Market Abuse: a comparative view between US system and European System as applied in Italy

(Abstract)

"Insider trading is an attack on the market […] is a virus in our business culture that must be eradicated". Insider trading "may reduce market liquidity, cause a widening of spreads, and increase market volatility and also reduce the returns to outsiders since they are trading against better – informed insiders".

Insider trading has long been considered a feature of the world's financial market, despite the universal criminalization of it. Criminalization of insider trading have a moral dimension. Maybe financial market is accustomed to live with it, but, in spite of this, governments around the world are looking for the best solution to contrast it. We know that in US system, SEC has introduced criminal penalties for insider trading and the European Union is working on a MAD2 to go at fiercely insider trading. But, we have to remember that European States should not apply exactly the whole European Union law, but each State implements, in accordance with its law, EU directives. But I think that without a working well civil liability, no criminal penalties will be enough. The reason why a person use illegally inside information to trade is money, so just the fear to lose "that" money, and more of that, could prevent him to be guilty of insider trading. I'm sure that this is not the universal solution to contrast or to eliminate insider trading in financial markets, but certainly it could be the beginning to fight back the issue.

US system, already in 1934, needs to prevent insider trading rules. Italian legislature established rules against insider trading only in 1991. But the problem of insiders abusing information that they obtain by virtue of the special relationship that they have with their company is not a new one. It is possible to find references to insiders taking advantage of their privileged position to dump over – valued secutirties on the market in official reports as early as the seventeeth century. But now this problem has huge dimension. In fact, insider trading in US and insider trading and market manipulation in Europe are problems that must be solved.

For this reason, European Union issued a directive to establish strong penalties against insiders and to promote the harmonization of European States systems. This harmonization, however, is still very far away.

In Italy insider trading is regulated from TUF (Testo unico in materia di intermediazione finanziaria). This is a civil law, but the rules about insider trading contain penal and administrative provisions: this is the first peculiarity. Then, the rules do not establish a private action for the investor or the possibility of a classaction by investors who were injured by an insider. Finally, the only one that could be as a civil party in criminal proceedings is the Consob, which is the public authority responsible for regulating the Italian securities market. Therefore, Consob may exercise the rights and powers granted by the Criminal Procedure Code to the bodies and associations representing the interests injured by the crime. It may also intervene as a civil claimant and request, by way of compensation for the loss occasioned to the integrity of the market by the crime, damages in an amount to be assessed by the court.

By virtue of the duty to protect the integrity of the market, the public authority may claim damages to the defendent and the compensation will not be allocated to a fund for the market, but it will be used by Consob for self-financing. This is an other peculiarity.

Also, the TUF establish only penal sanctions and administrative sanctions, but it not establish a civil liability for insiders. It implements the European Union MAD (Market Abuse Directive) directive and therefore follows its prescription in the rules.

So, three are the conduct that could be insider trading: i) the ordinary insider trading; ii) the tipping; iii) the tayautage. In particular, articles 184 and 187-bis TUF establish respectively a penal sanction and an administrative sanction when a person, possessing inside information by virtue of his membership of the management, administrative or supervisory bodies of an issuer, his holding in the capital issuer or the exercise of his employment, profession, duties, including public duties, or position:

"a) buys, sells or carries out other transactions involving, directly or indirectly, for his own account or for the account of a third party, financial instruments using such information;

b) discloses such information to other outside the normal exercise of his employment, profession, duties or position;

c) recommends or induces others, on the basis of such information, to carry out any of the transactions referred to in paragraph a)".

Both, articles 184 and 187-bis, are formulated in the same way. The only difference between them is that article 184 applies to the primary insiders. Primary insiders are persons with a direct contact to insider facts. Article 187-bis applies to the secondary insiders are defined solely by the fact that they possess inside information.

On the other hand, market manipulation is regulated like a different crime by articles 185 and 187-ter, that establish the imprisonment for any person who disseminates false information or sets up sham transactions or employs other devices concretely likely to produce a significant alteration in the price of financial instruments or a pecuniary administrative sanction for any person who, through the media, including the Internet, or by any other means, disseminates information, rumors or false or misleading news that give or are likely to give false or misleading signals as to financial instruments, without prejudice to the penal sanctions applicable when the action constitutes a criminal offence.

As can be seen, this legislation is based on criminal punishments but it doesn't establish a civil penalty for insiders. But, US system proves that a good civil penalty could stop insider trading. Especially the fear to lose money.

This research is a comparative study between US insider trading traditional system and European new and "young" market abuse system to prove that criminal punishment could be a good deterrent, but alone could not be sufficient to eradicate market abuse.