.esma.europa.eu/system/files/2012-270.pdf>.

9. On Criminal Sanctions for Market Abuse, *supra* note 5, pmlb. recital 6. See also On the Protection of the Environment through Criminal Law, *supra* note 2, pmlb. recital 3: "criminal

3. Before the Lisbon Treaty

In 1993, the Maastricht Treaty introduced the three pillars of the EU legal structure.¹⁰ The third pillar was dedicated to police and judicial cooperation in criminal matters (PJCC).¹¹ The Maastricht Treaty was the beginning of the creation of a European criminal law enforcement area.¹² Nevertheless, before the Lisbon Treaty, because of the lack of an explicit legal basis, only very few measures have been taken for the purpose of strengthening the enforcement of EU policies via criminal law.¹³

This changed with the decision of the Court of Justice on September 13, 2005, in C-176/03. In this case, the Court argued that although,

as a general rule, neither criminal law nor the rules of criminal procedure fall within the community competence the last-mentioned finding does not prevent the community legislature, when the application of effective, proportionate and dissuasive criminal penalties by the competent national authorities is an essential measure for combating serious environmental offences, from taking measures which relate to the criminal law of the Member States which it considers necessary in order to ensure that the rules which it lays down on environmental protection are fully effective.¹⁴

In a second decision on October 23, 2007, in case C-440/05, the Court of Justice, however, specified: “By contrast, and contrary to the submission of the Commission, the determination of the type and level of the criminal

penalties . . . demonstrate a social disapproval of a qualitatively different nature compared to administrative penalties or a compensation mechanism under civil law.”

10. Treaty on European Union, July 29, 1992, 1992 O.J. (C 191) 1 [hereinafter Treaty of Maastricht].

11. Called “Justice and Home Affairs” (JHA) from 1993 until the implementation of the Amsterdam Treaty in 1999. Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, Oct. 2, 1997, O.J. (C 340) 1.

12. Before Maastricht, measures were not really taken to create a European criminal justice system. The Council of Europe attempted to create interoperable judicial systems for its members by addressing the issue of “mutual assistance in criminal matters” through two conventions respectively on extradition (1957; CETS No.:02) and mutual assistance (1959; CETS No.:03) in criminal matters. Moreover, TREVI (Terrorism, Radicalism, Extremism, Violence International) was the forum of the operational cooperation between ministries of justice and internal affairs of the Member States from 1975 until 1993. The Schengen Treaty of 14 June 1985 was one of the first steps towards operational cooperation in criminal matters in the EU. It was executed through the Schengen Convention of 19 June 1990 and the Schengen acquis, art. 39, 2000 O.J. (L 239). “The Contracting Parties undertake to ensure that their police authorities shall, in compliance with national law and within the scope of their powers, assist each other for the purposes of preventing and detecting criminal offences.” *Id.*

13. See Council Framework Decision, On Increasing Protection Against Counterfeiting by Criminal Penalties and Other Sanctions Against Counterfeiting in Connection with the Introduction of the Euro, 2000 O.J. (L 140) 1; *Communication of the Commission Towards an EU Criminal Policy: Ensuring the Effective Implementation of EU Policies Through Criminal Law*, COM (2011) 573 final (Sept. 20, 2011) [hereinafter *Towards an EU Criminal Policy*].

14. Case C-176/03, *The Comm'n of the European Cmty's. v. Council of the European Union*, 2005 E.C.R. I-7907.

penalties to be applied does not fall within the community's sphere of competence."¹⁵ In that decision, the Court of Justice clarified that within the conditions set by the decision of September 13, 2005, the Commission may prescribe the use of criminal penalties (if the necessity conditions are fulfilled and the topic falls within its sphere of competence).¹⁶ However, the Court held that EU is clearly not competent to "determine the type and level of the criminal penalties to be applied."¹⁷

As it was already made clear in the introduction to this Article, the European Commission has used the new powers that were allocated to it with the promulgation of two criminal law directives.¹⁸ Both directives were implemented by the end of 2010. Since then, the legal framework has changed considerably as a result of the Treaty of Lisbon.

4. The Lisbon Treaty

In 2009, the Lisbon Treaty¹⁹ introduced three specific competences to the European Union for criminal law, providing for a new legal framework for criminal legislation and giving a strong role to the European Parliament, the European Council, and the European Court of Justice. The new legal framework under the Lisbon Treaty aims at providing means to develop consistent and coherent EU criminal law legislation. It allows the Member States to work together with the European Parliament, the Council of the European Union and the European Commission²⁰ by providing a stronger role for national parliaments in the field of criminal law than in the context of other EU policies.²¹ They can give their views on proposals and monitor the respect of the principle of subsidiarity.²² Moreover, the Lisbon Treaty

15. Case C-440/05, *The Comm'n of the European Cmty. v. Council of the European Union*, 2007 E.C.R. I-9128.

16. *Id.* ¶ 24 provides that "the Community is empowered to require Member States to provide for penalties—including, if appropriate, criminal penalties—at national level, where this proves necessary in order to achieve a Community objective."

17. For further details see Michael Faure, *The Continuing Story of Environmental Criminal Law in Europe after 23 October 2007*, 17 EUR. ENERGY & ENVTL. L. 74 (2008).

18. On the Protection of the Environment through Criminal Law, *supra* note 2; Amending Directive 2005/35 on the Ship-Source Pollution and on the Introduction of Penalties for Infringements, *supra* note 3.

19. The Lisbon Treaty amended the Maastricht Treaty (Treaty on European Union) and the Treaty of Rome (Treaty establishing the European Economic Community), both of which formed the constitutional basis of the European Union. Treaty of Lisbon, *supra* note 4. *See also* Consolidated Version of the Treaty on European Union, Oct. 26, 2012, 2012 O.J. (C 326) 13 [hereinafter TEU]. The Treaty of Rome was renamed the Treaty on the Functioning of the European Union (TFEU). Consolidated Version of the Treaty on the Functioning of the European Union, Oct. 26, 2012, 2012 O.J. (C 326) 47 [hereinafter TFEU].

20. These are the three main institutions involved in EU legislation making. *Towards an EU Criminal Policy*, *supra* note 13, at 4.

21. *See* Protocol on the Role of National Parliaments in the European Union, 2010 O.J. (C 83) 203.

22. *See* TFEU, *supra* note 19; TEU, *supra* note 19; Protocol on the Application of the Principles of Subsidiarity and Proportionality, art. 7(2), 2010 O.J. (C 83) 206 ("Where reasoned

made the Charter of Fundamental Rights legally binding, thus providing a high level of protection for citizens.²³

Finally, when a Member State determines that a proposal dealing with criminal law or criminal procedure touches upon fundamental aspects of its national criminal justice system, it has the option to refer it to the European Council.²⁴ Article 83 of the Treaty on the Functioning of the European Union (TFEU) defines the substantive competences of the European Union in criminal matters by providing two specific legal bases for substantive criminal law.²⁵

First, according to Article 83(1) TFEU,²⁶ the EU can adopt directives providing for minimum rules regarding the definition of criminal offences for the listed “Euro crimes”: terrorism, human trafficking and sexual exploitation of women and children, illicit drug trafficking, illicit arms trafficking, money laundering, corruption, counterfeiting of means of payment, computer crime and organized crime.²⁷ “Euro crimes” are crimes of a serious nature with cross-border dimensions, and are therefore thought to merit EU-level approaches. Directive 2014/62/EU, which focuses on the protection of the euro and other currencies against counterfeiting by criminal law,²⁸ was adopted on the basis of this article.

Secondly, Article 83(2) TFEU allows the European Parliament and the Council, on a proposal from the Commission, to establish “minimum rules with regard to the definition of criminal offences and sanctions if the approximation of criminal laws and regulations of the Member States

opinions on a draft legislative act’s non-compliance with the principle of subsidiarity represent at least one third of all the votes allocated to the national Parliaments in accordance with the second subparagraph of paragraph 1, the draft must be reviewed.”).

23. *Towards an EU Criminal Policy*, *supra* note 13.

24. TFEU, *supra* note 19, art. 83(3). *See also Towards an EU Criminal Policy*, *supra* note 13, at 4.

25. SAMULI MIETTINEN, CRIMINAL LAW AND POLICY IN THE EUROPEAN UNION 42 (2012).

27. TFEU, *supra* note 19, art. 83(1):

The European Parliament and the Council may, by means of directives adopted in accordance with the ordinary legislative procedure, establish minimum rules concerning the definition of criminal offences and sanctions in the areas of particularly serious crime with a cross-border dimension resulting from the nature or impact of such offences or from a special need to combat them on a common basis. These areas of crime are the following: terrorism, trafficking in human beings and sexual exploitation of women and children, illicit drug trafficking, illicit arms trafficking, money laundering, corruption, counterfeiting of means of payment, computer crime and organised crime.

On the basis of developments in crime, the Council may adopt a decision identifying other areas of crime that meet the criteria specified in this paragraph. It shall act unanimously after obtaining the consent of the European Parliament.

28. Council Directive 2014/62/EU, On the Protection of the Euro and Other Currencies Against Counterfeiting by Criminal Law and Replacing Council Framework Decision 2000/383/JHA, 2014 O.J. (L 151) 1.

proves essential to ensure the effective implementation of a Union policy in an area which has been subject to a harmonization measure.”²⁹

In addition, Article 325(4) TFEU allows Member States to take measures against the misuse of EU public money and fraud affecting the financial interests of the Union.

The Directive on criminal sanctions for market abuse is based on Article 83(2) TFEU. It should be added that, on September 20, 2011, the Commission issued the Communication “Towards an EU Criminal Policy: Ensuring the effective implementation of EU policies through criminal law” (the Communication), intending to provide, amongst other things, some specific guidance regarding Article 83(2) TFEU.³⁰ This Article provides the possibility for EU institutions to determine which EU policies require the use of criminal law as an additional enforcement tool.

The Treaty explicitly requires a test of whether criminal law measures are “essential” to achieve the goal of an effective policy implementation. According to the Communication, the Commission must carry out an assessment of the national enforcement regimes in place, “based on clear factual evidence,”³¹ and of the added value of common EU minimum criminal law standards,³² taking into account the principles of necessity, proportionality,³³ and subsidiarity. In this Communication, market abuse is the first policy area cited amongst those for which EU criminal law is desirable. Once the need for criminal law is established, the next step

29. TFEU *supra* 19, art. 83(2).

30. *Towards an EU Criminal Policy*, *supra* note 13, at 6.

31. *See id.* at 8.

To establish the necessity for minimum rules on criminal law, the EU institutions need to be able to rely on clear factual evidence about the nature or effects of the crime in question and about a diverging legal situation in all Member States which could jeopardise the effective enforcement of an EU policy subject to harmonisation. This is why the EU needs to have at its disposal statistical data from the national authorities that allow it to assess the factual situation. As part of its follow up action, the Commission will develop plans to collect further statistical data and evidence to deal with the areas covered by Article 325(4) and Article 83(2).

Id.

32. *See id.* at 3.

33. The Institutions have to establish a test to determine whether criminal law measures are “essential” to achieve the goal of an effective policy implementation. This requires the legislators to first analyze whether any other measures, besides criminal implications, would sufficiently ensure the policy implementation or if criminal law could more effectively address the problem. *See id.* at 7. Moreover, the condition of necessity requires deciding which criminal law measures to include in a particular legislative instrument. Article 49 of the Charter of Fundamental Rights (“[t]he severity of penalties must not be disproportionate to the criminal offense”) applies here. Charter of the Fundamental Rights of the European Union, art. 49(3), 2000 O.J. (C 364) 1, 20. *See also Towards an EU Criminal Policy*, *supra* note 13, at 8; MARCUS-SILVERSTOR GROENHUIJSEN & JANNEMIEKE OUWERKERK, *Ultima ration en criteria voor strafbaarstelling in Europees perspectief*, in ROOSACHTIG STRAFRECHT. LIBER AMICORUM THEO DE ROOS 258 (M. Groenhuijsen, T. Kooijmans & J. Ouwerkerk eds., 2013).

concerns the determination of the concrete criminal measure to be adopted at the EU level.

Under Article 83 of the Treaty, EU legislation is limited to “minimum” rules on criminal law.³⁴ Consequently, a full harmonization is impossible. Moreover, Article 83(2) TFEU mentions that the objective to reach is an “approximation of criminal laws and regulations of the Member States,” meaning a reduction of the variation degree between the national systems.³⁵ Nevertheless, according to the principles of legal certainty and proportionality, it is important to clearly define what conduct may be considered criminal, as well as the result to be achieved through the implementation of EU legislation.

The concept of “minimum” rules should be clarified³⁶ to avoid any ambiguity. Regarding sanctions, EU criminal law can require Member States to enact effective, proportionate, and deterrent criminal sanctions for a specific conduct. The Commission’s interpretation of “minimum rules” is clear: several documents specify that “EU law sometimes specifically determines which types and/or levels of criminal sanctions are to be made applicable.”³⁷ The Commission also states that “in each case, the EU

34. *Towards an EU Criminal Policy*, supra note 13.

35. *Id.* at 6.

