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Explanatory Report to the Convention on Insider Trading and the Protocol thereto *

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I. The Convention on Insider Trading was drawn up within the Council of Europe by a committee of experts subordinate to the European Committee on Legal Co-operation (CDCJ).

The Convention was opened for signature by the member States of the Council of Europe on 20 April 1989.

After the opening for signature of the Convention and on the request of the Council of the European Communities, the Committee of Ministers of the Council of Europe adopted an additional Protocol. Under this Protocol, Article 16 bis is inserted in the Convention, containing a provision called «disconnection clause» as regards the Parties to the Convention who are also members of the European Economic Community. This additional Protocol was opened for signature by the member States of the Council of Europe on 11 September 1989.

II. The text of the explanatory report prepared by the committee of experts and submitted to the Committee of Ministers of the Council of Europe, as amended and completed by the CCJ, does not constitute an instrument providing an authoritative interpretation of the Convention, although it might be of such a nature as to facilitate the application of the provisions contained therein.

Introduction

Public opinion is becoming more and more aware of the recent phenomenon of insider trading which often embitters business relationships. Moreover, insider trading presents a challenge for the legislature.

In order to take stock of the existing national regulations and legislation and to show the deficiencies in international law, a colloquy was organised in Milan from 16 to 18 November 1983 by the Council of Europe, the University of Bologna and the Commercial University Bocconi of Milan, under the chairmanship of Professor Joseph Voyame, Director of the Swiss Federal Office of Justice.

(*) The Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community entered into force on 1 December 2009. As a consequence, as from that date, any reference to the European Community shall be read as the European Union.

Following the conclusions of this colloquy, the Committee of Ministers of the Council of Europe set up a committee of experts, under the chairmanship of Professor Lutz Krauskopf, Vice-Director of the Swiss Federal Office of Justice, and the vice-chairmanship of Mr André Dupont-Jubien, Head of the Legal Service of the COB in Paris. The committee held four meetings from June 1985 to June 1987 and submitted a draft convention on insider trading to the European Committee on Legal Co-operation (CDCJ). The committee also benefited from the opinion given by the Committee of experts on the operation of European conventions in the penal field (PC-OC), one of the sub-committees of the European Committee on Crime Problems (CDPC). After examination, the CDCJ adopted the draft convention on 6 May 1988 and sent it to the Committee of Ministers which adopted it during the 423rd meeting of the Ministers' Deputies in January 1989 and decided to open it for signature on 20 April 1989.

The observers from Finland and the United States of America and from the Commission of the European Communities also participated in the work of the committee which prepared the draft convention and explanatory report.

Organised stock markets are based primarily on the principles of equal access to information for all market users and the quality of the information provided to investors. Respect for those principles is necessary to ensure fairness in dealings.

This Convention is intended to alleviate the difficulties which have emerged at international level in obtaining information and facts and punishing persons carrying out operations on organised stock market securities which are at variance with those principles.

On the one hand, such operations are carried out sometimes by persons operating, directly or indirectly, in the market of a country where they are not resident. On the other hand, the existing instruments for international co-operation are not adapted to obtaining information about such facts and the punishment of offenders.

In order to counter such behaviour effectively, therefore, it is necessary to remove the obstacles which prevent national authorities from discovering such operations and dealing with them in accordance with the provisions of the applicable national legislation.

One of the most important obstacles is ignorance of the identity and status of the persons actually involved who act through persons resident outside the country concerned.

The offence of insider trading is not characterised by the nature of the transaction. The unlawful transaction is identical to a regular transaction. It is because the person who carries out the operation possesses, by virtue of his position or by reason of circumstances, information not known to the public that the operation which he carries out or causes to be carried out becomes unlawful.

The essential aim of the Convention is therefore not to organise international mutual assistance in the institution of proceedings to deal with these effects; this is especially the aim of the European Convention on Mutual Assistance in Criminal Matters (European Treaty Series, No. 30). On the other hand, the present Convention is intended to create mutual assistance by exchanges of information between Contracting Parties, to enable supervision of securities markets to be carried out effectively and to establish whether persons carrying out certain financial transactions on the stock markets are or are not insiders, which would reveal whether their transactions were fraudulent or proper.

The Convention does not require Parties to set up control or supervisory bodies for the stock markets. However, co-operation by the exchange of information assumes the existence at national level of an adequate structure both in the field of legislation and in the field of institutions capable of ensuring the collection, the examination and the transmission of information. Without such a structure, it would be difficult for states to ensure an effective implementation of the Convention with the necessary speed and discretion.

The machinery of the Convention has intentionally been made extremely flexible. It is possible that some states do not wish to take part or do not feel the need, for the moment, to participate; such an attitude on the part of certain states should not prevent others from fully applying the Convention in their mutual relations. For this reason, it has been provided that the Convention shall enter into force as soon as a very limited number of states have ratified it.

