

REGULATION OF FINANCIAL MARKETS WITH PARTICULAR REFERENCE TO MARKET ABUSE: A PERSPECTIVE FROM THE NETHERLANDS

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Preface

This paper, giving a perspective from the Netherlands on the regulation of financial markets, with particular reference to market abuse, has been written by Professor Hans de Doelder, Vincent Mul and Marije van den Enden. They all work at the Department of Criminal Law and Criminology of the Erasmus University of Rotterdam, the Netherlands. They lecture in the field of Criminal Law and Criminal Procedure and carry out research on financial and administrative criminal law. They have written several books and articles on the subject of financial criminality: insider trading, money laundering and fraud.

Because of the background of the writers of this paper, not all topics are comprehensively addressed. The paper has been written with special interest being devoted to criminal law subjects.

1 The structure of financial markets

1.1 Amsterdam Exchanges NV

There are several financial markets in the Netherlands, such as the stock market, the option market and the debenture market. Trading in securities that are part of these markets takes place on an exchange, which is a specific

concrete place where the supply and the demand of certain securities meet. However, the traded security is not (physically) present at the exchange.

In the Netherlands one can discern two types of financial markets: public and private markets. The public markets are supervised by the Minister of Finance or in the case of delegation, the Securities Board. The private markets are not regulated by the Government. Besides that, the trading in securities that are part of private markets does not take place on an official exchange.

On 1 January 1997, the Amsterdam Stock Exchange and the EOE-Option Exchange merged. They now operate under the name "Amsterdam Exchanges NV (AEX)". AEX is a holding company with six working companies:¹

AEX-Stock Exchange, responsible for the stock market;
AEX-Option Exchange, responsible for the derivatives market;
AEX-Agrarian Term Market, engaged in the organisation of the trade in agrarian futures;
AEX-Clearing & Depository, responsible for the winding up and the use of the stock-transactions;
AEX-Information Technology, responsible for the automation;
AEX-Data Services, responsible for the distribution and exploitation of price-information.

1.2 Motivation for the merger

Both the AEX-Stock Exchange and the AEX-Option Exchange operate in a quickly changing environment. Deregulation, financial integration, new players and technological developments lead to increasing competition. Intermediaries can choose from several alternatives to trade their orders and they base their choices on liquidity, transaction costs, accessibility, quality of the service, safety etc., instead of basing them on custom or loyalty to the national or local market.

Another important development is the internationalisation of the stock market. Private investors invest in foreign companies and shares of internationally operating businesses are largely obtained by foreign investors. The chance of a migration of commodities to markets other than the Amsterdam Stock Exchange increases.

1. Amsterdam Exchanges NV, prospectus dated 20 February 1997, p. 6.

Amsterdam Exchanges NV expects that the merger between the EOE-Option Market and the Amsterdam Stock Exchange will lead to a strengthening of its position in the just presented international field. This position will be reinforced by the following (expected) positive effects of the merger:²

- I. an increase in their market position;
- II. synergy advantages;
- III. efficiency advantages.

1.3 Admitted institutions

In accordance with its articles of association, AEX is entrusted with the organisation, administration, regulation, preservation and development of the stock market and the derivatives market (derived products such as options and futures) on exchanges and trading systems exploited by AEX.

The public cannot deal substantively in stock or derivatives on the exchange. This trade is only possible through institutions admitted by the exchanges. These institutions are persons or corporations that are admitted to the trading/completion/saving of stock and derivatives on the AEX exchanges.

Besides this, AEX is responsible for the clearing and settlement of stocks and derivatives transactions and the keeping of stock and derivatives. AEX offers (on the exchanges exploited by it) the admitted institutions floor-space and other trading facilities.

Other tasks of AEX are:³

- formulation and application of rules and the supervision of compliance with these rules, dealing with the adequate functioning of the offered trading facilities;
- fixation and publication of the price of stocks/derivatives;
- providing the independent consideration of complaints, made by investors against admitted institutions and disputes between these institutions (Committee of Disputes);
- giving information concerning stock/derivatives markets.

2. Amsterdam Exchanges NV, prospectus dated 20 February 1997, p. 17.

3. Nederlands Instituut voor het Bank- en Effectenbedrijf, *Wegwijzer in bankenland*, Amsterdam 1997, p. 133.

2 Financial markets: the regulatory structure

2.1 Historical development

The climate of the Netherlands' financial industry has traditionally been very liberal. For quite some time the emphasis was upon self-regulation with only a minimum of governmental interference through legislation and supervision.

This liberal attitude towards the various branches operating in the financial industry can be illustrated by the fact that for decades there was only one Act on the subject of the regulation of financial markets that was declared by the combined consent of the Government and the Houses of Parliament (*Wet in formele zin*): *de Beurswet* (Stock Exchange Act) of 1914.

Stock Exchange Act of 1914

The Stock Exchange Act of 1914 was introduced as a result of the disruption of the Dutch Stock Exchange because of the First World War. This war was responsible for the total disorganisation of the Stock Exchange. To prevent a complete collapse, the Dutch Stock Exchange was closed on July 29, 1914. This chaotic situation created the need for new regulation and so the Stock Exchange Act of 1914 was drawn up, which entered into force on 6 September 1914.

The purpose of the Act was to enable a gradual return from the existing abnormal situation to a more or less normal functioning of the stock markets. The main provision was without doubt section two of the Act, of which the first sentence was the following: "The stock markets are supervised by the Minister of Finance". The importance of this supervision lies in the fact that the supervision gave the Minister of Finance the opportunity to promulgate regulations on the subject of the opening and closing of stock exchanges, as well as on the way business was carried out at the exchange and also on the quotation of stock.

This regulatory structure started to change in the early eighties. The Stock Exchange Act of 1914 was generally considered to be outdated. In particular, there was comment on the fact that the Act gave no specific indication as to the extent of the powers given to the Minister of Finance. People also criticised the fact that the range of the Act was limited. After all, the Act did not apply to trading in stocks that took place outside the stock exchange. Finally, it was pointed out that the Act was not based on a certain vision concerning the way in which the supervision of the financial industry should be arranged.