36. See MIETTINEN, supra note 25, at 44.

The choice of instruments and their inherent limits will also remain a point of contention. Express provisions on approximation refer to directives as the legal instrument by which the Union may create minimum rules. Given substantial limitations to the directive as an instrument, and to the potential lack of direct effect to instruments containing minimum rules, the question arises whether any provisions on the new Area of Freedom, Security and Justice (AFSJ) may allow directly applicable rules on criminal law to be created in the form of Regulation, or whether either these or other competences ostensibly outside the AFSJ can be exercised to circumvent AFSJ references to directives. If the narrative on the development of EU criminal competences can be seen as a contest between the centralizing effects of EU law and the desire of the Member States to retain criminal law as a relatively decentralized policy area, then Lisbon has changed the rules but has not ended the game. What, for example, are “minimum rules?”

Id.

37. The possibility to make a proposal in the field of criminal law including type and level of criminal sanctions included in the EU directive appears in *Towards an EU Criminal Policy*, supra note 13, at 8–9: “Regarding sanctions, ‘minimum rules’ can be requirements of certain sanction types (e.g. fines, imprisonment, disqualification), levels or the EU-wide definition of what are to be considered aggravating or mitigating circumstances.” See *Communication of the Commission on Reinforcing Sanctioning Regimes in the Financial Services Sector*, at 14, COM (2010) 716 final (Dec. 8, 2010): “Any proposals in the field of criminal law should aim at ensuring appropriate coherence and consistency across different sectors, in particular when considering the type and level of criminal sanctions included in EU directives.” The European Commission page dedicated to the criminal law policy also specifies that “[t]he EU can adopt directives providing for minimum rules regarding the definitions of criminal offences, i.e. rules setting out which behavior is considered to constitute a criminal act and which type and level of sanctions are applicable for such acts.” *Criminal Law Policy*, EUR. COMM’N <http://ec.europa.eu/justice/criminal/criminal-law-policy/> (last visited Jul. 21, 2014).

instrument may only set out which sanctions have to be made ‘at least’ available to the judges in each Member State.”³⁸

B. HARMONIZATION OF EU INSIDER TRADING LAW

The European Community was created after the Second World War to ensure integration and cooperation among Member States with the purpose of establishing peace and stability.³⁹

The EU aims at creating a single common market through harmonization towards an ideal of federation.⁴⁰ Nevertheless, political and cultural differences persist. Moreover, Member States are usually skeptical about giving total control to a central body. Consequently, the EU usually uses flexible legal instruments, only binding in relation to the “result that is to be achieved”⁴¹: directives.⁴² National regulators can thereby keep control over implementation. Prior to adopting the Directive on criminal sanctions for market abuse, the existing EU legislation concerning market abuse was restricted to administrative sanctions and measures. Member States enjoyed considerable autonomy in terms of choice and application of national sanctions.

The harmonization of European Union securities regulation started in the 1980s with a legislative framework for common market exchanges,⁴³ introducing a model of mutual recognition and minimum harmonization aimed at consolidating the internal market and opening the European market for investments. Amongst these measures, the 1989 Insider Dealing Directive was the first to prohibit insider trading at EU level.⁴⁴

38. *Towards an EU Criminal Policy*, *supra* note 13, at 8.

39. PAUL CRAIG & GRAINNE DE BURCA, *EU LAW: TEXT AND MATERIALS* 7 (Oxford Univ. Press, 5th ed. 2008).

40. Treaty of Amsterdam, *supra* note 11, art. 2.

41. TFEU, *supra* note 19, art. 249.

42. See *Reinforcing Sanctioning Regimes in the Financial Services Sector*, *supra* note 37. Prior to the MAD’s reforms, the European directives and regulations in place in the area of financial law dealt with four principal issues: (1) “coordination of the power to impose sanctions between several Member States”; (2) “obligation for Member States to provide for the application of appropriate administrative sanctions and measures and ensure that they are effective, proportionate, and dissuasive”; (3) “sanctions for specific infringements”; and (4) “provision for the authorities to publish the measures and sanctions under certain circumstances.” *Id.* at 5–6 (underlining omitted).

43. See generally Council Directive 79/279/EEC, 1979 O.J. (L 66) 21; Council Directive 80/390/EEC, 1980 O.J. (L 100) 1; Council Directive 82/121/EEC, 1982 O.J. (L 66) 21; Council Directive 88/627/EEC, 1988 O.J. (L 348) 1; Council Directive 2011/34/EC, 2011 O.J. (L 184) 1; *Completing the Internal Market*, COM (1985) 310 final (June 6, 1985); Single European Act, 1987 O.J. (L 169) 1; the *Communication of the Commission Towards a Single Market Act*, COM (2010) 608 final/2 (Nov. 11, 2011); Council Directive 85/611/EEC, 1985 O.J. (L 375) 3; Council Directive 89/298/EEC, 1989 O.J. (L 124) 1; Council Directive 93/22/EEC, 1993 O.J. (L 141) 1.

44. Council Directive 89/592, 1989 O.J. (L 334) 30 (EC).

In 1999, the Commission adopted the Financial Action Service Plan (FASP).⁴⁵ The idea of this plan was to promulgate 42 legislative measures, among which was the Market Abuse Directive (MAD). Ultimately, the MAD was enacted in 2003.⁴⁶ A few years later, after the adoption of the FSAP, the so-called Lamfalussy process⁴⁷ provided a new first level general legislative framework for European financial markets, complemented by a series of more detailed second level legislative measures,⁴⁸ providing technical details relative to the Market Abuse Directive.⁴⁹ The European Securities Committee (ESC)⁵⁰ and the Committee of European Securities Regulators (CESR)⁵¹ were also created.

Adopted in early 2003, the Market Abuse Directive (MAD) 2003/6/EC introduced a comprehensive framework to tackle insider dealing and market manipulation practices. In order to ensure the enforcement of Directive 2003/6/EC, Member States were required to implement appropriate administrative measures and sanctions. This requirement did not imply any consequences on Member States' criminal dispositions.

Nevertheless, according to the Commission, this system did not achieve the effective protection of the financial markets⁵² as desired. In December

45. *Financial Services: Implementing the Framework For Financial Markets: Action Plan*, COM (1999) 232 (May 11, 1999).

46. Council Directive 2003/6, On Insider Dealing and Market Manipulation (Market Abuse), 2003 O.J. (L 96) 16.

47. The reference to the Lamfalussy Process pays tribute to the Final Report of the Committee of Wise Men On The Regulation of European Securities Markets, which, under the chairmanship of Alexandre Lamfalussy, provided recommendations on the future regulation of European securities markets. *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets* (Feb. 15, 2001), available at http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf.

48. Resolution of the European Council on More Effective Securities Market Regulation in the European Union, 2001 O.J. (C 138) 1.

49. Commission Directive 2003/124, Implementing Directive 2003/6/EC of the European Parliament and of the Council as Regards the Definition and Public Disclosure of Inside Information and the Definition of Market Manipulation of Dec. 22, 2003, 2003 O.J. (L 339) 70; Commission Directive 2003/125/EC, Implementing Directive 2003/6 of the European Parliament and of the Council as Regards the Fair Presentation of Investment Recommendations and the Disclosure of Conflicts of Interest of Dec 22, 2003, 2003 O.J. (L 339) 73; Commission Directive 2004/72, Implementing Directive 2003/6/EC of the European Parliament and of the Council as Regards Accepted Market Practices, the Definition of Inside Information in Relation to Derivatives on Commodities, the Drawing Up of Lists of Insiders, the Notification of Managers' Transactions and the Notification of Suspicious Transactions of Apr. 29, 2004, 2004 O.J. (L 162) 70; Commission Regulation 2273/2003, 2003 O.J. (L 336) 33.

50. *Commission Decision Establishing the European Securities Committee (ESC)*, COM (2001) 1493 (Jun. 6, 2001). The ESC is constituted of officials of Member States' governments and Commission officials.

51. *Commission Decision Establishing the Committee of European Securities Regulators (CESR)*, COM (2001) 1501 (Jun. 6, 2001). The CESR is constituted of representatives of Member States' national regulators and Commission representatives.

52. *Proposal for Directive on Criminal Sanctions for Insider Dealing and Market Manipulation*, at 3, COM (2011) 654 (Oct. 20, 2011).

2010, the European Commission issued a communication on “Reinforcing sanctioning regimes in the financial services sector.”⁵³

ESMA replaced the Committee of European Securities Regulation on January 1, 2011. ESMA’s work on securities legislation aims at contributing to the development of a single European rulebook by improving coordination and cooperation amongst securities regulators, as well as acting as an advisory group to the European Union Commission. ESMA is also in charge of issuing guidance on the common operation of the Market Abuse Directive.

C. DIRECTIVE ON CRIMINAL SANCTIONS FOR MARKET ABUSE

The first aspect of the reform of the legislative framework for market abuse regulation at EU level consists of a Regulation,⁵⁴ which basically replaces the MAD and incorporates major elements of the Directives. This Regulation implies modifications to the prohibition, to the supervisory⁵⁵ and enforcement powers,⁵⁶ as well as to the administrative measures and sanctions⁵⁷ directly applicable by the Member States. The Commission justified this choice with the fact that a Regulation is the most appropriate legal instrument to define the market abuse framework within the Union because it actually reduces the regulatory complexity related to the diversity of legislation across the Union. Indeed, it would offer greater legal certainty for those subject to the legislation across the Union, introducing a harmonized set of core rules, thereby contributing to the functioning of the Single Market.⁵⁸

Secondly, the Directive on criminal sanctions for market abuse was adopted on the basis of Article 83(2) TFEU.⁵⁹ The motivation is that today, Member States use divergent criminal measures to enforce the prohibition of insider trading. The Commission argues that this may provide incentives

53. *Reinforcing Sanctioning Regimes in the Financial Services Sector*, *supra* note 37.

54. Regulation 596/2014, of the European Parliament and of the Council of 16 April 2014 on Market Abuse (Market Abuse Regulation) and Repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC, 2014 O.J. (L 173) 1 [hereinafter Regulation 596/2014].

55. Mathias Siems & Matthijs Nelemans, *The Reform of the EU Market Abuse Law: Revolution or Evolution?*, 19 MAASTRICHT J. EUR. & COMP. L. 195, 205 (2012).

56. See Regulation 596/2014, *supra* note 54, arts. 25–26. Cross-border cooperation will be reinforced.

57. *Id.* art. 23; *id.* art. 30 (“(h) maximum administrative pecuniary sanctions of at least three times the amount of the profits gained or losses avoided because of the infringement, where those can be determined . . . (i) in respect of a natural person, maximum administrative pecuniary sanctions of at least . . . EUR 5,000,000 . . . (j) in respect of legal persons, maximum administrative pecuniary sanctions of at least . . . EUR 15,000,000 or 15 % of the total annual turnover of the legal person according to the last available accounts approved by the management body . . .”).

58. *Id.* pmb. art. 23.

59. On Criminal Sanctions for Market Abuse, *supra* note 5.

for persons to carry out insider trading in those Member States that provide weak measures for this offense.⁶⁰

This Directive is in line with the policy of the Commission to increasingly introduce common EU minimum criminal law standards, arguing that only criminal law can demonstrate social disapproval of a qualitatively different nature compared to administrative sanctions or compensation mechanisms under civil law.⁶¹

Because the Commission can only address criminal matters by the way of directives, it produced a Directive that only addresses approximation in insider trading criminal matters and general minimum rules.

The Directive requires Member States:

- “[to] take the necessary measures to ensure that insider dealing . . . constitute[s] a criminal offence . . .”⁶² “when committed intentionally [Art. 3]”,⁶³
- “[to] take the necessary measures to ensure that the offences are punishable by effective, proportionate and dissuasive criminal sanctions [Art. 7]”,⁶⁴
- “to ensure that [insider trading] is punishable by a maximum term of imprisonment of at least four years [Art. 7]”,⁶⁵
- “to ensure that legal persons can be held liable for [criminal insider trading] [Art. 8]”.⁶⁶

Moreover, Article 12 of the Directive holds that by July 4, 2018 the Commission should provide a report to the European Parliament and the Council on the application of the Directive and, if necessary, on the need to amend it, in particular with regard to the appropriateness of introducing common minimum rules on types and levels of criminal sanctions. The Commission hence explicitly wishes to reserve the right to introduce common minimum rules on the types and level of criminal sanctions based on Article 83(2) TFEU.⁶⁷

60. *Id.* p.mbl. recital 7.

61. On the Protection of the Environment through Criminal Law, *supra* note 2, p.mbl.

62. On Criminal Sanctions for Market Abuse, *supra* note 5, art. 3(1). *See also* ESMA, *supra* note 8, at 73. This is not the case in one country: Bulgaria.

63. On Criminal Sanctions for Market Abuse, *supra* note 5, art. 3(1). *See also* ESMA, *supra* note 8, at 112. Proof of intent is not required in order to have a guilty verdict in a market abuse case in Cyprus, Germany, Denmark, Spain, Finland, Latvia, Malta, Netherlands, Sweden, and the United Kingdom.

64. On Criminal Sanctions for Market Abuse, *supra* note 5, art. 7(1).

65. On Criminal Sanctions for Market Abuse, *supra* note 5, art. 7(2). *See also* ESMA, *supra* note 8, at 105. The maximum length of imprisonment for insider dealing violations is less than four years in Belgium, France, Lithuania, Luxembourg, The Netherlands, Estonia and Hungary.

66. On Criminal Sanctions for Market Abuse, *supra* note 5, art. 8(1). *See also* ESMA, *supra* note 8, at 73. “Market abuse can not give rise to criminal sanctions in Bulgaria, the Czech Republic, Germany, Greece, Luxembourg, Poland, Portugal, and Sweden.