Account was taken, when drafting the Convention, of the fact that the exchanges of information between the Parties would have to deal with technical developments. In addition, the evolution of the domestic legislation of the Parties may lead to a review of the procedures laid down in the Convention which constitute only what is. possible in the present state of these laws.

Chapter I gives definitions of certain terms used in the Convention.

Chapter II introduces a system of mutual collaboration between the authorities of the various Parties, such as to ensure the necessary clarity whenever a stock market transaction appears suspect in relation to the principles mentioned above. This collaboration preserves the legitimate rights of the persons involved and the superior interests of the Parties concerned, respecting the requirements of discretion and confidentiality which are mandatory in such circumstances.

Chapter III enables this international co-operation to extend, if appropriate, to any criminal proceedings. To that end, Parties in which such proceedings are brought can obtain the assistance of the authorities in the other Parties, under the conditions provided for in the European Convention on Mutual Assistance in Criminal Matters. That mutual assistance will be provided if the conditions defined in the present Convention are satisfied. Those conditions constitute a common definition of «insider trading» in respect of which the Parties believe they need to co-operate in order to combat such improper dealings.

Chapter IV contains the final clauses which appear in most Council of Europe conventions and agreements.

Commentary on the provisions of the Convention and its Protocol

CHAPTER I – Definitions

Article 1

Article 1 defines the meaning and scope of certain terms used in the Convention which relate to the operations effected.

The first paragraph defines the irregular financial operation effected by an «insider». It is the operation effected by a person who has had direct knowledge of the privileged information through his personal position. The different cases are listed in sub-paragraph a. It also concerns an operation carried out by another person who, by reason of his occupation or profession cannot be unaware of the confidential nature of the information which he has acquired which excludes purely accidental circumstances (for example, a taxi-driver), sub-paragraph b. In addition, sub-paragraph c includes persons who, in effecting such operations, make use of confidential information received from one of the persons mentioned under sub-paragraph a or b.

The term «president or chairman» must be taken as meaning not only the holders of these offices but also the vice-president or vicechairman, and the term «member of a board of directors» includes alternate members. «Member of a (...) supervisory organ» is to be interpreted as including internal or external auditors and their alternates.

The term «market» mentioned in sub-paragraph a covers not only the price, but also the fluctuation of the negotiated quantities and the general position and movement of the stock and other elements such as negotiable options on securities or indices.

Finally, insider dealing involves operations which upset the market itself and are not limited to the «profit» element but cover every operation which produces or attempts to produce an advantage.

Paragraph 2 provides some additional definitions:

– the term «stock» signifies transferable securities issued or admitted on the organised stock market in accordance with the law applicable to that market (which may include, for instance, certain non-paper securities);

– the term «other issuer» includes, as the case may be, the state or the public authorities.

CHAPTER II – Exchange of information

Article 2

Article 2 contains the undertaking of the Contracting Parties to provide each other with the greatest possible measure of mutual assistance when facts might constitute proof or simply give rise to the belief that an irregular trading operation has been effected by an insider. This article does not establish supervision of the markets with a systematic exchange of information, nor does it oblige the Contracting States to set up a supervisory commission such as COB or CONSOB. The assistance is limited to operations effected by insiders.

Article 3

This article is intended to enable Contracting Parties to extend assistance by the exchange of information covering not only insider trading, but all operations effected which are likely to affect equal access to information for all users of the stock market or if the quality of the information given to potential investors is not adequate to ensure honest dealing. In that way, the States who so desire may extend their co-operation to other operations on the organised stock market, as for example in the case of price manipulation or in the case of non-respect of the duty of information.

This exchange of information is optional; by a simple declaration to the Secretary General of the Council of Europe a State can undertake to provide information, subject, however, to reciprocity.

The reciprocity is necessarily established between Parties who have made similar declarations to the Secretary General of the Council of Europe. This does not exclude these Parties co-operating with other States in accordance with Article 3 without such a formal declaration.

Article 4

The Parties may designate one or several authorities either according to their federal structures or according to the organisation of their services. These authorities may be either administrative or judicial bodies. However, the Parties have the obligation to designate at least one authority.

It is desirable that the authorities entrusted with the execution of the request should communicate directly between themselves.

When designating these authorities, the necessary details should be given so that the other Contracting Parties know which is the authority directly responsible for acting upon the requests. For this purpose, each Party shall make a declaration to the Secretary General of the Council of Europe who shall notify it to the other Parties.

Article 5

Article 5 indicates what explanations must accompany a request for assistance.

According to paragraph 1, a request for assistance must explain the reasons for the request.