The result of all this criticism was that the Act in its entirety was repealed and was subsequently replaced by new legislation: the Securities Trading Act of 1985.⁴

Securities Trading Act of 1985

As stated above, in the eighties the legislation on the regulation of the financial industry was generally considered to be outdated. The leading opinion was that a complete change of the existing legislation was needed. Such a project naturally takes time, as a result of which the gap in the legislation would remain for quite some time.

The government considered this to be unacceptable; an opinion that was based on the following train of thought.

At the beginning of the eighties, there was a strong growth in dishonest practices on the stock market. More specifically, one could detect an increase in the number of dubious offers of investment. According to the Explanatory Memorandum of the Securities Trading Act of 1985, these offers to enlist investors were extensive and aggressive, the information given to the investors was often suggestive and possible risks were trivialized or even concealed.

The government believed that an increase in fraud was mainly caused by the lack of Dutch legislation concerning the regulation of financial markets compared to the strict legislation in this field in adjoining countries. The lack of legislation and, because of that, the lack of legal instruments to deal with fraudulent stockbrokers and investors, could lead to a rush of persons involved in fraudulent offers shifting the centre of their actions to the Amsterdam Stock Exchange. A frightening thought, that was not pure fiction, since the government possessed data which showed that such a shift had already begun to take place.

There was yet another problem, related to the one just discussed. The Stock Exchange Act of 1914 only referred to stock traded on the Stock Exchange. However, in many cases, questionable trading took place in stock that was not admitted to a quotation in the official listing. There was therefore no legal way to oppose this form of trading.

These alarming developments and the knowledge that the existing legislation in the field of the regulation of financial markets was incapable of providing a sufficient response, brought the government to believe that it was important to expedite the entry into force of some of the parts of the new general

4. D.R. Doorenbos, *Financieel strafrecht*, Deventer 1992, pp. 167-171.

legislation. These parts, concerning regulations for the fight against undesirable developments that arise in the securities trade, constituted the Securities Trading Act of 1985.⁵

Act on the Supervision of Securities Trade (ASST)

The Act on the Supervision of Securities Trade came into force on 7 March 1991 and replaced the Securities Act of 1985. Along with the Act on the Supervision of Investment Institutes, which Act will be discussed later, the ASST constituted the core of the new general legislation concerning the regulation of the financial industry.

The two main objectives of the ASST were first, promoting the adequate functioning of the securities markets and second, protecting the investors on these markets.

According to the Explanatory Memorandum, promoting the confidence of investors in the financial industry is the (best) way to achieve the first objective. This statement is based on the consideration that confidence in financial markets can be promoted by striving for sufficient protection of investors on these markets. In other words, striving for the realization of the second objective – the protection of investors – promotes the confidence that investors have in these markets, which will bring the realization of the first objective nearer.

Under the ASST the establishment of a stock exchange is subject to the approval of the Minister of Finance (section 16). Before approval will be granted conditions relating to regulation of the stock exchange and the supervision of its members have to be met.

Stock exchanges will continue to be self-regulatory organizations with respect to listed securities and to the rules and regulations regarding their members. The Dutch Stock Exchanges are subject to the supervision of the Stichting toezicht effectenverkeer (Securities Board of the Netherlands, hereafter Securities Board). The role of the Securities Board is the supervision of the self-regulatory stock exchanges and the licensing of intermediaires that are not members of a stock exchange. Its objective is to supervise the trade in securities and to enforce the statutory securities regulations. The Minister of Finance, however, remains politically responsible.⁶

5. D.R. Doorenbos, *Financieel strafrecht*, Deventer 1992, pp. 177-179.

6. D.R. Doorenbos, *Financieel strafrecht*, Deventer 1992, Chapter 16.

Act on the Supervision of Investment Institutes

The general objective of the Act on the Supervision of Investment Institutes (ASII), which entered into force on 15 October 1990, was approximately the same as the objective(s) of the ASST: promoting the adequate functioning of the securities markets and protecting the investors on these markets. However, this Act concentrates in particular on the investment institutes. These institutes act as an intermediary between investors and investment objects. Because of the increasing number of abuses committed by investment institutes, the ASII was introduced.

The Minister of Finance, and after delegation, De Nederlandsche Bank (the Dutch Central Bank), is entrusted with the supervision of compliance with the Act. To execute this supervision, the Act has granted the supervisor the competence to use several means of control. For instance, it is obligatory for persons who are either being questioned or investigated, to provide all the information requested by the supervisor. Refusing to do so is a criminal offence (sections 19, 20 and 27).⁷

Act on the Supervision of Securities Trade 1995 (ASST 1995)

In 1995 the Act on the supervision of Securities Trade 1991 was replaced by the Act on the Supervision of Securities Trade 1995. This replacement was necessary because of the introduction of two EC Directives that had to be implemented in the Dutch legislation. The first directive was the Directive concerning the committing of services in the field of securities investments (Directive no. 93/22/ EEG). The second was the Directive concerning the capital sufficiency of investment enterprises and credit institutions (Directive no. 93/6/EEG).

In particular the way in which the supervision of the trading on stock markets was arranged changed as a result of the introduction of the ASST 1995.

According to the (former) ASST, the Securities Board was formally entrusted with the supervision and the enforcement of the regulations as set out in this act. In practice, however, it was the Control Office (Controlebureau) of the Stock Market Association (Vereniging voor de Effectenhandel), that executed this enforcement.