67. *See Towards an EU Criminal Policy*, *supra* note 13. According to the Communication of the European Commission, minimum rules for the definition of sanctions “rules out a full

The next portion of this Article focuses on the Directive on criminal sanctions for market abuse. The Directive raises two issues that seem separate, but merge within the purview of the Directive. On the one hand, the question arises whether insider trading should be criminalized, but on the other hand, if one has decided that there should be a role for criminal law one must consider if criminal law should be mandated at EU level.

II. CRIMINALIZATION OF INSIDER TRADING: AN ECONOMIC PERSPECTIVE

This section provides a law and economics perspective of whether insider trading should be criminalized. In order to answer that question, the first subsection analyzes under which circumstances public or private enforcement would lead to more cost-effective insider trading laws enforcement. Then, assuming that public enforcement of insider trading laws may be necessary, whether optimal sanctions should be monetary or non-monetary or if public enforcement should take the form of administrative or criminal law enforcement is considered. Criminalization implies particular criteria. The next subsection applies these economic criteria to insider trading and argues that criminal role should only play a role in very specific circumstances and more attention should be paid to alternative legal tools. Both from an economic and a legal perspective, criminal law should be considered as a last resort remedy (*ultimum remedium*), based on the fact that the costs of applying criminal law are very high and that criminal law infringes most strongly on human rights and individual civil liberties.

A. PUBLIC VERSUS PRIVATE ENFORCEMENT OF INSIDER TRADING REGULATION

The rationale for public enforcement of insider trading law relates to the question of why society cannot rely exclusively on private enforcement of laws to control undesirable insider behavior. This subsection explores the economic criteria under which the use of public law enforcement should be preferred over private enforcement.

Because of the relative costs of enforcement, private enforcement should be preferred to public enforcement from an economic perspective, as long as it is less costly and it can provide an equivalent deterrence effect.⁶⁸ Moreover, Gary Becker's classic model of optimal enforcement establishes

harmonisation" but "minimum rules can be requirements of certain sanction types (e.g. fines, imprisonment, disqualification)." *Id.* at 7–8.

68. Steven Shavell, *Liability for Harm Versus Regulation of Safety*, 13 J. LEGAL STUD. 357, 363–64 (1984). See also Steven Shavell, *The Optimal Structure of Law Enforcement*, 36 J. L. & ECON. 255, 273 (1993); Roger J. Van den Bergh & Louis T. Visscher, *Optimal Enforcement of Safety Law*, in MITIGATING RISK IN THE CONTEXT OF SAFETY AND SECURITY: HOW RELEVANT IS A RATIONAL APPROACH? 29 (Richard D. de Mulder ed., 2008)

that when the probability of detection is low or when the gain or the harm is high, more severe sanctions are needed in order to compensate and attain optimal deterrence.⁶⁹

In the trade-off between private and public enforcement, the most important criterion is whether potential victims will have sufficient incentives to file a lawsuit under private law. There could be many reasons why victims could suffer substantial damage but nevertheless never bring suit, even in insider trading cases. The most frequent reason is that their losses are often dispersed. They may, therefore, suffer from what is known as a rational apathy or a rational disinterest problem: since their losses appear to be very small, they are rationally disinterested in bringing suit.⁷⁰

The other major problem with private law enforcement is related to the fact that probability of detection can be low. It is well known that if the probability of bringing a lawsuit is less than 100%, the sanction for deterring a potential insider should be correspondingly higher. In that case, public enforcement is called for to outweigh the low detection rate.⁷¹ It is potentially possible to remedy the low probability of detection by increasing the amount of compensation payable by the injurer under tort law. This is precisely the idea behind the concept of punitive damages.⁷² Also, the rational apathy problem created by the potentially widespread nature of damages could be resolved by allowing collective action by victims.⁷³

Hence, private litigation of insider trading may constitute a problem because of rational apathy and low probability of detection. However, it is possible to resolve these problems with punitive damages,⁷⁴ collective

69. Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-Based Evidence*, 93 J. FIN. ECON. 207, 210 (2009).

70. Hans-Bernd Schäfer, *The Bundling of Similar Interests in Litigation: The Incentives for Class Actions and Legal Actions Taken by Associations*, 9 EUR. J. L. & ECON. 184, 185–86 (2000). See also ROGER VAN DEN BERGH, *Should Consumer Protection Law Be Publicly Enforced? An Economic Perspective on EC Regulation 2006/2004 and its Implementation in the Consumer Protection Laws of the Member States*, in COLLECTIVE ENFORCEMENT OF CONSUMER LAW: SECURING COMPLIANCE IN EUROPE THROUGH PRIVATE GROUP ACTION AND PUBLIC AUTHORITY INTERVENTION 179–203 (William Van Boom & Marco Loos eds., 2007); Goran Skogh & Charles Stuart, *An Economic Analysis of Crime Rates, Punishment and the Social Consequences of Crime*, 38 PUBLIC CHOICE 171, 178 (1982).

71. See Goran Skogh, *A Note on Gary Becker's Crime and Punishment: An Economic Approach*, 75 SWEDISH J. ECON. 305, 309 (1973).

72. William Landes & Richard A. Posner, *An Economic Theory of Intentional Torts*, 1 INT'L REV. L. & ECON. 128, 135 (1981). See generally Robert Cooter, *Economic Analysis of Punitive Damages*, 56 S. CAL. L. REV. 79 (1982).

73. See SONJA KESKE, ANDREA RENDA, & ROGER VAN DEN BERGH, *Financing and Group Litigation*, in NEW TRENDS IN FINANCING CIVIL LITIGATION IN EUROPE: A LEGAL, EMPIRICAL AND ECONOMIC ANALYSIS (Mark Tuil & Louis Visscher eds., 2010).

74. LOTTE MEURKENS & EMILY NORDIN, *THE POWER OF PUNITIVE DAMAGES: IS EUROPE MISSING OUT?* § 101 (Intersentia 2012).

action,⁷⁵ and conditional fee arrangements.⁷⁶ Currently, in most European legal systems, these tools do not exist or exist only to a limited extent. Before turning to criminal law, the focus should first fall on the possibilities to improve the way private enforcement of insider trading law functions.⁷⁷

From an economic perspective, criminal law, as an instrument of public enforcement, is only needed when private enforcement fails. In Europe, this is often the case with insider trading matters for the reasons mentioned above. On the policy level, it may be more interesting to look at alternative methods to improve private enforcement functionality, reducing the need for criminalization of insider trading.

B. ADMINISTRATIVE VERSUS CRIMINAL LAW AND CRITERIA FOR CRIMINALIZATION

The deterrence theory provides an economic framework for the analysis of law enforcement: the goal of the law and its enforcement is deterrence, which should be achieved by setting optimal expected sanctions. Based on this theoretical framework and the objectives of the law and economics theory, the regulators' numerous options to set optimal policies addressing insider trading regulation are introduced and discussed. The central concern of this subsection is the sanction, and more precisely, its type, nature, and form.

1. Optimal expected sanction

First, regarding the optimal expected sanctions, the use of high sanctions with a low probability of detection may not be optimal

75. There is certainly a debate at the European level about the development of collective action. See Hans Micklitz & Astrid Stadler, *The Development of Collective Legal Action in Europe, Especially in Germany*, 17 EUR. BUS. L. REV. 1473 (2006). See also Van den Burgh & Visscher, *supra* note 68:

For individual victims these costs are almost by definition insurmountable but associations might acquire adequate funding for such investigations by charging their members a membership fee or by means of sponsoring. Thanks to group actions economies of scale can be achieved . . . After all, the costs of the lawsuit decrease while the probability of winning the suit (and thereby the expected utility as well) increases if multiple plaintiffs have larger financial means, enabling them to have better access to evidence and get better legal advice. The problem of rational apathy is therefore reduced..

76. MICHAEL FAURE, FOKKE FERNHOUT & NIELS PHILIPSEN, *No Cure, No Pay and Contingency Fees*, in *NEW TRENDS IN FINANCING CIVIL LITIGATION IN EUROPE: A LEGAL, EMPIRICAL AND ECONOMIC ANALYSIS* (Mark Tuil & Louis Visscher eds., 2010).

77. Decriminalization is considered important in the relevant literature. See DIRK VAN ZYL SMIT, *HANDBOOK OF BASIC PRINCIPLES AND PROMISING PRACTICES ON ALTERNATIVES TO IMPRISONMENT*, 13, U.N. Sales No. E.07.XL2 (2007). See also J.-M. COULON, *La Dépenalisation de la Vie des Affaires* (Ministère de la Justice, France 2008).

considering the arguments relating to the risks of insolvency,⁷⁸ the costs of implementation of a large sanctions,⁷⁹ the marginal deterrence,⁸⁰ the importance of the enforceability of laws and the clearance rate,⁸¹ and the supposed risk aversion towards sanctions of the insider traders.⁸² Moreover, according to the scholarly literature, risk aversion implies that optimal sanctions should not be maximal.⁸³

78. Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 183–93 (1968). See also A. Mitchell Polinsky & Steven Shavell, *The Optimal Trade-Off Between the Probability and Magnitude of Fines*, 69 AM. ECON. REV. 880, 880 (1979) (“It is frequently argued that the probability should be as low as possible. The only constraint on lowering the probability that is recognized is the inability of individuals to pay the fine; thus, the optimal fine implied by this argument equals an individual’s wealth.”); Nuno Garoupa, *Optimal Magnitude and Probability of Fines*, 45 EUR. ECON. REV. 1765, 1766 (2001) (“The government should set the fine equal to an offender’s entire wealth and complement it with the appropriate probability in order to achieve optimal deterrence.”).

79. See generally STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW (2004).

80. This argument is related to the necessity of proportionality. Jeremy Bentham, *Introduction to the Principles of Morals and Legislation*, in THE UTILITARIANS 171 (Anchor Books, 1973). Bentham emphasized that the goal of a sanction is “to induce a man to choose always the least mischievous of two offenses; therefore where two offenses come in competition, the punishment for the greater offense must be sufficient to induce a man to prefer the less.”

81. Utpal Bhattacharya & Hazem Daouk, *The World Price of Insider Trading*, 57 J. FIN. 1, 2–3 (2002).

Theoretically and empirically . . . sometimes no corporate law may be better than a good corporate law that is not enforced. This is an important issue because a number of emerging markets have adopted corporate laws, but many of them have not enforced these laws . . . if a law is enacted but not enforced, only some will follow the law; the ones who do not follow the law will deviate with greater intensity in equilibrium, thereby causing law abiders more harm than they were incurring when there was no law. We next ask whether insider trading laws satisfy the above conditions. Our answer is sometimes they do. This happens when corporate insiders have very imperfect information, if the cost of acquiring perfect information is not too high nor too low, and if there are many who will not follow the insider trading law if the insider trading law is not enforced.

See also Arturo Bris, *Do Insider Trading Law Work?*, 11 EUR. FIN. MGMT. 267, 310 (2005).

It is worse to have a regulation that fails to prosecute those who violate it (Mexico, Norway, Russia), than no law at all. The legal reform in countries that have started it—especially in Eastern European countries—should definitely take into account that laws that are not accompanied by good enforcement are useless at best.

82. Elizabeth Szojckj & Gilbert Geis, *Insider Trading: Patterns and Analysis*, 30 J. CRIM. JUST. 277, 283 (2002); Nancy Reichman, *Regulating Risky Business: Dilemmas in Security Regulation*, 13 L. & POL’Y 263, 294 (1991). Reichman holds that insiders belong to the highly skilled category of individuals capable of minimizing risks and increasing the certainty of profitable outcomes. KENNETH G. ELZINGA & WILLIAM BREIT, THE ANTITRUST PENALTIES: A STUDY 126–7 (Yale Univ. Press. 1977).

83. According to Polinsky and Shavell, risk aversion implies that optimal sanctions should not be maximal. See ANTHONY M. POLINSKY & STEVEN SHAVELL, HANDBOOK OF LAW AND ECONOMICS 415 (Elsevier 1st ed. 2007).

2. Monetary and non-monetary sanctions

Regarding the trade-off between monetary and non-monetary sanctions, the major observations of the literature are as follows: society cannot exclusively rely on monetary sanctions,⁸⁴ and, furthermore, there are circumstances under which the use of non-monetary sanctions is necessary to operate either deterrence or incapacitation.