According to paragraph 2, the request must include a description of the facts giving rise to the suspicion that irregular operations of insider dealing may have been committed or, in a case failing within Article 3, the facts which establish or give rise to the belief that the principles of equal access to information or honest dealings have not been respected. In order to avoid difficulties in carrying it out, the request must be sufficiently detailed.

According to paragraph 3, the request must specify what provisions have not been respected and therefore warrant sanctions.

Paragraph 4 states that an official language of the requested authority or one of the official languages of the Council of Europe must be used; this limits the need to use the translation services which might affect not only the speed of the exchange of information, but also confidentiality. Derogations from this provision are possible under Article 11, simply by arrangement between two authorities.

Paragraph 5 lists the details to be supplied with the request for assistance. Here too, if by its nature the enquiry requires other details, they must obviously be included with the request; in other words, the list given in paragraph 5 is not exhaustive.

Article 6

Article 6 concerns the action to be taken upon the request and sets forth the undertakings entered into by the Parties.

Paragraph 1 indicates that the procedures to be followed by the requested authority in complying with the request are those laid down in the national legislation governing that authority.

According to paragraph 2, the requested authority must, if necessary, be able to implement or to make provision for the implementation of the procedure laid down by national law for obtaining evidence. Within these procedures, the sanctions laid down by national law for breaches of confidentiality shall not apply to the obtaining from a witness, in the course of an enquiry, of information which he may not refuse.

The above-mentioned provisions shall in no case affect the national law also applying to the protection of the rights of defence of persons, physical or legal, involved in an insider trading operation, or concerned by the request.

According to paragraph 4, secrecy must be maintained about any request and any assistance provided. It must be remembered that any information divulged, if only concerning the request itself, might be prejudicial to the reputation of the person or body concerned. The rule of secrecy is intended to ensure that the procedures instituted by the Convention operate smoothly.

However, in certain States, citizens must have access to the files of the administration, and in this case secrecy cannot be guaranteed. In addition, some civil servants and some departments are under an obligation to inform the competent authority of any action liable to prosecution. In this case, the Parties concerned must declare this when designating the authorities responsible for dealing with requests (see Article 4). This declaration will make it possible to evade the obligation of secrecy, provided, however, that this exception derives from the national legislation of the State making the declaration. In such a situation, the other Parties could invoke reciprocity.

Therefore, if the requesting Party has not been given the assurance that the requested authority will keep secret information received during the enquiry which it has carried out, the requesting Party will be entitled to consider itself to be no longer bound by the guarantee of secrecy with regard to this other Party when it has itself received a request in any other enquiry from this other Party.

The provisions of this paragraph, in contrast to Article 7 which deals with the requesting authority, concern the derogation of the confidentiality rule imposed upon the requested authority who might discover a violation of its penal law committed in its territory. Therefore, the one article does not neutralise the other.

Article 7

This article deals with the obligations of the requesting authority.

Paragraph 1 meets the principle of specificity: the information obtained through the request for assistance cannot be used for purposes other than those mentioned in the request.

Paragraph 2 indicates that the requested Party may, as a general rule, refuse to supply the information requested or subsequently, for new reasons not known before, oppose its use for purposes set out in the request or fix certain conditions. However, this possibility cannot be used in any case where the matters which are the subject of the request and which clearly fall within the scope of the Convention are considered an irregularity by both Parties. It is not required that these matters should be subject to identical sanctions in the two countries. It is sufficient that they constitute, for those countries, a criminal offence or an infraction subject to administrative, disciplinary or civil sanctions but not infractions for which damages are the only civil sanctions.

Certain delegations were of the opinion that this possibility of objecting to the use of the information furnished, even if the conditions for refusal laid down in Article 8 were not met, could form an obstacle to the good implementation of assistance. However, they considered that this provision was an acceptable point of departure in the present state of legislation in the various member states.

Paragraph 3 indicates clearly that the requesting Party can use the information for purposes other than those mentioned in the initial request only after informing the requested authority of this and that the requested authority can object or impose special conditions in the circumstances described above.

Paragraph 4 concerns the problem of using information obtained through this administrative co-operation before the criminal courts, where *actes internationaux d'instruction* are normally regulated by the procedures of the European Convention on Mutual Assistance in Criminal Matters. The committee of experts considered that information obtained by administrative means may be used before the criminal courts where this information could have been obtained within the framework of Chapter III of this Convention. Therefore, where the requesting authority wishes to use the information for a criminal prosecution, it should be sure that the information would have been provided by the requested authority under Article 12, paragraph 1.

By virtue of paragraph 5 of this article, both the use and transmission of information for fiscal, customs or exchange control purposes are prohibited, unless the requested Party has made a declaration allowing the use of information to be extended to such purposes.