The ASST 1995 justified this procedure by introducing an autonomous competence for the Control Office to investigate infringements of the ASST

7. D.R. Doorenbos, *Financieel strafrecht*, Deventer 1992, pp. 261-269.

1995. The Office was therefore allowed to make inquiries under its own responsibility and under its own name.⁸

On 8 November 1996, the Dutch Government presented a proposal to the Tweede Kamer (Second Chamber of Parliament) to amend the ASST 1995. This proposal concerns the amendment of the ASST 1995 in order to increase the effectiveness of this Act in the field of the fight against insider trading. According to the Explanatory Memorandum the reason why this change in the law is desired, is the importance of the existence of adequate regulation in this field and the lack of such adequacy in the existing legislation. For an optimal functioning of the stock markets it is important that persons operating on these markets have confidence in them. Now that the ineffectiveness of the existing legislation has caused a rapid decline of this confidence, it is possible that investors are no longer willing to participate in the stock markets. This will have negative consequences for the position of the stock exchange as a place where the supply and demand of capital takes place. Since stock markets play a central role in the economic process, this is unacceptable. The reasons for the ineffectiveness of the ASST 1995 and the content of the bill will be discussed later, in connection with the comment regarding insider trading.

3 Supervision

3.1 Structure and objective of supervision

As stated in section 2.1, the climate of the Dutch financial industry has traditionally been very liberal. Under the influence of EG Directives and because of several social and economic developments, the Netherlands has belatedly set up an entire supervisory structure for the various branches of industry.

The Dutch Central Bank, the Insurance Board and the Securities Board are entrusted with the enforcement of the financial Acts concerning supervision. The Dutch Central Bank is responsible for the enforcement of the Credit System (Supervision) Act 1992, the Act on the Supervision of Investment Institutes and the Exchange Offices Act.

8. H. de Doelder and V. Mul, *Misbruik van voorwetenschap: Het strafrechtelijke kader*, (NIBE-bankjuridische reeks: 30), Amsterdam 1996, p. 18.

The Insurance Board is entrusted with the enforcement of the Act on the Supervision of Insurance Operations 1993, the Act on the Pension- and Savingsfunds and the Act on the Supervision of Funeral Insurance Operations.

Finally the Securities Board. This Board is entrusted with the enforcement of the Act on the Supervision of Securities Trade 1995 and the Disclosure of Major Holdings in Listed Companies Act.

The objective of the supervision differs per Act. In general it can be said that the aim of the supervision is to maintain a stable, healthy and reliable financial system. The institutions that are being supervised must meet certain reporting and licensing obligations. In addition, they are periodically checked by the supervisor.

Licence

All acts concerning supervision have a provision according to which it is prohibited to practise financial activities as described in the Act without a licence having been granted by the supervisor in question. Under specific circumstances it is allowed to practice these activities without a licence, in which case an exemption will have been given by the supervisor.

To be eligible for a licence, the licence conditions must be complied with. These conditions relate to the company capital, the administrative organisation and the reliability and the expertise of the administrator.

Operating without the required licence is a regulatory offence under the Act on Economic Offences (*Wet Economische Delicten*). The Economic Control Agency (*Economische Controledienst*) is responsible for detecting these offences.

Control

To check whether the concerned institutions observe the rules as laid down by the law and other regulations, the supervisors carry out inspections at institutions that are under their supervision. The supervisor ensures that adequate procedures concerning the administrative organisation and internal control are introduced and observed.

The institutions given the power to supervise also inspect whether other relevant legislation, such as the Disclosure of Unusual Transactions Act (*Wet melding ongebruikelijke transacties*) and the Identification Act (*Wet identificatie bij financiële dienstverlening*) are observed.

Secrecy

The secrecy provisions in the Acts concerning supervision are the provisions aimed at in section 17 of the Disclosure of Unusual Transactions Act.

These provisions are important for an adequate functioning of the supervision. The supervisor has been given the power to supervise, which enables him to take cognisance of all matters concerning the supervised institutions. The concerned institutions are obliged to cooperate. Such an obligation can only exist if this obligation remains limited to matters of supervision and the information is only used for that purpose. The supervisor is therefore not allowed to make any of the requested information public. The revealing of inside information could have serious consequences for either the market position of the concerned institution or the functioning in general of the AEX. The supervisor is therefore committed to a strict code of secrecy. Very rarely, the supervisor is allowed to break this code, for instance in case of the discovery of an offence having been committed by the supervised institution.⁹

3.2 Supervisors

The Dutch Central Bank (DCB)

The Dutch Central Bank has many tasks. Probably the most important one is the financial supervision of the credit system. The purpose of this supervision is to protect the interest of persons who entrust their capital to banking institutions. The DCB therefore supervises the way in which these institutions operate. The Credit System (Supervision) Act regulates the practice of this supervision. However, the fact that an institution is being supervised does not mean that it can no longer be held responsible for its own actions.

The DCB checks in particular the solvency, liquidity and administrative organisation of a certain credit institution. Besides that, the DCB pursues a so-called "structure policy". This means that the permission of the DCB is required in order to obtain an interest in a banking institution or the obtaining by such an institution of an interest in a company of a different kind. The purpose of this policy is to take measures against undesired concentrations of power.¹⁰

9. Nederlands Instituut voor het Bank- en Effectenbedrijf, *Wegwijzer in bankenland*, Amsterdam 1997, pp. 138-139.

10. Nederlands Instituut voor het Bank- en Effectenbedrijf, *Wegwijzer in bankenland*, Amsterdam 1997, pp. 140-144.

The Insurance Board

The Insurance Board is entrusted with the supervision of the insurance industry. This supervision has always been based on the principle of freedom of commercial policy and the publication of business figures. The Dutch system of supervision could generally be classed as a normative system with some material elements. The European harmonisation and coordination process has led to substantial regulation and brought in some major material control mechanisms. An example of this change is the introduction of the authorisation requirement for the establishment of an insurance company in the Netherlands.