An individual's wealth or occupation can have an impact on the necessity of the use of non-monetary sanctions for deterrence. The literature raises three specific points regarding this issue. First, the deterrence effect of monetary sanctions is limited by wealth, and thus, non-monetary sanctions should be used as a complement to monetary fines.⁸⁵ Second, risk-seeking attitudes increase with wealth; wealthy individuals should therefore not be imposed with maximum monetary sanctions.⁸⁶ Third, shorter prison terms should be imposed with higher opportunity costs for their time.⁸⁷

Furthermore, non-monetary sanctions should be used for incapacitation under restricted circumstances and should be calibrated to the social or economic threat of the offender.⁸⁸

From an economic perspective, an optimal law enforcement policy should be achieved by first, using maximum monetary sanctions as well as

84. Roger Bowles, Michael Faure & Nuno Garoupa, *Economic Analysis of the Removal of Illegal Gains*, 20 INT'L REV. L. & ECON. 537, 538 (2000). See also Steven Shavell, *Criminal Law and the Optimal Use of Non Monetary Sanctions as a Deterrent*, 85 COL. L. REV. 1233, 1237 (1985). "If the likelihood of failure to deter undesirable acts, together with the expected harm in which the acts would result, is sufficiently high, then resort to nonmonetary sanctions may be desirable despite the greater social costs attending their use." *Id.*

85. Literature discusses how the appreciation of monetary sanctions' deterrence effect is *relative to* and *limited by* the personal level of assets or wealth, due to the fact that a monetary sanction is a transfer of wealth. See Richard A. Posner, *Optimal Sentences for White Collar Criminals*, 17 AM. CRIM. L. REV. 409 (1980). See also Shavell, *supra* note 84 at 1236 ("Since non-monetary sanctions are socially more costly to impose than monetary sanctions . . . it is easy to say where nonmonetary sanctions should be employed . . . Social welfare will be greater if only the less costly monetary sanctions are used to deter undesirable acts."); Roger Bowles, Michael Faure & Nuno Garoupa, *The Scope of Criminal Law and Criminal Sanctions: An Economic View and Policy Implications*, 35 J. L. & SOC'Y 389, 405 (2008); SHAVELL, *supra* note 79 (presenting the non-monetary sanction as a solution to operate deterrence on "poor" people).

86. Polinsky and Shavell established that the low-wealth-type of individuals should face maximum monetary sanctions equivalent to their wealth, whilst high-wealth-type of individuals should not be imposed with maximal monetary sanctions, because this may lead to over-deterrence. See Anthony M. Polinsky & Steven Shavell, *A Note on Optimal Fines When Wealth Varies Among Individuals*, 81 AM. ECON. REV. 618, 619 (1991).

87. A sophisticated analysis reveals how opportunity cost of time is a parameter influencing the appreciation of *socially incapacitating sanctions*. Indeed, Chu and Jiang consider that the burden of imprisonment falls more heavily on individuals with higher opportunity cost of time. See Cyrus Chu & Neville Jiang, *Are Fines More Efficient Than Imprisonment?*, 51 J. PUB. ECON. 391, 405 (1993).

88. See VAN ZYL SMIT, *supra* note 77; GUILLAUME ROYER, L'EFFICIENCE EN DROIT PENAL ECONOMIQUE—ETUDE DU DROIT POSITIF A LA LUMIERE DE L'ANALYSE ECONOMIQUE DU DROIT 143 (2009).

proportional and wealth-related ones, and second, by complementing them with non-monetary sanctions,⁸⁹ starting with the less costly ones (considering control, infrastructure, maintenance, and indirect and consequential costs) and the less restrictive ones, in order to induce a similar deterrent effect. From a theoretical point of view, to achieve an equal deterrence effect, non-incapacitating, non-monetary sanctions should be used first (naming and shaming sanctions should be dealt with carefully because of the irreversible stigma they impose and their error costs and potential disproportionate consequences),⁹⁰ followed by the economically incapacitating ones (status ban penalty, withdrawal of licenses, disqualification of managers) and lastly, by the socially incapacitating ones.⁹¹ Economic incapacitation should be applied to social harm (societal threats), whilst social incapacitation should be applied to economic harm (market-specific danger).⁹² Incarceration should always be the last resort, meaning that it should be based on the conclusion that other sanctions are insufficient. All the other means have to be explored and tried first.

3. Administrative and criminal sanctions

Together, the concepts surrounding sanctions⁹³ and the *ultima ratio* principle explain the subsidiary role of criminal law.⁹⁴ When criminalizing,

89. Bowles, Faure, & Garoupa, *supra* note 84. See Steven Shavell, *The Optimal Use of Non Monetary Sanctions as a Deterrent*, 77 AM. ECON. REV. 584 (1987); Steven Shavell & A. Mitchell Polinsky, *The Optimal Use of Fines and Imprisonment*, 24 J. PUB. ECON. 89 (1984); BECKER, *supra* note 78, at 208:

Offenders who cannot pay fines have to be punished in other ways Fines have several advantages over other punishments: for example, they conserve resources, compensate society as well as punish offenders, and simplify the determination of optimal *p*'s and *f*'s. Not surprisingly, fines are the most common punishment and have grown in importance over time.

See also Shavell, *supra* note 84, at 1236–37. “[N]onmonetary sanctions should be employed only when monetary sanctions cannot adequately deter undesirable acts”

90. Jan Van Erp, *Naming Without Shaming: The Publication of Sanctions in the Dutch Financial Market*, 5 REG. & GOVERNANCE 287, 292 (2011) (maintaining that naming offenders functions as a general deterrent in the market for financial intermediaries, but considerably less so in the capital market: “An undesired, but perhaps more likely potential effect is that the publication of sanctions is experienced as stigmatizing. In that case, naming offenders results in defiance, disengagement, distrust, and, expectedly, more crime”). See Note, *Shame, Stigma, and Crime: Evaluating the Efficacy of Shaming Sanctions and Criminal Law*, 116 HARV. L. REV. 2186 (2003). There is danger of overdeterrence and disproportional sanctions when stigmatisation is used as the goal of criminal law. See Alon Klement & Alon Harel, *The Economics of Stigma: Why More Detection of Crime May Result in Less Stigmatization*, 36 J. LEGAL STUD. 355 (2007).

91. By socially incapacitating sanction, we refer primarily to imprisonment.

92. See ROYER, *supra* note 88.

93. CESARE PEDRAZZI, *Le Rôle Sanctionnateur du Droit Pénal*, in LE RÔLE SANCTIONNATEUR DU DROIT PENAL (1985); N. EL-DIN HINDAWI, *ESSAI D'UNE THEORIE GENERALE DE LA JUSTIFICATION* (1979).

94. For an explanation of the sanctioning function of criminal law, see K. BINDING, *DIE NORMEN UND IHRE ÜBERTRETUNG: EINE UNTERSUCHUNG ÜBER DIE RECHTMÄSSIGE*

the *ultima ratio* principle, the principle of legitimate purpose, the principle of guilt, and the principle of legality should always be carefully considered.

From an economic point of view, in the trade-off between administrative and criminal enforcement, all things being equal, administrative procedure has the advantage of being less costly than criminal procedure.⁹⁵ However, there are clear economic reasons that prove society cannot rely exclusively on administrative law. The use of criminal law seems justified when there is a need for very stringent sanctions and accurate proceedings in order to secure the imposition of such stringent sanctions (reduction of error cost).⁹⁶ Particularly, the use of the most severe sanctions through criminal law is desirable to effectuate deterrence when the gain or the harm is very high, and when the probability of detection and conviction is very low. They may also be needed to effectuate incapacitation in cases of limited wealth, violence, or undeterrability.⁹⁷ The most severe sanctions should be imposed through criminal proceedings because criminal procedure offers the advantage of securing the imposition of such severe sanctions through high procedural requirements, which guarantee limited error costs.⁹⁸ Moreover, the inherent stigma associated with criminal law enables the strengthening of the deterrence effect of any criminal sanction. Nevertheless, it may not always be optimal to have a systematic recourse to criminal law when a high sanction is sought. It may be relevant to keep in mind that, even if criminal law seems to offer the most coercive sanctions through social incapacitation and inherent stigma, some sanctions, such as “naming and shaming” sanctions or classic fines with an added dimension of shame, can be considered as serious alternatives. Moreover, and as extensively described above, criminal law achieves a very specific goal and should be reserved for harms fulfilling specific criteria. Consequently, the recourse to such enforcement should be considered very cautiously and not be solely based on the belief that it is actually the most coercive measure.

HANDLUNG UND DIE ARTEN DES DELIKTS (Aalen: Scientia. 1965); R. GARRAUD, *TRAITÉ THÉORIQUE ET PRATIQUE DU DROIT PÉNAL FRANÇAIS* (Recueil Sirey 3d ed. 1913); L. JIMÉNEZ DE ASUA, *DERECHO PENAL* § t.I, n°8, par.13, in fine (1917).

95. See Michael Faure, Anthony Ogus & Niels Philipsen, *Curbing Consumer Financial Losses: The Economics of Regulatory Enforcement*, 31 L. & POL’Y 161,173–76 (2009).

96. See Thomas Miceli, *Optimal Prosecution of Defendants Whose Guilt is Uncertain*, 6 J.L. ECON. & ORG. 189 (1990).

97. See BECKER, *supra* note 78; Gary S. Becker & George J. Stigler, *Law Enforcement, Malfeasance, and Compensation of Enforcers*, 3 J. LEGAL STUD. 1 (1974); BOWLES, *supra* note 85; L. ESCRESA GUILLERMO, *REEXAMINING THE ROLE OF INCARCERATION AND STIGMA IN CRIMINAL LAW* (Erasmus Universiteit Rotterdam 2011); Shavell, *supra* note 84; Steven Shavell, *A Model of Optimal Incapacitation*, 77 AM. ECON. REV. 2 (1987); ANTHONY POLINSKY, *HANDBOOK OF LAW AND ECONOMICS* 415 (Elsevier 1st ed. 2007); KATARINA SVATIKOVA, *ECONOMIC CRITERIA FOR CRIMINALIZATION* (2012).

98. See Miceli, *supra* note 96.

Finally, regarding the accumulation of administrative and criminal enforcement of laws, it seems desirable to opt for a non-cumulative system of prosecutions in order to reduce the risk of over-punishment and the costs of prosecution.⁹⁹

In the place of criminal enforcement, administrative enforcement may be appropriate when the alleged harm is relatively low and the probability of sanctions relatively high, when the individual has many assets at stake, when the individual may be better punished by economic incapacitation and when criminal stigma is not necessary for deterrence.

C. CRIMINALIZATION OF INSIDER TRADING?

The economic criteria for criminalization can apply to insider trading. First, the question of the need for criminal law comes down to whether there is a need to use criminal law for deterrence. Therefore, one must determine whether the potential harm caused by, or the gain obtained via insider trading, can be high enough and the probability of sanctions low enough for the optimal administrative sanctions to fail in deterring potential insiders.

Even though the measure of the impact of insider trading on economic efficiency is controversial,¹⁰⁰ insider trading is considered harmful from both a moral,¹⁰¹ as well as a fairness and justice¹⁰² point of view.

99. Wouter Wils, *The Principle of "Ne Bis in Idem" in EC Antitrust Enforcement: A Legal and Economic Analysis*, 26 WORLD COMPETITION 131, 136 (2003). "From the perspective of minimizing cost, multiple prosecutions would thus always appear undesirable." *Id.* at 137.

100. The empirical literature has tried to measure the insider trading harm or benefits through the assessment of indirect variables or by evaluating its impact on the economy of insider trading law. For an assessment of the detrimental effects of insider trading on economic efficiency, see FRANK H. EASTERBROOK, INSIDER TRADING AS AN AGENCY PROBLEM (John W. Pratt & Richard J. Zeckhauser eds., Harv. Bus. Press 1985). See also REINIER KRAAKMAN, THE LEGAL THEORY OF INSIDER TRADING REGULATION IN THE UNITED STATES (K. Hopt & E. Wymeersch eds., 1991); James S. Ang & Don R. Cox, *Controlling the Agency Cost of Insider Trading*, 10 J. FIN. & STRATEGIC DECISIONS 1 (1997); Sanford J. Grossman & Oliver Hart, *Corporate Financial Structure and Managerial Incentives*, in THE ECONOMICS OF INFORMATION AND UNCERTAINTY (John J. McCall ed., 1982); Nicholas L. Georgakopoulos, *Insider Trading as a Transactional Cost: A Market Microstructure Justification and Optimization of Insider Trading Regulation*, 26 CONN. L. REV. 1, 6 (1993); Laura Beny, *A Comparative Empirical Investigation of Agency and Market Theories of Insider Trading*, (Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series, Discussion Paper No. 264 (1999)); Bhattacharya & Daouk, *supra* note 81. For a discussion on the economic efficiency of insider trading, see Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857 (1983). See also HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET (The Free Press 1966).

101. Roy A. Scotland, *Unsafe at Any Price: A Reply to Manne*, 53 VA. L. REV. 7 (1967).

102. ANTHONY OGUS, REGULATION: LEGAL FORMS AND ECONOMIC THEORY 46 (Clarendon Press, 1994) ("Regulation may be inspired by a desire, which is quite distinct from efficiency aims, to achieve 'fair' or 'just' distribution of resources"). For the concepts of "fairness" and "justice", see Thomas Hobbes, *Leviathan*, in MODERN MORAL AND POLITICAL PHILOSOPHY (1998); DAVID HUME, ENQUIRIES CONCERNING HUMAN UNDERSTANDING AND CONCERNING

The median insider trading gain or loss avoided appears to be stable through the decades, reaching approximately \$25,594.¹⁰³ Obviously, there are cases where gains are substantially lower or substantially higher in other cases. This means that, in many cases, administrative sanctions may suffice to achieve deterrence. However, an analysis by Frino, et al. establishes that the average insider trading gain or loss avoided is \$215,696.¹⁰⁴ This would suggest that some insiders obtain astronomical gains; these are the cases that justify the use of criminal law.

