The future German Capital Markets Criminal Law – tightened regulations and prosecution options

On 13 May 2016, the German Federal Council (*Bundesrat*) approved the First Financial Markets Amendment Act (*Erstes Finanzmarktnovellierungsgesetz*, "**1. FiMaNoG**"). One of the key aspects of the act is to tighten the administrative and criminal sanctions against insider dealing and market manipulation. Furthermore, it extends the duties and powers of the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, "**BaFin**").

Revision of Capital Markets (Criminal) Law due to European Law stipulations

The 1. FiMaNoG adapts the German Capital Markets (Criminal) Law in line with the European Market Abuse Regulation ("**MAR**") and the European Market Abuse Directive ("**CRIM-MAD**") of 16 April 2014. The MAR is directly applicable as from 3 July 2016, whereas the CRIM-MAD has to be transposed into national law until 3 July 2016. In addition to addressing some major aspects of the Capital Markets Law, for example ad hoc publicity, director's dealings and insider lists, the MAR in particular contains detailed provisions regarding the prohibitions on insider dealing (currently sections 12 to 14 German Securities Trading Act [*Wertpapierhandelsgesetz*, "**WpHG**"]) and market manipulation (currently section 20a WpHG). Therefore, the German legislator now has to amend the criminal and administrative law provisions of the WpHG (sections 38 and 39), which in particular contain regulations regarding the subjective requirements for liability and the sanctions, in light of the CRIM-MAD specifications.

Change of the reference technique of the provisions on sanctions

The 1. FiMaNoG overrules the national provisions on insider dealing (sections 12 to 14 WpHG) and market manipulation (section 20a WpHG). Furthermore, the provisions on criminal and administrative sanctions (sections 38 and 39 WpHG) will reference the directly applicable provisions of the MAR on insider dealing (Art 14, 8 *et seqq.*) and market manipulation (Art 15, 12 *et seq.* MAR).

Expansion of the scope of the provisions on sanctions

In addition, the 1. FiMaNoG expands and amends the provisions on sanctions for insider dealing and market manipulation. For example, all criminal offences contained in section 38 para 3 WpHG (as amended) in conjunction with Art 14, 8 *et seqq.* MAR can be committed by any natural person, whereas under current law this only holds true for a violation of the prohibition to trade insider securities using inside information (sections 14 para 1 no 1, 38 para 1 no 1 WpHG). By contrast, a violation of the prohibitions to disclose inside information or recommend insider dealing (section 14 para 1 no 2 and 3 WpHG) currently only constitutes a criminal offence if the offender is a so-called "primary insider", *i.e.*, in particular, a person who is in possession of such information due to his or her membership in the management or supervisory board or due to his or her profession (sections 38 para 1 no 2, 39 para 2 no 3 and 4 WpHG).

However, the scope of the provisions on sanctions for insider dealing is being restricted. In the future, reckless behaviour (*leichtfertiges Handeln*) can

only be punished with administrative sanctions with regard to all forms of insider dealing, whereas under current law a reckless violation of the prohibition to trade (section 14 para 1 no 1 WpHG) is subject to criminal sanctions (section 38 para 1 no 1 WpHG). By contrast, negligent behaviour (*einfach fahrlässiges Handeln*) in case of both insider dealing and market manipulation still remains exempted from administrative sanctions. A person acts recklessly if he or she fails to exercise reasonable care in a significant way in connection with a particular act, whereas for negligence it is sufficient to generally fail to exercise reasonable care.

The most important changes at a glance

- Criminal liability for any natural person for any form of insider dealing
- Market manipulation: attempt as criminal offence and new felony crime
- Higher administrative fines against legal entities
- Extended duties and powers of the BaFin

With regard to market manipulation, the scope of criminal offences is being expanded. For a (completed) market manipulation it is still required that there is an actual effect on the price – without which intentional and negligent market manipulation acts (that are merely suitable to influence the price) are only punishable as administrative offences. However, in the future, attempted market manipulation will constitute a criminal offence. This means that intentional market manipulation acts without actual price effects (but suitable to influence the price) will attract criminal liability.