The Act on the Supervision of Insurance Operations (ASIO) 1993, which is enforced by the Insurance Board, regulates the admission and practice of insurance companies which are seated in the Netherlands. All insurers in the private insurance market are under the supervision of the Insurance Board except reinsurance companies; they are not supervised. The agents who operate as an intermediary between the client and the insurer are also not subject to supervision.¹¹

Securities Board

The Securities Board is a foundation, established in 1988, with an independent board whose members are appointed by the Minister of Finance. The Act on the Supervision of the Securities Trade 1995 (ASST 1995) and the Disclosure of Major Holdings in Listed Companies Act form the basis for the prudential control of securities markets in the Netherlands exercised by the Securities Board. Under the ASST 1995 the Securities Board will exercise most of the powers of the Minister of Finance, including the supervision of the off-exchange trade.¹²

4 Insider trading

4.1 Insider trading: an introduction

Financial markets play a central role in the economic process. Therefore it is important that these markets function adequately. Market abuses, such as the misuse and abuse of insider information, undermine the confidence that

11. Nederlands Instituut voor het Bank- en Effectenbedrijf, *Wegwijzer in bankenland*, Amsterdam 1997, pp. 144-145.

12. Nederlands Instituut voor het Bank- en Effectenbedrijf, *Wegwijzer in bankenland*, Amsterdam 1997, p. 146.

investors have in the financial industry. This lack of confidence will eventually lead to a decrease in the willingness to participate on the financial markets, which could in time cause a general regression in the Dutch economy.

To prevent this situation, persons who possess inside information concerning certain securities, must be forced to refrain from abusing their privileged position to gain advantage for oneself or another.

This consideration from the Explanatory Memorandum formed the basis of the criminalisation of 'insider trading' in the Netherlands in 1989, at first in section 336a of the Dutch Criminal Code and at present in section 46 of the Act on the Supervision of the Securities Trade 1995.

Recently the legislation concerning insider trading has emerged as a topic of debate. The judgment of the Dutch Supreme Court in the HCS case (HR 27-6-1995, NJ 1995, 662), caused public discussion and some legal comment regarding the adequacy of the current legislation. Along with the experiences in practice with the criminal liability of insider trading, this resulted in a bill to amend the ASST 1995 in order to improve the effectiveness of this Act in the field of the fight against the use of inside information.¹³

The consequences of this bill for the problem of the criminalisation of the use or abuse of inside information will be discussed, but in order to fully comprehend the reasons for the suggested alterations, the present legislation in this field will be discussed first.

4.2 Insider trading: elements of the offence

According to section 46 of the ASST 1995 the abuse of insider information must be regarded as a criminal offence. This offence is committed when someone, a) who has inside information in his possession, b) in the Netherlands, c) deals in securities d) that are listed on a regulated market as mentioned in section 22 of the ASST 1995, e) if any advantage originates from this transaction.

a Inside information

Section 46 (3) contains the definition of 'inside information'. This definition reads as follows:

13. TK, 1996-1997, 25 095, no. 1-2.

Inside information is acquaintance with a detail regarding the corporate body, partnership or institution related to the securities or regarding the securities trade in general:

- a) of which the informed person knows or reasonably could assume that it is not public and could not have come from outside the circle of persons sworn to secrecy without violating a secret; and
- b) of which publication, reasonably expected, will influence the stock market price of securities.

According to this section information is considered to be 'inside information' if there is a) acquaintance with a detail regarding the corporate body, partnership or institution related to the securities or regarding the securities trade in general, b) of which the informed person knows or reasonably could assume that it is not public and could not have come from outside the circle of persons sworn to secrecy without violating a secret, c) of which publication, reasonably expected, will influence the stock market price of securities.

- a) Acquaintance with a detail; what is meant by the term 'detail'? In general it is assumed that details can be of a various nature. In the RDM case of 29 January 1996 the court was of the opinion that such a detail existed. In this case the accused was blamed for the fact that he, being chairman of the board and the major stockholder of Begemann, had sold Begemann shares during the so-called pre-negotiations between RDM, Begemann and the Department of Commerce. The defence stated that the information advantage the defendant had, could *not* be considered a detail in the sense of the law. The court stated in its (acquitting) verdict that the chief contents of the proposition of Begemann to take over RDM, which was known by some insiders before publication, was so concrete that it was considered to be a detail in the sense of the law.
- b) The meaning of the obligation of secrecy can be illustrated by the HCS case (HR 27 June 1995, NJ 1995,662). In this case the Supreme Court decided that the obligation of secrecy as mentioned in section 46 must not be interpreted restrictively.
- c) In the HCS case the Supreme Court also decided that the element 'influence on the stock market price' had to be read as follows:

To objective criteria must reasonably be expected that the announcement of the details will lead to an increase, respectively a decrease, of the stock market price.

b In the Netherlands

According to the Singapore judgment (HR 6 April 1964, NJ 1954,368), the insider who operates from abroad, can be considered to have accomplished the transaction *also* in the Netherlands.

c Dealing in securities

Dealing in securities means personally buying or selling securities or allowing another person to buy or sell them for you. Only acting *while* possessing inside information is punishable by law.

d Securities listed on a regulated market

Insider trading is a criminal offence as far as the trading concerns securities that are listed on a regulated market as mentioned in section 22 of the ASST 1995. A problem occurs when the insider trading takes place in securities that are not officially listed on such a market. This form of market abuse cannot be regulated under the current legislation.

e Advantage

According to section 46, any advantage must originate from the insider trading in order to establish a liability for this form of trading. For a long time, the significance of this provision was small. It was generally assumed that it goes without saying that any advantage originates from doing a transaction. However, the Supreme Court in the HCS case attributed a separate meaning to this provision: "From the history of the Dutch legislation, it follows that there must be such a direct relation between the transaction and the origination of any advantage, that the possible advantage can be assumed to have arisen out of this transaction. If the advantage depends on uncertain new events that arise after the accomplishment of the transaction, a direct relation cannot be assumed".

4.3 Enforcement

The criminal investigation as regards (possible) insider trading can be divided into two main stages. The first stage is the stage of the initial investigation. The Bureau of Control of the Stock Market Association will commence an investigation into a possible case of insider trading. There are several ways in which such a suspicion of insider trading can emerge. For example, unexplainable price fluctuations, rumours in the market, complaints or tips received and the findings of the frequent inspections of the Economic Control Department.