The literature on detection highlights several challenges in detecting insider trading. Even if the scholars have not yet been able to measure the quantity of undetected insider trading, several studies suggest that insider trading is a common practice that remains rarely detected mainly because of its immaterial¹⁰⁵ and diffuse¹⁰⁶ nature. Hence, the essence of insider trading is based on legitimately acquired but confidential information that one receives from a personal position.¹⁰⁷ Moreover, financial instruments and trades are considered to be international, anonymous, technical, and immaterial.¹⁰⁸ Insiders may also hide their trades using proxies or intermediaries.¹⁰⁹ Finally, the scholarly literature questions the limited

THE PRINCIPLES OF MORALS (Lewis Amherst & Selby-Bigge eds., Clarendon Press 1902) (1777); IMMANUEL KANT, THE PHILOSOPHY OF LAW (The Lawbook Exchange, Ltd. 2010).

103. Alex Frino et al., *How Much Does an Illegal Insider Trade?*, 13 INT'L REV. FIN. 241, 249 (2013). See also Lisa K. Meulbroek, *An Empirical Analysis of Illegal Insider Trading*, 47 J. FIN. 1661, 1666 (1992); Szockyj & Geis, *supra* note 82.

104. See Frino, *supra* note 103, at 249. The mean value was reached from a sample of 296 illegal insider trades.

105. See JONATHAN R. MACEY, INSIDER TRADING: ECONOMICS, POLITICS AND POLICY 5 (AEI Press. 1991) ("In addition, detecting insider trading is difficult. For one thing, insiders can disguise their identities and trade through proxies and foreign intermediaries."). See also EASTERBROOK, *supra* note 100, at 91; THOMAS MICELI, THE ECONOMIC APPROACH TO LAW (Stanford Univ. Press. 2004).

106. For instance, when an insider buys stocks or when informed insiders trade on inside information, any uninformed investor trading against them will lose in the transaction. See Joseph E. Finnerty, *Insiders and Market Efficiency*, 31 J. FIN. 1141, 1146 (1976); Jeffrey F. Jaffe, *Special Information and Insider Trading*, 47 J. BUS. 410, 414 (1974); Michael S. Rozeff & Mir A. Zaman, *Market Efficiency and Insider Trading: New Evidence*, 61 J. BUS. 25, 25 (1988); H. Nejat Seyhun, *The Effectiveness of Insider-Trading Sanctions*, 35 J.L. & ECON. 148, 149–48 (1992); Esther B. DelBrio, Alberto Miguel & Javier Perote, *An Investigation of Insider Trading Profits in the Spanish Stock Market*, 42 Q. REV. ECON. & FIN. 73, 75 (2002) (discussing the effects in Spain); Josef Lakonishok & Inmoo Lee, *Are Insider Trades Informative?*, 14 REV. FIN. STUD. 79, 80 (2001) (discussing the effects in the United States); Jerome B. Baesel & Garry R. Stein, *The Value of Information: Inferences from the Profitability of Insider Trading*, 14 J. FIN. & QUANTITATIVE ANALYSIS 553, 567 (1979) (discussing the effects in Canada); Sylvain Friederich et al., *Detecting Returns Around the Trades of Corporate Insiders in the London Stock Exchange*, 8 EUR. FIN. MGMT. 7, 26 (2002) (discussing the effects in the United Kingdom); P. F. Pope, R. C. Morris, & D. A. Peel, *Insider Trading: Some Evidence on Market Efficiency and Directors Share Dealings in Great Britain*, 17 J. BUS., FIN. & ACCT. 359, 378 (1990) (discussing the effects in the United Kingdom).

107. See Szockyj & Geis, *supra* note 82, at 283.

108. See EASTERBROOK, *supra* note 100; Miceli, *supra* note 96.

109. See KRAAKMAN, *supra* note 100; MACEY, *supra* note 105.

efficacy of the methods of detection used by the public authorities¹¹⁰ and the insufficiency of staff and budget resources dedicated to insider trading detection.¹¹¹ They also suggest that a large number of insider trading cases remain undetected.¹¹² All in all, the literature provides elements that support the idea that insider trading is difficult to detect.

Insider trading involves the trading on the basis of material non-public information. The establishment of the material and the non-public qualities of the information on which the trade is based are central to successfully prosecuting and convicting illegal insider trading. Under certain circumstances, the intention of the insider also has to be proven.¹¹³ This process is difficult, if not “impossible.”¹¹⁴ Most of the time, the establishment of a certain level of culpability is only required under criminal law. The establishment of any level of guilt proves to be extremely difficult in insider trading matters due to the nature of the crime. Finally, an ESMA report has established that the probability of conviction of insider trading is 52.3% for administrative insider trading and 37.3% for criminal insider trading.¹¹⁵

It has been established that insider trading can prove to be unfair and, more controversially, potentially harmful for the economy. Moreover, the gain or loss avoided from insider trading can be substantial. Furthermore, the probability of sanctions (resulting from the combination of the probability of detection and conviction) tends to be quite low. Under these circumstances, criminal law would be needed for deterrence.

Another consideration should be the stigma associated with criminal prosecutions. Although it is doubtful whether inflicting a stigma is a good criterion for criminalization, some literature suggests that first time offenders would particularly suffer social and economic consequences from being criminally convicted.¹¹⁶ Furthermore, the literature indicates that insiders mostly belong to the category of wrongdoers who are especially receptive to stigma.¹¹⁷ On the one hand, this may be an argument to use criminal law for its stigmatizing effect; on the other hand, the potential

110. See Frino, *supra* note 103; LARRY HARRIS, *TRADING AND EXCHANGES: MARKET MICROSTRUCTURE FOR PRACTITIONERS* (Oxford Univ. Press 2003); Meulbroek, *supra* note 103.

111. Laura Beny & Nejat Seyhun, *Has Insider Trading Become More Rampant in the United States? Evidence from Takeovers* (University of Michigan Law School Law and Economics Research Paper Series, Paper 50, (2012)).

112. Meulbroek, *supra* note 103.

113. HARRIS, *supra* note 110, at 588.

114. *Id.* Larry Harris was former Chief Economist at the SEC from July, 2002 to June, 2004.

115. See ESMA, *supra* note 8, at 83–84.

116. See J. Adam, Peter-Jan Engelen, & Marc Van Essen, *Reputational Penalties on Financial Markets to Induce Corporate Responsibility*, in *RESPONSIBLE INVESTMENT IN TIMES OF TURMOIL* (S. Signori & H. Schäfer eds., 2011). See also Van Erp, *supra* note 90.

117. See Szockyj & Geis, *supra* note 82, at 277 (“Frequency of insider trading refers to the number of times that non-public information was exploited. Two-thirds (67.5 percent) of the defendants were charged with illegally trading on only one occasion.”).

dangers of criminal prosecution (de-socialization and over-deterrence resulting from stigmatizing effects of criminal law)¹¹⁸ have to be seriously taken into account. As a result, it is doubtful that criminalization would be warranted for the stigma associated with it. This characteristic could nevertheless constitute an argument to consider the possibility of criminalization when it is really needed.

Second, insider trading is not a violent crime for which the use of non-monetary sanctions would effectuate social incapacitation. Indeed, statistics indicate that 67.5% of defendants in insider trading cases were only charged on one occasion.¹¹⁹ This means that they are not undeterrable repeat offenders that need to be incarcerated for the purpose of deterrence. Consequently, critics maintain that social incapacitation may not be necessary in the context of financial infractions¹²⁰ and that status sanctions are “sufficient” according to the law and economics precepts of deterrence.¹²¹ In this respect, non-monetary sanctions as an alternative to social incapacitation in general, and to incarceration more particularly, should be favored when dealing with insider trading.

D. ULTIMUM REMEDIUM

Criminal law must be considered in all circumstances as an *ultimum remedium*, a remedy of last resort.¹²² Criminal sanctions not only have high social costs, but also have very high standards of proof and “enforcement costs.”¹²³ Criminal law should only be employed when other remedies

118. See *Shame, Stigma and Crime*, *supra* note 90. There is a danger of disproportion when stigmatisation is used as the goal of criminal law.

119. See Szockyj & Geis, *supra* note 82, at 277.

120. See Posner, *supra* note 85, at 418. “But wherever and for whatever reason it is decided to retain criminal sanctions for individual white-collar offenders, the movement should be toward the abolition of imprisonment and the substitution of fines—albeit fines more severe than those today meted out to such offenders.”

121. ROYER, *supra* note 88, at 143.

122. For the *ultima ratio* principle notion, see G. STEFANI, QUELQUES ASPECTS DE L'AUTONOMIE DU DROIT PENAL (1956); R. MERLE & A. VITU, *Problème Généraux de la Science Criminelle, Droit Pénal Général*, in TRAITÉ DE DROIT CRIMINAL (1997); N. JAREBORG, *What Kind of Criminal Law Do We Want?*, in BEWARE OF PUNISHMENT: ON THE UTILITY AND FUTILITY OF CRIMINAL LAW 17–22 (A. Snare ed., 1995) (“Punishment is society’s most intrusive and degrading sanction. Criminalization should accordingly be used only as a last resort or for the most reprehensible types of wrongdoing.”). See also A. P. SIMESTER & G. R. SULLIVAN, CRIMINAL LAW: THEORY AND DOCTRINE (Hart Publishing 1999) (“Criminal censures should not be deployed merely as a tool of convenience, and where possible other forms of social control ought to be used in their stead.”); Douglas Husak, *The Criminal Law as Last Resort*, 24 OXFORD J. LEGAL STUD. 207 (2004).

123. Criminal law is associated with the highest enforcement costs. See SHAVELL, *supra* note 79. The different stages of criminal prosecution include investigation, interrogation, collection of evidence, and possible detention. The litigation is usually longer than for an administrative enforcement. The people involved in the criminal procedure include the Prosecutor, the investigator, the lawyers, the police, the judge and possibly the center of incarceration staff. Following the initial criminal proceedings, there may be up to two opportunities for appeal. Criminal sanctions may imply social incapacitation and therefore be associated with high

(private law or administrative enforcement) are not capable of achieving the same goal. For example, it is possible to use administrative fines for cases where there is no insolvency risk due to a limitation of wealth (where the gain is not too high and the probability of detection not too reduced).

Above all, incarceration, the most stringent sanction available to criminal law, should be the last resort of criminal sanctions.¹²⁴ Non-monetary alternatives to prison should be favored, starting with the non-incapacitating methods, followed by financially impairing methods, and socially incapacitating methods. For example, a corporation can prohibit an offender from serving as a director for a period of time, or an offender's license the revocation of a license or the prohibition to exercise a particular profession.

III. CRIMINALIZATION OF INSIDER TRADING AT EU LEVEL?

If a policymaker were to decide that there should be a (limited) role for criminal law, one must then decide whether such criminalization should be promulgated at the EU level. This question must be addressed while simultaneously considering whether insider trading law should be harmonized at the EU level.¹²⁵ The latter issue will not be addressed for the simple reason that insider trading has been regulated at the EU level. However, the mere fact that the norm (in this case, the prohibition of insider trading) has been promulgated at the EU level does not necessarily imply that the enforcement measures (criminal law) should be prescribed at the EU level as well. Recently, Josephine van Zeben has rightly indicated that as far as the allocation of competences within a federal system like the EU is concerned, one should distinguish between competences for standard-setting (making the norm) implementation and enforcement. In both cases, one could make a choice between allocation to the central or the Member State level based on economic criteria.¹²⁶ Ultimately, the question is whether the mere fact that the norm itself (prohibition of insider trading) has been promulgated at the EU level should necessarily imply that the

enforcement costs. The cost of criminal law enforcement includes the maintenance of the entire public system (prison and courts). Furthermore, a stigma effect and a reputational loss are associated with the punitive dimension of the criminal sanction. *Id.*

124. See VAN ZYL SMIT, *supra* note 77.

125. A similar problem arises when discussing the desirability of harmonization of procedural law. This issue is also strongly related to the harmonization of substantive private rules as well. See LOUIS VISSCHER, A LAW AND ECONOMICS VIEW ON HARMONIZATION OF PROCEDURAL LAW 65–91 (X.E. & C.H. Van Rhee Kramer eds., 2012).

126. See JOSEPHINE VAN ZEBEN, COMPETENCE ALLOCATION AND REGULATORY FUNCTIONING: A STUDY OF THE EUROPEAN EMISSION TRADING SCHEME (Cambridge Univ. Press 2014).

method of enforcement (i.e., use of the criminal law) should be harmonized as well.¹²⁷

These questions are addressed by (A) briefly looking at the economic criteria for centralization, (B) considering the issue from a European legal perspective, and (C) finally considering a fundamental legal doctrine argument. However, from the outset it should be stated that it may be difficult to apply the economic criteria for the simple reason that such criteria have been developed primarily to examine whether there would be arguments in favor of centralization of normative legal standards (prohibition of insider trading), and not for the question of whether enforcement measures ought to be harmonized as well. In that respect, only the general need for harmonization of the method of enforcement (criminalization) is questioned. The economic theoretical framework does not provide an answer as to whether a specific modality of criminalization such as the procedural requirement of intent or the criminal liability of legal person is desirable. However, the legal doctrine provides some relevant insight to such queries.

A. ECONOMICS OF FEDERALIZATION CRITERIA FOR CENTRALIZATION OF NORMSETTING

Economics of harmonization provide a relevant framework for questioning whether harmonization is desirable depending on the characteristics of a certain domain. The assessment is made on the basis of three criteria: inter-jurisdictional externalities, jurisdictional competition, and transaction costs. Analysis of internal markets and benefits of different perspectives offer interesting complementary arguments.