Tightening of the sanctions

The possible sanctions for insider dealing and market manipulation are being tightened in accordance with the European standards. While the maximum sentence of five years imprisonment for criminal offences of insider dealing and basic market manipulation remains unchanged, a threat of punishment of one to ten years imprisonment is introduced where the market manipulation is committed commercially (*gewerbsmäßig*) or by colluding with others (*bandenmäßig*). Such a qualified offence does not exist under current law. Experience with other criminal offences (for example, tax fraud) shows that the risk of being accused of acting commercially or by colluding with others is particularly high where legal entities are involved. Due to the minimum sanction of one year imprisonment the qualified offence no longer falls within the definition of a misdemeanour (section 12 para 2 German Criminal Code [*Strafgesetzbuch*, "**StGB**"]), but rather constitutes a felony (section 12 para 1 StGB). Under the general rules of criminal and criminal procedure law, criminal liability in the future already begins when a person agrees to commit market manipulation commercially or by colluding with others (section 30 para 2 StGB). Furthermore, the possibilities of discontinuance against instructions (*Einstellung gegen Auflagen*, section 153a German Criminal Procedure Code [*Strafprozessordnung*, "**StPO**"]) or settlement in summary proceedings (*Erledigung im Strafbefehlsverfahren*, section 407 StPO) are excluded.

In addition, the possible amount of administrative fines is being increased for both, individual persons and legal entities. In particular, fines up to EUR 5 million can be imposed on individual persons for reckless insider dealing (instead of EUR 200,000 so far). The same applies for intentional market manipulation without price effect (provided there is no attempt punishable as criminal offence, as mentioned above) and reckless market manipulation.

Generally, administrative fines of up to EUR 15 million may be levied on legal entities for intentional and reckless violations of the prohibitions on insider dealing and market manipulation. Even higher fines can be imposed if 15% of the legal entity's annual sales exceed the amount of EUR 15 million. According to the government's reasoning to the 1. FiMaNoG, the sanctions still have to be based on existing legal requirements (*cf.* section 30 Administrative Offences Act [*Ordnungswidrigkeitengesetz*, "**OWiG**"]). As such, a company related criminal or administrative offence committed by a senior manager (an "underlying offence" [*Anknüpfungstat*]) is required. However, as has been the case under existing arrangements, such an offence can, in particular, be a violation of supervisory duties (sections 130, 9 OWiG), for example where an insufficient compliance management system is in place.

Moreover, individual persons as well as legal entities can be charged with administrative fines three times higher than the economic benefit drawn from the violation, whereby this calculation method can even lead to fines against legal entities exceeding the amount of EUR 15 million or 15% of the annual sales mentioned above.

Extended enforcement powers of the BaFin

Finally, the 1. FiMaNoG provides for an extension of duties and powers of the BaFin. In particular, 12 new paragraphs are being added to the new section 4 WpHG (as amended) (para 3b to 3k and para 4a to 4b). According to these, the BaFin can ask a telecommunications provider to hand over certain traffic data on the basis of section 96 para 1 Telecommunications Act (*Telekommunikationsgesetz*) if certain facts support the suspicion of market manipulation or insider dealing (section 4 para 3c WpHG [as amended]). Furthermore, in accordance with Art 30 MAR, the BaFin is authorised to publish a "public warning" on its website indicating the name of the natural person or legal entity that has violated the prohibitions on insider dealing or market manipulation (section 4 para 3k WpHG [as amended]). Whether such a publication requires a final conviction, is not clear from the legislative material, but it would be preferable from a constitutional perspective.

In-house actions based on new regulations

Banks and other financial institutions, as well as, in particular, stock-listed companies, should plan ahead in order to align their capital markets compliance with the new tightened regulations for insider dealing and market manipulation. As part of this, internal guidelines should be completely reviewed as to whether the new regulations are fully reflected. Furthermore, relevant employees should be trained and internal processes should be tested as to their compatibility with the new regulations. Compliance with these stricter regulations in the future should be a high priority for the relevant financial institutions and companies, in particular against the background of the extended duties and powers of the BaFin.

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