The investigation will subsequently be carried out (formally) by the Securities Board. Eventually this can lead to a report being sent to the Public Prosecutions Office.

The President of the Stock Market Association is the authority who orders the initial investigation, which investigation is subsequently carried out by the part (the pool) Insider Trading / Observance Listing and Issuing Rules of the Bureau of Control. During the investigation the investigators make use of requested information from several sources, in order to be able to report the crime to the Public Prosecutions Office.

The second stage is the stage of the continued investigation under the direction of the public prosecutor and executed by the Economical Control Department. This phase starts when a (supposed) crime has been reported. From the moment of this report, the investigation becomes a full criminal investigation in the sense of the Dutch Code of Criminal Procedure (CCP).

The investigating officers do not merely exercise the powers given to them by the CCP, but also powers that are invested in them on the basis of the Economic Offences Act (EOA).

In case that the investigation and the report give rise to the conviction that there is a suspect in the sense of section 27 (1) of the CCP, the public prosecutor can, according to section 181 in conjunction with section 149 of the CCP, demand a preliminary inquiry by the rechter-commissaris (examining judge).

Besides this (or instead), the public prosecutor can in accordance with the provisions of section 126 CCP, request the delegated judge to grant him permission to open a criminal financial investigation (strafrechtelijk financieel onderzoek).

As regards the investigative powers, the EOA offers several possibilities, specifically directed at economic offences. Consecutively can be mentioned 1) Seizure of objects which are subject to seizure by investigating officers (section 18 EOA), 2) demand the presentation of certain documents for inspection (section 19 EOA) and 3) the entering of premises by investigative officers (section 20 EOA).¹⁴

Since 1 January 1997 the organization of the enforcement of the ASST 1995 has slightly changed. Because of the merger of the Amsterdam Stock

14. H. de Doelder en V. Mul, *Misbruik van voorwetenschap: Het strafrechtelijke kader*, (NIBE-bankjuridische reeks: 30), Amsterdam 1996, pp. 37-38.

Exchange and the EOE-Option Exchange into Amsterdam Exchanges NV (AEX),¹⁵ the Stock Market Association has been discontinued. The Control Office still (formally) exists, but most of its powers have been taken over by the Compliance Department of the AEX.

The tracing of insider trading, however, has not been taken over by this department. Since 1 April 1996 the Securities Board has a new department: the Control Department. This department, as of 1 January 1997 together with the Control Office, is concerned with the tracing of and the investigation into insider trading. However, as a result of the discontinuation of the Stock Market Association, the role of the Control Office in this field has been severely decreased. Therefore the Securities Board, through the Control Department, is at present in practice the only institution entrusted with the enforcement of the ASST 1995.

4.4 Future developments

4.4.1 The bill to amend the ASST 1995

On 8 November 1996 the bill to amend the 1995 Act in order to increase the effectiveness of this Act in the fight against the use of inside information was introduced. The reason for this proposal to amend the ASST 1995 was the general consideration that the present legislation in this field was inadequate. In particular the fact that only one person had been convicted for insider trading since the criminalisation of insider trading in 1989 (Weweler, Rb. Amsterdam, 3 January 1997) gave rise to many questions. Together with the judgment of the Dutch Supreme Court in the HCS case, this formed the basis for some legal comment regarding the adequacy of the current legislation.

The bill introduces several changes to the provisions of the ASST 1995. For instance, in the bill the advantage criterion in the crime definition is removed.¹⁶ Also removed is the secrecy criterion in the definition of inside information.¹⁷ These are relatively minor alterations. More important is the expansion of the range of the penal provision by expanding the categories of securities to which the prohibition of insider trading applies. According to the bill, liable for penalty on the basis of section 46 ASST 1995 is not only trading in securities that are listed on a regulated market as mentioned in section 22 of the ASST 1995, but also trading in securities that do not have their price quoted on a regulated market, but soon will. Insider trading in

15. See this report, paragraph 1: "The structure of financial markets", pp. 1-3.

16. See the comment on page 11 under e.

17. See page 10 sub a.

non-listed derived instruments such as options and warrants will also be a criminal offence under the new Act.

The bill also changes the definition of inside information. It is no longer required that the direction in which the stock market price will move by disclosure of the information should have been foreseeable. The criterion is whether the publication of the information could influence the stock market price of the securities, regardless of the direction of that price.

Besides modifying the existing provisions of the ASST 1995, the bill also introduces several new general provisions and regulations. The first runs as follows. Under the present law, the passing on of inside information to others, can not be prosecuted on the basis of the ASST 1995. The bill, however, introduces a rather fundamental change in this direction. According to the bill, the “tipping” off of others, by either informing or recommending, is a criminal offence (section 46a).

The second is the exclusion of certain transactions from criminal liability because of insider trading. According to the letter of the bill, dealing in these transactions is the criminal offence of insider trading. However in general, this is not considered to be criminal behaviour.

For instance, there is the situation that some persons within a corporate enterprise have inside information concerning the enterprise, partnership or institution to which the traded securities relate, but the persons who are actually concerned with the effectuation of the transaction, have not. In this situation it is not possible to prosecute the company for insider trading.

Also when a party has committed itself to effectuating a transaction and that party acquires inside information after the conclusion of the agreement, dealing in the concerned securities will not be considered a criminal offence.

The third is the introduction of the obligation for administrators and commissioners of securities-emitting institutions to report any transaction in securities of their own institution to the Securities Board (section 46b). These notifications will be made public. However, for the sake of privacy, it has been decided that publication will be anonymous, in so far that the name of the insider concerned will not be mentioned, only his function in the institution (for example whether that person is an administrator, a commissioner or an insider from a different category).