1. Transboundary externalities

The economic criteria in favor of centralization of powers, as mentioned, usually relate to the normative legal rules and not to enforcement issues. Arguments that speak to enforcement issues include the fear of transboundary externalities, the risk of a race-to-the-bottom, and the diminution of transaction costs.¹²⁸ Interestingly, those arguments are to some extent also advanced as criteria by criminal lawyers for harmonization of the criminal law.¹²⁹ The danger of cross-border crimes is also advanced

127. Recently, Klip rightly contended that at a European level the subsidiarity principle should also be considered as a criterion for criminalization. See André Klip, *European Criminal Policy*, 20 EUR. J. CRIME, CRIM. L. & CRIM. JUST. 3, 6 (2012).

128. See Michael Faure, *Regulatory Competition vs. Harmonization in EU Environmental Law*, in REGULATORY COMPETITION AND ECONOMIC INTEGRATION: COMPARATIVE PERSPECTIVES 282–86 (D. Geradin & D. Esty eds., 2001).

129. See André Klip, *Conditions for a Corpus Iuris Criminalis*, in TOWARDS A EUROPEAN IUS COMMUNE IN LEGAL EDUCATION AND RESEARCH 110–15 (Michael Faure, H. Schneider & J. Smits eds., 2002).

by the European Commission in favor of the use of EU common criminal law to prevent unpunished offences against EU law in certain policy areas (such as the protection of the environment and finance).¹³⁰ This is the traditional transboundary or inter-jurisdictional externalities argument that would justify harmonization.

Of course, it is not difficult to make the argument that securities markets have become increasingly transboundary and even global. The '80s and the '90s have led to the advent of the current global marketplace. During the '80s, restrictions on cross-border capital flows were gradually relaxed within the major industrial countries.¹³¹ Internationalization of the securities markets can be illustrated by the significant increase in securities transactions that occur across the borders of several countries. Investors have access to foreign securities and issuers can tap the major stock markets in the United States or Europe to raise equity capital.¹³² Indicators showing the reality of the internationalization of the securities market include cross-listing of securities,¹³³ cross-country hedging and portfolio diversification,¹³⁴ open national stock market,¹³⁵ and "passing the book."¹³⁶ All of these practices have significantly increased in the past decades.¹³⁷

130. *Towards an EU Criminal Policy*, *supra* note 13.

131. See Marc I. Steinberg & Lee Michaels, *Disclosure in Global Securities Offerings: Analysis of Jurisdictional Approaches, Commonality and Reciprocity*, 20 MICH. J. INT'L L. 207, 208 (1999).

132. LI ZHAO, *SECURITIES REGULATION IN THE INTERNATIONAL ENVIRONMENT* 100 (Univ. of Glasgow, 2008).

133. Cross-listing means that a company incorporated in one country lists its securities on an exchange in another country. See Jodi G. Scarlata, *Institutional Developments in the Globalization of Securities and Futures Markets*, 74 FED. RES. BANK ST. LOUIS REV. 17 (1992), available at http://research.stlouisfed.org/publications/review/92/01/Developments_Jan_Feb1992.pdf. See also John Coffee, *Competition Among Securities Markets: A Path Dependant Perspective* 17 (192 Columbia Law and Economics Working Paper, 2002) ("[T]he number of foreign companies listed on the two principal U.S. stock markets (the NYSE and Nasdaq) grew from 170 in 1990 to over 750 in 2000 (or roughly a 450% increase)"); Stijn Claessens, Simeon Djankov & Daniela Klingebiel, *Stock Markets in Transition Economies*, (World Bank Financial Sector Discussion Paper No. 5, 2000).

134. Cross-national portfolio investment is the degree to which investors of a country buy securities listed in another country. See Scarlata, *supra* note 132, at 18 ("A U.S. trader, for example, can diversify a portfolio composed of U.S. stocks by buying stocks of a U.K. firm in London through a London broker."); ZHAO, *supra* note 132, at 72 ("In the 1950's, foreign investors held a little more than 2 percent of U.S. securities; by mid-1988 it was nearly 12 percent.")

135. ZHAO, *supra* note 134, at 72:

Many countries opened their exchanges for membership by foreign firms in 1980s. Holding membership in another country's exchanges is another form of internationalization. Before December 1997, only 45 nations offered serious market-opening measures in the World Trade Organization (WTO) context. In December 1997 WTO issued an accord to liberalize worldwide financial markets. The current agreement commits over 102 WTO members to liberalize their domestic markets and provide access to foreign financial services providers.

Internationalization of the world's securities market has challenged traditional notions of regulation and enforcement.¹³⁸ In order to ensure the operational and informational efficiency of their market, domestic regulators have been forced to deal with cross-border cases. This means that they must be in a position to assess the nature of activities within markets and environments different from their own. As a direct effect of the globalization, financial and technological innovations, cross-border activities, cross-asset effects, and broader financial and economic policy issues are changing.¹³⁹ Most modern securities markets are regulated on a national basis and the current territorial approach to regulation may suffer from numerous weaknesses. Regulators can be captured or pressured by local interest groups in the securities industry. They can also be subject to opportunism whilst trying to maximize their personal prestige and act in favor of their carrier through complicated regulations.¹⁴⁰ Moreover, different levels of expertise amongst regulators and courts may lead to problematic interpretation issues.

These arguments clearly show that the securities market is transboundary, but that does not necessarily mean that Member States would be able to externalize harm to other Member States if, for instance, one Member State decided to criminalize insider trading and another did not. The powerful argument in favor of centralized rule making based on the risk of externalities between jurisdictions relates to whether divergent insider trading rules in criminal insider trading matters within the European Union eventually risk passing negative externalities from one Member State

136. See Scarlata, *supra* note 134, at 18. "Passing the book" is an expression describing how the "control of trading is passed between traders at exchanges around the globe. This enables 24 hour trading of a financial instrument". It consists in transferring the handling instructions between trades and mostly concerns foreign exchange and bullion, not equities.

137. See ZHAO, *supra* note 132, at 70–73.

138. See Uri Geiger, *Harmonization of Securities Disclosure Rules in the Global Market—A Proposal*, 66 *FORDHAM L. REV.* 1785, 1786–89 (1998); Stephen J. Choi, *Assessing Regulatory Responses to Securities Market Globalization*, 2 *THEORETICAL INQUIRIES IN L.* 631 (2001); IOSCO, *CAUSES, EFFECTS AND REGULATORY IMPLICATIONS OF FINANCIAL AND ECONOMIC TURBULENCE IN EMERGING MARKETS* 63 (1998) [hereinafter *IOSCO REPORT*], available at <http://www.sc.com.my/wp-content/uploads/eng/html/resources/discussion/ioscosept98.pdf>.

What these developments suggest is that the environment of securities regulation no longer appears to be limited in scope . . . A major implication for regulators in these jurisdictions therefore, is that they will have to consider whether the regulatory framework within which they operate has sufficient capacity and appropriate structure to accommodate a wider and more complex set of objectives.

Id.

139. See *IOSCO REPORT*, *supra* note 138, at 63 ("This has certain implications for securities regulators—and particularly for emerging market regulators. It is likely that they would be increasingly expected to deal with issues outside of their traditional scope of responsibilities, in particular, those involving cross-border activity, cross-asset effects and broader financial and economic policy issues.").

140. See ZHAO, *supra* note 134, at 100.

to another.¹⁴¹ Domestic criminal laws may not always guarantee a full internalization of the negative externalities occurring outside the insider's home state. If the costs of a legal rule cannot remain in the Member State that enacted it, centralization should be favored.

2. Race-to-the-bottom

Secondly, the possibility of a race-to-the-bottom in enforcement of insider trading laws should also be considered. Scholarly literature posits that some Member States would not be interested in seriously enforcing insider trading laws, e.g., by enforcing it through very weak enforcement mechanisms.¹⁴² There is, however, no concrete evidence that such a race-to-the-bottom in this area would take place. One problem is that all Member States (with one exception, Bulgaria) have *de facto* criminalized insider trading, although the level of penalties differs. It is, however, unlikely that the differences in levels of penalties are merely state attempts to engage in a race-to-the-bottom, which would lead to a destructive competition in order to attract insider traders. There is no evidence whatsoever that such a scenario is likely to occur between European Member States.

Some, specifically Roberta Romano, have even advocated for a race-to-the-top.¹⁴³ The race-to-the-top refers to the idea that investors would not be willing to pay as much for securities of firms incorporated in states that have a legal regime, which is detrimental to shareholders' interest, and overwhelmingly benefit management. The reasoning is that lenders will not make loans to these firms without compensation for the risk associated with managers' lack of accountability. The result would consequently be a rise of these firms' cost of capital and a decline of their earnings. For these reasons, corporate managers have strong incentives to implant their companies in countries offering rules preferred by investors.¹⁴⁴

3. Transaction costs

Thirdly, centralization may allow for transaction cost savings.¹⁴⁵ This argument is often advanced by European legal scholars pleading for harmonization of private law in Europe and is based on the argument that differences in legal systems are very complex.¹⁴⁶ With insider trading,

141. VAN DEN BERGH, *supra* note 70, at 22 ("Consequently, the need to cope with externalities between legal orders is a major argument in favour of centralized decision-making.").

142. James D. Cox, *Regulatory Duopoly in US Securities Markets*, 99 COL. L. REV. 1200, 1237 (1999). See also Merrit B. Fox, *Retaining Mandatory Disclosure: Why Issuer Choice is Not Investor Empowerment*, 85 VA. L. REV. 1335 (1999).

143. Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J. L., Econ. & Org. 225, 226 (1985).

144. Van den Bergh & Visscher, *supra* note 71.

145. *Id.*

146. This is one of the arguments made by the Danish scholar Ole Lando in favor of harmonised private law. Ole Lando, *Die Regeln des Europäischen Vertragsrecht*, in

issuers and investors may face transaction costs associated with the international aspect of a trade. Divergences in sanctions and enforcement of insider trading laws from one country to another may create transaction costs for issuers and financial institutions in obtaining the information as well as in undertaking actions to comply with host countries regulation, in addition to complying with home country regulations. If a company seeks to export and expand its operations into a foreign country, it faces transaction costs.¹⁴⁷ These transaction costs vary depending on the area of laws. For example, a commissioner for Internal Market and Services identified that amongst the 250 EU issuers listed in the United States, the largest companies spend between \$1 million and \$10 million per year to reconcile International Accounting Standards (IAS) to the United States Generally Accepted Accounting Principles (US GAAP).¹⁴⁸

The costs associated with the divergence of regimes may reduce the advantages of investing internationally and might prevent investors and companies from participating in the international securities market. From this point of view, full harmonization would be beneficial since it would completely eliminate the problem, as companies would only need to comply with a unique set of regulatory requirements.¹⁴⁹ However, so far, there is little empirical evidence supporting the theory that substantial transaction cost savings in criminal insider trading would be eliminated by harmonizing enforcement methods.

4. Internal market

Economic arguments in favor of a harmonization of the enforcement mechanisms do not seem to be very convincing. There is little evidence of a particular risk of externalization of transaction costs nor of a race-to-the-bottom. It also is not clear that the internal market would be endangered without harmonization of insider trading criminal sanctions. Differences between legal rules, as has often been stated, only endanger the internal market when those differences would endanger the free movement of services, capital goods, or persons.¹⁵⁰ Currently, insider trading law seems not to be a big issue in any of the Member States; there are not many cases

GEMEINSAMES PRIVATRECHT IN DER EUROPÄISCHEN GEMEINSCHAFT 473–74 (Peter-Christian & Müller-Graff eds., 1993).

147. See ZHAO, *supra* note 134, at 100–01.

148. Charlie McCreevy, European Comm'r for Internal Mkt. and Servs., Speech at the European Fed'n of Accountants' (FEE) Seminar on Int'l Fin. Reporting Standards (IFRS): EC Strategy on Financial Reporting: Progress on Convergence and Consistency (Dec. 1, 2005), available at <http://www.iasplus.com/en/binary/europe/0512mccreevyifrs.pdf>.

149. See ZHAO, *supra* note 134, at 101.

150. See Anthony Ogus, *Competition Between National Legal Systems: A Contribution of Economic Analysis to Comparative Law*, 42 INT'L COMP. L. Q. 405 (1999). See also Michael Faure, *Product Liability and Product Safety in Europe: Harmonization or Differentiation?*, 53 KYKLOS 467, 471–72 (2000).

of enforcement of insider trading through criminal law. Hence, the Commission may have a point if, for instance, one Member State would fanatically enforce insider trading and systematically throw insiders in jail whereas others would not and would therefore attract criminal behavior. There is no evidence of such behavior and hence no evidence that the current situation would cause any social harm. Moreover, it should also not be forgotten that investors are informed of the applicable insider trading laws and the ways in which they are enforced. Hence, in an application of the Coase Theorem,¹⁵¹ if one Member State were not, for instance, to enforce insider trading laws effectively, investors would presumably react to this by offering lower prices for the concerned shares.

5. Benefits of differentiation

Finally, economic analysis of harmonization and the law and economics of federalism have often emphasized the substantial benefits of differentiated legal rules. First, differentiated legal rules allow for the satisfaction of heterogeneous preferences. This corresponds with the Tiebout framework of competition between legal orders where citizens are free to choose the insider trading law that corresponds optimally with and varies according to their preference.¹⁵² In that respect, one advantage of decentralization is to enable Member States to provide for rules which best serve the goals preferred by the local population.¹⁵³ As presented, criminal law is a traditional State sovereignty matter. Consequently, States are very attached to their competences in this particular domain of law. Criminal law embodies States' cultural, historical, and political specificities and is particularly representative of local individual preferences. Therefore, the substantial benefit from differentiation of criminal insider trading legislation should not be neglected.