Article 8

Article 8 lists the cases in which the requested authority may refuse to accede to the request for assistance, namely:

– when the request is not in conformity with the substantive or procedural provisions of the Convention;

– when it may be harmful to the sovereignty, security, essential interests or public policy of the requested Party to do so (the interpretation of these expressions, particularly «essential interests», being left to the discretion of the requested authorities and reasons being given for refusal on any of these grounds);

– when the irregularities are time-barred in the requesting or requested Party;

– when the matters arose before the Convention entered into force for the requesting or the requested Party;

– when the requested Party has already instituted proceedings against a person or body in respect of the facts which are the subject of the request for information ; or

– when the requested Party has already pronounced or has, for example, decided not to start proceedings or to stop proceedings already begun.

Article 9

Article 9 states that the requesting Party must indicate how it wishes to receive the information; the requested Party must comply in so far as it is able to do so, and to this effect it shall use the technical means at its disposal.

Article 10

Article 10, paragraph 1, guarantees respect for the confidentiality provided for in Article 6, by permitting the requested State, having ascertained that confidentiality has been breached by the requesting State, to suspend the application of Chapter II vis-à-vis that State. This decision shall be notified to the Secretary General of the Council of Europe by simple letter. This suspension may be lifted at any time, which shall be also notified to the Secretary General.

Paragraph 2 subjects the application of paragraph 1 to a preliminary procedure during which the accused Party will be able to make its comments on the alleged breach of confidentiality.

Paragraph 3 instructs the Secretary General to inform not only the Parties but all member States of the cases where paragraph 1 has been applied. The object of this provision is to improve good collaboration between the Parties.

Article 11

Article 11 in fact leaves authorities corresponding with each other across frontiers free to choose the form and/or language which suits them best. This can involve simpler procedures, means of communication other than the exchange of correspondence and languages other than the official languages of the Council of Europe or that of the requested State.

CHAPTER III – Mutual assistance in criminal matters

Article 12

Paragraph 1 contains the undertaking by the Parties to afford each other the widest assistance possible in criminal matters related to offences involving insider trading. This is the general principle.

Paragraph 2 indicates however that the existing agreements in the field of legal co-operation relating to criminal proceedings, and in particular the European Convention on Mutual Assistance in Criminal Matters and the Additional Protocol thereto, and other specific agreements or arrangements in this field in force between Parties, shall be respected.

CHAPTER IV – Final provisions

Articles 13 to 21

In general, these provisions follow the model final clauses adopted by the Committee of Ministers of the Council of Europe for conventions and agreements drawn up within the Organisation.

Articles 14 and 18

The number of ratifications requested for the entry into force of the Convention was intentionally fixed at three so as to allow an early entry into force and not to object to its application by a few States who want to use the procedures set up. Moreover, an early entry into force will make it possible to discover if there is any reason for the application of the procedure set up by Article 18.

Article 15

Paragraph 1 of this article is aimed at allowing, *inter alia*, the accession of international intergovernmental organisations such as the European Economic Community.

Article 16 bis

See Protocol hereafter.

Article 17

The Convention allows no reservation. However, the text of Article 6 as it stands shows that certain Parties, by application of their legal provisions, some of which are constitutional, may not be in a position to give full application to certain provisions. In such a case, they are invited to declare it under Article 6. In so far as such a declaration may be considered as a reservation, it should be the only one allowed under the Convention.

Article 18

The evolution of the domestic legislation of the Parties, technical developments and new situations may make it necessary to adapt the Convention.

On the other hand, the Parties to the Convention may encounter difficulties in mutual collaboration that are difficult to foresee now.

Moreover, some member states might wish to take part in the mutual assistance system, but find difficulties in their way – for example domestic legal arrangements. It might be possible to obviate these difficulties by adjustments to the Convention without causing any problems for the other Parties.

Finally, in the opinion of some experts, this Convention constitutes only a point of departure in the present state of legislation in the various member states.

For these reasons, it is provided that, at the request of two or more Parties, a meeting shall necessarily be convened by the Secretary General of the Council of Europe with the task not of directly modifying the Convention but of making the appropriate suggestions. The meeting shall be attended by experts representing the member states and the Parties which are not member States of the Council of Europe.

The possibility for the Secretary General to take the initiative of such a meeting is aimed at meeting the need of more information on behalf of states not yet Parties to the Convention.

PROTOCOL

Article 16 bis is designed to cover the particular situation of those Parties which are members of the European Economic Community. It states that, in their mutual relations, those Parties shall apply Community rules and shall not therefore apply the rules arising from the Convention except in so far as there is no Community rule governing the particular subject concerned. Since it governs exclusively the internal relations between the Parties members of the European Economic Community, this paragraph is without prejudice to the application of this Convention between those Parties and Parties which are not members of the European