Finally, section 46d, the final provision of the bill, sets out the obligation for securities-emitting institutions to draw up regulations in which rules will be set concerning the possession of and the dealing in securities that relate to

this institution. The regulations must comply with rules set by ministerial regulation

4.4.2 The consequences of the bill

Perhaps the most significant change in the law is the strengthening of the position of the Public Prosecutions Office (O.M.). Most of the alterations, introduced by the bill, remove components of the description of the offence, which could impede or prevent a successful prosecution and conviction. This can be illustrated by the far-reaching objectification of the term “inside information”. The bill’s point of departure is that one can speak of ‘inside information’ if it can objectively be determined whether a) the information was price-sensitive, while it is not important whether the direction in which the price will go was foreseeable and b) the information had not been made public.

In general it is assumed that information will have been made public if the information has been published without reservations and therefore known to the investing public.

The result of the amendments is that the introduced regulation can be considered one of the strictest regulations in this field in the world, an observation that has been the reason for much criticism. The core of this criticism regards the problem of the “common transactions”. According to the critics, it must be prevented that certain transactions that often occur in practice and are generally accepted, fall under the penal provision. The original (strict) text of the bill, with the wide description of the offence, did not rule out this danger. In order to prevent this criminal liability from occurring, two amendments of the Act were drawn up, which exclude some transactions from the penal provision. Furthermore, section 46 (4) provides that by Order in Council categories of transactions can be pointed out, which do not fall under the scope of the prohibition.

Another issue put forward, is the problem of the increasing shareholding by employees. To an increasing degree, Dutch corporations provide their executive officials and other staff with options on shares held by the company in its own capital. With the introduction of the bill, questions have arisen about the relation between the prohibition of insider trading and the granting of shares to employees, since the bill does not deal with this issue. As a result of the remarks made, an amendment has been introduced that creates the obligation, as mentioned before, for securities-emitting institutions to draw up regulations in which rules will be set concerning the possession of and the dealing in securities that relate to this institution, which regulations must comply with rules set by ministerial regulation.

As observed before, many critical questions have already been asked about the consequences of the new penal provision for insider trading. The admissibility of common transactions and the allowability of corporate share-option arrangements are two examples of problems that arise from the new legislation. But also the obligation to report transactions in securities of the own institution has provided reason for concern. The main cause of this concern is the extent of anonymity. This is considered to be insufficient because it is quite a simple matter to discover the identity of the person concerned.

In general it can be concluded that the bill is indeed likely to increase the effectiveness of the Act. The extension of the scope of the criminal provision and the broad description of the offence, will probably create this effect. However, some serious comments have been made regarding the other consequences of the bill. And although the effect of the bill has been slightly moderated by the Amendments, it remains to be seen if these moderations are sufficient to convince the Dutch government and the Houses of Parliament to accept the bill in its present form.

4.4.3 Enforcement

On 18 December 1997 another bill was introduced: the bill to include clauses in the ASST 1995, the Credit System (Supervision) Act 1992, the Funeral Insurance Act, the Insurance Industry (Supervision) Act 1993, the Exchange Offices Act, the Disclosure of Major Holdings in Listed Companies Act 1996 and the Foreign Financial Relations Act, concerning enforcement by means of a penal sum or an administrative penalty (TK, 1997-1998, 25 821).

The purpose of this bill is to bring about a shift from criminal enforcement to administrative enforcement of financial legislation by introducing the penal sum and the administrative penalty. At the moment, the supervision of financial markets often leads to criminal procedures. The bill provides two new administrative instruments of enforcement. Because of these instruments, the enforcement of the financial legislation is likely to be improved and the criminal system will be somewhat relieved.

4.5 Price manipulation and price rigging

Insider trading is not the only market abuse investors have to be protected from. In the field of securities, price manipulation and price rigging are also considered to undermine and damage the fair and orderly functioning of markets. In other words, these two forms of conduct can be categorized as abusive trading.

Section 334 of the Dutch Criminal Code provides that he who, for the purpose of undue advantage to himself or another, by spreading a false notice, increases or decreases the price of merchandise, funds or monetary instruments, will be liable to a penalty.

Cross states that this section has no real significance in practice, since it is extremely difficult to prove that a notice is false and even more difficult to prove that it was the notice that made the price rise or fall. Because of this problem, the criminal standard has been supplemented by analogy with the general standards that apply to the members of the (formal) Stock Market Association. On 10 September 1993 the Association issued a circular, in which price manipulation is defined as follows:

The spreading of a false notice in order to influence the price of a certain fund. Also actions or conduct that give or have as a result an untrue or misleading impression of the market, can, considering the circumstances, be regarded as price manipulation.

According to Cross, such a – wide – description of the concept ‘price manipulation’ corresponds with the way in which price manipulation is described in other European and international regulations.

In the definition of price manipulation as described in section 334 of the Criminal Code, the spreading of a false notice is an important element. However, there are other forms of price manipulation which are conceivable, forms that do not involve a false notice. For instance, if someone creates a quotation that gives a false image of the supply and demand proportions on the market, this is called ‘price rigging’.

For instance, in the HCS case, the public prosecutor alleged that the defendant was guilty of this form of market abuse. He stated that the acceptance and execution of the order to sell 4.1 million shares of HCS Technology N.V. in order to (strongly) lower the price of this stock could be defined as price rigging. However, for formal reasons connected with the appeal in cassation, the Supreme Court did not comment on price rigging in this case. The remarks were merely limited to price manipulation.

5 Money laundering

5.1 General considerations

In the Netherlands there are several laws which deal with combating money laundering. The crime of laundering money is penalised under the Dutch

Criminal Code (*Wetboek van Strafrecht*) as “fencing” (“receiving goods with an illegal source”). Fencing is a serious offence, for which imprisonment of up to six years and/or a fine not exceeding Dfl. 100,000 can be imposed.

Next to the penalising of money laundering, the Dutch Criminal Code and the Dutch Criminal Procedure Code (*Wetboek van Strafvordering*) provide for the seizure and confiscation of assets derived from criminal activities, with the objective of depriving criminals (including those who have laundered money) of the profit of their behaviour.