Another benefit of differentiated legal rules is that through the application of different legal rules, substantial learning effects can be obtained.¹⁵⁴ A disadvantage of harmonization at the European level is that those learning effects would be lost.¹⁵⁵ Especially in this new domain of the enforcement of insider trading, where learning about the most effective

151. See Ronald Coase, *The Problem of Social Cost*, 15 J. L. & ECON. 1 (1960).

152. See Anthony Ogus, *Standard Setting for an Environmental Protection*, in ENVIRONMENTAL STANDARDS IN THE EUROPEAN UNION IN AN INTERDISCIPLINARY FRAMEWORK 25–30 (Michael Faure, J. Vervaele & A. Weale eds., 1994); Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956).

153. Van den Bergh & Visscher, *supra* note 71. See also Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 281 (1985) (stating that “a centralized system could impose a welfare loss on firms, to the extent that it would be difficult to duplicate the important transaction-specific assets that serve to safeguard the interests of the parties.”).

154. Van den Bergh & Visscher, *supra* note 71.

155. See VISSCHER, *supra* note 125, at 84–85.

methods of enforcing insider trading law may be quite important, learning from the experiences in different Member States could provide valuable insights on the most effective tools to remedy insider trading.¹⁵⁶ It is likely that those benefits of mutual learning would be gone in a model of harmonization of criminal law as the Commission is currently proposing in its directive.

B. COMMISSION LEGAL PERSPECTIVE: MEMBER STATES' ENFORCEMENT DEFICIT

Of course, the perspective from the European Commission may be a totally different one than the economics of federalism. The Commission would not focus on the economic theory that would address whether there are inter-jurisdictional externalities or a race-to-the-bottom, but whether criminal law is needed to encourage compliance with the EU directives concerning insider trading. This idea to criminalize insider trading should be seen within the context of the general worry at EU level that there is a considerable implementation deficit with respect to EU law, although this is stronger in some areas than in others. Therefore, a major focus of European law during the past thirty years has been on the issue of how implementation of European law can be improved by requiring a correct implementation from Member States. In this respect, we can turn to several evolutions in case law.

Although Member States remain free in the choice of instruments for the implementation of a directive, case law holds that these sanctions in case of a violation of implementing legislation should at least be effective, proportional, and dissuasive.¹⁵⁷ Hence, one can now find in many directives the obligation for Member States to provide sanctions that are "effective, proportionate and dissuasive."¹⁵⁸

Case law also held that the lack of effective prosecution against violators of implementing legislation can be considered as a violation of European law.¹⁵⁹ Hence, Europe has increasingly received effective remedies to cope with the implementation deficit.¹⁶⁰ However, most recently, starting with the environmental crimes directives we mentioned in the introduction, the EU now also wishes to cure the implementation deficit

156. Van den Bergh & Visscher, *supra* note **Error! Bookmark not defined.**, at 19 ("Differences in rules allow for different experiences and may improve an understanding of the effects of alternative legal solutions to similar problems. This advantage relates both to the formulation of the substantive rules and their enforcement.").

157. See Case C-68/88, Comm'n of the European Cmnty. v. Hellenic Republic, 1989 E.C.R. 2979.

158. On Criminal Sanctions for Market Abuse, *supra* note 5, art. 7.

159. Case C-265/95, Comm'n of the European Cmnty. v. French Republic (Spanish Strawberries), 1997 E.C.R. I-06959.

160. See GEERT CORSTENS & JEAN PRADEL, EUROPEAN CRIMINAL LAW (Kluwer Law International 2002).

by forcing Member States to choose a particular type of sanction, in this particular case criminal law.¹⁶¹ The question can, however, be asked whether a harmonization of criminal law, as currently proposed, is indeed necessary to guarantee a correct implementation of European law and, in this particular case, the Market Abuse Directive.

ESMA's report presents enforcement of insider trading laws data about 15 Member States for which the information was available for the years 2008, 2009, and 2010.¹⁶² As far as insider dealing is concerned, all the Member States provide criminal sanctions except for Bulgaria.¹⁶³ Moreover, one can observe that the 15 countries for which the data is available display a total of 155 criminal sanctions¹⁶⁴ imposed over the entire period; higher than the total of 101 administrative sanctions. This information does not seem to support a Member State's enforcement of criminal insider trading law deficiency.

1. Effectiveness doubtful

All Member States, with the exception of Bulgaria, do have criminal sanctions for insider trading, but there are considerable differences in the modalities of the sanctions. It is unclear whether the differences in sanctions are necessarily a problem. Sanctions do not only differ between Member States as far as insider trading is concerned, but also for many other crimes as well. This very often has to do with the legislative tradition concerning criminal law in the various Member States. However, these differences do not indicate that the system of enforcement in one Member State would necessarily be more effective than in another. In this respect, it

161. A few years ago, Corstens and Pradel, two leading criminal law scholars in Europe, wrote that "[s]uch a method requiring Member States to use criminal penalties is compatible with neither the character of a directive, nor the opinion that the communities do not have authority to require Member States to impose criminal penalties." *Id.* This statement was obviously written before the Lisbon Treaty was enacted.

162. ESMA, *supra* note 8, at 5.

163. Bulgaria does not provide criminal sanctions for market manipulation either. See BULGARIA: PROGRESS REPORT AND WRITTEN ANALYSIS BY THE SECRETARIAT OF CORE RECOMMENDATIONS 6 (2011), available at [http://www.coe.int/t/dghl/monitoring/moneyval/Evaluations/Progress%20reports%202y/MONEYVAL\(2011\)5_ProgRep2_BLG.pdf](http://www.coe.int/t/dghl/monitoring/moneyval/Evaluations/Progress%20reports%202y/MONEYVAL(2011)5_ProgRep2_BLG.pdf).

According to the Bulgarian authorities, at present, a new Concept for Criminal Policy of the Republic of Bulgaria was adopted in July 2010. The abovementioned Concept envisages the elaboration and adoption of a new Penal Code. One of the main purposes of the new Penal Code is to address the necessity to criminalize modern types of criminal activity, including those provided for under the international agreements undertaken by the Republic of Bulgaria. The timescale for the drafting and adoption of the new Penal Code is estimated to be 2014.

It is understood that market manipulation and insider trading are taken into consideration in the concept of the new Penal Code.

164. ESMA, *supra* note 8, at 41, 91, 111 (explaining the number of monetary and non-monetary sanctions imposed on natural and legal persons).

should be stressed that the sanctions provided for in legislation often just provide for the maximum penalties, but are not related to what is effectively imposed by judges. There would, from an economic perspective, only be a problem if the sanctions provided in legislation would be of such a nature that it is, taking the economic criteria into account, impossible to impose effective sanctions for insider trading in practice.

Finally, it should also be stressed that the current Directive will, at least in the first phase, imply little change. The Directive will merely force Member States towards criminalization that, with the exception of Bulgaria, all Member States already do. Regarding the modalities of this criminalization, for all other Member States, as far as the sanctions are concerned, three things may change. First, the Directive requires Member States to provide for criminal liability of legal persons (which is not the case in eight Member States currently in Europe).¹⁶⁵ Second, the Directive requires the establishment of “intent” to prove guilt in a criminal insider trading proceeding (which is not the case in ten Member States).¹⁶⁶ Third, the Directive requires a punishment of a maximum term of imprisonment of at least four years (not the case in seven Member States).¹⁶⁷

The remaining differences will hence remain in existence and would only change if the European Commission would use its powers in Article 12, introducing common minimum rules on the types and levels of criminal sanctions. However, even if that were the case, one always has to take into account that it still will be impossible to constrain the prosecution policy of public prosecutors or the discretionary powers of the judiciary as far as the application of penalties is concerned. Even if one were hence, according to Article 12, to harmonize the rules on the types and levels of criminal sanctions, this may, to a large extent, remain a symbolic window dressing operation that should not necessarily change anything in the practice of the Member States, except perhaps facilitating mutual recognition and cooperation.

It can therefore be concluded that this attempt to harmonize the method of enforcement of insider trading laws through criminalization at a EU level will be largely symbolic with limited effects as far as the sanctions that will be implied in practice on insider trading are concerned.

165. *Id.* at 73. This does not apply in Bulgaria, the Czech Republic, Germany, Greece, Luxembourg, Poland, Portugal and Sweden.

166. *Id.* at 112. Proof of intent is not required in order to have a guilty verdict in a market abuse case in Cyprus, Germany, Denmark, Spain, Finland, Latvia, Malta, Netherlands, Sweden, and the United Kingdom.

167. *Id.* at 105. The maximum length of imprisonment for insider dealing violations is less than four years in Belgium, France, Lithuania, Luxembourg, the Netherlands, Estonia and Hungary.

2. Unconvincing arguments from the Commission

In this respect, the motivation provided by the European Commission can also be criticized. A first argument in favor of criminal sanctions at the EU level is that “the sanctions currently in place to fight market abuse offences are lacking impact and are insufficiently dissuasive which results in ineffective enforcement of the Directive.”¹⁶⁸ In line with this argument, the Directive explains that “[t]he adoption of administrative sanctions by Member States has proven to be insufficient to ensure compliance with the rules on preventing and fighting market abuse” and that “the availability of criminal sanctions for at least serious market abuse across the Union, cannot be sufficiently achieved by the Member States.”¹⁶⁹ These arguments are, however, hardly convincing.

First, there is no empirical basis for these extreme statements.¹⁷⁰ Second, it remains unclear how the Directive will actually change the “ineffective enforcement of the Directive.” Indeed, the Directive merely forces criminalization in one Member State, introduces criminal liability for legal entities in eight Member States, introduces a higher threshold for *mens rea* (intent) for ten Member States, and increases the maximum term of imprisonment for seven Member States. Its effectiveness concerning enforcement can be questioned.

Third, the Directive argues that the current “different approaches by Member States undermine the uniformity of conditions of operation in the internal market” and even argues that perpetrators would be able “to carry out market abuse in [jurisdictions] which do not provide for criminal sanctions for those offences.”¹⁷¹ Here, the Directive relies on a race-to-the-bottom argument. As previously mentioned, the only Member State for which this holds true is Bulgaria. According to the Directive, Bulgaria is a potential haven for insider traders. There is, however, no empirical proof that Bulgaria will become plagued by insider trading.

Fourth, the Directive stresses the importance of criminal law to “demonstrate a stronger form of social disapproval compared to administrative penalties . . . and sends a message to the public and to potential offenders that competent authorities take such behaviour very seriously.”¹⁷² This statement evidences the Commission’s belief in the “stigma” effect of the criminal law. Moreover, since 27 out of 28 Member

168. *Proposal for Directive on Criminal Sanctions for Insider Dealing and Market Manipulation*, *supra* note 52, at 2.

169. On Criminal Sanctions for Market Abuse, *supra* note 5, pmbl. recitals 5–6.

170. The Directive refers, for instance, to the evaluation of the national regimes for administrative sanctions under Directive 2003/6/EC. The call for evidence on the review of the Market Abuse Directive launched by the Commission on April 20, 2009 mainly focused on the scope of the Market Abuse Directive and not on the necessity of introducing criminal sanctions at the EU level. *Id.* pmbl. recital 2.

171. *Id.* pmbl. recital 7.

172. *Id.* pmbl. recital 6.

States already have criminal sanctions for insider trading in place, one may question whether European-wide criminal sanctions will have added value.

Finally, the importance of criminal law is also stressed to “improve deterrence as they demonstrate to potential offenders that the authorities take serious enforcement action.”¹⁷³ Again, this strongly stresses the symbolic value, not only of criminalization, but also of criminalization at the EU level. All in all, the main arguments of the Directive are abstract and symbolic in nature since they mainly rely on consultations and conferences.¹⁷⁴ Furthermore, the impact assessments provided with the Directive provides weak support for the Directive’s purpose, which calls into question its effectiveness.¹⁷⁵ This aspect is particularly sensitive since it raises some concerns regarding compliance with the legal basis of the Directive. Indeed, Article 83(2) TFEU calls for clear reliance on empirical data regarding essential criminal sanctions.¹⁷⁶ The interpretation of Article 83(2) TFEU is critical since the Directive is the first to be adopted based on the Article.

3. Inconsistency with European policy

Finally, it is remarkable that the European Commission stresses the need to introduce criminal sanctions in the area of insider dealing and market manipulation, while following a completely different strategy in the area of competition policy. For years, European competition policy has been based on an administrative sanctioning by the European Commission, not criminal penalties. Many have stressed the importance of introducing criminal penalties to be applied to more severe violations of competition law, like sophisticated cartels,¹⁷⁷ but these voices have not been heard.¹⁷⁸

173. *Proposal for a Directive of the European Parliament and of the Council on Criminal Sanctions for Insider Dealing and Market Manipulation*, at 3, SEC (2011) 1217 final (Oct. 20, 2011).

174. Marta Miglietti, *The New EU Criminal Law Competence in Action: The Proposal for a Directive on Criminal Sanctions for Insider Dealing and Market Manipulation* 29 (Inst. for Eur. Studies, Working Paper 5/2013, 2013) (“It is possible to affirm that the consultations and the conferences did not provide a ‘clear factual evidence’ of ‘the added value of common EU minimum criminal law standards.’”).