Besides the Dutch Criminal Code and the Dutch Criminal Procedure Code, there are some specific anti-money laundering laws, dealing with the role of the financial system in restraining money laundering. Those laws mainly deal with the mandatory identification of customers of financial institutions and the disclosure of “unusual” financial transactions. Apart from that, a specific law for currency exchange offices has entered into force. Each of those laws has a double goal: on the one hand, the fight against money laundering, on the other the integrity of the financial system.

5.2 Know your customer rules

As a result of the EC Directive on Prevention of the Use of the Financial System for the Purpose of Money Laundering and the recommendations of the Financial Action Task Force on Money Laundering, on 1 February 1994 the Act on Customer Identification for Financial Services came into force (*Wet identificatie bij financiële dienstverlening 1993*). The most important provision of this Act deals with the obligation for financial institutions to check the identity of (new) customers, either natural persons or legal entities.

Under the Act on Customer Identification for Financial Services, financial institutions are defined as banks, investment institutions, securities brokers, investment managers, life insurance companies and life insurance agents, casinos, credit card companies and currency exchange offices. Furthermore, other professions, companies or institutions that are “particularly suitable for money laundering purposes” can easily and quickly be brought under the scope of this Act. The Dutch Government is now considering bringing dealers in art and precious metals within the scope of this Act.

The mandatory identification includes the duty to register some details relating to the identity of the customer. At least the following aspects have to be registered:

- the name and the address of the customer, etc.
- the nature, the number and the date and place of issue of the document used for the identification;
- the nature of the transaction;
- specific information about the value of the goods deposited, a description of the account opened, etc.

Documents which can be used to identify customers are a (valid) passport, a (valid) driver's licence or an alien's residence permit. The recognition of valid identity documents has required specific education and training on the part of employees of financial institutions; it is not easy to detect whether a West African passport, or a passport from a former Soviet State, is valid or not.

Once the identity check is made, the financial institutions have to record the information and keep a record of this for at least five years after the transaction or after the end of the relationship with the customer. The result of this record is a paper trail which will exist for at least five years.

Before recording all this information, the financial institution has to check (ask) whether the customer acts as a principal or for a third party. In the latter case, the institution has to verify and register both the identity of the appearing customer and of the third party.

There are some exclusions from the mandatory customer identification. Despite these exclusions, the identity check always has to be made in case of an "unusual transaction", in which case a second anti-money laundering act becomes important: the Act on the Disclosure of Unusual Transactions.

5.3 Disclosure of unusual transactions

At the same time as the Act on Customer Identification for Financial Services, a second important law against money laundering came into force: the Act on the Disclosure of Unusual Transactions (*Wet melding ongebruikelijke transacties*). The central provisions of this act contain a mandatory disclosure system: anyone, who makes it his profession or business to provide financial services, is obliged to disclose a (considered or completed) unusual transaction to a Central Disclosures Office (*Meldpunt Ongebruikelijke Transacties*).

5.3.1 *Financial Service, (unusual) transactions*

The Act on the Disclosure of Unusual Transactions defines the term “financial service”. Financial services are all possible activities, provided by the financial institutions, that are mentioned above (paragraph 5.2).

A “transaction” is defined as one or more activities by or for a customer in relation to the provision of one or more financial services. A transaction is to be considered “unusual” when it complies with one or more of the criteria mentioned in the “List of indicators”. This means that only transactions that can be considered unusual *because of the existence of indicators* have to be disclosed. Lists of indicators are made for the financial institutions, mentioned in the Act on Customer Identification for Financial Services.

In other words: where the Act on the Disclosure of Unusual Transactions provides a duty to disclose for *anyone*, in practice this duty only exists for financial institutions, because of the fact that indicators are needed to consider a transaction unusual. As an example, the list of indicators for banks can be found as an appendix.

5.3.2 *Disclosures Office*

All disclosed transactions are received by the Central Administrative Disclosures Office. The two most important tasks of the Disclosures Office are (a) to collect and register the disclosed transactions and (b) to analyse and - if possible - upgrade those transactions.¹⁸ If there is a possibility to upgrade a disclosed transaction, the transaction can become “suspicious”. If so, the information will become available for law enforcement purposes. To obtain the required intelligence for upgrading an unusual transaction, the Disclosures Office has the possibility to demand further information from a financial institution.

Already in the first year that the Disclosures Office became operational, around 23,000 disclosures were received, concerning a total sum of Dfl. 3,000,000,000. Only 10 % of these transactions seemed to be suspicious, after upgrading. During the following years, the List of Indicators changed and became more efficient. The amount of disclosures became less, but just about the same amount of disclosed transactions - after upgrading to suspicious - became available for law enforcement purposes.

18. To upgrade a transaction means completing the transaction with other relevant information.

It goes without saying that financial institutions and their directors and employees shall not disclose to the customer concerned nor to other third parties that information has been transmitted to the Disclosures Office.

As provided by the EU Directive on Prevention of the Use of the Financial System for the Purpose of Money Laundering, the disclosure in good faith to the Disclosures Office shall not constitute a breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision, and shall not involve the financial institution, its directors or employees in liability of any kind.

5.4 Currency Exchange Offices

At the same time that the Act on Customer Identification for Financial Services and the Act on the Disclosure of Unusual Transactions came into force, there was a proposal for an Act on Currency Exchange Offices. The Dutch Central Bank had estimated that the currency exchange offices had a turnover of some thousands of billions of Dutch Guilders each year, money which would partly come from criminal activity. The currency exchange offices were allegedly used for money laundering purposes. The problem was that there was no sufficient supervision of the exchange offices. The reliability and integrity of the directors and other leading persons within the sector of the currency exchange offices could not be checked. Therefore, on 1 January 1995, the Act on the Currency Exchange Offices came into force.

The drift of the act is simple. It is forbidden to work as a currency exchange office, unless there is registration in the currency exchange offices register, held by the Dutch Central Bank. Before registration, the Dutch Central Bank checks the reliability and integrity of the directors and other leading persons of the exchange office. Alongside this, there are some requirements with regard to the conduct of business and the administrative organisation of the currency exchange offices. The Dutch Central Bank enacted a special directive for this purpose.