175. See *Commission Staff Working Paper Impact Assessment*, at 57, SEC (2011) 1217 final (Oct. 20, 2011) (“In accordance with article 83(2) of the Treaty (TFEU), the introduction of a requirement for criminal sanctions to address market abuse *is likely to lead* to increased successful prosecution of market abuse offences and to contribute to ensuring the effective functioning of the internal market . . .”). This statement underlines the fact that the “necessity requirement” of article 83(2) is not fulfilled. See *id.* at 176.

176. TFEU, *supra* note 19, art. 83(2).

177. Wouter Wils, *Is Criminalization of EU Competition Law the Answer?*, 28 *WORLD COMPETITION* 15 (2005).

178. For an overview of EU enforcement of competition policies, see Roger VAN DEN BERGH & MICHAEL FAURE, *Critical Issues in the Enforcement of the Anti-Monopoly Law in China: A Law and Economics Perspective*, in *COMPETITION POLICY AND REGULATION: RECENT DEVELOPMENTS IN CHINA, THE US AND EUROPE* 54–75 (Michael G. Faure & X. Zhang, eds., 2011).

Moreover, increasing attention is now given to possibilities of private enforcement and methods to provide incentives to potential plaintiffs to bring suits in the area of competition law (introducing treble damages, class actions, etc.).

It is striking that in the related domain of insider dealing the European discussion on enforcement mechanisms seems to focus on criminalization and not, for instance, on ways of improving private enforcement in order to increase deterrence. This not only shows that there is, apparently, little consistency in the general enforcement strategy at the EU level, but also that the Commission should probably learn from the experience with competition policy to look at methods other than criminalization to improve enforcement. In that way, criminal law could truly remain an *ultimum remedium*.

C. FUNDAMENTAL PRINCIPLES OF EUROPEAN CRIMINAL LAW: QUALITATIVE PROBLEMS

The Directive may not be consistent with the principles governing the introduction of substantive criminal rules at a EU level. For instance, the Manifesto on European Criminal Policy published in 2009 by the European Criminal Policy Initiative aimed at clarifying the major principles of criminal law rooted in European law: the principle of a legitimate purpose, the *ultima ratio* principle, the principle of guilt, the principle of legality, the principle of subsidiarity, and the principle of coherence.¹⁷⁹ The question arises how those principles relate to the Directive on criminal sanctions for market abuse.

1. The principle of proportionality

The principles of legitimate purpose, the *ultima ratio* principle and the principle of guilt can be perceived as directly emanating from the principle of proportionality. The principle of proportionality is a fundamental principle of European law stated in the fourth paragraph of Article 5 TEU.¹⁸⁰ It begets the requirement of a legitimate purpose. The resort to criminalization at EU level could be regarded as proportionate and legitimate only if a fundamental legal interest worthy of protection against socially harmful conduct of significant degree can be justified.¹⁸¹ In that

179. EUR. CRIM. POL'Y INITIATIVE, A MANIFESTO ON EUROPEAN CRIMINAL POLICY (2009), available at http://www.zis-online.com/dat/artikel/2009_12_383.pdf.

180. TEU, *supra* note 19, art.5.

181. Maria Kaiafa-Gbandi, *The Importance of Core Principles of Substantive Criminal Law for a European Criminal Policy Respecting Fundamental Rights and the Rule of Law*, 1 EUR. CRIM. L. REV. 7, 15 (2011) ("The requirement of a fundamental interest that is harmed in a socially significant way would be of particular usefulness in determining when the EU shall be justified in employing criminal law means to effectively implement its policies under article 83(2) TFEU."). See also *The Manifesto on European Criminal Policy in 2011*, 1 EUR. CRIM. L. REV. 86 (2011)

respect, the need to reach the objectives of the EU cannot constitute a good motivation for harmonization. Of course, it should be observed that fundamental legal interests may eventually differ and diverge at national and European levels.

Second, the *ultima ratio* principle also plays a major part in this context. The EU is now capable of binding its Member States as to the minimum standards of criminal law to larger extent than ever thanks to the new Article 83(2). With respect to the application of the *ultima ratio* principle any criminal law proposal at EU level should come with a requisite burden to ensure that it is used as a last resort to protect fundamental interests.¹⁸² Setting even minimum standards in criminal matters should be a last resort for the EU. The question should then be whether administrative sanctions could not be at least equally effective to ensure the effective implementation of the Union's policy in the area of insider trading. Wouldn't administrative law be sufficient to ensure equivalent protection? Previous legislative initiatives should be carefully assessed. Where other sanctions have proven insufficient, the EU should adopt criminal dispositions.¹⁸³ Finally, some commentators argue that harmonization may be perceived as encouraging movement towards an increased repression,¹⁸⁴ making criminal law the principle method of punishment.

In that respect, the Regulation provides for administrative sanctions for non-criminal actions. This is consistent with the idea that there is a softer alternative to criminal law at EU level. However, both the Regulation and the Directive were adopted at the same time. This may demonstrate how the EU did not explore and try all available means *before* resorting to criminal law. The need to improve the 2003 MAD does not automatically imply the need to resort to criminal law.

Third, according to the principle of guilt (*nulla poena sine culpa*), a criminal sanction can only be imposed when a criminal act has affirmatively been proven to be the product of a "guilty mind" and the actor has the requisite *mens rea*. In the EU, this principle stems from Article 48

The legislative powers of the EU in relation to criminal law issues should only be exercised in order to protect fundamental interests if: (1) These interests can be derived from the primary legislation of the EU; (2) The Constitutions of the Member States and the fundamental principles of the EU Charter of Fundamentals Rights are not violated, and (3) The activities in question could cause significant damage to society or individuals.

182. See Kaiafa-Gbandi, *supra* note 181, at 18.

183. Martin Böse, *The Principle of Proportionality and the Protection of Legal Interests*, 1 EUR. CRIM. L. REV. 35 (2011).

184. Peter Asp, *The Importance of the Principles of Subsidiarity and Coherence in the Development of EU Criminal Law*, 1 EUR. CRIM. L. REV. 44 (2011) ("[C]riminal law is a legal area which, by its very nature, is repressive, which (in turn) means that harmonization in this area will—at least in practice—focus on increased repression.") (italization omitted).

of the Charter of Fundamental Rights.¹⁸⁵ Apparently, the principle of guilt seems to be the one that guided the Commission to require Member States to establish “intent” to criminally sanction insider trading and to provide for criminal liability of legal persons. As stated above, the level of culpability required to prove a person guilty of insider trading varies across the different Member States, ranging from “negligence” to “intent.” Moreover, some Member States reject the criminal responsibility of legal persons, partially because it is incompatible with their conception of the principle of guilt.¹⁸⁶

Finally, some suggest that the proof of intent regime and the criminal liability of legal persons should be decided at a national level.¹⁸⁷ Therefore, Directive dispositions regarding criminal liability of legal entities, as well as the degree of culpability (intent) necessary to be found liable, may face resistance in practice at Member States’ level. Furthermore, in the Convention on the Protection of the European Union’s Financial Interests, the EU made exceptions regarding culpability. It accepted that “[t]he intentional nature of an act or omission . . . may be inferred from objective, [or] factual circumstances”¹⁸⁸ and that “[e]ach Member State shall take the necessary measures to allow [these persons] to be declared criminally liable in accordance with the principles defined by its national law”¹⁸⁹

185. Charter of the Fundamental Rights of the European Union, *supra* note 33, art. 48(1) (“Everyone who has been charged shall be presumed innocent until proved guilty according to law.”).

186. See Kaiafa-Gbandi, *supra* note 181, at 31; EUR. CRIM. POL’Y INITIATIVE, *supra* note 179. “There are framework decisions that obligate the Member States to impose sanctions on legal person. However, it should be positively noted that as yet it is up to the Member States whether they fulfill this obligation by means of criminal law.” *Id.* at 711.

187. See *The Manifesto on European Criminal Policy in 2011*, *supra* note 181.

This does not predetermine the answer to the question of whether legal entities can be held criminally liable. There is a decisive difference between guilt of an individual and that of a legal entity. Rules concerning criminal liability of legal entities must thus be elaborated on the basis of criminal law provisions at the national level.

Id. at 88.

In some Member States rules on criminal liability for legal persons would not be compatible with their concept of the principle of guilt, forming the basis of their national criminal law system. There are framework decisions that obligate the Member States to impose sanctions on legal person. However, it should be positively noted that as yet it is up to the Member States whether they fulfill this obligation by means of criminal law.

Id. at 95–96.

188. Council Act, Drawing up the Convention on the Protection of the European Communities’ Financial Interests, art.1(4), 1995 O.J. (C 316) 50.

189. *Id.* art. 3.

2. Principles of subsidiarity and coherence

According to Article 5(3) of the Treaty on European Union (TEU), “the Union shall, in areas that do not fall within its exclusive competence, act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States.”¹⁹⁰ Alternatively, the European legislation should not intervene in criminal matters when the national legislator can effectively deal with a given issue. This principle ensures the protection of the differentiated legal rules and the satisfaction of heterogeneous preferences. As mentioned above, these preferences are of particular importance in criminal matters since they reflect national identities. This restricts the EU’s competence and is related to the principle of coherence, which states that none shall, without good reason, disturb or interfere with the coherence of the national criminal law systems.¹⁹¹ In the case where instruments dealing with criminal matters are enacted, Article 4(2) TEU draws special attention to the coherence of the national criminal law systems of the Member States. The system’s coherence relies upon the idea that the entire regime is rooted in historical and cultural national values that are particularly sensitive to external influence.¹⁹² This principle is closely related to the notions of democracy, self-governance, and State sovereignty. In that respect, it seems that not sufficiently convincing arguments were advanced so far to hold that the national enforcement of criminal insider trading law has failed.

The above analysis allows one to deduce the following conclusion: criminal law is the most stringent mechanism of control that deeply affects fundamental civil liberties. Therefore, any initiative the Commission takes in that field should be consistent with the principles governing the introduction of substantive criminal rules at the EU level. In that respect, the Directive on criminal sanctions may be criticized in various aspects. The Directive was adopted at the same time as the Regulation, which may also raise problems regarding the principles of proportionality and the principle of *ultima ratio*. The principles of subsidiarity and coherence support the need to have a differentiation of legal rules.

190. TEU, *supra* note 19, art. 5.

191. Asp, *supra* note 184, at 46.

The principle of subsidiarity is founded on the idea that society is built from the bottom to the top and not the other way around. This means that the central—or in the case of the EU: the supranational—authorities should fulfill only those tasks that cannot be fulfilled effectively by actions on a decentralized, local or regional, level. In this way one ensures that decisions will be taken as closely to the citizens as is possible having regard to the demands of society.

Id.

192. *Id.* at 44. See also *The Manifesto on European Criminal Policy in 2011*, *supra* note 181, at 91 (“[C]riminal law is also a value system, and as such it is a component part of the ‘national identities’ of the Member states . . .”).

The point is not to contest the legitimacy of the EU in criminal matters, but rather to highlight the importance of restraining the content of the Directive to the strict minimum, in order to facilitate its implementation in a manner that respects civil liberties and citizens' preferences. The Treaty of Lisbon mentions the guarantee of the fundamental rights of the citizen as a goal. The Directive should therefore reflect this will and should be consistent with such a guarantee in practice.

Finally, Member States may oppose any future proposals to amend the Directive by invoking the emergency clause of Article 83(3) TFEU. Indeed, when legislating on substantive criminal law or criminal procedure, Member States can express their opposition and refer to the European Council¹⁹³ if they believe the proposed Directive touches upon fundamental aspects of their national criminal justice system¹⁹⁴ or breaches one of the fundamental principles of criminal law outlined above.

CONCLUDING REMARKS

This paper has critically analyzed the Directive on criminal sanctions for market abuse. The core of the Directive is that insider dealing and market manipulation as defined therein must be criminalized when committed as an intentional offence, and legal entities will be criminally liable. Additionally, maximum terms of imprisonment are mandated. We hold that even though criminal law has some role to play in enforcing insider trading (more particularly to supplement private and administrative law enforcement), there is currently little evidence to show that the enforcement of insider trading laws at the Member State level would be ineffective. Twenty-seven out of the twenty-eight EU Member States already utilize criminal law to back up insider trading legislation. Here, the added value of European legislation is limited. Therefore, the mere imposition of criminal sanctions at the EU level will not guarantee that the current problems with the effective enforcement of insider trading law would be solved. Moreover, the Commission refers to a current "ineffective enforcement" of insider trading law, but there is little empirical proof in support. Furthermore, the Directive is not entirely consistent with the principles governing the introduction of substantive criminal rules at the EU level. Specifically it is not consistent with the *ultima ratio* principle, the principle of guilt, and the principles of subsidiarity and coherence.

Based on the economic theory of harmonization, if there is a need to criminalize insider trading under specific circumstances, then that need cannot be sustained at this stage. Additionally, the Directive on criminal sanctions for market abuse may be qualitatively criticized. Thus, there are

193. *Towards an EU Criminal Policy*, *supra* note 13.

194. Denmark and the United Kingdom are not adopting this Directive and are therefore not bound by it or subject to its application. See *On Criminal Sanctions for Market Abuse*, *supra* note 5, pmbl. recitals 29, 31.

both legal and economic reasons for criticizing this first Directive adopted on the basis of Article 83(2).