Registration can be refused when the Dutch Central Bank has reasons to believe that the (persons working at the) exchange office are a threat to the integrity of the financial system, are (possibly) involved with money laundering, or otherwise are not sufficiently capable of complying with the law.

For regular financial institutions (mainly banks), it is not allowed to do business with a forbidden (that is: not registered) currency exchange office.

As a result of the Act on Currency Exchange Offices, many small exchange offices, mainly situated in the centre of Amsterdam, disappeared. They could not comply with the demands of the Dutch Central Bank, or were supposed to be involved in money laundering.

5.5 *Banking secrecy*

In the Netherlands, there is not a specific statutory provision which imposes a confidentiality obligation on banks or other financial institutions. The only obligation concerning secrecy is an assumed one, based on contract law (General Banking Terms). In general, the “obligation” of financial institutions to keep information confidential follows from the principle that according to Dutch contract law the contents of an agreement may be extended by custom as well as by reasonableness and fairness. Given the fact that a real bank secrecy law does not exist, a statutory obligation to disclose (e.g. the Act on the Disclosure of Unusual Transactions) is accepted as overruling any contractual secrecy obligation.

In criminal cases, neither a bank or other financial institution nor the employees thereof can excuse themselves from being called as a witness in a trial.

6 International cooperation

Extradition to and confiscation on behalf of authorities of foreign countries is allowed within the framework of international treaties on criminal assistance. The Kingdom of The Netherlands is party to all the important treaties in this field. The most important examples are the European Convention on Extradition of 1957, the European Convention on Mutual Assistance in Criminal Matters of 1959, the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of 1988, The Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime of 1990, the so-called Schengen Agreement and the Maastricht Treaty on the European Union of 1992.

Besides these European and otherwise international treaties, The Kingdom of the Netherlands is party to many bilateral treaties. In the field of confiscation

the most far-reaching treaty is the “Asset Sharing Agreement”, which was concluded in 1992 with the United States of America and came into force in June 1994.

Next to these treaties, there are national provisions to facilitate foreign requests. The most important provisions on this matter came into force on 1 March 1993. This legislation, popularly called “Squeeze-em legislation”, provided extensive powers for seizure and confiscation of assets with a criminal origin. Half of this legislation is especially enacted for international purposes. As a result of this legislation, upon the request of a foreign country a specific criminal financial investigation can be conducted. Within this investigation, assets can be seized for the purpose of confiscation. Asset seizure is also possible without a criminal financial investigation. The only demand is the expectation that the requesting country shall intend the confiscation. Next to that, it has to concern an act which is not only criminal in the requesting country, but in the Netherlands too.

The facilitation of foreign requests concerning criminal matters has to be based on the Dutch Criminal Procedure Code. Title X of the 4th Book of this Code deals with international legal assistance (articles 552h – 552hh DCPC). Next to the provisions of the Dutch Criminal Procedure Code, the Code on Assignment of Execution of Criminal Judgements in particular deals with this matter.

In short, all national possibilities in the field of criminal investigation, can be used for international assistance purposes as well. Not only seizure, but also for instance surveillance, arrest and extradition, search and the interception of telecommunications.

Appendix

(Investment) Banking Indicators

- 1) Transactions or proposed transactions that are notified to the police or to the prosecutor's office in connection with money laundering;
- 2) Cash transactions over Dfl. 1,000,000;
- 3) Cash transactions over Dfl. 25,000:
 - a. where a change into larger denomination banknotes takes place;
 - b. concerning a change into another currency;
 - c. concerning a purchase of (travellers') cheques;
- 4) Wire transfer transactions by non-clients over Dfl. 25,000 intended for a foreign country;

Notification is also compulsory if the financial institution considers that the following (subjective) indicators apply:

- 1) Transactions or proposed transactions which provide the possibility of assuming that they might be related to money laundering;
- 2) New accounts that fulfil two or more of the following criteria:
 - a. non-resident client;
 - b. identification problems;
 - c. unusual terms proposed by the client; or
 - d. unusual number of accounts;
- 3) Cash transactions where:
 - a. the client displays a preference for conducting transactions under the threshold amount of Dfl. 25,000;
 - b. the transaction amount is above Dfl. 25,000 and the transaction has two or more of the following characteristics:
 - (i) identification problems;
 - (ii) unusual terms proposed by the client;
 - (iii) the transaction is atypical for the client;
 - (iv) transaction in, for the client, unusual denomination banknotes;
 - (v) banknotes or coins in, for the client, an unusual package;
 - (vi) frequent deposits by a non-account holder;
 - (vii) inexplicable nervousness on the part of the client;

- (viii) client is accompanied and supervised;
 - (ix) client acts as a front or figurehead;
 - (x) no explicable legal objective or no clear relation to any business activity;
 - (xi) striking turnover or notable changes in account balance;
 - (xii) incoming amounts are small, whilst outgoing amounts are larger;
 - (xiii) the client provides the money uncounted, without any relation to his (business) activities;
 - (xiv) the money is not paid into the client's own account or that of his employer;
 - (xv) the money is paid in favour of a foreign account.
- 4) Wire transactions above Dfl. 10,000,000 that fulfil two or more of the following criteria:
- a. from and/or to a foreign country;
 - b. no explicable legal objective or clear relation to any (business) activity;
 - c. striking turnover or notable changes in account balance;
 - d. identification problems;
 - e. unusual terms proposed by the client;
 - f. transaction is atypical for the client;
 - g. the client acts as a front or figurehead.
- 5) Transactions above Dfl. 25,000 involving securities, including physical import and export of securities, which fulfil two or more of the following criteria:
- a. identification problems;
 - b. unusual terms proposed by client;
 - c. transaction is atypical for client;
 - d. client acts as a front or figurehead;
 - e. inexplicable nervousness on the part of the client;
 - f. no explicable legal objective or clear relation to any (business) activity;
 - h. client did not appear in the office at any time previously.